

The Co-operative Pension Scheme (Pace): The Co-operative Bank Section

Financial Statements
For the 6 month period ended 5 April 2019

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Trustee's Annual Report

We are pleased to present the audited financial statements for The Co-operative Pension Scheme (Pace): The Co-operative Bank Section ("Bank Section") for the period 6 October 2018 to 5 April 2019. The financial statements (set out on pages 7 to 39) have been prepared and audited in accordance with Sections 41(1) and (6) of the Pensions Act 1995.

Further details about the Bank Section, including the investment report, are set out in the consolidated Pace Scheme report and accounts for the 6 month period ended 5 April 2019 and these financial statements should be read in conjunction with them.

Report on Actuarial Liabilities

The first actuarial valuation of the Bank Section will be carried out as at 5 April 2019. The statutory deadline for agreeing the results with the sponsoring employer is 5 July 2020. Once the valuation results have been agreed, they will be submitted to the Pensions Regulator and members will be provided with a funding update.

Further details of the last completed actuarial valuation for The Co-operative Pension Scheme (Pace) as at 5 April 2016 is available in the consolidated Pace Scheme report and accounts.

Statement of Trustee's Responsibilities

The financial statements, which are prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including the Financial Reporting Standard applicable in the UK (FRS 102), are the responsibility of the Trustee. Pension Scheme regulations require, and the Trustee is responsible for ensuring, that those financial statements:

- show a true and fair view of the financial transactions of the Bank Section during the Bank Section period and of the amount and disposition at the end of that period of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Bank Section period; and
- contain the information specified in the Regulation 3A of the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, including making a statement whether the financial statements have been prepared in accordance with the relevant financial reporting framework applicable to occupational pension schemes.

In discharging the above responsibilities, the Trustee is responsible for selecting suitable accounting policies, to be applied consistently, making any estimates and judgments on a prudent and reasonable basis, and for the preparing of the financial statements on a going concern basis unless it is inappropriate to presume that the Bank Section will not be wound up.

The Trustee is responsible under the trust deed for the preparation of the non-statutory financial statements in accordance with the requirements of the trust deed, applicable law and United Kingdom Accounting Standards.

The Trustee also has a general responsibility for ensuring that adequate accounting records are kept and for taking such steps as are reasonably open to them to safeguard the assets of the Bank Section and to prevent and detect fraud and other irregularities, including the maintenance of an appropriate system of internal control.

The Trustee is responsible for the maintenance and integrity of the corporate and financial information included on the Scheme's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

For and on behalf of PACE Trustees Limited

Bestrustees Limited,
represented by Christopher Wheeler
Trustee Director

Sarah Horan
Secretary

Date:

Independent Auditor's Report to the Trustee of The Co-operative Pension Scheme (Pace) – The Co-operative Bank Section

Report on the audit of the non-statutory financial statements

Opinion

In our opinion the non-statutory financial statements of The Co-operative Pension Scheme (Pace) – The Co-operative Bank Section (the “Bank Section”):

- show a true and fair view of the financial transactions of the Bank Section during the 6 month period ended 5 April 2019 and of the amount and disposition at that date of its assets and liabilities, other than the liabilities to pay pensions and benefits after the end of the period;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 102 “The Financial Reporting Standard applicable in the UK and Republic of Ireland”; and
- have been properly prepared in accordance with the requirements of the trust deed.

We have audited the non-statutory financial statements which comprise:

- the fund account;
- the statement of net assets; and
- the related notes 1 to 20.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 “The Financial Reporting Standard applicable in the UK and Republic of Ireland” (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the non-statutory financial statements Bank Section of our report.

We are independent of the Scheme in accordance with the ethical requirements that are relevant to our audit of the non-statutory financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the Trustee's use of the going concern basis of accounting in preparation of the non-statutory financial statements is not appropriate; or

Independent Auditor's Report to the Trustee of The Co-operative Pension Scheme (Pace) – The Co-operative Bank Section (continued)

Conclusions relating to going concern (continued)

- the Trustee has not disclosed in the non-statutory financial statements any identified material uncertainties that may cast significant doubt about the Bank Section's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the non-statutory financial statements are authorised for issue.

We have nothing to report in respect of these matters.

Other information

The Trustee is responsible for the other information. The other information comprises the information included in the annual report, other than the non-statutory financial statements and our auditor's report thereon. Our opinion on the non-statutory financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the non-statutory financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the non-statutory financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the non-statutory financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of Trustee

As explained more fully in the Statement of Trustee's Responsibilities, the Trustee responsible under the trust deed for the preparation of the non-statutory financial statements in accordance with the requirements of the trust deed, applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and for such internal control as the Trustee determines is necessary to enable the preparation of non-statutory financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the non-statutory financial statements, the Trustee is responsible for assessing the Bank Section's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Trustee either intends to liquidate the Bank Section or to cease operations, or has no realistic alternative but to do so.

Independent Auditor's Report to the Trustee of The Co-operative Pension Scheme (Pace) – The Co-operative Bank Section (continued)

Auditor's responsibilities for the audit of the non-statutory financial statements

Our objectives are to obtain reasonable assurance about whether the non-statutory financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the requirements of the trust deed and ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these non-statutory financial statements.

A further description of our responsibilities for the audit of the non-statutory financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

This report is made solely to the Bank Section's Trustee, as a body, in accordance with the requirements of the trust deed and rules and our engagement letter dated 2 May 2019. Our audit work has been undertaken so that we might state to the Bank Section's Trustee those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Scheme's Trustee as a body, for our audit work, for this report, or for the opinions we have formed.

Deloitte LLP
Statutory Auditor
Manchester
United Kingdom

Date:

Fund Account

for the 6 month period ended 5 April 2019

In plain English – what does this show?

The Fund Account shows all contributions, investment income and asset return received by the defined benefit section (DBS) and defined contribution section (DCS) of the Co-operative Bank Section, minus the benefits and expenses paid out during the period 6 October 2018 to 5 April 2019. The result is the Co-operative Bank Section's net asset position at the end of the reporting period.

		DBS 6 month period ended 5 Apr 19	DCS 6 month period ended 5 Apr 19	Total 6 month period ended 5 Apr 19	Total for the period ended 7 Aug 18 - 5 Oct 18
	Note	£'000	£'000	£'000	£'000
Contributions and Benefits					
Employer contributions		12,500	5,829	18,329	1,824
Employee contributions		-	409	409	146
Total contributions	3	12,500	6,238	18,738	1,970
Transfers in	4	-	232	232	5
Other income	5	-	57	57	-
		12,500	6,527	19,027	1,975
Benefits paid or payable	6	(18,315)	(259)	(18,574)	(6,857)
Payments to and on account of leavers	7	(30,158)	(10,031)	(40,189)	(21,222)
Administrative expenses	8	(1,397)	(26)	(1,423)	(429)
		(49,870)	(10,316)	(60,186)	(28,508)
Net withdrawals from dealing with members		(37,370)	(3,789)	(41,159)	(26,533)
Returns on investments					
Investment income	9	20,364	-	20,364	7,655
Change in market value of investments	10	182,065	2,140	184,205	(109,800)
Investment management expenses	11	(1,215)	-	(1,215)	(303)
Net returns on investments		201,214	2,140	203,354	(102,448)
Net increase/(decrease) in the Bank Section during the period		163,844	(1,649)	162,195	(128,981)
Transfers between sections		197	(191)	6	-
Net assets of the Bank Section: As at 6 October 2018 / 7 August 2018		1,822,209	55,101	1,877,310	2,006,291
As at 5 April 2019 / 5 October 2018		1,986,250	53,261	2,039,511	1,877,310

The notes on pages 10 to 39 form part of these financial statements.

