The Co-operative Pension Scheme ("Pace")

The Chair of the Trustee's Annual Governance Statement

As Chair of the Pace Trustee I am very pleased to share with you the third annual governance statement for the Defined Contribution (DC) Section.

This Statement has been prepared to demonstrate how Pace has complied with important governance standards that were introduced under the Occupational Pension Schemes (Charges and Governance) Regulations 2015. A normal scheme year for Pace is 12 months ending on each 5 April. However, the last scheme year was extended as a result of the creation of separate segregated sections for the Co-operative Bank and Group. Therefore, this Annual Governance Statement covers the 18 month period from 6 April 2017 to 5 October 2018 and considers four key areas:

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 Trustee Directors' compliance with their knowledge and understanding (TKU) requirements.

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

1 Pace's DC default investment

Once employees meet the Government's eligibility criteria they are automatically enrolled into the DC Section.

When employees are automatically enrolled, the Trustee invests contributions in a default investment, although members can change how their DC account is invested at any time. A lot of time is spent making sure that the Pace DC investments and the default investment are appropriate. Below is an explanation of our investment objectives and how the Pace Trustee reviews and monitors the performance of the DC investments.

Statement of investment principles

The Trustee maintains a statement of investment principles which outlines the principles and policies that govern its decisions about investments. A copy of the current statement of investment principles is appended to this Annual Governance Statement and includes information on:

i. The aims and objectives for the Pace DC default investment, the 'Target: Lump Sum' Lifestyle strategy.

ii. The Trustee's policies on such matters as:

   a. The kinds of investments to be held
   b. The balance between the different kinds of investment
   c. Risks, including how these are measured and managed
   d. Expected return on investments

e. The realisation of investments, and

f. The extent (if any) to which social, environment or ethical considerations are taken into account in the acquisition, retention and disposal of investments.

iii. How the default strategy (The Target: Lump Sum Option) and the other 'Target' lifestyle arrangements are intended to ensure that assets are invested in the best interests of members and beneficiaries.

Investment review

The Trustee reviews the suitability of the DC investments annually and conducts a strategic investment review of all investment options available to members (including the default strategy and the performance of the default arrangement) approximately every three years. The last strategic review was completed in 2015 and 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. It also considered the impact of performance on different groups of members to help ensure that it remains on target.

The next strategic review of Pace DC's investments has started and we expect to be in a position to report on the outcome later in 2019.

Investment monitoring

Each quarter, the Trustee reviews how the funds within the default strategy, and the other available investment options have performed. More detailed monitoring is undertaken annually, which takes into account members' prospective outcomes at retirement. The Trustee remains satisfied that the returns achieved by the default investment are consistent with its aims and objectives.

Annual monitoring of Pace's legacy AVC arrangements is undertaken. The suitability of Pace's legacy AVC arrangements was last reviewed in August 2018.

2 Financial transactions

The Trustee has a service level agreement (SLA) in place with the DC Section administrator, Legal & General, which includes performance standards relating to the accuracy and timeliness of all core transactions.

Legal & General's processes include daily monitoring of bank accounts, a dedicated contributions processing team and peer review of investment and banking transactions.

The Trustee regularly monitors the core financial transactions of the DC Section to ensure that they have been processed promptly and accurately during the scheme year. These include the investment of contributions, transfers into and out of the DC Section, fund switches and payments out, both to and in respect of members.

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

The Trustee, in conjunction with Willis Towers Watson, also undertakes an annual assessment 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.

3 Charges and transaction costs

From 6 April 2018 the Occupational Pension Schemes (Administration and Disclosure) (Amendment) Regulations 2018 introduced new requirements relating to the disclosure and publication of the level of charges and transaction costs by the trustees and managers of a relevant scheme. These changes are intended to improve transparency on costs and to help members understand the relative merits of different investment options in a DC scheme like Pace DC. Illustrative examples of the cumulative effect over time of the application of transaction costs and charges on the value of a member's benefits in respect of the default fund are appended to this Statement.

Charges

The annual charges applied to the DC default investment, the 'Target: Lump Sum' lifestyle strategy, during the scheme year ranged from 0.23% to 0.26%.

