THE CO-OPERATIVE PENSION SCHEME (Pace)

Financial Statements
For Year Ended 5 April 2017

PENSION SCHEME REGISTRY NO. 10274818

Contents

Some Helpful Terms

In this document, when we say:	We mean:
Actuary	An individual who is appointed to advise the Trustee in relation to the funding and financing of the Scheme. The actuary values the Scheme's assets and liabilities. The Scheme's actuary is Neil Brougham.
Articles of Association	This covers the Trustee's formal governing documents, namely its memorandum and articles of association. These documents which, together with the Scheme's trust deed and rules, governs the Trustee.
Bank	The Co-operative Bank plc.
Brixham Fund	Brixham Co-operative Society Limited Employees' Superannuation Fund.
Chairs' Forum	A meeting of the chairs and Independent Trustee Directors of all the Co-op pension schemes (including the Scheme).
Closure Members	Members who were still building up benefits on the date the Scheme closed to future accrual, 28 October 2015.
Co-op Appointed Directors	Trustee Directors who are selected by the Co-op.
Deferred Members	Member of the Scheme who are not Closure Members and whose benefits have not yet come into payment.
Former Schemes	Either, the Co-operative Group (CWS) Limited Pension Fund (known as the Co-operative Group Pension Fund), the CIS Employees' Pension Scheme, or the Co-operative Bank Pension Scheme. Pace was formed when these 3 schemes merged, in April 2006.
GMP	Guaranteed Minimum Pension. GMPs arise in respect of periods of service when a contributing member was contracted-out of the State Second Pension arrangements prior to 6 April 1997.
Pensioners	Members of the Scheme whose benefits have come into payment.
Independent Trustee Director	A professional independent trustee who is a director of the Trustee and appointed by the Co-op.
Leeds Fund	Leeds Co-operative Society Limited Employees'

	Pension Fund.
Lothian Fund	Lothian Borders & Angus Co-operative Society Limited Employees' Pension Fund.
MNDs	Member-Nominated Directors of the Trustee. These are directors of the Trustee who have been chosen by and from the Schemes' Closure Members and pensioners.
Pensioner MNDs	MNDs appointed from Pace's pensioners.
Secretary	The Secretary is responsible for helping the Trustee with its arrangements, and providing support for its meetings. Sarah Horan, of the Co-op's Trustee Services team, currently holds this role.
Sheffield Fund	Sheffield Co-operative Society Limited Employees' Superannuation Fund.
The Co-op	Co-operative Group Limited. The Co-op is the Scheme's principal employer.
The Scheme	The Co-operative Pension Scheme (Pace).
The Trustee	PACE Trustees Ltd. A company which is appointed as the trustee of the Scheme and acts via its directors.

Trustee Directors & Advisers

PACE Trustees Ltd is appointed by the Co-op as the Trustee to manage the Scheme.

The Scheme's trust deed and rules give the Co-op the power to appoint or remove the Scheme's Trustee.

Our registered office is 1 Angel Square, Manchester, United Kingdom, M60 0AG.

The board of directors of the Trustee

We are the board of a trustee company which is governed by its Articles of Association.

We have nine directors:

- 3 Professional Independent Trustees who are pensions experts
- 3 Trustees chosen by the Co-op
- 3 Trustees chosen by members of Pace

Who are the current directors of the Trustee?

- Harry Baines (Independent Trustee Director) (Chair)
- Stuart Benson (Independent Trustee Director)
- John Buckingham (Pensioner MND)
- Sarah Clayton (Co-op Appointed Director)
- Geoffrey Hayzelden (MND)
- Stuart Hookins (Co-op Appointed Director)
- Anne Kershaw (Independent Trustee Director)
- Andrew Lang (Co-op Appointed Director)
- Heather Marsh (MND)

Which Trustee directors left during the year?

Peter Stanyer (Independent Trustee Director) resigned on 20 October 2016 and was replaced, from 21 October 2016, by Anne Kershaw. Paul Hutton and Kevin Sullivan's terms of office ended on 29 September 2016 and Ian Scott resigned on 30 April 2016.

Appointment, resignation and removal of Trustee directors

Pace's Articles of Association give the Co-op the power to remove or appoint three Trustee directors plus up to 3 independent directors.

In addition, pensions law requires that at least a third of the Trustee directors are selected by the Scheme's members. The Articles of Association gives the Scheme's members the power to appoint three Trustee directors: two who are Employee members, and one who is a Pensioner member.

The directors of the Company shall consist of up to ten individual directors, consisting of:

- Three appointed by the Employer ("**Employer Directors**");

- Up to three appointed by and from the Scheme Members who are active members of the Scheme ("**Employee Directors**");

- 1 appointed by and from the Scheme Members who are pensioners ("**Pensioner Directors**"); and
- Up to 3 independent directors who shall be appointed by the Employer ("**Independent Directors**"). The Employer may remove one or more of the Independent Directors at any time.

Each Co-op Appointed Director holds office indefinitely or until they:

- resign as a Trustee Director, or
- are removed by the Co-op, or
- are removed by a majority of the other Trustee Directors.

Each MND holds office for a period of three years or until they resign, unless otherwise agreed by the Trustee Board:

Chair of the Trustee

We elect the Chair. Currently the Chair is Harry Baines.

Vacancies

If a Co-op Appointed Director vacancy arises then the Co-op will appoint a replacement.

If an MND vacancy arises then it will be filled in accordance with the Trustee's MND policy.

Decision Making

Any decision we make must be:

(a) a decision by a majority of Trustee Directors present at and voting at a meeting,
(b) where decision-making has been delegated to a committee, a decision taken at a meeting of that committee by a majority of the members of that committee, or
(c) a unanimous decision of the Trustee Directors

and will be subject to the provisions of the Scheme's trust deed and rules. Each Trustee Director has one vote.

Meetings

We meet at least four times a year, with special meetings convened as appropriate.

We undertake regular training in relation to issues that we will need to understand in detail in order to carry out our role, for example investment strategy or valuing DB scheme benefits, as well as current pensions issues.

Our Committees

We have formed a number of committees to assist with running the Scheme:

- DC Committee;
- Investment Committee;
- Governance, Audit and Risk Committee;
- Manager Review Committee;
- Strategy Committee; and
- Valuation Committee.

The Committees generally meet every quarter, apart from the Valuation Committee which was formed to progress the actuarial valuation as at 6 April 2016 and meets as required.

Secretary

The Co-op appoints the Secretary to the Trustee. Sarah Horan, Head of the Co-op's Trustee Services team, is appointed as the Secretary.

Trustee Director Remuneration

The Trustee Remuneration Policy provides for payment of £2,000 p.a. to Employee MNDs and £5,000 p.a. to Pensioner MNDs. MNDs can choose not to receive any remuneration. Additional remuneration of £1,000 p.a. is payable to MNDs who are members of the Committees.

The Trustee remuneration policy is reviewed by the Trustee annually.

The Scheme's Professional Advisers are:	
Actuary	Neil Brougham FIA, of Mercer Limited
Administrator (DB)	Co-operative Group Ltd Co-op Pensions Department (10406), 1 Angel Square, Manchester, M60 0AG
Administrator (DC)	Legal & General Assurance Society Ltd Trustee Services, Governance Reporting Team, 4th Floor, Brunel House, 2 Fitzalan Road, Cardiff, CF24 0EB
Auditor	Deloitte LLP 2 Hardman Street, Manchester, M3 3HF
AVC providers	Royal London (CIS) Limited Legal & General Assurance Society Ltd The Prudential Assurance Company Ltd Aviva Life Services UK Ltd The Equitable Life Assurance Society
Bankers	The Co-operative Bank PLC Barclays Bank PLC
Custodian	The Bank of New York Mellon International DLA Piper UK LLP Osborne Clark LLP (appointed 13 September 2016)
Employer Covenant Advisers	PricewaterhouseCoopers International Limited (terminated May 2017) KPMG LLP (appointed 2 June 2017)
Investment Adviser (DB)	Mercer Limited
Investment Adviser (DC)	Willis Towers Watson
Investment Managers (DB)	BlackRock Limited Cantillon Capital Management Ltd (terminated 9 December 2016) Comgest Asset Management International Ltd (terminated 9 December 2016) Insight Investment Management (Global) Ltd LaSalle Investment Management Ltd Legal & General Investment Management

	Limited Marathon Asset Management Ltd (terminated 9 December 2016) Matthews Capital International Management (terminated 9 December 2016) Mercer Limited Royal London Asset Management Limited PGIM Limited (appointed 13 September 2016) TwentyFour Asset Management LLP (appointed 31 January 2017)
Investment Manager (DC)	Legal & General Assurance Society Ltd
Legal adviser	Linklaters LLP
Life Assurance provider	Zurich Assurance Limited
Principal employer	Co-operative Group Ltd
Participating employers	Co-operative Brands Limited Co-operative Legal Services Limited CFS Management Services Limited The Co-operative Bank PLC Unity Trust Bank PLC Co-operatives UK Limited Co-operative Party Limited
Secretary	Sarah Horan, Head of Trustee Services, Co-op

Trustee’s Annual Report

Introduction

We are pleased to present our annual report together with the audited financial statements for the year ended 5 April 2017. The financial statements (set out on pages 36 to 68) have been prepared and audited in accordance with Sections 41(1) and (6) of the Pensions Act 1995.

The report on actuarial liabilities set out on pages 14 and 15 and the investment report set out on pages 26 to 33 also form part of this annual report.

Constitution of the Scheme

The Scheme is an occupational pension scheme, which started on 6 April 2006 and was constituted by a trust deed dated 22 March 2006. The current rules became effective from 29 October 2015.

We hold the Scheme’s funds on trust, to apply them for the purpose of paying pensions and other benefits in accordance with the Scheme’s trust deed.

Scheme Structure

Pace has two sections:

- a defined benefit (DB) section, Pace Complete, which provided benefits on a career average revalued earnings basis, and

- a defined contribution (DC) section.

The DB section of the Scheme closed to future accrual on 30 September 2015 for Bank employees and 29 October 2015 for Co-op employees. This section provides benefits based on a member’s average career salary and length of membership.

The DC section of the Scheme was established on 7 October 2012, and from 29 October 2015 is the only section of Pace which has actively contributing members.

Scheme Mergers

When Pace was established in 2006, it replaced three of the Co-op’s other pension arrangements (the ‘Former Schemes’) whose assets and liabilities were transferred to the Scheme. The Former Schemes are the Co-operative Group (CWS) Limited Pension Fund, The Co-operative Bank Pension Scheme and the CIS Employees’ Pension Scheme.

On 30 April 2015 four of the Co-op’s remaining pension arrangements were transferred to Pace:

- The Brixham Fund;
- The Leeds Fund;
- The Lothian Fund; and
- The Sheffield Fund.

Tax Status

The Scheme is a registered pension scheme under the provisions of Schedule 36 of the Finance Act 2004. Accordingly, under the provisions of sections 186 and 187 of that Act, the Scheme’s income and investment gains are free of taxation.

Rule changes during the year

A rule amendment dated 29 September 2017 relating to the contribution rates for the DC Section of Pace took effect from October 2017:

- The Bank deferred increases to minimum contributions payable to align with the new dates in the automatic enrolment implementation regulations; and

- The Group will retain the earlier increase dates as set out in the Rules but will retain the lower contribution tiers beyond October 2017

The changes have been reflected in the contribution rates shown on page 12.

Transfer values

Transfer value calculations use a method and basis determined by the Trustee, after taking advice from the Scheme Actuary, to be consistent with relevant legislation and the rules of Pace. No discretionary increases are included in the calculation of transfer values. No transfers were reduced to less than their cash equivalent value during the year.

We do not accept individual transfers into the DB section of Pace.

Membership statistics for the year to 5 April 2017

	6 April 2016	Adjustments	Additions	Retirements, leavers and pensions ceasing	Deaths	6 April 2017
Closure Members DB	**9,644**	(1)	-	(1,503)	-	**8,140**
Deferred Pensioners DB	**41,393**	18	1,211	(2,048)	(69)	**40,505**
Pensioners DB	**38,381**	127	1,842	(202)	(1,300)	**38,848**
Total DB	**89,418**	**144**	**3,053**	**(3,753)**	**(1,369)**	**87,493**
Active Members DC	**46,763**	-	8,255	(7,654)	(27)	**47,337**
Deferred Pensioners DC	**7,817**	-	9,277	(3,378)	(8)	**13,708**
Total DC	**54,580**	**-**	**17,532**	**(11,032)**	**(35)**	**61,045**

Guarantee

The Co-op's main trading and/or asset-holding subsidiaries guarantee the Co-op's obligations to the Scheme. The identity of these guarantors may change from time to time depending on the internal financial metrics of the wider Co-op Group: the criteria for this are set based on the Co-op's banking arrangements. The guarantors under this guarantee are also guarantors for the Co-op's banking and bond debt. This guarantee covers the amounts due from the Co-op under either the schedule of contributions or under the employer debt provisions of section 75 of the Pensions Act 1995, and has a long-stop date of 31 December 2034.

Pension increases

Pensions in payment

Pensions in payment for the Former Scheme benefits (accrued before 6 April 2006) that are in excess of the guaranteed minimum pension (GMP) are increased annually on 6 April in line with the Retail Prices Index (RPI) as at the preceding December up to a maximum of 5% (or 6% for former members of the CIS Employees' Pension Scheme who joined before 6 April 2000). There are some exceptions for certain Former Scheme members.

The increase applied to pensions in payment for Former Schemes in April 2016 was 1.2%, pro rata for any pensions in payment for less than a year.

Pensions in payment for Pace Complete benefits (accrued after 5 April 2006) are increased annually on 6 April in line with the RPI as at the preceding December to a maximum of 2.5%, and are paid in full regardless of length in payment (i.e. not pro rata).

The increase applied to pensions in payment for Pace Complete benefits in April 2016 was 1.2%.

GMPs in payment are increased in accordance with legislation up to a maximum of 3.0%. The maximum GMP increase applied in April 2016 was 0%.

Pensions in payment for members whose benefits have been transferred from acquired schemes were increased in April 2016 in line with their respective scheme rules as follows:

- Ex-Alldays PLC Pension Scheme
    - Pre April 1997 pension in excess of GMP was increased by 3.0%
    - Post April 1997 pension was increased by 1.2%
- Ex-Kenneth Balfour Limited Pension, Life Assurance and Widows Pension Scheme (1976)
    - Pre April 1997 pension was increased by 3.0%
    - Post April 1997 pension was increased by 1.2%
- Ex-Trademarket Pension Scheme
    - Pension in excess of GMP was increased by 1.2%
- Ex-W&P Foodservice Pension Scheme
    - Pre April 1996 pension in excess of GMP was increased by 3.0%
    - Post April 1996 pension in excess of GMP was increased by 1.2%
- Ex-GT Smith & Sons Ltd Retirement and Death Benefit Scheme
    - Pension in excess of GMP was increased by 1.2%

Pensions in payment for members whose benefits transferred into Pace from the Brixham, Leeds, Lothian and Sheffield Funds were increased in line with their respective scheme rules as follows:

- Brixham Fund pension increased in January 2017:
    - Pre 6 April 1997 increased by 3.0%
    - 6 April 1997 to 13 January 2006 increased by 2.0%
    - Post 14 January 2006 increased by 2.0%
- Leeds Fund pension increased in January 2017 by 2.2%
- Lothian Fund pension increased on 1 April 2017 by 2.0%
- Sheffield Fund pension in August 2016:
    - Pre May 2006 pension increased by 1.2%
    - Post May 2006 pension increased by 1.2%

Pensions in deferment

Pensions in excess of any GMP under the Former Schemes and the Brixham, Leeds, Lothian and Sheffield Funds will be revalued for each year of deferment, subject to a cap of 5% p.a. compounded over the whole period of deferment. The revaluation rate will reference either the increase in RPI (or RPI and Consumer Prices Index (CPI)), depending on the rules of the Former Scheme or Brixham, Leeds, Lothian and Sheffield Funds.

Pensions in deferment for Pace benefits (accrued after 5 April 2006) are increased annually on 6 April in line with the RPI as at the preceding December to a maximum of 5%. The increase applied in April 2015 was 1.6%.

GMPs are increased in deferment in accordance with statutory requirements.

There were no discretionary increases awarded to pensions in deferment and in payment.

Contributions

Members who participate in a salary sacrifice arrangement accept a reduction in pay in return for non-contributory membership of Pace with the balance of cost paid by the appropriate sponsoring employer. Contributions to Pace DC are as follows:

Pace DC

Contribution rates to the DC Section of Pace are as follows:

Bank Employees (represents employees of The Co-operative Bank PLC)

Employee %	Employer %	Total %
1%*	2%**	3%
2%	3%	5%
3%	5%	8%
4%	8%	12%
5%	10%	15%
6%	10%	16%
7%	10%	17%
8%	10%	18%

*Increases to 2% from April 2018 and 3% from April 2019, for Bank employees.
** Increases to 3% from April 2018 and 5% from April 2019, for Bank.

Co-op Employees (represents all other employees)

Employee %	Employer %	Total %
1%*	2%**	3%
2%	3%	5%
3%	5%	8%
4%	8%	12%
5%	10%	15%
6%	10%	16%
7%	10%	17%
8%	10%	18%
9%	10%	19%
10%	10%	20%

*Minimum level of contribution for automatic enrolment increases to 2% from October 2017 and 3% from October 2018, for Co-op employees.
** Minimum level of contribution for automatic enrolment increases to 3% from October 2017 and 5% from October 2018, for Co-op.
The 1% and 2% contribution options will remain available for members to select should they wish to do so.

On 28 September 2017, the Trustee and the Co-op agreed a variation to the schedule of contributions dated 4 July 2014 to reflect the some changes to the contribution structure in Pace DC for employees of the Co-op and the Bank:

- For the minimum contribution increases under automatic enrolment to be deferred to align with the statutory increase dates (April 2018 and April 2019 respectively), for Bank employees; and

- For the 1% and 2% contribution tier options to be retained beyond the October 2017 and October 2018 increase dates, for Co-op employees.

During the year, the Co-op (or other participating employers) paid an expense contribution of £150,000 each pay period, or such amount agreed as appropriate and in writing between the Trustee and the Co-op, to meet any expenses, life insurance premiums and scheme levies in respect of the DC Section.

On 29 September 2017, the Trustee and the Co-op agreed a variation to the schedule of contributions. This variation was agreed due to a surplus of funds which had built up in the DC expense account after expenses, life insurance premiums and scheme levies had been paid. With effect from 1 October 2017, it was agreed that the £150,000 per pay period would be modified as follows:

- For contributions falling due by 19 October 2017, 19 November 2017 and 19 December 2017 inclusive, no expense contributions will be payable.
- For contributions falling due by 19 January 2018 onwards, expense contributions of £160,000 per pay period will be payable.

The expense contribution amount is reviewed periodically against the actual level of expenses. The Bank directly meets its share of DC expenses.

Pace DB

Following the valuation of Pace DB as at 5 April 2013 it was agreed that the Co-op (or other participating employers) would pay deficit correction contributions of £20m per annum in monthly instalments from 1 April 2011 to 30 June 2014, and £25m per annum in monthly instalments from 1 July 2014 to 30 June 2019 inclusive.

