Link Fund Solutions Limited

Governance Advisory Arrangement

Annual report to unitholders

of the

LF Stakeholder Pension Scheme

Year-ended 31 December 2019

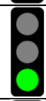
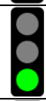
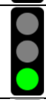
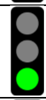
Contents

1. Chair's report

I am pleased to present the 2019 annual report of the independent governance Committee of the LF Stakeholder Pension Plan ("the Plan"). The Committee is known for technical reasons as a "governance advisory arrangement" or "GAA" and its sole objective is to ensure that you are getting "value-for-money" ("VfM") out of your pension plan and in your dealings with Link Fund Solutions Limited ("LFS").

Since our last report, the chairman of your Committee has stood down, although he will continue to serve as a member of the Committee until his retirement on 31st May 2020. He will be replaced as a Committee member by another experienced pensions professional, from 1st June.

Summary evaluation

What overall level of VfM do we think the Plan provides to investors?	
Is the default investment strategy suitable for most investors?	
Does the default investment strategy have clear aims and objectives?	
Does LFS regularly review the characteristics and net performance of its funds to ensure alignment with your interests?	
How well are core financial transactions processed?	
How competitive are the charges associated with the Plan that are borne by investors?	
How competitive are direct and indirect costs associated with managing and investing funds, including transaction costs?	
Investment performance of default fund during growth phase (assessed over three years)	
Investment performance of default fund during de-risking phase (assessed over three years)	
Investor experience (service received)	
Investor experience (quality of communications)	
Environmental, social and governance credentials	

Why aren’t all traffic lights green?

In 2019, LFS developed an “Optimisation Plan”, which was intended to result in a more appropriate range of funds and default investment strategies, whilst reducing costs. The original timetable was completion by 31st March 2020.

Unfortunately, the plan is behind schedule and most issues that your Committee has previously identified have yet to be addressed as a result. We therefore feel that some areas that were previously assessed as amber should be reassessed as red, as they are overdue for resolution.

At 31st December 2019, the default strategy continues to be 100% invested in UK equities until five years before retirement age. Thereafter, the default lifestyle option means that the equity funds are switched into cash - in tranches of 20% each year - over the period leading up to retirement.

We believe that exclusive exposure to the UK stock-market during the “growth” phase of investment concentrates risk unduly in a single market, thereby maintaining a higher level of investment risk than would exist in a more diversified portfolio.

Since 31st December 2019, the Optimisation Plan has taken a number of significant steps forward and a new project timetable is put in place. Your Committee’s input has been (and will continue to be) invited at various stages of the plan’s evolution and we are hopeful that it will be fully implemented by 31st December 2020.

The proposed default investment strategy, range of funds, associated costs and options for taking retirement benefits are all being evaluated in association with the Optimisation Plan. We continue to await confirmation of the ongoing charges (including transaction costs) and we hope that, once implemented, the new arrangements will improve value-for-money for investors.

How we have considered your interests

Over the last year we have again considered the appropriateness of the default investment strategy and other funds that have been made available to investors, annual management charges (but not transaction costs, which remain elusive), service delivery and how LFS is addressing environmental, social and governance matters associated with the underlying funds. We hope to see a further reduction in charges when the Optimisation Plan goes live.

Concerns raised with the Financial Conduct Authority (“FCA”)

There have been no instances during the year where we have felt it necessary to approach the FCA. We were disappointed that the improvements anticipated by/similar to those in the Optimisation Plan have not been implemented but we expect its implementation during 2020 will allay the issues. We will reconsider this if sufficient action is not taken during the year.

Expertise, independence and experience of members of the GAA

When first establishing the Committee, our Chair was keen to ensure that collectively, we had the necessary skills to evaluate all of the areas required by the FCA in our assessment of VfM and that each member was able to bring creative solutions to issues that we were likely to face. This meant inviting accomplished professionals with broad experience in their respective fields.

Our Committee includes a qualified pensions solicitor who is involved actively in the governance of trust-based pension schemes. She is highly regarded within the world of UK pensions, having worked for a major London law firm before becoming the first Director of Legal at the Pension Protection Fund. She is now the managing director of a trustee company, chairing many trustee boards, and her primary objective is to look after the interests of members of schemes on whose boards she sits.

Our investment specialist is an Associate of the Chartered Institute for Securities and Investment and has, for many years, advised pension funds on investment strategies. As an investment consultant, he is fully conversant with all aspects of investment, and has considerable experience and market knowledge. In addition, our investment specialist is extremely knowledgeable about market drivers, charges (direct and indirect) and investment objectives for specific funds.

As your Chair, I am a practising actuary and I have advised many FTSE 100 and FTSE 250 companies over the years on pension scheme funding and strategy. I have held a senior management role within a national actuarial practice and have been managing director of a smaller practice. I now run my own actuarial consultancy.

The final independent member of the Committee (and former Chair) has spent almost his entire working lifetime dealing with occupational and contract-based pensions, with over 30 years working in an advisory capacity. He is qualified as a Fellow of the Pensions Management Institute and also holds a diploma in Personal Financial Services, which permits him to advise individuals, as well as companies and boards of trustees.

All of the above are wholly independent of LFS and its associated companies. We are also independent of each other although our investment specialist was previously a partner at Smith & Williamson.

