Square Mile Report

PruFund Range

September 2021

This report is for professional Advisers only

Introduction

Savers have long sought the holy grail of investment; that is a return which is ahead of cash but with little or no risk to capital. Of course, no such investment exists, however the PruFund range go some way to this ideal by providing products that are designed to generate attractive long-term returns but where price movements are smoother than many other strategies investing in a similar mix of assets. Indeed, this range of multi-asset funds from Prudential Assurance Company (PAC), which helps manage expectations around growth rates, is home to a body of assets which as at the end of 2020 totalled circa £53bn.

However, the product comes with some restrictions and limitations as well as a non-traditional method for calculating the unit price for the funds. Advisers using the PruFunds should be fully aware of these factors and ensure that their clients are well informed about their implications.

Many advisers will be attracted to the PruFunds due to their past performance record and this is further evidenced by their strong growth in assets seen over the years. Square Mile has been commissioned by Prudential to undertake a review of their PruFunds to help advisers better understand this investment proposition.

Within this report, we examine the different PruFund options available to investors and how the team behind the funds aim to achieve the stated objective of each. We discuss the mechanism which is used to smooth returns and provide a steady, incremental increase in unit price as well as the circumstances in which this mechanism can break down. We also describe how the portfolios are constructed on a layer by layer basis and the team responsible for this. An assessment of the complexity and transparency of the funds, relative to retail multi-asset collective funds is also made. Finally, we look at performance and value for money although this is not a straight-forward exercise due to the bundled charging structure of the funds on many products.

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1.1 Opinion

The Prufund range is a collection of multi-asset funds that offer investors different return and therefore risk outcomes and aim to provide smoother returns than many other multi-asset funds.

We believe the PruFund range of funds offered by Prudential Assurance Company (PAC) are an attractive proposition for investors who are willing to take on some investment risk but who would like a smoother return profile than is generally available from many multi-asset funds. PAC are one of only a few businesses that have the infrastructure and capital strength to offer a product which has the potential to smooth returns. We believe the funds' simple and tangible objectives, which are to deliver an explicit level of capital growth each year, known as the expected growth rate (EGR), will resonate with both adviser and investor. Added to this, PAC has an open and transparent policy of publishing EGRs and the rationale for any change is communicated to advisers.

Whilst the smoothing of investment returns is an attractive feature, investors should be aware that circumstances exist where the mechanism that is used to calculate this smoothed unit price can be suspended. We believe that this potential scenario, and the less transparent nature of the underlying asset value, caused by the smoothing mechanism, may be an impediment for some investors. Additionally, reductions in the EGR, which are possible, are unlikely to be warmly greeted by investors regardless of the circumstances surrounding the move and investors need to keep on top of the current growth rate to ensure it remains appropriate in meeting their longer term financial goals. In addition, the fact that the funds are only available via Prudential products and that the business reserves the right to delay cancellation of units for 28 days, under certain circumstances, may make them a less attractive option for some investors.

PAC are long-term investors. Their approach is a sensible one which relies on assessing the long-term potential returns from a broad range of asset classes and constructing a portfolio which seeks to deliver relatively stable returns across a range of market environments. The modelling and work which go into building the asset class assumptions is very strong and we believe is on a par with leaders in the field.

We think the core competency and strength of the team responsible for the investment engine which drives the PruFunds is in strategic asset allocation (SAA) and risk management, both of which are fundamental to the successful delivery of the objectives of the funds. In our view, the multi-asset investment team at M&G Treasury & Investment Office (T&IO) is well-resourced, with the necessary skills to continue to manage the funds in a successful manner.

Over the long-term the PruFunds have delivered strong absolute returns and have met their objectives. They also have a proven track record of delivering smoother investment returns than many other multi-asset funds. However, we caution that some of the strong returns across these funds and many other multi-asset funds have been bolstered by the fall in real interest rates and subsequent re-rating of equity markets. This means the expectation is that forecasted returns will be lower in the future than in the past, and this has been reflected in the reduction in the EGR on the funds over the years. Indeed, if we were to see a correction in markets, like that experienced during the global financial crisis, or the initial phase of the Covid-19 pandemic, the PruFunds, like many other multi-asset funds, may go through a period of very poor returns, which possibly could be negative if it becomes necessary for a unit price adjustment to be made, as was the case in 2008-2009 and 2020

The PruFunds are competitively priced compared to other multi-asset funds available via Prudential products, but they have a lower level of price transparency. The economies of scale and use of M&G group managers provide cost savings for PAC and some of these benefits look like they are passed on to investors. The benefits of a large asset base, which provides the economies of scale, can at times be an impediment, as it has the potential to move markets. T&IO seek to mitigate this to some extent by using derivatives to change the portfolio shape and long-term they have demonstrated that they are good allocators of capital despite the large asset base and we see no reason why they cannot continue in the same vein going forward.

In summary, we think that the Prufunds will appeal to the type of investor that isn't suited to the daily ups and downs of market returns and in return is willing to forego some of the transparency that you would receive in a unit trust or OEIC structure. These investors would also need to understand that, over time, any fund can only pay out what it has earned and returns are likely to be in line with the fund's net asset value and would have had to accommodate the requirement within its asset allocation to match liabilities as well as provide returns.

1.2 Outcomes & Objectives

1.2.1 Fund Outcomes

The PruFunds are a range of multi-asset funds which aim to provide capital growth over the longer term. The funds offer investors a range of different risk and return profiles.

PruFund Growth is the flagship fund and was launched in November 2004. PruFund Cautious was launched in July 2009 and the Risk Managed PruFund range was launched in November 2011. Within the report we refer to the funds collectively as PruFunds.

Each PruFund provides a clear expectation of the level of growth which it aims to deliver over the longer term (up to 15 years), known as the EGR. The EGR is reviewed and updated on a quarterly basis and may move up or down. The current EGRs applicable through one of Prudential's pension plans, the Retirement Account as at 25th August 2021, are detailed in figure 1: Note these rates may vary depending on the Prudential product through which the funds are purchased but provide an indication of the level and spread of returns potentially available.

Figure 1

PruFund Range and Expected Growth Rates

Name	*Current EGR*
PruFund Cautious	*4.8%*
PruFund Growth	*5.7%*
PruFund Risk Managed 1	*4.3%*
PruFund Risk Managed 2	*4.8%*
PruFund Risk Managed 3	*5.3%*
PruFund Risk Managed 4	*5.7%*
PruFund Risk Managed 5	*6.0%*

Source: Prudential, as at 25 August 2021

Guaranteed versions of the PruFund Cautious and Growth funds are also available. Here Prudential guarantee to provide a return of capital at the end of the selected term, which ranges from 10 to 15 years. There is an additional cost for the guarantee, on top of the total fund charge, and this extra charge varies by fund and term selected. The Risk Managed PruFunds are not available with guarantees.

1.2.2 PruFund Stated Objectives

PruFund Cautious
The fund aims for steady and consistent growth over the medium to long term (5 to 10 years or more) through a cautious approach to investing. The fund invests in UK and international equities, property, fixed interest securities, index-linked securities, cash and other specialist investments. The fund will aim to invest 50-75% in fixed interest securities, index-linked securities and cash, although it may occasionally move outside this range to meet the fund objectives.

PruFund Growth
The fund aims to maximise growth over the medium to long term by investing in shares, property, fixed interest and other investments. The fund currently invests in UK and international equities, property, fixed interest securities, index-linked securities and other specialist investments.

PruFund Risk Managed 1
The fund aims to achieve a long-term total return (the combination of income and growth of capital). The fund is actively managed and aims to limit the fluctuations ('volatility') your investment experiences, after allowing for smoothing, to 9% per annum over the medium to long term. There is no guarantee that the fund will achieve its objective of managing the volatility to the target level.

PruFund Risk Managed 2
The fund aims to achieve a long-term total return (the combination of income and growth of capital). The fund is actively managed and aims to limit the fluctuations ('volatility') your investment experiences, after allowing for smoothing, to 10% per annum over the medium to long term. There is no guarantee that the fund will achieve its objective of managing the volatility to the target level.

PruFund Risk Managed 3
The fund aims to achieve a long-term total return (the combination of income and growth of capital). The fund is actively managed and aims to limit the fluctuations ('volatility') your investment experiences, after allowing for smoothing, to 12% per annum over the medium to long term. There is no guarantee that the fund will achieve its objective of managing the volatility to the target level.

PruFund Risk Managed 4
The fund aims to achieve a long-term total return (the combination of income and growth of capital). The fund is actively managed and aims to limit the fluctuations ('volatility') your investment experiences, after allowing for smoothing, to 14.5% per annum over the medium to long term. There is no guarantee that the fund will achieve its objective of managing the volatility to the target level.

PruFund Risk Managed 5
The fund aims to achieve a long-term total return (the combination of income and growth of capital). The fund is actively managed and aims to limit the fluctuations ('volatility') your investment experiences, after allowing for smoothing, to 17% per annum over the medium to long term. There is no guarantee that the fund will achieve its objective of managing the volatility to the target level.

1.3 Fund Details

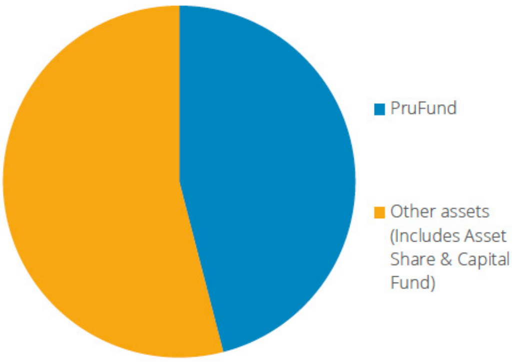
1.3.1 Fund Structure

The PruFunds have clear return objectives, however their underlying structure is complex. They are insured funds and so their accessibility is limited and they are only available via Prudential's own pension and investment products. Unlike most other retail open-ended funds where returns are directly based on the performance of the underlying investments within the funds, the PruFunds' returns are based on the EGRs and any unit price adjustments (UPA) are intrinsically linked to the performance of the assets within the Prudential With-Profits Fund.

The assets which support the PruFunds, and other with-profits funds, are held within one central pot of assets which totalled £117.9bn as at 31st December 2020, of which £53bn can be attributed to PruFunds. This pot is divided up into what Prudential refer to as the Asset Share Fund and the Capital Fund, the latter being the inherited estate and working capital of the life company. Whilst the inherited estate can be used to support PruFunds, any new business should be priced such that it is financially self-supporting. The returns from the Asset Share Fund provide the growth for the PruFunds, and the Capital Fund is used to support guarantees, smoothing and any redemptions at a time when the net asset value of the fund is below the smoothed unit price. Similarly, the Capital Fund will receive any surplus from redemptions when the NAV is above the smoothed unit price.