In addition to the above, additional deficit contribtions of £2.8m per annum in monthly instalments from 1 May 2015 to 20 June 2019 inclusive, are paid to the Scheme as a result of the transfer of assets and liabilities of four of the Co-op's pension funds into Pace with effect from 30 April 2015.

A new schedule of contributions will be agreed with the Co-op following the completion of the actuarial valuation as at 5 April 2016.

Additional Voluntary Contributions (AVCs)

From 7 October 2012, Legal & General became the AVC provider for the Scheme. Legal & General holds AVC investments separately from the main fund. Members have the option of selecting from the following funds:

- Pace Growth (Shares) Fund
- Pace Growth (Ethical Shares) Fund
- Pace Growth (Mixed) Fund
- Pace Pre-Retirement (Inflation-linked) Fund
- Pace Pre-retirement Fund
- Pace Cash Fund

Prior to October 2012, active members of Pace DB were also able to make AVC contributions to Royal London, and the available funds are listed below:

- FTSE All-Share Pension Tracker Fund (unitised)
- With-Profits Pension Fund
- Lifestyle Fund
- Deposit Fund

From October 2015, when Pace DB closed, it was not possible for any further contributions to be made to Royal London.

Actuarial Valuation

We are currently discussing the results of the 2016 valuation with the Co-op. The statutory deadline for the Scheme's actuarial valuation as at 5 April 2016 expired on 5 July 2017. The Pensions Regulator is aware of the position and has been kept up to date with the progress of the discussions. This was due to the uncertainty caused by the agreement to separate Pace into two ring-fenced sections following the successful recapitalisation of the Bank.

In the meantime the deficit recovery plan agreed at the last valuation will remain in place until the 2016 valuation has been finalised.

Report on Actuarial Liabilities

Under Section 222 of the Pensions Act 2004, every scheme is subject to the Statutory Funding Objective, which is to have sufficient and appropriate assets to cover its technical provisions. The technical provisions represent the present value of the benefits members are entitled to, based on pensionable service to the valuation date. This is assessed using the assumptions agreed between the Trustee and the Co-op and set out in the Statement of Funding Principles, which is available to Scheme members on request.

The most recent full actuarial valuation of the Scheme was carried out as at 5 April 2013.

This showed that on that date:

The value of the technical provisions was:	£8,328 million
The value of the assets at that date was:	£7,728 million

The method and significant actuarial assumptions used to determine the technical provisions are as follows (all assumptions adopted are set out in the Appendix to the Statement of Funding Principles).

Method

The actuarial method to be used in the calculation of the technical provisions is the Projected Unit Method.

Significant actuarial assumptions

- **Discount interest rate (pre-retirement):** an estimate of the yield available on a notional portfolio of UK Government conventional gilt stocks whose cashflows approximately match the Scheme's estimated benefit cashflows, plus an additional 1.0% per annum.

- **Discount interest rate (post retirement):** an estimate of the yield available on a notional portfolio of UK Government conventional gilt stocks whose cashflows approximately match the Scheme's estimated benefit cashflows, plus an additional 0.5% per annum.

- **Future Retail Price inflation (RPI):** the investment markets' expectation for inflation as indicated by the difference between an estimate of the yields available on notional portfolios of conventional and index-linked UK Government bonds whose cashflows approximately match the Scheme's estimated benefit cashflows.

- **Future Consumer Price inflation (CPI):** derived from the RPI assumption, with a deduction of 0.7% per annum to recognise the long term difference between expectations of future RPI increases and future CPI increases.

- **Pension increases:** in line with the provisions in the Scheme's rules, pension increases are set in line with the assumption for future RPI or CPI as appropriate, up to a maximum of the relevant annual increase cap.

- **Pay increases:** Pace Complete was closed to future accrual in October 2015. In some circumstances members retain a final salary link for benefits accrued before 6 April 2006 in the former Bank, Group and CIS Schemes. An assumption for salary increases in excess of increases in RPI of 0.5% per annum has been determined after consultation with the Co-operative Group. No additional allowance has been made for promotional increases.

- **Mortality:** The mortality assumptions are based on up to date information published by the Continuous Mortality Investigation ("CMI") and National Statistics, making allowance for future improvements in longevity and the experience of the Scheme. The mortality tables are S1NA Year of Birth tables with improvements based on the CMI 2013 model with a long term improvement rate of 1.5% per annum, with male members being treated as though they were 1 year younger than their actual age.

Chair's Statement

The Co-operative Pension Scheme ("Pace")

The Chair of the Trustee's Annual Governance Statement

This Statement has been prepared by the Trustee of the Co-operative Pension Scheme (Pace) to demonstrate how Pace has complied with the governance standards introduced under the Occupational Pension Schemes (Charges and Governance) Regulations 2015. It covers the 12 month period to 5 April 2017 and considers four key areas relating to the Defined Contribution (DC) Section:

1. The investment strategy relating to DC default investment.
2. The financial transactions made within the DC Section.
3. The charges and transactions costs within the DC Section.
4. The Trustees' compliance with their knowledge and understanding (TKU) requirements.

Where applicable, this statement also covers Pace's Additional Voluntary Contribution (AVC) arrangements.

Pace's DC default investment

Statement of investment principles

The Trustee maintains a statement of the investment principles which outlines the principles and policies that govern its decisions about investments, including:

- Its aims, objectives and policies for the DC Section's default investment strategy.
- How the default strategy is intended to ensure that assets are invested in the best interests of members and beneficiaries.
- The design of the default strategy takes account of Pace's membership demographics with a focus on members' needs in retirement.
- The Trustee's investment policies on risk, return and ethical investing.

A copy of the current statement of investment principles is appended to this Annual Governance Statement.

Investment monitoring

Each quarter the Trustee reviews how the funds within the default strategy have performed. Annual monitoring of Pace's legacy AVC arrangements is undertaken.

During 2016, the Trustee introduced an additional tier of investment monitoring whereby performance of the default investment is measured with reference to prospective member outcomes at retirement.

The Trustee reviews the suitability of the DC investments at annual intervals and conducts a strategic investment review at three yearly intervals.

2015 investment review

The last strategic investment review was undertaken in 2015 which led to the introduction of three new outcome focused 'Target' lifestyle strategies from October 2015. The target strategies are designed to help members who have decided how they will take their DC benefits on retirement and wish to align their investment approach.

The Trustee also implemented a new default lifestyle strategy ('Target: Lump Sum') which is designed to be closely aligned with how the majority of members are anticipated to draw their retirement benefits. The default investment strategy was designed and constructed having taken account of modelling to help anticipate future member behaviour following the introduction of additional flexibilities for DC pension arrangements from April 2015.

2016 AVC consolidation

Following a review of Pace's legacy AVCs arrangements, the Trustee transferred some of the AVCs held with Royal London (CIS) to Pace's main AVC plan with Legal & General. This was done to simply the AVC arrangements, ensure members benefited from low charges and improved services. This exercise did not affect members who have AVCs in the Royal London (CIS) 'Extra Plan' arrangement.

Financial transactions

The Trustee regularly monitors the core financial transactions of the DC Section. These include the investment of contributions, transfers out of the DC Section, fund switches and payments out, both to and in respect of members.

This is achieved through the review of quarterly reporting from the DC Section's administrator and the monthly monitoring of contribution payments by the administrators. Pace's financial accounts are also audited annually by the appointed auditors, Deloitte LLP.

The Trustee, in conjunction with Willis Towers Watson, has undertaken a review of the DC Section's governance processes and internal controls and has confirmed that they are compliant with the Pensions Regulator's DC Code of Practice no. 13 on governance and administration (paragraphs 70 to 84 relating to core financial transactions).

Contributions to Pace's legacy AVC arrangements with Royal London are also monitored.

Based on the above, the Trustee is satisfied that the core financial transactions relating to the DC Section and AVCs have been processed promptly and accurately during the scheme year.

Charges and transaction costs

Charges

The charges applied to the DC default investment, the 'Target: Lump Sum' lifestyle strategy, range from 0.23% to 0.26% per annum.

The charges applied to all other funds (excluding the default arrangement) used by members of the DC Section and Legal & General AVCs range from 0.23% to 0.43% per annum.

The above charges comprise an annual management charge that contributes towards the operation of the DC Section and fund management charges, including investment expenses such as fund administration, custodian, accounting and auditing fees and regulatory charges.

Legacy AVCs

Pace's current AVC plan for members is managed by Legal & General. It also has a number of legacy AVCs arrangements. These are largely held with Royal London but there is also a small number of AVC policies with Aviva, Equitable Life, Legal & General and Prudential. The latter invest in a combination of with-profits, unit-linked and deferred annuity contracts, some of which have implicit charging structures. Where explicit charges apply, these typically range from 0.65 to 0.85% per annum.

A review of the legacy AVCs was completed in May 2017 and at the time of preparing this statement, the Trustee is considering the findings of that review. The Trustee will decide how the small AVC arrangements can be best managed in the future for the benefit of members.

Transaction costs

Transaction costs are those incurred as a result of routine fund management activities such as buying, selling, lending or borrowing investments. The Trustee understands that the Financial Conduct Authority (FCA) published their latest consultation paper on transaction costs disclosure in 5 October 2016. The consultation ended on 4 January 2017, and the FCA is expected to publish their final rules in a policy statement in second quarter of 2017. Once new regulatory guidance emerges in the second quarter of 2017, it is expected that Legal & General, along with other investment managers and providers, will start planning their reporting processes on transaction costs. Once the Trustee can make meaningful comparisons on transaction charges it will report further on this in future governance statements.

Value for members

The Trustee is committed to ensuring that members receive value for money from Pace and that any costs and charges that are deducted from members' DC accounts provide good value in relation to the benefits and services that are provided by or on behalf of Pace.

The Trustee undertakes annual value for member assessments, with support from their advisers, and give specific focus on costs for members. These assessments form part of the Trustee's annual plan and are included as an item on Pace's risk register.

The Trustee has just completed a value for members' assessment for the 12 month period ending 5 April 2017. This assessment was undertaken in accordance with the Pensions Regulator's DC Code of Practice no. 13 (paragraphs 18-41) and with the relevant legislation. It considered the scope, quality, efficiency and general value of a range of services and features, including:

- Governance and scheme management.
- Member's investment options and fund performance.
- Administration services and member support; and
- How members are helped to understand their choices and plan for retirement.

The conclusion of the latest assessment is that Pace continues to provide excellent value for money for members because:

- Pace offers members a wide range of quality services.
- Pace charges compare very favourably to the average charges for other similar schemes, including the Government's National Employment Savings Trust (NEST).

Trustee knowledge and understanding (TKU)

The Trustee has a strong TKU process in place which, together with advice available, enables it to exercise its functions as the Trustee of Pace. The Trustee's approach to meeting the TKU requirements includes:

- Maintaining a rolling programme of bespoke trustee training.
- Individual Trustee directors completing the Pensions Regulator's trustee training toolkit, as required.
- Recording all training and attendance at appropriate seminars in the Trustee training log in order to support the Chair's statement.
- Circulating to each Trustee director information on hot topics and general updates from its advisers that are relevant to the Pace.

The Trustee, in conjunction with its advisers, has also undertaken independent assessments of its TKU process and the effectiveness of the Trustee Board to verify that it meets the regulatory standards and is therefore compliant with the Pensions Regulator's DC Code of Practice no 13 (paragraphs 41-50) and the Code of Practice no 7 on TKU. The Trustee is satisfied that it has met the relevant legislative requirements.

Signed by the Chair on behalf of the Pace Trustee:

Signed **Dated**

Harry Baines (Chair of the Trustee for Pace)

Subsequent events

Bank Separation

On 28 June 2017, the Bank announced that it had come to an agreement with its investors to raise funds to meet its longer term capital requirements. The Co-op was supportive of this exercise, which resulted in its shareholding in the Bank being reduced from 20% to 1% in early September 2017. The Co-op has subsequently sold its remaining 1% shareholding.

The Bank successfully completed the recapitalisation exercise on 1 September 2017. As part of the new arrangements, the Co-op, Bank and the Trustee have entered into a legally binding agreement to split the total pension liabilities of Pace between the Bank and the Co-op. Pace will continue as a single pension scheme, with Pace Trustees Limited continuing to oversee the whole scheme. However, Pace will be sectionalised into two ring-fenced sections (a Co-op and a Bank section), to ensure that the pension obligations of the Co-op and the Bank remain completely separate. The Co-op will become the principal employer of the Co-op Section, and the Bank, the principal employer of the Bank Section. This arrangement has received clearance from the Pensions Regulator.

Once implemented, the sectionalisation of Pace means that the Bank will become responsible for its own section of Pace and will not have an obligation to support the Co-op's share of the Pace pension scheme liabilities.

There are a number of stages to be completed to implement the separation of Pace. It is anticipated that the sectionalisation process will be completed by mid-2018.

Sale of Equity investments

As part of the on-going discussions with the Co-op regarding the 2016 actuarial valuation, the Scheme Actuary provided an updated estimate of the funding position as at the end of June 2017, which showed that the position had improved and the Scheme had an opportunity to reduce investment risk.

As a result, in August the Trustee proposed reducing Pace Complete's equity exposure from c.10% of total assets at that point to zero, to reduce the volatility of the Scheme's funding position.

The Co-op agreed to the Trustee's proposal, and on 4 September 2017 the Trustee instructed the termination of the Scheme's equity futures mandate. Realised gains from 1 April 2017 to 5 September 2017 were £34.1m (with notional exposure being reduced from £1,024m at the year end to £731m on 4 September 2017), and £961m of cash was transferred to the Scheme's LDI portfolio. On 7 September 2017, the Trustee disinvested fully from its equity holdings managed by LGIM with the proceeds of £429.7m again invested in the Scheme's LDI portfolio.

Financial Development of the Scheme

During the year ended 5 April 2017 the net assets of the Scheme increased by £1.6bn; from £9.9bn to £11.5bn.

Investments

The investment reports are set out on pages 26 to 33.

Enquiries

For enquiries about the Scheme please contact:

Co-operative Group Limited
Pensions Department
Department 10406
1 Angel Square
Manchester
M60 0AG

Email address: staffpensions@coop.co.uk

Statement of Trustee Directors' Responsibilities for the Financial Statements

The financial statements, which are prepared in accordance with United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", are the responsibility of the Trustee. Pension scheme regulations require the Trustee to make available to Scheme members, beneficiaries and certain other parties, audited financial statements for each Scheme year which:

- show a true and fair view of the financial transactions of the Scheme during the Scheme year and of the amount and disposition at the end of that year, of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Scheme year;

- state whether applicable United Kingdom Accounting Standards, including FRS 102, have been followed, subject to any material departures discussed and explained in the financial statements; and

- contain the information specified in Regulation 3 and 3A of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996.The Trustee has supervised the preparation of the financial statements and have agreed suitable accounting policies, to be applied consistently, making any estimates and judgments on a prudent and reasonable basis.

The Trustee is also responsible for making available certain other information about the Scheme in the form of an Annual Report. The Trustee is responsible under pensions legislation for ensuring that there is prepared, maintained and from time to time revised a schedule of contributions showing the rates of contributions payable towards the Scheme by or on behalf of the employer and the active members of the Scheme and the dates on or before which such contributions are to be paid.

The Trustee is also responsible for keeping records in respect of contributions received in respect of any active member of the Scheme and for monitoring whether contributions are made to the Scheme by the employer in accordance with the schedule of contributions. Where breaches of the schedule occur, the Trustee is required by the Pensions Acts 1995 and 2004 to consider making reports to The Pensions Regulator and the members.

The Trustee also has a general responsibility for ensuring that adequate accounting records are kept and for taking such steps as are reasonably open to them to safeguard the assets of the Scheme and to prevent and detect fraud and other irregularities, including the maintenance of an appropriate system of internal control.

For and on behalf of PACE Trustees Limited

Harry Baines Chair	Sarah Horan Secretary

Date: 3 November 2017

More Helpful Terms

In this document, when we say:	We mean:
Additional Voluntary Contribution (“AVC”)	Contributions over and above a member's normal contributions which the member chose to pay to the Scheme in order to secure additional benefits.
Alternative Inflation-linked Property	Investment in property which has inflation-linked income streams as part of the investment terms. This type of investment aims to generate income which keeps up or exceeds inflation in addition to capital appreciation. These types of properties can include student accommodation and long lease ground rents on commercial properties such as hotels, for example.
Alternatives	A term used to categorise investment in non-traditional asset classes such as Stocks, Bonds and Cash. Alternative asset classes include; Hedge Funds, Private Equity and Property, for example.
Asset backed securities	An asset backed security is the term given to a bond, whose value is derived from a pool of underlying assets which together generate income and collateralise the specific pool. Examples include a pool of mortgages or credit card debt.
Benchmark	A “yardstick” against which the investment performance of a fund manager can be compared.
Bond	An investment in the form of a loan to a company or government which pays a fixed rate of interest over a given time period, at the end of which the initial amount borrowed is repaid. Also known as “fixed interest” investments.
Corporate Bond	A bond issued by a company.
Custodian	A custodian provides safe-keeping of a pension scheme’s assets by holding and recording the investments, and processing tax reclaims etc.
Default	When talking about bonds or investments, a “default” is a failure on the part of the borrower to pay interest on a loan, or to be able to repay a loan at full value.

