

Denholm Money Purchase Scheme

Chairman's Statement

Annual governance statement by the Chairman of Trustees

1. Introduction

As the Chairman of the Denholm Money Purchase Scheme ("DMPS") Trustees, I have to provide you with a yearly statement which explains what steps have been taken by the trustee board, with help from our professional advisors, to meet governance standards. These are designed to help members achieve a good outcome from their pension savings. The law sets out what information has to be included in my statement and this is covered in sections 2 to 5 below. This statement covers the period from 1st July 2019 to 30th June 2020.

The DMPS Trustees are committed to having high governance standards and we meet regularly to monitor the controls and processes in place in connection with the DMPS's investments and administration.

The DMPS Trustees are also committed to consider whether the current provision of pension benefits to members is the best method of providing these in the long term. We have completed a detailed review of the pensions market working in conjunction with the participating employers in DMPS and taking professional advice. Following this review, we have concluded that in view of the significant changes to the pensions marketplace in recent years, it is in the best interests of DMPS members to put in place a new pensions arrangement with Aviva.

This new arrangement is a Defined Contribution Master Trust known as the Aviva Master Trust. The Aviva Master Trust has a board of trustees with full legal responsibility. Its trustees are professional trustees who are independent of the participating employers.

As part of this review, we have decided to commence the wind up of DMPS and have written to DMPS members to inform them of this fact following detailed consultation with active DMPS members. Ongoing contributions for active DMPS members have already started to flow to the new Aviva Master Trust and existing funds for all members in DMPS will be transferred out in two different ways.

Where DMPS members have a variety of guarantee with Standard Life, such as monies in one of the With Profits funds, then the entirety of the member's pension policy will be retained with Standard Life under a new individual policy, unless the member opts otherwise.

Where DMPS members do not have such a guarantee with Standard Life, then the entirety of the member's pension policy will be transferred to a new individual policy with the Aviva Master Trust.

The wind up of DMPS can't take place until all funds have been transferred out and it is anticipated that this will commence in October 2020. The DMPS Trustees are still obliged to produce a Chairman's Statement despite the imminence of this wind up.

I welcome this opportunity to explain what the DMPS Trustees do to help to ensure the DMPS is run as effectively as it can be in the final months of its existence. All material actions of the DMPS trustees have been taken following the receipt of professional advice and with the best interests of DMPS members very much in mind. If you have any questions about anything that is set out in this statement please contact the DMPS Secretary, Alistair Wesley, at dmps@denholm-group.co.uk.

2. Default investment arrangement

The default investment arrangement is provided for members who have joined DMPS and do not choose an investment option for their contributions. Members had also the choice to invest in the default arrangement which was set up by the DMPS Trustees. In the year to end-June 2020, 86% of new members had their contributions invested in the default investment arrangement. As at end-June 2020, 51% of members had investments in the default investment arrangement.

As part of the pensions review mentioned in the first section of this statement, DMPS trustees have concluded that the default investment arrangement in the Aviva Master Trust is superior to that currently obtaining in DMPS, but as this statement concerns DMPS the following review is of the DMPS default investment arrangement.

Setting an appropriate investment strategy

The DMPS Trustees are responsible for investment governance. This includes setting and monitoring the investment strategy for the Scheme's default arrangement.

We have chosen the Denholm Equity Profile as the DMPS's default arrangement. Details of the investment strategy and investment objectives of the default arrangement are recorded in a document called the Statement of Investment Principles. An amendment to the 10th edition of this document was prepared after taking investment advice and was signed in September 2019. A copy of the 10th edition and the amendment is shown as Appendix 1 to this Chairman's Statement. The key points to note in relation to the default arrangement are as follows:

Under The Denholm Equity Profile investments are made in the Standard Life Stock Exchange Fund in the early part of a members working life but as the member approaches the Normal Retirement Date they have selected, their funds are switched into less volatile investments comprising a mixture of the Standard Life Multi-Asset (20% - 60% shares) Pension Fund, Standard Life At Retirement (Multi Asset Universal) Pension Fund and the Standard Life Deposit and Treasury Pension Fund.

The Standard Life Stock Exchange fund is a fund with a high equity content, designed to produce returns in excess of both salary and price inflation over the long term. This fund is an appropriate vehicle for younger members to protect and enhance the real value of their pension fund assets over the long term, which is a fundamental objective of the Trustees' investment policy. This fund is expected to produce volatile absolute returns over the short term. This volatility is regarded as an acceptable price to pay for the superior returns over the long term.

The Standard Life Stock Exchange fund is monitored on a monthly basis and its performance compared with the other investment options in the Scheme. At least twice-yearly, risks and performance are discussed at the trustees' meetings.

Investments are realisable in the default arrangement without cost or other penalty.

