Severn Trent Pension Scheme ("the Scheme"), Pension Choices Section and AVC plans Chair's Annual Governance Statement for the year ending 31 March 2019

This statement has been prepared by the Trustee of the Scheme in accordance with regulation 23 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996. It describes how the Trustee has met the statutory governance standards in relation to the Scheme's Pension Choices Section and additional voluntary contribution (AVC) plans (the defined contribution (DC) Sections) in the areas set out below.

This statement covers the period between 1 April 2018 to 31 March 2019.

In last year's statement the Trustee noted that as the Scheme as a whole is closed to future accrual, both the Company and the Trustee had concluded that moving the assets of Pension Choices to an alternative and suitable defined contribution plan was expected to be in the interests of members. As a result, in the Scheme year covered by this statement, the Trustee has been working with the Company on a project to select, and to pass the bulk of the assets in Pension Choices to a suitable alternative arrangement. Following a review of their options, the Trustee and the Company selected the Aviva Master Trust as the alternative arrangement.

The Trustee subsequently received advice from its advisers in relation to a bulk transfer of defined contribution assets in accordance with the Department for Work and Pensions' (DWP's) Regulations and Guidance following amendments to Regulation 12 of the Occupational Pension Schemes (Preservation of Benefit) Regulations 1991. Having considered that advice, the Trustee agreed in March 2019 that most of the assets of Pension Choices should be bulk transferred to the Aviva Master Trust.

A small number of defined benefit members of the Scheme used Pension Choices as a facility by which to pay Additional Voluntary Contributions (AVCs). These assets will not be transferred to the Aviva Master Trust but will instead be switched to an AVC policy, also with Aviva and on the same terms as negotiated for the Master Trust. This will enable the assets to remain in the Severn Trent Pension Scheme thereby enabling the usual retirement options to remain available to AVC payers.

The bulk transfers are scheduled to take place in January 2020. As such, it is expected that this will be the final statement prepared by the Scheme in relation to Pension Choices.

As would be expected, the closure project has had an impact on the activity of the Trustee and the development of Pension Choices in the Scheme year as the Trustee did not wish to make significant change prior to the bulk transfers to Aviva. This is highlighted where relevant in this statement.

Trustee Board

- The Trustee Board acts in accordance with its fiduciary duties to the beneficiaries of the Scheme, as well as legal requirements and, as a whole, possesses, maintains, or has access to knowledge and understanding.
- Fitness and propriety of candidates is considered as part of the Trustee recruitment process. All Trustee Directors are required to complete a declaration form on appointment which covers the skills necessary to run the Scheme properly. This includes Directorship disqualification declarations, conflict of interest declarations, bankruptcy checks and criminal record declarations.
- The Chair of the Trustee is appointed from an independent firm of experienced professional trustees, with significant experience of acting as a trustee for other schemes. The process

for appointing the Chair is through a series of interviews with various stakeholders, including the Finance Director and Group Pensions Manager of Severn Trent. This process has now been used several times.

- The Trustee has a documented process for appointing Member-Nominated Directors which includes a selection panel to ensure the appointee has the most relevant skills and experience.
- The Trustee and the Company appointed a working party to oversee the selection and transfer of Pension Choices to the Aviva Master trust. The working party reported back to the Trustee on a regular basis with relevant decisions taken by the Trustee Board as a whole.

Trustee knowledge and understanding

The Trustee has a strong Trustee Knowledge and Understanding (TKU) process in place, which, together with the advice available to them, enables the Trustee Directors:

- to have a working knowledge of the trust deed and rules of the scheme, the SIP, and all other documents setting out the Trustee's policies;
- to have sufficient knowledge and understanding of the law relating to pensions and trusts, the relevant principles relating to the funding and investment of occupational schemes; and
- to properly exercise their functions as Trustee of the Scheme.

During the period between 1 April 2018 and 31 March 2019 (the end of the Scheme year), the Trustee's approach to meeting the TKU requirements included:

- Receiving training sessions from its advisers during Trustee meetings to ensure an appropriate level of knowledge and understanding of current and general issues affecting DC pensions was maintained, and receiving regulatory and general updates from advisers about matters relevant to the DC Sections on a quarterly basis.
- Attending external events and webinars and providing feedback to the wider Board at Trustee meetings, ensuring all training received was recorded in a training log.
- Being expected to complete the relevant modules on the Pension Regulator's Trustee Toolkit.

