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

Financial Statements
For Year Ended 5 April 2020

PENSION SCHEME REGISTRY NO. 19023302

Contents

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 year ended 5 April 2020. The financial statements (set out on pages 8 to 40) 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 year ended 5 April 2020 and these financial statements should be read in conjunction with them. Definitions for the defined terms used in this document can also be found in the consolidated Pace Scheme report.

Report on Actuarial Liabilities

Under Section 222 of the Pensions Act 2004, every scheme is subject to the Statutory Funding Objective, which is to have sufficient and appropriate assets to cover its technical provisions. The technical provisions represent the present value of the benefits members are entitled to, based on pensionable service to the valuation date. This is assessed using the assumptions agreed between us and the Bank and set out in the Statement of Funding Principles, which is available to Bank Section members on request.

In 2018 the Scheme was sectionalised into two sections: the Co-op Section and the Bank Section. The first full actuarial valuation of the Bank Section of the Scheme was carried out as at 5 April 2019.

This showed that on that date:

The value of the technical provisions was:	£1,908 million
The value of the assets at that date was:	£1,980 million

The method and significant actuarial assumptions used to determine the technical provisions are as follows (all assumptions adopted are set out in the Appendix to the Statement of Funding Principles).

Method

The actuarial method to be used in the calculation of the technical provisions is the Projected Unit Method.

Significant actuarial assumptions

- **Discount interest rate (pre and post retirement):** The discount rate used is a term structure derived from the yields on UK Government conventional gilt stocks appropriate to the date of each future cashflow (extrapolated for cash flows beyond the longest available yields) plus an additional:
    - 0.5% per annum for the period to 31 December 2027; and
    - 0.25% per annum thereafter

  to reflect the allowance we have agreed for additional expected investment returns based on the investment strategy.

- **Future Retail Price inflation (RPI):** The assumption for the rate of increase in the Retail Price Index (RPI) will be a term structure derived from the difference between the yield on conventional and index-linked UK Government bonds at the date of each future cash flow (extrapolated for cashflows beyond the longest available bonds).

- **Future Consumer Price inflation (CPI):** Derived from the RPI assumption, with a deduction of 0.7% per annum to recognise the long term difference between expectations of future RPI increases and future CPI increases. The Trustee discussed the Government's consultation on changes to RPI published in March 2020 and expect to review the assumption for the gap between RPI and CPI at future valuations subject to the outcome of that consultation.

- **Pension increases:** In line with the provisions in the Scheme's rules, the assumption for the rate of pension increases applying to each benefit tranche is a full curve of annual gilt-implied inflation forward rates, adjusted for the probability that future inflation is above or below any applicable maximum and minimum annual increase entitlements. A stochastic model is used to derive the adjustment at each point on the curve. The model allows for the volatility of inflation to vary with time.

- **Pay increases:** No members in the Bank Section of the Scheme have benefits which increase in line with changes in salaries.

- **Mortality:** The mortality assumptions are based on up to date information published by the Continuous Mortality Investigation ("CMI") and National Statistics, making allowance for future improvements in longevity and the experience of the Bank Section of the Scheme. The mortality tables are the S3PA Year of Birth tables (standard for male and middle for female) with weightings of 103% for male pensioners, 109% for male non-pensioners, 96% for female pensioners and 99% for female non-pensioners. Future improvements are based on the CMI 2018 model with a long term improvement rate of 1.75% p.a., an S-Kappa of 7.5 and no initial adjustment factor.

Further details of the completed actuarial valuation and funding arrangements for the Bank Section are available in the consolidated Pace Scheme 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 year and of the amount and disposition at the end of that year of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Bank Section year; 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

Thomas Taylor
Secretary

Date: 5 November 2020

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 year ended 5 April 2020 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 year;
- 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 21

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 26 February 2020. 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
Reading
United Kingdom

Date: 5 November 2020

Fund Account

for the year ended 5 April 2020

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 Bank Section, minus the benefits and expenses paid out during the year ended 5 April 2020. The result is the Bank Section's net asset position at the end of the reporting year.