Figure 2

With Profit Sub Fund (WPSF) Asset Breakdown



Source: Prudential, as at 31 December 2020

The Capital Fund essentially contains the excess of the life company assets over those required to meet the reasonable expectations of policyholders and the solvency capital for PAC. It therefore invests predominantly in short duration bonds. The scope of this report does not extend to any opinion of the financial strength of the Prudential With-Profits Fund as this is outside of Square Mile's area of specialisation. There are businesses that specialise in providing guidance on the financial strength of with-profits funds and investors should refer to these for guidance in this regard.

This large central pot of assets also supports a number of Prudential's business activities including, traditional with-profits, non-profit, unitised with-profits and with-profits annuities. The current structure of the overall Asset Share Fund is circa 69% in real assets (equities, property and alternatives) and 31% in nominal assets (fixed income). This mix is deemed appropriate by PAC to provide a sufficient level of return over the long term to meet the expected growth rates supporting a number of funds which form part of this central pot as well as support the underlying liabilities of the funds. The PruFund Cautious fund is legally a separate pool of assets. This is based on the fact that it has a materially different mix of assets, where circa 65% is in nominal assets and 35% in real assets.

The method of calculating returns for the Risk Managed PruFunds is based on the performance of the appropriate assets in the With Profits fund and is referred to by Prudential as 'hypothecated returns'. The easiest way to illustrate how this works is through the simplified example below.

If a Risk Managed PruFund had an asset mix of 50% UK equities and 50% UK bonds, and the return net of fees of the UK equity portion of the with-profits fund was 7% and the UK bond portion 3%, then the hypothecated return on the fund would be 5% (i.e. 3.5% (50% x 7%) + 1.5% (50% x 3%)).

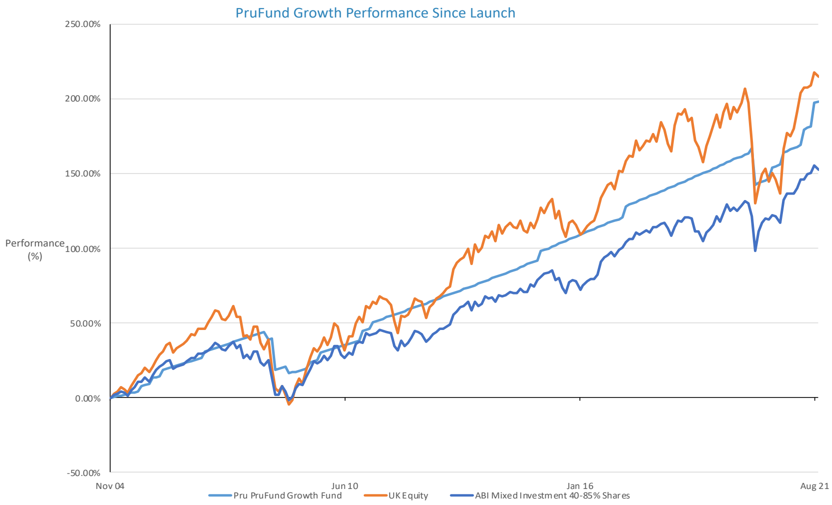
The large size of the Asset Share Fund is likely to be an impediment to the team's ability to be nimble and quickly change its underlying asset allocation in a targeted way, however futures can be used to implement capital efficiently. The investment approach for this fund is very long-term in nature and the team try to anticipate thematic changes in markets and sentiment before they are reflected in asset prices. Whilst the volume of assets under their control is large, the T&IO has a good track record of being able to manage investments on this scale. Flows into the PruFunds have historically been strong, however last year they were significantly lower than in previous years. Over 2019 the funds received net inflows of over £10bn however in 2020 this fell to £0.5bn. The underlying unit holders continue to be retail investors.

1.3.2 How the PruFunds are priced

Another feature which differentiates the PruFunds from a standard retail collective multi-asset fund is the smoothing mechanism (illustrated in figure 3) used to mitigate some of the effects of sharp market movements of the price of the fund. It should be noted that the smoothing mechanism works in either direction and does not offer any guarantee as to the future return which can be expected from the funds. If the value of the underlying investments supporting PruFunds fall, the price of units in the PruFunds may also fall, but maybe not quite as sharply. This is illustrated by figures 4 & 5, which shows the performance of PruFund Growth during the 2020 Covid-19 induced market sell-off and the global financial crisis (GFC). Note during the Covid-19 induced market falls PruFund Growth recovered relatively quicker than the UK equity market but over similar time frame to peers. Following the 2008-2009 GFC market falls PruFund Growth took longer to recover back to its highest unit price and was slower than the UK equity market and peers.

Figure 3

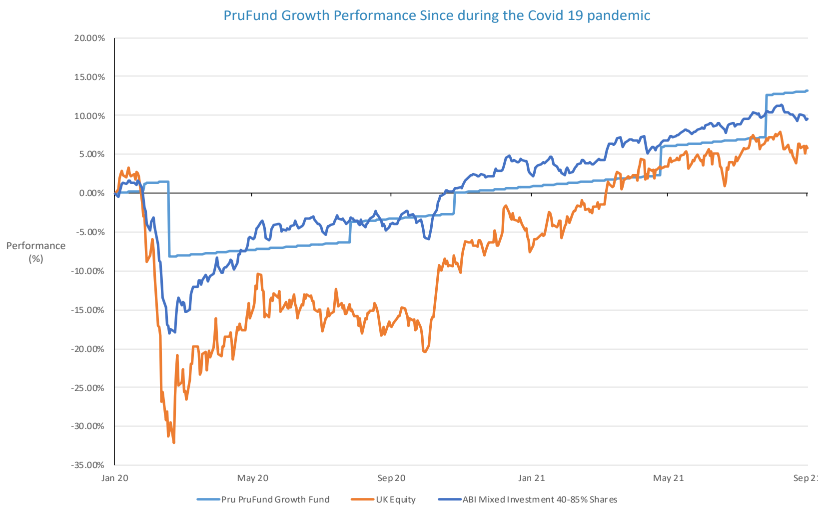
PruFund Growth Performance Since launch



Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

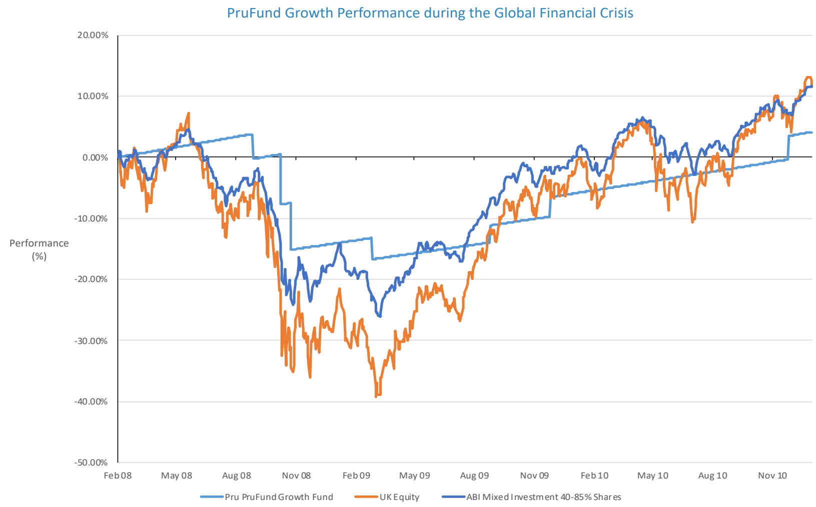
Figure 4

PruFund Growth Performance During the Covid 19 pandemic.



Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

Figure 5
PruFund Growth Performance During the Global Financial Crisis.



Source: FE Fundinfo, as at 30 September 2021
Past performance is not a guide to future returns

Each quarter Prudential sets an EGR for each fund which is based on their long-term expectations (15 year plus) for asset class returns and the objectives and risk budgets of the funds. The unit price of the PruFunds increases daily in line with the specified EGR. The funds therefore will then move in line with the EGR in what is referred to as the smoothed unit price (SUP), rather than the net asset value (NAV) of the supporting assets.

Initial investments into the PruFunds go into a holding fund, called the 'PruFund Account', and switch into the selected PruFund on the next monthly (quarterly for some products) investment date. While the initial investment is in the 'PruFund Account', it will increase daily with the applicable EGR. During this period charges are taken but the investment will not be subject to any smoothing adjustments or suspension, the process for which is described in further detail below. Therefore, clients have downside protection during this phase of their investment.

On each monthly investment date, should the SUP be more than 4% or 5% (depending on the fund*) above or below the NAV of the underlying assets then the SUP will be moved 50% back towards the value of the underlying assets. At any time, should the SUP become more than 8% or 10% (depending on the fund*) adrift of the value of the underlying assets, again in either direction, then it will be immediately adjusted. Should this happen the price will be moved to within +/-2.0% or +/-2.5% (depending on the fund**) of the underlying asset value. This smoothing adjustment was last applied in March 2020.

PAC use a 5-day rolling average to calculate the underlying assets' value. Using a 5-day rolling average reduces the instances when such adjustments are required by reducing the impact of single day market movements. PAC also have the ability to suspend the whole smoothing process should they experience large movements of capital into or out of the funds. On a suspension, the SUP will revert to the underlying asset value of the fund. To date PAC has never had to suspend the smoothing process on any of the PruFunds.

Any shortfall between the SUP of the PruFunds and the NAV of the underlying assets supporting these is borne by the supporting Fund on encashment. Similarly, should the NAV of the underlying assets be above the SUP of the PruFunds, then this will be retained.

Figure 6 shows the EGR for the PruFund Growth Life fund. This highlights the fact the EGR has reduced by 1.90% over the 17 years or so since the fund was launched. However it has not been a straight downward line as the EGR was increased by 0.2% in May 2014 following four prior reductions. Since November 2014, the EGR has been reduced downward on a further five occasions. The EGR reduction of 1.90% over the last 17 years does not to us seem an excessive move when considering that global growth over this period has slowed to below trend and that this is widely expected to continue to be the case in the foreseeable future. It is worth highlighting that the majority of unit price adjustments (UPA) have been upwards and that the fund did not have a UPA in 2018 despite the falls in global markets in the fourth quarter. Figure 7 details the historical unit price adjustments for PruFund Growth Life Fund which are also graphically illustrated in figure 3.