A TKU self assessment was undertaken in November 2018 covering both the defined benefit and Pension Choices sections of the Scheme.

On appointment Trustee Directors are provided with an induction plan and instruction on access to the Trustee library where they are directed to key documents. The induction plan includes meetings with the Group Pensions Manager, Scheme Secretary, Actuary and Investment Consultant. Once these meetings have taken place Trustee Directors complete a TKU questionnaire so any gaps can be identified and any further training arranged.

The Trustee has appointed advisers and service providers whose responsibilities are set out in comprehensive contracts and service agreements. Advice is robustly challenged, where required. The Trustee informally reviews the performance of advisers and service providers at the end of every meeting and carries out formal reviews every three years.

The Trustee has a documented conflicts of interest policy which is reviewed annually.There is an agenda item on conflicts and register of interests which is considered at each meeting. Declarations of interests and conflicts are made on the appointment of all Trustee Directors and advisers.

Advisers' and service providers' contracts contain details of their own conflict policies.
The Scheme's internal controls are considered as part of the external audit process, when all suppliers' AAF01/06 or equivalent reports are reviewed. The Group Pensions Manager and

Pensions, Risk and Governance Manager also regularly attend meetings with the administrator at which they review internal controls and processes.

The Trustee has a risk register which formally logs the risks to the Scheme and controls in place to mitigate those risks. It also records the results of risk evaluation and treatment of any risks. In December 2017 a separate risk register was established covering the defined contribution provision within the Scheme. This considers the impact and likelihood of different risks so that the Trustee can consider what it needs to do to mitigate those risks.

No subsequent changes were made in the 2018/19 Scheme year.

Core financial transactions

The third party administration service provided by Capita, including performance targets, is considered at every regular Trustee Board meeting by means of quarterly stewardship reports. These reports cover the defined benefit and Pension Choices sections and include information on performance against the service level agreement (SLA), complaints and errors. It covers transfers, fund switches and payments out of the Pension Choices Section. As the Scheme is closed to future accrual, there are no longer any contributions paid over to the Pension Choices Section.

Capita has a target of completing 95% of tasks within the SLA but, over the period covered by this Scheme year, that target was not achieved. A number of actions have been agreed between the Trustee and Capita to seek to improve performance. This includes Capita speaking directly to members when there is a delay, hiring more staff, improved staff training, automating letters and calculations and introducing a dedicated team for the Scheme. These actions took place outside the Scheme year and so the outcome cannot be reported at this stage.

The Scheme's accounts are also audited annually by the Scheme's appointed auditors, PwC. The Trustee, having considered the reports received from the Scheme's administrators, Capita, and appointed auditors, has concluded that the Scheme's core financial transactions have been processed promptly and accurately during the Scheme year.

Investment governance

The Scheme does not have a default fund as Pension Choices was closed to new entrants prior to the automatic enrolment regulations becoming effective for Severn Trent plc, and closed to future contributions prior to the introduction of the charge cap in April 2015. However, although not a default option, LifeModel is the overwhelming choice of members. During the growth phase (up to 10 years before selected retirement date) it seeks to maximise the returns as far as reasonably possible, whilst in the consolidation phase (the last 10 years) it seeks to preserve the annuity and cash purchasing power of members' accounts as they approach retirement. As an alternative to LifeModel, members can choose FreeModel that comprises of a range of self select funds covering a broad range of investment risk.

When setting and reviewing investment objectives and strategies, the Trustee takes into account the interests of all members, the characteristics of different segments of members (such as proximity to retirement) and the risks affecting the long-term sustainability of the investments.

A strategic review of the Scheme's investment strategy was not undertaken in the Scheme year.The last review of the investment strategy of LifeModel and the range of funds available under FreeModel was undertaken by the Trustee in the 2017/18 Scheme year in conjunction with its investment adviser, Hymans Robertson. That review showed that 10% of the membership were expected to retire in the next 10 years and that projected fund sizes for the majority of members were lower than £50,000. The relatively low projected account sizes led the Trustee to anticipate that many members would take their account as one or more cash lump sums from the date of their retirement.