The charges applied to all other funds (excluding the default arrangement) used by members of the DC Section and Legal & General AVCs during the period to which this Statement relates ranged from 0.23% to 0.43% per annum. The following table shows how the charges are broken down by individual funds.

Fund	AMC (% p.a.)	FMC (% p.a.)	Fund expenses (% p.a.)	Total expense ratio (% p.a.)	Transaction costs* (% p.a)
Pace Growth (Mixed) Fund	0.13	0.13	N/A	0.26	-0.02
Pace Growth (Shares) Fund	0.13	0.14	N/A	0.27	0.05
Pace Growth (Ethical Shares) Fund	0.13	0.30	N/A	0.43	0.00
Pace Pre-Retirement (Inflation-linked) Fund	0.13	0.13	N/A	0.26	0.00
Pace Pre-Retirement Fund	0.13	0.12	N/A	0.25	-0-03
Pace Cash Fund	0.13	0.09	0.01	0.23	-0.06

AMC = annual management charge. The AMC is a charge paid to Legal & General to cover its administration costs. The AMC for Co-op Section of Pace increased to 0.16%, from 6 April 2019. The AMC for Bank Section members remains at 0.13%.

FMC = fund management charge. The FMC is the charge paid to Legal & General to cover fund management expenses for each of Pace DC's funds, and is paid in addition to the AMC.

Transaction costs

Transaction costs are those incurred as a result of routine fund management activities such as buying, selling, lending or borrowing investments. New Financial Conduct Authority (FCA) guidance and rules for investment managers on how to calculate and disclose transaction costs were introduced from 3 January 2018.

*The transaction costs shown above are the average annual costs based on the 18 months data for the period 1 April 2017 to 30 September 2018.

Further details of transaction costs and charges for funds invested with Royal London can be found by visiting:

https://coop.pacepensions.co.uk/useful-information/pace-dc/

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 18 month period ending 5 October 2018. 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.
- The fund-based charges that members pay from their DC accounts remain highly competitive and generally well below the average for similar DC schemes, including the Government's National Employment Savings Trust (NEST).

4 Additional Voluntary Contributions (AVCs)

Members who are already paying the maximum 'employer matched' contributions can make further pension savings by paying AVCs. Pace's main AVC plan is managed by Legal & General and shares the same administration features and member services as for the DC Section. The statements relating to the DC Section therefore apply to the main Legal & General AVC plan.

Legacy AVCs

Pace also has a number of older 'legacy' AVCs arrangements which are now closed to new contributions. The largest is with Royal London and is referred to as 'Extra Plan' but there are also a small number of AVC policies with Aviva, Legal & General and Prudential.

Collectively, the legacy AVCs are invested in a range of with-profits, unit-linked and deferred annuity contracts, some of which have implicit charging structures. Where explicit annual charges apply, these typically range from 0.50% to 0.875%.

The Trustee, in conjunction with its advisers, completed a review of the legacy AVCs in May 2017. It found that the legacy AVC arrangements have been established many years and have charges that are higher than the main Legal & General AVC plan, although they are typically average for similar with-profits type contracts in the market.

The Trustee considered transferring the legacy AVCs to the Legal & General AVC plan but on balance has decided that members should be given the choice to decide whether to leave their AVCs where they are or move them to Legal & General. The primary reasons for this approach are that there are no directly 'like-for-like' investments into which the AVCs can be transferred into with Legal & General. In addition, some of the legacy AVC contracts contain policy guarantees (e.g. minimum bonus rates or interest) which would be lost on transfer.

A number of guides and factsheets have been produced to help members make informed decisions on how to manage their AVCs. The Trustee will continue to communicate with members annually regarding their AVCs and provide information on their broader options.

The Trustee will continue to monitor the legacy AVCs arrangements and review their suitability.

5 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 on appointment and maintaining a rolling programme to revisit the toolkit, as required.
- The Trustee directors are conversant with scheme's governing documents (including their powers under the scheme rules) and have knowledge and understanding of applicable pensions/trust law and investment principles. Trustees have received training and receive ongoing advice in this area.
- The Trustee directors have a working knowledge of Pace's statement of investment principles through regular review each year or as often as changes to investment strategy or policy necessitate. The DC Committee also reviews the DC related sections of the statement and seeks professional advice as appropriate on any changes.