**Note: Movement from the PruFund Account into the PruFunds is monthly for the Prudential Retirement Account and quarterly for the Prudential Investment Plan, Prudential ISA, Prudential International Investment Bond, Flexible Retirement Plan and Trustee Investment Plan.*

***PruFund Cautious, PruFund Risk Managed 1 and PruFund Risk Managed 2 will make an adjustment if the SUP is more than 4% away from the NAV on the monthly investment date and is more than 8% away at any time. A 2% gap will apply following the rebalance. PruFund Growth, PruFund Risk Managed 3, PruFund Risk Managed 4 and PruFund Risk Managed 5 will make an adjustment if the SUP is more than 5% away from the NAV on the monthly investment date and is more than 10% away at any time. A 2.5% gap will apply following the rebalance.*

Figure 6

PruFund Growth Life Expected Growth Rate

From	To	EGR
26/05/2020	Present	4.70%
27/08/2019	25/05/2020	4.90%
25/08/2016	26/08/2019	5.10%
25/05/2016	24/08/2016	5.50%
25/02/2016	24/05/2016	5.90%
25/11/2014	24/02/2016	6.00%
27/05/2014	24/11/2014	6.40%
26/11/2012	26/05/2014	6.20%
26/11/2009	25/11/2012	6.60%
26/05/2009	25/11/2009	6.70%
26/02/2006	25/05/2009	6.85%
25/11/2004	25/02/2006	6.60%

Source: Prudential, as at 25 August 2021

Figure 7

PruFund Growth Life Historical Unit Price Adjustments

From	To	EGR ^
25/08/2021	+5.06%**	End
25/05/2021	+3.56%	End
25/11/2020	+2.72%	End
25/08/2020	+2.69%	End
19/03/2020	-9.54%	Mid
26/02/2020	+0.90%*	End
27/02/2017	+3.18%	End
25/02/2015	+2.69%	End
25/02/2011	+2.63%	End
25/11/2010	+3.86%	End
25/11/2009	+3.54%	End
25/08/2009	+3.26%	End
25/02/2009	-4.00%	End
23/11/2008	-8.26%	Mid
06/10/2008	-8.20%	Mid
26/08/2008	-3.96%	End
26/02/2006	+3.26%	End

*This was a special Unit Price Adjustment which allows for the additional surplus already shared. This had no impact on the smoothing process.

** This is a unit price reset, to reset the unit price to the un-smoothed price.

EGR^ Indicates whether the Unit Price Adjustment was made at the end of the quarter or mid quarter.

Source: Prudential, as at 25 August 2021

The link below provides details of all PruFund historic growth rates and unit price adjustments:

1.4 Team and Company

1.4.1 Parent

Prudential Assurance Company is part of M&G plc. M&G plc was created following the demerger of M&G Prudential from Prudential Plc in 2019. M&G Prudential was created in 2017 when Prudential UK & Europe and M&G Investments came together to form a new saving and investments business. M&G plc is a FTSE 100 company and as of 31 December 2020 it had £367bn of assets under management.

PAC continue to dominate flows of both regular and single premium with profits business although flows did slow last year largely attributable to the Covid-19 pandemic. There remains a reasonable number of providers open for new with-profits business, however many of the historically larger players, for example, Aviva, Royal London, Scottish Widows, Legal & General and Standard Life, are no longer actively seeking new business. The rest of the market is made up by products provided by Mutual and Friendly Societies.

1.4.2 Investment Team

The Treasury & Investment Office is the team responsible for managing PruFunds. They are and independent team within M&G plc. The team consists of experienced investment professionals with expertise across a wide range of investment activities.

Being part of M&G plc means the T&IO can leverage the wider group's investment resources, which includes M&G Investments, M&G Real Estate and M&G Alternatives. However, the team do make use of external managers within the funds. M&G currently manage around two thirds of the PruFunds assets.

The T&IO is headed by David King and is structured into defined investment teams, with key positions held by Parit Jakhria - Head of Long Term Investment Strategy, Charles Griffith - Head of Multi-Asset and Ciaran Mulligan - Head of Manager Oversight.

1.4.3 Investment Philosophy

The T&IO believe asset allocation is the key driver of investor returns, as opposed to fund or stock selection or market timing. Moreover, they see asset allocation as a specialist skill and believe it should exist separately from other investment activities.

T&IO believe in;

- A long-term approach to investing
- Diversification, by both asset category and geography
- Active management
- The importance of valuation
- Illiquidity and credit premiums
- The importance of ESG

The team seek to add value through;

- Strategic asset allocation
- Mandate design
- Tactical asset allocation (working closely with the macro team in M&G Investments)
- Underlying manager alpha
- Efficient implementation

PruFund portfolios will have some common characteristics;

- Active equity portfolios generally have a slight value bias
- Fixed income portfolios have a credit bias
- Property portfolios have a bias towards high quality assets in core locations
- Private assets represent a relatively sizeable proportion of portfolios
- Portfolios will evolve as new asset classes and opportunities are embraced

1.5 Asset Allocation

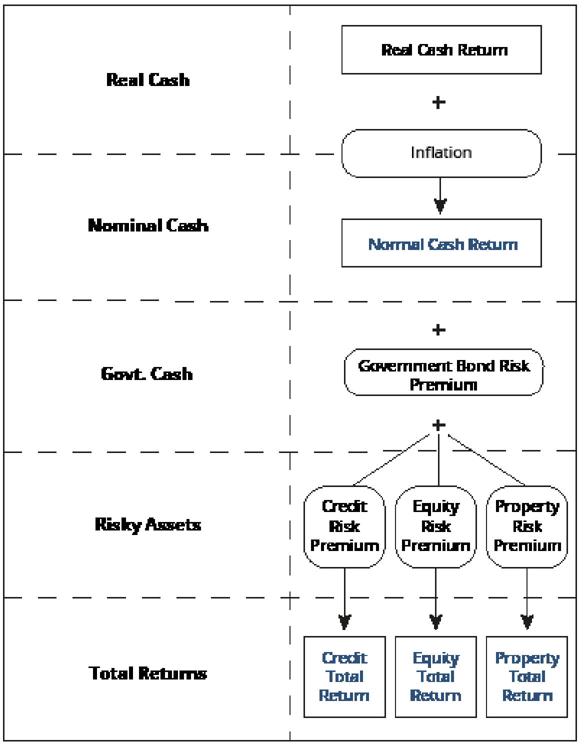
1.5.1 Developing Long-Term Assumptions

The Long Term Investment Strategy (LTIS) team is responsible for building long-term Capital Market Assumptions (CMAs) for M&G plc and for recommending asset allocation for both retail and life office products (including the PruFund). LTIS, which is part of the T&IO, consists of a team of 11 investment professionals from different academic backgrounds including actuaries and economists. Parit Jakhria is head of the team and Director of LTIS. He has been at Prudential for over 18 years and is a Fellow of the Institute and Faculty of Actuaries and a CFA charterholder.

A significant amount of data is used by the LTIS team to help build a picture for the global outlook. The team assess each major economy and region on an individual basis, principally assessing the growth of the productive capacity for each economy. Inputs to this include both faster and slower moving trends, including population growth, GDP growth, demographics, availability of labour, savings & investment rates and trends in technological progress. Environmental Social & Governance (ESG) factors are also built into this assessment. Not only does the assessment of these factors help to build a picture of a country or region across a broad range of economic indicators but it also helps build a level of consistency within expectations across economies.

The team accept their assumptions are a trade-off between stability and fundamental change. However, the building block framework they use is based on the principle that investors face a risk and return trade off when choosing assets, based on how much they can realistically expect to receive for the risk they are taking on. Their approach captures how a change in one factor automatically feeds through into asset classes dependent on it. For example inputs from demographics and the economic growth models inform views on longer-term real cash rate assumptions. Assumptions for each asset class and region are unique and individually constructed based on the building block approach. The simple example below illustrates this.

Figure 8
Equilibrium Building Block Approach



The team build a view on expected cash returns, inflation and government bond returns for each region/country. They will then add a 'risk premium' which is effectively an element of extra return investors can expect to receive to compensate them for taking on extra risk.

Using the framework for UK equities the current long-term assumptions for UK real cash (0%) + inflation (2.0%) = a nominal long-term cash return of 2.0%.

The current government bond risk premium is 0.75%. Adding a UK equity risk premium of 3.0% gives a current long-term return expectation for UK equities is 5.75%.

This process is repeated across geographies and asset classes. The team believe that the modelling they undertake on alternatives, including private equity, hedge funds and infrastructure, is superior to competitors because they have a long history of investing in these asset classes which has enabled them to collect proprietary data.

When trying to estimate future volatility, the team look at historical data from the various regions over different rolling time periods and investment regimes e.g. high inflation and recessionary environments. They also consider the liquidity, size and financial standing of the market. On this basis equity regions are currently categorised into four broad groupings which are developed, developing, frontier and private equity.

The choice of indices and benchmarks used when modelling asset class returns is based on a set of common principles, such that indices need to be representative of the opportunity set and capture a large part of the asset class performance under different market conditions. In addition, the team try to avoid concentration risk and therefore aim to be diversified across countries, industries, sectors and issuers. ESG risk are also incorporated into this analysis. All assumptions are fed into PAC's proprietary optimiser which builds an asset allocation on a layer by layer basis for portfolios with different risk and return characteristics.

1.5.2 Modelling

Prudential believe that the future is uncertain and therefore can have many possible outcomes based on world events and political and economic change. They therefore try to build portfolios that can withstand some of this uncertainty whilst still meeting their stated objectives.

In the early 2000's the T&IO started developing and building their in-house multi-asset economic scenario generator known internally as GeneSIS. By developing and using their own system, PAC believe they have an advantage over many competitors. They think the proprietary system allows for a consistency of views to run through both long-term and short-term expectations as well as portfolio construction considerations and we can see merit in their claim. Having your own economic scenario generator means you are able to make it bespoke to suit your requirements. There is also an element of knowledge which is built up which only comes with developing and building your own systems. This knowledge, particularly within their stochastic work, is retained within the business and is used to enhance their offering.

GeneSIS enables the team to build asset class and portfolio return probability graphs across a complete term structure. The system allows for a certain amount of refining of the results by tweaking different variables and inputs within the system. The output provides a median return estimate, along with the probability of other potential outcomes. A large number of scenarios (typically between 5000 and 10000) are modelled which should give a broad range of outcomes. The long-term assumptions used to generate the scenarios are updated twice a year. The team do not necessarily aim to build an asset allocation which will provide the highest return outcome but one which is likely to be the most stable over time and one which is positioned to benefit from a broad number of scenarios, not just a few. Scenario testing is carried out to ensure the portfolios are 90% stable across a range of risk outcomes. This work also helps the team understand the potential risks posed by black swan events.

The T&IO describe their asset allocation process as "optimised with robustness overlaid". The asset allocation is checked for robustness over a range of qualitative and quantitative scenarios, subject to sense checks and fine tuning. The final portfolio is usually decided following an iterative process, with many considerations. These considerations may include factors such as ensuring the asset mix remains appropriate for the target market as well as an appreciation of the current portfolio and any implications for trading. When modelling and checking has been completed, the new SAA is presented to the PAC board for sign-off.

1.5.3 Tactical Asset Allocation

The funds do not make tactical adjustments versus the longer term SAA. Instead they employ a tactical mandate which aims to take advantage of short term opportunities. The Macro Investment Business (MIB) within M&G plc is responsible for tactical asset allocation (TAA) decisions. The team is close-knit and very experienced. The CIO, Dave Fishwick, has run a TAA mandate for PAC since 1999. He will have final say in any investment decisions, although the MIB do work as a team, constantly sharing and testing investment ideas.