		Year ended 5 April 2020			6 month period ended 5 April 2019		
		DBS	DCS	Total	DBS	DCS	Total
Contributions and Benefits	Note	£'000	£'000	£'000	£'000	£'000	£'000
Employer contributions		-	12,612	12,612	12,500	5,829	18,329
Employee contributions		-	703	703	-	409	409
Total contributions	**3**	**-**	**13,315**	**13,315**	**12,500**	**6,238**	**18,738**
Transfers in	4	-	136	136	-	232	232
Other income	5	-	1,535	1,535	-	57	57
		-	**14,986**	**14,986**	**12,500**	**6,527**	**19,027**
Benefits paid or payable	6	(36,652)	(2,084)	(38,736)	(18,315)	(259)	(18,574)
Payments to and on account of leavers	7	(40,703)	(1,431)	(42,134)	(30,158)	(10,031)	(40,189)
Administrative expenses	8	(3,552)	(52)	(3,604)	(1,397)	(26)	(1,423)
		(80,907)	**(3,567)**	**(84,474)**	**(49,970)**	**(10,316)**	**(60,186)**
Net (withdrawals)/ additions from dealing with members		**(80,907)**	**11,419**	**(69,488)**	**(37,370)**	**(3,789)**	**(41,159)**
Returns on investments							
Investment income	9	50,055	-	50,055	20,364	-	20,364
Change in market value of investments	10	153,155	(4,515)	148,640	182,065	2,140	184,205
Investment management expenses	11	(2,139)	-	(2,139)	(1,215)	-	(1,215)
Net returns on investments		**201,071**	**(4,515)**	**196,556**	**201,214**	**2,140**	**203,354**
Net increase in the Bank Section during the year		120,164	6,904	127,068	163,844	(1,649)	162,195
Transfers between sections		403	(401)	2	197	(191)	6
Net assets of the Bank Section:							
As at 6 April 2019 / 6 October 2018		**1,986,250**	**53,261**	**2,039,511**	**1,822,209**	**55,101**	**1,877,310**
As at 5 April 2020 / 5 April 2019		**2,106,817**	**59,764**	**2,166,581**	**1,986,250**	**53,261**	**2,039,511**

The notes on pages 11 to 40 form part of these financial statements

Statement of Net Assets

(available for benefits) as at 5 April 2020

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 2020. 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 year; this is dealt with in the Report on Actuarial Liabilities.

	Note	5 April 2020			5 April 2019		
		DBS £'000	**DCS** £'000	**Total** £'000	**DBS** £'000	**DCS** £'000	**Total** £'000
Investment assets	10-14						
Bonds		1,771,382	-	1,771,382	1,902,281	-	1,902,281
Pooled investment vehicles		150,675	58,478	209,153	60,321	52,810	113,131
Derivatives		798,757	-	798,757	569,467	-	569,467
AVC investments		5,857	-	5,857	6,186	-	6,186
Cash deposits		28,079	-	28,079	4,094	-	4,094
Sales awaiting settlement		219,557	-	219,557	12	-	12
Dividend entitlement		9,866	-	9,866	11,300	-	11,300
Investment liabilities							
Derivatives		(736,738)	-	(736,738)	(487,199)	-	(487,199)
Repurchase agreements		-	-	-	(83,592)	-	(83,592)
Purchases awaiting settlement		(149,824)	-	(149,824)	(2,546)	-	(2,546)
Total net investments		2,097,611	58,478	2,156,089	1,980,324	52,810	2,033,134
Current assets	15	11,234	1,965	13,199	8,110	917	9,027
Current liabilities	16	(2,028)	(679)	(2,707)	(2,184)	(466)	(2,650)
Net assets of the Bank Section		**2,106,817**	**59,764**	**2,166,581**	**1,986,250**	**53,261**	**2,039,511**

The notes on pages 11 to 40 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 year. 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 2020, and these financial statements should be read in conjunction with them.

The Trustee Directors approved these financial statements on 5 November 2020.

