Co-operative Pension Scheme (Pace)

2024 UK Stewardship Code and Responsible Investment report

Introduction

The Pace Trustee is pleased to publish its annual report on responsible investment for the year to 5 April 2024.

This report, which has been prepared for the Trustee by the Co-op Pensions Department, and reviewed and approved by the Pace Trustee, explains what the Trustee and Pace's investment managers have been doing during the year to make sure we meet the requirements of our Responsible Investment Policy, and how we've exercised stewardship on behalf of both the defined benefit (DB) and defined contribution (DC) sections of Pace.

It also demonstrates how we've complied with the principles underlying the updated UK Stewardship Code, which came into force on 1 January 2020. The Stewardship Code sets out a number of areas of good practice which the Financial Reporting Council (FRC), the UK's independent regulator responsible for promoting high quality corporate governance and reporting, believes institutional investors like Pace should aspire to. The Appendix lists each of the 12 principles in the Stewardship Code and highlights where they are covered in this report.

This report sits alongside the 'Implementation Statements' for the Co-op and Co-operative Bank sections of Pace, which set out how we've complied with the policies in our Statements of Investment Principles, and alongside our Taskforce on Climate-Related Financial Disclosures (TCFD) report, quantifying climate risk within Pace DB and Pace DC. These reports are available on the Scheme's website under 'Pace investments' in the 'Useful information' section.

Chris Martin, Chair, Pace Trustees Limited

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Executive summary

As the Trustee of Pace, we're responsible for both DB and DC assets on behalf of Scheme members. Many of our members want to know these pension savings are being invested responsibly, while at the same time providing security for their futures.

This summary provides the highlights from our 2023/24 investment reporting, letting you know how the Trustee has carried out its Responsible Investment Policy over the past year.

Investing responsibly is one of our key aims, and one of the expectations of our stakeholders (both Scheme members and our sponsoring employers).

This year:

- We published our second formal report on Pace's exposure to climate risk and setting out progress against our net-zero targets (including Scope 3 carbon emissions);
- We entered into a further buy-in policy for the Co-op Section of Pace DB in November 2023, which means that the vast majority of Pace's defined benefit liabilities are now matched with insurance policies. This involved the sale or transfer of Pace DB's remaining bond investments, property holdings and alternative assets, and as at 5 April 2024 Pace DB's assets are now made up of annuity policies and residual cash held to meet future expenses;
- We implemented a number of changes to the default investment strategy for the Co-op Section of Pace DC, to increase expected returns and make the strategy more flexible and easier to communicate; and
- Prior to the buy-in, we continued to apply an exclusions list where possible, to prevent investment in companies that manufacture or distribute controversial weapons, or those in the oil, gas or mining industries that have poor environmental records, or those based in countries with poor human rights records.

How do we invest?

We've prepared a Statement of Investment Principles (SIP) for each of the Co-op and the Bank sections of Pace, which are available on the Scheme's website – these are the documents that govern the way the Scheme's assets are invested.

In brief:

- The Pace DB sections aim to pay benefits to members and their dependants as set out in the Scheme's Rules. These benefits are paid out of investments selected by the Pace Trustee.
- Pace DC allows its members to build their own retirement pots; members can choose how they want to invest their money from a selection of investment options offered by the Trustee.

We're committed to achieving these goals in a way that considers broader social and environmental concerns.

Our report this year focusses primarily on Pace DC. In November 2023, the Co-op Section of Pace entered into a buy-in transaction to purchase a bulk annuity insurance policy with Rothesay Life, a UK insurance company authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority. This covers the vast majority of pensioner and non-pensioner defined benefit liabilities not previously insured with either the Pension Insurance Corporation (PIC) or Aviva UK Life and Pensions (Aviva) as part of the pensioner buy-in transactions implemented in 2020, and aligned with the full buy-in implemented for the Bank Section in December 2022. Under these policies, Rothesay Life, PIC and Aviva undertake, via the Scheme, to pay the DB Sections' benefit obligations as they fall due. In due course, the Trustee's intention is that the buy-in assets will be moved to a buy-out contract and the Sections could then be wound up.

The execution of the buy-ins involved the transfer of the bulk of the DB section's assets to the insurer, with residual assets in the DB Section consisting of cash held to meet future ongoing costs; given the transfer of the DB Section's assets (including the corporate bond and LDI portfolios we covered in detail last year), we have not covered the DB Section in as much detail in this year's report.

We would like our approach to responsible investment to reflect the views of Pace members as far as reasonably possible. We therefore welcome members' views on these issues – we've previously surveyed current employees of the Co-op to understand their responsible investment priorities and the themes which mattered to them, which we considered when setting our Responsible Investment Policy, and also through ad hoc questions from members over the year.

We believe that our approach to responsible investment should be consistent with the values of our sponsors, and their members and colleagues, again as far as reasonably possible, and we engage with them when reviewing our policies to understand their priorities. Finally, we believe that our Responsible Investment Policy should reflect the extent to which environmental, social and corporate governance (ESG) issues might represent a risk to the Scheme.

Over time, we've worked with the Co-op and the Co-operative Bank to identify three broad issues which we feel reflect the views of these stakeholders. These issues are:

- climate change and the protection of the environment;
- labour conditions and equal pay; and
- corporate governance.

Our Responsible Investment Policy is available on the Scheme's website. The website also works as a platform for us to communicate with our members on important information such as changes to the DC fund range, and reporting on stewardship and climate change.

About us

The Co-operative Pension Scheme (Pace) is a UK-registered occupational pension scheme with assets held on behalf of members by Pace Trustees Limited (the Trustee).

In 2018, Pace was separated into two legally separate sections. The Co-operative Bank is the only employer in the Bank Section; all other employers participating in Pace are in the Co-op Section.

Both the Co-op Section and the Bank Section contain historic defined benefit (DB) and defined contribution (DC) sections, the latter for members who are currently contributing.

At 5 April 2024, there were over 71,000 members of Pace with DB benefits. This comprised 36,500 members with pensions already in payment, and around 35,000 members who are yet to retire; Pace's DB assets at that date were just under £6.5bn.

The DB Section of Pace (Pace DB) closed to future accrual in 2015. DB benefits were built up based on a member's salary and length of membership.

The DC Section of Pace (Pace DC) was established in 2012, and since 2015 is the only section of Pace which has actively contributing members. At 5 April 2024, there were around 84,500 members of Pace DC, all still contributing or yet to draw benefits (when members draw their benefits from Pace DC by taking cash, buying an annuity or transferring out, they leave the Scheme). The total value of members' pension pots, as at 5 April 2024, in Pace DC was around £923m.

The average age of members of Pace DC is approximately 40, while the average age of members of Pace DB (both pensioner and non-pensioners), at the last actuarial valuation in 2022, was higher at approximately 61.

Following the buy-in policies implemented in 2022 and 2023 for Pace DB, one of the Trustee's key objectives for the DB Section is to achieve an appropriate discharge of the Scheme's liabilities, which would then allow the DB sections to be wound up. We therefore assume a longer time horizon when looking at investment strategy for Pace DC than for Pace DB.