Statement of Net Assets

(available for benefits) as at 5 April 2019

In plain English – what does this show?

The Statement of Net Assets below provides a snapshot of the financial position of the Bank Section as at 5 April 2019. It sums up the Bank Section's assets and liabilities at this date. It does not take account of obligations to pay pensions and benefits, which fall due after the end of the Bank Section period; this is dealt with in the Report on Actuarial Liabilities.

	Note	DBS 5 Apr 19 £'000	DCS 5 Apr 19 £'000	Total 5 Apr 19 £'000	Total 5 Oct 18 £'000
Investment assets	10-14				
Bonds		1,902,281	-	1,902,281	1,706,156
Pooled investment vehicles		60,321	52,810	113,131	99,738
Derivatives		569,467	-	569,467	496,462
AVC investments		6,186	-	6,186	6,848
Cash deposits		4,094	-	4,094	-
Sales awaiting settlement		12	-	12	1,027
Dividend entitlement		11,300	-	11,300	11,175
Investment liabilities					
Cash deposits		-	-	-	(738)
Derivatives		(487,199)	-	(487,199)	(446,084)
Repurchase agreements		(83,592)	-	(83,592)	(5,167)
Purchases awaiting settlement		(2,546)	-	(2,546)	(556)
Total net investments		1,980,324	52,810	2,033,134	1,868,861
Current assets	15	8,110	917	9,027	11,215
Current liabilities	16	(2,184)	(466)	(2,650)	(2,766)
Net assets of the Bank Section		1,986,250	53,261	2,039,511	1,877,310

The notes on pages 10 to 39 form part of these financial statements.

The financial statements summarise the transactions of the Bank Section and deal with the net assets at the disposal of the Trustee. They do not take account of obligations to pay pensions and benefits, which fall due after the end of the Bank Section period. The Actuary deals with the actuarial position of the Scheme, which does take account of such obligations, in the Report on Actuarial Liabilities within the annual report in the Pace Scheme consolidated report and accounts as at 5 April 2019, and these financial statements should be read in conjunction with them.

The Trustee Directors approved these financial statements on _____.

Signed for and on behalf of the Trustee Directors:

Bestrustees Limited,
represented by Christopher Wheeler
Trustee Director

Sarah Horan
Secretary

Notes to the Financial Statements

In plain English – what does this show? This section outlines the general accounting policies of the Bank Section that relate to the financial statements as a whole.

1 Basis of preparation

The financial statements have been prepared in accordance with the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, Financial Reporting Standard 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland issued by the Financial Reporting Council and the guidance set out in the Statement of Recommended Practice (Revised November 2014).

These non-statutory accounts have been prepared for the purpose of the scheme funding valuation for the Bank Section. Separate audited statements have been prepared for the Pace Scheme in accordance with Audit Accounts Regulations. Full SORP disclosures can be found in the Pace Scheme financial statements.

Due to the material significance of sectionalising the Pace Scheme, we agreed to extend the accounting period of the Pace Scheme to a 18-month accounting period from 6 April 2017 to 5 October 2018, and then to prepare a 6-month accounting period set of accounts to revert back to a 5 April year-end to take into account the first actuarial valuation of the Bank Section. The prior period comparative in these accounts is from 7 August 2018 to 5 October 2018, which is from the date that sectionalisation occurred.

2 Accounting policies

The principal accounting policies of the Bank Section are as follows:

Contributions and benefits

Employee normal and additional contributions are accounted for when deducted from pay and in the period to which the corresponding pay relates. Employer normal contributions are accounted for on the same basis as employee contributions. Deficit funding and employer expense allowance contributions are accounted for in the period they are due.

Benefits are accounted for in the period in which the member notifies us of their decision on the type or amount of benefit to be taken or, if there is no member choice, on the date of retirement or leaving.

Transfers

Individual transfers in or out represent the capital sums either received in respect of members from other pension schemes or paid to other pension schemes for members who have left the Bank Section. Transfer values are accounted for when the liability is accepted, or discharged.

Expenses

Expenses are accounted for on an accruals basis.

Investment income

Dividends from quoted securities are accounted for when due, with the addition of dividends outstanding as at 5 April 2019 on listed stocks which were then ex-dividend. Interest on deposits is accounted for on an accruals basis and accrued daily.

Investment income is reported net of attributable tax credits but gross of withholding taxes, which are accrued in line with the associated investment income. Irrecoverable withholding taxes are reported separately as a tax charge.

Investment income arising from the underlying assets within pooled investment vehicles is reinvested in those vehicles and is reflected in the unit price. This income is reported within 'change in market value'.

Income arising from annuity policies held in our name as Trustee for the Bank Section is accounted for as investment income on an accruals basis.

Foreign currencies

Translation of foreign income into sterling is at the exchange rate on the date of receipt. For the investments held in foreign currency, the translation into sterling is at the exchange rate as at period end.

Where forward sales of foreign currency have been made as a hedge against exposure on foreign currency investments, any unrealised profit or loss at the period-end, measured by the difference between the spot and the contract rate, is included in the changes in market value of investments, together with realised gains and losses on forward contracts maturing during the period.

Valuation of investments

Investments are included in the statement of net assets at market value. UK and foreign listed securities are valued at the bid-market value or latest traded price at the period-end. Pooled investment vehicles and unit trusts are stated at the bid price for funds with bid/offer spreads, single price, or dealing price where there are no bid/offer spreads, as provided by the investment manager at the period end.

Bonds are stated at their clean (i.e. excluding accrued income) prices. Accrued income is accounted for within investment income.

Derivatives are stated at market value. Exchange traded derivatives are stated at market values determined using market quoted prices. For exchange traded derivative contracts which are assets, market value is based on quoted bid prices. For exchange traded derivative contracts which are liabilities, market value is based on quoted offer prices.

Forward foreign exchange contracts are valued by determining the gain or loss that would arise from closing out the contract at the reporting date by entering into an equal and opposite contract at that date.

Swaps are revalued on a daily basis. The fair value is calculated using pricing models, where inputs are based on market data as of close of business the previous day. Interest is accrued on a basis consistent with the terms of each contract. The amounts included in 'change in market value' are the realised gains or losses on closed contracts and the unrealised gains or losses on open contracts. Net receipts or payments on swap contracts are reported within change in market value.

Realised and unrealised gains and losses arising on derivative contracts are disclosed within change in market value and are taken directly to the fund account.

Repurchase agreements are valued on an amortised cost basis and are accounted for as follows:

Repurchase agreements (repo) - the Bank Section continues to recognise and value the securities that are delivered out as collateral, and includes them in the financial statements. The cash received is recognised as an asset and the obligation to pay it back is recognised as a payable amount. These agreements are valued on an amortised cost basis.

We have estimated that the fair value of annuities purchased in the Trustee's name, which fully provide the benefits for certain members, are immaterial. The asset has therefore been excluded from these financial statements. The cost of purchasing these annuities is reported within the Fund Account under 'Benefits paid or payable'.

AVC investments are included at market value, as provided by the AVC provider.

3 Contributions

In plain English – what does this show? This note shows what contributions have been received by the Bank Section from the Co-operative Bank during the period.