Signed for and on behalf of the Trustee Directors:

Bestrustees Limited, represented by Christopher Wheeler Trustee Director	Thomas Taylor 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.

1.1 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 (2018). This is the first year of the adoption of the 2018 SORP. There were no transitional adjustments required to the Section as a result of adopting the 2018 SORP.

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 6 October 2018 to 5 April 2019, which is a 6-month accounting period set of accounts to revert back to a 5 April year end.

1.2 Identification of the financial statements

The Section is established as a trust under English law. The address for enquiries to the Section is Co-operative Group Limited, Pensions Department, Department 10406, 1 Angel Square, Manchester, M60 0AG.

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 2020 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 year 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 year-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 year.

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 year-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 year 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 by recognising and valuing 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 Bank during the year.

	DBS year ended 5 April 20 £000	**DCS year ended 5 April 20** £000	**Total year ended 5 April 20** £000
Employer			
normal	-	12,552	12,552
expense allowance	-	60	60
	-	**12,612**	**12,612**
Employee			
normal	-	1	1
additional voluntary contributions	-	702	702
	-	**703**	**703**
	-	**13,315**	**13,315**

3 Contributions (continued)

	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**

Further details on the Schedules of Contributions agreed for the year can be found on pages 14 to 17 of the consolidated Pace Scheme accounts.

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 year.

	DBS year ended 5 April 20 £000	DCS year ended 5 April 20 £000	Total year ended 5 April 20 £000
Individual transfers in	-	136	136

	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

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 year ended 5 April 20 £000	DCS year ended 5 April 20 £000	Total year ended 5 April 20 £000
Life assurance claims	-	1,535	1,535
	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

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 year.

	DBS year ended 5 April 20 £000	DCS year ended 5 April 20 £000	Total year ended 5 April 20 £000
Pensions	33,359	-	33,359
Commutations and lump sum retirement benefits	3,165	357	3,522
Lump sum death benefits	107	1,647	1,754
Purchases of annuities	-	80	80
Tax charges	21	-	21
	36,652	**2,084**	**38,736**
	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**

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 year.

	DBS year ended 5 April 20 £000	DCS year ended 5 April 20 £000	Total year ended 5 April 20 £000
Individual transfers to other schemes	40,703	1,431	42,134
	40,703	**1,431**	**42,134**

	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**

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 year. It splits expenses into key categories, such as actuarial and administration fees.

	DBS year ended 5 April 20 £000	DCS year ended 5 April 20 £000	Total year ended 5 April 20 £000
Administration	2,079	52	2,131
Actuarial	423	-	423
Audit	42	-	42
Legal and other	977	-	977
Pension levies	31	-	31
	3,552	**52**	**3,604**

8 Administrative expenses (continued)

	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**

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 contributions 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 year.

DBS	Total year ended 5 April 20 £000	Total 6 month period ended 5 April 19 £000
Income from bonds	47,031	21,220
Interest on cash deposits	1,069	142
Foreign exchange gain/(loss)	1,156	(1,330)
Income from collateral	4	1
Income from securities lending	28	-
Irrecoverable taxation	(3)	(2)
Annuity income	432	238
Other	338	95
	50,055	**20,364**

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 year between the opening and closing value of investments and analysed by asset class as disclosed on the face of the Statement of Net Assets.

DB Assets	Note	5 April 2019 £000	Purchases at cost and derivative payments £000	Sales proceeds and derivative receipts £000	Change in market value £000	5 April 2020 £000
Bonds		1,902,281	673,748	(919,648)	115,001	1,771,382
Pooled investment vehicles	10.1	60,321	585,986	(493,269)	(2,363)	150,675
Net derivative contracts	10.2					
- Swaps		82,969	83,365	(152,279)	55,589	69,644
- Futures		(6)	915	(504)	364	769
- Foreign exchange		(695)	22,759	(15,689)	(14,769)	(8,394)
AVC investments	10.3	6,186	547	(863)	(13)	5,857
		2,051,056	**1,367,320**	**(1,582,252)**	**153,809**	**1,989,933**
Repurchase agreements		(83,592)			(654)	-
Cash deposits		4,094				28,079
Dividend entitlement		11,300				9,866
Sales awaiting settlement		12				219,557
Purchases awaiting settlement		(2,546)				(149,824)
TOTAL DB ASSETS		**1,980,324**			**153,155**	**2,097,611**

