Link Fund Solutions

Governance Advisory Arrangement

Annual report to unit-holders

of the

LF Stakeholder Pension Scheme

Year-ended 31 December 2018

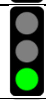
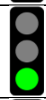
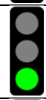
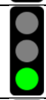
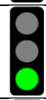
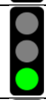
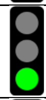
Contents

1. Chairman's report

I am pleased to present the 2018 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 ("Link").

My colleagues and I wanted to make our annual report more accessible than previously so this year, we have introduced a "traffic light" approach to key areas that we have assessed for VfM on your behalf, the background to which is explained in greater detail throughout this report. We assessed key areas of value that have been identified by the Financial Conduct Authority, along with additional areas that we consider to be relevant.

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 Link 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?

Our overall evaluation is unlikely to show a green light until the default investment strategy has been modified and various charges (including transaction costs) have been assessed. Details of transaction costs are proving difficult for Link to obtain although we are hopeful that pressure on the fund management industry by the Financial Conduct Authority will yield results over the next year.

We have previously expressed concern about exposure of the default fund exclusively to the UK equity market and to the lack of an income drawdown-focussed default investment strategy. In response to our concerns, Link has developed an optimisation plan that is to be embarked upon in the coming year (scheduled for completion in Q1 2020). This plan includes a detailed member analysis, evaluation of the funds available and a de-risking investment strategy for investors approaching their retirement age.

Since there are significant similarities between the Plan and another plan managed by Link, consideration will be given to merging the two and to delivering a better product for both groups of investors. Such a merger should benefit from greater economies of scale, which we would hope will translate into lower costs and charges for investors.

How we have considered your interests

We have obtained data about the number of investors using each fund, age, average fund size and related information. This gives us an idea about the “average” investor. We recognise that some investors and the size of their funds will materially differ from “average” so it is important to offer other investment strategies alongside the default strategy.

We have reviewed contract charges and options available, with some success in encouraging Link (in its former guise as Capita Asset Services) to reduce charges (e.g. in the Money Market Pension Fund) although we would like to see a further reduction of charges associated with the LF Corporate Bond Pension Fund. However, this might be superseded over the next 15 months or so, depending on the outcome of the Optimisation plan.

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 and we think it unlikely that such circumstances will arise in the future, given the commonality of purpose that exists between Link and the Committee.

Expertise, independence and experience of members of the GAA

When first establishing the Committee, I 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 pensions world, having worked for a major London law firm before becoming the first legal adviser to the Pension Protection Fund. She is now a 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 trustee boards she sits.

Another independent member of the committee is a practising actuary, who has advised many FTSE 100 and FTSE 250 companies over the years on pension scheme funding and strategy. This member has had a senior management role in a national actuarial practice, has been managing director of a smaller practice, and she now runs her own actuarial consultancy.

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 chairman, I am the final independent member of the committee and have spent almost an entire working lifetime dealing with occupational and contract-based pensions, with over 30 years working in an advisory capacity. I am qualified as a Fellow of the Pensions Management Institute and I also hold a diploma in Personal Financial Services, which permits me to advise individuals, as well as companies and boards of trustees.

All of the above are wholly independent of Link 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 the sponsoring company. Our “fifth member” is head of product at Link, which means that he is responsible for the development and on-going product management of all funds operated by Link, 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 your 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, leading to inappropriate outcomes. To date, we have not encountered such a situation.

Environmental, social and governance strategy ("ESG")

Over the last year there has been a substantial shift in the investment world (instigated by Government) for companies to identify their ESG credentials and for fund managers to consider ESG as a material factor in long-term investment. 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 also need to be considered.

In the next section of our report, we have outlined our initial thinking on how we will take ESG matters into account and we will comment more fully, in due course, as fund managers refine their nascent ESG policies.

Changes to the LF Money Market Pension Fund

In January 2019 there was a change to the regulatory framework for all money market funds. Janus Henderson Global Investors, the manager of the LF Cash Pension Fund (formerly the "LF Money Market Fund") decided to withdraw from the market. Legal and General Investment Management has since been appointed as the replacement manager for this fund.

The future

Next year, we hope to be reporting to you on progress with the optimisation plan, which we believe will further improve VfM and should address issues surrounding the default investment strategies and suitability of some of the underlying funds.