The strategy employed within the TAA mandate is based on two key beliefs. Firstly, that investors are surprised by markets and secondly, that they are prone to overreacting to these surprises. In practice, if MIB believe a sell-off in equity markets has been driven by investor fear but fundamentals are still strong, they will view this as a strong buy signal. The team describe these scenarios as 'episodes' which can be short-lived or last for several years.

Alongside this 'behavioural' approach the MIB also have a long-standing valuation framework which helps them assess and understand the long-term value of an asset class before any investment is made.

Mr Fishwick generally implements his strategy through taking more macro long/short positions in regional market indices and bonds. However, if he feels that a specific sector looks particularly over or undervalued he will take a position.

1.6 Fund Selection

1.6.1 Implementation

The portfolio managers within the T&IO are responsible for efficient implementation of the SAA and the ongoing management of portfolios, which includes numerous important activities. Key responsibilities of the portfolio managers are:

Managed to Mandate;
- Ensuring portfolios are managed in-line with target exposures and limits whilst minimising cost and risk manage cash flows and other fund dynamics

Implementation;
- Ensuring changes in strategic asset allocation are implemented effectively and efficiently

Operational management;
- Systematic preparation and review of trade instructions to minimise operational errors

Portfolio monitoring;
- Ongoing review of exposures, risks and performance in conjunction with Risk and Manager Oversight teams

Liquidity;
- Managing and reporting on liquidity to ensure that outflows can be covered in stressed scenarios

Hedge implementation;
- Ensuring hedge programmes are managed against liability benchmarks by instructing and executing suitable derivatives within approved VaR limits

Derivative documentation;
- Managing derivative agreements with bank counterparties and ensure they are negotiated on an ongoing basis to maximise implementation efficiency in a rapidly evolving market and regulatory environment

Collateral management
- Ensuring that ample collateral is available to meet derivative collateral and margin requirements

1.6.2 Positioning

The funds continue to be highly diversified both at an asset class and regional level. The funds have no benchmark and each is managed on a flexible basis to achieve the performance objective as well as remain within its risk parameters.

Within equities the funds continue to have a bias to developed markets, in particular the UK, however there has been a gradual shift towards emerging markets over the years which is a function of their greater growth prospects. Currently the equity portfolios have broadly 40% in the UK, 30% in Asian and emerging markets excluding Japan and 30% spread across the US, Europe and Japan. More recently a strategic allocation to China and the Middle East and Africa has been added to the funds. The funds are highly diversified within fixed income too but have a significant bias to credit over government bonds. Unlike a number of multi-asset funds which invest predominantly in UK bonds, the funds have a relatively high exposure to European, US, and Asian fixed income and private credit markets. Like on the equity side there has been a shift away from developed market fixed income over recent years and a higher exposure to Asian and private markets. Compared to mainstream fixed income indices the portfolios also have a lower duration position.

The funds retain a meaningful exposure to physical property and this ranges from 7.4% to 15.4% across the various funds. The majority is UK commercial property, although some US, European and Asian property exposure is also held. The property portfolio has become more global over the years and the expectation is for this trend to continue. The funds also hold positions within other alternative assets including hedge funds, infrastructure, alternative credit and private equity. Cash levels vary across the portfolios but are generally low within the moderate to higher risk funds.

1.7 Investment Governance

1.7.1 Oversight

The PruFunds are populated using investments predominantly managed by M&G Investments. A high number of the underlying strategies are run as segregated mandates due to the scale of the overall funds. However, where the business does not have the expertise in-house, they may utilise external managers. External managers have historically represented around 12% of the portfolio. Whilst active management is most prevalent, passive strategies are also used.

A separate Manager Oversight team ensures that all managers selected are performing in line with their objectives set out in the Investment Management Agreement (IMA). The team not only check compliance with the mandate but also have a good understanding through regular reviews of reasons behind the key performance drivers.

The Manager Oversight team, in conjunction with the other teams within the T&IO, are responsible for deciding on whether a mandate or existing fund is used within the portfolios. The same collaborative process is used to decide on whether to use active or passive strategies. The T&IO then work with the underlying sub-managers to agree how much latitude each has, for example from a stock and sector perspective. The mandate is designed to maximise risk adjusted returns, for example the UK exposure uses a mixture of passive and active mandates to try and provide returns ahead of the index.

The T&IO utilise the M&G alternatives team who select investments for this part of the portfolio. Areas of focus for the team include private equity, infrastructure, hedge funds and alternative credit. The governance around many of these less liquid and more specialist alternative investments needs to be thorough and robust. The team carry out many layers of due diligence covering operational factors, investment risk and legal implications.

1.7.2 Risk

Risk and compliance functions operate with three lines of defence. Its role and purpose is to challenge risks effectively and proactively and to add value by providing enhanced business insights to support the delivery of customers long-term needs.

Within this model, risk is considered from many different perspectives. For example; investment risk - the impact that market movements can have on the portfolio and also the risk of failing to meet stated performance objectives; credit risk - where counterparties could potentially default, or fixed income portfolios become overexposed to a single issuer; liquidity risk - portfolios are stressed and a liquidity coverage ratio (LCR), which is the amount of highly liquid assets held by financial institutions to meet short-term obligations is reported. This liquidity analysis is particularly important as the fund invests fairly heavily in alternative assets, which can have lower liquidity profiles than many more traditional asset classes. For example, the funds can hold property, private equity, infrastructure, hedge funds and alternative credit.

Finally, there is a team responsible for monitoring operational risk, which is the risk of failure within investment processes, including people or anything from systems malfunction to fraud or inputting errors. These all qualify as operational risks.

Liquidity risk

It is fair to say that the level of transparency of the PruFunds and the assets that support it are not as high as many other investments, although this is improving as the company now share high level holdings data and information on the underlying building blocks for portfolios (see Figure 11). There are a number of reasons for this, one being the structure of a with profits business and the numerous assets and liabilities it supports. The funds structure also means no liquidity report is produced like those we see on retail mutual funds and Prudential has not provided us with any liquidity data.

Like many multi-asset funds the PruFunds hold a number of assets which are less liquid and which would take time to sell, examples include commercial property, infrastructure and some of its fixed income assets. However, based on our conversations with the business it appears there are robust governance and procedures in place which look to mitigate these risks and maintain a good level of liquidity.

Supervisory Statement 5/19 of September 2019 sets out the PRA's expectations concerning the liquidity risk management framework an insurer must have in place. This provides principles-based guidance and following its publication PAC made only minor changes to its approach as they believed they were largely fulfilling these requirements.

PAC manages liquidity in a number of ways. Firstly it will always hold a significant proportion of its assets in readily realisable securities such as equities and currently this is c.£40bn. Additionally, very short-term liquidity requirements can be provided by selling equity and fixed income futures which are held, as well as cash, gilts and treasuries and the business estimates that around 10% of the fund is in these types of assets. As the underlying holdings are managed on a segregated basis the managers are very alive to each of the underlying mandates individual liquidity profiles and activity and can use this as a further source of liquidity if and when needed.

As the Prufunds hold a significant amount of its assets in non-sterling securities foreign exchange risk is actively managed so it can meet its sterling cash flow requirements. There are also a number of factors which help to mitigate against the fund experiencing a sharp liquidity squeeze and these include a very diverse investor base, with around half a million customers, and understanding the profile of these. The portfolio also undergoes various stress tests to see how it would cope with sustained outflows and the team look at liquidity over multiple time horizons. The business is also very aware of the demographics of its investor base and is continually monitoring and modelling expected flows and tries to anticipate when liquidity may be needed.

The Prufund's liquidity credentials were tested in the first half of 2020 when it experienced some negative flows as a number of investors withdrew their money. During this period the fund utilised the highly liquid part of the portfolio and these assets did their job. Should another event like this occur, outflows of course could be more persistent and prove an even greater test of the funds liquidity. However, in the brief test it had last year the fund appeared to cope well. More over, during this testing period not only was the fund able to manage liquidity well but it did not cause any meaningful change in the shape of the portfolio and there was no forced sale of any of its more illiquid assets. In fact, the managers were able to raise the fund's risk through the first half of 2020 to take advantage of market opportunities caused by the Covid-19 induced sell-off.

ESG

The PruFunds incorporate the assessment of ESG risk into many aspects of the investment process. This includes asset allocation, manager selection and oversight and mandate design.

ESG factors are integrated into the funds' SAA process through three main channels.

- Sensitivity Analysis - portfolio exposures to ESG factors are assessed in terms of physical, transition and litigation risks.
- Country Risk Categorisation - since 2019 the framework was extended to add environmental factors alongside existing social and governance factors.
- Benchmark Construction - analysis to understand the distribution of ESG factor exposures within benchmarks is undertaken.

The Manager Oversight team, when carrying out their investment due diligence, look for asset managers who integrate ESG within their investment process and who actively engage with companies. They also look for those that participate in voting on key issue, such as climate changes and actively engage with companies they own to build a more sustainable economy. There is also a requirement from external managers to manage assets in accordance with the firms own ESG Policy.

The funds do have some portfolio exclusions. The policy currently excludes companies that manufacture controversial weapons including anti-personnel land mines, cluster munitions, biological weapons and chemical weapons, as well as companies that are complicit in violations of the Nuclear Non-Proliferation Treaty. These weapons are currently prohibited by international treaties which the UK has signed and ratified. Although not currently prohibited by international treaty, Prudential have also decided to exclude depleted uranium munitions from the portfolios as they do not wish to support or be associated with the disproportionate and indiscriminate harm that these weapons can do to civilians.

They use norms-based screening to identify companies that maliciously violate global norms in the areas of human rights, labour standards, environmental standards and anti-corruption and will potentially exclude companies from portfolios that flag up. The Investment Office will look into each flagged company and judge them against the firms core values of care and integrity, with consideration given as to whether violations are alleged or verified, the legality and nature of the event, company co-operation with investigations and whether there is a wider pattern of behaviour present across flags that might indicate deeper problems in the corporate culture. Both the controversial weapons and norms-based screening exclusions are applied to all funds and mandates (active or passive) where the Investment Office is empowered to make investment decisions.