DC Assets	Note	£000	£000	£000	£000	£000
Pooled investment vehicles	10.1	52,810	12,062	(1,879)	(4,515)	58,478
TOTAL DC ASSETS		**52,810**	**12,062**	**(1,879)**	**(4,515)**	**58,478**

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, 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 £275 comprising of commission (5 April 2019: £128). These costs are attributable to the key asset classes as follows:

	Fees £	Commission £	Stamp Duty £	Total £
Cash instruments	-	275	-	275
For the year to 5 April 2020	**-**	**275**	**-**	**275**
For the period to 5 April 2019*	-	128	-	128

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

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 20 £000	**Total 5 Apr 19** £000
Members	59,746	53,252
Trustee	18	9
	59,764	**53,261**

10.1 Pooled investment vehicles

DBS	**Total 5 Apr 20** £000	**Total 5 Apr 19** £000
Cash fund	137,080	43,094
Alternative fund	13,595	17,214
Hedge fund	-	13
	150,675	**60,321**

10.1 Pooled investment vehicles (continued)

DCS	Total 5 Apr 20 £000	Total 5 Apr 19 £000
Diversified Growth	54,330	49,860
Cash	3,159	2,133
Equity	931	812
Bonds	58	5
	58,478	**52,810**

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 year 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 year-end the Bank Section had the following derivatives:

10.2 Derivatives

DBS		Assets 5 Apr 20 £000	Liabilities 5 Apr 20 £000	Assets 5 Apr 19 £000	Liabilities 5 Apr 19 £000
OTC swaps	(i)	795,721	(726,077)	568,726	(485,757)
Futures	(ii)	937	(168)	7	(13)
Forward FX contracts	(iii)	2,099	(10,493)	734	(1,429)
		798,757	**(736,738)**	**569,467**	**(487,199)**

i. Swaps

Nature Duration	Nominal Amount £000	Asset value at year-end £000	Liability value at year-end £000
Inflation rate			
2020	17,205	-	(577)
2021-2030	354,115	1,568	(34,312)
2031-2040	39,764	10,429	(15,808)
2041-2050	48,410	39,584	(36,405)
2051-2063	20,336	47,049	(52,332)
		98,630	**(139,434)**
Interest rate			
2020	24,500	199	(32,999)
2021-2030	220,081	5,715	(12,047)
2031-2040	94,344	159,796	(126,732)
2041-2050	101,644	282,291	(303,755)
2051-2063	31,113	131,656	(111,110)
		579,657	**(586,643)**
Total return			
2020	363,747	109,693	-
2051-2063	36,272	7,741	-
		117,434	**-**
Total 5 April 2020		**795,721**	**(726,077)**
Total 5 April 2019		568,726	(485,757)

In relation to the swap contracts above, the fund and counterparties have deposited a total of £79m and £145m (2019: £31m and £115m) of bonds and cash as collateral at the year-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 10YR Ultra Future (CBT)	144	< 1 year	631	-
Long Gilt Future (ICF)	58	< 1 year	158	-
US Treas BD Future (CBT)	10	< 1 year	79	-
US 10YR Treas NTS Future (CBT)	23	< 1 year	69	-
US Ultra Bond (CBT)	7	< 1 year	-	(168)
Total 5 April 2020			**937**	**(168)**
Total 5 April 2019			7	(13)

Included within cash balances is £184k (5 April 2019: £19k) in respect of initial and variation margins arising on open futures contracts at the year-end.

iii. Forward Foreign Exchange (FX)