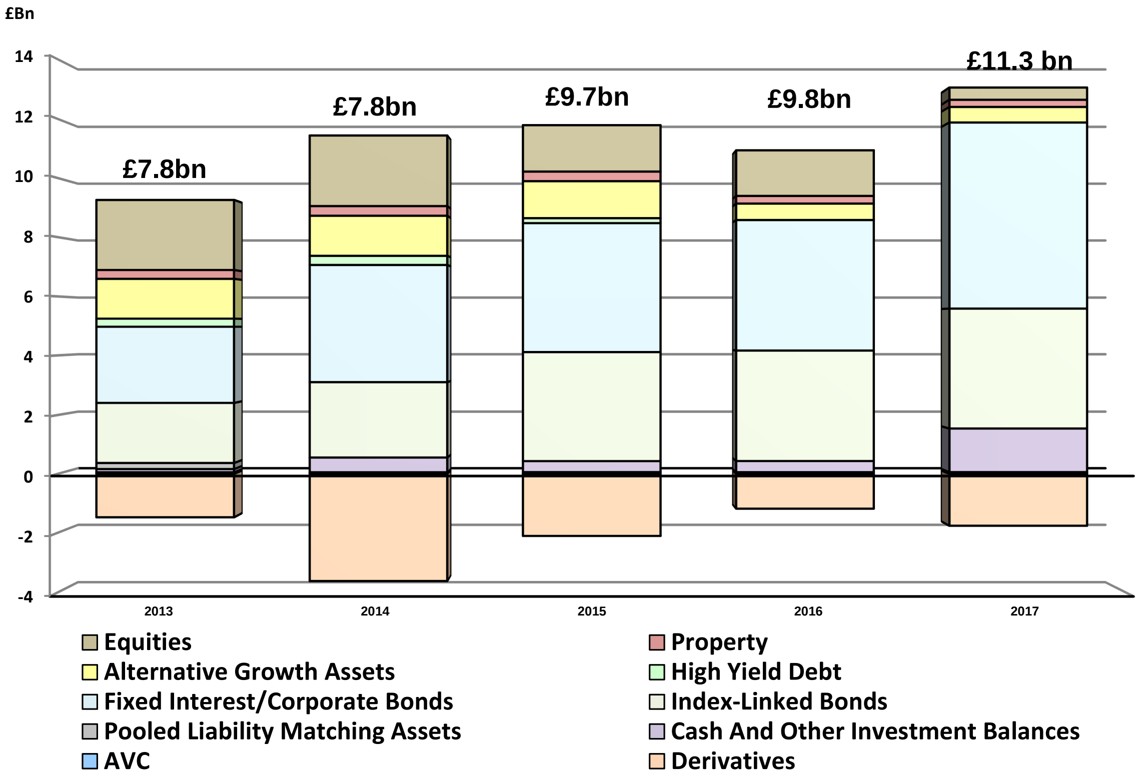
Derivatives	Financial instruments whose price is dependent on one or more underlying assets or market indicators (e.g. interest rates or inflation). Derivatives can be used to gain exposure to, or to help protect against, changes in the value of the underlying investments.
Equity	An investment in the form of shares in companies (also known as stocks). Owning shares makes shareholders part owners of the company in question and usually entitles them to a share of the profits (if any), which are paid as dividends.
Fixed Interest	See “bond”.
Gilt	A bond issued by the UK Government.
Illiquid Credit	Illiquid Credit investments take the principles of bond investing, lending of money in return for regular interest payments, into less standardised areas which are not actively traded. This results in favourable terms for investors and greater potential gain, which the Scheme is able to access as a long-term investor.
Index-linked Gilt	A bond issued by the UK Government which increases each year in line with inflation, which has the effect of increasing the amount of interest paid (or decreasing it if inflation is negative – “deflation”). Also known as inflation-linked gilts.
Investment Grade	A category of ratings provided by a ratings agency based on its assessment of the credit worthiness of that company or asset. The assessments within investment grade range from 'extremely strong capacity to meet financial commitments’ (defined as AAA or Aaa) to 'adequate capacity to meet financial commitments but more subject to adverse economic conditions’ (BBB or Baa).
Investment Manager	A company to whom the Trustee delegates the day to day management of part of the Scheme’s assets. Also known as an “asset manager” or “fund manager”.
Liability Driven Investment	An investment approach which focuses on matching the sensitivities of a pension scheme’s assets to those of its underlying liabilities in response to changes in certain factors, normally interest rates and inflation expectations.
London Interbank Offered Rate (“LIBOR)	A benchmark for short term interest rates between banks world-wide, which is published daily.

Market Value	The price at which an investment can be bought or sold on a given date.
Pooled Investment Vehicle / Pooled Fund	An investment fund in which a number of different investors hold “units”, and where the underlying assets are not directly held by each investor but as part of a “pool”. The investors have the right to the cash value of these units rather than to the underlying assets of the investment fund.
Property	Typically investments in commercial property such as offices, shops and factories. These investments earn money from rent, and any increase in the value of the properties.
Repurchase Agreement	A transaction used to finance ownership of a bond. In a ‘repo’ agreement, an asset, government bond, is sold with a combined agreement for it to be repurchased in the future at an agreed price. This process is used to raise ready money and is backed by the sold asset. This allows the Scheme to access bond investments in an efficient way, allowing us to increase interest rate and inflation protection.
Strategic Asset Allocation	The target split of the Scheme’s assets between different types of investments (e.g. Bonds and Equities).
Swing Manager	LGIM is considered a ‘swing manager’ as its allocation is used (and increased or decreased) to maintain the Scheme’s expected return at or around the target set by the Trustee.

Our Investment Report

Pace DB Investment Report

The chart below provides a snapshot of the different types of investment categories held by the Scheme at each year end.



	2013		2014		2015		2016		2017	
	£000	%	£000	%	£000	%	£000	%	£000	%
AVC	44,242	0.6	45,145	0.6	49,230	0.5	46,688	0.5	49,410	0.4
Derivatives*	(1,486,511)	(19.1)	(3,628,980)	(46.4)	(2,113,263)	(21.8)	(1,179,521)	(12.1)	(1,770,381)	(15.7)
Pooled Liability Matching Assets	205,535	2.7	-	-	-	-	-	-	-	-
Fixed Interest Bonds (Corporate Bonds and Government Bonds)	2,558,853	32.9	3,963,842	50.7	4,383,913	45.4	4,436,216	45.5	6,299,828	55.8
Property	298,704	3.8	324,088	4.1	321,797	3.33	258,441	2.6	240,975	2.1
Cash and Other Investment Balances	108,965	1.4	497,600	6.3	372,994	3.9	378,188	3.9	1,473,763	13.0
Index-Linked Bonds	2,043,076	26.2	2,556,655	32.7	3,685,995	38.0	3,735,341	38.3	4,067,484	36.0
Alternative Growth Assets	1,344,929	17.3	1,368,001	17.5	1,242,662	12.8	551,447	5.7	522,038	4.6
Equities	2,377,425	30.5	2,387,201	30.5	1,577,208	16.2	1,533,157	15.7	410,659	3.6
High Yield Debt	289,861	3.7	309,935	4	167,647	1.7	-	-	-	-
TOTAL	**7,785,079**	**100**	**7,823,487**	**100**	**9,688,183**	**100**	**9,759,946**	**100**	**11,293,776**	**100**

*Repurchase agreements included within derivatives

The Scheme's investment policy

The investment objective is to invest the Scheme's assets in the best interest of the members and beneficiaries, and in the case of a potential conflict of interest in the sole interest of the members and beneficiaries. Within this framework we have agreed a number of objectives to help guide us in the strategic management of the assets and control of the various risks to which the Scheme is exposed. Our primary objectives are as follows:

- We have agreed to implement an investment strategy that initially targets an expected return of around 1.2% p.a. (net of fees) above the return on a portfolio of gilts representing Pace Complete's liabilities. This investment return target was chosen taking into account the associated level of risk.

- Our primary goal is to work progressively towards a fully funded position on the technical provisions basis. We are separately considering a longer term target.

- If funding improves as a result of better than expected investment returns, we expect to use the opportunity to reduce investment risk.

The Scheme's Statement of Investment Principles

We have produced a Statement of Investment Principles in accordance with Section 35 of the Pensions Act 1995. A copy of the statement is available on request to the Secretary to the Trustee at the address shown on page 21. We have appointed Mercer Limited as the Scheme's investment consultant.

As mentioned below, the Scheme is in the process of changing its investment strategy; as a result, and as expected, some of the existing holdings are different to the targets stated within the Statement of Investment Principles, which reflects the agreed new strategy. These legacy investments are in the process of being redeemed. We are monitoring the implementation of the new strategy closely, and expect the holdings to come into line with the Statement of Investment Principles over time as the new strategy come into place.

Management of assets

We have delegated management of investments to professional investment managers which are listed on pages 7 and 8. These managers manage the investments within the restrictions set out in investment management agreements and policy documents which are designed to ensure that the objectives and policies set out in the Statement of Investment Principles.

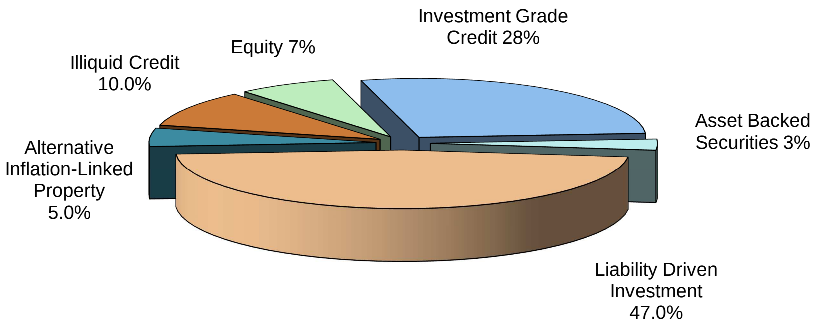
What is the Scheme's investment strategy?

Over the year, we reviewed the investment strategy of the Scheme and agreed to make a number of changes to the Scheme's investments, and to move towards the strategic asset allocation set out below.

We agreed to increase the Scheme's holdings in corporate bonds and alternative 'bond-like' assets, and to reduce its holdings in equities (selling the Scheme's actively managed equity holdings in December 2016). We also continued to redeem our funds held in the Mercer (Alternative Investments) portfolio, and started to redeem our existing UK property investments and invest in a new inflation-linked property mandate with PGIM.

The Investment Committee believes that these changes are in keeping with our desire to increase the predictability of investment returns where possible.

Target benchmark asset allocation as at 31 March 2017



Source: Mercer Limited

At the same time, we refreshed our "liability matching assets" portfolio, which invests in assets that protect the Scheme from changes in interest rates and inflation. The agreed target exposure for these assets is 75% of the Scheme's liabilities; at 31 March 2017 these assets covered 69.5% of the Scheme's interest rate exposure and 73.3% of inflation exposure, with a mechanism in place to increase these to 75% by the end of 2017 (and quicker if market conditions permit).

As at the year end, the Scheme was mid-implementation of the revised strategy. In order to efficiently implement the changes, the Scheme has a temporary investment in equity derivatives which will be wound down over time. The table below shows the Scheme's asset allocation as at 31 March 2017.

Asset allocation as at 31 March 2017

Equity/equity futures	Property	Alternatives	Asset backed securities	Alternative inflation-linked property	Liability driven investment (LDI) and cash	Investment grade credit
LGIM 3.7%	LaSalle 2.3%	Fortress 0.1%	24AM 3.0%	PGIM 0.0%	BlackRock 58.8%	LGIM 4.1%
BlackRock (Equity Futures) 9.2%		Mercer Alternatives 4.6%				Insight 4.7%
						RLAM 9.5%
12.9%	**2.3%**	**4.7%**	**3.0%**	**0.0%**	**58.8%**	**18.3%**

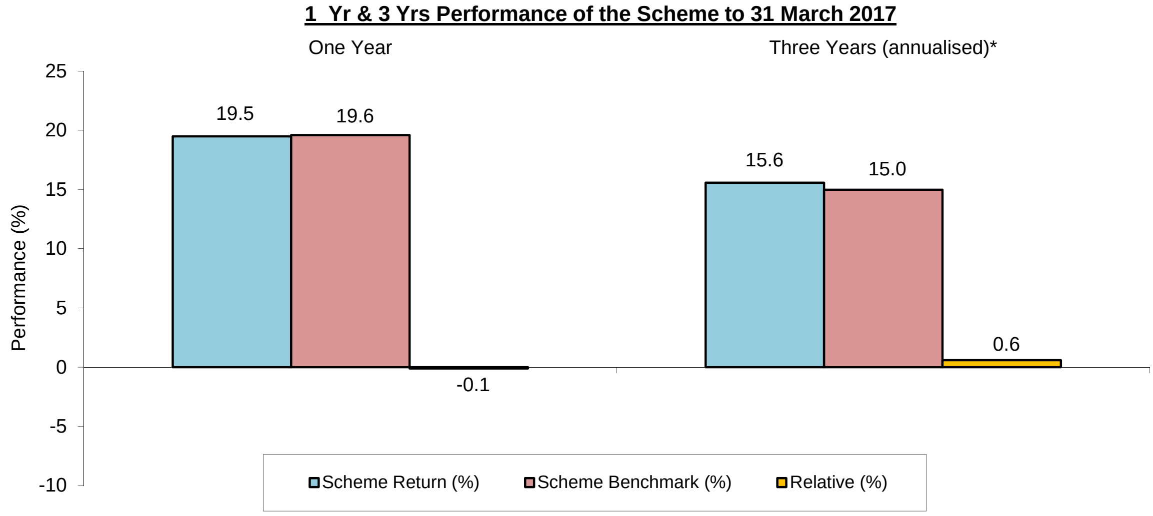
Source: Mercer Limited
All figures reported as at 31 March 2017 representing the most up to date information at reporting.

Investment performance

Investment performance is measured on a quarterly basis; all performance data is shown to 31 March 2017.

On an absolute basis, the fund value of Pace DB section increased from £9.8bn at 5 April 2016 to £11.3bn at 5 April 2017. The performance of the Scheme for the year to 31 March 2017 was 19.5% compared with the overall total fund monitoring benchmark of 19.6%.

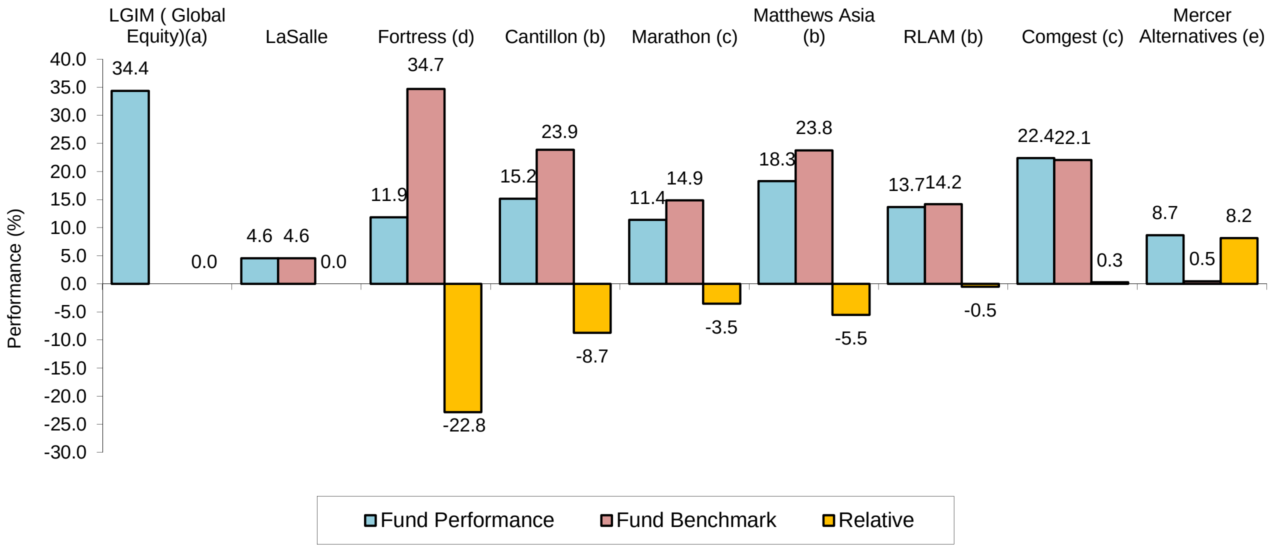
The overall gross of fees performance of Scheme assets, over one and three years to 31 March 2017, is shown below:



Source: Mercer Limited

We measure performance against an overall benchmark which is recommended by the DB investment adviser, and consists of two main elements: firstly, the performance of the 'return-seeking' assets (equity, property, and alternative growth assets) is measured against a composite of separate investment indices that apply to individual asset classes; and secondly, a comparison of changes in the 'liability-matching' assets (fixed interest and index linked securities) to changes in the Scheme's liabilities.

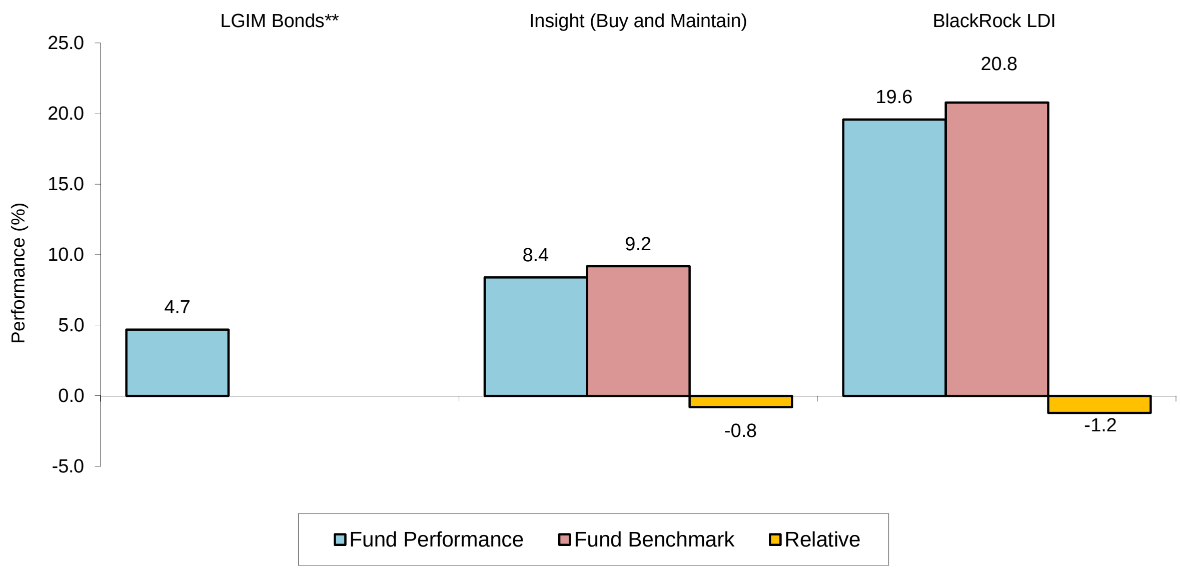
Performance of the Growth Asset Investment Managers for the Year Ended 31 March 2017



Source: Mercer Limited

(a) LGIM's role as swing manager means a benchmark return cannot be calculated.
(b) The mandates of Cantillon, Matthews Asia and RLAM were terminated in December 2016, and performance is shown to 9 December 2016.
(c) The mandates of Marathon and Comgest were terminated in December 2016, and performance is shown to 21 December 2016.
(d) The mandate of Fortress was terminated in January 2015. Some of the assets held in the mandate take time to disinvest and as a result a small holding of 0.1% of Pace assets remains invested in the Fortress fund. Full redemption is expected to take a number of years.
(e) Redemption of the funds held in the Mercer (Alternative investments) portfolio commenced in January 2016. Some of the assets held in the mandate take time to disinvest and full redemption is expected to take a number of years.

Performance of Liability Matching Investment Managers for the Year Ended 31 March 2017 *



Source: Mercer Limited

* Excluding mandates with less than one year track record.
** LGIM's role as swing manager means a benchmark return cannot be calculated.

Custodial arrangements

Segregated Assets

Bank of New York Mellon is the appointed custodian for the DB Section's segregated assets.

Bank of New York Mellon's services provided during the year included custody of assets, performance measurement, investment accounting, stock lending, money market services, compliance monitoring and class action services.

Pooled Assets

The Scheme's investments in pooled vehicles give the Trustee the right to the cash value of units rather than to the underlying assets of the funds. The respective managers of the pooled arrangements are responsible for appointing and monitoring custodians for the underlying assets.

Property

DLA Piper UK LLP and Osborne Clark LLP hold the title deeds in respect of the Scheme's property assets managed by LaSalle and PGIM.

Pace DC Investment Report

Contributions made for members of the DC section of the Scheme are invested with Legal & General Assurance Society Ltd, '(Legal & General)'.