PruFund Asset Allocation

Figure 9

	PruFund Risk Managed 1	*PruFund Risk Managed 2*	*PruFund Risk Managed 3*	*PruFund Risk Managed 4*	*PruFund Risk Managed 5*
UK Equities	6.4%	10.8%	15.3%	20.3%	25.8%
North American Equities	2.3%	3.9%	5.6%	7.4%	9.4%
European Equities	2.3%	3.9%	5.5%	7.3%	9.2%
Japanese Equities	1.3%	2.1%	3.0%	4.0%	5.0%
Pacific Market Equities	3.2%	5.4%	7.7%	10.2%	12.9%
Global Emerging Markets Equities	1.2%	2.0%	2.8%	3.7%	4.7%
Property	8.0%	10.5%	12.7%	14.0%	15.4%
UK Fixed Interest	16.9%	13.3%	9.75%	6.2%	2.2%
Euro Fixed Interest	8.1%	6.4%	4.7%	3.0%	1.0%
US Fixed Interest	18.0%	14.2%	10.4%	6.6%	2.3%
Asia Fixed Interest	10.0%	7.9%	5.8%	3.7%	1.3%
Other Fixed interest	13.7%	10.8%	7.9%	5.0%	1.8%
Other Investment Assets	4.5%	5.6%	6.6%	7.3%	8.1%
Cash	4.3%	3.3%	2.5%	1.8%	1.0%

Source: Prudential, as at 30th June 2021

Figure 10

	PruFund Cautious	*PruFund Growth*
UK Equity	10.9%	19.6%
European Equity	4.2%	6.8%
US Equity	4.6%	6.7%
Japanese Equity	1.9%	3.4%
Asian Equity	5.8%	9.7%
GEM Equity	2.5%	4.5%
Property	7.4%	13.2%
Fixed Income UK & Europe	21.0%	9.1%
Fixed Income US	16.2%	6.2%
Fixed Income Asia	8.9%	3.7%
Other Fixed Interest	7.4%	3.6%
Other Investment Assets	7.3%	11.3%
Cash	1.9%	2.2%

Source: Prudential, as at 30 June 2021

Underlying Structure of the PruFund Growth

The table below highlights the asset allocation of PruFund Growth and details the main funds or mandates, the investment style used by the manager and the overall allocation. This will be reflected across the other funds but the weightings will be different.

Figure 11
PruFund Growth Main Holdings

Asset		*SAA (June 2021)*		*Fund Name*	*Investment Style*
Equity	UK Equity	18.77	3 x segregated mandates 1 x bespoke mandate	M&G UK Absolute Return Fund M&G (ACS) UK Listed Mid Cap Equity Fund M&G UK All Share Index Mandate M&G UK 200 Index Mandate	Active Active Passive Passive (evenly weighted)
	Europe excluding UK Equity	6.55	3 x bespoke mandates	M&G (Lux) European Active Fund M&G (Lux) European Small Cap Fund M&G (Lux) European Passive Fund"	Active Active Passive
	US Equity	6.16	4 x bespoke mandates	M&G (ACS) BlackRock US Equity Fund M&G (ACS) Granahan US Small Cap Growth Fund M&G (ACS) Earnest Partners US Small Cap Value Fund M&G (ACS) Canada Index Fund"	Passive Active Active Passive
	Japan Equity	3.33	1 x bespoke mandate 1 x pooled fund	M&G (ACS) Japan Equity Fund ESI Japanese Smaller Companies Mandate	Active Active
	Asia ex. Japan Equity	7.47	1 x bespoke mandate	M&G APAC ex Japan Equity Mandate	Active
	China Equity	1.79	2 x bespoke mandates	M&G (ACS) Value Partners China Equity Fund M&G (ACS) China Equity Fund	Active Index Enhanced
	Global Emerging Markets Equity	2.14	1 x pooled fund	ESI Global Emerging Markets Equity Fund	Active
	Middle East and Africa Equity	2.14	2 x pooled funds	PIMSA South Africa Unit Trust ESI (PIMSA) Africa Equity Fund	Active Active
Property	UK Property	9.62	Segregated mandate	M&G UK Direct Property	Active
	Europe Property	1.51	Pooled fund	M&G European Property Fund	Active
	North America Property	1.01	Segregated mandate	M&G US Direct Property	Active
	Asia Property	1.62	Pooled fund	M&G Asia Property Fund	Active
Alts	Private Equity	4.20		Portfolio of Private Equity	Active
	Hedge Funds	1.51	1 x segregated mandate	Portfolio of Hedge Funds	Active
	Infrastructure	2.43		Portfolio of Infrastructure	Active
TAA	UK (Investment Grade)	6.38	3 x bespoke mandates	M&G UK and European Investment Grade Mandate M&G European/UK High Yield Mandate M&G European Leveraged Loans Mandate	Active
	Europe (Investment Grade)	1.89			Active
	UK & Euro (High Yield)	1.18			Active
	US (IG & HY)	6.00	2 x segregated mandates 1 x pooled fund	M&G US Total Return Fixed Income Mandate M&G US Short Dated Fixed Income Mandate M&G US Treasuries Mandate	Active
	US Treasury	0.74			Active
	Asian Fixed Income	4.00	4 x pooled funds	ESI Local Currency Asian Bond Fund ESI Hard Currency Asian Bond Fund ESI High Yield Asian Bond Fund ESI China Bond Fund	Active Active Active Active
	Convertibles	0.50	Segregated mandate	M&G Global Convertibles Fund	Active
	Lower Risk Private Credit	0.37	1 x pooled fund	Prudential Credit Opportunities Fund	Active
	Private High Yield	1.59	1 x bespoke mandate	Bespoke Private Asset Mandate	Active
	Global High Yield	0.25	1 x pooled fund	M&G Global High Yield Fund	Active
	South African Debt	0.60	1 x pooled fund	PIMSA Pan-African Bond Fund	Active
	Emerging Market Debt	1.25	1 x pooled fund	M&G Emerging Market Debt Fund	Active
	TAA Mandate	3.00	1 x segregated mandate 1 x pooled fund"	M&G Episode Strategies	Active
	Cash	2.00	1 x segregated mandate	M&G Cash Fund	Active

Source: Prudential, as at 30th June 2021

1.8 Performance

The unit prices of the PruFunds are based on the EGR declared for each individual fund and not the NAV of the underlying assets supporting it. This approach to unit pricing, whereby 1/365th of the declared EGR is added to the unit price daily, means comparing the PruFunds' historic volatility, and other risk-adjusted measures, with multi-asset funds priced on their NAV, (which applies to the majority of funds), is not a useful exercise. This is because the smoothing of the unit price created by the pricing mechanism leads to the funds exhibiting a lower level of volatility. This means the PruFunds will always have a volatility lower than funds with a similar asset allocation or risk profile.

Although the NAVs of the PruFunds are not very transparent, there are other funds managed by the group which follow a similar high-level asset allocation and which are priced based on their NAV, see figure 12. The underlying investments of these funds will differ, as will the charges, but they can be used as a broad proxy for the unsmoothed price of funds.

PAC do not publish daily information on the PruFunds' underlying NAVs and so a clear and accurate understanding of this is not available. In addition, the PruFunds are only distributed within Prudential product wrappers and therefore only funds that are also available within the same product can be easily assessed on a like-for-like basis.

Each PruFund has an explicit EGR which lets investors know the level of return they can expect on a forward-looking basis. However, this EGR is subject to change and both the long running PruFund Growth and Cautious funds have had their EGRs changed on many occasions over the last 10 years. In line with PAC's expectations for growth over the last decade, and general market consensus, the EGRs have progressively been reduced. Having a moving performance objective presents more of a challenge than one which is static over time, when trying to assess whether a fund has successfully met its outcome. To date most PruFunds are meeting their expected outcomes based on those set when the funds were originally launched, i.e. the EGR at outset.

Given the above challenges, we have assessed the performance of the PruFunds in a number of ways. Firstly, we have measured performance against their stated EGRs and we believe this is the best measure of success. For this exercise we have taken the earliest EGR quoted for the fund (which is generally the highest) and the current EGR quoted (which is generally the lowest) and compounded these over the review period. These two return series illustrate the broad range of returns investors could have expected over the life of their investment. Clearly investors who invested at the beginning of the funds' lives will have a higher return expectation as their EGR is likely to have been higher at outset.

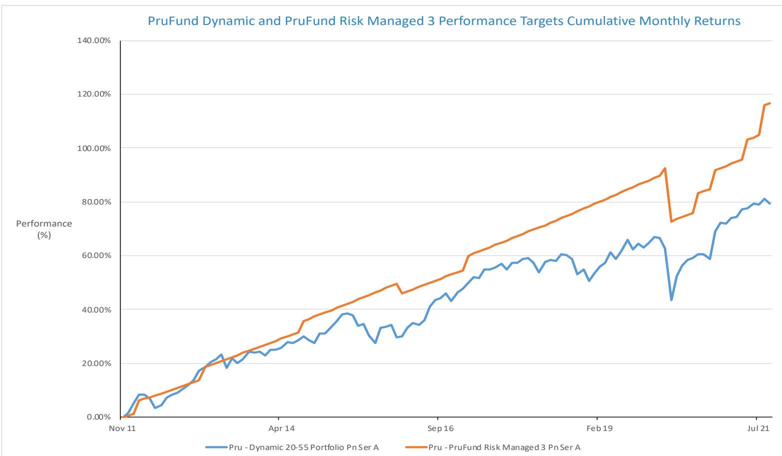
We have also compared the PruFunds against selected competitor multi-asset funds available within Prudential's investment and pension products. Whilst the PruFunds do not aim to beat these competitor funds they provide a good indication of the type and level of returns produced by competitors. It also helps illustrate the smoothing mechanism in action. Finally, we have also assessed the PruFunds against some of the ABI Mixed Investment peer groups as many investors still see these as a good proxy for returns of multi-asset funds generally.

When analysing these results, it is important to be mindful that not all competitor funds have the same performance objective (and/ or reside in the same sector) nor do we know the annual management charge PAC are paying each investment company fund, as on a number of products only the total plan charge is disclosed.

The chart below plots the PruFund Risk Managed 3 Pension Fund vs the Prudential Risk Managed Active 3 Pension Fund which has a similar asset allocation. The return profile illustrates the lower volatility of the PruFund vs the non-smoothed fund.

Figure 12

Smoothing process in action

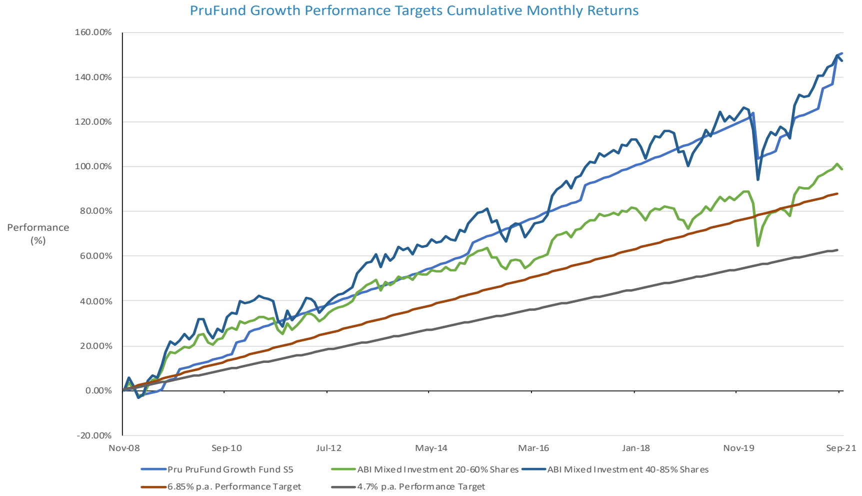


Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

The PruFund Growth Life fund (using the fund series with the longest track record in FE Fundinfo) has delivered strong absolute returns over it's life. The fund has comfortably outperformed its stated EGR applicable at outset (6.8%) and the one currently in place (4.7%). The fund has also outperformed the ABI Mixed Investment 20-60% Shares sector median but has moderately underperformed the ABI Mixed Investment 40-85% Shares sector median.