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

Contract	Settlement date	Currency bought	Currency	Currency sold	Currency	Asset value at 5 April 20 £000	Liability value at 5 April 20 £000
Forward FX	<2months	3,525	EUR	(3,673)	GBP	-	(148)
Forward FX	<2months	34,778	GBP	(34,259)	EUR	896	(377)
Forward FX	<2months	129,418	GBP	(135,642)	USD	386	(6,610)
Forward FX	<2months	21,105	USD	(21,567)	GBP	189	(650)
Forward FX	>2months	49,913	GBP	(51,798)	USD	540	(2,425)
Forward FX	>2months	9,727	USD	(9,921)	GBP	88	(283)
Total 5 April 20		**248,466**		**(256,860)**		**2,099**	**(10,493)**
Total 5 April 2019		**263,765**		**(264,461)**		**734**	**(1,429)**

10.3 AVC investments

DBS	**Total 5 April 20** £000	**Total 5 April 19** £000
Royal London (CIS) Ltd	2,842	3,136
Legal & General	3,015	3,050
	5,857	**6,186**

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

The following investments represented more than 5% of the net assets of the Bank Section:

		2020		**2019**	
		Market value £000	**Net assets %**	**Market value £000**	**Net assets %**
BlackRock	ICS-INS Sterling Liquidity Fund	108,668	5.0	32,350	1.5

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 year.

DBS	**Total for the year ended 5 Apr 20** £000	**Total for the 6 month period ended 5 Apr 19** £000
Investment management fees	1,608	894
Custody fees	140	110
Performance measurement services	21	3
Other advisory fees	370	177
Other investment expenses	-	31
	2,139	**1,215**

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

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 2020	Held at cost not FV £000	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
DB Section					
Bonds	-	-	1,640,382	131,000	1,771,382
Pooled investment vehicles	-	-	137,080	13,595	150,675
Swaps	-	-	69,644	-	69,644
Futures	-	769	-	-	769
Foreign exchange	-	-	(8,394)	-	(8,394)
AVC investments	-	-	5,857	-	5,857
Repurchase agreements	-	-	-	-	-
Cash deposits	-	28,079	-	-	28,079
Dividend entitlement	-	9,866	-	-	9,866
Sales awaiting settlement	-	219,557	-	-	219,557
Purchases awaiting settlement	-	(149,824)	-	-	(149,824)
	-	108,447	1,844,569	144,595	2,097,611
DC Section					
Pooled investment vehicles	-	-	58,478	-	58,478
TOTAL	**-**	**108,447**	**1,903,047**	**144,595**	**2,156,089**

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**

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

- "**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.

- “**Inappropriate investments**”: The risk that the Scheme invests in inappropriate investments (e.g. investments that are too risky).

- **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.

The emergence of a new coronavirus, COVID-19, in early 2020 has caused widespread disruption to economic activity which has been reflected in investment performance during the year, and valuations at the year end. In conjunction with our investment adviser, we are monitoring the situation and considering the effects on the operation and financial position of the Scheme.

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 diversifying holdings across a number of investment managers, 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 year end a total of 0.4% of the Bank Section's invested assets were rated sub-investment grade (5 April 2019: 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 year end, the total cash held is 0.5% of the Bank Sections' total net assets (5 April 2019: 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 year end, the Bank Section had lent £1.2m of UK quoted securities and £nil of non-UK quoted securities (5 April 2019: nil).

Credit risk – repurchase agreements and swaps:

Credit risk on repurchase agreements and swaps is mitigated through collateral arrangements. At the year end, the Bank Section held £145 million in collateral posted by its counterparties (5 April 2019: £115m).

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 year end, 7.2% of the Bank Section's invested assets were held in pooled investment vehicles (5 April 2019: 3.0%) – this increase is primarily due to increased holdings in a pooled cash fund as part of the funding of the bulk pensioner annuity purchased after the year end.