The trustees recognise that they must consider all factors that can impact the financial performance of the investments in the default arrangement. This includes, but is not limited to Environmental, Social and Governance (ESG) factors. It is recognised that financially material ESG issues, such as climate change, could potentially affect the financial interests of DMPS's beneficiaries. The trustees consider how ESG matters are integrated within investment processes when appointing new investment managers and monitoring existing investment managers. The ESG ratings of the investment managers are reviewed annually at the annual trustees meeting at which investments are considered in detail.

Having considered their fiduciary duty, the trustees have delegated the evaluation of ESG factors, including climate change considerations, and exercising voting rights and stewardship obligations to the appointed investment manager.

Trustees do not explicitly take into account non-financial matters in the selection, retention and realisation of investments.

Reviewing the default investment arrangement

The Trustees are expected to

- review the investment strategy and objectives of the default investment arrangement at regular intervals, and at least once every 3 years: and
- take into account the needs of DMPS membership when designing the default arrangement.
- monitor how ESG, climate change and stewardship is integrated within investment processes, taking advice from an assessment of how the fund manager incorporates ESG into its investment processes.

The Trustees review the investment objectives and the performance of the default arrangement at least once a year and consider the performance of DMPS's investment manager.

As of September 2020, the default arrangement is managed by Aberdeen Standard Life Investments Limited ('Aberdeen Standard'). Aberdeen Standard believes that ESG factors are financially material and can have a meaningful impact on companies' performance. They also consider ESG risks before making any investments, and do so by seeking to understand if the company is adequately managing associated risks and making sure the market has priced these risks accordingly.

The default investment arrangement was reviewed in April 2019. In carrying out this review we considered a number of factors including the profile of members investing in the default arrangement, the take-up of the default investment arrangement to ascertain whether the current strategy fits with member expectations. The performance of the default investment arrangement was also compared to alternative strategies to ascertain whether members would be better served by an alternative approach.

The long-term performance of the core fund in the default strategy, the Standard Life Stock Exchange fund, compared to the other three investment options which have been available since the advent of the default investment arrangement in July 2013, is as shown below.

| Fund | Stock Exchange | Managed | Tracker | Multi Asset |
|-------------------|----------------|---------|---------|-------------|
| Annual return (%) | 7.4 | 5.8 | 5.2 | 5.1 |

The above percentages represent annualised returns from July 2013 to December 2018, which means that this is the average annual percentage return over that period. The Stock Exchange fund is clearly well ahead of the other three funds available for members to invest in and has provided a very strong investment return for members.

The April 2019 review concluded that the DMPS default investment arrangement was performing strongly and had once more exceeded the returns available in alternative investment strategies available through DMPS. In view of this conclusion, no changes were proposed to the DMPS default investment arrangement. As noted above, the DMPS trustees have now concluded that it is in the best interests of members to wind up DMPS.

Members are encouraged to view the Chairman's statement for this year and previous years on the Group Intranet, details of which have previously been provided to members. This is available to all members at:

<https://denholm.sharefile.com> , login: dmps@denweb.info, password: Pension65

The 2020 Chairman's statement is also available for viewing on the Denholm website at www.denholm-group.co.uk

3. Charges and transaction costs paid by members

We are required to explain the charges and transaction costs (i.e. the costs of buying and selling investments in the Scheme) which are paid by members rather than the employer. As you may know the employer pays the administration costs of the Scheme, such as legal, accounting and consultancy services required.

The level of annual charges applicable to each of the five Investment Profiles currently available to members is shown in the table below, as at end-June 2019. The DMPS trustees are unaware of any changes to the level of charges since then.

| Lifestyle Profiles | Annual Management Charges | Additional Expenses | Transaction Costs | Total Charges |
|--------------------|---------------------------|---------------------|-------------------|---------------|
| Denholm Equity | 0.50% | 0.03% | 0.01% | 0.54% |
| Denholm Tracker | 0.50% | 0.01% | 0.00% | 0.51% |
| Balanced | 0.50% | 0.02% | 0.01% | 0.53% |
| Cautious Lifestyle | 0.50% | 0.02% | 0.01% | 0.53% |
| Absolute Return | 0.92% | 0.09% | 0.01% | 1.02% |

The transaction costs shown are to end-March 2019 but in view of the small size of these, we do not consider the above table to be misleading.

We are also required to show an illustrative example of the cumulative effect over time of costs and charges on the value of a member's benefits in DMPS.

We have done this by asking Standard Life to calculate this using the following parameters:

- a) Scheme member, aged 55 on 27/11/18
- b) With a starting pension pot of £50,000
- c) With a retirement age of 68
- d) With on-going employer contributions of £1,650pa
- e) With on-going employee contributions of £1,500pa
- f) Invested 100% at outset in the scheme default, the Denholm Equity Profile.