Total contributions of £79,964,000 (2016: £50,605,000) were paid to the Scheme during the year of which £78,014,000 was invested with Legal & General. The balance of £1,950,000 is an expense allowance which the Co-op agreed to pay the Scheme. An analysis of these amounts is shown in note 2 to the financial statements.

The default lifestyle strategy invests in the Pace Growth (Mixed) Fund, switching into Cash Funds, starting 10 years from the member's selected retirement age. This strategy has been designed to suit members who wish to take their pension benefit as a cash lump sum.

Two other lifestyle funds have been made available to members who wish to take their benefits as either a pension or to draw down pension savings over time.

For members who prefer to make their own choice of investment fund, we have selected a range of funds members can choose from, based on advice from our DC investment advisor. The funds and their aims are:

Pace Growth (Shares) Fund

The fund aims to capture the total returns of the UK and overseas equity markets while maintaining a fixed 30:70 weighting between the UK and the overseas assets.

Pace Growth (Ethical Shares) Fund

The fund aims to track the total returns of the FTSE4Good Global Equity Index.

Pace Growth (Mixed) Fund

The fund aims to provide long-term investment growth through exposure to a diversified range of asset classes. The diversified nature of the fund means that it is expected to have less exposure than an equity-only fund to adverse equity market conditions. However, the fund may perform less strongly than an equity-only fund in benign or positive equity market conditions.

Pace Pre-retirement (Inflation-linked) Fund

The fund aims to provide diversified exposure to assets that reflect the investments underlying a typical inflation-linked annuity. The fund, however, does not provide full protection against changes in inflation-linked annuity rates for individual members due to a number of factors (for example, its assets are not sensitive to changes to mortality assumptions). The asset allocation is reviewed periodically by Legal & General.

Pace Pre-retirement Fund

The fund aims to provide diversified exposure to assets that reflect the investments underlying a typical traditional level annuity product. The fund invests in Legal & General index-tracking bond funds. The fund, however, does not provide full protection against changes in annuity rates for individual members, since these also depend upon a number of other factors (e.g. changes to mortality assumptions). The asset allocation is reviewed quarterly by Legal & General.

Pace Cash Fund

The fund aims to provide capital protection, with growth at short term interest rates. The fund invests in the short-term money markets such as bank deposits and Treasury Bills. The fund does not invest in any assets where the nominal capital value can fall, such as fixed interest securities. The value of the fund's assets would only fall if a deposit holder or the UK Government were unable to meet their obligations or if the interest earned by the fund's assets is insufficient to cover the fund management charge and any additional fund expenses.

The first contributions were invested with Legal & General in November 2012. As at 5 April 2017 the value of the funds totalled £236,000,000 (2016: £136,122,000).

The Legal & General pooled funds are provided through a unit policy and the value of the units fluctuate directly in relation to the value of the underlying assets. All the units are redeemable on any working day at prices that reflect market valuations and net cash flow on that day.

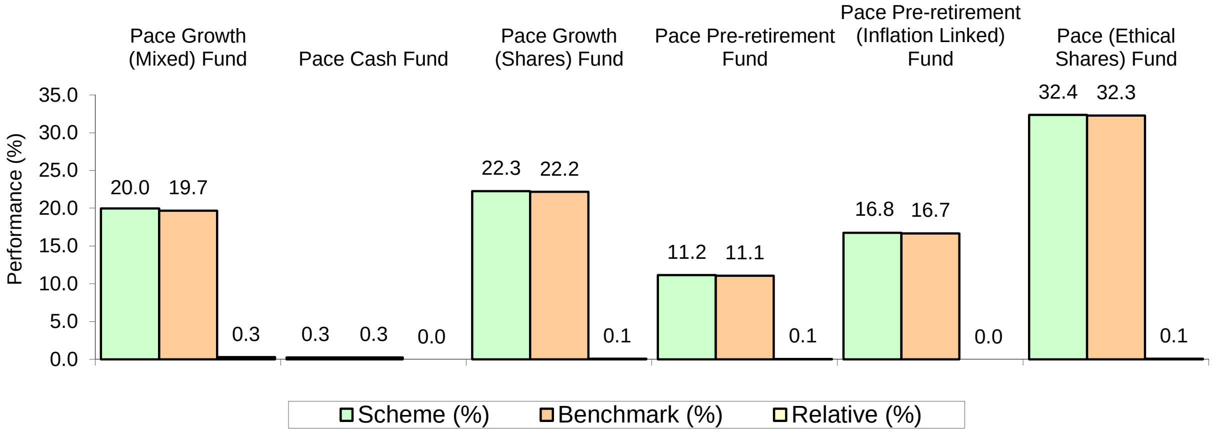
The total value of the units held in the DC section at the end of the reporting period were:

Investment Funds	Market Value As at 5 April 2017 £000	Market Value As at 5 April 2016 £000
Pace Growth (Mixed) Fund	223,217	129,878
Pace Cash Fund	10,565	5,132
Pace Growth (Shares) Fund	1,051	390
Pace Pre-retirement Fund	739	590
Pace Growth (Ethical Shares) Fund	392	108
Pace Pre-retirement (Inflation-Linked) Fund	36	24
Total	**236,000**	**136,122**

Performance

The investment performance of the DC section funds is shown below.

Performance of the DC Section Funds after fees for the year to 31 March 2017



Source: Legal & General

Independent Auditor's Report to the Trustee of The Co-operative Pension Scheme (Pace)

We have audited the financial statements of The Co-operative Pension Scheme (Pace) for the year ended 5 April 2017 which comprise the fund account, the statement of net assets and the related notes 1 to 21. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland".

This report is made solely to the Trustee, as a body, in accordance with regulation 3 of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 made under the Pensions Act 1995. Our audit work has been undertaken so that we might state to the Trustee those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Trustee as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Trustee and Auditor

As explained more fully in the Statement of Trustee Director's Responsibilities, the Scheme's Trustee is responsible for the preparation of financial statements which give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Scheme's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Trustee; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- show a true and fair view of the financial transactions of the Scheme during the year ended 5 April 2017, and of the amount and disposition at that date of its assets and liabilities, other than the liabilities to pay pensions and benefits after the end of the year;

Independent Auditor's Report to the Trustee of The Co-operative Pension Scheme (Pace) (continued)

Opinion (continued)

- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- contain the information specified in Regulations 3 and 3A of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, made under the Pensions Act 1995.

Deloitte LLP
Statutory Auditor
Manchester
United Kingdom

Date:

Fund Account

for the year ended 5 April 2017

In plain English – what does this show?	Our Fund Account shows all contributions, investment income and asset return received by the Scheme, minus the benefits and expenses paid out during the year. The result is the Scheme's net asset position.

Contributions and Benefits	Note	**DBS 2017** £'000	**DCS 2017** £'000	**Total 2017** £'000	**Total 2016** £'000
Employer Contributions		27,780	74,638	102,418	113,118
Employee Contributions		-	5,326	5,326	4,320
Total Contributions	**3**	**27,780**	**79,964**	**107,744**	**117,438**
Transfers in	4	136	145	281	130,170
Other income	5	985	864	1,849	1,618
		28,901	**80,973**	**109,874**	**249,226**
Benefits paid or payable	6	(239,292)	(2,230)	(241,522)	(250,208)
Payment to and on account of leavers	7	(205,784)	(5,598)	(211,382)	(99,768)
Administrative expenses	8	(4,604)	(3,067)	(7,671)	(5,987)
Pension Protection Fund levy	9	(358)	-	(358)	(913)
		(450,038)	**(10,895)**	**(460,933)**	**(356,876)**
Net (withdrawals)/additions from dealing with members		**(421,137)**	**70,078**	**(351,059)**	**(107,650)**
Returns on investment					
Investment income	10	277,391	-	277,391	218,221
Change in market value of investments	11	1,716,643	31,168	1,747,811	15,845
Investment management expenses	12	(14,632)	-	(14,632)	(14,903)
Net returns on investments		**1,979,402**	**31,168**	**2,010,570**	**219,163**
Net increase in the Scheme during the year		1,558,265	101,246	1,659,511	111,513
Net assets of the Scheme as at 6 April		**9,744,737**	**138,740**	**9,883,477**	**9,771,964**
Transfers between sections		2,795	(2,795)	-	-
Net assets of the Scheme as at 5 April		**11,305,797**	**237,191**	**11,542,988**	**9,883,477**

The notes on pages 39 to 68 form part of these financial statements.

Statement of Net Assets

(available for benefits) as at 5 April 2017

In plain English – what does this show?	The Statement of Net Assets below provides a snapshot of the financial position of the Scheme as at 5 April. It sums up the Scheme's assets and liabilities at this date. It does not take account of obligations to pay pensions and benefits, which fall due after the end of the Scheme year; this is dealt with in the Report on Actuarial Liabilities.

	Note	**DBS 2017** £'000	**DCS 2017** £'000	**Total 2017** £'000	**Total 2016** £'000
Investment assets	11-15				
Bonds		9,908,640	-	9,908,640	7,732,841
Equities		6	-	6	771,066
Pooled investment vehicles		1,415,788	236,000	1,651,788	1,920,511
Derivatives		1,815,119	-	1,815,119	1,893,275
Properties		216,550	-	216,550	226,300
AVC investments		49,410	-	49,410	46,688
Insurance policies		116	-	116	99
Cash deposits		1,458,227	-	1,458,227	353,219
Sales awaiting settlement		7	-	7	128,241
Dividend entitlement		46,450	-	46,450	40,160
Recoverable withholding tax		1,428	-	1,428	1,242
Investment liabilities					
Derivatives		(1,439,584)	-	(1,439,584)	(1,487,500)
Repurchase agreements		(2,145,916)	-	(2,145,916)	(1,585,301)
Purchases awaiting settlement		(32,465)	(4,851)	(37,316)	(149,544)
Total net investments		11,293,776	231,149	11,524,925	9,891,297
Current assets	16	32,332	7,146	39,478	16,181
Current liabilities	17	(20,311)	(1,104)	(21,415)	(24,001)
Net assets of the Scheme as at 5 April		**11,305,797**	**237,191**	**11,542,988**	**9,883,477**

The notes on pages 39 to 68 form part of these financial statements.

The financial statements summarise the transactions of the Scheme and deal with the net assets at the disposal of the Trustee. They do not take account of obligations to pay pensions and benefits, which fall due after the end of the Scheme year. The Actuary deals with the actuarial position of the Scheme, which does take account of such obligations, which is dealt with in the Report on Scheme Liabilities on pages 14 to 15 of the annual report and these financial statements should be read in conjunction with them.

The Trustee Directors approved these financial statements on 3 November 2017.

Signed for and on behalf of the Trustee Directors:

Harry Baines
Chair

Sarah Horan
Secretary

Notes to the Financial Statements

In plain English – what does this show?	This section outlines the general accounting policies of the Scheme that relate to the financial statements as a whole.

1 Basis of preparation

The financial statements have been prepared in accordance with the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, Financial Reporting Standard 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland issued by the Financial Reporting Council and the guidance set out in the Statement of Recommended Practice (Revised November 2014).

The Trustee has elected to early-adopt the changes proposed by the FRC in Amendments to FRS 102 – Fair Value Hierarchy Disclosures to align the reporting standards more consistently with International Financial Reporting Standards (IFRS).

2 Accounting policies

The principal accounting policies of the Scheme are as follows:

Contributions and benefits

Employee normal and additional contributions are accounted for when deducted from pay and in the period to which the corresponding pay relates. Employer normal contributions are accounted for on the same basis as employee contributions. Deficit funding and employer expense allowance contributions are accounted for in the period they are due.

Benefits are accounted for in the period in which the member notifies the Trustee of the decision on the type or amount of benefit to be taken or, if there is no member choice, on the date of retirement or leaving.

Transfers

Transfers in or out (including the bulk transfer of sums from other Co-op schemes) represent the capital sums either received in respect of members from other pension schemes or paid to other pension schemes for members who have left the Scheme. Transfer values are accounted for when the liability is accepted, or discharged.

Expenses

Expenses are accounted for on an accruals basis.

Investment income

Dividends from quoted securities are accounted for when due, with the addition of dividends outstanding as at 5 April 2017 on listed stocks which were then ex-dividend. Interest on deposits is accounted for on an accruals basis and accrued daily. Rents are earned in accordance with the terms of the lease and accounted for on an accruals basis.

Investment income is reported net of attributable tax credits but gross of withholding taxes, which are accrued in line with the associated investment income. Irrecoverable withholding taxes are reported separately as a tax charge.

Investment income arising from the underlying assets within pooled investment vehicles is reinvested in those vehicles and is reflected in the unit price. This income is reported within 'change in market value'.

Foreign currencies

Translation of foreign income into sterling is at the exchange rate on the date of receipt. For the investments held in foreign currency, the translation into sterling is at the exchange rate as at year-end.

Where forward sales of foreign currency have been made as a hedge against exposure on foreign currency investments, any unrealised profit or loss at the year-end, measured by the difference between the spot and the contract rate, is included in the changes in market value of investments, together with realised gains and losses on forward contracts maturing during the year.

Basis of accounting for property investments

PGIM Limited and LaSalle Investment Management manage the Scheme's property portfolio.

Indirect

The Scheme holds investments in geared property vehicles with LaSalle Investment Management through joint arrangements which are accounted for by including the Scheme's share of the assets, liabilities and revenue, based on the latest information made up to dates not earlier than 31 March 2017.

Direct

The financial statements show all of the Scheme's assets and liabilities in respect of the property portfolio (bank account, debtors and creditors in connection with rental of the properties, and rental income) on an accruals basis.

This basis is in line with the other investments, providing clarity on all transactions relating to the Scheme's investment in property and reflects the substance of the arrangement.

Valuation of investments

Investments are included in the statement of net assets at market value. UK and foreign listed securities are valued at the bid-market value or latest traded price at the year-end. Pooled investment vehicles and unit trusts are stated at the bid price for funds with bid/offer spreads, single price, or dealing price where there are no bid/offer spreads, as provided by the investment manager at the year-end.

Bonds are stated at their clean (i.e. excluding accrued income) prices. Accrued income is accounted for within investment income.
Property is valued at open market value by Chartered Surveyors, Savills in accordance with the Royal Institute of Chartered Surveyors' Valuation Standards.

Derivatives are stated at market value.

Exchange traded derivatives are stated at market values determined using market quoted prices.

For exchange traded derivative contracts which are assets, market value is based on quoted bid prices. For exchange traded derivative contracts which are liabilities, market value is based on quoted offer prices.

Forward foreign exchange contracts are valued by determining the gain or loss that would arise from closing out the contract at the reporting date by entering into an equal and opposite contract at that date.

Swaps are revalued on a daily basis. The fair value is calculated using pricing models, where inputs are based on market data as of close of business the previous day. Interest is accrued on a basis consistent with the terms of each contract. The amounts included in 'change in market value' are the realised gains or losses on closed contracts and the unrealised gains or losses on open contracts. Net receipts or payments on swap contracts are reported within change in market value.

Realised and unrealised gains and losses arising on derivative contracts are disclosed within change in market value and are taken directly to the fund account.

Repurchase agreements are valued on an amortised cost basis and are accounted for as follows:

> Repurchase agreements (repo) - the Scheme continues to recognise and value the securities that are delivered out as collateral, and includes them in the financial statements. The cash received is recognised as an asset and the obligation to pay it back is recognised as a payable amount. These agreements are valued on an amortised cost basis.

The Scheme lends certain bonds and equity securities in return for fee income. At the year-end, the stock on loan is included in the financial statements at market value to reflect the Scheme's ongoing economic interest in such securities.

The fair value of annuities purchased by the Trustee, which fully provide the benefits for certain members, are estimated to be immaterial by the Trustee. The asset has therefore been excluded from these financial statements. The cost of purchasing these annuities is reported within the Fund Account under 'Benefits paid or payable'.

AVC investments are included at market value, as provided by the AVC provider.

Insurance policies are non-profit deferred annuity contracts valued by the provider (Aviva PLC) using the gross premium method.

3 Contributions

In plain English – what does this show?	This note shows what contributions have been received by the Scheme from the Co-op and participating employers during the year.

	DBS 2017 £000	**DCS 2017** £000	**Total 2017** £000
Employer			
normal	-	72,688	72,688
deficit funding	27,780	-	27,780
expense allowance	-	1,950	1,950
	27,780	**74,638**	**102,418**
Employee			
normal	-	2,506	2,506
additional voluntary contributions	-	2,820	2,820
	-	**5,326**	**5,326**
	27,780	**79,964**	**107,744**
	2016 £000	**2016** £000	**2016** £000
Employer			
normal	36,615	46,966	83,581
deficit funding	27,587	-	27,587
expense allowance	-	1,950	1,950
	64,202	**48,916**	**113,118**
Employee			
normal	728	718	1,446
additional voluntary contributions	1,903	971	2,874
	2,631	**1,689**	**4,320**
	66,833	**50,605**	**117,438**

The Co-op agreed a supplement to the recovery plan to pay additional deficit contributions of £2.8m per annum in monthly instalments from 1 May 2015 to 30 June 2019 inclusive. This is in addition to the recovery plan agreed with the Co-op to pay £25m per annum, payable in monthly instalments until 30 June 2019 and an expense allowance of £1.95m per annum, payable in 4-weekly instalments from October 2012, for the DCS administration costs.

Included within DBS employer normal contributions is an amount of £nil (2015: £10.1m) relating to the additional contributions made on the employees' behalf in relation to salary sacrifice arrangements.

4 Transfers in

In plain English – what does this show?	This note shows the value of transfers in which have been transferred into the Scheme during the year. This includes bulk transfers from other Schemes.

	DBS 2017 £000	**DCS 2017** £000	**Total 2017** £000
Bulk transfers in	136	-	136
Individual transfers in	-	145	145
	136	**145**	**281**
	2016 £000	**2016** £000	**2016** £000
Bulk transfers in	130,149	-	130,149
Individual transfers in	-	21	21
	130,149	**21**	**130,170**

During the year the remaining £0.1m (2016: £130.1m) of assets and liabilities of the Leeds Fund was transferred into the Pace DB section. In the prior year, £130.1m of assets and liabilities of the Lothian, Leeds, Sheffield and Brixham Funds transferred into the Pace DB section.

5 Other income

In plain English – what does this show?	This note shows income received from Zurich Assurance Limited, the life insurance provider for the Scheme.

	DBS 2017 £000	**DCS 2017** £000	**Total 2017** £000
Life assurance claims	985	864	1,849
	2016 £000	**2016** £000	**2016** £000
Life assurance claims	816	802	1,618

6 Benefits paid or payable

In plain English – what does this show?	This note shows the types and values of benefits that have been paid out to members of the Scheme during the year.