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 0.8% of assets at year end; 5 April 2019: 0.9%). 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 year-end was as follows:

Currency	**Total at 5 April 2020 £000**	**Total at 5 April 2019 £000**
US Dollar	4,083	1,123
Euro	(480)	121
Japanese Yen	-	-
Other	29	33
Net overseas exposure	**3,633**	**1,277**

(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 £4.9 million for a change in interest rates of 0.01% (5 April 2019: £5.3m). The Bank Section's liabilities would change by approximately £4.8 million for a change in interest rates of 0.01% (5 April 2019: £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 £2.8 million for a change in expected inflation of 0.01% (5 April 2019: £3.2m). The Bank Section's liabilities would change by approximately £2.6 million for a change in expected inflation of 0.01% (5 April 2019: £3.3m).

At 5 April 2020 the Trustee was in the process of rebalancing the Bank Section's LDI holdings to reflect revised cashflows from the 2019 actuarial valuation along with the bulk annuity transaction which occurred shortly after the year end; following the year end the levels of interest rate and inflation protection were rebalanced so that the sensitivity of the assets more closely matched that of the liabilities.

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

At the year end the LDI portfolio and bonds represented 95.7% of the total investment portfolio for the Bank Section (5 April 2019: 94.9%).

(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 year 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 year end, the Bank Section's exposure to investments subject to other price risk was 0.6%, covering alternative assets only (5 April 2019: 0.9%).

(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.

- **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.

- **Inappropriate investments** – this is managed by our policies in relation to the range of assets held and the pooled funds invested in.
- **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
- ESG 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 2020 £000
Pace Growth (Shares) Fund	YES	-	-	YES	YES	756
Pace Growth (Ethical shares) Fund	YES	-	-	YES	YES	175
Pace Growth (Mixed) Fund	YES	YES	YES	YES	YES	54,330
Pace Pre-retirement (inflation-linked) Fund	YES	YES	YES	-	YES	49
Pace Pre-retirement Fund	YES	YES	-	-	YES	9
Pace Cash Fund	YES	YES	-	-	-	3,159

(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 year, cash balances were held in a bank with an investment grade credit rating. The cash balance at year end was £50k for the Bank Section (5 April 2019: £469k).

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 and provide a return in line with 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.

- **ESG risk (including climate change)** – the Bank Section incorporates Pace's Responsible Investment Policy when implementing its investment strategy for the DC Section. In 2019 the strategy for the Pace Growth (Mixed) Fund, which is used in the default option, was reviewed and in June 2019 the underlying holdings were switched into a multi-asset fund which explicitly considers ESG factors when determining how much to invest in companies' shares and bonds, as the Trustee believed this strategy was better aligned with the Responsible Investment Policy and would reduce ESG risk to members.

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 year end.

	DBS 5 Apr 20 £000	DCS 5 Apr 20 £000	Total 5 Apr 20 £000
Contributions due:*			
Employer's normal contributions	-	1,065	1,065
Member's normal contributions	-	-	-
Members' AVCs	-	160	160
Cash balances	10,301	53	10,354
Pensioner payroll paid in advance	560	-	560
Tax debtor	55	5	60
Other debtors	318	682	1,000
	11,234	**1,965**	**13,199**

	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**

*Contributions due at year-end were all received subsequent to the year-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 year end.

	DBS 5 Apr 20 £000	DCS 5 Apr 20 £000	Total 5 Apr 20 £000
Unpaid benefits	(244)	(679)	(923)
Accrued expenses	(1,385)	-	(1,385)
Tax creditor	(343)	-	(343)
Other creditors	(56)	-	(56)
	(2,028)	**(679)**	**(2,707)**

	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)**

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.

Apart from the payment of contributions to the Section by the Bank, other related party transactions are:

- The DB Administrator is the Co-op.
- Up to the 27 September 2019, Pensioner Member Nominated Trustee Directors received pensions from the Scheme under normal terms and conditions and were paid £5,000 per annum from the Scheme.
- Up to the 27 September 2019, Member Nominated Trustee Directors were paid £2,000 per annum in respect of attendance at the quarterly Trustee meetings. Attendance at additional sub-committee meetings is remunerated based on the workload 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 or the Bank, depending on which entity appointed them.