The fifth member of our Committee is the only non-independent person on the Committee. The FCA permits non-independent members, so long as they are not in the most senior roles in a sponsoring company. Our “fifth member” is head of product at LFS, which means that he is responsible for the development and on-going product management of all funds operated by LFS, including those available through the LF Stakeholder Pension Scheme.

A conflicts policy is in place, although to date, there have been no circumstances where this has had to be invoked.

Your views – how we take them into account

The nature of a governance advisory arrangement is to act as an independent governance Committee for smaller or less-complex schemes. Relative to the large pension providers that are household names, the LF Stakeholder Pension Scheme is not large and its structure is fairly straight-forward.

We have yet to contact investors directly in order to establish their views, although our analysis of member data has given us a fair idea of the overall membership of the scheme.

We believe that it would only be appropriate to approach investors directly (by letter) where issues arise which could lead to fundamental decisions that might otherwise be incorrect, resulting in inappropriate outcomes. To date, we have not encountered such a situation.

Environmental, social and governance ("ESG") strategy

Over the last two years there has been a substantial shift in the investment world (instigated by governments, sovereign funds and other institutional investors) for companies to assess the impact of their business on customers, suppliers, employees, shareholders and the natural world/environment. Investors are starting to analyse the ESG credentials of companies to assess whether they will materially affect long-term returns. This is on the basis that those companies with strong ESG credentials may have a greater chance of long-term success and of delivering more sustainable returns.

As a Committee whose task is to consider VfM, the potential to deliver long-term returns is a key metric, so ESG credentials are going to have an increasing impact on those returns.

In the next section of our report, we have outlined our thinking on how we will take ESG matters into account.

The future

Whilst we had hoped to be reporting to you this year on the outcome of the Optimisation Plan, circumstances unrelated to your scheme have caused progress to be considerably slower than anticipated. We believe that these circumstances should not present themselves again in the coming year so we would hope to be reporting to you next year on substantial progress that has been achieved by the Optimisation Plan.

We believe that delivery of the Optimisation Plan will result in significant improvements in the default investment strategy, fund choice and charges, all of which is designed to improve value-for-money from your scheme.

Sarah Farrant FIA
Chair

2. Environmental, social and governance strategy

Introduction

The UK Government has been one of the foremost in creating a code of good conduct for companies. There have been many policies instigated over the years, and the Environmental, Social and Governance (ESG) policy is the latest manifestation, which is looking to build on previous initiatives.

An ESG policy is not to be confused with an ethical policy, although these are also likely to be referenced when assessing a company's overall ESG policy. Such a policy is looking to encourage good practice in relation to every aspect of a business. There are many aspects involved in a company's ESG rating, from remuneration policy to the impact of the business on the environment.

This document sets out the GAA's current approach to ESG and how the Committee believes it should be factored into the processes. Our approach will be developed further as ESG policy in the fund management industry evolves over the coming years.

Environmental, Social and Governance Issues

The Committee's objective is to ensure that investment managers have the financial interests of members as their first priority when reviewing investments.

The Committee may take ESG considerations into account only when these factors do not contradict, or actively support, the primary objective or where these considerations are specified within the mandate of the funds used. In the case of passive equity funds, there is an expectation that all fund managers will be active as shareholders, and will apply their own ESG policies.

During 2019, we have seen considerable change in the approach to all issues surrounding ESG, from reporting to the implications for investment returns. The Committee feels that ESG factors will have a significant impact on future returns from all assets. At the start of the year the consensus amongst investment institutions was that investors had a number of years to reflect ESG in portfolios. Regulators are now forcing through change ahead of the fund management industry so the Committee is looking for ESG considerations to be reflected in all assets within the next 2 years.

The issue facing investors is how to reflect ESG risks in portfolios when the majority of the fund options are relatively new (less five years) and there is little ESG experience amongst fund managers. The shortage of expertise in the wider market increases the risks associated with integrating ESG into the default funds under the Optimisation Plan, although we are aware that the regulators are expecting imminent change.

In the case of active funds, each fund manager will have an ESG policy, which should be integrated into the overall investment management process. The Committee will review the ESG policy and highlight any issues with LFS. Our approach is one of "positive engagement".

Voting Rights attaching to Investments

LFS delegates to the investment managers responsibility for exercising rights (including voting rights) attaching to investments and encourages the managers to exercise those rights.

The investment managers are expected to provide regular reports for LFS, detailing their voting activity.

3. Review of 2019

Investment review

The LF Stakeholder Pension Scheme (formerly "Nationwide Building Society Stakeholder Pension Scheme") uses a single institution to administer and manage the Scheme. Separate fund managers (Janus Henderson Asset Management and Legal & General Investment Management – "LGIM") manage the underlying assets, with Janus Henderson managing the Cash Fund for a short period early in 2019 before being replaced by LGIM.

The available fund range is shown below:

- LF Tracker Pension Fund
- LF Corporate Bond Pension Fund
- LF Cash Pension Fund, formerly LF Money Market Pension Fund

At 31st December 2019, approximately 80% of the scheme's assets were held in the LF Tracker Pension Fund. Your Committee's task is to ensure the suitability of each fund.

It is usual to include some form of de-risking (or "life-styling") arrangement in the run-up to retirement so that investors are not exposed to the full volatility of equity (share) markets at a time when it could be too late to recover from a sudden fall in those markets.