Christopher J Murray FPMI, Dip PFS
Chairman

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. Theoretically a tobacco or an arms company could score highly yet a wind power generator could have a poor score.

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 develops 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 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.

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 Link. The approach is one of positive engagement.

Voting Rights attaching to Investments

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

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

3. Review of 2018

Investment review

The LF Stakeholder Pension Scheme (formerly the "Nationwide Building Society Stakeholder Pension Scheme") used one institution to administer and manage the Scheme. Separate fund managers (Janus Henderson Asset Management and Legal & General Investment Management) manage the underlying assets.

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 2018, 82% of the total assets of the scheme 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 would be too late to recover from a sudden fall in those markets.

The Scheme documentation describes the LF Tracker Pension Fund (a 100% equity fund) as its "default" and identifies 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 lump sum.

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

Suitability of funds

The Scheme should be operated in the interests of members reflecting the current environment for savers, 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 Henderson Money Market Unit Trust". 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 the 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 as 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 relative risk-adjusted return although it has followed the value of the FTSE All Share Index downwards. Members have also continued to contribute money to the fund.

However, we would question whether a single return-seeking fund investing in a single 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 Link 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.

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

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

Selected retirement ages for the 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 14 and 19 years. We believe that this investment term is sufficient to ensure the fund is suitable for a medium risk investor. 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.

Most members have sold their units in the LF Tracker Fund by the age of 65, with only 0.8% of the £287 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 a series of periods to 31 December 2018.

Fund Statistics to 31st December 2018	*3 months*	*1 year*	*3 years*	*5 years*	*10 years*
LF Tracker Fund	-10.87%	-10.25%	15.19%	15.27%	111.50%
Pensions UK All Companies	*-12.16%*	*-11.20%*	*9.89%*	*15.45%*	*134.85%*
FTSE All Share Index	*-10.25%*	*-9.47%*	*19.54%*	*22.13%*	*138.35%*

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 2018 to help identify whether investors have been rewarded for the risks taken in each of the funds.

Fund Statistics to 31st December 2018	*Volatility*	*Jensens Alpha*	*Maximum Drawdown/Fall*
LF Tracker Fund	11.94	0.11	-17.80
Pensions UK All Companies	*11.00*	*0*	*-16.89*
FTSE All Share Index	*12.50*	*1.52*	*-16.32*

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.

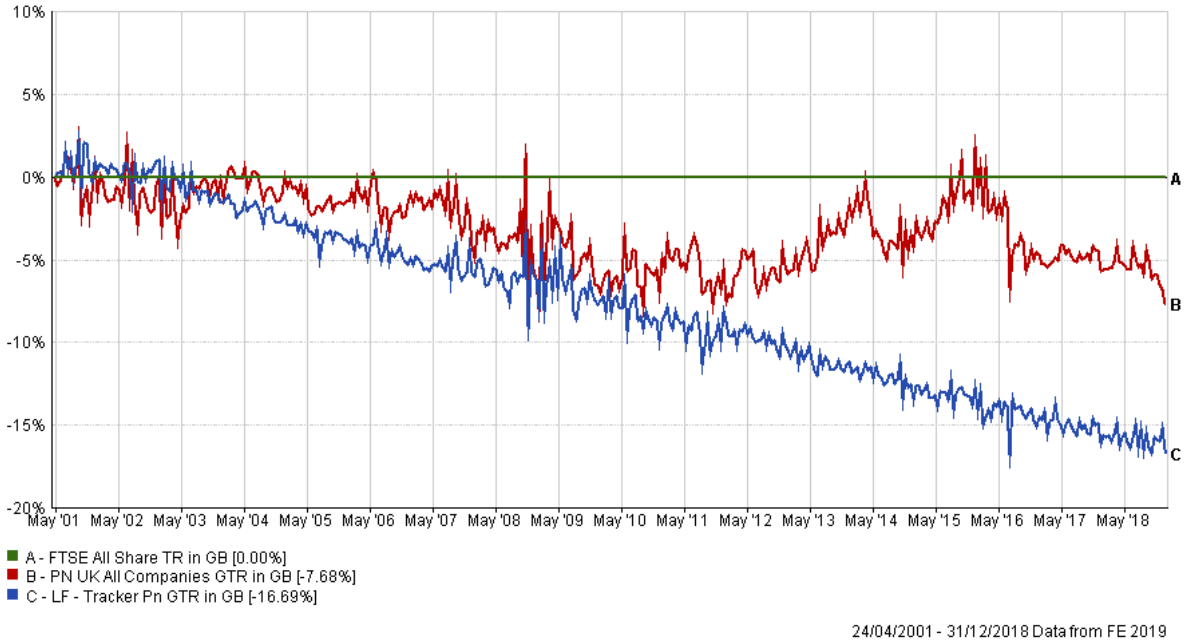
"Jensen's Alpha" ("Jensen's Information Ratio") is a measure of the marginal return a fund has achieved, relative to its peer group, i.e. other comparable funds, net of fees, adjusted for volatility (hence risk). The ratio provides investors with a simple measure of whether a fund manager has performed better than his 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 unit-holders 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 2018, 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 for L&G 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. Despite L&G delivering returns in line with expectations, the impact of charges has resulted in a significant level of underperformance. By flat-lining the FTSE All-Share Index, we can see below the impact of this underperformance.