- The total of all Trustee Director remuneration paid from the Scheme during the year ended 5 April 2020 was £126,470 (6 month period to 5 April 2019: £32,096).

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 year, 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 year and the date the financial statements are authorised for issue.

Buy-in

The Bank Section implemented a buy-in policy after the Section year end and paid a premium of c. £400m to PIC on 8 April 2020.

Deficit contributions due

The £12.5m per annum contribution for the period 1 January 2020 to 31 December 2020 originally fell due on 31 December 2019 but was deferred by agreement (as set out in the Schedules of Contributions certified by the Actuary on 20 December 2019 and 17 April 2020) so that it fell due on 31 May 2020, and was paid into the escrow arrangement by 19 June 2020.

20 Other signficant events

In plain English – what does this show?	This note shows other signficant events during the reporting year.

Covid-19

From 1 January 2020, global financial markets have experienced and may continue to experience significant volatility resulting from the spread of a novel coronavirus known as Covid-19. The outbreak of Covid-19 has resulted in travel and border restrictions, quarantines, supply chain disruptions, lower consumer demand, and general market uncertainty. The effects of Covid-19 have and may continue to adversely affect the global economy, the economies of certain nations, and individual issuers, all of which may negatively impact the Section's investment return and the fair value of the Section's investments.

The quantum of the effect on the Section investments in the portfolio is difficult to assess because of the frequency of pricing of some of the investments held. In accordance with the requirements of FRS 102 and the Pensions SORP the fair valuations at the date of the statement of net assets reflect the economic conditions in existence at that date.

The Trustee has considered the impact of the Covid-19 pandemic, the impact of which has been felt in the UK following the Section's accounting year-end:

- Trustee governance is not impacted by the pandemic. The Trustee has run its meetings remotely and has a variety of methods for keeping in touch with the Co-op Pensions Department's support team and managing communications between Trustee Directors and advisers.

- The Trustee's business continuity plan has been refreshed several times in light of the pandemic, and is kept up to date on a regular basis (alongside those of the other Co-op pension schemes). Key suppliers, including investment managers, are monitored for signs of strain, and the Trustee has no significant concerns at present.

- The Trustee has considered the Co-op's covenant in light of the pandemic, and has instigated more frequent, light touch monitoring. The Trustee has no significant concerns about the covenant of the Co-op's key businesses in light of the pandemic. This has formed part of the Trustee's view that the going concern basis remains the appropriate basis for the Section's accounts.

- Given the relatively high levels of interest rate and inflation protection in place, together with the low exposure to growth assets, the diversification of the Section's assets both by asset class and geography, the Trustee is comfortable that the investment strategy remains appropriate.

The Trustee has evaluated all subsequent events or transactions for potential recognition or disclosure to the date on which these financial statements were signed and has determined that there were no additional subsequent events requiring adjustment to or disclosure in the Section financial statements.

Brexit

On 31 January 2020, the United Kingdom left the European Union. The Trustee continues to monitor the situation carefully and is taking appropriate advice on the expected impact to the investment portfolio.

21 GMP equalisation

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 in relation to GMP equalisation.

On 26 October 2018, in the *Lloyds Banking Group* legal case, the High Court ruled that schemes that were contracted out of the State Earnings Related Pension Scheme (SERPS) between 1990 and 1997 need to equalise benefits overall, to address the effect of unequal GMPs.

An interim solution has been implemented for equalising GMPs for transfer values and trivial commutation payments made by the Bank Section, ahead of when GMP equalisation is completed for all benefits in the Bank Section.

The Trustee, with the assistance of its legal and actuarial advisers, is in the process of considering with the Bank, the most appropriate GMP equalisation methodology for equalising GMPs for main Scheme benefits.

GMP equalisation is expected to increase the liabilities to the Bank Section. The liability impact will vary depending on the equalisation methodology approach taken, although the differences in liability impact on the Bank Section's technical provisions basis are expected to be immaterial in the context of total Bank Section liabilities. Therefore, we have not included a liability in respect of GMP equalisation in these financial statements. They will be accounted for in the year they are determined.