The Scheme's documentation describes the LF Tracker Pension Fund (a 100% equity fund) as its "default" and mentions that all participants ultimately will have their funds moved into the Cash Pension Fund in 20% tranches over the five years leading up to their selected retirement date. One can opt-out of this process, but it is otherwise automatic. Arguably, this type of life-styling (targeting cash) could be appropriate for members who wish to take their benefits as a cash lump sum.

Following the advent of "pension freedoms" in 2015, members of workplace schemes are typically offered several life-styling options. The Committee has asked LFS to consider introducing additional life-styling options to cater for different intended outcomes, such as income drawdown or annuity purchase.

In December 2019, the FCA mandated that workplace pension schemes must offer a range of investment options for members who choose not to purchase an annuity at the point of retirement. Accordingly, LFS will need to review its current approach before 1st August 2020.

Suitability of funds

The Scheme should be operated in the interests of members reflecting the current environment for savers (which can change over time), rather than assuming it will remain suitable indefinitely.

Investment mandates for the LF Stakeholder Pension Trust are set out in the prospectus, as shown below.

"aims for long-term capital growth by each investing in a single authorised collective investment scheme.

The underlying funds are L&G (N) Tracker Trust, Legal & General Sterling Income Fund and Legal & General Sterling Liquidity Plus Fund". The limited number of funds available means that the selection process cannot truly be driven by members' needs. We have therefore made assumptions about the needs of the majority of members. Factors we would consider when selecting a default fund are as follows:

1) Time horizon

2) Risk profile

3) Financial knowledge and experience of members

4) Liquidity

5) Return targets

Our report is divided between return-seeking assets and de-risking assets.

Return-seeking: LF Tracker Fund

This fund was created when the contract was designed and is wholly invested in the L&G (N) Tracker Trust. The mandate for the underlying fund is shown below.

"Investment objective and policy: L&G (N) Tracker Trust aims to track the capital performance of the UK equity market, as represented by the FTSE All-Share Index, by investment in a representative sample of stocks selected from all economic sectors.

Securities in the FTSE All-Share Index will be held with weightings generally proportionate to their company's market capitalisation. From time to time non-index constituents may be held as a result of a corporate action and these holdings will be sold or transferred as soon as reasonably practical."

Over the year, the fund has delivered an attractive risk-adjusted return and has followed the value of the FTSE All Share Index upwards. Members have also continued to contribute money to the fund.

However, we have questioned whether a single return-seeking fund investing in just one stock market is an appropriate default fund for the Scheme, given the natural volatility and cyclical nature of equities, especially when invested exclusively in the UK stock market.

Limited data is available on the membership profile and there is no requirement for LFS to ask each member about their attitude to risk, time horizons and investment objectives. Neither is there any information about the financial knowledge and experience of participants. Some data is available about the number of members invested in each fund, their ages and the average value of their holding, which is shown in the table overleaf.

Date	Fund	Number of Members	Value	Value per member	Average age	Weighted Average Age
31-Dec-16	LF Tracker Fund	20,456	297,475,616	14,542	45.1	47.2
31-Dec-17	LF Tracker Fund	19,635	322,334,827	16,416	45.6	47.6
31-Dec-18	LF Tracker Fund	18,931	279,208,135	14,749	46.3	48.2
31-Dec-19	LF Tracker Fund	18,262	323,655,323	17,723	47.0	48.8

It should be noted that membership of the Scheme is relatively young, which would have had an impact on the averages shown above.

Selected retirement ages for workplace schemes are between 60 and 65 so the time-frames for these investments (before they will be drawn upon) are likely to be between 12 and 17 years (based on the average age above). In view of these time-frames, we believe that the fund is likely to be suitable for an investor with a "medium" attitude to investment risk. At every opportunity, members should be informed of the risks and advised about all aspects of the Scheme.

There is no specific data on the membership of the Scheme. Therefore, the Committee has assumed the worst-case scenario, i.e. the financial literacy of the majority of members is unsophisticated. This suggests that there should be an enhanced duty of care to the members to ensure that the funds are suitable for the majority.

Over the last year, 246 members of the Scheme have taken benefits from their pension plans, rather than transferring out, to the value of £3,332,489. The objective of this analysis is to understand how individuals are taking their pension funds and where the money is coming from. The average value of the pension pots withdrawn was £13,547.

The money was taken from the funds shown below.

	Cash	Bond	Tracker
Total	£1,554,810	£125,270	£1,652,410
Average withdrawal	£6,302	£509	£6,717

We do not have the data to analyse the ages at which the benefits were taken. On the assumption that a number of the individuals are within a life styling program and they are taking the benefits close to their stated normal retirement ages, then we would have expected more money to be coming from the Cash Fund.

Knowing the past performance of the funds, we can estimate the contribution regimes for the plans. Contribution levels indicate that the members' earnings were below average for the UK. Lower earnings probably mean that members are less likely to seek professional pensions advice so they are less likely to appreciate the implications of taking benefits now, leaving them with less savings to provide for them later in life.

The average size of individual pension funds could indicate that members are likely to incur income tax on their benefits, which could be mitigated by spreading the withdrawals. The Committee would encourage LFS to promote the benefits of financial education amongst members, to reduce the risks of them making inappropriate decisions. Any checks and balances can only help members to question whether their actions are appropriate.

Most members have sold their units in the LF Tracker Fund by the age of 65, with only 1% of the £323 million assets in the LF Tracker Fund being held by members over age 65.