	DBS 2017 £000	DCS 2017 £000	Total 2017 £000
Pensions	203,209	-	203,209
Commutations and lump sum retirement benefits	33,719	1,341	35,060
Purchases of annuities	49	97	146
Lump sum death benefits	2,315	792	3,107
	239,292	**2,230**	**241,522**

	2016 £000	2016 £000	2016 £000
Pensions	202,664	-	202,664
Commutations and lump sum retirement benefits	43,679	792	44,471
Purchases of annuities	-	111	111
Lump sum death benefits	1,529	838	2,367
Life time and annual allowance tax charges	595	-	595
	248,467	**1,741**	**250,208**

7 Payment to and on account of leavers

In plain English – what does this show?	This note shows how much has been paid out to members and other pension schemes for members who have left the Scheme during the year.

	DBS 2017 £000	DCS 2017 £000	Total 2017 £000
Refunds to members leaving service	7	2,064	2,071
Individual transfers to other schemes	205,777	3,534	209,311
	205,784	**5,598**	**211,382**

7 Payment to and on account of leavers (continued)

	DBS 2016 £000	DCS 2016 £000	Total 2016 £000
Refunds to members leaving service	8	4,961	4,969
Payments for members joining the State Scheme	10	-	10
Individual transfers to other schemes	92,498	2,291	94,789
	92,516	**7,252**	**99,768**

8 Administrative expenses

In plain English – what does this show? This note shows the different types of expenses the Scheme has incurred during the year. It splits expenses into key categories, such as actuarial and administration fees.

	DBS 2017 £000	DCS 2017 £000	Total 2017 £000
Administration	3,222	535	3,757
Actuarial	923	-	923
Audit	82	-	82
Legal and other	932	258	1,190
Life assurance premiums	-	2,274	2,274
Life assurance premiums refund*	(555)	-	(555)
	4,604	**3,067**	**7,671**

	2016 £000	2016 £000	2016 £000
Administration	2,922	425	3,347
Actuarial	533	8	541
Audit	95	-	95
Legal and other	441	154	595
Life assurance premiums	756	653	1,409
	4,747	**1,240**	**5,987**

*During the year a refund of £555k was received from Zurich Assurance Limited for premiums paid in advance following the closure of the DB section.

9 Pensions Protection Fund levy

In plain English – what does this show?	This note shows the total amount of levies paid to the Pensions Regulator during the year.

DBS	Total 2017 £000	Total 2016 £000
Pension Protection Fund levy	358	913

The Pensions Act 2004 introduced the Pension Protection Fund levy and the Scheme, in common with other pension schemes, is required to contribute.

10 Investment Income

In plain English – what does this show?	The Scheme receives income and pays interest from its assets; this note shows the different types of income received and interest paid during the year.

DBS	Total 2017 £000	Total 2016 £000
Income from bonds	215,300	172,638
Dividends from equities	17,613	20,727
Income from pooled investment vehicles	(2,338)	6,966
Rents from properties	12,376	14,259
Interest on cash deposits	751	1,657
Foreign exchange gain/(loss)	29,733	(786)
Income from securities lending	136	155
Irrecoverable withholding tax	(876)	(1,399)
Annuity income	3,596	3,459
Other	1,100	545
	277,391	**218,221**

Investment income shown above reflects income earned by investments within the DBS. All income received on pooled investment vehicles (excluding property) is re-invested and is included in the change in market value. All income earned on pooled investment units held by DCS is accounted for within the value of those funds.

In 2015 we received distributions to the sum of £4.2m in relation to the LaSalle Garden Centre Fund. During the year we were informed this was capital distributions and therefore an adjustment has been made to remove this from income from pooled investment vehicles.

11 Reconciliation of investments

In plain English – what does this show?	This note provides a reconciliation of the sales, purchases and change in market value during the year between the opening and closing value of investments and analysed by asset class as disclosed on the face of the Statement of Net Assets.

		6 April 2016	**Purchases at cost and derivative payments**	**Sales proceeds and derivative receipts**	**Change in market value**	**5 April 2017**
DB Assets	Note	£000	£000	£000	£000	£000
Bonds		7,732,841	10,726,888	(9,811,980)	1,260,891	9,908,640
Equities		771,066	1,091,235	(1,985,425)	123,130	6
Pooled investment vehicles	10.1	1,784,389	126,345	(735,272)	240,326	1,415,788
Net derivative contracts	10.2					
-Swaps		406,762	13,725	(120,018)	80,794	381,263
-Futures		-	17,984	(64,943)	55,104	8,145
-Foreign exchange		(987)	75,774	(58,443)	(30,217)	(13,873)
Properties		226,300	4,360	(8,413)	(5,697)	216,550
AVC investments	10.3	46,688	8,898	(12,283)	6,107	49,410
Insurance policies	10.4	99	-	-	17	116
		10,967,158	**12,065,209**	**(12,796,777)**	**1,730,455**	**11,966,045**
Repurchase agreements		(1,585,301)			(13,812)	(2,145,916)
Cash deposits		353,219				1,458,227
Dividend entitlement		40,160				46,450
Sales awaiting settlement		128,241				7
Recoverable withholding tax		1,242				1,428
Purchases awaiting settlement		(144,773)				(32,465)
TOTAL DB ASSETS		**9,759,946**			**1,716,643**	**11,293,776**

DC Assets	Note	£000	£000	£000	£000	£000
Pooled investment vehicles	10.1	136,122	75,339	(6,629)	31,168	236,000
Purchases awaiting settlement		(4,771)				(4,851)
TOTAL DC ASSETS		**131,351**				**231,149**

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments.

Transaction costs

Included within the DBS purchases and sales figures are direct transaction costs of £2.1m (2016: £1.3m) comprising fees, commissions and stamp duty. These costs are attributable to the key asset classes as follows:

	Fees	**Commission**	**Stamp Duty**	**Total 2017**	**Total 2016**
	£000	£000	£000	£000	£000
Equities	19	826	491	1,336	844
Pooled investment vehicles	-	5	1	6	-
Derivatives	-	166	-	166	-
Property	560	-	-	560	464*
2017	579	997	492	2,068	1,308
2016	486*	485	337	-	1,308

*Prior year figures revised to reflect transaction costs on property.

Transaction costs are also borne by the Scheme in relation to transactions in pooled investment vehicles. Such costs are taken into account in calculating the bid/offer spread of these investments and are not separately reported.

For the DC section, investments purchased by the Scheme are allocated to provide benefits to the individuals on whose behalf corresponding contributions are paid. Legal & General hold the investment units on a pooled basis for the Trustee. Legal & General allocates investment units to members. The Trustee may hold investment units representing the value of employer contributions that have been retained by the Scheme that relate to members leaving the Scheme prior to vesting.

Defined contribution assets are allocated to members and the Scheme as follows:

	Total 2017	**Total 2016**
	£000	£000
Members	236,011	136,450
Scheme	1,180	2,290
	237,191	**138,740**

11.1 Pooled investment vehicles

DBS	Total 2017 £000	Total 2016 £000
Equity	410,653	762,086
Bonds	458,672	438,715
Property	24,424	32,141
Hedge funds	7,629	11,312
Alternative funds	514,410	540,135
	1,415,788	**1,784,389**

DCS	2017 £000	2016 £000
Diversified Growth	223,217	129,878
Bonds	775	614
Cash	10,565	5,132
Equity	1,443	498
	236,000	**136,122**

Derivative contracts - Objectives and policies

We have authorised the use of derivatives by investment managers to manage risk within the investment strategy.

The main objectives for the use of key classes of derivatives and the policies followed during the year are summarised as follows:

Swaps – Our aim is to match, as far as possible, the liability matching portfolio and the Scheme's long-term liabilities, in particular in relation to sensitivity to interest rate and inflation movements. For capital efficiency, we have entered into derivative agreements (interest rate and inflation-linked swap contracts and gilt total return swaps) that enable the liability matching portfolio to better match the long-term liabilities of the Scheme. Total return swaps allow exposure to index-linked and conventional gilts to match the long-term liabilities of the Scheme in a capital efficient manner.

Futures – Futures are used to manage interest rate risk and gain synthetic equity exposure. Equity futures contracts are efficient instruments to allow the manager to position the portfolio for overall movements in yields and changes in shape to the yield curve.

Forward foreign exchange – In order to maintain appropriate diversification of investments within the portfolio, and take advantage of overseas investment returns, a proportion of the investment portfolio is invested overseas. To balance the risk of investing in foreign currencies whilst having an obligation to settle benefits in Sterling, we operate a policy of hedging a portion of non-sterling currency exposure in the fixed income portfolio to reduce the currency exposure of the overseas investments to the targeted level.

At the year-end the Scheme had the following derivatives:

11.2 Derivatives

DBS		Assets 2017 £000	Liabilities 2017 £000	Assets 2016 £000	Liabilities 2016 £000
OTC swaps	(i)	1,799,715	(1,418,452)	1,893,271	(1,486,509)
Futures	(ii)	13,540	(5,395)	-	-
Forward FX contracts	(iii)	1,864	(15,737)	4	(991)
		1,815,119	**(1,439,584)**	**1,893,275**	**(1,487,500)**

i. Swaps

Nature Duration	Nominal Amount £000	Asset value at year-end £000	Liability value at year-end £000
Inflation			
2017-2020	206,916	375	(10,266)
2021-2030	910,065	17,478	(54,104)
2031-2040	324,669	15,306	(55,946)
2041-2050	80,379	57,452	(53,916)
2051-2060	83,961	63,736	(61,886)
		154,347	**(236,118)**
Interest Rate			
2017-2020	53,506	43,953	(79,895)
2021-2030	278,811	141,729	(109,040)
2031-2040	172,179	596,378	(212,714)
2041-2050	114,753	447,491	(579,140)
2051-2063	34,270	415,382	(201,318)
		1,644,933	**(1,182,107)**
Credit Default			
2017-2020	5,280	435	(227)
		435	**(227)**
Total 2017		**1,799,715**	**(1,418,452)**
Total 2016		1,893,271	(1,486,509)

In relation to the swap contracts above, the fund and counterparties have deposited a total of £231m and £758m (2016: £125m and £574m) of bonds and cash as collateral at the year-end respectively. This collateral is not reported within the Scheme’s net assets.

ii. Futures

Nature	Notional Amount long/(short) position	Expiration	Asset value at year-end £000	Liability value at year-end £000
EURO Stoxx 50 Future (EUX)	9,016	Jun 17	5,567	-
Mini MSCI EMG MKT Fut (NYF)	3,993	Jun 17	5,160	-
SPI200 Index Future (SFE)	954	Jun 17	1,701	-
FTSE 100 Index Future (ICF)	2,572	Jun 17	1,112	-
Topix Index Future (OSE)	769	Jun 17	-	(2,030)
S&P 500 Emini Index Fut (CME)	2,688	Jun 17	-	(3,365)
Total 2017	**-**		**13,540**	**(5,395)**
Total 2016	-		-	-

Included within cash balances is £55,559k (2016: £nil) in respect of initial and variation margins arising on open futures contracts at the year-end.

iii. Forward Foreign Exchange (FX)

The Scheme had open FX contracts at the year-end as follows:

Nature	Settlement date	Currency bought	Currency	Currency sold	Currency	Asset value at year-end £000	Liability value at year-end £000
Forward OTC	13 Apr 2017	3,128	USD	(3,194)	GBP	-	(66)
Forward OTC	13 Apr 2017	51,030	GBP	(51,732)	USD	-	(702)
Forward OTC	21 Apr 2017	80,468	AUD	(82,395)	GBP	-	(1,927)
Forward OTC	21 Apr 2017	249,878	EUR	(254,553)	GBP	-	(4,675)
Forward OTC	21 Apr 2017	88,398	JPY	(87,695)	GBP	703	-
Forward OTC	21 Apr 2017	374,834	USD	(383,100)	GBP	-	(8,266)
Forward OTC	26 Apr 2017	71,231	GBP	(70,836)	USD	394	-
Forward OTC	11 May 2017	1,864	GBP	(1,875)	EUR	-	(11)
Forward OTC	7 June 2017	14,144	GBP	(14,090)	USD	54	-
Swap OTC	6 Apr 2017	881	EUR	(884)	GBP	-	(3)
Swap OTC	11 Apr 2017	3,419	EUR	(3,430)	GBP	-	(11)
Swap OTC	12 Apr 2017	2,137	EUR	(2,144)	GBP	-	(7)
Swap OTC	18 Apr 2017	14,532	EUR	(14,599)	GBP	-	(66)
Swap OTC	3 May 2017	151,009	GBP	(150,318)	EUR	691	-
Swap OTC	3 May 2017	6,461	GBP	(6,439)	EUR	22	-
Swap OTC	3 May 2017	2,302	GBP	(2,305)	USD	-	(3)
Total 2017		**1,115,716**		**(1,129,589)**		**1,864**	**(15,737)**
Total 2016		74,382		(75,369)		4	(991)

11.3 AVC investments

DBS	Total 2017 £000	Total 2016 £000
Royal London (CIS) Ltd	34,992	41,760
Prudential	54	80
Legal & General	14,354	4,837
Aviva	7	7
Equitable Life	3	4
	49,410	**46,688**

Contributions to Additional Voluntary Contribution investments made by both DBS and DCS members are invested separately from the main Scheme on a money purchase basis with Legal & General. As Legal & General does not distinguish between investments held for DBS and DCS members, all Legal & General AVCs are reported as DBS assets.

Royal London (CIS) Ltd provided AVCs for DBS members up to October 2015, when Pace DB closed. It is no longer possible for any further contributions to be made to Royal London since Pace DB closed.

Prudential, Legal & General, Aviva and Equitable Life also provide AVCs for members who have transferred into the Scheme from other Co-op pension schemes.

11.4 Insurance policies

DBS	Total 2017 £000	Total 2016 £000
Aviva	116	99

These policies relate to deferred annuity contracts for former GT Smith Ltd employees.

Concentration of investments

The following investments represent greater than 5% of the net assets of the DB Section.

		2017		2016	
		Market value £000	**Net assets %**	**Market value £000**	**Net assets %**
Mercer	Alternatives fund	514,410	4.5	540,135	5.5
BlackRock	ICS-INS Sterling Liquidity Fund	1,146,502	10.1	-	-

12 Investment management expenses

In plain English – what does this show?	This note shows the investment management expenses incurred by the Scheme during the year.

DBS	Total 2017 £000	Total 2016 £000
Investment management fees	11,277	11,992
Custody fees	408	287
Performance measurement services	66	66
Property expenses	1,652	1,639
Other investment expenses	2	-
Other advisory fees	1,227	919
	14,632	**14,903**

Included within investment manager fees there is £2.1m (2016 £2.2m) relating to performance fees.

13 Taxation

The Scheme is a registered Pension Scheme under Chapter 2 of Part 4 of the Finance Act 2004 and is therefore exempt from income tax and capital gains tax. The tax charge in the Revenue Account represents irrecoverable withholding taxes arising on investment income.

14 Fair value determination

In plain English – what does this show?	This note categorises the investment assets and liabilities held by the Scheme into specific levels which correspond to how its market value has been determined. Market values can be determined from a number of sources including taking pricing information from market data i.e. a stock exchange, or using a valuation model not widely available.

The fair value of financial instruments has been estimated using the following fair value hierarchy:

- **Level 1:** The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.
- **Level 2:** Inputs other than quoted prices included within Level 1 that are observable (i.e. developed using market data) for the asset or liability, either directly or indirectly;
- **Level 3:** Inputs are unobservable (i.e. for which market data is unavailable for the asset or liability).

The scheme's investment assets and liabilities have been fair valued using the above hierarchy categories as follows:

At 5 April 2017	Held at cost not FV £000	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
DB Section					
Bonds	-	-	9,383,079	525,561	9,908,640
Equities	-	6	-	-	6
Pooled investment vehicles	-	-	869,325	546,463	1,415,788
Swaps	-	-	381,263	-	381,263
Futures	-	8,145	-	-	8,145
Foreign exchange	-	-	(13,873)	-	(13,873)
Properties	-	-	-	216,550	216,550
AVC investments	-	-	49,374	36	49,410
Insurance policies	-	-	-	116	116
Repurchase agreements	(2,145,916)	-	-	-	(2,145,916)
Cash deposits	-	67,803	1,390,424	-	1,458,227
Dividend entitlement	-	46,450	-	-	46,450
Sales awaiting settlement	-	7	-	-	7
Recoverable tax	-	1,428	-	-	1,428
Purchases awaiting settlement	-	(32,465)	-	-	(32,465)
	(2,145,916)	**91,374**	**12,059,592**	**1,288,726**	**11,293,776**
DC Section					
Pooled investment vehicles	-	-	236,000	-	236,000
Purchases awaiting settlement	-	(4,851)	-	-	(4,851)
TOTAL	**(2,145,916)**	**86,523**	**12,295,592**	**1,288,726**	**11,524,925**

At 5 April 2016	Held at cost not FV £000	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
DB Section					
Bonds	-	-	7,683,178	49,663	7,732,841
Equities	-	771,066	-	-	771,066
Pooled investment vehicles	-	15,313	1,185,489	583,587	1,784,389
Swaps	-	-	406,762	-	406,762
Foreign exchange	-	-	(987)	-	(987)
Properties	-	-	226,300	-	226,300
AVC investments	-	-	46,631	57	46,688
Insurance policies	-	-	-	99	99
Repurchase agreements	(1,585,301)	-	-	-	(1,585,301)
Cash deposits	-	55,070	298,149	-	353,219
Dividend entitlement	-	40,160	-	-	40,160
Sales awaiting settlement	-	128,241	-	-	128,241
Recoverable tax	-	1,242	-	-	1,242
Purchases awaiting settlement	-	(144,773)	-	-	(144,773)
	(1,585,301)	**866,319**	**9,845,522**	**633,406**	**9,759,946**
DC Section					
Pooled investment vehicles	-	-	136,122	-	136,122
Purchases awaiting settlement	-	(4,771)	-	-	(4,771)
TOTAL	**(1,585,301)**	**861,548**	**9,981,644**	**633,406**	**9,891,297**

15 Investment risk disclosures

In plain English – what does this note show?	This note provides additional information to enable readers to evaluate the nature and extent of credit, market and other risks arising from certain investment assets which the Scheme is exposed to. Information about how the Scheme manages these risks is also provided.

FRS 102 requires that we, the Trustee, provide information in relation to certain investment risks. The risks are set out by FRS 102 are:

Credit Risk: this is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation, e.g. the risk that a borrower may not repay a loan or a debt to the Scheme.

Market Risk: this includes “currency risk”, “interest rate risk”, “inflation risk” and “other price risk”.

- **Currency risk**: this is the risk that the value of an investment changes because of changes in foreign exchange rates.

- **Interest rate risk**: this is the risk that the value of an investment increases or decreases because of changes in interest rates.

- **Inflation risk**: this is the risk that the value of an investment increases or decreases because of changes in inflation expectations.

- **Other price risk**: this is the risk that the value of an investment decreases or increases because of changes in market prices (apart from changes in value as a result of movements in interest rates, inflation or currencies).