	DBS 6 month period ended 5 April 19 £000	DCS 6 month period ended 5 April 19 £000	Total 6 month period ended 5 April 19 £000
Employer			
normal	-	5,784	5,784
deficit funding	12,500	-	12,500
expense allowance	-	45	45
	12,500	5,829	18,329
Employee			
normal	-	3	3
additional voluntary contributions	-	406	406
	-	409	409
	12,500	6,238	18,738

3 Contributions (continued)

	DBS for the period 7 August 18 to 5 October 18 £000	DCS for the period 7 August 18 to 5 October 18 £000	Total for the period 7 August 18 to 5 October 18 £000
Employer			
normal	-	1,824	1,824
deficit funding	-	-	-
expense allowance	-	-	-
	-	1,824	1,824
Employee			
normal	-	1	1
additional voluntary contributions	-	145	145
	-	146	146
	-	1,970	1,970

In accordance with the Schedule of Contribution certified by the Actuary on 1 May 2019, The Co-operative Bank plc agreed to pay the following amounts into the DBS of the Bank Section. These contributions are payable in advance.

- £12.5m per annum for the period 1 January 2019 to 31 December 2022; and
- £7.5m per annum for the period 1 January 2023 to 31 December 2027.

The Co-operative Bank plc also meets the cost of any expenses, life assurance premiums and Scheme levies in respect of the DCS directly, with the exception of costs charged by the Co-operative Group Limited in respect of the provision of services to the DCS, which will be met by way of contributions payable to the DCS:

- For the period 6 August 2018 to 5 May 2019: a single contribution of £37,500 payable by 10 October 2018, and a further single contribution of £7,500 payable on 8 March 2019.
- From 6 May 2019 to 31 December 2027; a fixed contribution of £50,000 plus VAT per annum payable in annually in advance.

4 Transfers in

In plain English – what does this show? This note shows the value of transfers in which have been transferred into the Bank Section during the period.

	DBS 6 month period ended 5 April 19 £000	DCS 6 month period ended 5 April 19 £000	Total 6 month period ended 5 April 19 £000
Individual transfers in	-	232	232

4 Transfers in (continued)

	DBS for the period 7 August 18 to 5 October 18 £000	DCS for the period 7 August 18 to 5 October 18 £000	Total for the period 7 August 18 to 5 October 18 £000
Individual transfers in	-	5	5

5 Other income

In plain English – what does this show? This note shows income received from Zurich Assurance Limited, the life insurance provider for the Scheme.

	DBS 6 month period ended 5 April 19 £000	DCS 6 month period ended 5 April 19 £000	Total 6 month period ended 5 April 19 £000
Life assurance claims	-	57	57

	DBS for the period 7 August 18 to 5 October 18 £000	DCS for the period 7 August 18 to 5 October 18 £000	Total for the period 7 August 18 to 5 October 18 £000
Life assurance claims	-	-	-

6 Benefits paid or payable

In plain English – what does this show? This note shows the types and values of benefits been paid out to members of the Bank Section during the period.

	DBS 6 month period ended 5 April 19 £000	DCS 6 month period ended 5 April 19 £000	Total 6 month period ended 5 April 19 £000
Pensions	16,229	-	16,229
Commutations and lump sum retirement benefits	1,948	112	2,060
Lump sum death benefits	138	147	285
	18,315	259	18,574

6 Benefits paid or payable (continued)

	DBS for the period 7 August 18 to 5 October 18 £000	DCS for the period 7 August 18 to 5 October 18 £000	Total for the period 7 August 18 to 5 October 18 £000
Pensions	6,097	-	6,097
Commutations and lump sum retirement benefits	674	62	736
Lump sum death benefits	24	-	24
	6,795	62	6,857

7 Payments to and on account of leavers

In plain English – what does this show?

This note shows how much has been paid out to members and other pension schemes for members who have left the Bank Section during the period.

	DBS 6 month period ended 5 April 19 £000	DCS 6 month period ended 5 April 19 £000	Total 6 month period ended 5 April 19 £000
Refund of overpaid CEP	(143)	-	(143)
Individual transfers to other schemes	30,301	10,031	40,332
	30,158	10,031	40,189

	DBS for the period 7 August 18 to 5 October 18 £000	DCS for the period 7 August 18 to 5 October 18 £000	Total for the period 7 August 18 to 5 October 18 £000
Refund of overpaid CEP	-	-	-
Individual transfers to other schemes	20,761	461	21,222

8 Administrative expenses

In plain English – what does this show?

This note shows the different types of expenses the Bank Section has incurred during the period. It splits expenses into key categories, such as actuarial and administration fees.

	DBS 6 month period ended 5 April 19 £000	DCS 6 month period ended 5 April 19 £000	Total 6 month period ended 5 April 19 £000
Administration	976	26	1,002
Actuarial	134	-	134
Audit	40	-	40
Legal and other	247	-	247
	1,397	26	1,423

	DBS for the period 7 August 18 to 5 October 18 £000	DCS for the period 7 August 18 to 5 October 18 £000	Total for the period 7 August 18 to 5 October 18 £000
Administration	307	8	315
Actuarial	40	-	40
Audit	41	-	41
Legal and other	33	-	33
	421	8	429

The Co-operative Bank plc meets all DCS costs directly, with the exception of costs charged by the Co-operative Group Limited in respect of the provision of services to the DCS, which is met by way of contribution payable to the DCS. The DBS meets all costs in respect of the DBS.

9 Investment Income

In plain English – what does this show?

The Bank Section receives income and interest from its assets; this note shows the different types of income and interest received during the period.

DBS	Total 6 month period ended 5 April 19 £000	Total for the period 7 August 18 to 5 October 18 £000
Income from bonds	21,220	7,667
Interest on cash deposits	142	39
Foreign exchange loss	(1,330)	(134)
Income from collateral	1	-
Irrecoverable taxation	(2)	-
Annuity income	238	80
Other	95	3
	20,364	7,655

Investment income shown above reflects income earned by investments within the DB Section. All income received on pooled investment vehicles is re-invested and is included in the change in market value. All income earned on pooled investment units held by the DC Section is accounted for within the value of those funds.

10 Reconciliation of investments

In plain English – what does this show?

This note provides a reconciliation of the sales, purchases and change in market value during the period between the opening and closing value of investments and analysed by asset class as disclosed on the face of the Statement of Net Assets.

		6 October 2018	Purchases at cost and derivative payments	Sales proceeds and derivative receipts	Change in market value	5 April 2019
DB Assets	Note	£000	£000	£000	£000	£000
Bonds		1,706,156	222,746	(160,567)	133,946	1,902,281
Pooled investment vehicles	10.1	45,585	108,515	(94,153)	374	60,321
Net derivative contracts	10.2					
-Swaps		48,168	9,800	(23,284)	48,285	82,969
-Futures		13	27	(16)	(30)	(6)
-Foreign exchange		2,197	6,196	(8,827)	(261)	(695)
AVC investments	10.3	6,848	448	(1,104)	(6)	6,186
		1,808,967	347,732	(287,951)	182,308	2,051,056
Repurchase agreements		(5,167)			(243)	(83,592)
Cash deposits		(738)				4,094
Dividend entitlement		11,175				11,300
Sales awaiting settlement		1,027				12
Purchases awaiting settlement		(556)				(2,546)
TOTAL DB ASSETS		1,814,708			182,065	1,980,324
DC Assets		£000	£000	£000	£000	£000
Pooled investment vehicles	10.1	54,153	6,491	(9,974)	2,140	52,810
TOTAL DC ASSETS		54,153	6,491	(9,974)	2,140	52,810

The change in market value of investments during the period comprises all increases and decreases in the market value of investments held at any time during the period, including profits and losses realised on sales of investments.