The remainder of this report sets out how we, and our asset managers, have aimed to be responsible asset owners over the year. Following the buy-in transactions for the DB Sections in 2022 and 2023, our report this year focuses primarily on Pace DC.

Pace has limited scope, if any, to influence the investment strategy or stewardship practices of its bulk annuity providers. Once assets are transferred to an insurer, a pension scheme relinquishes direct control over investment decisions, with the insurer assuming all responsibility for managing its own assets to meet its contractual and regulatory obligations.

The DB Sections' residual assets are all held in cash (or pooled cash funds) to meet ongoing costs.

The assets invested for Pace DC are administered by Legal & General Assurance Society Ltd, via a range of funds selected by the Trustee as appropriate, and from which members can make their own choices. More details of the funds available for Pace DC are shown on page 22.

How do we exercise 'stewardship'?

> **'Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.'**
>
> The 2020 UK Stewardship Code

We're committed to achieving our investment objectives in a way that considers broader social and environmental concerns, and by investing responsibly.

Governance structure

On 1 July 2024, Independent Trustee Services Limited (ITS, part of the Independent Governance Group) was appointed to the Trustee Board as a sole professional trustee. ITS's main representatives are Chris Martin (the Chair of Pace) and Priti Ruparelia, who work primarily on the DB and DC sections respectively. Chris is also appointed as an individual Trustee Director, to meet the requirements of Section 155 of the Companies Act 2006 for there to be at least one individual director appointed.

Using ITS as professional trustee gives the Pace Trustee Board access to a broad team of pensions specialists drawn from diverse backgrounds and disciplines. This ensures key decisions can be made quickly in an informed, balanced and impartial way. To ensure that the appropriate level of skill, attention and diligence is applied to all areas of managing the Scheme, the Trustee has appointed a number of Committees to oversee specific areas, where members are selected based on relevant knowledge and experience.

The Pace Trustee is ultimately responsible for managing Pace, and ensuring its duties and objectives are met. The structure and composition of the Board is illustrated below.

The Trustee believes that an effective governance structure is crucial to achieve best practice.

Committees

Pace Trustees Limited

Defined Contribution Committee

Manager Monitoring and Implementation Committee (Co-op Pensions Department)

The Trustee retains responsibility for setting the investment objectives for Pace DB and for making decisions on asset allocation and the selection, retention and termination of investment managers. The DC Committee is responsible for the development and operation of Pace's investment policy for Pace DC. As set out below, the Trustee also takes advice from its DC investment consultant (LCP), while the Co-op Pensions Department also supports the Trustee and the Committees in their activities.

The Trustee believes that the governance structure, choice of service providers and investment managers enables it to be an effective steward of assets.

Resources

Responsibility for the day-to-day management of assets is delegated to our appointed investment managers, and their approach to implementing responsible investment principles is monitored by the Manager Monitoring and Implementation Committee (MMIC), which consists of senior members of the Co-op Pensions Department, including the Scheme Secretary of Pace.

The duties of the MMIC and DC Committee include considering, in detail, performance monitoring, risk assessment and operational and implementation matters. The Committees report back to the Trustee on key issues raised at their meetings in quarterly Trustee Board meetings or at ad hoc meetings when needed. The MMIC also reviews the internal control reports produced by investment managers across the Co-op's pension schemes. This review includes looking at the operating effectiveness of the investment managers' organisations and highlighting any exceptions noted as a result of testing carried out by auditors. The MMIC engages with managers where their reports have been qualified by auditors, and monitors their progress to remediate any issues.

The in-house team is responsible for ensuring that there is effective governance and risk management. Tom Taylor, a solicitor with over 16 years of pensions experience, is the Scheme Secretary of Pace and Lead Governance Manager. Over the year, the MMIC was chaired by James Giles, Head of Pensions Investment and Risk, who is a Fellow of the Faculty and Institute of Actuaries with over 16 years' pensions and investment experience.

Investment managers

We encourage our appointed investment managers to commit to the Stewardship Code. Our managers have their own policies to demonstrate how they monitor and engage with the companies in which they invest, to protect and enhance value to clients, which we review.

Following the buy-ins implemented by the Bank and Co-op Sections of Pace DB in 2022 and 2023 respectively, Pace DB's only uninsured assets are held in cash to meet ongoing costs. This residual cash for each Section is invested with BlackRock in its Liquid Environmentally Aware Fund (LEAF). BlackRock have published a statement of compliance with the UK Stewardship Code.

In addition, Pace DC's investment managers (Legal & General and HSBC, who manage Pace DC's Shariah equity fund) and Pace DB's insurers (Rothesay Life, Pension Insurance Corporation and Aviva) all adhere to the UK Stewardship Code, and (along with BlackRock) are signatories to the UN-backed Principles for Responsible Investment. These initiatives, and membership of collaborative initiatives with other investors, are also factors that we consider when we select investment managers.

We're delighted that last year's Stewardship Code report by Pace also met the FRC's expected standards of reporting, and that Pace therefore continues to be a signatory of the UK Stewardship Code in its capacity as an asset owner. This year's report reflects the FRC's ongoing feedback.