Figure 13

PruFund Growth Life Fund performance since launch to end of September 2021

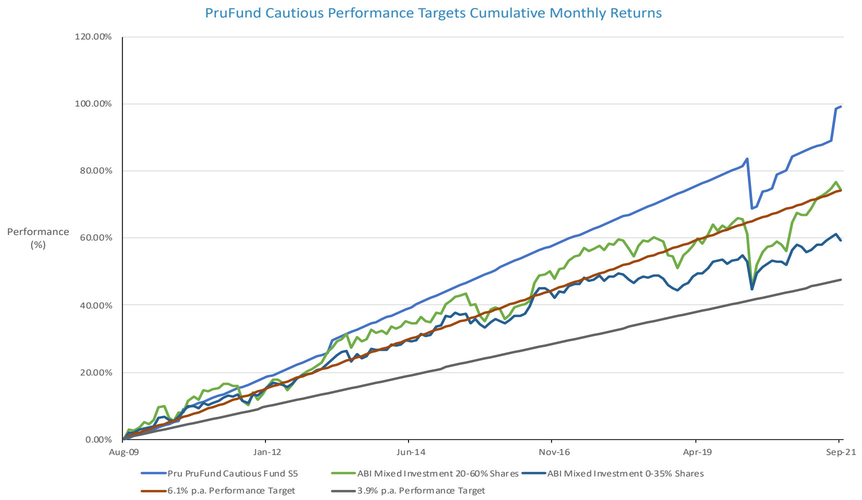


Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

The PruFund Cautious Life fund (using the fund series with the longest track record in FE Fundinfo) has delivered strong absolute returns over it's life. The fund has comfortably outperformed its stated EGR applicable at outset (6.1%) and the one currently in place (3.9%). The fund has also outperformed both the ABI Mixed Investment 20-60% Shares sector median and the ABI Mixed Investment 0-35% Shares sector median.

Figure 14

PruFund Cautious Life Fund performance since launch to end of September 2021

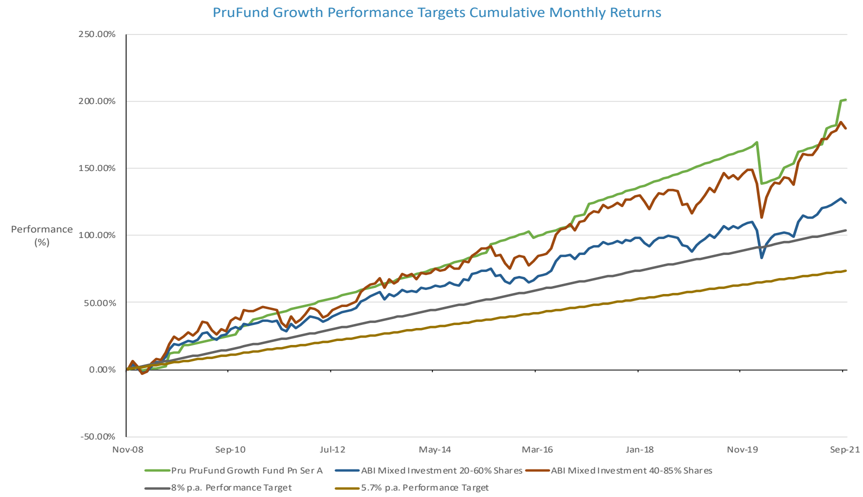


Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

The PruFund Growth Pension fund (using the fund series with the longest track record in FE Fundinfo) has delivered strong absolute returns over it's life. The fund has comfortably outperformed its stated EGR applicable at outset (8.0%) and the one currently in place (5.7%). The fund has also outperformed the ABI Mixed Investment 20-60% Shares sector median and the ABI Mixed Investment 40- 85% Shares sector median.

Figure 15

PruFund Growth Pension Fund performance since launch to end of September 2021

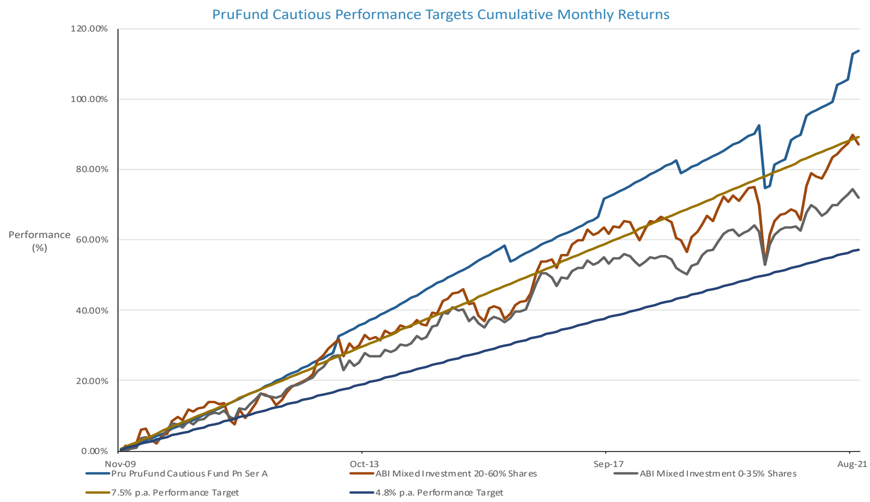


Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

The PruFund Cautious Pension fund (using the fund series with the longest track record in FE Fundinfo) has delivered strong absolute returns over it's life. The fund has comfortably outperformed its stated EGR applicable at outset (7.5%) and the one currently in place (4.8%). The fund has also outperformed both the ABI Mixed Investment 20-60% Shares sector median and the ABI Mixed Investment 0-35% Shares sector median.

Figure 16

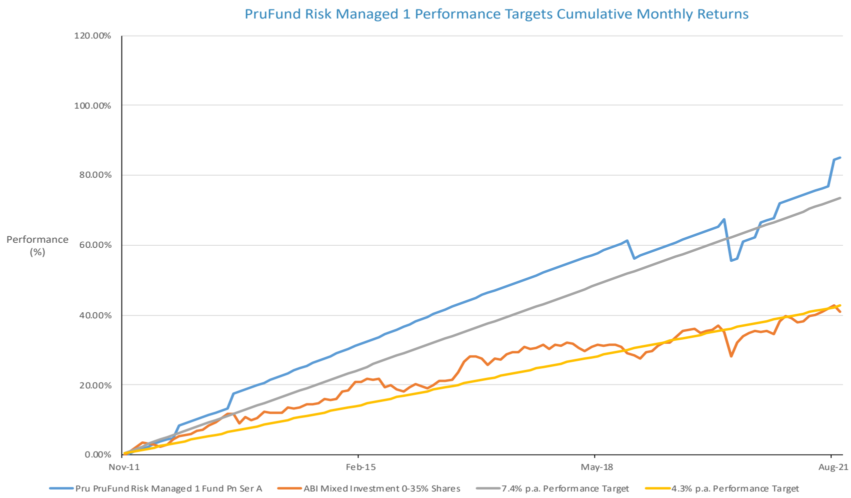
PruFund Cautious Pension Fund performance since launch to end of September 2021



Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

The PruFund Risk Managed 1 pension fund (using the fund series with the longest track record in FE Fundinfo) has delivered strong absolute returns over it's life. The fund has outperformed its stated EGR applicable at outset (7.4%) and the one currently in place (4.3%). The fund has comfortably outperformed the ABI Mixed Investment 0-35% Shares sector median over it's life.

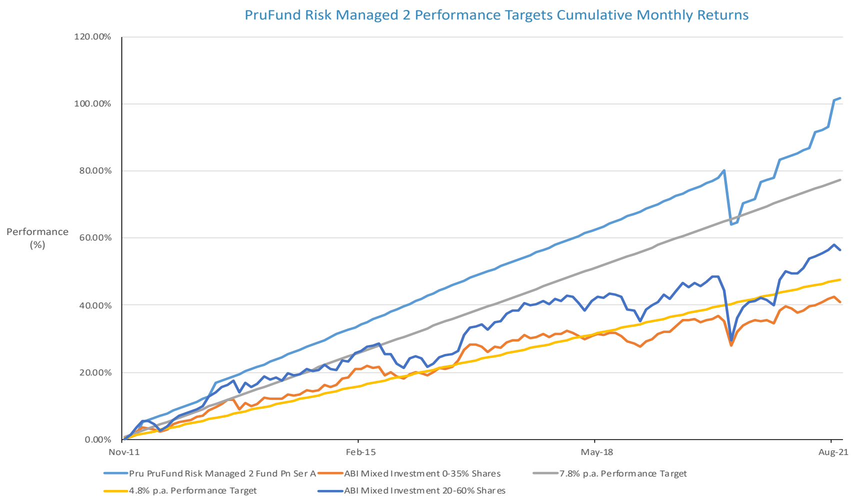
Figure 17
PruFund Risk Managed 1 Pension Fund performance since launch to end of September 2021



Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

The PruFund Risk Managed 2 pension fund (using the fund series with the longest track record in FE Fundinfo) has delivered strong absolute returns over it's life. The fund's return has exceeded the stated EGR applicable at outset (7.8%) and the one currently in place (4.8%). The fund has comfortably outperformed the ABI Mixed Investment 0-35% Shares sector and Mixed Investment 20-60% Shares sector median over it's life.

Figure 18
PruFund Risk Managed 2 Pension Fund performance since launch to end of September 2021

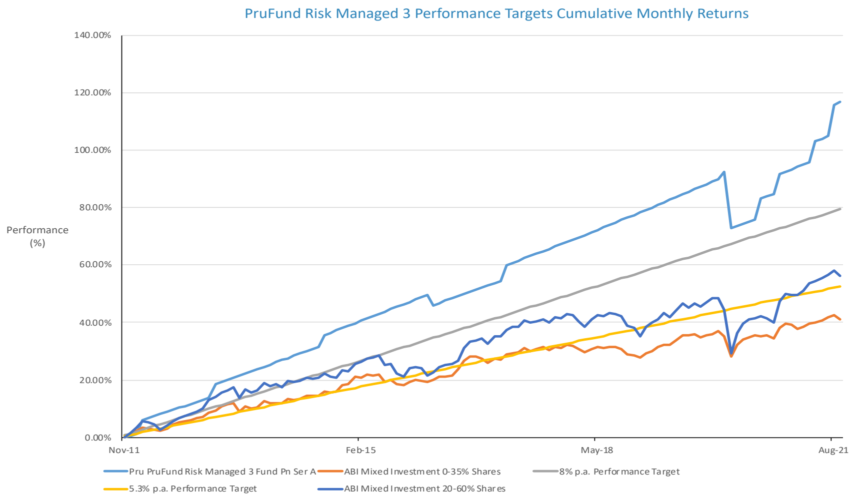


Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

The PruFund Risk Managed 3 pension fund (using the fund series with the longest track record in FE Fundinfo) has delivered strong absolute returns over it's life. The fund's return has exceeded the stated EGR applicable at outset (8.0%) and the one currently in place (5.3%). The fund has comfortably outperformed the ABI Mixed Investment 0-35% Shares sector and Mixed Investment 20-60% Shares sector median over it's life.

