The Co-operative Pension Scheme ("Pace")

The Chair of the Trustee's Annual Governance Statement
Year ending 5 April 2020

As Chair of the Pace Trustee I am very pleased to share with you the fifth annual governance statement for the Defined Contribution (DC) Section and Additional Voluntary Contributions (collectively referred to as Pace DC or "the Scheme" in this statement).

This Statement has been prepared to demonstrate how Pace has complied with important governance standards required under regulation 23 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996, as amended. It describes how the Trustee has met the statutory governance standards over the Plan year ended 5 April 2020 in relation to:

1. The investment strategy relating to the DC default investment.
2. The financial transactions made within Pace DC.
3. The charges and transaction costs within Pace DC. (including an illustration of the cumulative effect of these charges)
4. The assessment of value for members.
5. Additional Voluntary Contributions (AVCs).
6. The Trustee Directors' compliance with their knowledge and understanding (TKU) requirements.

The Trustee has elected to use the Scheme year as the period against which the charges and transaction costs incurred under Pace DC will be assessed (the "Pace DC Year").

As with last year's statement, we have included information relating to charges and transaction costs and 'pounds and pence' illustrations demonstrating the potential impact of costs and charges on a member's DC savings over the course of their Pace DC membership.

1 Pace's DC default investment

Once employees meet the Government's eligibility criteria they are automatically enrolled into Pace DC (therefore Pace DC is a "Qualifying Scheme" for automatic enrolment.)

When employees are automatically enrolled, the Trustee ("we") invests contributions in a default investment (Target: Lump Sum Lifestyle Strategy, further information is available in the Pace DC Fund Guide), although members can change how their DC account is invested at any time. The Trustee is responsible for the Scheme's governance, which includes setting and monitoring the investment strategy for the Scheme's default arrangements. A lot of time is spent making sure that the Pace DC investments and the default investment are appropriate. The Trustee has documented an explanation of their investment objectives and how they review and monitor the performance of the DC investments, this document is called the Statement of Investment Principles and this is explained below.

Statement of Investment Principles

We maintain a Statement of Investment Principles ("SIP") for each section which outlines the principles and policies that govern our decisions about investments. A copy of the current SIP for each section is appended to this Annual Governance Statement at Appendix 1 (Co-op Section) and Appendix 2 (Bank Section) in the accounts and includes information on:

i. The aims and objectives for the Pace DC default investment, the 'Target: Lump Sum' option. In particular, the aim of the default arrangement, as stated in each SIP, is to grow member contributions ahead of inflation over a member's 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.

ii. Our policies on such matters as:

   a. The kinds of investments to be held

   b. The balance between the different kinds of investment

   c. Environmental, Social and Governance (ESG) factors and stewardship

   d. Risks, including how these are measured and managed

   e. Expected return on investments; and

   f. The realisation of investments.

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

There is also a self-select fund range for Pace DC members, which the Trustee considers to be a suitable range of funds for members who wish to make their own investment choices.

The SIPs were last updated on 24 September 2020 to reflect new legislative requirements requiring trustees to explain their policies on how they monitor their asset managers. The components of the SIP for the Co-op and Bank Sections relating to DC arrangements were unchanged through the scheme year (although various changes were made to reflect changes to the investment strategy for the DB arrangements, which are documented in the same SIPs).

Investment strategy review

We review the suitability of the DC investments annually and conduct a strategic investment review of all investment options available to members (including the default strategy and the performance of the default arrangement) around every three years on no less than a three-yearly cycle. We would also review it immediately after any significant change in investment policy or the demographic profile of the membership.

The last strategic review was completed on 6 December 2019. The Trustee concluded that the design of the default investment strategy, other working life strategies and self-select fund range remain appropriate for the Pace DC members.

In June 2019, the Trustee introduced the Legal & General Future World Multi-Asset Fund to the Pace Growth (Mixed) Fund. The investment objective of the fund is to provide long-term investment growth through exposure to a diversified range of asset classes (excluding physical property) while reflecting significant environmental, social and corporate governance (ESG) issues into the fund's investment strategy.