Transaction costs

Included within the DB Section purchases and sales figures are direct transaction costs of £128 comprising of commission (5 October 2018: £3 comprising of fees). These costs are attributable to the key asset classes as follows:

	Fees £	Commission £	Stamp Duty £	Total £
Cash instruments	-	128	-	128
For the period to 5 April 2019*	-	128	-	128
For the period to 5 Oct 2018**	3	-	-	3

*represents transaction costs for the 6 month period 6 October 2018 to 5 April 2019

**represents transaction costs for the 2 month period 7 August to 5 October 2018

Transaction costs are also borne by the Bank Section in relation to transactions in pooled investment vehicles. Such costs are taken into account in calculating the bid/offer spread of these investments and are not separately reported.

For the DC section, investments purchased by the Bank Section are allocated to provide benefits to the individuals on whose behalf corresponding contributions are paid. Legal & General holds the investment units on a pooled basis on our behalf. Legal & General allocates investment units to members. We may hold investment units representing the value of employer contributions that have been retained by the Bank Section that relate to members leaving the Bank Section prior to vesting.

DC assets are allocated to members and the Trustee as follows:

	Total 5 Apr 19 £000	Total 5 Oct 18 £000
Members	53,252	55,109
Trustee	9	(8)
	53,261	55,101

10.1 Pooled investment vehicles

DBS	Total 5 Apr 19 £000	Total 5 Oct 18 £000
Cash fund	43,094	21,200
Alternative fund	17,214	24,372
Hedge fund	13	13
	60,321	45,585

10.1 Pooled investment vehicles (continued)

DCS	Total 5 Apr 19 £000	Total 5 Oct 18 £000
Diversified Growth	49,860	51,122
Cash	2,133	2,026
Equity	812	997
Bonds	5	8
	52,810	54,153

Derivative contracts - Objectives and policies

We have authorised the use of derivatives by investment managers to manage risk within the investment strategy.

The main objectives for the use of key classes of derivatives and the policies followed during the period are summarised as follows:

Swaps – Our aim is to match, as far as possible, the liability matching portfolio and the Bank Section’s long-term liabilities, in particular in relation to sensitivity to interest rate and inflation movements. For capital efficiency, we have entered into derivative agreements (interest rate and inflation-linked swap contracts and gilt total return swaps) that enable the liability matching portfolio to better match the long-term liabilities of the Bank Section. Total return swaps allow exposure to index-linked and conventional gilts to match the long-term liabilities of the Bank Section in a capital efficient manner.

Futures – Futures are used to manage interest rate risk and gain synthetic bond exposure. Bond future contracts are efficient instruments to allow the manager to position the portfolio for overall movements in yields and changes in shape to the yield curve.

Forward foreign exchange – In order to maintain appropriate diversification of investments within the portfolio, and take advantage of overseas investment returns, a proportion of the investment portfolio is invested overseas. To balance the risk of investing in foreign currencies whilst having an obligation to settle benefits in Sterling, we operate a policy of hedging a portion of non-sterling currency exposure in the fixed income portfolio to reduce the currency exposure of the overseas investments to the targeted level.

At the period-end the Bank Section had the following derivatives:

10.2 Derivatives

DBS		Assets 5 Apr 19 £000	Liabilities 5 Apr 19 £000	Assets 5 Oct 18 £000	Liabilities 5 Oct 18 £000
OTC swaps	(i)	568,726	(485,757)	494,186	(446,018)
Futures	(ii)	7	(13)	13	-
Forward FX contracts	(iii)	734	(1,429)	2,263	(66)
		569,467	(487,199)	496,462	(446,084)

i. Swaps			
Nature Duration	Nominal Amount £000	Asset value at period-end £000	Liability value at period-end £000
Inflation rate			
2019-2020	46,000	-	(379)
2021-2030	437,535	1,170	(14,531)
2031-2040	33,057	7,087	(8,589)
2041-2050	48,410	6,476	(10,806)
2051-2060	7,160	18,360	(17,062)
		33,093	(51,367)
Interest rate			
2019-2020	46,140	17,881	(32,471)
2021-2030	91,755	6,678	(8,449)
2031-2040	94,236	167,639	(94,691)
2041-2050	106,877	197,452	(238,054)
2051-2060	14,904	116,144	(60,016)
		505,794	(433,681)
Total return			
2041-2050	183,474	15,516	-
2051-2065	282,843	14,323	(709)
		29,839	(709)
Total 5 April 2019		568,726	(485,757)
Total 5 October 2018		494,186	(446,018)

In relation to the swap contracts above, the fund and counterparties have deposited a total of £31m and £115m (2018: £41m and £108m) of bonds and cash as collateral at the period-end respectively. This collateral is not reported within the Bank Section's net assets.

ii. Futures

Nature	Notional Amount long/(short) position	Expires	Asset value at year-end £000	Liability value at year-end £000
US Treasury Bond (CBT)	3	< 1 year	5	-
US 10 Year Ultra (CBT)	(2)	< 1 year	2	-
US 5 Year Note (CBT)	(1)	< 1 year	-	(1)
US 10 Yr Treasury Notes (CBT)	(4)	< 1 year	-	(2)
US Ultra Bond (CBT)	(4)	< 1 year	-	(10)
Total 5 April 2019			7	(13)
Total 5 October 2018			13	-

Included within cash balances is £19k (5 October 2018: £28k) in respect of initial and variation margins arising on open futures contracts at the period-end.

iii. Forward Foreign Exchange (FX)

The Bank Section had open FX contracts at the period-end as follows:

Contract	Settlement date	Currency bought	Currency	Currency sold	Currency	Asset value at 5 April 19 £000	Liability value at 5 April 19 £000
Forward FX	<2months	29,581	GBP	(29,598)	EUR	18	(35)
Forward FX	<2months	31,992	USD	(31,931)	GBP	63	(1)
Forward FX	<2months	136,715	GBP	(137,331)	USD	651	(1,268)
Forward FX	>2months	3,281	GBP	(3,299)	EUR	-	(18)
Forward FX	>2months	364	USD	(363)	GBP	2	-
Forward FX	>2months	61,832	GBP	(61,939)	USD	-	(107)
Total 5 April 2019		263,765		(264,461)		734	(1,429)
Total 5 October 2018		216,198		(214,001)		2,263	(66)

10.3 AVC investments

DBS	Total 5 April 19 £000	Total 5 Oct 18 £000
Royal London (CIS) Ltd	3,136	3,961
Legal & General	3,050	2,887
	6,186	6,848

Contributions to Additional Voluntary Contribution investments made by both DBS and DCS members are invested separately from the investments of the Bank Section on a money purchase basis with Legal & General. As Legal & General does not distinguish

between investments held for DBS and DCS members, all Legal & General AVCs are reported as DBS assets.

Royal London (CIS) Ltd provided AVCs for DBS members up to October 2015, when the Pace DB Section closed. It is no longer possible for any further contributions to be made to Royal London since the Pace DB Section closed.

10.4 Concentration of investments

As at 5 April 2019 and 5 October 2018, no investments represented more than 5% of the net assets of the Bank Section.

11 Investment management expenses

In plain English – what does this show? This note shows the investment management expenses incurred by the Bank Section during the period.