Accordingly the review concluded that some changes to LifeModel would be appropriate over the medium term by changing the de-risking phase, principally to reflect the greater choice over the ways in which pensions can be drawn. Currently LifeModel targets 75% investment in the L&G Pre-Retirement fund and 25% in the L&G Cash fund at retirement, and is expected to be appropriate for members who wish to take 25% of the account as tax free cash and buy an annuity with the balance. The investment advisers recommended changing the retirement strategy to 70% in the L&G Cash fund and 30% in a diversified growth fund.

Some potential changes to the FreeModel range were also recommended, including removing one of the UK equity funds in order to simplify the range and adding a Shariah fund if there was sufficient support from the membership for this.

If Pension Choices was going to continue then the Trustee would have implemented these changes. However, the Trustee concluded that it should not make any short term changes prior to switching Pension Choices to an alternative provider. This is because changes would incur transaction costs which might be incurred again when the assets are subsequently switched to the Aviva Master Trust.

Furthermore, there are anticipated to be relatively few retiring members in the lead up to closure and the investment review did not propose any changes to the growth phase of LifeModel. This is the area in which the majority of members continue to be invested.

The Trustee reviews the performance of the FreeModel funds quarterly in conjunction with its investment adviser and via separate reports received by its investment manager, Legal & General Investment Management.

The Trustee reviews its Statement of Investment Principles (SIP) and the performance of each investment option against the relevant aims and objectives, annually. The SIP was updated in March 2018 and a copy of the latest Statement of Investment Principles for Pension Choices is appended to this statement.

Investment options are provided through L&G pooled funds which are liquid and sit in an insurance wrapper which means any loss of assets would be covered by the Financial Services Compensation Scheme.

Value for members (VfM)

The law requires trustees annually to calculate the charges (including transaction costs where possible) members pay and to assess the extent to which these represent good value for members.

Within the Scheme members only meet the cost of investing, broken down into the annual management charge and transaction/dealing costs. The Scheme offers two investment approaches

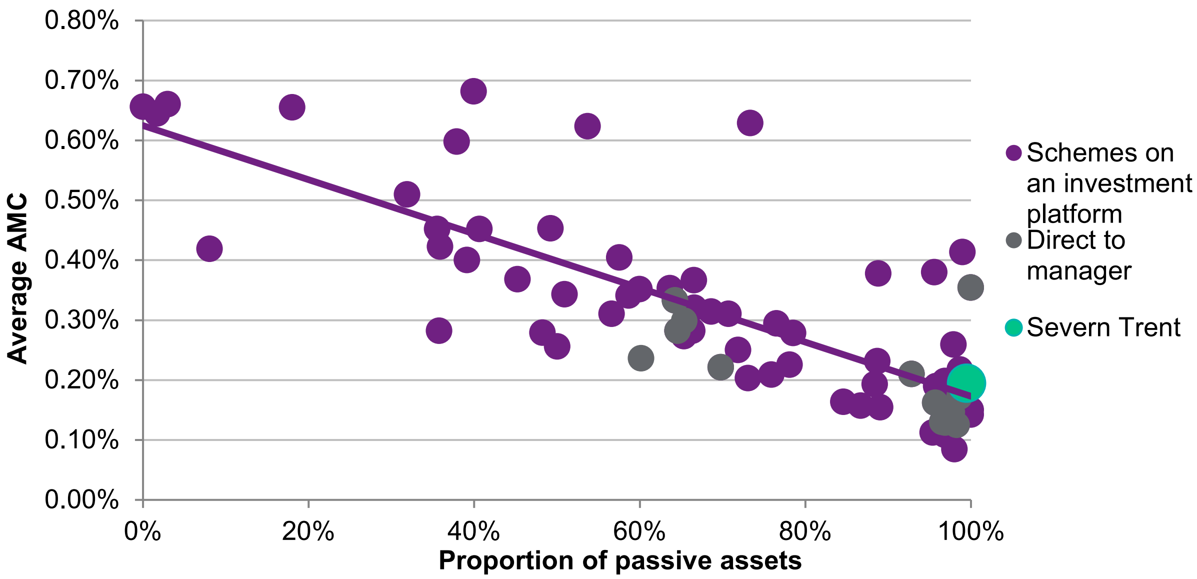
LifeModel is a ‘lifestyle strategy’ which means members invest in different funds depending on their age. The charges and transaction costs applied to LifeModel are set out below:

Fund	Annual management charge	Transaction costs
L&G Global Equity fund	0.20	0.04
L&G Pre-Retirement fund	0.15	0.02
L&G Cash fund	0.125	0.00