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 a single stock market.

De-risking funds - Cash and Corporate Bond

The Cash and Corporate Bond funds have clear investment objectives, summarised in the table below

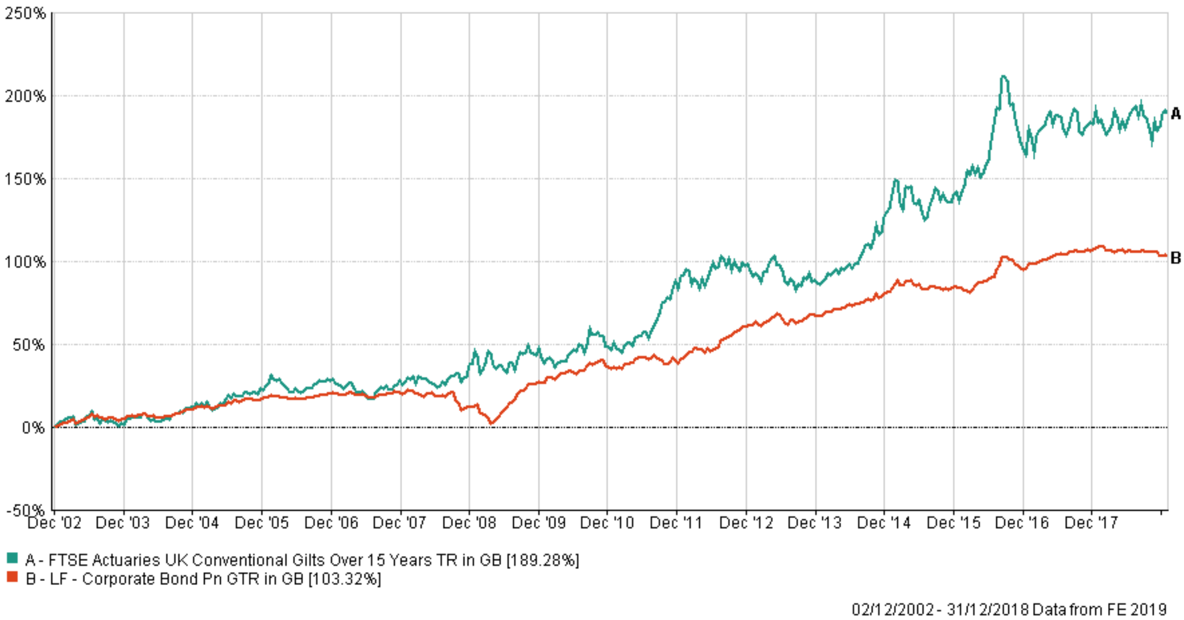
Fund	*Investment objectives*
Cash	
Cash	To achieve a high level of return consistent with a high degree of capital security.
Bonds	
Corporate Bond	To produce a high level of income consistent with long-term preservation of capital in sterling terms.

The assessment of these funds is simpler than for the return-seeking fund because they are invested in two separate asset classes, each with its own benchmark index.