As part of the review, the Trustee has also looked to improve the diversification of investments for members invested in the Scheme's lifestyle strategies, and is considering introducing an equity component into the lifestyle options for younger members. Timing of the implementation is currently under consideration.

Investment monitoring

In addition to the strategy review, with the support of the Co-op Pensions Department and its DC advisor, the Trustee also reviews the performance of the default arrangement against its aims, objectives and policies on a quarterly basis. This review includes an analysis of the underlying funds' performance against their respective benchmarks, relevant ABI sectors (i.e. similar funds) as well as a consideration of the volatility of the Pace Growth (Mixed) Fund against equity markets, together with a high level review of member activity to check that the risk and return levels meet expectations. The Trustee's reviews that took place during the Scheme year concluded that the default arrangement was performing broadly as expected and is consistent with the aims and objectives of the default as stated in the SIP, and as set out above. The performance of the default arrangement was reviewed at quarterly DC Committee meetings over the Scheme year, and was last considered on 9 September 2020.

Environmental Social and Governance (ESG) Considerations

Regulations introduced in 2018 mean that pension schemes need to formally document how they incorporate Environmental, Social and Corporate Governance issues (and specifically consideration of climate risk) into their investment strategies, for both DB and DC investments. Pace publishes its Responsible Investment Policy on its website, with an annual report on how its investments have complied with this policy. In 2018, we reviewed each Section's SIP with input from Pace's sponsors to ensure it reflected our responsible investment policy.

In particular, we believe that members of Pace DC are long-term investors, and that a default investment option for the Scheme should invest in companies that can deliver sustainable, long-term value, with proper consideration of environmental, social and corporate governance factors (including climate change). Following the changes highlighted above, the Pace Growth (Mixed) Fund aims to take into account the environmental and social behaviours of businesses it invests in, as well as how well they are governed and run, when deciding how much to invest in different companies.

2 Financial transactions

We have a service level agreement (SLA) in place with the Pace DC administrator, Legal & General, which includes performance standards relating to the accuracy and timeliness of all core transactions. These include the investment of contributions, processing of transfers in and out of the Scheme, transfers of assets between different investments within the Scheme, and payments to members/beneficiaries. These transactions are regularly monitored to ensure that they have been processed promptly and accurately during the scheme year.

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

Monitoring is achieved through the review of quarterly reporting from Pace DC'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.

In conjunction with our advisers, we also undertake an annual assessment of Pace DC's governance processes and internal controls and can confirm 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).

We also ensure that our AVC providers (see section 5) have service levels in place for core financial transactions and each year we seek confirmation from each provider that these service levels continue to be met.

3 Charges and transaction costs

We are required to include information on charges and transaction costs in this statement each year, to improve transparency on costs and to help members understand the relative merits of different investment options in a DC scheme like Pace DC.

Charges

Pace DC scheme charges (Total Expense Ratio) comprise of three elements:

- An Annual Management Charge (AMC) - a charge paid to cover administration costs.
- A Fund Management Charge (FMC) – a charge paid to cover fund management expenses.
- Fund expenses – any expense not covered by the AMC or FMC.

The Pace DC Total Expense Ratio (including transaction costs) is paid for by members through the scheme charges. The Bank pays £5 a year to Legal & General for each member, to reduce the charges that apply to their accounts.

Transaction costs

Transaction costs are the costs of buying and selling securities. These can be easily identifiable 'explicit' costs (i.e. charged to and paid directly by the fund) which include Brokers Commission, Research Commissions, Transaction Taxes and Fees, or, not directly observable 'implicit' costs which relate to the market impact when the investments are bought and sold. Implicit costs can, therefore, be difficult for managers to identify and disclose.

The charges and transaction costs for each fund in Pace DC are shown in Appendix 3 for the Co-op Section and Appendix 4 for the Bank Section and have been prepared in accordance with statutory guidance.

Further details of transaction costs and charges for funds invested with Pace's AVC arrangements can be found by visiting:

Co-op: https://coop.pacepensions.co.uk/pace-dc-governance/
Bank: https://bank.pacepensions.co.uk/pace-dc-governance/

All transaction costs quoted have been supplied by the provider of that pension arrangement.