15.1 Defined Benefit Section

<u>Other Defined Benefit Risks:</u>

Apart from the risks listed above, we make sure the following investment related risks are managed:

- **"Solvency risk and mismatching risk"**: The risk that the Scheme does not generate strong enough investment returns, and cannot meet benefits

- "**Manager risk**": The risk that individual investment managers underperform their objectives

- "**Liquidity risk**": The risk that the Scheme does not hold enough cash to meet short term requirements to pay benefits

- "**Corporate governance risk"**: The risk that the Scheme invests in poorly managed companies, and that the value of those investments falls as a result

- "**Custody risk":** The risk that the Scheme's assets are not held safely

- "**Sponsor risk**": The risk that the Scheme's sponsor cannot afford to pay money into the Scheme if needed

- "**Leverage risk**": The risk that the Scheme's liability matching investments fall in value, and additional cash is required

- **"Hedging related risks"**: The risk that investments made by the Scheme to "match" its liabilities are not a good fit and do not behave in the same way as those liabilities.

15.1.1 Defined Benefit Investment Strategy

We make investment decisions after taking advice from a professional investment adviser. The Scheme is subject to the risks above because of the investments it makes to implement its strategy, as described on page 27 of this report. We manage investment risks, including credit risk and market risk, within agreed limits which are set taking into account the Scheme's investment objectives. These investment objectives and risk limits are applied through the legal agreements the Scheme has with its investment managers, and we regularly monitor that the managers are complying with these agreements.

A more detailed description of our approach to risk management and the Scheme's exposures to credit and market risks is set out below. This does not include annuity insurance policies or AVC investments, because these are relatively small compared to the overall investments of the Scheme.

15.1.2 Defined Benefit Investment Risk Management

The Trustee invests in two pooled investment vehicles where the Trustee has control over the investment mandates. The risks related with these pooled investment vehicles are considered as if the investments are held directly.

(i) Credit risk

The Scheme is subject to credit risk because it invests in bonds issued by UK and overseas companies (which could default on their debt to the Scheme), derivatives, undertakes stock lending activities, enters into repurchase agreements and because it holds cash in bank accounts and with investment managers. The Scheme also invests in pooled investment vehicles, such as open ended investment companies and unit linked insurance contracts, and is therefore directly exposed to credit risk in relation to these pooled investment vehicles. The Scheme is also indirectly exposed to credit risks arising on some of the financial instruments held by the pooled investment vehicles and from the tenants of directly held properties.

<u>Credit risk – UK government and investment grade bonds:</u>

Direct credit risk arising on bonds held directly by the Scheme are mitigated by investing in government bonds where the credit risk is minimal, or corporate bonds which are rated at least investment grade (i.e. where they are more secure). The risk is also reduced by requiring the appointed investment managers to invest in a range of bonds issued by different entities, which reduces the impact on the total portfolio if a bond issuer is unable to meet the payments due (see note 10).

<u>Credit risk – sub-investment grade bonds:</u>

The Scheme's investment managers are also allowed to invest in corporate bonds and similar investments which are not rated as investment grade. These investments are held at the investment managers' discretion and are subject to limits. BlackRock, Insight and 24AM are not permitted to purchase bonds which are sub-investment grade, however if a bond becomes sub-investment grade, Insight are allowed to hold up to 10% of Net Asset Value (NAV) exposure in sub investment grade bonds and BlackRock can hold up to 2%. Royal London Asset Management (RLAM) are allowed to invest in corporate bonds which are not rated as investment grade, at RLAM's discretion and subject to limits; if a bond is downgraded RLAM can continue to hold it, but at most 20% of the Scheme's investment with RLAM can be sub-investment grade.

<u>Credit risk - derivatives:</u>

Credit risk arising on derivative contracts, which are not guaranteed by any regulated exchange, are subject to risk of failure of the counterparty. The level of credit risk for derivative contracts is reduced by using collateral arrangements (see note 10.2 (i)). Credit risk can also arise on forward foreign currency contracts (see note 10.2 (iii)). There are no collateral arrangements for these contracts but, when used, all counterparties are required to be at least investment grade.

The Scheme's overseas bond holdings with LGIM, Insight and 24AM are also exposed to credit risk on the currency hedging derivatives held by the manager (and, in the case of LGIM, interest rate derivatives). These risks are mitigated by the managers using a range of counterparties, undertaking on-going monitoring of counterparty creditworthiness and requiring all counterparties to maintain minimum credit ratings.

The Mercer alternatives fund is also exposed to credit risk in relation to currency hedging contracts that are used to hedge the bulk of its overseas currency exposure. This credit risk is mitigated by renewing and settling the cumulative profit or loss on these contracts at least once every two months and by Mercer undertaking ongoing monitoring of counterparty creditworthiness and requiring the sole counterparty to maintain an investment grade credit rating.

Credit risk – cash:

Cash is currently held within financial institutions which are at least investment grade credit rated. Over the reporting year, some cash balances were held in a bank with a credit rating below investment grade. We have appointed a provider for banking services with an investment grade credit rating and the bulk of the cash balances were transferred to the new bank in August 2016. The cash balance at year end was £28.9 million (2016: £5.7 million).

Credit risk – stock lending:

Over the year, the Scheme lent certain equity securities under a Trustee-approved stock lending programme. We managed the credit risk arising from stock lending activities by restricting the amount of overall stock that could be lent, only lending to approved borrowers who are rated investment grade, limiting the amount that can be lent to any one borrower and putting in place collateral arrangements. At the year end, the Scheme had lent £nil (2016: £22.2 million) of UK quoted securities and £nil (2016: £34.7 million) of non-UK quoted securities.

Credit risk – repurchase agreements:

Credit risk on repurchase agreements is mitigated through collateral arrangements. At the year end, the Scheme held £149 million in collateral (2016: £50 million).

Credit risk – pooled investments:

The Scheme also invests in pooled investment vehicles ('PIVs'), pooled funds which invest in underlying assets like shares and bonds on behalf of a number of investors, and is therefore directly exposed to credit risk for these investments (as the PIVs could default on their obligations to the Scheme). A summary of pooled investment vehicles by type of arrangement can be found in note 10.1.

The Scheme's investments in PIVs and bonds are rated investment grade or are unrated. Direct credit risk arising from bonds and PIVs are reduced because:

- the underlying investments held by the pooled funds are legally ring-fenced from the investment manager(s);
- the investment managers that operate the PIVs need to meet the requirements of various financial regulations; and,
- We invest in a number of different PIVs, spreading risk.

Credit risk – custody:

We have appointed a global custodian for the safe-keeping of assets. The risk that the custody of the Scheme's assets is not secure is addressed by monitoring the custodian's activities and creditworthiness. In addition, cash balances held by the custodian are transferred to a ring-fenced fund each night to reduce the risk of losses occurring should the custodian become un-creditworthy overnight.

Indirect credit risk:

Indirect credit risk arises in relation to underlying investments held in the bond and alternatives pooled investment vehicles as well as property pooled investment vehicles. For example, if the Scheme invested in a pooled investment which itself invests in bonds issued by a company, there is a risk that that company does not repay the bond to the pooled fund. We manage this risk by making sure that our investment managers diversify their investments over a number of companies and investments, to minimise the impact of a default on any individual investment.

Indirect credit risk arises from the tenants of directly held properties (see note 9). We do not consider that this risk is material due to the underlying value of the direct properties and letting terms in place with tenants, however, this credit risk is mitigated by the relevant investment managers monitoring tenant credit worthiness and by diversification of type of tenant by location and industry.

(ii) Currency risk

The Scheme is subject to currency risk because the Scheme invests in overseas investments either as segregated investments or through pooled funds.

To reduce the risk that the value of these overseas investments falls in sterling terms, we operate a policy of hedging a portion of non-Sterling currency exposure as appropriate, and where we judge this risk to be material. The management of currency risk is delegated to the appointed managers and is managed within each manager's overall risk framework.

The Scheme's total net unhedged exposure by major currency at the year-end was as follows:

Currency	**2017 £'000**	**2016 £'000**
US Dollar	117,402	294,012
Euro	105,684	303,556
Japanese Yen	32,357	49,299
Other	130,110	197,088
Net overseas exposure	**385,553**	**843,955**

Total unhedged overseas currency exposure has fallen over the year as a result of the reduction in equity exposure; the Scheme's exposure through equity futures is hedged back to sterling.

(iii) Interest rate and inflation risk

The Scheme is subject to interest rate and inflation risk on its investments in bonds and financial derivatives, and also through its liabilities. The liability driven investments it makes are intended to protect the Scheme against the impact of changes in interest rates and inflation on the Scheme's liabilities.

The Scheme currently manages these risks through investments in a segregated LDI portfolio managed by BlackRock and long-dated corporate bond portfolios managed by Insight and RLAM. These portfolios hold gilts, corporate bonds, derivatives and cash collateral. We monitor the level of assets available within the BlackRock LDI portfolio for use as collateral and operate a framework to ensure that if gilt yields rise, then additional cash can be provided in a timely manner, should it be required.

We have set a benchmark for total investment in LDI and corporate bonds of 78% of the total investment portfolio. Under this strategy, if interest rates fall, the value of LDI and bond investments will rise to help match the increase in actuarial liabilities arising from a fall in discount rate. Similarly, if interest rates rise, the LDI and bond investments will fall in value, as will the actuarial liabilities because of an increase in the discount rate. These assets would be expected to change in value by £21.9 million for a change in interest rates of 0.01% (2016: £17.2 million). The Scheme's liabilities would change by approximately £31.5 million for a change in interest rates of 0.01% (2016: £26.8 million); these long-term liabilities in respect of benefits due to members are not included in the Report and Accounts but are assessed at least every three years by the Scheme Actuary.

The LDI portfolio is also exposed to inflation risk. If inflation expectations increase, the value of these assets will rise to help match the increase in actuarial liabilities arising from the rise. Similarly, if inflation expectations fall, the LDI portfolio will fall in value, as will the actuarial liabilities. These assets would be expected to change in value by £13.7 million for a change in expected inflation of 0.01% (2016: £10.4 million). The Scheme's liabilities would change by approximately £18.7 million for a change in expected inflation of 0.01% (2016: £17.8 million). Again, these liabilities are not included in the statements set out in the Scheme's Report and Accounts.

At the year end the LDI portfolio and bonds represented 80.1% of the total investment portfolio (2016: 75.4%).

(iv) Other price risk

The Scheme is also exposed to "other price risk", largely because of its investments in return seeking assets (which included over the year investments in equities, equities held in pooled vehicles, equity derivatives, investment properties and alternative investments held in a pooled vehicle). Alternative investments include such asset classes as hedge funds, private equity and insurance linked assets.

The Scheme manages this exposure to other price risk by constructing a diverse portfolio of investments across various markets. This Scheme's target asset allocation to growth investments is updated regularly to ensure the overall target return for the Scheme remains in line with our objective at approximately 1.2% p.a. above gilts. The long-term target for equity and property investments at year end was 12% of Scheme assets.

At the year end, the Scheme's exposure to investments subject to other price risk was 19.9%, covering equities, alternative assets, property and the Scheme's equity exposure through equity derivatives (2016: 24.6%).

(v) Other Defined Benefit risks

Other Defined Benefit investment risks are managed as outlined below:

- **Solvency risk and mismatching risk** – this is managed by setting appropriate investment objectives as part of our actuarial valuation every three years. Mismatching risk is also partly addressed through investing in liability matching assets.

- **Manager risk** – this is managed by spreading the Scheme's assets over a range of managers, and through regularly monitoring these managers.

- **Liquidity risk** - the Co-op Pensions Department estimates the cash needed each month to meet benefit payments, and ensures that sufficient cash is available, seeking advice where necessary.

- **Corporate governance risk - t**his is managed through setting controls to limit concentration of investments in individual companies, and through regular discussions with and reporting on investment managers' approach to sustainability risks.

- **Custody risk** – this is managed by the safe custody of the assets being delegated to professional custodians either directly or via the use of pooled funds, with each manager appointing a custodian and being responsible for monitoring the custodian's activities.

- **Sponsor risk –** this is managed by regular assessments of the ability and willingness of the Co-op to support the Scheme.

- **Leverage risk –** this is managed by regular reviews of the amount and nature of any leveraged investments made by the Scheme's investment managers.

- **Hedging related risk** - the management of these risks is delegated to the Scheme's liability driven investment manager; we also review liability hedging risks each quarter as part of monitoring the manager.

15.2 Defined Contribution Section

<u>Other Defined Contribution Risks:</u>

As well as considering the risks that apply to the underlying funds, summarised in Section 14 above, we consider the following investment related risks:

- Purchasing power risk
- Conversion risk
- Manager risk
- Lack of diversification risk

15.2.1 Defined Contribution investment strategy

Our objective is to make available to members of the Scheme, an appropriate range of investment options designed to generate income and capital growth, which together with contributions from members and their employer, will provide a retirement amount which the member can use for the provision of retirement income; either by taking their defined contribution account as cash, using it to purchase a pension annuity (or other type of retirement product) or transferring it out of the Scheme to provide alternative retirement benefits.

We have an insurance policy with Legal & General. The value of the policy is linked to the value of the underlying assets or pooled funds in which we choose to invest. The day to day management of the underlying investments of the funds is the responsibility of Legal & General, including the direct management of credit and market risks.

We have determined the defined contribution investment strategy, after taking professional investment advice and following consultation with the Sponsor. We provided three Target investment options for members which are designed to be an appropriate match for the different retirement options a member can take.

The default option is Target: Lump Sum, which has been selected as appropriate for members who want to take their account as a one-off cash sum on retirement. As a member approaches retirement, the funds are steadily moved into lower risk funds. These funds may not grow so quickly but are less likely to have large falls in value in the short term.

The other options available to members are Target: Secure Income and Target: Flexible Income.

Target: Secure Income is designed to be an appropriate match for members who want to use their account to buy a pension (annuity) at retirement.

Target: Flexible Income is designed to be an appropriate match for members who want to leave their account invested after retirement, taking sums of money from it (drawdown) over time. Drawdown is not currently offered through the Scheme so members will need to transfer their account to another arrangement at retirement to take advantage of it.

Although the Target funds have been designed to be a good match for the different retirement options a member can take, they do not guarantee a particular outcome at retirement. Members are advised to consider taking independent financial advice if they are unsure as to what investment fund is right for them.

Members who would rather make their own investment decisions can select the following range of funds:

- Pace Growth (Shares) Fund
- Pace Growth (Ethical Shares) Fund
- Pace Growth (Mixed) Fund
- Pace Pre-retirement (Inflation-linked) Fund
- Pace Pre-retirement Fund
- Pace Cash Fund

The three Target options invest in the following Funds over a member's working life:

- Target: Lump Sum - Pace Growth (Shares) Fund and Pace Cash Fund
- Target: Secure Income - Pace Growth (Shares) Fund, Pace Pre-retirement Fund and Pace Cash Fund
- Target: Flexible Income: Pace Growth (Shares) Fund and Pace Cash Fund

15.2.2 Defined Contribution Investment Risk Management

Member level exposure to the risks outlined in Section 14 will be dependent on the funds invested in by members. The funds which have significant exposure to these risks are set out below:

	Credit risk	Interest rate risk	Inflation risk	Currency risk	Other price risk
Pace Growth (Shares) Fund	YES	-	-	YES	YES
Pace Growth (Ethical shares) Fund	YES	-	-	YES	YES
Pace Growth (Mixed) Fund	YES	YES	YES	YES	YES
Pace Pre-retirement (inflation-linked) Fund	YES	YES	YES	-	YES
Pace Pre-retirement Fund	YES	YES	-	-	-
Pace Cash Fund	YES	YES	-	-	-

(i) Credit risk

Credit risk – Insurer:
The Defined Contribution Section (DC Section) is subject to direct credit risk in relation to the Scheme's holding in unit-linked funds provided by Legal & General. Legal & General is regulated by the Financial Conduct Authority and they maintain separate funds for policyholders. We monitor the creditworthiness of Legal & General by reviewing published credit ratings. Legal & General invests all the Scheme's funds in its own investment funds, reinsured to Legal & General Assurance (Pension Management) Ltd funds, and it does not use other externally managed investment funds or reinsurance arrangements.

Credit risk – cash:
Cash is currently held within financial institutions which are at least investment grade credit rated. Over the reporting year, cash balances were held in a bank with an investment grade credit rating. The cash balance at year end was £1.9 million (2016: £2.8 million).

Indirect credit risk:
The DC Section is also subject to indirect credit arising from the underlying investments held in the funds. Indirect credit risk is mitigated by the spread of assets held in the funds, which provides diversification. Within the Pre-retirement Funds, indirect credit risk is also mitigated by the funds only holding government bonds or investment grade corporate bonds. The Cash Fund invests in short-term money markets such as bank deposits or Treasury Bills. All investments are held with institutions with investment grade credit ratings.

In addition, the DC Section is subject to indirect credit risk arising from the custodians appointed by the fund provider for the safe-keeping of assets. The selection and assessment of the ongoing appropriateness of the custodians is delegated to the fund provider and the indirect credit risk is addressed through the fund provider's monitoring of the custodian's activities and creditworthiness.

(ii) Indirect Currency risk

The DC Section is subject to currency risk because some of the funds invest in investments denominated in overseas currencies. The Growth (Shares) Fund mitigates this risk by currency hedging 75% of the overseas assets (excluding emerging markets) to Sterling. The Growth (Ethical Shares) Fund mitigates this risk by currency hedging all overseas assets to Sterling. The Growth (Mixed) Fund mitigates currency risk through the overall risk framework of the Fund.

(iii) Indirect Interest rate risk

The Pre-retirement Fund and Pre-retirement (inflation-linked) Funds are subject to indirect interest rate risk. This risk is mitigated through the construction of the Funds, which are designed to change in value when interest rates change in a similar way to how the price of buying a retirement income changes.

The Cash Fund is also subject to indirect interest rate risk. The Fund aims to provide capital protection with growth at short term interest rates. The value of the assets would only fall should the interest earned by the Fund's assets be insufficient to cover the Fund management charge and any additional Fund expenses.

(iv) Indirect Inflation risk

The Pre-retirement (inflation-linked) and Growth (Mixed) Funds are subject to indirect inflation risk as they invest in assets that are affected by changes in inflation expectations.

This inflation risk associated with the Pre-retirement (inflation-linked) Fund is mitigated through the construction of the Fund, which is designed to change in value when inflation expectations change in a similar way to how the price of buying an inflation-linked retirement income changes. For example, if inflation expectations increase, the value of the Fund will rise in a similar, but not exact, amount to the cost of buying an inflation-linked retirement income. Similarly, if inflation expectations fall, the value of the Fund will fall in value in a similar, but not exact, amount as the cost of buying an inflation-linked retirement income.

The inflation risk of the Growth (Mixed) Fund is considered by the Fund provider as part of the overall risk and return framework in place.

(v) Other price risk

Other price risk arises principally in relation to the Growth Funds and the Pre-retirement Fund. Other price risk in these Funds is mitigated through the diversification of assets within the Funds

(vi) Other Defined Contribution investment risks

- **Purchasing power risk** - The purchasing power risk to members is that the investment return over members' working lives does not keep pace with inflation and does not therefore secure an adequate retirement income. This risk is mitigated through the design of the Target Funds, which aim to provide sufficient investment returns over a member's working life. In addition, we have made available three Growth Funds, should members wish to select their own investment options.