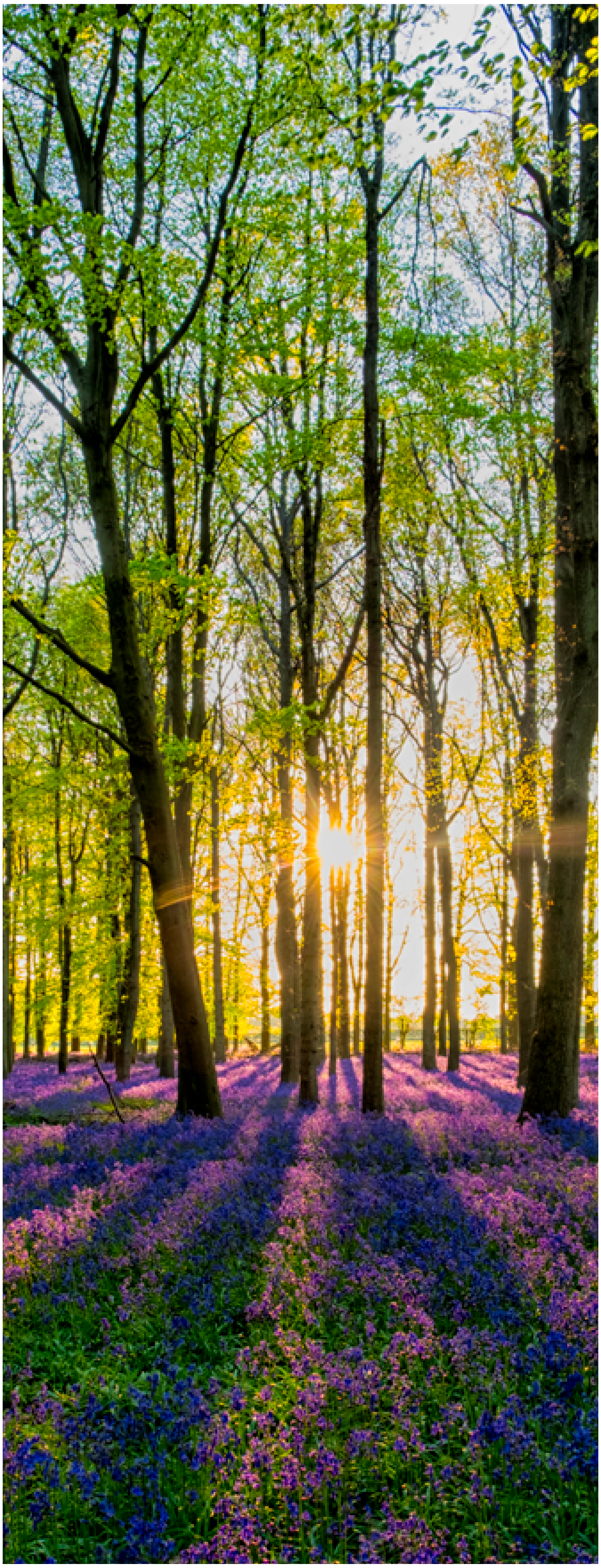
Investment consultants

As well as appointing asset managers, we as a Trustee have appointed investment consultants to provide specialist advice in relation to both Pace DB and Pace DC.

Each year, we set our investment consultants specific objectives, in relation to their advice to Pace, to ensure a high quality of service, and at the end of each year we formally review their performance against these objectives, using a balanced scorecard approach (in line with the requirements of paragraphs 35 and 36 of the Occupational Pension Schemes (Scheme administration) Regulations 1996 as amended).

These objectives cover the consultants' demonstration of value add; their delivery of speciality services (including in relation to support on climate risk, building on the criteria set out by the Investment Consultants Sustainability Working Group's 2021 trustee guide for assessing investment consultants on climate competence); the proactivity of their advice; their support with scheme management and compliance; and the overall relationship and service standards.

We formally assessed our consultants in December 2023 and remain confident that they continue to meet their objectives. However, in the interests of good governance, we review informally throughout the year too, and provide feedback as and when required.



Review and assurance

Under the Stewardship Code, signatories should review their policies, assure their processes and assess the effectiveness of their activities.

A summary of Pace's relevant policies and processes together with the review process is set out below.

Statement of Investment Principles	The Co-op and Bank Sections of Pace each have a Statement of Investment Principles (SIP), which is reviewed annually and after any significant change in investment policy by the Trustee, with advice from Pace's DB and DC investment consultants; the Sections' sponsors are consulted on changes. The SIPs cover our policies on market-wide risks, such as changes in interest rates and currency fluctuations, as well as our approach to other systemic risks such as climate risk. The Bank Section's SIP was reviewed and updated in August 2023 to reflect the investment of the Bank Section's residual DB assets in the BlackRock LEAF fund. The Co-op Section's SIP was updated in June 2023 to reflect changes to the default investment strategy for Pace DC, and again in January 2024 to reflect the bulk annuity policy entered into with Rothesay Life in respect of the vast majority of the remainder of the DB section's uninsured pensioner and deferred liabilities in November 2023. An update was also made to meet new legislative requirements, requiring trustees to state their policy on investing in illiquid assets within default arrangements for the DC section.
Risk register	The Trustee maintains a risk register, summarising the key risks to which Pace DB and Pace DC are exposed, and who is responsible for managing these risks. The risk register is considered quarterly and formally reviewed annually. It has been amended over the year to reflect the buy-in implemented for the Co-op Section.
Responsible Investment Policy	Pace maintains a Responsible Investment Policy covering both DB and DC investments. This policy was reviewed over the year and updated in March 2024 to reflect the implementation of the Bank and Co-op Section buy-ins with Rothesay Life in 2022 and 2023 respectively. An update was also made to the statement of the interaction of financial and non-financial factors and Trustee fiduciary duty, aligning closer with the conclusions of the Financial Markets Law Committee's February 2024 paper, *'Pension Fund Trustees and Fiduciary Duties – Decision-making in the context of Sustainability and the subject of Climate Change'*.

Trustee Statement on Oversight of Climate Change Risks and Opportunities	Pace maintains a Trustee Statement on Oversight of Climate Change Risks and Opportunities, in which the Trustee commits to a number of annual actions, including a review of its own governance arrangements and investment policies in relation to climate change, and an annual review of the statement itself. The Statement was last reviewed in June 2024 (after the year end for this report) to reflect the implementation of the buy-ins for the Bank and Co-op Sections of Pace DB in 2022 and 2023 respectively.

External assurance

On a rolling quarterly basis, the MMIC reviews each investment manager's internal controls reports. Any exceptions are discussed with the investment manager and followed up by MMIC until they are resolved in a satisfactory manner.

Managing conflicts of interest

We have a clear procedure for identifying and managing conflicts of interest which may arise from time to time.

The Trustee reviews the conflicts of interest policy, which covers both the Trustee and its advisers, at least annually. The Trustee Board meets at least quarterly, and in advance of each meeting, Trustee Directors are asked to consider if they have:

- any material personal interest in the outcome of any discussions on the agenda;
- any involvement in negotiating on funding or on any other matter on behalf of the Co-op or the Co-operative Bank;
- any knowledge acquired from another role which would materially impact on decision-making, and which may not be shared with the Board; and
- any difficulties in treating discussions as confidential.

The Trustee maintains a Register of Interests which sets out the relevant interests of the Trustee Directors. The Register is reviewed at each quarterly meeting and is updated on an ongoing basis as and when the Scheme Secretary is advised of any required changes or updates.

We also have a Register of Conflicts in place to record all conflicts which have been declared by the individual Trustee Directors, together with details of the action taken to manage each conflict. Potential conflicts of interest might arise if, for example, a Trustee Director were to have a relevant relationship with an investment manager being considered for appointment, or where they were a trustee for a pension scheme sponsored by a company Pace was considering engaging with or disinvesting from. These conflicts are managed by obtaining appropriate legal advice where necessary, with full disclosure being made within minutes of meetings and the Trustee Director(s) in question absenting themselves from discussions if appropriate.

No new actual or current conflicts of interest were identified in the last Scheme year.

How we communicate with members

We believe it's important to be transparent, so we tell our members how we invest in order to show the Scheme is exercising its responsibilities as an asset owner effectively.

The following documents are reviewed at least annually and are publicly available on the Scheme's website:

- Pace's Statements of Investment Principles for the Co-op and Bank Sections;
- Pace's Implementation Statements (again, for the Co-op and Bank Sections);
- Responsible Investment Policy;
- the Scheme's annual report and accounts;
- our annual Stewardship Code report; and
- an annual Taskforce on Climate-Related Financial Disclosures (TCFD) report.

