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 fourth annual governance statement for the Defined Contribution (DC) Section and Additional Voluntary Contributions (collectively referred to as Pace DC in this statement).

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 6 month period from 6 October 2018 to 5 April 2019 and considers four key areas:

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

1 Pace's DC default investment

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

When employees are automatically enrolled, the Trustee Directors ("we") invest 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 we review and monitor the performance of the DC investments.

Statement of investment principles

We maintain a statement of investment principles which outlines the principles and policies that govern our decisions about investments. A copy of the current statement of investment principles for each section is appended to this Annual Governance Statement at Appendix 1 and includes information on:

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

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. Risks, including how these are measured and managed
   d. Expected return on investments; and
   e. The realisation 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.

The statements of investment principles were last updated in March 2019 to better reflect how environmental, social and corporate governance considerations are taken into account in the acquisition, retention and disposal of investments – more detail is set out below.

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

We are currently in the process of conducting an updated strategic investment review, taking into account the characteristics of Pace's members including the estimated values of members' funds on retirement, as well as changes in the long-term investment outlook and the investment strategies of other, comparable pension schemes. We are also considering the impact of performance on different groups of members to help ensure that the default strategy remains on target. This work will conclude later in the year, and if any changes are proposed as a result these will be communicated to members in advance.

Environmental Social and Governance (ESG) Considerations

New regulations introduced in 2018 mean that pension schemes now 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 has already done a lot of work to make sure it is investing responsibly, and publishes its Responsible Investment Policy on its website, with an annual report on how its investments have complied with this policy. Over the year we reviewed each Section's Statement of Investment Principles ("SIP") to ensure it reflected our responsible investment policy. Updated SIPs were agreed in March 2019 with input from Pace's sponsors, and are available on the website.

We have also recently made a change to the way the default fund - The Pace Growth (Mixed) Fund invests.

The fund still retains the same financial objectives, but it now also 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.

We have made this change because 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).

Investment monitoring

Each quarter, we review 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' expected outcomes at retirement. We remain satisfied that the returns achieved overall by the default investment are consistent with its aims and objectives.

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.

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

We regularly monitor the core financial transactions of Pace DC 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 Pace DC, fund switches and payments out, both to and in respect of members.

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).

Based on the above, we are satisfied that the core financial transactions relating to Pace DC have been processed promptly and accurately during the scheme year.

3 Charges and transaction costs

We are required to include information on charges and transaction costs in the 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

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

https://coop.pacepensions.co.uk/pace-dc-governance/

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 a member's fund value are shown in Appendix 3 and have been prepared in accordance with statutory guidance.

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 on costs for members. These assessments form part of our annual plan and are included as an item on Pace's risk register.

We have just completed a value for members' assessment for the 6 month period ending 5 April 2019. 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:

- 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 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
- Following the recent change to the way the default fund - The Pace Growth (Mixed) Fund invests, we are confident that the 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).

Next year we will look at ways to further improve our communications to members, and also review the support available to members to help them understand their choices at retirement.

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, Prudential and Equitable Life.

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.

Annual monitoring of Pace's legacy AVC arrangements is undertaken. As one of our next areas of focus, the suitability of Pace's AVC arrangements with Royal London (formerly CIS) is also being reviewed and this work is expected to be completed later in the year.

5 Trustee knowledge and understanding (TKU)

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

- Maintaining a rolling programme of bespoke trustee training. During the year the DC Committee received investment training in advance of commencing the strategic investment strategy review, and the Trustee Board received training on Pace DC's benefit design, membership and investment strategy.
- Individual Trustee directors completing the Pensions Regulator's trustee training toolkit on appointment and maintaining a rolling programme to revisit the toolkit, as required.
- Making sure we 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. We have received training and receive ongoing advice in this area.
- 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.
- Recording all training and attendance at appropriate seminars in the Trustee training log in order to support the Chair's statement.

We have also undertaken, in conjunction with our advisers, independent assessments of our 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. We are satisfied that the relevant legislative requirements have been met.

Signed by the Chair on behalf of the Pace Trustee:

Signed **Dated**

CPJ MARTIN 14/10/19.