DBS	Total period ended 5 Apr 19 £000	Total period ended 5 Oct 18 £000
Investment management fees	894	254
Custody fees	110	11
Performance measurement services	3	1
Other advisory fees	177	37
Other investment expenses	31	-
	1,215	303

There were no performance fees included in investment management fees during the period.

12 Taxation

The Scheme is a registered pension scheme under Chapter 2 of Part 4 of the Finance Act 2004 and is therefore exempt from income tax and capital gains tax. The tax charge in the Fund Account (see note 9) represents irrecoverable withholding taxes arising on investment income.

13 Fair value determination

In plain English – what does this show?

This note categorises the investment assets and liabilities held by the Bank Section into specific levels which correspond to how its market value has been determined. Market values can be determined from a number of sources including taking pricing information from market data i.e. a stock exchange, or using a valuation model not widely available.

The fair value of financial instruments has been estimated using the following fair value hierarchy:

- **Level 1:** The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.
- **Level 2:** Inputs other than quoted prices included within Level 1 that are observable (i.e. developed using market data) for the asset or liability, either directly or indirectly;
- **Level 3:** Inputs are unobservable (i.e. for which market data is unavailable for the asset or liability).

The Bank Section's investment assets and liabilities have been fair valued using the above hierarchy categories as follows:

At 5 April 2019	Held at cost not FV £000	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
DB Section					
Bonds	-	-	1,790,487	111,794	1,902,281
Pooled investment vehicles	-	-	43,094	17,227	60,321
Swaps	-	-	82,969	-	82,969
Futures	-	(6)	-	-	(6)
Foreign exchange	-	-	(695)	-	(695)
AVC investments	-	-	6,186	-	6,186
Repurchase agreements	(83,592)	-	-	-	(83,592)
Cash deposits	-	4,094	-	-	4,094
Dividend entitlement	-	11,300	-	-	11,300
Sales awaiting settlement	-	12	-	-	12
Purchases awaiting settlement	-	(2,546)	-	-	(2,546)
	(83,592)	12,854	1,922,041	129,021	1,980,324
DC Section					
Pooled investment vehicles	-	-	52,810	-	52,810
TOTAL	(83,592)	12,854	1,974,851	129,021	2,033,134

At 5 October 2018	Held at cost not FV £000	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
DB Section					
Bonds	-	-	1,616,746	89,410	1,706,156
Pooled investment vehicles	-	-	21,200	24,385	45,585
Swaps	-	-	48,168	-	48,168
Futures	-	13	-	-	13
Foreign exchange	-	-	2,197	-	2,197
AVC investments	-	-	6,848	-	6,848
Repurchase agreements	(5,167)	-	-	-	(5,167)
Cash deposits	-	(738)	-	-	(738)
Dividend entitlement	-	11,175	-	-	11,175
Sales awaiting settlement	-	1,027	-	-	1,027
Purchases awaiting settlement	-	(556)	-	-	(556)
	(5,167)	10,921	1,695,159	113,795	1,814,708
DC Section					
Pooled investment vehicles	-	-	54,153	-	54,153
TOTAL	(5,167)	10,921	1,749,312	113,795	1,868,861

14 Investment risk disclosures

In plain English – what does this note show?

This note provides additional information to enable readers to evaluate the nature and extent of credit, market and other risks arising from certain investment assets which the Bank Section is exposed to. Information about how the Bank Section manages these risks is also provided.

FRS 102 requires that we, the Trustee, provide information in relation to certain investment risks. The risks are set out by FRS 102 are:

Credit Risk: this is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation, e.g. the risk that a borrower may not repay a loan or a debt to the Bank Section.

Market Risk: this includes “currency risk”, “interest rate risk”, “inflation risk” and “other price risk”.

- **Currency risk:** this is the risk that the value of an investment changes because of changes in foreign exchange rates.
- **Interest rate risk:** this is the risk that the value of an investment increases or decreases because of changes in interest rates.

- **Inflation risk:** this is the risk that the value of an investment increases or decreases because of changes in inflation expectations.
- **Other price risk:** this is the risk that the value of an investment decreases or increases because of changes in market prices (apart from changes in value as a result of movements in interest rates, inflation or currencies).

14.1 Defined Benefit Section

Other Defined Benefit Risks:

Apart from the risks listed above, we make sure the following investment related risks are managed:

- **“Solvency risk and mismatching risk”:** The risk that the Bank Section does not generate strong enough investment returns, and cannot meet benefits
- **“Manager risk”:** The risk that individual investment managers underperform their objectives
- **“Liquidity risk”:** The risk that the Bank Section does not hold enough cash to meet short term requirements to pay benefits
- **“Corporate governance risk”:** The risk that the Bank Section invests in poorly managed companies, and that the value of those investments falls as a result
- **“Custody risk”:** The risk that the Bank Section’s assets are not held safely
- **“Sponsor risk”:** The risk that the Bank Section’s sponsor cannot afford to pay money into the Bank Section if needed
- **“Leverage risk”:** The risk that the Bank Section’s liability matching investments fall in value, and additional cash is required
- **“Hedging related risks”:** The risk that investments made by the Bank Section to “match” its liabilities are not a good fit and do not behave in the same way as those liabilities.
- **Environmental, social and governance (“ESG”) risk (including climate change)** – The risk that the Scheme’s investment returns and/or reputation are damaged due to the failure to implement and adhere to its responsible investment policy.

14.1.1 Defined Benefit Investment Strategy

We make investment decisions after taking advice from a professional investment adviser. The Bank Section is subject to the risks above because of the investments it makes to implement its strategy. We manage investment risks, including credit risk and market risk, within agreed limits which are set taking into account the Bank Section’s investment objectives. These investment objectives and risk limits are applied through the legal agreements the Bank Section has with its investment managers, and we regularly monitor that the managers are complying with these agreements.

A more detailed description of our approach to risk management and the Bank Section's exposures to credit and market risks is set out below. This does not include annuities, insurance policies or AVC investments, because these are considered immaterial compared to the overall investments of the Bank Section.

14.1.2 Defined Benefit Investment Risk Management

For the Bank Section, we do not currently invest in pooled investment vehicles where we have control over the investment mandates. We currently have assets invested in an alternative growth fund in a pooled investment vehicle.

(i) Credit risk

The Bank Section is subject to credit risk because:

- it invests in bonds issued by UK and overseas governments and companies (which could default on their debt to the Bank Section);
- it enters into repurchase agreements and invests in derivatives; and
- it holds cash in bank accounts and with investment managers.

The Bank Section also has asset holdings in pooled investment vehicles, such as open ended investment companies and unit linked insurance contracts, and is therefore directly exposed to credit risk in relation to these pooled investment vehicles.

Credit risk – UK government and investment grade bonds:

We look to limit the credit risk the Bank Section is exposed to through its bond holdings by ensuring that the majority of the bonds held by BlackRock, Insight, Legal and General (LGIM), Royal London Asset Management (RLAM) and 24AM are either government bonds (where the risk of default is minimal), or corporate bonds which are rated at least investment grade (i.e. where they are higher quality). The risk is also reduced by requiring the appointed investment managers to invest in a range of bonds issued by different entities, which reduces the impact on the total portfolio if a bond issuer is unable to meet the payments due (see note 10).