In addition, there are dedicated sections focused on responsible investment in our annual report and accounts, and our shorter DB members' report and DC benefit statements.

What has the Trustee been doing this year?

Responding to systemic risks

Climate risk

Climate change risk is perhaps the most pressing challenge facing our planet and represents a material risk to pension scheme assets. In addition, around the globe, governments have been introducing regulations to step towards decarbonisation, and these regulations themselves are expected to have an impact on some financial assets – it is therefore a risk we need to recognise and manage.

We published our second report in line with the TCFD framework in October 2023, and our third report will be published by November 2024. Our reporting, and the TCFD framework, covers four areas:

- **Governance:** an organisation's governance around climate-related risks and opportunities (i.e. establishing processes for assessing and managing climate-related risks and opportunities);
- **Strategy:** the actual and potential impact of climate-related risks on investment strategy and funding strategy (including scenario analysis);
- **Risk management:** the processes used by the organisation to identify, assess and manage climate-related risks (e.g. monitoring voting/engagement on climate, and considering investment choices); and
- **Metrics and targets:** the metrics and targets used to assess and manage relevant climate-related risks and opportunities. Trustees must report on a minimum of two emissions-based metrics, one of which must be an absolute measure of emissions, and one which must be an intensity-based measure of emissions; a forward-looking alignment metric looking at how a scheme's investments are aligned with the Paris Agreement goal of pursuing efforts to limit the global average temperature increase to 1.5°C above pre-industrial levels; and one additional climate change metric.

Our analysis in 2023, supported by advice from our investment consultants and scheme actuary, shows that given the de-risked investment strategy for Pace DB, the investment returns and funding strategy for both DB sections is not expected to be materially impacted by climate risk, although the effect on the less mature DC Section could be more significant. We do, however, recognise that there are limitations to climate scenario modelling (which have been highlighted by a report from the Institute and Faculty of Actuaries and the University of Exeter), and that there is a reasonable likelihood that physical impacts are grossly underestimated by these models. This modelling has been updated in our 2024 TCFD report.

We've agreed to manage our DB and DC investments in line with achieving net-zero greenhouse gas (GHG) emissions by 2050 or sooner. We believe this decision is consistent with our fiduciary duty to our stakeholders; it is also supported by:

- the Co-op and the Co-operative Bank's net-zero commitments;
- market developments;
- regulations (in particular, the UK's Nationally Determined Contribution, and the UK Carbon Budget); and
- the emergence of credible methodologies and tools.

This objective is also consistent with the goals of the Paris Agreement and the UK government's legally binding targets. More details of our net-zero commitment can be found in our TCFD report on the Scheme's website.

What is 'net zero'?
Net zero (for a company or a business) refers to achieving a balance between the amount of greenhouse gas emissions produced and the amount removed from the atmosphere. For a pension scheme, 'net zero' means that this balance in greenhouse gases applies across the companies and governments the scheme is invested in, having worked out the scheme's share of these emissions based on the proportion of those companies/ economies the scheme 'owns'.
These emissions include:

Scope 1 'direct' emissions: those from sources owned or controlled by the company (e.g. direct combustion of fuel from vehicles);

Scope 2 'indirect' emissions: those caused by the generation of energy (e.g. electricity) purchased by the company; and

Scope 3 'indirect' emissions: all other indirect emissions across a company's value chain (e.g. emissions related to purchased goods and services, business travel, the use and disposal of goods sold to end consumers).

There are two different routes to achieving net zero, which work in tandem: reducing existing emissions and actively removing greenhouse gases from the atmosphere.

Scope 3 emissions are important, as for most businesses and public bodies, the majority of their emissions are outside their own operations. Addressing Scope 3 emissions can therefore help advance an organisation's decarbonisation and sustainability journey. However, we recognise that issues with methodology and data quality (and availability) at the moment makes the use of Scope 3 emissions challenging for investors. We will continue to work with our advisers and engage with our asset managers and service providers to increase the depth of coverage and the reliability of Scope 3 disclosures in future reporting.

LCP's review of LGIM's stewardship

In 2023, our DC adviser, LCP, carried out an assessment of LGIM's stewardship practices. This involved carrying out detailed research into LGIM's voting, engagement and other stewardship practices through extensive written responses and in-depth meetings.

LCP's assessment recognised that LGIM has a strong focus on systemic risks reflected in their emphasis on thematic engagement and policy advocacy, and that LGIM takes a more activist approach compared to some of the providers in the market. This view was shared by other external specialist stewardship research organisations such as InfluenceMap, Majority Action and ShareAction.

The assessment also highlighted that LGIM has developed a highly detailed voting policy, with standalone policies on a range of environment and social issues, but have some concerns whether LGIM's policy-driven approach could make it more difficult to take account of company-specific considerations and whether more manual reviews would be appropriate. We reached out to LGIM and understand that they have enhanced their processes around voting to adapt to the changing environment and expect this to continue into 2024. We will continue to monitor LGIM's stewardship approach and engage with them when required.

Deforestation

Over the year, we continued to support the ambitions of the Race to Zero Financial Sector Commitment on Eliminating Agricultural Commodity-Driven Deforestation by 2025; and continued our ongoing engagement with LGIM on deforestation.

LGIM updated their deforestation policy to reflect:

- the progress they have made on the milestones set out;
- their strengthening expectations of companies; and
- data improvements which allowed them to broaden the scope and increase the depth of their assessments and engagement.

LGIM have also integrated the social aspects of commodity-driven deforestation and consideration of human rights, including indigenous people and land rights.

LGIM has steadily evolved its approach to assessing and engaging on deforestation risk, most recently with a new risk assessment tool and a refresh of their assessment of deforestation policies and programmes (with voting sanction implications). LGIM's minimum expectation is that all companies in 'deforestation-critical sectors', for which they have data, have both a deforestation policy and programme.

Other systemic and market risks

We recognise that pension schemes face a wide range of investment risks. Over the year, until the buy-in took place, we continued to work with our asset managers to ensure our Liability Driven Investment mandates for the Co-op and Co-operative Bank sections of Pace DB had sufficient collateral, rebalancing as required, in line with our pre-agreed processes, and engaging with our asset managers to review this framework and adapt to new regulatory requirements designed to ensure the effective functioning of the gilt market.

More broadly, in order to identify and respond to market-wide and systemic risks over the year, we've engaged with the wider industry through membership of the UK Sustainable Investment Forum and through our membership of the Occupational Pensions Stewardship Council (OPSC). The OPSC is a forum established by the Department for Work and Pensions (DWP) and supported by the FRC to promote and facilitate high standards of stewardship of UK pension scheme assets.

We believe it is also important to engage directly with policy makers, and in particular will look to use our voice to contribute to the policy debate through responding to consultations.

In September 2023, Pace responded to the DWP's consultation, *'Helping savers understand their pension choices: supporting individuals at the point of access'* to relay our experience of implementing decumulation pathways for Pace DC.

The Co-op Pensions Department also supported the Co-op's response to the DWP's 'Options for defined benefit schemes: a call for evidence' in September 2023, and the follow up 'Options for defined benefit schemes: open consultation' in April 2024.