- **Conversion risk** - the risk that relative market movements in the years just prior to retirement lead to substantial reduction in the retirement income and cash lump sum secured. This risk is mitigated through the design of the three Target Funds, which aim to protect members from relative market movements in the years just prior to retirement. In addition, we have made available two Pre-retirement Funds and a Cash Fund, should members wish to select their own investment options.

- **Manager risk** - the risk that the chosen investment manager underperforms the benchmark against which the investment manager is assessed. This risk is mitigated through the regular review of investment performance by us.

- **Lack of diversification risk** – we recognise the risks that may arise from a lack of diversification within the investments. We therefore invest in pooled fund vehicles, to ensure an adequately diversified portfolio for each fund option.

16 Current assets

In plain English – what does this show?	This note shows the value of current assets held by the Scheme at the year end.

	DBS 2017 £000	DCS 2017 £000	Total 2017 £000
Contributions due:*			
Employer's normal contributions	-	4,608	4,608
Employer's deficit contributions	2,314	-	2,314
Employer's expense allowance contributions	-	150	150
Members' normal contributions	-	192	192
Members' AVCs	-	51	51
Cash balances	28,891	1,926	30,817
Other debtors	1,127	219	1,346
	32,332	**7,146**	**39,478**

	2016 £000	2016 £000	2016 £000
Contributions due:*			
Employer's normal contributions	-	4,533	4,533
Employer's deficit contributions	2,316	-	2,316
Employer's expense allowance contributions	-	150	150
Members' normal contributions	-	52	52
Members' AVCs	-	186	186
Cash balances	5,672	2,825	8,497
Other debtors	447	-	447
	8,435	**7,746**	**16,181**

*Contributions due at year-end were all received subsequent to the year-end on a timely basis, in accordance with the schedule of contributions.

17 Current liabilities

In plain English – what does this show?	This note shows the value of current liabilities owed by the Scheme at the year end.

	DBS 2017 £000	DCS 2017 £000	Total 2017 £000
Unpaid benefits	(8,370)	(310)	(8,680)
Tax due	(2,034)	-	(2,034)
Investment management expenses due	(2,956)	-	(2,956)
Other creditors	(6,830)	(794)	(7,624)
VAT creditor	(121)	-	(121)
	(20,311)	**(1,104)**	**(21,415)**

	2016 £000	2016 £000	2016 £000
Unpaid benefits	(9,390)	(260)	(9,650)
Tax due	(1,973)	-	(1,973)
Investment management expenses due	(3,972)	-	(3,972)
Other creditors	(6,669)	(97)	(6,766)
VAT creditor	(1,640)	-	(1,640)
	(23,644)	**(357)**	**(24,001)**

18 Related party transactions

In plain English – what does this show?	Related parties include people (such as directors and key personnel) as well as entities. This note outlines the nature of the relationship of any related parties.

Apart from the payment of contributions to the Scheme by businesses within the Co-op, The Co-operative Bank PLC, CIS Ltd and other participating employers, other related party transactions are:

- One of the Scheme bankers is The Co-operative Bank PLC, which was partly owned by the Co-op.
- The DB Administrator is the Co-op.
- Pensioner Member Elected Trustee Directors receive pensions from the Scheme under normal terms and conditions and are paid £5,000 per annum from the Scheme.
- Member Nominated Trustee Directors are paid £2,000 per annum in respect of attendance at the quarterly Trustee meetings. Attendance at additional sub-

committee meetings is remunerated based on the work load of each committee. MNDs may opt out of receiving this remuneration.

- Independent Trustee Directors receive remuneration from the Scheme based on rates negotiated with the Co-op, as the principal employer of the Scheme.
- The total of all Trustee Director remuneration paid from the Scheme during the year was £160,021.

19 Securities lending

In plain English – what does this show?	This note shows the value of securities out on loan at the year-end.

The Scheme lends certain bonds and equity securities under a securities lending programme managed by the global custodian, Bank of New York Mellon, in return for fee income. At the year-end, the securities on loan are included in the financial statements at market value to reflect the Scheme's ongoing economic interest in such securities. Security for the loans is obtained by holding collateral in the form of securities and short-term financial instruments. Collateral received on securities loans is excluded from the financial statements, but is reported below.

	2017 £000	**2016** £000
Value of securities on loan at year-end - Equities	-	56,876
Value of collateral held at year-end	-	63,640

20 Employer related investments

In plain English – what does this show?	Employer related investments include securities issued by the employer, loans to the employer and any investment property occupied by the employer. They also include investments made indirectly through pooled investment vehicles.

During the year, there were no direct or indirect employer related investments.

21 Post Balance Sheet Events

In plain English – what does this show?	Significant events which occured between the reporting date and the date the report and accounts are formally signed by the Trustee.

Bank Separation

Following the successful recapitalisation of the Bank on 1 September 2017, the Pensions Regulator has provided clearance to sectionalise Pace into two ring fenced sections, to separate the pension obligations of the Co-op and the Bank. Further details are provided for on page 20.

Investment activity

Since the year end, the Trustee has continued to implement Pace Complete's revised investment strategy. We have continued to sell down our holdings in UK property and in Alternative Assets and to reduce our investments in shares, at the same time increasing the Scheme's investments in corporate bonds and illiquid credit (in particular, funding two new corporate bond mandates managed by Insight and LGIM in April and June respectively, and starting to fund illiquid credit investments with Insight and ICG later in the year). The inflation-linked property mandate which we set up in January 2017 has continued to grow as the investment manager purchases properties, with a number of deals agreed after the year end.

We also implemented a significant de-risking exercise in September 2017, and more detail is given below.

Sale of equity investments

As part of the sale of equity investments, detailed on page 20, the following investment activity has taken place post year-end.

- An instruction was sent to BlackRock on 4 September 2017 to close out its equity futures positions across various markets as soon as practicably possible, which was completed by close of business on 5 September 2017. The fair value of these holdings at year-end was £8.1m for a base notional exposure of £1,024.3m (at the time of closure, base notional exposure had been reduced to £731.0m as instructed to BlackRock by the Trustee). £961m of cash and money market funds was transferred from the BlackRock transition account to the Scheme's LDI portfolio in two tranches, on 20 and 22 September 2017. A residual balance of c. £7m remains in the transition account to cover margin balances at various futures clearing accounts.
- Equity holdings managed by LGIM were disinvested fully on 7 September 2017 with the proceeds of £429.7m settling in the BlackRock LDI portfolio on 11 September 2017. The fair value of these holdings at the year-end was £410.6m.

Independent Auditor's Statement about Contributions to the Trustee of the Co-operative Pension Scheme (Pace)

We have examined the summary of contributions for The Co-operative Pension Scheme (Pace) for the year ended 5 April 2017 to which this statement is attached.

This statement is made solely to the Trustee, as a body, in accordance with regulation 4 of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 made under the Pensions Act 1995. Our work has been undertaken so that we might state to the Trustee those matters we are required to state to it in an auditor’s statement about contributions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Trustee as a body for our work, for this statement, or for the opinion we have formed.

Respective Responsibilities of Trustee Directors and Auditor

As explained more fully in the Statement of Trustee Director’s Responsibilities, the Scheme’s Trustee is responsible for ensuring that there is prepared, maintained and from time to time revised a schedule of contributions showing the rates and due dates of certain contributions payable towards the Scheme by or on behalf of the employer and the active members of the Scheme. The Trustee is also responsible for keeping records in respect of contributions received in respect of active members of the Scheme and for monitoring whether contributions are made to the Scheme by the employer in accordance with the schedule of contributions.

It is our responsibility to provide a Statement about Contributions paid under the schedule of contributions and payment schedule and to report our opinion to you.

Scope of work on Statement about Contributions

Our examination involves obtaining evidence sufficient to give reasonable assurance that contributions reported in the attached summary of contributions have in all material respects been paid at least in accordance with the schedule of contributions. This includes an examination, on a test basis, of evidence relevant to the amounts of contributions payable to the Scheme and the timing of those payments under the schedule of contributions and payment schedule.

Statement about Contributions payable under the schedule of contributions and payment schedule

In our opinion contributions for the Scheme year ended 5 April 2017 as reported in the summary of contributions and payable under the schedule of contributions have in all material respects been paid at least in accordance with the schedule certified by the Scheme actuary on 4 July 2014 and the payment schedule signed on 28 September 2015.

Deloitte LLP

Deloitte LLP
Statutory Auditor

Manchester, United Kingdom

Date: 3 November 2017

Statement of Trustee Directors' Responsibilities in respect of Contributions

The Trustee is responsible under pension legislation for ensuring that there is prepared, maintained and from time to time revised a Schedule of Contributions showing the rates of contributions payable towards the Scheme by or on behalf of the Employer and the active members of the Scheme and the dates on or before which such contributions are to be paid.

The Trustee is also responsible for keeping records in respect of contributions received in respect of any active member of the Scheme and for monitoring whether contributions are made to the Scheme by the Employer in accordance with the Schedule of Contributions. Where breaches of the Schedule occur, the Trustee is required by the Pensions Acts 1995 and 2004 to consider making reports to The Pensions Regulator and the members.

Trustee Directors' Summary of Contributions payable and reported on in the Auditor's statement in respect of the Scheme year ended 5 April 2017

This Summary of Contributions has been prepared by, or on behalf of, and is the responsibility of the Trustee Directors. It sets out the employer and employee contributions payable to the Scheme under the schedule of contributions certified by the Actuary on 4 July 2014 and the payment schedule signed on 28 September 2015. The Scheme Auditor reports on these contributions payable in the Auditor's Statement about Contributions.

Contributions payable under the schedule of contributions and payment schedule in respect of the scheme year

Contributions payable under the schedule in respect of the Scheme year			
	DBS	**DCS**	**TOTAL**
	£'000	**£'000**	**£'000**
Employer:			
Normal contributions	-	72,688	72,688
Deficit contributions	24,980	-	24,980
Expense allowance contributions	-	1,950	1,950
Employee:			
Normal contributions	-	2,506	2,506
Contributions payable under the schedule (as reported on by the fund auditor)	**24,980**	**77,144**	**102,124**

Reconciliation of contributions payable under schedule of contributions to total contributions reported in the financial statements			
Contributions payable under the schedule (as above)	**24,980**	**77,144**	**102,124**
Contributions payable in addition to those due under the schedule (and not reported on by the Scheme Auditor):			
Deficit contributions	2,800	-	2,800
Additional voluntary contributions	-	2,820	2,820
Total contributions reported in the financial statements	**27,780**	**79,964**	**107,744**

Signed for and on behalf of the Scheme's Trustee Directors on 3 November 2017.

Harry Baines
Chair

Sarah Horan
Secretary

Actuary's Certification of Schedule of Contributions

MERCER

CERTIFICATION OF SCHEDULE OF CONTRIBUTIONS

Name of Scheme	The Co-operative Pension Scheme (Pace)

Adequacy of rates of contributions

1. I certify that, in my opinion, the rates of contributions shown in this schedule of contributions are such that the statutory funding objective can be expected to be met by the end of the period specified in the recovery plan dated 4 July 2014.

Adherence to statement of funding principles

2. I hereby certify that, in my opinion, this schedule of contributions is consistent with the statement of funding principles dated 4 July 2014.

The certification of the adequacy of the rates of contributions for the purpose of securing that the statutory funding objective can be expected to be met is not a certification of their adequacy for the purpose of securing the Scheme's liabilities by the purchase of annuities, if the Scheme were to be wound up.

Signature	
Scheme Actuary	Neil Brougham
Qualification	Fellow of the Institute and Faculty of Actuaries
Date of signing	
Name of employer	Mercer Limited
Address	Belvedere 12 Booth St Manchester M2 4AW

Corporate Governance

Pace has a Responsible Investment Policy, and the Responsible Investment Policy and Practice Statement can be found at https://pensions.coop.co.uk/documents/investment-documents. The policy and practice statement sets out the Scheme's Responsible Investment policy and practice and the Scheme's approach to the incorporation of environmental, social and governance factors into investment decision-making.

Where the Scheme invested directly in equity, we retained the overall responsibility for exercising voting rights but has instructed each investment manager to exercise, on its behalf, all voting rights attached to the investments in the best interests of the Scheme beneficiaries, and to engage with the companies in which they invest, taking into account where possible any social, environmental and ethical factors that are considered appropriate. Arrangements were in place to ensure that should we wish to cast a vote it may do so via circular. As at the year end, the Scheme no longer held direct equity investments.

Where the Scheme invests in equity through indirect holdings, we do not have responsibility for exercising voting rights; however, these investment managers operate their own corporate governance policies.

Summaries of the corporate governance policy of each relevant equity investment manager for the year to 5 April 2017 are shown below.

Legal & General Investment Management ("LGIM")

LGIM global equity investments are held indirectly by Pace DB and DC sections.

LGIM aims to maximise and protect shareholder value on behalf of clients by exercising its voting rights. The manager also engages with companies both directly and collaboratively with other investors to reduce risks of corporate failure and promote best practices. LGIM complies with the principles set out in the UK Stewardship Code and is a signatory to the UN Principles of Responsible Investment (PRI).

In order to demonstrate key governance issues, voting statistics are divided up into main voting categories. LGIM engages on a range of Environmental, Social, Governance (ESG) and Financial issues and integrates all components where appropriate.

LGIM votes in all major developed and emerging markets including. It informs companies of voting decisions which helps lead to further engagement.

Cantillon Capital Management to December 2016

Over the year, Cantillon invested directly in global equities for Pace DB.

Cantillon believes it should be aware of major issues impacting the corporate structure and governance of its holdings. For example, excessive compensation schemes, change of auditors, and aggressive acquisitions are all topics that need to be monitored carefully.

Cantillon analysts review all proxies for companies in the portfolio, and also use ISS/Risk Metrics to co-ordinate its proxy voting. ISS provides commentary and analysis on the proposals at shareholder meetings, using a shareholder value maximization philosophy (i.e. they recommend the votes that are most likely to create value for equity holders in the long-term). Cantillon analysts may decline to accept the ISS recommendation if they believe it to be at odds with their view on how the proxy should be voted.

Cantillon aims to vote in all cases. Occasionally, it may abstain from voting in share blocking markets so that it is not prevented from selling the stock during the voting period. Cantillon does not recall stock for voting if the stock is on loan, as part of a client's lending programme. Cantillon discloses its voting records directly to clients.

Comgest Asset Management International to December 2016

Over the year, Comgest invested directly in emerging market equities for Pace DB.

As an investment manager, Comgest has the responsibility to act in the best long-term interests of its clients. As a signatory to the UN Principles for Responsible Investment Comgest believes that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios.

Comgest has a Controversial Weapons policy to exclude companies involved in anti-personnel landmines and cluster weapons.

In 2011, Comgest launched a programme to integrate ESG criteria systematically and simultaneously within its investment process. Comgest has adopted a risk / opportunity ESG integration approach. Comgest has a team of 2 ESG analysts conducting ESG research in collaboration with all investment teams.

The following ESG data providers are used to support Comgest's ESG integration: MSCI ESG Research, Sustainalytics, Solaron, BoardEx, RepRisk, and Trucost.

The ESG analysis methodology is applied in a systematic and pragmatic manner. Priority is given to the most material ESG factors, i.e. ESG risks / opportunities that are most likely to have a negative / positive impact on a company's reputation and valuation. These factors differ according to the sector and context. Comgest check if investments are made by the company on long-term aspects to ensure the sustainability of the business and also carefully monitor weak signals (controversies) to anticipate any future negative impact.

The most significant ESG issues are addressed through dialogue with companies. Examples of dialogue / engagement activity are available in Comgest's quarterly Responsible Investment reports.

The results of the ESG analysis are compiled in ESG reports on each company and are discussed at research meetings. ESG reports, together with all of the ESG research, are classified on the Comgest research platform and are at the disposal of all analysts and portfolio managers in a similar manner to traditional financial analysis reports.

As an active investor and a member of the UN PRI, Comgest's objective is to vote systematically at all shareholder meetings held by all companies it invests in when this is technically possible and deemed to be in the interest of the shareholders. As a responsible investor, Comgest has chosen to vote in accordance with responsible investment principles. A summary of the manager's voting activity is available in its quarterly Responsible Investment reports.

In 2014, Comgest made the decision to design and implement its own voting policy, based on their convictions and beliefs about what good corporate governance should be. This set of principles and rules is the result of the manager's experience gained over the last 25 years. The ESG factors are taken into account in Comgest's votes, when appropriate, and it incorporates the active ownership and investment philosophies of leading globally recognized initiatives such as the United Nations Environment Programme Finance Initiative, the UNPRI or national best practices like the UK Stewardship Code.

Comgest's Responsible Investment policy is publicly available on www.comgest.com.

Marathon Asset Management to December 2016

Over the year, Marathon European equity investments was held indirectly by Pace DB.

Within the spectrum of ESG, Marathon's focus is on governance issues, to the extent that all members of the investment team pay particular attention to corporate governance issues through the detailed analysis of company management. The investment team carries out in the region of 1,700 company meetings per annum, including conferences. The aim of these company meetings is to make an assessment of the business model and corporate strategy, management competence and incentives as well as the company valuation. However, the sole criteria for investment is shareholder value and the investment approach is aimed at finding companies that are able to generate returns over the longer term. Social and environmental considerations play a limited role Marathon's decision making process.

Matthews Capital International ("Matthews Asia") to December 2016

Mathews Asia invests directly in Asian equities for Pace DB.

Matthews Asia generally supports the objectives that underlie the UK Stewardship Code but has not yet determined whether to publish a statement regarding compliance with the Code.

As long-term investors in businesses, Matthews Asia historically has incorporated factors commonly included under "ESG factors" into the fundamental, bottom-up research process, including a focus on the sustainability of business models and the governance structure of companies considered for portfolios. Matthews Asia evaluates the "survivability" and "sustainability" of the companies in which they invest. Fundamental research emphasizes the quality of company management and governance, including management's integrity, corporate governance culture, alignment with minority shareholders, business strategy, and ability to adapt to change and to handle risk appropriately.

Matthews Asia are mindful that changing demographics, rising incomes, and wealth creation across Asia are leading to greater emphasis by Asia's citizens on social and environmental issues including a clean environment, food safety, gender-inclusive employment markets, equitable incomes and distribution of wealth, and access to health care. They are also mindful that ESG standards in Asia may look and sound different than those in the West. Accordingly, they are careful not to apply a 'one size fits all' approach to evaluating companies on ESG criteria.

Matthews Asia believes that payment of dividends are an important signal of corporate governance when investing in the Asian region.

Meetings with company management are a mandatory part of the investment process. They practice ongoing engagement with management of current holdings to address issues that they believe are relevant to our long-term investments.

Matthews Asia uses research and proxy-related services provided by ISS, and has adopted a Proxy Voting Policy and Procedures as a guide in voting its proxies

Royal London Asset Management Ltd (“RLAM”) (to December 2016)

Over the year, RLAM invested directly in UK equities for Pace DB.