Cumulative illustration

In addition to the above, we are also required to present the costs and charges typically paid by a member as a "pounds and pence figure". Illustrative examples of the cumulative effect over time of the application of charges and transaction costs on the value of a member's accrued rights to money purchase benefits are shown in Appendix 5 for the Co-op Section and Appendix 6 for the Bank Section. The illustrations have been prepared having regard to the guidance issued by the DWP in September 2018

4 The assessment of Value for Members

We are 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.

We undertake annual 'value for member' assessments, with support from our advisers, and give specific focus to costs for members. These assessments form part of our annual plan and are included as an item on Pace's risk register.

We have completed a value for members assessment for the period ending 5 April 2020. This assessment was undertaken in accordance with the Pensions Regulator's DC Code of Practice no. 13 (paragraphs 113-133 and with the relevant legislation. It considered the scope, quality, efficiency and general value of a range of services and features, including:

- The benefits of Pace DC membership covering;
  - governance and scheme management;
  - investment;
  - communications; and
  - administration
- The cost of Pace DC membership
- Comparison with other schemes.

The conclusion of the latest assessment, completed in September 2020, is that Pace continues to provide excellent value for money for members because:

- Pace is providing a highly rated service with excellent standards of governance and administration
- We are confident that the Pace Growth (Mixed) Fund can deliver sustainable, long-term value, with proper consideration of environmental, social and corporate governance factors (including climate change).
- Pace DC charges are highly competitive and generally well below the average for similar DC schemes, including the Government's National Employment Savings Trust (NEST).

This year a written communication was issued to members over age 50, reminding them to select a realistic retirement age. A reminder was also included in the 2019 benefit statements. We have also undertaken a review of all literature to help members understand their choices at retirement.

5 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' AVC 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, Prudential and Equitable Life (now Utmost Life & Pensions).

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 1.00%.

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.

With effect from 1 January 2020, members with investments with Equitable Life were transferred to a new AVC provider, Utmost Life and Pensions. On transfer, guarantees that applied to with-profits investments were removed from the policies, and members received uplifted policy values.

Annual monitoring of Pace's legacy AVC arrangements is undertaken. The suitability of Pace's AVC arrangements with Royal London (formerly CIS) is on-going and further work will take place in 2021.

6 Trustee knowledge and understanding (TKU)

In Q3 2019, the composition of the Pace Trustee Board and governance model changed, retaining only the four professional independent trustees; the next review of the Trustee Board's effectiveness will be considered in Q4 2020. It is proposed that this review will consider the effectiveness of the new Trustee Board and governance model following its first year of operation.

We have a strong TKU process in place and our combined knowledge and understanding, together with advice available to us, enables us to properly exercise our functions as the Trustee of Pace. Our approach to meeting the TKU requirements includes:

- Maintaining a rolling programme of bespoke trustee training in keeping with our status as a professional trustee board. This includes short, bespoke training sessions with Pace's advisers (either one-to-one or in small groups) as required. When the Pace Chair was appointed in May 2019, copies of existing scheme documentation and advice were shared as background, and members of the pensions department held one to one sessions covering Pace's governance structure, investment strategy and other ongoing projects to support this.

- Making sure we are conversant with scheme's governing documents (including their powers under the scheme rules) and we have knowledge and understanding of applicable pensions/trust law and investment principles. We regularly attend external seminars and training on technical pensions matters to keep up to date with developments in the pensions industry.

- We 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.

- We are required to complete a Skills and Experience Form annually to identify any particular training requirements. This exercise is to identify:-

  - if there are any gaps in a Trustee Director's skill set / soft-skill set.
  - which Trustee Directors are best placed to (i) sit on the different committees; and (ii) lead/participate in specialist projects.
  - if there are any collective gaps in the Trustee Board overall skill set.
  - if there are any collective gaps in the Trustee Board skill set when a Trustee Director leaves the Board, and a replacement Trustee Director is being considered.

- Obtaining accredited professional trustee status independently, once the accreditation programmes offered by the two main providers, the Association of Professional Pension Trustees and the Pensions Management Institute, have been developed further, and the Trustee Board has agreed the approach and timeframe to achieve this.

Signed by the Chair on behalf of the Pace Trustee:

Signed CON MARTIN - ITS LTD **Dated** 29/10/20.