The Bank Section's investment managers are also allowed to invest in corporate bonds and similar investments which are not rated as investment grade. These investments are held at the investment managers' discretion and are subject to limits. BlackRock, Insight and 24AM are not permitted to purchase bonds which are sub-investment grade, however if a bond becomes sub-investment grade, Insight are allowed to hold up to 10% of Net Asset Value (NAV) exposure in sub investment grade bonds and BlackRock can hold up to 2%. RLAM are allowed to invest in corporate bonds which are not rated as investment grade, at RLAM's discretion and subject to limits; if a bond is downgraded RLAM can continue to hold it, but at most 20% of the Bank Section's investment with RLAM can be sub-investment grade.

At the period end a total of 0.4% of the Bank Section's invested assets were rated sub-investment grade (5 October 2018: 0.4%).

Credit risk - derivatives:

Credit risk arising on derivative contracts, which are not guaranteed by any regulated exchange, are subject to risk of failure of the counterparty. The level of credit risk for derivative contracts is reduced by using collateral arrangements (see note 10.2 (i)). Credit risk can also arise on forward foreign currency contracts (see note 10.2 (iii)). There are no

collateral arrangements for these contracts but, when used, all counterparties are required to be at least investment grade.

The Bank Section's overseas bond holdings with LGIM, Insight and 24AM are also exposed to credit risk on the currency hedging derivatives held by the manager (and, in the case of LGIM, interest rate derivatives). These risks are mitigated by the managers using a range of counterparties, undertaking on-going monitoring of counterparty creditworthiness and requiring all counterparties to maintain minimum credit ratings.

The Mercer alternatives fund is also exposed to credit risk in relation to currency hedging contracts that are used to hedge the bulk of its overseas currency exposure. This credit risk is mitigated by renewing and settling the cumulative profit or loss on these contracts at least once every two months and by Mercer undertaking on-going monitoring of counterparty creditworthiness and requiring the sole counterparty to maintain an investment grade credit rating.

Credit risk – cash:

Cash is currently held within financial institutions which are at least investment grade credit rated. We have appointed a banking services provider with an investment grade credit rating at period end, the total cash held is 0.4% of the Bank Sections' total net assets (5 October 2018: 0.4%).

Credit risk – stock lending:

The Bank Section can lend certain equity securities under a Trustee-approved stock lending programme. We manage the credit risk arising from stock lending activities by restricting the amount of overall stock that could be lent, only lending to approved borrowers who are rated investment grade, limiting the amount that can be lent to any one borrower and putting in place collateral arrangements and an indemnification from the lending agent. At the period end, the Bank Section had lent £nil of UK quoted securities and £nil of non-UK quoted securities (5 October 2018:nil).

Credit risk – repurchase agreements and swaps:

Credit risk on repurchase agreements and swaps is mitigated through collateral arrangements. At the period end, the Bank Section held £115 million in collateral posted by its counterparties (5 October 2018: £108m).

Credit risk – pooled investments:

The Bank Section also has holdings in pooled investment vehicles ('PIVs'), invests in pooled funds which invest in underlying assets like shares and bonds on behalf of a number of investors, and is therefore directly exposed to credit risk for these investments (as the PIVs could default on their obligations to the Bank Section). A summary of pooled investment vehicles by type of arrangement can be found in note 10.1.

The Bank Section's investments in PIVs and bonds are rated investment grade or are unrated. Direct credit risk arising from bonds and PIV are reduced because:

- the underlying investments held by the pooled funds are legally ring-fenced from the investment manager(s);
- the investment managers that operate the PIVs need to meet the requirements of various financial regulations; and,
- we invest in a number of different PIVs, spreading risk.

At period end, 3.1% of the Bank Section's invested assets were held in pooled investment vehicles (5 October 2018: 2.5%).

Credit risk – custody:

We have appointed a global custodian for the safe-keeping of assets. The risk that the custody of the Bank Section's assets is not secure is addressed by monitoring the custodian's activities and creditworthiness. In addition, cash balances held by the custodian are transferred to a ring-fenced fund each night to reduce the risk of losses occurring should the custodian become un-creditworthy overnight.

In addition, the investment managers for the PIVs appoint their own custodians to ensure the safe-keeping of the assets within their mandates.

Indirect credit risk:

Indirect credit risk arises in relation to underlying investments held in the alternatives pooled investment vehicles that the Bank Section invests in (totalling 0.9% of assets at period end; 5 October 2018: 1.4%). For example, if the Bank Section invested in a pooled investment, which itself invests in bonds issued by a company, there is a risk that that company does not repay the bond to the pooled fund. We manage this risk by making sure that our investment managers diversify their investments over a number of companies and investments, to minimise the impact of a default on any individual investment.

(ii) Currency risk

The Bank Section is subject to currency risk because it invests in overseas investments either as segregated investments or through pooled funds.

To reduce the risk that the value of these overseas investments fall in sterling terms, we operate a policy of hedging a portion of non-Sterling currency exposure as appropriate, and where we judge this risk to be material. The management of currency risk is delegated to the appointed managers and is managed within each manager's overall risk framework.

The Bank Section's total net unhedged exposure by major currency at the period-end was as follows:

Currency	Total at 5 April 2019 £000	Total at 5 October 2018 £000
US Dollar	1,123	1,002
Euro	121	(1)
Japanese Yen	-	-
Other	33	97
Net overseas exposure	1,277	1,098

(iii) Interest rate and inflation risk

The Bank Section is subject to interest rate and inflation risk on its investments in bonds and financial derivatives, and also through its liabilities. The liability driven investments it

makes are intended to protect the Bank Section against the impact of changes in interest rates and inflation on the Bank Section's liabilities.

The Bank Section currently manages these risks through investments in a segregated LDI portfolio managed by BlackRock and long-dated corporate bond portfolios managed by LGIM, Insight and RLAM. These portfolios hold gilts, corporate bonds, derivatives and cash collateral. We monitor the level of assets available within the BlackRock LDI portfolio for use as collateral and operate a framework to ensure that if gilt yields rise then additional cash can be provided in a timely manner, should it be required.

We have set a benchmark for total investment in LDI and corporate bonds of 97% for the Bank Section. Under this strategy, if interest rates fall, the value of LDI and bond investments will rise to help match the increase in actuarial liabilities arising from a fall in discount rate. Similarly, if interest rates rise, the LDI and bond investments will fall in value, as will the actuarial liabilities because of an increase in the discount rate. These assets would be expected to change in value by £5.3 million for a change in interest rates of 0.01% (5 October 2018: £4.8m). The Bank Section's liabilities would change by approximately £5.4 million for a change in interest rates of 0.01% (5 October 2018: £5.4m). These long-term liabilities in respect of benefits due to members are not included in the Report and Accounts but are assessed at least every three years by the Scheme Actuary.

The LDI portfolio is also exposed to inflation risk. If inflation expectations increase, the value of these assets will rise to help match the increase in actuarial liabilities arising from the rise. Similarly, if inflation expectations fall, the LDI portfolio will fall in value, as will the actuarial liabilities. These assets would be expected to change in value by £3.2 million for a change in expected inflation of 0.01% (5 October 2018: £3.0m). The Bank Section's liabilities would change by approximately £3.3 million for a change in expected inflation of 0.01% (5 October 2018: £3.4m).

Again, these liabilities are not included in the statements set out in the Co-op Section's Report and Accounts.

At the period end the LDI portfolio and bonds represented 95.5% of the total investment portfolio for the Bank Section (5 October 2018: 94.6%).

(iv) Other price risk

The Bank Section is also exposed to "other price risk", largely because of its investments in return seeking assets (which included over the period investments in alternative investments held in a pooled vehicle). Alternative investments include such asset classes as hedge funds, private equity and insurance linked assets.