- 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, including those relating to pensions law and trusts.

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.

The combined knowledge and understanding of the Trustee directors, together with advice from the Trustee's advisers, enables them to properly exercise their trustee duties. This is verified through a periodic assessment of the Trustee's effectiveness against agreed objectives, as well as through trustee meeting minutes, meeting packs and action logs.

Signed by the Chair on behalf of the Pace Trustee:

Signed **Dated**

4.4.2019

Example Illustrations

As trustees we are required to provide you with examples to show you what you might get from your plan in today's terms and explain how charges, transaction costs and investment performance could impact your pension savings over time.

Showing the value of money in real terms takes the effect of inflation into account and give an indication of how much a sum of money in the future would be worth today. This is called its buying power.

These examples were correct as at March 2019.

We have assumed the following:

- That the amounts paid in to your pension will not change over time and that the frequency will not vary. In reality contributions paid into your pension are linked to salary so will vary over time and may also be impacted by changes in pensions legislation or breaks in employment.
- We've assumed inflation remains constant at 2.50% per year. In reality this will vary over time. Inflation reduces the worth of all savings and investments.

Please remember that these are just examples and may not reflect your individual circumstances. The exact amount you'll get will depend on a number of things including:

- The actual amount paid into your plan;
- How the fund or investments that you hold perform;
- When you choose to access your pension savings.

Costs and charges

We've assumed a number of charges in these illustrations and assume that they will not change over time. These charges reflect the costs incurred in keeping your pension plan running smoothly and managing the funds you're invested in.

Annual management charge (AMC): 0.13%

This covers the cost of running your pension plan, as agreed with your employer and is deducted from your plan monthly.

Costs and charges

Investment choices

The investment strategy used in these illustrations is Target: Lump-Sum. This is the default investment option for your scheme. We've used the following fund management charge (FMC) and growth rate(s) in these illustrations. These growth rates take into account the effect of inflation. If you are invested in a Pathway fund the growth rates assume that you are invested in the fund from the 1st January each year.

Target: Lump-Sum	FMC	Growth rate	Transaction costs
Pace Growth (Mixed) Fund	0.13%	2.1%	0.00%
L&G Cash 3	0.10%	-1.3%	-0.04%

Fund management charge (FMC)

This covers the cost of managing the fund or funds you're invested in and is included in the funds unit price.

Transaction costs

Transaction costs reflect the trading costs incurred by a fund in day-to-day management and when you make a request to buy, sell or switch your investments. Where transaction costs data is available we've included them in the calculation of these illustrations and they are based on the average yearly costs incurred, measured over a period of up to the last five years. This may be different to the charges shown on the scheme's annual chairman's statement. If the value in the table above is N/A we've not been able to include them, but you may still incur these costs.

If a cost does apply, it will not have been included in the calculation of your pension benefit statement so the outcomes may be different. It will be reflected in the unit prices used to calculate the value of your pension pot. You can find out more about transaction costs at landg.com/transactioncosts.

Retirement age

We have assumed that you will take your pension benefits when you reach 65 and that you are currently aged 30. These illustrations assume your money will remain invested for the periods shown in the table.

How will the charges affect what my pension is worth?

Pot value at end of year	Current fund value: £5,000.00 Contribution: £100.00 per month		Current fund value: £30,000.00 Contribution: £375.00 per month	
	Investment growth after inflation reduced from 1.6% a year to 1.4%.		Investment growth after inflation reduced from 1.7% a year to 1.4%.	
	No charges	After all charges	No charges	After all charges
1	6,308	6,293	35,145	35,059
3	8,920	8,864	45,440	45,136
5	11,533	11,420	55,759	55,175
10	18,104	17,779	81,802	80,225
20	31,700	30,603	136,079	131,093
30	45,123	42,791	189,851	179,568
35	48,364	45,512	202,254	189,791

Important note:
The charges mean that the value of your pension pot could be less than has been paid in, particularly if contributions stop during the early years of your pension plan.