Based on the above scheme member, the estimated Standard Life calculation is as follows:

| Year/ (Age) | Before Charges | After Charges |
|----------------|-------------------|------------------|
| 1 | £54,300 | £54,000 |
| 3 | £63,500 | £62,400 |
| 5 | £73,200 | £71,100 |
| 10 | £96,800 | £92,000 |
| (At 68) | £107,000 | £101,000 |

The following notes are relevant:

- a) Projected pension pot values are shown in today's terms, and do not need to be reduced further for the effect of future inflation.
- b) Inflation is assumed to be 2.5% each year.
- c) Contributions are assumed to increase by 4% each year.
- d) All charges and transaction costs have been included.
- e) Assumed investment growth is based on the funds, which make up the scheme default investment option, the Denholm Equity Profile, and is shown below.

| | |
|--|----|
| Standard Life Stock Exchange pension fund | 5% |
| Standard Life At Retirement (Multi Asset Universal) pension fund | 2% |
| Standard Life Deposit and Treasury pension fund | 1% |

Good value for members

When assessing the charges and transaction costs which are payable by members, the DMPS Trustees are required to consider the extent to which the investments options and the benefits offered by DMPS represent good value for members when this is compared to other options in the market.

There is no legal definition of ‘good value’ and so the process of determining good value for members is a subjective one. We have considered regulatory guidance on this.

As a starting point in assessing good value, we have compared the level of charges in each fund in the default investment arrangement with the levels of return they have delivered to members. The charges shown above are low in relation to medium and long-term investment returns which are shown after deducting these charges.

We have also considered how the charges borne by members (the costs of membership) compare against the services and benefits provided by DMPS (the benefits of membership). The benefits of membership include amongst other things: the design of the default arrangement and how this reflects the interests of members; the range of investment options; the efficiency of administration processes and the extent to which Standard Life as administrator met and exceeded its service level standards for the scheme year; the quality of communications delivered to members; and the quality of support services and scheme governance.

Based on a strategic review carried out in May 2018, we concluded that DMPS represented good value for members. Since that date, investment returns have been affected by the downturn in equity markets in the early part of 2020. They are adequate with the annualised returns to end-June 2020 for the main fund in the default investment arrangement, the Denholm Equity Profile, at 3.4% over 3 years and 6.5% over 5 years. Governance reports produced by Standard Life in conjunction with trustees’ examination of transactions showed that administration standards continue to be high.

DMPS trustees have concluded that good value for members can best be achieved by a transition to the Aviva Master Trust, where no Standard Life guarantees are given up.

4. Core financial transactions

The Trustees are required to report to you about the processes and controls in place in relation to the ‘core financial transactions’. The law specifies that these include the following:

- investing contributions paid into DMPS;
- transferring assets related to members into or out of DMPS;
- transferring assets between different investments within DMPS; and
- making payments from DMPS to or on behalf of members

We must ensure that these important financial transactions are processed promptly and accurately. In practice we delegate responsibility for this to the DMPS administrator, Standard Life, and the J. & J. Denholm Group.

The Scheme Secretary works closely with Standard Life, members and their IFA's to ensure that financial transactions are conducted accurately and in a timely fashion. Detailed investment reports are received twice-yearly and reviewed by the Scheme Secretary and another trustee. Governance reports were received quarterly from Standard Life to end-September 2019 just prior to the decision to move to a Master Trust and reviewed by trustees and discussed at trustee meetings. There have been no complaints from members to trustees, formally or informally, over the last three years which is a sign that administration is working well.

There is also an external audit every year which checks such things as timely and correct investment of contributions.

We are confident that the processes and controls in place with the administrator are robust and, even with the decision to move to a Master Trust, that this enables transactions to continue to be processed promptly and accurately.

5. Trustee knowledge and understanding

The law requires the trustee board to possess, or have access to, sufficient knowledge and understanding to run DMPS effectively. We take our training and development responsibilities seriously and review changes to legislation at each trustee meeting.

As at 30th June 2020, four of the six Scheme trustees had an average of 19 years experience as trustees for DMPS, in addition to experience in other pension schemes. The remaining two trustees have both completed the relevant modules of the Trustee Toolkit in addition to receiving copies of all relevant scheme documents and going through the induction process for new trustees.

Trustees receive regular training from JLT Benefit Solutions to further enhance their skills with the latest training session held in November 2018. During each trustee board meeting, trustees are provided with and discuss changes in pension law and regulations as they affect DMPS.

The above level of competence indicates that trustees have a working knowledge of the Trust Deed and Rules. They also have a working knowledge of the Statement of Investment Principles, the latest edition of which was signed in 2018 with an amendment signed in September 2019. This Statement of Investment Principles is available to be viewed online at www.denholm-group.co.uk.

Trustees have a working knowledge of the current policies governing DMPS and a sufficient knowledge and understanding of the law governing pensions and trusts. They also have a sufficient knowledge of the principles governing funding and investment for occupational pension schemes.

As a result of the training and experience of the trustee board, and taking into account the professional advice available to the Trustees, I am confident that the combined knowledge and understanding of the board enables us to exercise properly our functions as DMPS Trustees.

John S Denholm
Chairman of Trustees