The Bank Section manages this exposure to other price risk by constructing a diverse portfolio of investments across various markets. The Bank Section's target asset allocation is reviewed regularly to ensure the overall target return for the Section remains in line with our objective at approximately 0.5% p.a. above gilts.

At the period end, the Bank Section's exposure to investments subject to other price risk was 0.9%, covering alternative assets only (5 October 2018: 1.5%).

(v) Other Defined Benefit risks

Other Defined Benefit investment risks are managed as outlined below:

- **Solvency risk and mismatching risk** – this is managed by us setting appropriate investment objectives as part of our actuarial valuation every three years. Mismatching risk is also partly addressed through investing in liability matching assets.
- **Manager risk** – this is managed by spreading the Bank Section’s assets over a range of managers, and through us regularly monitoring these managers.
- **Liquidity risk** - the Co-op Pensions Department estimates the cash needed each month to meet benefit payments, and ensures that sufficient cash is available, seeking advice where necessary.
- **Corporate governance risk** - this is managed through setting controls to limit concentration of investments in individual companies, and through regular discussions with and reporting on investment managers’ approach to sustainability risks.
- **Custody risk** – this is managed by the safe custody of the assets is delegated to professional custodians either directly or via the use of pooled funds, with each manager appointing a custodian and being responsible for monitoring the custodian’s activities.
- **Sponsor risk** – this is managed by regular assessments of the ability and willingness of the sponsor to support the Bank Section.
- **Leverage risk** – this is managed by regular reviews of the amount and nature of any leveraged investments made by the Bank Section’s investment managers.
- **Hedging related risk** - the management of these risks is delegated to the Bank Section’s liability driven investment manager; we also review liability hedging risks each quarter as part of monitoring the manager.
- **Environmental, social and governance (“ESG”) risk (including climate change)** – the Bank Section incorporates Pace’s Responsible Investment Policy when implementing its investment strategy, and reports on this annually. It also reviews the policy each year to make sure it remains appropriate. We also engage with investment managers, and where appropriate and viable, exclude specific investments from the Bank Section’s portfolios to comply with the policy.

14.2 Defined Contribution Section

Other Defined Contribution Risks:

As well as considering the risks that apply to the underlying funds, summarised in Note 14 above, we consider the following investment related risks:

- Purchasing power risk
- Conversion risk
- Manager risk
- Lack of diversification risk

14.2.1 Defined Contribution investment strategy

Our objective is to make available to members of the Bank Section an appropriate range of investment options designed to generate income and capital growth, which together with contributions from members and their employer, will provide a retirement amount which the member can use for the provision of retirement income; either by taking their defined contribution account as cash, using it to purchase a pension annuity (or other type of retirement product) or transferring it out of the Bank Section to provide alternative retirement benefits.

We have an insurance policy with Legal & General. The value of the policy is linked to the value of the underlying assets or pooled funds in which we choose to invest. The day to day management of the underlying investments of the funds is the responsibility of Legal & General, including the direct management of credit and market risks.

We have determined the defined contribution investment strategy, after taking professional investment advice and following consultation with the Sponsor. We provided three Target investment options for members which are designed to be an appropriate match for the different retirement options a member can take.

The default option is Target: Lump Sum, which has been selected as appropriate for members who want to take their account as a one-off cash sum on retirement. As a member approaches retirement, the funds are steadily moved into lower risk funds. These funds may not grow so quickly but are less likely to have large falls in value in the short term.

The other options available to members are Target: Secure Income and Target: Flexible Income.

Target: Secure Income is designed to be an appropriate match for members who want to use their account to buy a pension (annuity) at retirement.

Target: Flexible Income is designed to be an appropriate match for members who want to leave their account invested after retirement, taking sums of money from it (drawdown) over time. Drawdown is not currently offered through the Bank Section so members will need to transfer their account to another arrangement at retirement to take advantage of it.

Although the Target funds have been designed to be a good match for the different retirement options a member can take, they do not guarantee a particular outcome at retirement. Members are advised to consider taking independent financial advice if they are unsure as to what investment fund is right for them.

Members who would rather make their own investment decisions can select the following range of funds:

- Pace Growth (Shares) Fund
- Pace Growth (Ethical Shares) Fund
- Pace Growth (Mixed) Fund
- Pace Pre-retirement (Inflation-linked) Fund
- Pace Pre-retirement Fund
- Pace Cash Fund

The three Target options invest in the following Funds over a members working life:

- Target: Lump Sum - Pace Growth (Shares) Fund and Pace Cash Fund

- Target: Secure Income - Pace Growth (Shares) Fund, Pace Pre-retirement Fund and Pace Cash Fund
- Target: Flexible Income: Pace Growth (Shares) Fund and Pace Cash Fund

14.2.2 Defined Contribution Investment Risk Management

Member level exposure to the risks outlined in Note 14 will be dependent on the funds invested in by members. The funds which have significant exposure to these risks are set out below:

	Credit risk	Interest rate risk	Inflation risk	Currency risk	Other price risk	Asset Value 5 April 2019 £000
Pace Growth (Shares) Fund	YES	-	-	YES	YES	668
Pace Growth (Ethical shares) Fund	YES	-	-	YES	YES	144
Pace Growth (Mixed) Fund	YES	YES	YES	YES	YES	49,860
Pace Pre-retirement (inflation-linked) Fund	YES	YES	YES	-	YES	-
Pace Pre-retirement Fund	YES	YES	-	-	YES	5
Pace Cash Fund	YES	YES	-	-	-	2,133

(i) Credit risk

Credit risk – Insurer:

The Defined Contribution Section (DC Section) is subject to direct credit risk in relation to the Bank Section's holding in unit-linked funds provided by Legal & General. Legal & General is regulated by the Financial Conduct Authority and they maintain separate funds for policyholders. We monitor the creditworthiness of Legal & General by reviewing published credit ratings. Legal & General invests all the Bank Section's funds in its own investment funds, reinsured to Legal & General Assurance (Pension Management) Ltd funds, and it does not use other externally managed investment funds or reinsurance arrangements.

Credit risk – cash:

Cash is currently held within financial institutions which are at least investment grade credit rated. Over the reporting period, cash balances were held in a bank with an investment grade credit rating. The cash balance at period end was £469k for the Bank Section (5 October 2018: £422k).

Indirect credit risk:

The DC Section is also subject to indirect credit arising from the underlying investments held in the funds. Indirect credit risk is mitigated by the spread of assets held in the funds, which provides diversification. Within the Pre-retirement Funds, indirect credit risk is also mitigated by the funds only holding government bonds or investment grade corporate bonds. The Cash Fund invests in short-term money markets such as bank deposits or Treasury Bills. All investments are held with institutions with investment grade credit ratings.

In addition, the DC Section is subject to indirect credit risk arising from the custodians appointed by the fund provider for the safe-keeping of assets. The selection and assessment of the on-going appropriateness of the custodians is delegated to the fund provider and the indirect credit risk is addressed through the fund provider's monitoring of the custodian's activities and creditworthiness.

(ii) Indirect Currency risk

The DC Section is subject to currency risk because some of the funds invest in investments denominated in overseas currencies. The Growth (Shares) Fund mitigates this risk by currency hedging 75% of the overseas assets (excluding emerging markets) to Sterling The Growth (Mixed) Fund mitigates currency risk through the overall risk framework of the Fund. The Growth (Ethical Shares) Fund does not hedge overseas currency risk.