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Please remember that these are just examples and may not reflect your individual circumstances. The exact amount you'll get will depend on a number of things including:

- The actual amount paid into your plan;
- How the fund or investments that you hold perform;
- When you choose to access your pension savings.

Costs and charges

We've assumed a number of charges in these illustrations and assume that they will not change over time. These charges reflect the costs incurred in keeping your pension plan running smoothly and managing the funds you're invested in.

Annual management charge (AMC): 0.16%

This covers the cost of running your pension plan, as agreed with your employer and is deducted from your plan monthly.

Legal & General

Costs and charges

Investment choices

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3	8,920	8,857	45,440	45,102
5	11,533	11,407	55,759	55,108
10	18,104	17,742	81,802	80,045
20	31,700	30,480	136,079	130,532
30	45,123	42,528	189,851	178,412
35	48,364	45,183	202,254	188,358

Important note:
The charges mean that the value of your pension pot could be less than has been paid in, particularly if contributions stop during the early years of your pension plan.

The Co-operative Pension Scheme (Pace) – Co-op Section ("the Section")

Statement of Investment Principles – August 2018

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.

Since August 2018, the Co-operative Pension Scheme (Pace)'s assets and liabilities have been sub-divided into two sections, relating to the Co-operative Group Limited ("the Group") and the Co-operative Bank ("the Bank") respectively. Investment policy is determined separately for each section.

The remainder of this Statement refers primarily to the section of Pace of which the sponsoring employer is the Group, namely the Co-op Section ("the Section"). The Group has been consulted in preparing this Statement and will be further consulted regarding any proposed changes to the Statement. However, the ultimate power and responsibility for deciding investment policy lies solely with the Trustee.

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

The Section provides two types of benefit; a defined benefit section (the "Defined Benefit" section) and a defined contribution arrangement (the "Defined Contribution" Section). These are covered separately in Sections 2 and 3 respectively. The Defined Benefit section is closed to new entrants.

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 the Section. The Investment Committee comprises at least six Trustee Directors (including the three Independent Trustee Directors) along with other suitably experienced individuals. The Defined Benefit section's Investment Adviser attends each Investment Committee meeting.

2. *Defined Benefit 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 the 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. Where matters described in this Statement may affect the Section'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 the Section in a manner which, over the life of the Defined Benefit section, should enable the Trustee to provide the promised benefits under the rules.

With regards to the Section, the Trustee has agreed to implement an investment strategy that targets an expected return of around 0.8% p.a. (net of fees) above gilts to support the approach used to value the Section's liabilities. This investment return target was chosen taking into account the associated level of risk. The Trustee is aware (and comfortable) that the expected return of the investment strategy for the Section may vary from gilts + 0.8% (net of fees) from time to time as strategic changes are implemented and/or with changing market conditions.

The primary goal of the Trustee is to achieve a fully funded position on a low risk basis, whilst meeting statutory requirements on a Technical Provisions funding basis.

If funding improves as a result of better than expected investment returns, the Trustee, in consultation with the Group, expects to consider whether to use the opportunity to reduce risk, or to continue to maintain the level of risk with a view to improving the funding level position further.

2.3 *Risk Management and Measurement*

The Trustee recognises a number of risks involved in the investment of the defined benefit assets of the Section. The Trustee will continue to monitor and aim to 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 the Section's assets across a range of 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 the Section enters into derivative transactions, either directly or via pooled funds, these will be collateralised as appropriate. Where possible, the Section will engage a range of counterparties (with counterparty selection for specific trades delegated to investment managers), with limits placed on exposure to any individual counterparty, 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.

- **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 the Section 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 Section'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 the Section invests and through appropriate limits on credit quality.

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

- **Environmental, social and governance risk** – addressed through engagement with managers, including an annual report, and by periodic review of Pace's Responsible Investment Policy.