The charges and transaction costs applied to all other **FreeModel** funds used by members of the Scheme are set out below:

Fund	Annual management charge	Transaction costs
L&G World (ex UK) Index fund	0.22%	-0.01
L&G Ethical Global Equity Index fund	0.30%	0.01
L&G UK Equity Index fund	0.10%	-0.02
L&G UK Equity (5% Capped) Passive fund	0.11%	0.02
L&G Over 5 year Index-Linked fund	0.10%	0.03
L&G Property fund	0.70%	-0.22

Members' attention is drawn to the fee benchmarking chart which shows total fees, expressed as an average annual management charge (AMC), that apply for Willis Towers Watson clients' schemes (the Trustee's DC adviser).



The chart shows that the Scheme's annual management charge is slightly above the average for schemes that invest in a similar way.

In addition to the annual management charges, transaction costs are those incurred as result of buying, selling, lending or borrowing investments. These costs are taken into account via the unit price for each of the pooled funds and are not directly charged to the members. These costs are typically categorised as:

- Explicit costs which are directly observable and include broker commissions and taxes; or

- Implicit costs which cannot be observed in the same way but can also result in a reduction in the value of capital invested; these implicit costs include market impact or delay costs which can also result in a gain for the pooled fund (i.e. a negative transaction cost).

The FCA's Policy Statement 'Transaction cost disclosure in workplace pensions' establishes a defined methodology to calculate transaction costs (known as the 'slippage cost' methodology). Details of the transaction costs incurred for each of the Scheme's pooled funds are outlined in the table above.

The Trustee ensures that when undertaking changes to the Scheme's investment strategy, transaction costs are minimised as far as possible.

The participating employers have to date met the Scheme's administration charges.

£ and pence illustration

To show the cumulative effect of charges and transaction costs over time, a '£ and pence' illustration example is included in the Appendix. This shows the cumulative effect over time of the charges and transaction costs on the value of a range of realistic and representative funds, pot sizes and contribution rates. Statutory guidance has been taken into account in the preparation of this example.

The Trustee has concluded that the Scheme offers fair VfM in line with the legal requirements, for the following reasons:

- The range of investment options was originally designed and selected with the needs of members in mind. The investment options are available at competitive terms and have performed in line with their benchmarks.

- The funds are highly rated passive pooled funds managed by Legal & General.

- LifeModel provides a managed approach to risk although it does not take full account of the options members now have when they get to retirement. For example the options do not explicitly cater for non annuity based outcomes which have become relevant since the introduction of pension freedoms in April 2015.

- If the Pension Choices assets were not being transferred to the Aviva Master Trust in 2020, the Trustee would be intending to adapt the default investment strategy to reflect Hymans Robertson's recommedations. As noted earlier the Trustee considered the advantages and disadvantages of making changes prior to the bulk transfer and concluded that, as there are relatively few older members in the switching period, the costs of short term changes potentially outweigh the short term benefits.

- The Trustee has agreed that when the assets are transferred to the Aviva Master Trust, the default investment strategy should be Aviva's 'My Future' strategy. This approach is designed to offer a degree of flexibility to reflect the greater retirement benefit choices now available to pension savers.

DC Governance Statement (continued)

Additional Voluntary Contributions ("AVC")

There are four legacy AVC arrangements with Aegon, Aviva, Clerical Medical and Equitable Life linked to the Scheme. The Clerical Medical and Equitable Life arrangements include money invested in with-profits funds. These arrangements are now closed to future contributions.

The Trustee reviews the AVC arrangements annually in conjunction with its advisors, Willis Towers Watson. The last review took place in September 2018. The Trustee concluded that these AVC arrangements and the options available represent sufficient value for members. As members currently have an option to convert their AVC accounts into main Scheme benefits at retirement (which a majority of members use), the majority of members will see value for money as this is likely to be more beneficial than purchasing an annuity outside of the Scheme.

Signed by the Chair on behalf of the Trustee of the Severn Trent Pension Scheme

DC Governance Statement (continued)

Appendix: '£ and pence' illustrations

In the following table the examples of deferred members, aged 25, 42 and 63 respectively have been taken to show the potential cumulative effect of pooled fund charges and investment transaction costs on projected personal account values over a range of periods on the value of realistic and representative funds. A typical initial pot size based on the member's age has been used and no further contributions are assumed to be paid into the pot. The assumptions underlying the illustrations are explained in the notes below the table.