Developments within Pace DB and Pace DC

We have continued to monitor our investment managers' approaches to incorporating ESG factors in their investment processes.

We recognise that ESG factors can affect the financial performance of the companies and other assets we invest in. Our investment managers take account of ESG factors when they're implementing their mandates. As part of this, they engage directly with the companies they invest in to understand and assess topics like climate change, workers' rights, board constitution, the appropriate use of capital and directors' remuneration.

We meet with each of our investment managers at least annually (at Trustee meetings or via our quarterly MMIC meetings), and ESG considerations and developments are a standing agenda item. Furthermore, our investment advisers assign a rating to each manager according to the extent to which ESG issues and active ownership practices are integrated into their investment processes. The investment adviser's ESG-related ratings are reported to the Trustee and MMIC each quarter, and are used as a factor in manager evaluation and selection (including in relation to the selection of Rothesay Life for the Co-op Section's bulk annuity transaction in November 2023).

What have our investment managers and service providers been doing?

PACE DB

Our buy-in providers

Bulk annuity providers: Rothesay Life, Pension Insurance Corporation and Aviva (three regulated UK insurers).
Allocation: c. 95% of total Co-op Section and Bank Section assets as of April 2024.
Objectives of mandates: to pay the Scheme an income equal to the benefits of the members covered and therefore remove the risk of there being insufficient assets to meet those future liabilities.
Voting rights: not relevant.

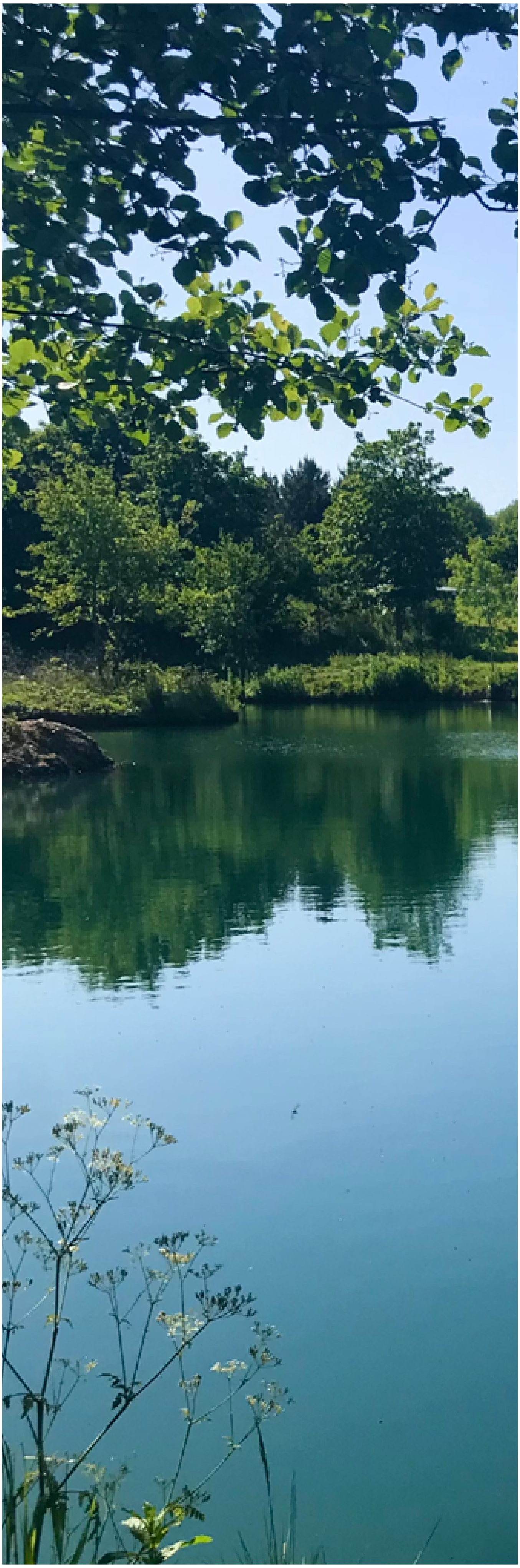
In November 2023, the Co-op Section of Pace entered into a 'buy-in' transaction to purchase a bulk annuity insurance policy with Rothesay Life, a UK insurance company authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority. This policy covered the vast majority of pensioner and non-pensioner liabilities not previously insured with Pension Insurance Corporation (PIC) or Aviva as part of the pensioner buy-in transactions implemented in 2020, and aligned with the full buy-in implemented for the Bank Section in December 2022. Under these policies, Rothesay Life, PIC and Aviva undertake, via the Scheme, to pay the DB Sections' benefit obligations as they fall due. In due course, the Trustee's intention is that the buy-in assets will be moved to a buy-out contract and the Sections could then be wound up.

The execution of the buy-ins involved the transfer of the bulk of the DB section's assets to the insurer, with residual assets in the DB Section consisting of cash held to meet future expenses. Given the transfer of the DB Section's assets (including the corporate bond and LDI portfolios we covered in detail last year), we have not covered the DB Section in as much detail in this year's report.

Pace has limited scope (if any) to influence the investment strategy or stewardship practices of its bulk annuity providers. Once assets are transferred to an insurer, a pension scheme relinquishes direct control over investment decisions, with the insurer assuming all responsibility for managing its own assets to meet its contractual and regulatory obligations.

The Trustee can clearly assess a provider's stewardship before committing funds, and prior to the implementation of the buy-in arrangements in 2022 and 2023, the Trustee undertook comprehensive due diligence checks on Rothesay Life through its advisers (as it did in 2020 prior to the transactions with PIC and Aviva).

These checks encompassed a range of assessments, including, but not limited to, financial stability, governance practices and sustainability. This included commissioning a review of Rothesay Life's ESG capabilities, and its management of climate risk in particular. The Trustee noted that Rothesay Life is a member of the UN-convened net-zero asset owner Alliance, and has a commitment to transitioning its investment portfolio to net-zero greenhouse gas emissions by 2050, aligned with a maximum temperature rise of 1.5°C (and with a 20% reduction by 2025 compared to a 2020 base line, and a 50% reduction in carbon intensity for its listed corporate bond holdings by 2030).



Residual cash holdings

Mandate manager: BlackRock Investment Management (BlackRock).
Allocation: c. 5% of total Co-op Section and Bank Section assets as of April 2024.
Objectives of mandates: BlackRock's objective is to provide a return in line with money market rates. This aim is consistent with maintaining capital and ensuring its underlying assets can be easily bought or sold in the market.
Voting rights: not relevant.

As mentioned, the Trustee has entered into bulk annuity policies with PIC, Aviva and Rothesay Life covering the vast majority of DB liabilities. The only remaining residual DB assets are holdings in cash to meet future costs. A small amount of cash is held in the Trustee bank account for each Section for immediate cashflow needs, but to reduce counterparty risk, the majority is invested in pooled cash funds for each section – specifically the BlackRock Liquid Environmentally Aware Fund (LEAF).