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

2.4. *Portfolio Construction*

It is the Trustee's policy to consider a full range of assets either directly or via pooled funds, which utilise a wide range of asset classes and investment management techniques, including but not limited to:

- Illiquid Credit
- Alternative Inflation-linked Assets
- Asset-backed Securities
- Investment-grade Credit
- Liability Driven Investment ("LDI")

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

- There is a role for active management in some asset classes where it can add value or reduce risk, while in other asset classes other approaches are appropriate, including "buy and maintain" (for investment grade credit specifically); this includes:
  - 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 are preferred where practical (e.g. investment grade credit and illiquid credit).
- At total Section 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 the Section's overseas assets. It has agreed, in conjunction with its Investment Adviser, 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 limited quantities. The proportion of

such investments will be monitored at the individual manager and at the total Section 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 the Section are predominantly invested on regulated markets.

- No investment in securities issued by the Group, Participating Employers or affiliated companies will be made directly (i.e. this excludes any such securities held within a pooled fund in which the Section invests and any securities provided by the Participating Employers which may be held in escrow as contingent assets).

- 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 Section 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 the Section, 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 provides 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 the Section'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 the Section's investment arrangements. The changes will allow the Section 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 the Section's actual asset allocation is likely to be different to the target allocation set out for the next 12 months or more as the investment strategy is implemented.)

Asset Class	Target Allocation (%)
Illiquid credit	10.0
Alternative inflation-linked assets	5.0
Asset-backed securities	3.0
Investment grade credit	40.0
Liability Driven Investment	42.0
Total	**100**

The Section 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.

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

The Trustee has agreed to target a hedge of 95% of the interest rate and inflation exposure of the Section's liabilities as measured on a "gilts plus 0.25% p.a." basis.

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 0.8% (net of fees) in excess of gilts to support the approach used to value the Section'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.

The default arrangement aims to grow member contributions ahead of inflation over the members working life, reducing absolute fund volatility as the member approaches retirement. It is designed to be appropriate for members who want to take all of their account as a lump sum on retirement. During the early years, it will be invested in the Pace Growth (Mixed) Fund with the objective of achieving growth over the long term. As members approach their selected retirement age, the default arrangement automatically switches holdings into the Pace Cash Fund to provide capital protection.

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 capacity of members to respond to an adverse event.

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 the Section, subject to agreed constraints and applicable legislation.

For the Defined Benefit section, the Investment Managers have been selected for their expertise in different specialisations and each manages investments for the Defined Benefit section 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 the Defined Benefit section, 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 Pace's 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's members. Specifically, 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. Professional Investment Advice

The Trustee has appointed Mercer Limited to provide advice on all aspects of investment relating to the defined benefit section of the Section. 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.

10. 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.

Signed: ______________ Date: 6 August 2018

Name: HARRY BAINES

Signed: Sarah H

Date: 6 August 2018

Name: SARAH [illegible]

For and on behalf of Pace Trustees Limited

Appendix: Division of Duties and Responsibilities

Duties and Responsibilities	**Executed By**
▪ Overall responsibility for the Section's investments. ▪ Define the terms of appointment of the Investment Committee. ▪ Appoint the members of Investment Committee.	The Trustee
▪ Recommend the Investment Adviser to the Trustee. ▪ Recommend investment objectives to the Trustee. ▪ Recommend strategic framework to the Trustee. ▪ Monitor the Investment Adviser ▪ Make day-to-day decisions relevant to the operation of the Section's investment strategy.	The Investment Committee / Defined Contribution Committee as applicable
▪ Monitor appointed Investment Managers and other service providers	The Manager Review Committee / Defined Contribution Committee as applicable
▪ Perform asset liability modelling exercises, as required. ▪ Advise on the strategic framework. ▪ Advise on the selection of the Investment Managers. ▪ Monitor the Investment Managers, providing both qualitative and quantitative input to the Investment Committee and Manager Review Committee as appropriate. ▪ Advise on the implementation of mandates. ▪ Advise on the Statement of Investment Principles.	The respective Investment Advisers to the Section (both defined contribution and defined benefit)
▪ Operate within the conditions set down by the Investment Management Agreement. ▪ Select individual investments with regard to their suitability and diversification. ▪ Supply the Trustee with sufficient information to allow the review of activity.	The Investment Managers