When these funds were created in 2001, the expectation was that on retirement, 25% of a member's fund would be taken as a tax-free lump sum and the balance would be used to purchase an annuity, which would provide an income in retirement. The Cash Fund will facilitate the withdrawal of a lump sum at retirement.

When the contract was conceived in 2001 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 and interest rate/inflation linked SWAPs. The price of annuities is closely linked to movements in yield on UK government bonds with a duration reflecting the life expectancy of the annuitants. The FTSE Government Bond Over 15-year index is widely considered to be a suitable index for this purpose.

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 (the corporate bond fund). The construction of this fund is very different to one that is designed to track annuity prices. Hence, the relative performance of each will be entirely random, as illustrated in the table below:



By flat-lining the FTSE Government Bond index in the graph below, we can see that members have incurred greater risk, 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 Link to review the mandate of this fund. Fortunately, matters have not deteriorated over the last year.

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

The weighted average age of unit-holders is as expected for the Cash Fund, if funds are being held by individuals approaching retirement.

The average age and weighted average age for the Corporate Bond Fund are relatively low, at 47.2 and 51.9 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 2018	*3 months*	*1 year*	*3 years*	*5 years*	*10 years*
LF Cash	0.11%	0.34%	0.83%	1.36%	3.22%
Pensions Money Market	*0.06%*	*0.12%*	*0.91%*	*1.37%*	*2.94%*
LIBOR 1 month	*0.19%*	*0.61%*	*1.31%*	*2.33%*	*5.59%*
LF Corporate Bond	-1.17%	-2.44%	10.87%	22.15%	78.47%
Pensions Sterling Corporate Bond	*-0.44%*	*-2.29%*	*11.89%*	*23.92%*	*93.78%*
iBoxx Non Gilt Index	*0.14%*	*-1.51%*	*13.68%*	*28.17%*	*87.61%*

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 performance of the LF Corporate Bond Fund has been good over most periods and recent returns reflect the short duration positioning of the fund, which has 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 L&G has a good record across all of its investment grade corporate bond funds.

Return metrics for the LF Corporate Bond Fund are good, relative to its peers and its benchmark; the iBoxx Non-Gilt Index.

Fund Statistics to 31st December 2018	*Volatility*	*Jensens Alpha*	*Maximum Drawdown/Fall*
LF Corporate Bond	2.92	-0.01	-4.24%
Pensions Sterling Corporate Bond	*3.80*	*0.00*	*-5.49%*
iBoxx Non Gilt Index	*4.73*	*0.68*	*-6.52%*

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

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 charge 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.

Annual Management Charges

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.

Link should be congratulated on applying the fund rebate from Legal and General to benefit members, which means that the Ongoing Charges Ratio remains the same as the AMC. The Committee will continue to press Link 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 been encouraging 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 inflows and outflows of money into and out of the fund.

Charges for the fund are higher than in the wider market. We therefore need to consider other aspects of the customer experience when judging whether or not the Scheme offers value for money.

De-risking funds

Turning to the de-risking assets, the charges for these funds are shown below

Fund	*Annual Management Charge*	*Operating Charges Ratio*
LF Cash	0.33%	0.31%
LF Corporate Bond	1.00%	1.00%

As with the LF Tracker fund, Link has ensured that the fund rebate from L&G benefits unit-holders, such that the AMC is the same as the Ongoing Charges Ratio. Link should be congratulated for using the rebate for the Cash fund to reduce the Operating Charges Ratio (to 30th September 2018) to 0.31% per annum, which is less than the AMC.

Despite the low rates of interest Link should be congratulated for continuing to keep the annual management charges for its Cash Fund under control, to avoid delivering a negative return to unit holders.

Prospective returns under current market conditions do not comply with the investment objectives described in the prospectus for the fund. The prospectus states that the objective is “a high level of return”, and we would argue that less than 0.5% 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. We note that in the Report and Accounts, there is no specific comment on how the current rates of return for the fund are less than inflation, net of expenses.

The same issues apply to the Corporate Bond Fund, where the current gross redemption yield for the underlying fund remains low. After taking into account the annual management charges, unit holders 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 would suggest that members are reminded of the risks, specifically the inflation risk for this fund, which is highlighted in the brochures. 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, Link 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 Link 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 Link's costs with other providers' charges because products with a lower AMC may charge administration fees for transactions that Link currently provides at no additional cost to the member.