Figure 19

PruFund Risk Managed 3 Pension Fund performance since launch to end of September 2021

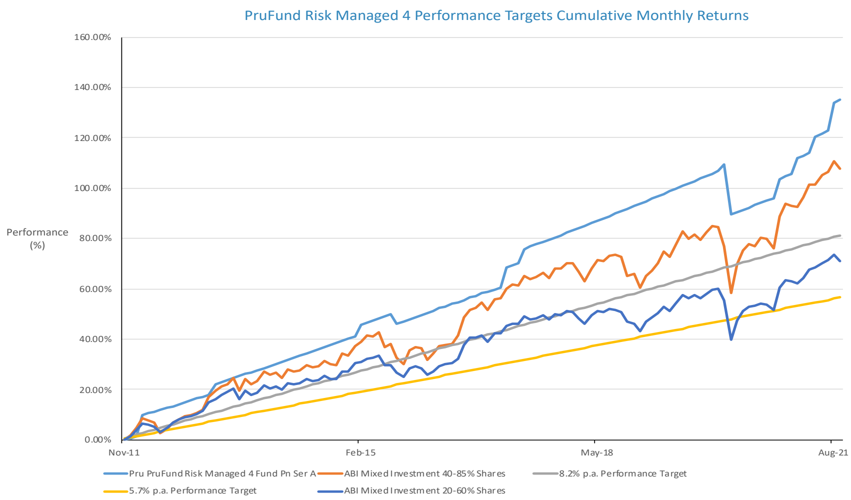


Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

The PruFund Risk Managed 4 pension fund (using the fund series with the longest track record in FE Fundinfo) has delivered strong absolute returns over it's life. The fund's return has exceeded the stated EGR applicable at outset (8.2%) and the one currently in place (5.7%). The fund has comfortably outperformed the ABI Mixed Investment 20-60% Shares sector and Mixed Investment 40-85% Shares sector median over it's life.

Figure 20

PruFund Risk Managed 4 Pension Fund performance since launch to end of September 2021

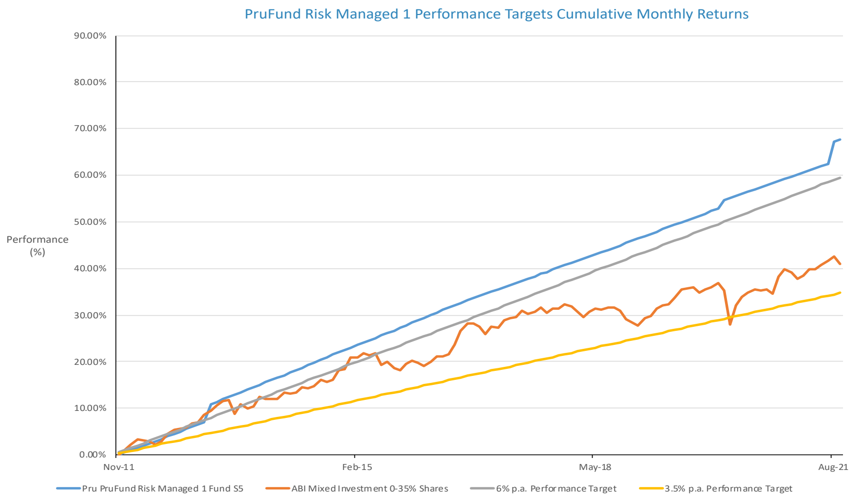


Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

The PruFund Risk Managed 1 life fund (using the fund series with the longest track record in FE Fundinfo) has delivered strong absolute returns over it’s life. The fund has outperformed its stated EGR applicable at outset (6.0%) and the one currently in place (3.5%). The fund has comfortably outperformed the ABI Mixed Investment 0-35% Shares sector median over it’s life.

Figure 21

PruFund Risk Managed 1 Life performance since launch to end of September 2021

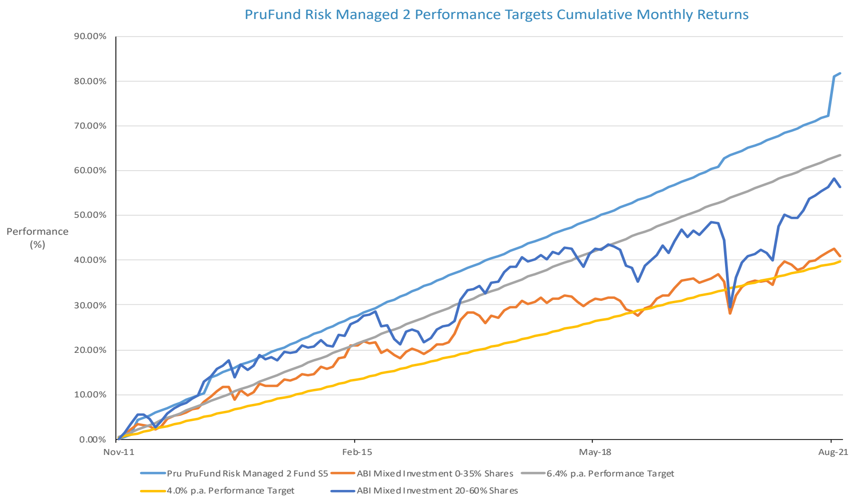


Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

The PruFund Risk Managed 2 life fund (using the fund series with the longest track record in FE Fundinfo) has delivered strong absolute returns over it’s life. The fund’s return has exceeded the stated EGR applicable at outset (6.4%) and the one currently in place (4.0%). The fund has comfortably outperformed the ABI Mixed Investment 0-35% Shares sector and Mixed Investment 20-60% Shares sector median over it’s life.

Figure 22

PruFund Risk Managed 2 Life performance since launch to end of September 2021

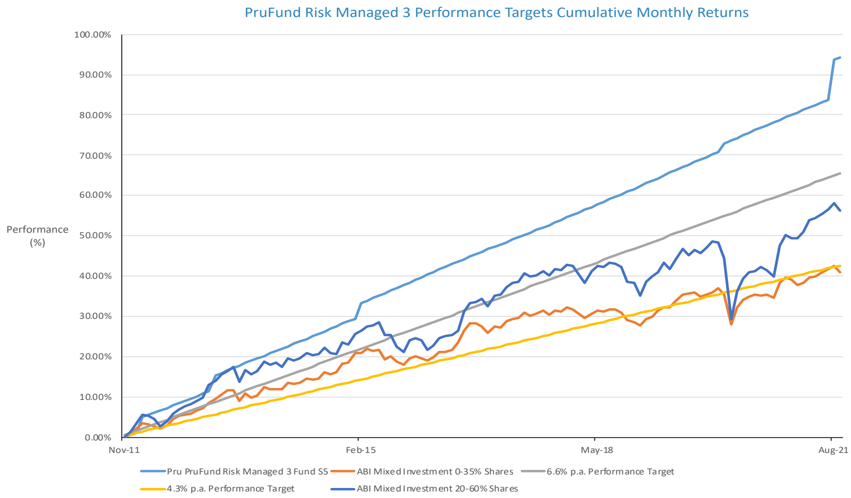


Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

The PruFund Risk Managed 3 life fund (using the fund series with the longest track record in FE Fundinfo) has delivered strong absolute returns over it's life. The fund's return has exceeded the stated EGR applicable at outset (6.6%) and the one currently in place (4.3%). The fund has comfortably outperformed the ABI Mixed Investment 0-35% Shares sector and Mixed Investment 20-60% Shares sector median over it's life.

Figure 23

PruFund Risk Managed 3 Life performance since launch to end of September 2021

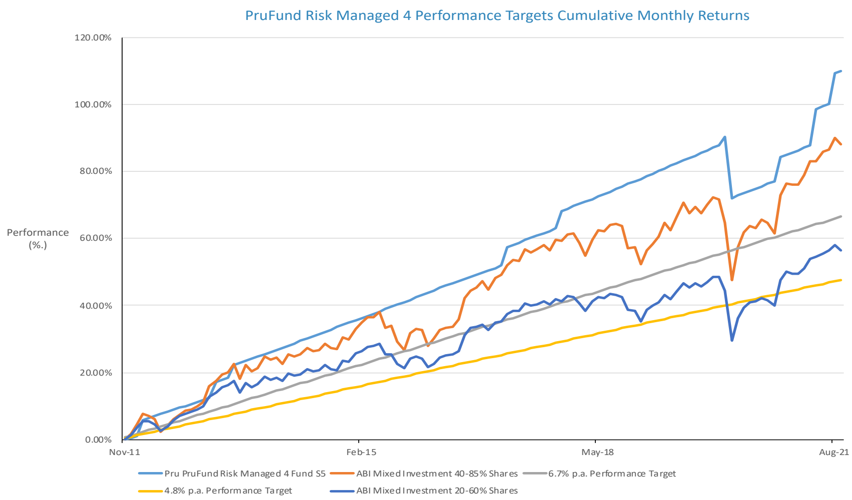


Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

The PruFund Risk Managed 4 life fund (using the fund series with the longest track record in FE Fundinfo) has delivered strong absolute returns over it's life. The fund's return has exceeded the stated EGR applicable at outset (6.7%) and the one currently in place (4.8%). The fund has comfortably outperformed the ABI Mixed Investment 20-60% Shares sector and Mixed Investment 40-85% Shares sector median over it's life.

Figure 24

PruFund Risk Managed 4 Life performance since launch to end of September 2021



Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

1.9 Value For Money

The PruFunds are available across a number Prudential's pension and investment plans and the cost of accessing the funds across different products varies. Therefore, assessing whether they offer value for money from a whole of market perspective is less straightforward than a unit trust or OEIC structure with a clean share class that is available across most third-party investment platforms.

In addition, Prudential does not explicitly quote an ongoing charge figure (OCF) for the PruFunds. Instead, they quote a total charge figure which is similar to the OCF but which also includes costs for property expenses. Hence a simple like-for-like comparison of the PruFunds and other retail mutual funds is more challenging.

To assess the value for money of the PruFunds we have reviewed the total cost of the funds on three of Prudential's Pension and Investment products currently accepting new business, the Retirement Account, Prudential Investment Plan and Prudential ISA, and compared them to other multi-asset funds available within the same products where they are available. Figure 25 illustrates that the PruFunds appear competitively priced relative to the external multi-asset funds reviewed. Based on this we believe that the PruFunds represent good relative value for money when accessed via Prudential products when considering the smoothing mechanism of the funds, the experience of the team and the strong long-term track record.

Unlike most investments targeted at retail investors, the PruFunds do not explicitly break out costs within the total charge figure for the funds. We do not think this demonstrates best practice, as investors cannot then put a price on the cost of the various features offered, for example the cost of the smoothing mechanism.