Cumulative performance of the fund (i.e. total return) is shown below, over various periods to 31 December 2019.

Fund Statistics to 31st December 2019	*3 months*	*1 year*	*3 years*	*5 years*	*10 years*
LF Tracker Fund	4.38%	18.94%	19.39%	37.26%	96.48%
Pensions UK All Companies	*6.05%*	*20.42%*	*20.09%*	*38.19%*	*118.18%*
L&G UK Index Trust	*4.02%*	*19.09%*	*22.60%*	*43.78%*	*114.89%*

The colour coding outlines the quartile position of the fund relative to its peers

1st Quartile
2nd Quartile
3rd Quartile
4th Quartile

The table below uses three measures of performance over 5 years to 31 December 2019 to help identify whether investors have been rewarded for the risks taken in each of the funds.

Fund Statistics to 31st December 2019	*Volatility*	*Jensens Alpha*	*Maximum Drawdown/Fall*
LF Tracker Fund	11.74	-0.04	-17.80
Pensions UK All Companies	*10.78*	*0*	*-16.89*
L&G UK Index Trust	*12.04*	*1.12*	*-17.38*

Glossary

The Committee has selected three fund characteristics to help members appreciate the risks and the rewards of their selections.

"Volatility" illustrates the level of risk over the last five years. The unit price will vary from day to day and will oscillate around the average returns for the period. Deviation against the long-term averages will provide a measure of risk; greater deviation in the unit price = higher volatility = higher risk. Ideally, a fund will have a deviation in line with (or less than) its benchmark, which is highlighted in light blue. The lower the volatility, the higher will be its quartile ranking.

Where a fund is more volatile than the benchmark index, an investor should expect to achieve a higher return, relative to the benchmark index. This is to compensate them for the higher level of risk.

"Jensen's Alpha" ("Jensen's Information Ratio") is a measure of the marginal return a fund has achieved, relative to its peer group, i.e. other comparable funds, net of fees, adjusted for volatility (hence risk). The ratio provides investors with a simple measure of

whether a fund manager has performed better than his or her peers, allowing for the risks taken. It may be regarded as a measure of the skill of a fund manager. Ideally, the value should be above zero and a higher number is better.

"Maximum drawdown/fall" is the maximum percentage loss incurred by unitholders within the last five years. The Committee has taken the maximum unit price over the last five years and compared it with the minimum price over the subsequent period. The purpose is to provide investors with an assessment of the maximum potential loss of capital, assuming no further contributions were made to the fund over the remaining period. The greater the fall, the higher will be the down-side risk associated with owning that asset during the period. A top quartile rating is given to funds with the lowest fall in fund value.

The quartile positions reflect where the fund stood at 31 December 2019, relative to its peers.

The underlying fund is designed to perform in line with the FTSE All Share Index, even though the fund description of the performance is to "track the capital performance of the UK equity market, as represented by the FTSE All-Share Index." There is no mention of the total return from the index, i.e. the contribution to the total returns from the reinvestment of dividend income.

The underlying goal of the fund from LGIM is to perform in line with the FTSE All Share Index over the long term. The fund has slightly outperformed the index as a result of L&G electing to take scrip dividends, gross of fees. A scrip dividend is where a company distributes the dividend as a number of shares rather than as cash, which avoids Stamp Duty, so enhancing returns to the fund.

Whilst the fund is benchmarked against the FTSE All Share Index, we are not permitted to use the index data for charts and tables. Hence, we are using the L&G UK Index Trust Fund, which tracks the FTSE All Share Index and has ongoing fund charges of 0.13% per annum.

We have used this data to identify the impact of charges. By flat-lining the L&G UK Index Trust Fund (below), we can see below the impact of this underperformance, which has been significant.

After taking charges into account, fund performance has been in line with expectations. The issue remains whether the mandate is right for a workplace pension, i.e. a single tracker fund invested in just one stock market.

Turning to the ESG aspects, the fund has no ESG filter but LGIM prides itself on being a good steward of investors' capital. LGIM is one of the largest shareholders in the world and it continues to engage the management of companies on governance aspects of their business. LGIM will use its voting rights to reflect its views of companies' management decisions.

Like many institutions, LGIM is looking for companies to improve their governance in terms of their impact on the environment and the wider community. Currently, there are no specific goals around environmental and social issues.

LGIM does not have a formal ESG system in place for this fund, although it does plan to have a reporting system in place before 30th June 2020. There are no specific dates when these reports are due to appear.

De-risking funds - Cash and Corporate Bond

The Cash and Corporate Bond funds have clear investment objectives, as shown below.

Fund	*Investment objectives*
Cash	To achieve a high level of return consistent with a high degree of capital security
Corporate Bond	To produce a high level of income consistent with long-term preservation of capital in sterling terms

These funds are invested in two separate asset classes, each with its own benchmark index. When they were created in 2001, the expectation was that on retirement, 25% of a member's retirement fund would be taken as a tax-free lump sum and the balance would be used to purchase an annuity (providing an income in retirement). A cash fund is generally considered to be a suitable investment to support the withdrawal of a lump sum at retirement.

Before the advent of "pension freedoms" in 2015, the majority of bond funds in personal pension plans were designed to mirror movements in annuity rates. Annuity rates are driven by mortality rates, government and corporate bond yields, as well as interest rate/inflation linked swaps. The price of annuities is closely linked to movements in the yield on UK government bonds with a duration reflecting the life expectancy of the annuitants. The FTSE Government Bond All Stocks index is widely considered to be a suitable index for this purpose.

