Somerfield Pension Scheme

Responsible Investment Update

February 2020

In December 2018, we published a Responsible Investment Policy for the Scheme, which is available on the Scheme's website. This policy sets out the Trustee's views on responsible investment, and the issues that we identified as risks to the Scheme which we believed reflect the views of members and the Co-op and which we could address in the Scheme's investments.

We recognise that environmental, social and governance ("ESG") factors can affect the financial performance of the companies and other assets that we invest in. Our investment managers take account of ESG factors when they are implementing their mandates, and engage directly with the companies they invest in. On top of this, we agreed that we would provide updates on the Scheme's specific Responsible Investment activities on the website. As part of this commitment this short paper sets out the changes we've made over the first twelve months the policy has been in place.

We updated our Statement of Investment Principles

The Scheme's Statement of Investment Principles ("SIP") is a written document that sets out the principles that the Trustee applies when setting investment strategy. It formally sets out the Trustee's policies covering how we select investments, the balance between different types of investments and the way we manage investment risks (amongst other factors).

In June 2019, having consulted with the Co-op, we updated the Scheme's SIP to more explicitly reflect the environmental, social and corporate governance ("ESG") risks we consider when making investment decisions These include the long-term sustainability of the companies we invest in through our investment managers and, in particular, the impact of climate change.

Our updated SIP is on the pension website at: https://coop.pacepensions.co.uk/other-schemes/

We moved our equity investments into funds better aligned with our Responsible Investment Policy

In July 2019, we moved the Scheme's 'developed market' equity investments from "market cap" index-tracking equity funds (which invest in companies around the world in proportion to their size, or market cap) into LGIM's Future World equity index funds, which we believe are better aligned with the Scheme's Responsible Investment Policy.

These funds use LGIM's ESG scores (calculated for the companies they invest in) to reduce exposure to companies associated with poor ESG practices and provide greater exposure to those that are better positioned from an ESG perspective. For example, this means investing more in companies with lower greenhouse gas emissions, more diverse workforces and boards, that have robust policies on bribery, discrimination, freedom of association, and in companies with stronger corporate governance processes. The funds also exclude manufacturers of controversial weapons and coal miners, and companies that fail to engage with LGIM on climate change. The Trustee believes this fund is therefore a good 'fit' for the criteria set out in our Responsible Investment Policy.

This has had a quantifiable impact, in particular on climate change related factors:

- The "carbon emissions intensity" (which measures the relationship between carbon emissions of a company and its sales) is over 40% lower for the new funds than the market as a whole; and

- The carbon reserves of the companies we invest in are over 60% lower than the market. Based on LGIM's analysis this means investing in the Future World funds reduced Somerfield's exposure to fossil fuel reserves by the equivalent of approximately 410,000 barrels of oil compared to an unadjusted index tracking approach.

We have implemented a list of exclusions for companies in extractive industries and the manufacture of controversial weapons, as well as government bonds issued by countries with poor human rights.

Part of the Scheme's investments are in pooled funds, where we do not directly own the underlying assets but invest alongside other investors. Although we can engage with the investment managers to understand their approach to Responsible Investment, we can't directly influence what assets are held.

The Scheme does however have "segregated" corporate bond mandates with RLAM and LGIM, where we have more direct control over the investments the managers are allowed to make. At 30 September 2019, these mandates were around £200m (26% of the Scheme's assets).

In April 2019, we signed up with MSCI, a leading provider of investment tools and research, to implement an exclusions list to help us avoid investing in assets in this mandate that don't fit with our core beliefs. We developed this exclusion list alongside the other Co-op pension funds so that it's practical to apply and doesn't constrain our investment managers in securing the investment returns needed to pay members' benefits. The investment exclusions we agreed include:

- Extractive industries: excluding investment in companies involved in the oil, gas or mining industries which are also rated poorly by MSCI with respect to how their specific environmental risks are addressed;
- Controversial weapons: excluding investment in companies involved in the manufacture or distribution of land mines, cluster munitions, chemical weapons, blinding lasers or depleted uranium munitions; and,
- Human rights: excluding investment in debt issued by countries, which score poorly on a number of indicators of effective governance and provision of basic rights and services to their populations.

Throughout the year, we worked with MSCI to keep the exclusions list up to date. As at October 2019, the exclusion list covered:

- Corporate bonds issued by 487 companies in the extractive industries with poor environmental ratings;
- Corporate bonds issued by four companies involved in the manufacture or distribution of controversial weapons; and
- Government bonds issued by 71 countries with poor human rights scores

Royal London have confirmed that at the time of writing they did not hold any investments on the exclusions list on behalf of the Scheme, LGIM have confirmed that a small amount of residual holdings (0.2% of Somerfield's total assets) are in investments on the exclusions list; this is expected to naturally fall over time, as these residual investments mature or are sold.

Next steps

We see the development of our Responsible Investment Policy as an evolving process and will review our approach to Responsible Investment at least annually; in addition, over the next year we will continue to engage with our managers to monitor their approach to responsible investment, and as mentioned above will review the approach we take for emerging market equities.

We also welcome members' feedback and will consider this as we continue to develop our policy for Responsible Investment. If you have feedback on the RI policy, please let us know by email: staffpensions@co-operative.coop

The Trustee of the Somerfield Pension Scheme, February 2020