LEAF is an 'ESG aware' cash fund that prohibits investment in issuers that fall within the exclusionary screens defined for the LEAF strategy.

For example, the fund excludes issuers that:

- have exposure to the production of controversial weapons;
- derive 5% or more of their revenues from fossil fuel mining exploration and/or refinement;
- derive 5% or more of their revenues from the production or distribution of tar sands or oil sands;
- derive 5% or more of their revenues from thermal coal extraction;
- have any exposure to the production of, and/or derive 5% or more of their revenues from the distribution of, firearms and small arms ammunition intended for civilian use;
- have any exposure to the production of, and/or derive 5% or more of their revenues from the retailing, distribution and/or licensing of tobacco;
- have been deemed to violate the principles of the UN Global Compact as determined by MSCI;
- have an MSCI '0' controversy score; or
- have an MSC ESG rating of B or below.

In addition to fund's environmentally-focused investment strategy, at least 5% of the net revenue from BlackRock's management fee is used to purchase and retire carbon offsets either directly or through a third-party organisation. BlackRock also makes an annual contribution of $185,000 to the World Wildlife Fund (WWF), a leading environmental non-profit organisation with recognised expertise and experience in environmental protection.

Pace DC

Pace DC is administered by Legal & General Assurance Society Ltd, and members have the option to invest in a range of funds.

In August 2023, the Trustee introduced a number of 'blended' investment funds to the three lifestyle target options for the Co-op Section. All three of the target options make use of the same underlying blended investment funds to provide appropriate levels of expected investment risk and return for members with different timescales to their selected retirement date.

The blended funds used to create the target options are:

- Pace – build your pot: constructed as a blend of two funds consisting of 30% Pace Growth (Mixed) Fund and 70% Pace Growth (Shares) 2021 Fund.
- Pace – consolidate your pot: 100% Pace Growth (Mixed) Fund.
- Pace – take your pot – as cash, as an annuity, or as drawdown. The composition for these options is as follows:
    - Pace – take your pot as cash: 75% Cash Fund; 25% Pace Growth (Mixed) Fund
    - Pace – take your pot as an annuity: 75% Pace Pre-retirement (Annuity Aware) fund; 25% Cash Fund
    - Pace – take your pot as drawdown: 75% Pace Growth (Mixed) Fund; 25% Cash Fund.

The below table shows the range of funds LGIM administered for Pace DC, together with the proportion of members' assets invested in each fund as at 5 April 2024 ('looking through' the blended funds to the underlying LGIM funds).

Mandate manager: Legal & General Investment Management (HSBC for the Pace Growth (Shariah) Fund).

Fund	Proportion of assets (5 April 2024)		Fund objective	
	Co-op Section	Bank Section		
Growth (Mixed)	47.3%	67.6%	Long-term investment growth, using a diversified set of asset classes. The fund also takes into account the environmental and social behaviours of businesses, as well as how well they are governed and run, when deciding how much to invest in different companies.	These funds form part of Pace DC's default option
Growth (Shares) 2021	42.3%	23.5%	Invest in the equity of a diversified range of businesses in the UK and overseas, with strong and improving ESG attributes.	
Cash	9.0%	6.8%	Provide capital protection, with growth at short-term interest rates.	
Growth (Ethical Shares)	1.0%	1.8%	Track the total return of the FTSE4Good Global Equity Index.	
Growth (Shares)	0.1%	0.0%	Capture UK (30%) and overseas (70%) equity market returns.	
Pre-retirement	0.0%	0.0%	Reflect diversified investment underlying a typical traditional annuity product, while also incorporating ESG considerations as part of the investment strategy.	
Pre-retirement (inflation-linked)	0.0%	0.1%	Reflect diversified investment underlying a typical inflation-linked annuity product, while also incorporating ESG considerations as part of the investment strategy.	
Pace Growth (Shariah)	0.1%	0.2%	Reflect Shariah-compliant investment option consistent with the principles of Islamic finance.	

Overall, the most significant holding in Pace DC is the Pace Growth (Mixed) Fund, which is invested in Legal & General's Future World Multi-Asset Fund. This fund invests in a range of assets which may include equities, bonds, cash, listed infrastructure, private equity and global real estate companies, aiming to provide long-term investment growth while also reflecting significant ESG issues into the fund's investment strategy through 'tilts' towards more sustainable companies.

LGIM publishes a number of metrics to quantify the impact of the ESG tilts within the Pace Growth (Mixed) Fund. This has had a quantifiable impact on the profile of the companies in which the fund invests, 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 49% lower for the Future World Multi-Asset Fund than the market as a whole (i.e. a similar fund without the tilts); and
- The carbon reserves of the companies LGIM invests in are 92% lower than for a fund without these tilts.

Participation in industry initiatives

As already noted, LGIM are signatories to the UN PRI, and the UK Stewardship Code. They also participate in wider industry initiatives, engaging with policyholders and non-government stakeholders across the entire policy ecosystem, including Financial Sector Deforestation Action, the Institutional Investors Group on Climate Change, Net Zero Asset Managers Initiative, ShareAction, the Taskforce on Nature-related Financial Disclosures and the Transition Pathway Initiative.

Specific collaboration examples which have been highlighted and discussed at DC Committee meetings over the year include:

- Collaborative engagement with European chemical companies as part of a collaboration of approximately 35 investors organised by ShareAction, to encourage them to implement credible decarbonisation strategies. LGIM believe that progress has been made, with the outcome that some companies have confirmed plans to reach net zero by 2050. Collaboration moving forwards will focus on clear plans to make the transition happen.
- Submitting a resolution at ExxonMobil, co-filed with Christian Brothers Investment Services, calling for full disclosure on their asset retirement obligations, seeking greater clarity into the potential costs Exxon may incur to retire its assets in the event of an accelerated energy transition.
- Supporting the Carbon Disclosure Project's (CDP) Non-Disclosure Campaign, with the aim to engage with companies that have failed to respond to requests to disclose through CDP's climate change, forests and/or water security questionnaires, to aim to promote transparency and accountability from investee companies.
- Joining FAIRR's Restaurant Antibiotics Engagement stream, a collaborative initiative representing over $15 trillion (USD) in assets that aim to improve communications and disclosure between fast-food restaurants and investors, focussing on the topic of antimicrobial resistance and how these companies are mitigating these risks in their supply chains. Outcomes to date include identifying target companies, and LGIM's first engagement call with Restaurant Brands International, the conglomerate owner of a number of fast-food companies, including Burger King.
- Working in partnership with the Environmental Defense Fund, a US-based NGO which works with businesses to find market-based solutions to climate issues (focussing on transferred emissions and methane emissions).

Further information on LGIM's collaborative engagement and the outcomes this has led to is set out in their 2023 Active Ownership report.

Exercise of voting rights

Following changes to reduce risk in its investment strategy in late 2017, Pace DB no longer invests in company shares (either directly or through pooled funds) and therefore does not hold investments with attaching voting rights.