However, as stated above, we are unable to use the FTSE data, so we have replaced that with the L&G All Stocks Gilt Index Trust, which tracks the gilt market. The fund has charges of 0.15% per annum.

The original provider, Nationwide, opted for a different approach and selected a bond fund that was intended to deliver an absolute total return through the L&G Sterling Income Fund (a corporate bond fund). The construction of this fund is very different to one that is designed to track annuity prices. Hence, there is no guarantee of a high correlation between the two, as illustrated in the table below.

By flat-lining the Government Bond index fund in the graph below, we can see that members have incurred greater risk, relative to movements in annuity prices, but they have not been rewarded with higher returns.

There is a clear mismatch with annuity rates, of which the Committee believes members should be made aware. We would encourage LFS to review the investment mandate of this fund.

The stated objective of the underlying L&G Sterling Income Fund is to retain its capital value and to generate an income which should deliver a positive return over most periods. Consequently, the fund could be more appropriate for investors looking to draw down capital under new pension flexibility rules.

Basic membership details for each of these funds are shown below.

31st December 2016

Fund	*Number of Members*	*Value*	*Value per member*	*Average age*	*Weighted Average Age*
LF Money Market	2,645	31,927,919	12,071	59.0	61.7
LF Corporate Bond	5,305	23,637,915	4,456	46.3	51.1

31st December 2017

Fund	*Number of Members*	*Value*	*Value per member*	*Average age*	*Weighted Average Age*
LF Money Market	2,682	36,140,830	13,470	59.4	61.9
LF Corporate Bond	5,039	24,068,752	4,776	46.7	51.4

31st December 2018

Fund	Number of Members	Value	Value per member	Average age	Weighted Average Age
LF Cash	2,770	39,349,027	14,205	59.8	62.3
LF Corporate Bond	4,794	22,664,718	4,728	47.2	51.9

31st December 2019

Fund	Number of Members	Value	Value per member	Average age	Weighted Average Age
LF Cash	2,877	43,741,481	15,204	60.3	62.5
LF Corporate Bond	4,587	23,493,107	5,122	47.7	52.4

The weighted average age of unitholders is as expected for the Cash Fund, if funds are being held by individuals approaching retirement. Investors should continue to be warned about the impact of inflation on the real value of the units in the Cash Fund.

The average age and weighted average age for the Corporate Bond Fund are relatively low, at 47.7 and 52.4 years. This suggests that there is a cohort of the membership who are lower to moderate risk investors to the extent that they selected the Corporate Bond Fund. Ideally, this cohort should be made aware of the inflation risks which will have an impact on the real value of their pension funds over the long term.

The fund returns are as shown below

Fund Statistics to 31st December 2019	*3 months*	*1 year*	*3 years*	*5 years*	*10 years*
LF Cash	0.20%	0.90%	1.37%	2.05%	3.69%
Pensions Money Market	*0.05%*	*0.63%*	*0.87%*	*1.58%*	*2.98%*
LIBOR 3 month	*0.20%*	*0.81%*	*1.90%*	*3.00%*	*6.61%*
LF Corporate Bond	1.17%	6.90%	9.59%	18.97%	71.37%
IA Sterling Corporate Bond	*-0.10%*	*9.49%*	*12.47%*	*22.36%*	*71.58%*

Performance of the LF Cash Fund is in line with expectations, i.e. at a discount to LIBOR, with the underperformance reflecting charges for the fund. The returns are ahead of its peer group. Please note that the peer group is not purely Money Market funds, which are targeting LIBOR; it also includes equity-linked cash deposit funds, expensive cash funds and non-UK cash funds. Some of these have delivered extreme returns, which will distort the averages. Therefore, the LF Cash Fund could be underperforming the benchmark, yet still be in the top quartile.

The LF Corporate Bond Fund has been good at delivering positive absolute returns as a result of its short duration, which has also caused the underperformance over the last year. Over the longer term, returns have been in line with expectations. The current manager has a solid record across all his funds and LGIM has a good record of performance across all of its investment grade corporate bond funds.

Return metrics for the LF Corporate Bond Fund are solid, relative to its peers and its benchmark; the IA Sterling corporate bond sector. We have previously noted changes to the underlying funds and their benchmarks, and our concerns in relation to these changes.

Fund Statistics to 31st December 2019	*Volatility*	*Jensens Alpha*	*Maximum Drawdown/Fall*
LF Corporate Bond	2.71	0.89	-4.24%
IA Sterling Corporate Bond	*3.71*	*0.00*	*-4.99%*

In summary, the performance of both funds has been satisfactory, relative to their benchmarks.

Turning to the ESG aspects of the Corporate Bond fund, there are no ESG filters applied directly as part of the investment process. However, credit analysts will consider the ESG scores for each issuer when assessing a bond. The short-term nature of bonds in the Fund should mean that ESG risks are relatively small since climate change is not likely to have a significant impact on the issuers' underlying business models over that time period.

The fund management industry is developing how managers should report on ESG policies adopted for each fund. We are looking for investment institutions to identify appropriate ESG benchmarks for their funds, covering the Environmental, Social and Governance aspects of their policies. There are relatively few industry-wide criteria which have been adopted. One example is carbon usage, number of tons of carbon per $1 million of sales, and the hope is that others will be forthcoming, soon.