(iii) Indirect Interest rate risk

The Pre-retirement Fund and Pre-retirement (inflation-linked) Funds are subject to indirect interest rate risk. This risk is mitigated through the construction of the Funds, which are designed to change in value when interest rates change in a similar way to how the price of buying a retirement income changes.

The Cash Fund is also subject to indirect interest rate risk. The Fund aims to provide capital protection with growth at short term interest rates. The value of the assets would only fall should the interest earned by the Fund's assets be insufficient to cover the Fund management charge and any additional Fund expenses.

(iv) Indirect Inflation risk

The Pre-retirement (inflation-linked) and Growth (Mixed) Funds are subject to indirect inflation risk as they invest in assets that are affected by changes in inflation expectations.

This inflation risk associated with the Pre-retirement (inflation-linked) Fund is mitigated through the construction of the Fund, which is designed to change in value when inflation expectations change in a similar way to how the price of buying an inflation-linked retirement income changes. For example, if inflation expectations increase, the value of the Fund will rise in a similar, but not exact, amount to the cost of buying an inflation-linked retirement income. Similarly, if inflation expectations fall, the value of the Fund will fall in value in a similar, but not exact, amount as the cost of buying an inflation-linked retirement income.

The inflation risk of the Growth (Mixed) Fund is considered by the Fund provider as part of the overall risk and return framework in place.

(v) Other price risk

Other price risk arises principally in relation to the Growth Funds and the Pre-retirement Funds. Other price risk in these Funds is mitigated through the diversification of assets within the Funds.

(vi) Other Defined Contribution investment risks

- **Purchasing power risk** - The purchasing power risk to members is that the investment return over members' working lives does not keep pace with inflation and does not therefore secure an adequate retirement income. This risk is mitigated through the design of the Target Funds, which aim to provide sufficient investment returns over a members working life. In addition, we have made available three Growth Funds, should members wish to select their own investment options.
- **Conversion risk** - the risk that relative market movements in the years just prior to retirement lead to substantial reduction in the retirement income and cash lump sum secured. This risk is mitigated through the design of the three Target Funds, which aim to protect members from relative market movements in the years just prior to retirement. In addition, we have made available two Pre-retirement Funds and a Cash Fund, should members wish to select their own investment options.
- **Manager risk** - the risk that the chosen investment manager underperforms the benchmark against which the investment manager is assessed. This risk is mitigated through the regular review of investment performance by us.
- **Lack of diversification risk** – we recognise the risks that may arise from a lack of diversification within the investments. We therefore invest in pooled fund vehicles, to ensure an adequately diversified portfolio for each fund option.

15 Current assets

In plain English – what does this show?

This note shows the value of current assets held by the Bank Section at the period end.

	DBS 5 Apr 19 £000	DCS 5 Apr 19 £000	Total 5 Apr 19 £000
Contributions due:*			
Employer's normal contributions	-	436	436
Member's normal contributions	-	1	1
Members' AVCs	-	5	5
Cash balances	7,250	469	7,719
Pensioner payroll paid in advance	525	-	525
Tax debtor	155	2	157
Other debtors	180	4	184
	8,110	917	9,027
	DBS 5 Oct 18 £000	DCS 5 Oct 18 £000	Total 5 Oct 18 £000
Contributions due:*			
Employer's normal contributions	-	908	908
Member's normal contributions	-	1	1
Members' AVCs	-	47	47
Cash balances	7,705	422	8,127
Pensioner payroll paid in advance	1,830	-	1,830
Tax debtor	56	-	56
Other debtors	246	-	246
	9,837	1,378	11,215

*Contributions due at period-end were all received subsequent to the period-end on a timely basis, in accordance with the schedule of contributions.

16 Current liabilities

In plain English – what does this show? This note shows the value of current liabilities owed by the Bank Section at the period end.

	DBS 5 Apr 19 £000	DCS 5 Apr 19 £000	Total 5 Apr 19 £000
Unpaid benefits	(409)	(466)	(875)
Accrued expenses	(1,324)	-	(1,324)
Tax creditor	(360)	-	(360)
Other creditors	(91)	-	(91)
	(2,184)	(466)	(2,650)

	DBS 5 Oct 18 £000	DCS 5 Oct 18 £000	Total 5 Oct 18 £000
Unpaid benefits	(678)	(422)	(1,100)
Accrued expenses	(1,443)	-	(1,443)
Tax creditor	-	-	-
Other creditors	(215)	(8)	(223)
	(2,336)	(430)	(2,766)

17 Related party transactions

In plain English – what does this show? Related parties include people (such as directors and key personnel) as well as entities. This note outlines the nature of the relationship of any related parties.

Related party transactions include:

- The DB Administrator is the Co-op.
- Pensioner Member Elected Trustee Directors receive pensions from the Scheme under normal terms and conditions and are paid £5,000 per annum from the Scheme, which is shared equally between the Co-op Section and Bank Section.
- Member Nominated Trustee Directors are paid £2,000 per annum in respect of attendance at the quarterly Trustee meetings, which is shared equally between the Co-op Section and Bank Section. Attendance at additional sub-committee meetings is remunerated based on the work load of each committee. MNDs may opt out of receiving this remuneration.

- Independent Trustee Directors receive remuneration from the Scheme based on rates negotiated with the Co-op, as the principal employer of the Scheme. This cost is also shared equally between the Co-op Section and Bank Section.
- The total of all Trustee Director remuneration paid from the Bank Section during the period was £32,096 (2 month period ended 5 October 2018: £10,615).

18 Employer related investments

In plain English – what does this show?

Employer related investments include securities issued by the employer, loans to the employer and any investment property occupied by the employer. They also include investments made indirectly through pooled investment vehicles.

During the period, there were no direct or indirect employer related investments.

19 Subsequent Events

In plain English – what does this show?

This note shows those events, favourable and unfavourable, that occur between the end of the reporting period and the date the financial statements are authorised for issue.

Brexit

Following the EU Referendum in 2016, the UK had been expected to leave the European Union on 29 March 2019 (and at the time of writing, uncertainty around the eventual timing and terms of any exit continues). We identified the possibility of a “no deal” Brexit and the related uncertainty as a particular risk with regards to Pace’s investments, and took action to identify any mitigating action required. In light of Pace’s low exposure to growth assets, the very limited exposure to overseas currencies and the high degree of interest rate and inflation protection in place, we were comfortable that no changes to strategy were required. We also reviewed the risk management plans in place for the Bank Section’s investment managers, in particular where the Bank Section holds assets domiciled within the EU. Finally, we also considered updates from the Bank Section’s sponsor, the Co-operative Bank, on the Brexit related risks they have identified and their associated actions.

20 Contingent liabilities

In plain English – what does this show?

This note shows possible but uncertain obligation or a present obligation that is not probable and/or cannot be reliably determined.

GMP equalisation

On 26 October 2018, the High Court handed down a judgment involving the Lloyds Banking Group’s defined benefit pension schemes. The judgment concluded that schemes should be amended to equalise pension benefits for men and women in relation to guaranteed minimum pension (“GMP”) benefits. The issues determined by the judgement arise in relation to many other defined benefit pension schemes. We are aware that the issue will affect the Bank Section and will be considering this at a future meeting and decisions will be made as to the next steps. Under the ruling, schemes are required to

backdate benefit adjustments in relation to equalising for the effect of unequal GMPs and provide interest on the backdated amounts. Based on an initial assessment of the likely backdated amounts and related interest, we do not expect these to be material to the financial statements and therefore has not included a liability in respect of these matters in these financial statements. They will be accounted for in the year they are determined.