Pace DC offers options for investment to members which do include exposure to shares (either through equity funds or the multi-asset fund). The Trustee does not directly exercise voting rights as these investments are through pooled funds which have many other investors.

LGIM

Voting rights are exercised by LGIM using ISS's ProxyExchange electronic voting platform, although voting decisions are retained by LGIM, and strategic decisions are made by LGIM's Investment Stewardship Team, in accordance with their governance policies for each region.

Over the year, LGIM tightened its voting thresholds as part of their custom voting policy, including around gender diversity on boards of smaller companies, in line with its pre-announced timelines. From 2025, LGIM will also extend voting sanctions for lack of ethnic representation on the board to UK and US companies in the FTSE 250 and Russell 1000 indices.

HSBC

The legal right to the underlying votes lies with the directors of the HSBC Islamic Global Equity Fund, which is the underlying fund behind the Pace Growth (Shariah) Fund. They have delegated this execution of this voting to HSBC Global Asset Management (UK) Limited.

HSBC uses the ISS to assist with the global application of our voting guidelines. ISS reviews company meeting resolutions and provides recommendations highlighting resolutions which contravene our guidelines. HSBC review voting policy recommendations according to the scale of their overall holdings. The bulk of holdings are voted in line with the recommendation based on their guidelines.

The table below sets out the further details relating to LGIM's voting record for stocks held within each fund held within Pace DC which has exposure to equities for the year to 5 April 2024.

	Pace Growth (Shares) 2021 Fund	Pace Growth (Mixed) Fund	Pace Growth (Ethical Shares) Fund	Pace Growth (Shares) Fund	Pace Growth (Shariah) Fund
Size of Pace DC's holdings as at 5 April 2024	c. £369m	c. £453m	c. £10m	c. £0.7m	c. £1.3m
Asset manager	LGIM	LGIM	LGIM	LGIM	HSBC
Number of equity holdings in the fund (at 31 March 2024)	2,229	6,855	1,065	4,692	108
Number of meetings at which asset manager was eligible to vote over the year	3,189	8,965	1,167	7,147	104
Number of resolutions asset manager was eligible to vote on over the year	36,189	91,840	16,564	72,082	1,702
% of resolutions asset manager was eligible to vote on where it exercised that vote	99.9%	99.8%	99.8%	99.9%	96.0%
% of resolutions where asset manager voted for management/voted against management /abstained from voting*	Voted with 78.3% Voted against 21.4% Abstained 0.4%	Voted with 76.7% Voted against 23.1% Abstained 0.2%	Voted with 81.4% Voted against 18.5% Abstained 0.2%	Voted with 80.9% Voted against 18.6% Abstained 0.5%	Voted with 76.0% Voted against 23.0% Abstained 0.0%
% of meetings at which asset manager voted at least once against management	70.0%	73.6%	75.0%	61.5%	82.0%
% of meetings at which asset manager voted against the recommendation of the proxy adviser	14.3%	14.4%	14.1%	10.7%	0.9%

*May not sum due to rounding.

Significant votes

LGIM

LGIM's quarterly ESG impact reports provide information on LGIM's voting activity and details of 'significant votes'. The Pace DC Committee reviews the report quarterly, with any comments or questions fed back to LGIM via the Co-op Pensions Department.

In determining which votes are 'significant', LGIM considers the criteria provided by the Pensions & Lifetime Savings Association guidance, such as:

- a high-profile vote (which may be controversial and therefore subject to a degree of client and/or public scrutiny);
- significant client interest in a vote: communicated directly by clients to the Investment Stewardship team at LGIM's annual stakeholder roundtable event, or where LGIM notes a significant increase in requests from clients on a particular vote;
- a sanction vote as a result of a direct, or collaborative, engagement (e.g. publicly voting against the appointment of directors to highlight failures to engage on important issues);
- a vote linked to an LGIM engagement campaign – in line with the LGIM Investment Stewardship team's five-year engagement policy.

The Trustee and the Co-op Pensions Department have reviewed LGIM's reporting and identified the votes on the following page as 'most significant' using these criteria and considering which votes were most aligned with the Trustee's stewardship priorities as set out on page 8. Note that shares in individual companies will likely be held across multiple funds within the DC Sections, and the holdings below aggregate the value of holdings across all funds within the Bank and Co-op Sections of Pace DC.

HSBC

HSBC regards votes against management recommendation as the most significant. With regards to climate, in its engagement HSBC encourages companies to disclose their carbon emissions and climate-related risks in line with the recommendations of the TCFD. Where companies in energy intensive sectors have persistently failed to disclose their carbon emissions and climate risk governance, HSBC will generally vote against the re-election of the Chairman. HSBC also generally supports shareholder resolutions calling for increased disclosure on climate-related issues.

LGIM

Relevant Stewardship priority	Climate change and the protection of the environment	Climate change and the protection of the environment	Labour conditions and equal pay	Climate change and the protection of the environment	Corporate governance	Corporate governance
Company	**Toyota Motor Corp.**	**Shell**	**Amazon.com, Inc.**	**McDonald's Corp.**	**Microsoft Corp.**	**Apple Inc.**
Date of the vote	14 June 2023	23 May 2023	24 May 2023	25 May 2023	7 December 2023	28 February 2024
Approximate size of Pace DC's holding (based on holding at year end)	c. £1.4m	c. £2.1m	c. £1.0m	c. £0.6m	c. £4.3m	c. £3.3m
Summary of the resolution	Shareholder resolution to amend Articles to report on corporate climate lobbying aligned with Paris Agreement.	To approve the Shell Energy Transition Progress report.	Shareholder resolution to report on median and adjusted gender/racial pay gaps.	Shareholder resolution to adopt policy to phase out use of medically-important antibiotics in beef and pork supply chain.	Shareholder resolution to report on risks related to AI generated misinformation and disinformation.	Shareholder resolution to ask Apple to produce a transparency report on the company's use of AI in its business operations and disclose any ethical guidelines that the company has adopted regarding the company's use of AI technology.
Why the Trustee considers this vote 'significant'	Aligned with the Trustee's engagement priorities; identified as 2023 as one of Pace's top 20 holdings most exposed to deforestation risk.	Aligned with the Trustee's engagement priorities.	Aligned with the Trustee's engagement priorities.	Aligned with the Trustee's engagement priorities.	Aligned with the Trustee's engagement priorities; high profile as an emerging issue.	Aligned with the Trustee's engagement priorities; high profile as an emerging issue.
How the asset manager voted	In favour (against management)	Against (against management)	In favour (against management)	In favour (against management)	Against	In favour (against management)
Was the voting intention communicated to the company ahead of the vote?	Yes	No	Yes	Yes	No (voted in line with management)	Yes