The overarching principle is that the reporting process is Specific, Measurable, Achievable, Relevant and Time-bound. No doubt the reporting process will evolve and we will engage with LFS to identify suitable processes to reduce the risks and to enhance long-term returns.

LGIM prides itself on being a good steward of investors' capital. It is one of the largest equity and bond holders in the world. Many of the bond issuers also have publicly quoted shares and L&G will engage the management of such companies on the governance aspects of their business. It will also use its equity voting rights to reflect its views of management decisions.

Like many institutions, LGIM is looking for companies to improve governance in relation to their impact on the environment and the wider community. However, there are no specific goals around environmental and social issues.

LGIM does not have a formal ESG system in place for this fund although it plans to have a reporting system in place before the 30th June 2020. There are no specific dates when these reports are due to appear.

The banks are starting to measure their ESG credentials in the context of cash funds and these credentials will be one part of the credit analysis process. However, since cash funds are typically of a short-term nature and ESG issues are broadly long-term, the impact of ESG on such funds is likely to be limited.

Charges

Costs for the default funds ought to be competitive since they attract most assets. The following charges apply to members of the LF Stakeholder Pension Scheme:

- Initial charge

  There is no initial management charge.

- Annual Management Charge (AMC)

  The AMC is dependent upon which fund is selected. The AMC is deducted from the assets of a fund and is reflected in the daily unit price. It is not a charge that is deducted from individual plans. The AMC is stated in the Prospectus as a maximum charge, allowing the option to charge a lower fee.

- Operating Charges Ratio

  The Operating Charges Ratio represents the annual operating expenses of each fund. The Ratio includes charges taken from the assets of the funds and the underlying funds in which they invest. This includes registration fees, audit fees, FCA fees, custody fees, the AMC and rebates from the fund manager – a positive item. It does not include transaction costs, which have yet to be identified.

Return-seeking fund

The table below sets out the annual management charge for the LF Tracker Fund alongside its operating ratio.

Fund	*Annual Management Charge*	*Operating Charges Ratio*
LF Tracker Fund	1.00%	1.00%

The Operating Charges Ratio is determined as the total costs associated with a fund, expressed as a percentage of its assets over the year. Total costs include the annual management charge as well as ancillary costs such as custodians, accounting and legal costs. Administration costs are included within the annual management charge.

LFS should continue to apply the fund rebate from LGIM to benefit members, which means that the Ongoing Charges Ratio remains the same as the AMC. The Committee will continue to press LFS to ensure that this practice continues.

These charges are at the limit for a workplace pension plan, and exceed those permitted for a default fund within a plan that is used for auto-enrolment purposes. Over the year the Committee has continued to ask for a review of charges for this fund.

Members should be aware that when buying the underlying fund, the pension fund will be buying units which operate a "single swinging price" mechanism. This is standard practice within the fund management industry. Investors should note that the value of the units can vary irrespective of any movement in the value of the underlying assets. Variations in price are directly attributable to the flow of money into and out of the fund.

De-risking funds

Charges for these funds are shown below

Fund	*Annual Management Charge*	*Operating Charges Ratio*
LF Cash	0.33%	0.18%
LF Corporate Bond	1.00%	1.00%

As with the LF Tracker fund, LFS has ensured that the fund rebate from L&G benefits unitholders, such that the AMC is the same as the Ongoing Charges Ratio. LFS should continue to apply the rebate for the Cash Fund to reduce the Operating Charges Ratio from the 11th January 2019 to 0.18% per annum, which is less than the AMC. The reduction was made possible by using the L&G Sterling Liquidity fund.

Returns under current market conditions are unlikely to comply with the investment objective described in the prospectus for this fund, which states that the objective is "a high level of return"; we would argue that less than 1.0% per annum is not high.

We would suggest that members are reminded of the risks, specifically the inflation risk for this fund, which is highlighted in the brochures. The Committee is disappointed to note that the Report and Accounts for this Scheme is silent on the subject of inflation risk.

The same issues apply to the Corporate Bond Fund, where the current gross redemption yield for the underlying fund remains low. Net of the annual management charges, unitholders are unlikely to achieve a "high level of income consistent with long-term preservation of capital in sterling terms", as set out in the prospectus.

We feel that members should be reminded of the risks, specifically the inflation risk, for this fund which is highlighted in the brochures. Again the Report and Accounts are silent on the matter to the extent that there is no specific comment on how the gross redemption yields for the fund are less than inflation, net of expenses.

Other potential charges

All administration costs are included within each fund's annual management charge.

For LF Stakeholder Scheme, LFS currently makes no charge for the following:

Transaction
Plan set up
Transfer-in
Transfer-out to UK scheme
Transfer-out to overseas scheme
Fund Switch
Pension Splitting on Divorce
Small pot lump sum payment
Account closure fee
Arranging death benefits
Annual Statements
Duplicate copies of correspondence
Account closure

All switches take place on a bid to bid basis, i.e. they will be free of charge. Whilst LFS does not currently charge for any of the above, it reserves the right to do so in the future. The processing of pension sharing orders, for example, can be particularly complex and a specialist's technical input may be required.

Members may find it difficult to compare LFS's costs with other providers' charges because products with a lower AMC may charge administration fees for transactions that LFS currently provides at no additional cost.

Liquidity

All funds available through the Scheme continue to provide daily liquidity to investors and there are no reports of members being unable to buy or sell funds during the period.