RLAM is dedicated to encouraging long-term wealth creation within the companies in which it invests for the benefit of shareholders, bondholders and the company. Corporate governance is of central importance in creating and protecting shareholder value, and plays a pivotal role in ensuring companies are in good standing with their stakeholders. RLAM believes it is the responsibility of institutional investors to act as owners of the companies in which they invest and to seek to maximise value from their investments by using their influence as a shareholder. RLAM does this through engagement and the use of voting rights to promote good corporate governance in investee companies. RLAM regards voting in a responsible, informed and consistent manner to be a fiduciary duty of institutional investors.

In developing and applying its engagement and voting policy and guidelines, RLAM will take account of the provisions of the UK Corporate Governance Code and of institutional guidelines, such as those of the Investment Association (IA). In reflecting this policy, RLAM will apply discretion and have due regard for the particular circumstances of an investee company, whilst vigorously pursuing the interests of its customers and clients. RLAM recognises that best practice can develop ahead of code provisions.

RLAM publicly discloses its voting record, covering all votes available to it on the accounts it manages. RLAM subscribes to Manifest research and the IVIS voting service provided by the IA to help in this process. This provides information around company meetings, and highlights items of particular interest or where there could potentially be an exception to generally agreed principles affecting RLAM’s shareholder rights. Although it purchases external research, it makes all of its voting decisions in-house and does not rely on the voting recommendations of third parties. Its voting record can be found at the following link: http://www.rlam-voting.co.uk/voting/.

BNY Mellon

At BNY Mellon, responsible investing is integral to market integrity. BNY seek to provide substantive programs to support clients' Environmental, Social and Governance (ESG) needs. BNY Mellon has recently been recognized as a leader in sustainability and climate change responsibility by two highly regarded indices. As one of the world’s leading financial services companies, BNY can leverage their market leadership and investment expertise to act as a catalyst for positive change. BNY provide employees and clients with the guidance, skills and tools to anticipate and mitigate risk, enabling them to make profitable decisions for the long term. A foundation of strong governance complements an evolving suite of policies, training and technologies that support consistent performance and high ethical standards in all market conditions.

Appendix 1: Statement of Investment Principles – December 2016

1. Introduction

Pace Trustees Limited ("the Trustee") has drawn up this Statement of Investment Principles ("the Statement") to comply with the requirements of the Pensions Act 1995 ("the Act") and subsequent legislation. The Statement seeks to take into account the principles underlying the (Myners) Code of Best Practice for pension scheme investment, which has been endorsed by the Government and the Pensions and Lifetime Savings Association. The Statement also seeks to take into account the Investment Governance Group ('IGG') principles for defined benefit and defined contribution schemes.

The Statement is intended to affirm the investment principles that govern decisions about Pace's investments.

Pace provides two types of benefit: a defined benefit ("Pace Complete" Section) and a defined contribution arrangement (the "Defined Contribution" Section). These are covered separately in Sections 2 and 3 respectively.

In October 2015 the defined benefit section of Pace closed to new entrants. Following the closure, all contributing members joined the defined contribution arrangement.

The Trustee has consulted Co-operative Group Limited ("the Group") acting on behalf of all Participating Employers. The Trustee will consult the Group before revising this document. However, the ultimate power and responsibility for deciding investment policy lies solely with the Trustee.

The investment responsibilities of the Trustee are governed by the Scheme Rules (which are available on the Pace website) and relevant legislation.

The Trustee recognises the specialist technical nature of investment management and has established an Investment Committee. The Investment Committee is provided with formal terms of reference approved by the Trustee, to provide a greater focus and appropriate level of expertise to assist and advise on investment matters to Pace Complete. Pace Complete is represented on the Investment Committee by at least five Trustee Directors (including the three Independent Trustee Directors) along with other suitably experienced individuals. Pace Complete's Investment Adviser attends each Investment Committee meeting.

2. Pace Complete Section

2.1 Process for Choosing Investments

The process for choosing investments is as follows:

- Identify appropriate investment objectives, covering both risk tolerance and target return

- Construct a portfolio of investments that is expected to meet the investment objectives

In considering the appropriate investments for Pace Complete, the Trustee has obtained and considered the written advice of the Investment Adviser, whom the Trustee believes to be suitably qualified to provide such advice. Where matters described in this Statement may affect the Scheme's funding policy, input has also been obtained from the Scheme Actuary. The advice received and arrangements implemented are, in the Trustee's opinion, consistent with the requirements of Section 36 of the Pensions Act 1995 (as amended).

2.2 Investment Objectives

The Trustee has a duty to invest the defined benefit assets of Pace in a manner which, over the life of Pace Complete, will enable the Trustee to provide the promised benefits under the rules.

The Trustee has agreed to implement an investment strategy that initially targets an expected return of around 1.2% p.a. (net of fees) above gilts representing Pace Complete's liabilities. This investment return target was chosen taking into account the associated level of risk.

The primary goal of the Trustee is to work progressively towards a fully funded position on the technical provisions basis. The Trustee is separately considering a longer term target.

If funding improves as a result of better than expected investment returns, the Trustee expects to use the opportunity to reduce investment risk.

2.3 Risk Management and Measurement

The Trustee recognises a number of risks involved in the investment of the defined benefit assets of Pace Complete. The Trustee will continue to monitor and manage the key risks, principally:-

- **Solvency risk and mismatching risk** - addressed through the asset allocation strategy, through triennial actuarial valuations and the funding objectives.

- **Manager risk** - addressed through the diversification of Pace Complete's assets across a range of reputable and proven managers with different styles and through the ongoing monitoring of the managers.

- **Liquidity risk** - the monthly benefit and expenses outgo is monitored to ensure that sufficient cash balances are available. Investment in illiquid assets is kept to an appropriate level, and a prudent approach is taken to maintaining suitable levels of collateral to support derivative programmes.

- **Counterparty risk** – where Pace Complete enters into derivative transactions, either directly or via pooled funds, these will be collateralised as appropriate. Where possible, Pace will engage a range of counterparties to reduce the impact of a potential counterparty default.

- **Custody risk** – addressed by monitoring the custodian's activities and the creditworthiness of the custodian bank, and discussing the performance of the custodian with the investment managers when appropriate.

- **Political risk** – addressed through regular reviews of the actual investments relative to policy and through regular assessment of the levels of concentration in individual markets within the existing policy.

- **Corporate governance risk** – managed through regular reviews of stock concentration and regular discussions with the investment managers about sustainability risks.

- **Sponsor risk –** addressed by regular assessments of the ability and willingness of the sponsor to support Pace Complete and to make good any deficit.

- **Leverage risk** – addressed by regular review of the size, amount and nature of any leveraged investments made by the Scheme's investment managers and monitoring of potential collateral requirements.

- **Currency risk** – addressed through hedging a portion of non-Sterling currency exposure as appropriate and where this risk is judged to be material.

- **Credit risk** – addressed through holding a diverse range of credit investments across a variety of issuers and sectors, with exposure limits in place, through having in place investment managers who assess the creditworthiness of the debt instruments in which Pace Complete invests and through appropriate limits on credit quality.

- **Hedging Related Risks** – management of the majority of these risks is delegated to the Scheme's liability hedging manager. However, the Trustee also regularly reviews a range of liability hedging risks within quarterly reporting and other analysis.

Other risks are addressed through the Investment Restrictions or within the individual investment manager and custodian agreements.

2.4. Portfolio Construction

The Trustee has adopted the following control framework in structuring Pace Complete's investments:

- There is a role for both active and passive management. Passive management will be used for one of a number of reasons, namely:

  - To diversify risk

  - To invest in markets deemed efficient where the scope for active management to add value is limited

  - As a temporary home pending investment with an active manager

- To help diversify manager specific risk, multiple manager appointments within single asset classes are preferred where practical.

- At total Pace Complete level and within individual manager appointments investments should be broadly diversified to ensure there is not a concentration of investment with any one issuer.

- The Trustee has a policy to consider the place for passive currency hedging for Pace Complete's overseas assets. It has agreed, in conjunction with its Investment Adviser, to leave non-Sterling currency exposure generally unhedged within the equity portfolio, but to target a 100% hedge of non-Sterling currency exposure within the credit portfolio.

- Investment in illiquid investments, such as private equity, property or illiquid credit assets, may be held in controlled quantities. The proportion of such investments will be monitored at the individual manager and at the total Pace Complete level.

- Investment in derivatives is permitted as agreed on a manager by manager basis as long as they contribute to a reduction in risk or facilitate efficient portfolio management.

- Investment may be made in securities that are not traded on regulated markets. Recognising the risks (in particular liquidity and counterparty exposure), the Trustee will look to ensure that the assets of Pace Complete are predominantly invested on regulated markets.

- No investment in securities issued by Pace Complete's Sponsoring Employer or affiliated companies will be made (other than any such securities held within a pooled fund in which the Trustee invests).

- No investment by an appointed investment manager in the securities issued by the relevant manager's company, or any affiliated companies, will be made (other than any such securities held within a pooled fund in which the Trustee invests).

2.5 Investment Strategy

The Trustee recognises that it is not necessarily possible, or even desirable, to select investments that exactly match the liabilities. Given the on-going commitment of the Group to Pace Complete, a degree of mismatching risk can be accepted on the basis that it is acceptable to the Group and the Trustee is satisfied that the Group's covenant strength is adequate to support the mismatching risk.

The Investment Committee has decided to set an investment strategy which is expected, over the medium term, to produce investment returns to meet the investment objectives as set out in Section 2.2, while limiting the risk inherent in the mismatch between assets and liabilities to a level acceptable to the Trustee and to the Group.

The Investment Adviser provided advice on an appropriate investment strategy with input from the Scheme Actuary and the Group on the acceptable degree of mismatch.
The Trustee has considered the effect of the volatility of assets in relation to the liabilities. In setting the investment policy, the Trustee has considered the influence that this will have on Pace Complete's Funding Objective. It will, however, continue to monitor the position in the light of future developments.

At the time of writing, the Trustee is in the process of implementing a series of changes to Pace Complete's investment arrangements. The changes will allow the Scheme to better meet the investment objectives as set out in Section 2.2, with a lower level of risk and a higher focus on assets with known income and maturity proceeds than the previous arrangements.

The target investment strategy asset allocation, as agreed by the Trustee, is shown in the table below. (This target is subject to change over time and Pace Complete's actual asset allocation is likely to be different to the target allocation set out for the next few years as the investment strategy is implemented.)

Asset Class	**Target Allocation (%)**
Equities	7
Illiquid credit	10
Alternative inflation-linked assets	5
Asset-backed securities	3
Investment grade credit	28
Liability Driven Investment	47
Total	**100**

Pace Complete may continue to have legacy holdings not listed in the above table over the short to medium term (for example in property or alternatives) but these are in the process of being redeemed. The redemption process may take several years in some cases (for example illiquid private equity/debt holdings) and so the above should be seen as an indicative longer term target that the Trustee is working towards.

Over the course of the transition to the target allocation above, the Trustee will make use of an equity overlay (implemented through use of derivatives) to broadly maintain the Scheme's expected return at the level noted as an objective in 2.2.

The Trustee delegates the definition and implementation of investment strategy, based on the Trustee's stated investment objectives, to the Investment Committee.

The liability matching assets are invested to target a hedge of between 70% and 75% of Pace Complete's interest rate and inflation exposure, though the level of hedging may fall outside this range from time to time.

2.6 Expected Return

Over the long term, the Trustee's expectation is for the assets to achieve a rate of return which is at least 1.2% (net of fees) in excess of gilts representing Pace Complete's liabilities.

Returns over shorter periods are assessed against benchmarks set by the Investment Committee.

3 Defined Contribution Section

3.1 Process for Choosing Investments

The process for choosing investments is as follows:

- Identify appropriate investment objectives
- Consider the risks faced by members of the Defined Contribution Section
- Identify a range of investment options for members suitable to cover the range of likely investment objectives and risk tolerances over a member's working life

In considering the appropriate investments for the Defined Contribution Section the Trustee has obtained and considered the written advice of the Investment Adviser, whom the Trustee believes to be suitably qualified to provide such advice.

3.2 Investment Objective

The Trustee's objective is to make available to members a programme of investment, via pooled funds, which seeks to generate income and capital growth and which, together with new contributions from members, the Group and Participating Employers, will provide a fund at retirement with which to provide an income in retirement.

The Trustee recognises that members have differing investment needs and that these may change during the course of members' working lives. The Trustee also recognises that members have differing attitudes to risk and retirement objectives. The Trustee believes that members should be provided with a range of options to tailor their pension investments to their individual circumstances.

3.3 Risk Management and Measurement

The Trustee recognises specific investment risks which can be managed by the range of investment options provided to members. These are:

- **Shortfall or 'opportunity cost' risk** - the risk that members end up with insufficient funds at retirement with which to secure a reasonable income.
- **Capital risk** - the risk of a fall in the value of the members' funds.
- **Custody risk** - the safe custody of the defined contribution assets is delegated to professional custodians appointed by the fund provider.
- **Purchasing power risk** - the purchasing power risk to members is that the investment return over members' working lives does not keep pace with inflation and does not therefore secure an adequate retirement income. This risk is mitigated through the design of the Target Funds, which aim to provide sufficient investment returns over a member's working life. In addition, the Trustee has made available three Growth Funds, should members wish to select their own investment options.
- **Conversion risk** - the risk that relative market movements in the years just prior to retirement lead to substantial reduction in the retirement income and cash lump sum secured. This risk is mitigated through the design of the three Target Funds, which aim to protect members from relative market movements in the years just prior to retirement. In addition, the Trustee has made available two Pre-retirement Funds and a Cash Fund, should members wish to select their own investment options.
- **Manager risk** - the risk that the chosen investment manager underperforms the benchmark against which the investment manager is assessed. This risk is mitigated through the regular review of investment performance by the Trustee.

- **Lack of diversification risk** – the Trustee recognises the risks that may arise from a lack of diversification within the investments. The Trustee therefore invests in pooled fund vehicles, to ensure an adequately diversified portfolio for each fund option.

In formulating the investment options to make available to members the Trustee has considered the willingness and ability of Pace's defined contribution membership to take investment risk. As part of this, the Trustee considered the following measures of risk, and the capacity of members to respond to an adverse event:

- **Contributions at risk** – the ability of members to increase contributions in order to offset the effect of the adverse event.

- **Retirement at risk** – the ability of members to delay retirement in order to receive the level of income expected at retirement.

- **Conversion at risk –** the risk a member faces when converting pension savings into the different retirement objectives

- **Pension at risk** – the ability of members to accept a lower pension in retirement.

The funds offered through the defined contribution section of Pace have been chosen, in part, to help members mitigate these risks.

3.4 Investment Strategy

The Defined Contribution Section of Pace offers three lifestyle strategies plus a range of self-select funds to members with growth or protection objectives.

The lifestyle strategies have been designed to target the three retirement objectives; lump sum, secure income and flexible income. All of the lifestyles invest in equities, bonds and alternative growth assets during the 'growth phase'. The lump sum lifestyle strategy is designed for members targeting a lump sum at retirement and has a high exposure to cash at retirement. The flexible income targeting lifestyle de-risks to a much smaller allocation to cash and the secure income targeting lifestyle de-risks into bonds and cash, as members approach retirement.

The lump sum lifestyle strategy acts as the "default" investment option for those members who do not wish to select their own funds.
The Trustee believes that the investment strategy options are currently appropriate for meeting the Pace objective set out in 3.2 and controlling the risks identified in 3.3 for the membership as a whole.

3.5 Expected Return

The funds available are expected to provide an investment return relative to the level of risk associated with it. The Trustee believes that the range of funds offered should provide a range of returns suitable for the membership as a whole.

4. Day–to-Day Management of the Assets

In compliance with the Financial Services and Markets Act 2000, day to day management of the assets is delegated to professional Investment Managers who are all regulated by the Financial Conduct Authority ("FCA") or the relevant authority in the domicile country. The Investment Managers have full discretion to buy and sell investments on behalf of Pace, subject to agreed constraints and applicable legislation.

For Pace Complete, the Investment Managers have been selected for their expertise in different specialisations and each manages investments for Pace Complete to a specific mandate which includes performance objectives, risk parameters and timescales over which their performance will be measured.

For the Defined Contribution Section, the Trustee has selected a number of suitable pooled funds for members to invest in.

5. Realisation of Investments

The investment managers have discretion in the timing of realisation of investments and in considerations relating to the liquidity of those investments, within parameters stipulated in the relevant appointment documentation.

For Pace Complete, the Investment Committee monitors the allocation between the appointed managers and between asset classes, and rebalances the portfolio as appropriate. This includes consideration of the split within the broad asset classes shown above and the selection, monitoring and termination of the underlying investment managers.

6. Additional Assets

The Trustee is responsible for the investment of Additional Voluntary Contributions ("AVCs") paid by members and various immediate annuity contracts. The Trustee reviews the investment performance of the chosen AVC providers on a regular basis and takes advice as to the providers' continued suitability.

7. Socially Responsible Investment

The Trustee has a Responsible Investment Policy which it reviews periodically. This document details the policy for considering Environmental, Social and Governance ("ESG") factors in the strategic investment process and investment decision-making process, assessing the investment managers' performance on ESG issues, engagement with investee companies, consideration of and participation in third party ESG initiatives and public disclosure of Scheme ESG policy in practice.

In accordance with its fiduciary responsibilities, the Trustee recognises that the investment managers must base their investment decisions primarily on financial considerations. In addition, the Trustee has asked the investment managers to take account of any social, environmental and ethical factors that may be considered appropriate by the investment managers in carrying out their mandates and to adopt a practice of engaging in discussions on such matters with those companies in which they invest. The Trustee may, from time to time, raise specific ESG issues with investment managers and seek a response, or in some instances (subject to appropriate legal and investment advice) instruct managers in relation to specific ESG factors.

The Trustee will use engagement, where it is considered necessary, to influence investee company management to act in the best interests of Pace members.

The managers are asked to report to the Investment Committee on the issue of responsible investment. In addition, the Investment Committee monitors how each manager is incorporating ESG issues in investment decisions.

8. Corporate Governance

As a responsible investor, the Trustee exercises rights, including any voting rights attaching to Pace's investments, in the best interests of Pace members. The Trustee has instructed the investment managers to exercise voting rights accordingly, wherever it is practicable to do so and to report to the Investment Committee.

The Trustee recognises that where investments are held in pooled funds, it may not be possible to notify the manager to follow a separate voting policy or to exercise votes.

9. Compliance with this Statement

The Trustee monitors compliance with this Statement annually and obtains written confirmation from the investment managers that they have given effect to the investment principles in this Statement so far as reasonably practicable, and that in exercising any discretion the investment managers have done so in accordance with Section 4 of The Occupational Pension Schemes (Investment) Regulations 2005.

10. Professional Investment Advice

The Trustee has appointed Mercer Limited to provide advice on all aspects of investment relating to Pace Complete (the Defined Benefit Section of Pace). The Trustee has appointed Willis Towers Watson to provide advice in relation to the principles and fund choice set out in this document relating to the Defined Contribution Section of Pace.

11. Review of this Statement

The Trustee will review this Statement annually and without delay after any significant change in investment policy. The Investment Advisers will provide the advice needed to allow the Trustee to review and update this Statement as required. In addition, no change will be made to the Statement unless the proposed changes to investment policy have been approved by the Trustee and recorded in the minutes of a Trustee meeting.