Figure 25
PruFund Charges

Retirement Account		Investment Plan		ISA	
Fund	Total Charge	Fund	Total Charge	Fund	Total Charge
PruFund Cautious	0.76%	PruFund Cautious	1.20%	PruFund Cautious	1.30%
PruFund Growth	0.85%	PruFund Growth	1.29%	PruFund Growth	1.39%
PruFund Risk Managed 1	0.76%	PruFund Risk Managed 1	1.18%	PruFund Risk Managed 1	1.27%
PruFund Risk Managed 2	0.78%	PruFund Risk Managed 2	1.21%	PruFund Risk Managed 2	1.30%
PruFund Risk Managed 3	0.80%	PruFund Risk Managed 3	1.24%	PruFund Risk Managed 3	1.33%
PruFund Risk Managed 4	0.82%	PruFund Risk Managed 4	1.26%	PruFund Risk Managed 4	1.37%
PruFund Risk Managed 5	0.82%	PruFund Risk Managed 5	1.28%	PruFund Risk Managed 5	1.38%
Aegon Ethical Cautious Managed	0.79%	Invesco Managed Growth	1.49%		
BNY Mellon Multi Asset Balanced	0.68%	M&G Episode Growth	0.98%		
Invesco Distribution	0.82%	M&G Managed Growth	1.01%		
Janus Henderson Cautious Managed	0.74%				
Liontrust Sustainable Future Managed	0.87%				
Jupiter Merlin Balanced	1.58%				
Ninety One Cautious Managed	0.92%				

Source: FE Fundinfo, as at 25 May 2021

During our discussions with Prudential we tried to gain a better understanding of the constituents of the total cost figure quoted. Prudential confirmed that the estimated cost for management of the PruFunds is circa 0.65%. The remainder of the total charge is used to pay for the cost of administration of the tax wrapper where applicable.

The 0.65% charge covers investment expenses, the smoothing charge and shareholder transfers. The wrapper charge covers administration and acquisition expenses.

Note: The cost of insurance company and platform product charges is outside the scope of this report and does not fall within Square Mile's area of specialisation. Our comments do not therefore relate to whether the product fees of Prudential are competitive or not within the broader market.

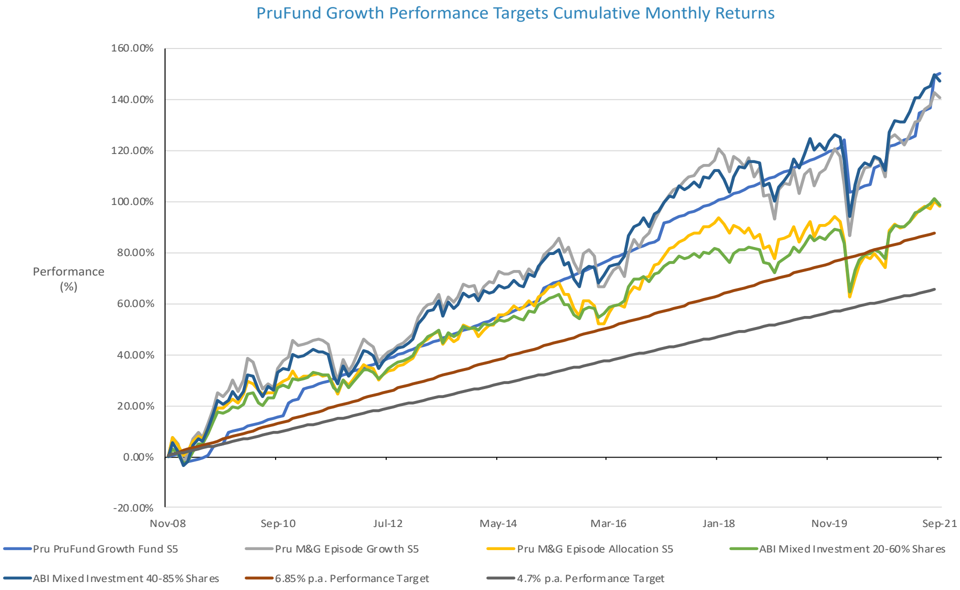
2.1 Appendix

2.1.1 Historical Performance of the PruFunds versus other Multi-Asset funds

The charts below illustrate the longer term performance of the PruFund Growth and Cautious funds versus a number of competitor multi-asset funds which are also available within the various Prudential products.

Figure 26

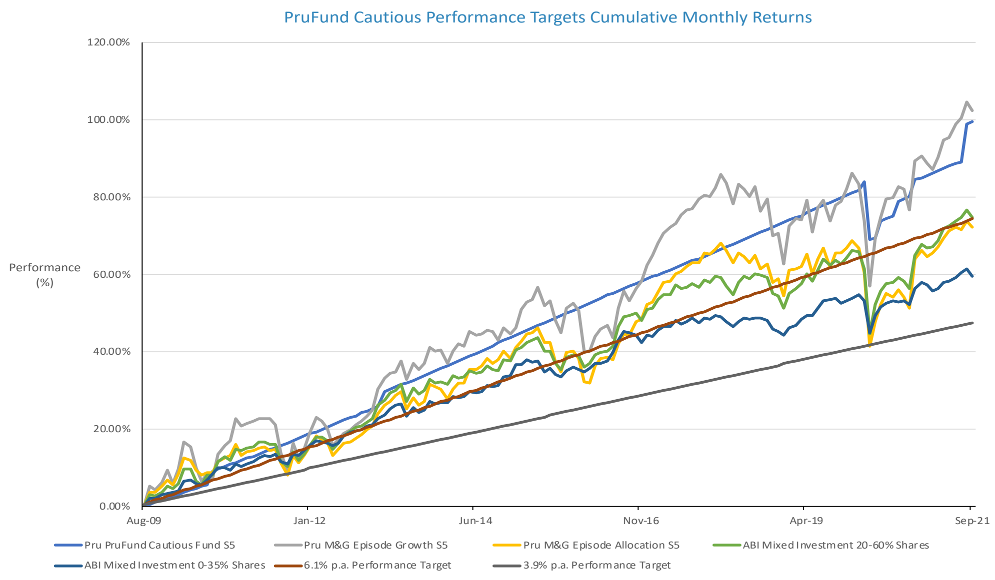
PruFund Growth Life performance since launch to end of September 2021 vs other Multi-Asset Funds



Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

Figure 27

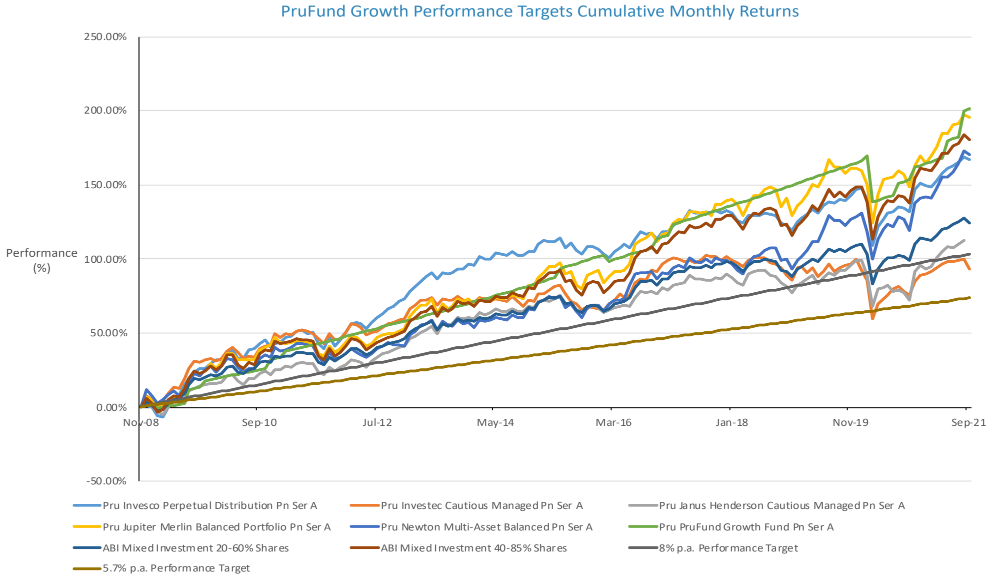
PruFund Cautious Life performance since launch to end of September 2021 vs other Multi-Asset Funds



Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

Figure 28

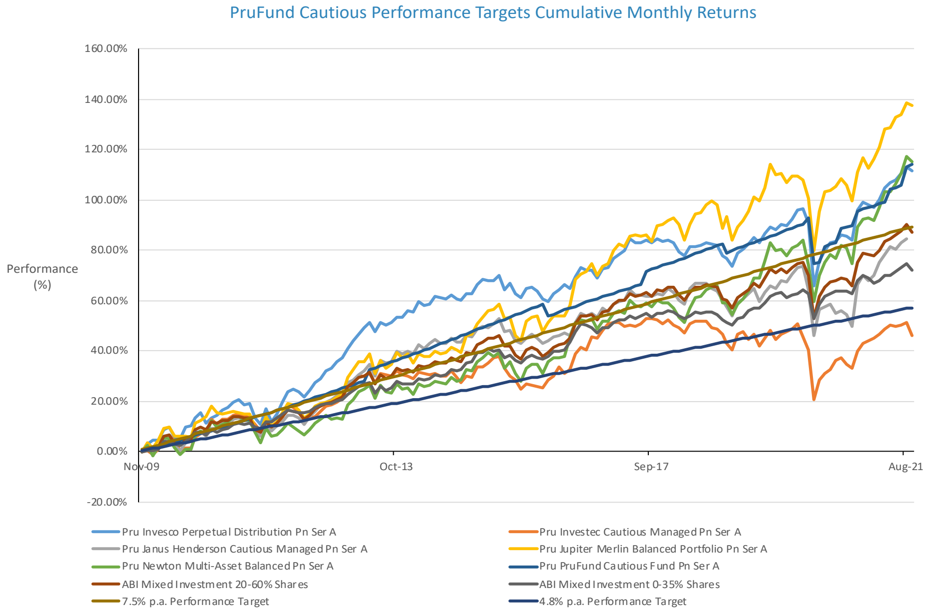
PruFund Growth Pension performance since launch to end of September 2021 vs other Multi-Asset Funds



Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

Figure 29

PruFund Cautious Pension performance since launch to end of September 2021 vs other Multi-Asset Funds



Source: FE Fundinfo, as at 30th September 2021
Past performance is not a guide to future returns

Glossary

ABI - Association of British Insurers

EGR - Expected Growth Rate

ESI - EastSpring Investments

ISA - Individual Savings Account

LTIS - long Term Investment Strategy

MIB - Macro Investment Business

NAV - Net Asset Value

PPMA - Prudential Portfolio Management America

OCF - Ongoing Charge Figure

OEIC - Open Ended Investment Company

SAA - Strategic Asset Allocation

TAA - Tactical Asset Allocation

UPA - Unit Price Adjustment

VaR - Value at Risk

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