Summary

Over the year, the Cash Fund and the Tracker Fund have had clear mandates. Before expenses, they performed well in relation to their benchmark indices for most periods.

The Corporate Bond Fund's returns have been modest over the last year but at the same time the volatility of the fund has been less than its peers. The behaviour of this fund is a result of the manager's decision to overweight short-dated corporate bonds. While this helps reduce the fund's risk profile it also reduces potential returns. More importantly, future returns are expected to remain lower than inflation for the coming period, as measured by the Retail Prices Index.

There is a recurring issue of the lack of correlation between movements in annuity prices and the LF Corporate Bond Fund, which is important for an individual looking to purchase an annuity to provide an income in retirement. Nothing has changed over the last year.

Other issues arise in relation to fund charges to the extent that they undermine returns, especially in relation to the LF Tracker Fund, which holds the majority of assets for the Scheme.

Charges for the LF Corporate Bond Fund and the LF Tracker Fund remain above the maximum permitted for workplace pension schemes. These charges were appropriate when the product was originally created but have generally reduced with the advent of auto-enrolment and dramatic steps forward in computerisation, resulting in smaller workforces. We feel that this merits urgent attention because the contributions into these funds are substantial.

Customer Experience

The Scheme is set up to provide a fairly standard level of documentation and customer support as might be expected from a retail arrangement.

Through most of the year the Scheme received a very low level of complaints; there was a slight uptick in May but it remained low overall. Standards for the telephony service have slipped below target in the first quarter of the year.

The Committee no longer has the level of visibility of customer experience which it had when the support was provided in-house, and we have had some difficulty in obtaining regular data; therefore while service appears generally adequate we are no longer confident that it plays a positive role in the value-for-money delivered to unitholders . We understand that LFS may be considering the provision of Customer Support as part of its Optimisation Plan.

The Website has thus far been fairly static with basic information and limited functionality, and traffic has been limited accordingly, reflecting the telephone-based support which until now has tended to be favoured by members and has been well supported by the Fund. We will seek further information this year, both on traffic, and on LFS's proposals to develop online functionality as member demand for this develops.

Vulnerable Persons, and how schemes deal with them, is an increasingly important theme on which providers are required to have a policy (which LFS does). The Committee has asked LFS for further information on how it identifies and deals with vulnerable persons and will report in more detail on this aspect next year.

Please see experience of errors, complaints and telephony services, below.

Complaints		Jan	Feb	March	April	May	June	July	Aug	Sep	Oct	Nov	Dec
Brought forward		0	1	0	0	1	2	0	1	1	1	0	0
Received		1	3	0	1	4	2	1	1	1	1	2	0
Closed		0	4	0	0	3	4	0	1	1	2	2	0
Upheld		0	0	0	0	1	2	0	0	0	1	1	0
Carried forward		1	0	0	1	2	0	1	1	1	0	0	0
Costs paid			£100			£75					£100	£75	

Standard of telephony Service	Target SLA	Jan	Feb	March	April	May	June	July	Aug	Sep	Oct	Nov	Dec
% of calls answered within 20 seconds	80%	74.4%	75.5%	88.4%	87.1%	88.5%	87.4%	86.9%	93.5%	85.5%	93.3%	93.3%	90.9%
% of calls abandoned	Less than 5%	5.7%	3.7%	0.9%	1.5%	2.9%	1.7%	1.9%	0.2%	1.8%	0.5%	0.5%	2.3%

LFS was unable to share data on transaction errors during the year although historically, it has made relatively few errors and the cost of remedial action has been modest.

3. Areas Requiring Attention

The FCA introduced new guidance for workplace pension arrangements in December 2019. This guidance requires all funds in workplace pension arrangements to have a clear ESG mandate and benchmarks. Your Committee is required to oversee LFS's policies on member concerns and stewardship. In August 2020, LFS will need to introduce at least four investment pathway solutions for individuals choosing pension drawdown as a way of taking benefits.

The new guidance creates a challenge for LFS, which has already decided upon an Optimisation Plan to merge this plan with its Stakeholder Pension plan. The Committee feels that the Optimisation Plan will need to be developed further in order to achieve the outcomes sought by the FCA's recent announcements. The time-table set by the FCA is very tight, such that the original target date of Q4 2020 for implementation of the Optimisation Plan may prove to be too late.

The regulatory environment might mean all the issues raised below are addressed, but we feel strongly that members should be made aware of our concerns. The Committee has asked LFS to act in previous years and now feel that matters cannot be delayed any longer.

The areas that we have identified as requiring attention are set out below.

LF Tracker Fund

The mandate for this fund is to track the FTSE All Share Index, which includes a narrow range of assets, i.e. a single asset class and a single stock market. Out of the developed world markets, the UK stock market is relatively narrow in that the top 10 companies represent 34.6% of the index and therefore the risk could be considered more concentrated.

Our concern is whether a single return-seeking fund, investing in a single stock market, is an appropriate default fund for the Scheme. We therefore believe that the mandate should be amended in order to ensure that the fund remains suitable for the membership.

LF Corporate Bond Fund

Whilst the Corporate Bond Fund has achieved its performance objectives, it might not be an appropriate investment where the intention is to purchase an annuity at retirement. This is because its duration is short, whereas annuity prices broadly reflect movements in the price of bonds of a longer duration. Hence, there is a lack of correlation between movements in annuity prices and the LF Corporate Bond Fund.