Example Member	Projection period (years)	LifeModel Strategy		L&G Global Equity fund		L&G Pre-Retirement fund		L&G Cash fund	
		Before charges	After charges	[illegible]	[illegible]	Before charges	After charges	Before charges	After charges
Youngest member	1	£10,500	£10,400	£10,500	£10,400	£10,000	£10,000	£10,000	£10,000
	3	£11,400	£11,300	£11,400	£11,300	£10,000	£10,000	£10,000	£10,000
	5	£12,500	£12,300	£12,500	£12,300	£10,100	£10,000	£10,000	£9,900
	10	£15,500	£15,200	£15,500	£15,200	£10,100	£9,900	£10,000	£9,900
	15	£19,400	£18,700	£19,400	£18,700	£10,200	£9,900	£10,000	£9,800
	20	£24,100	£23,000	£24,100	£23,000	£10,200	£9,900	£10,000	£9,700
	25	£30,100	£28,400	£30,100	£28,400	£10,300	£9,800	£10,000	£9,700
	30	£37,500	£35,000	£37,500	£35,000	£10,300	£9,800	£10,000	£9,600
	35	£45,200	£41,700	£46,700	£43,100	£10,400	£9,800	£10,000	£9,600
	40	£48,500	£44,300	£58,200	£53,100	£10,400	£9,700	£10,000	£9,500
Average member	1	£26,100	£26,100	£26,100	£26,100	£25,000	£25,000	£25,000	£25,000
	3	£28,500	£28,300	£28,500	£28,300	£25,100	£24,900	£25,000	£24,900
	5	£31,200	£30,800	£31,200	£30,800	£25,100	£24,900	£25,000	£24,800
	10	£38,800	£37,900	£38,800	£37,900	£25,300	£24,800	£25,000	£24,700
	15	£48,100	£46,500	£48,400	£46,700	£25,400	£24,700	£25,000	£24,500
	20	£56,100	£53,600	£60,300	£57,600	£25,500	£24,700	£25,000	£24,400
	23	£57,400	£54,600	£68,800	£65,300	£25,600	£24,600	£25,000	£24,300
Approaching retirement	1	£30,200	£30,200	£31,400	£31,300	£30,000	£30,000	£30,000	£30,000
	2	£30,200	£30,100	£32,800	£32,600	£30,100	£30,000	£30,000	£29,900

Notes

1. Projected pension account values are shown in today's terms.
2. Contributions and costs/charges that are shown as a monetary amount and reductions are made halfway through the year.
3. Investment returns and costs/charges as a percentage reduction per annum are assumed to be deducted at the end of the year.
4. Charges and costs are deducted before applying investment returns.
5. Switching costs are not considered in the lifestyle strategy.
6. Inflation is assumed to be 2.5% each year.
7. Contributions are assumed to be paid from age 22 to 65 for the youngest member, 42 to 65 for the average member, and 63 to 65 for the member approaching retirement.
8. Salaries are assumed to increase in line with inflation (2.5% per year).
9. Values shown are estimates and are not guaranteed.
10. The real projected growth rates for each fund are as follow:
    - LifeModel Strategy – from 0.075% to 4.50% (see note 11)
    - L&G Global Equity fund – 4.5%
    - L&G Pre-Retirement fund – 0.1%
    - L&G Cash fund – 0.0%
11. The estimated future growth rate for the default investment strategy varies in each year according to which underlying funds the member is invested in at any one time and the proportion of the personal account value in each fund. In the early years the assumed growth rate is 4.50% each year, after allowance for inflation, reflecting the estimated growth rate for the Global Equity fund. This reduces in each of the final 10 years before normal retirement age as more of the personal account value is switched from the Global Equity fund and into the Pre-Retirement and then Cash funds. For example, the estimated growth rate for the final year before retirement is 1.42%, again after allowance for inflation.
12. Transactions costs and other charges have been provided by Legal & General Investment Management Limited, and cover the year to 31 March 2019.
13. Pension scheme's normal retirement age is 65.
14. Example members:
    - Youngest: age 25, total contribution: nil, starting fund value: £10,000.
    - Average: age 42, total contribution: nil, starting fund value: £25,000.
    - Approaching retirement: age 63, total contribution: nil, starting fund value: £30,000.