Liquidity

The funds 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 and, gross of expenses, they performed well in relation to their benchmark indices for most periods.

The Corporate Bond fund has had a poor experience relative to its peers over the last year. The prime reason for this underperformance has been its short duration. The relative underperformance has been modest and taking into account the lower levels of volatility, as defined by standard deviation, returns have been satisfactory.

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.

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

Investment returns are net of charges to the members, and charges for the Corporate Bond and the LF Tracker fund are high in comparison with the wider market today. These charges were appropriate when the product was originally created. However, with the imposition of charge-caps for workplace pension schemes, we believe that Link should review these arrangements. We feel that this merits urgent attention because the total contributions into these funds are substantial, running at £793,000 per month.

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. It continues to have a good record of processing member transactions.

Through most of the year the Scheme received a very low level of complaints; there was a slight uptick in October/November due to less experienced staff joining the team but it remained below previous years and low overall. We believe customer experience continues to play a positive role in the value for money delivered to unit-holders though this may be an increasing challenge as time passes and the core team dilutes further.

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

Transaction Errors	Jan	Feb	March	April	May	June	July	Aug	Sep	Oct	Nov	Dec
Recorded Errors	0	0	0	0	1	0	0	2	0	4	0	4
Errors requiring remedial activity	0	0	0	0	1	0	0	2	0	4	0	4
Cost of remedial activity	0	0	£252	£150	0	0	0	0	0	£150	£225	£100

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

*1 case not investigated from 28/04/2018

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%	90.6%	90.2%	89.7%	89.2%	81.3%	88.4%	91.4%	90.3%	78.9%	90.2%	94.0%	86.1%
% of calls abandoned	Less than 5%	2.6%	3.7%	2.0%	1.7%	3.2%	1.6%	2.0%	2.9%	5.8%	1.2%	1.1%	2.1%

3. Areas Requiring Attention

We have identified the following areas that we believe require attention:

LF Tracker Fund

Over the year the LF Tracker Fund has had clear mandates and, gross of expenses, performed well in relation to its benchmark index for most periods.

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. The UK stock market, out of the developed world markets, is relatively narrow, in that the top 10 companies represent 37% of the index and therefore 37% of the risk, as at 31st December 2018. Our concern is whether a single return-seeking fund, investing in a single stock market, is an appropriate default fund for the Scheme.

In view of the on-going contributions to the fund, there is a clear duty of care to ensure that the fund offerings remain suitable for the membership. We believe the mandate should be reviewed so that the fund reflects the needs of the membership.

LF Corporate Bond Fund

Performance of the LF Corporate Bond Fund has been good over most periods but recent poor returns reflect the short duration positioning of the fund, which has adversely affected performance over the last year. The relative underperformance has been modest, and once we take into account the lower levels of volatility, as defined by standard deviation, the returns have been satisfactory.

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

Despite the low rates of interest Link should be congratulated for reducing the annual management charges for its Money Market Fund so that unit-holders are more likely to avoid a negative return.

Charges for the LF Corporate Bond Fund and the LF Tracker Fund are high in comparison with the wider market today. These charges were appropriate when the product was originally created. However, with the imposition of charge-caps for workplace pension schemes, we believe Link should review these arrangements. We feel that this requires urgent attention because the total contributions into these funds are substantial, at around £793,000 per month.

Transaction costs are routinely excluded from total operating charges ratio by all fund managers. These apply to the underlying funds; they are not imposed by Link. However, these charges still impact on overall investment returns and, we believe, need to be visible. The FCA has also shown a keen interest in bringing these costs into the open and we hope that Link will be able to obtain this information from its investment managers in future.

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) suits people who intend to adopt income drawdown and cash-type investments are a good match for those who wish to take their funds as cash.

The current life-styling facility (described as an "option" but is 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 Link to reconsider the default life-styling option and perhaps introduce a wider choice for their investors.

Appendix 1 - Constitution of GAA Committee

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

Christopher Murray (Chair)
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.

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 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 has 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.

Sarah Farrant
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.

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 Asset Services Limited, including those offered through the Pension Scheme.

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