Company	Toyota Motor Corp.	Shell	Amazon.com, Inc.	McDonald's Corp.	Microsoft Corp.	Apple Inc.
Rationale	LGIM views climate lobbying as a crucial part of enabling the transition to a net-zero economy. A vote for this proposal is warranted as LGIM believes that companies should advocate for public policies that support global climate ambitions and not stall progress on a Paris-aligned regulatory environment. LGIM acknowledges the progress that Toyota has made in relation to its climate lobbying disclosure in recent years. However, LGIM believes that additional transparency is necessary with regards to the process used by the company to assess how its direct and indirect lobbying activity aligns with its own climate ambitions, and what actions are taken when misalignment is identified. Furthermore, LGIM expects Toyota to improve its governance structure to oversee this climate lobbying review. LGIM believes the company must also explain more clearly how its multi-pathway electrification strategy translates into meeting its decarbonisation targets, and how its climate lobbying practices are in keeping with this.	LGIM acknowledges the substantial progress made by the company in meeting its 2021 climate commitments and welcome the company's leadership in pursuing low carbon products. However, LGIM remains concerned by the lack of disclosure surrounding future oil and gas production plans and targets associated with the upstream and downstream operations; both of these are key areas to demonstrate alignment with the 1.5° trajectory.	A vote in favour was applied as LGIM expects companies to disclose meaningful information on its gender pay gap and the initiatives it is applying to close any stated gap. This is an important disclosure so that investors can assess the progress of the company's diversity and inclusion initiatives. Board diversity is an engagement and voting issue, as LGIM believes cognitive diversity in business – the bringing together of people of different ages, experiences, genders, ethnicities, sexual orientations, and social and economic backgrounds – is a crucial step towards building a better company, economy and society.	The resolution asks McDonald's to adopt a company-wide policy to phase out the use of medically important antibiotics for disease prevention purposes in its beef and pork supply chains and to set targets with timelines, metrics for measuring implementation and third-party verification. Antimicrobial resistance (AMR) is a key area of focus within LGIM's approach to health, and LGIM considers AMR to be a systemic risk. In line with the shareholder resolution on AMR (resolution 6) that LGIM has co-filed and LGIM's conviction that AMR is a systemic risk, LGIM consider this a material issue and voted in favour.	Having engaged with Microsoft directly to discuss its approach to the risks described in this resolution, LGIM considers at the present time that the company is a leader in the disclosures, governance processes and mitigation steps it is taking on risks posed by its operations from generative AI. LGIM therefore took the decision not to vote in favour of this shareholder resolution.	LGIM believes companies should be assessing and mitigating risks associated with AI and providing transparency to the market on their approach; this applies particularly to those companies that develop AI systems and will shape the way it is used in our economy and society. Apple has announced general plans to further develop its use of generative AI and other AI capabilities; however, the company discloses very little about its approach to managing AI-related risks, nor any principles or guidelines to inform how the company uses AI, putting the company behind its peers and increasing exposure potential regulatory and other risks. LGIM met with the company to discuss these topics, and it did not commit to increasing transparency and disclosures around AI at this time. Apple is among several companies that have outsized influence on the integration of AI into our economy. In line with LGIM's expectations, LGIM believes companies like Apple should be transparent in their uses of AI and their risk management processes.

Company	Toyota Motor Corp.	Shell	Amazon.com, Inc.	McDonald's Corp.	Microsoft Corp.	Apple Inc.
Outcome	Not passed – 15.1% of voters supported the resolution.	Pass – 80% of voters supported the resolution.	Not passed – 29% of voters supported the resolution.	Not passed – 16.3% of voters supported the resolution.	Not passed – 21.2% of voters supported the resolution.	Not passed – 37.5% of voters supported the resolution.
Does the asset manager intend to escalate the stewardship efforts?	LGIM will continue to engage with the company and monitor progress.	LGIM continues to undertake extensive engagement with Shell on its climate transition plans.	LGIM will continue to engage with the company and monitor progress.	LGIM will continue to engage with the company and monitor progress.	LGIM will continue to engage with Microsoft on this issue as it evolves and as shareholder expectations evolve, too. AI will continue to be an important issue and Microsoft's position as a leader in its industry brings with it the responsibility to take appropriate actions regarding governance, risk and transparency on this issue.	LGIM will continue to engage with the company and monitor progress.

HSBC

Relevant Stewardship priority	Corporate governance	Corporate governance
Company	**Novartis AG**	**Apple Inc.**
Date of the vote	3 May 2024	28 February 2024
Approximate size of Pace DC's holding (based on holding at year end)	c. £10k	c. £104k
Summary of the resolution	To re-elect Patrice Bula as Director.	Report on median gender/racial pay gap.
Why the Trustee considers this vote 'significant'	Aligned with the Trustee's engagement priorities.	Aligned with the Trustee's engagement priorities.
How the asset manager voted	Against (against management)	In favour (against management)
Was the voting intention communicated to the company ahead of the vote?	No	No
Rationale	HSBC voted against the Nomination Committee Chair as HSBC have concerns about insufficient gender diversity of the board.	HSBC believe that the proposal would contribute to improving gender inequality.
Outcome	Pass	Not passed
Does the asset manager intend to escalate the stewardship efforts?	HSBC will likely vote against a similar proposal should they see insufficient improvements.	HSBC will likely vote against the management for a similar proposal should they see insufficient improvements.

Appendix

Signposting the requirements of the UK Stewardship Code 2020 within this report

The UK Stewardship Code sets out the FRC's expectations for best practice reporting on asset owners' exercise of stewardship. The code contains a set of 12 key principles, and asset owners are expected to report on activity undertaken in line with these principles as well as outcomes (and in some cases, providing context to allow readers to understand and assess the approach taken).

To help readers, we've signposted below where these 12 principles are covered in this report.

Principles	Document reference
Purpose and Governance	
1. Purpose, strategy and culture	'How do we invest?' (page 5)
2. Governance, resources and incentives	'How do we exercise 'stewardship'?' (page 8)
3. Conflicts of interest	'Managing conflicts of interest' (page 13)
4. Promoting well-functioning markets	'Responding to systemic risks' (page 15)
5. Review and assurance	'Review and assurance' (page 11)
Investment approach	
6. Clients and beneficiary needs	'About us' (page 7), 'How do we invest?' (page 5), and 'How we communicate with members' (page 14)
7. Stewardship, investment and ESG integration	'How do we exercise 'stewardship'?' (page 8) 'What has the Trustee been doing this year?' (page 15) 'What have our investment managers and service providers been doing?' (pages 19 - 31)
8. Monitoring managers and service providers	'What have our investment managers and service providers been doing?' (pages 19 - 31)

Principles	Document reference
Engagement	
9. Engagement	'How do we exercise 'stewardship'?' (page 8) 'What have our investment managers and service providers been doing?' (pages 19 - 31)
10. Collaboration	'Responding to systemic risks' (page 15)
11. Escalation	'How do we exercise 'stewardship'?' (page 8) 'What have our investment managers and service providers been doing?' (pages 19 - 31)
Exercising rights and responsibilities	
12. Exercising rights and responsibilities	'What have our investment managers and service providers been doing?' (pages 19 - 31)