The Committee would like to understand the original intention behind the inclusion of a bond fund of this type within this portfolio.

Fund Charges

Charges for the LF Corporate Bond Fund and the LF Tracker Fund are high in comparison with the wider market today. These charges were probably appropriate when the product was originally created. However, with the imposition of charge-caps for workplace pension schemes, we believe that LFS should review these arrangements. We feel that this requires urgent attention because the total contributions into these funds are substantial.

Transaction costs in the underlying funds are currently not identified by all fund managers. These apply to the underlying funds; they are not imposed by LFS. However, transaction costs impact on overall investment returns and, we believe, need to be visible. The FCA has also mandated that these costs are made visible and we hope that LFS will be able to obtain this information from its investment managers in future.

Environmental, Social and Governance ("ESG")

In our view, an increasing amount of capital around the world will be invested through ESG-sensitive mandates, varying from "ESG Lite" funds, which tilt portfolios away from supplying capital to businesses with a poor ESG score, to overweighting business with a good ESG score, to specialist ESG-friendly funds.

Over the coming 10 to 15 years, we believe companies that are being proactive about ESG are more likely to be successful in servicing the needs of their customers, as well as generating profits and meeting their regulatory requirements.

We anticipate that, on a 10 to 15-year timeframe, shares and bonds issued by companies with a high ESG score will outperform the wider market with less fundamental risk. We would therefore encourage LFS to adopt ESG mandates for an increasing proportion of the assets, with the majority of assets to be invested in this way by 31 December 2021.

Life-styling

We believe that members should reduce investment risk over their final few years before retirement. The advent of "pension freedoms" in April 2015 means that today, individuals are faced with the options of buying an annuity, moving funds into an income drawdown facility or taking their entire fund as cash. In each case, 25% of the fund at retirement is available as a tax-free lump sum.

Traditionally, Stakeholder schemes targeted 25% tax-free cash plus annuity purchase. Today, few people buy annuities; they are particularly expensive in times of very low interest rates and corresponding bond yields, and newer options appear to have greater appeal.

In general, people with smaller funds often prefer to withdraw their entire funds as cash, whereas those with larger funds at retirement typically favour income drawdown. Nearly all members seek capital growth during much of the investment period but as they approach retirement, it is considered prudent to try to align investments with the way in which funds are intended to be applied at the point of retirement. This gradual reduction of risk in the later years is known as "life-styling".

Generally, investments in long-dated bonds are a good match for intended annuity purchase; a fair holding in equities (and other asset classes) tends to suit people who wish to adopt income drawdown and cash-type investments are considered to be a good match for those who wish to take their funds as cash.

The current life-styling facility (described as an “option” but actually part of the default investment strategy) is a gradual movement into cash over the five-year period preceding retirement. Whilst this might be appropriate for the smaller investor, it does not suit individuals who seek to move their assets into an income drawdown facility or those who wish to buy an annuity. We would urge LFS to introduce a wider choice for its investors.

Appendix - Constitution of GAA Committee

The Committee is comprised of four independent members and one member appointed by LFS. FCA guidance was observed over selection of the employer-appointed member. Committee members during the year were:

Sarah Farrant (Chair)
Director of Sarah Farrant Consulting

Professional qualifications

- Fellow of the Institute of Actuaries

Ms Farrant has been a qualified actuary for over 25 years. She has been Scheme Actuary to many schemes, including a number of FTSE 100 and FTSE 250 companies and has enjoyed senior roles with national employee benefit consultancies and a "Big four" firm of Chartered Accountants.

Naomi L'Estrange
Managing Director of 20-20 Trustee Services Limited

Professional qualifications

- Solicitor (current practising certificate)
- Qualified Executive Coach
- Certificate in Advanced Business Management from Ashridge

Ms L'Estrange has over 20 years' experience as a pension lawyer and a director of the Pension Protection Fund. She advised the Institute of Actuaries and many individual pension schemes and was seconded to Government to advise on Pensions Act 2004.

As the PPF's Director of Strategy and Policy, Ms L'Estrange worked with various Government departments and the EU on matters of pension policy. She is a professional trustee to a number of pension schemes of all types, was Trustee of the Year at the Women in Pensions Awards 2018 and is a member

Mark Garnett
Director of Advisory Investment Services Limited

Professional qualifications

- Associate of the Chartered Institute for Securities & Investment
- Associate of the Chartered Insurance Institute

Mr Garnett provides investment management and advice for pension schemes and is a former Partner of Smith & Williamson Investment Management LLP.

He advises employers and boards of trustees, and regularly presents on the economy and investment markets.

Adam Tookey
Head of Product, Link Fund Solutions Limited

Mr Tookey is responsible for the development and on-going product management of all funds operated by Link Fund Solutions Limited, including those offered through the Pension Scheme.

He has more than 20 years' asset management experience, working for a number of global firms.

Christopher Murray
Director of Smith & Williamson Financial Services Limited

Professional qualifications

- Fellow of the Pensions Management Institute
- Diploma of the Personal Finance Society

Mr Murray has extensive experience of advising companies on pension schemes and working with trustees, as well as acting in a trustee capacity on behalf of Smith & Williamson Trust Corporation Limited.

He will be retiring on 31st May 2020 and will be replaced on the Committee by an experienced colleague from Smith & Williamson Financial Services Limited.