Pace
pension
scheme

The co-operative bank

Co-operative Pension Scheme (Pace)

2021 UK Stewardship Code and **Responsible Investment report**

1. Chair’s introduction

The Pace Trustee is pleased to publish its annual report on responsible investment for the year to 5 April 2021.

In a year where headlines have been dominated by the coronavirus pandemic, we’ve been working with the Co-op Pensions Department to ensure we had all the processes in place to continue to run Pace, and with our external asset managers to understand the actions they were taking on behalf of the Scheme in relation to the companies and assets Pace invests in.

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

It also demonstrates how we have complied with the principles underlying the updated UK Stewardship Code, which came into force on 1 January 2020. The Stewardship Code sets out a number of areas of good practice which the Financial Reporting Council, the UK’s independent regulator responsible for promoting high quality corporate governance and reporting, believes institutional investors like Pace should aspire to. Appendix 3 lists each of the 12 principles in the Stewardship Code and highlights where they are covered in the report.

This year we’ve also included a short summary of how Pace complies with the ‘Myners’ Principles’ – a series of six principles codifying best practice for decision-making in relation to institutional investment. This is set out in Appendix 4.

This report sits alongside our ‘Implementation Statement’, which is published on the **Scheme website** and in our report and accounts, and is a statutory requirement setting out how we have complied with the policies in our Statement of Investment Principles.

Chris Martin, Chair, Pace Trustees Limited

2. Executive Summary

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

This summary provides the highlights from our 2020/21 investment report, letting you know how the Trustee of Pace has carried out its Responsible Investment Policy over the past year.

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

This year:

- We made some changes to the default investment strategy for Pace DC, introducing a new equity fund which actively considers environmental, social and corporate governance factors when deciding how much to invest in different companies (and excluding investment in coal companies in particular);
- We've engaged with our asset managers on climate risk and the systemic risks posed by the Covid-19 pandemic; the report that follows gives examples of how our managers have worked with the companies they invest in on our behalf;
- We've established a Taskforce for Climate-Related Financial Disclosures (TCFD) Working Group to help us quantify our exposure to climate risk and to identify risks and opportunities, ahead of our first formal TCFD report in 2022; and
- We continued to apply an exclusions list where possible, to prevent investment in companies that manufacture or distribute controversial weapons, or those in the oil, gas or mining industries that have poor environmental records, or those based in countries with poor human rights records.

3. How do we invest?

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

In brief:

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

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

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

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

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

- Climate change and the protection of the environment;
- Labour conditions and equal pay; and
- Corporate governance.

This is set out in our Responsible Investment Policy, which is available on the **Scheme website**.

The Trustee is supported in its work on stewardship and responsible investment by the Co-op Pensions Department and our investment consultants. Alongside our DB and DC investment consultants, Mercer and LCP, Pace uses a third-party ESG data provider, MSCI.

About us

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

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

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

As at 5 April 2021, there were just under 79,000 members of Pace with DB benefits (including those members of the former Yorkshire and Plymouth pension funds which merged into Pace in March 2021). This comprised just over 38,000 members with pensions already in payment, and 41,000 members who are yet to retire; Pace's DB assets at that date were over £11bn.

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

The DC Section of Pace (Pace DC) was established in 2012, and since 2015, is the only section of Pace which has actively contributing members. As at 5 April 2021, there were over 73,000 members of Pace with DC benefits, all still contributing or yet to draw benefits (when members draw their benefits from Pace DC by taking cash, buying an annuity or transferring out, they leave the Scheme). The total value of members' pension pots as at 5 April 2021 in Pace DC was around £620m.

The average age of members of Pace DC is approximately 41 while the average age of members of Pace DB (both pensioner and non-pensioners) at the last actuarial valuation was higher at approximately 62; we therefore assume a longer time horizon when looking at investment strategy for Pace DC than for Pace DB.

The remainder of this report sets out how we, and our asset managers, have aimed to be responsible asset owners over the year.

Over time, we have implemented a lower risk investment strategy for Pace DB. This means that we invest more in bonds and bond-like investments and less in shares (equities) and other more risky investments, aiming to reduce the volatility of Pace's funding position and improve security for members and employers.

As part of this journey, in early 2020 we entered into insurance policies with Aviva and Pension Insurance Corporation (PIC), two UK insurers, to match the pension payments due to some members of the Co-op Section of Pace DB. The value of these policies was around £2.4bn. In April 2020 we also entered into an insurance policy with a value of c. £400m with PIC, to match the pension payments due to some members of the Bank Section of Pace DB. As we don't have control over how PIC or Aviva invest, we don't cover the insurance policies in this report, although both insurers operate their own responsible investment priorities and in particular, both have established frameworks for managing climate risk within the investments supporting the insurance policies they have issued.

4. How do we exercise 'stewardship'?

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

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

As the Trustee, we exercise our stewardship responsibilities in the best interests of all the members of Pace. We operate a Defined Contribution Committee which is responsible for the development and operation of Pace's investment policy for Pace DC, while the Trustee Board performs the same role for the Scheme's DB assets. Responsibility for the day-to-day management of assets is delegated to our appointed investment managers, and their approach to implementing responsible investment principles is monitored by the Manager Implementation and Monitoring Committee (MMIC). The duties of the MMIC and the DC Committee are to consider in detail performance monitoring, risk assessment, and operational and implementation matters. The Committees report back to the Trustee on key issues raised at the Committee in quarterly Trustee Board meetings or at ad hoc meetings when needed.

Following changes in late 2017 to reduce risk in our investment strategy, Pace DB no longer invests in company shares (either directly or through pooled funds). Nevertheless, we have acknowledged the importance of considering ESG factors (and specifically climate risk) in investment decision-making and reserve the right to use a more direct engagement approach with investment managers and investee companies. In such situations, we may:

- Work with investment managers and other institutions to engage with companies; and
- Contact investee companies directly or through our investment managers.

We encourage our appointed investment managers to commit to the Stewardship Code. Our managers have their own policies to demonstrate how they monitor and engage with the companies in which they invest, to protect and enhance value to clients. Seven of Pace's ten investment managers (as at 5 April 2020) have published statements of compliance with the UK Stewardship Code, and links to their statements can be found in Appendix 1. In addition, all of Pace's mandates are managed by signatories to the United Nations backed Principles for Responsible Investment (UNPRI).

Managing conflicts of interest

We have a clear procedure for identifying and managing conflicts of interest which may arise from time to time. The Trustee Board meets at least quarterly, and in advance of each meeting, Trustee Directors are asked to consider if they have:

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

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

Potential conflicts of interest might arise if, for example, a Trustee Director were to have a relevant relationship with an investment manager being considered for appointment, and are managed by obtaining appropriate legal advice where necessary, with full disclosure being made within minutes of meetings.

One potential conflict that was mitigated over the year was in relation to the merger of two smaller pension schemes into the Co-op Section of Pace, where one Trustee Director of Pace was also a Trustee Director of one of the smaller schemes; the potential conflict was minuted (the appointment having previously been noted in the Register of Interests) and the Trustee Director in question did not participate in discussions on the merger in their role as a Pace Trustee Director.

We believe it is important to be transparent so we inform our members how we invest in order to show the Scheme is exercising its responsibilities as an asset owner effectively. The following documents are reviewed at least annually and are publicly available on the **Scheme's website**:

- Pace's Statement of Investment Principles (SIP) for the Co-op and Bank sections;
- Pace's Implementation Statement;
- Responsible Investment Policy (covering both DB and DC assets);
- The Scheme's annual report and accounts; and
- Our Annual Responsible Investment Report.

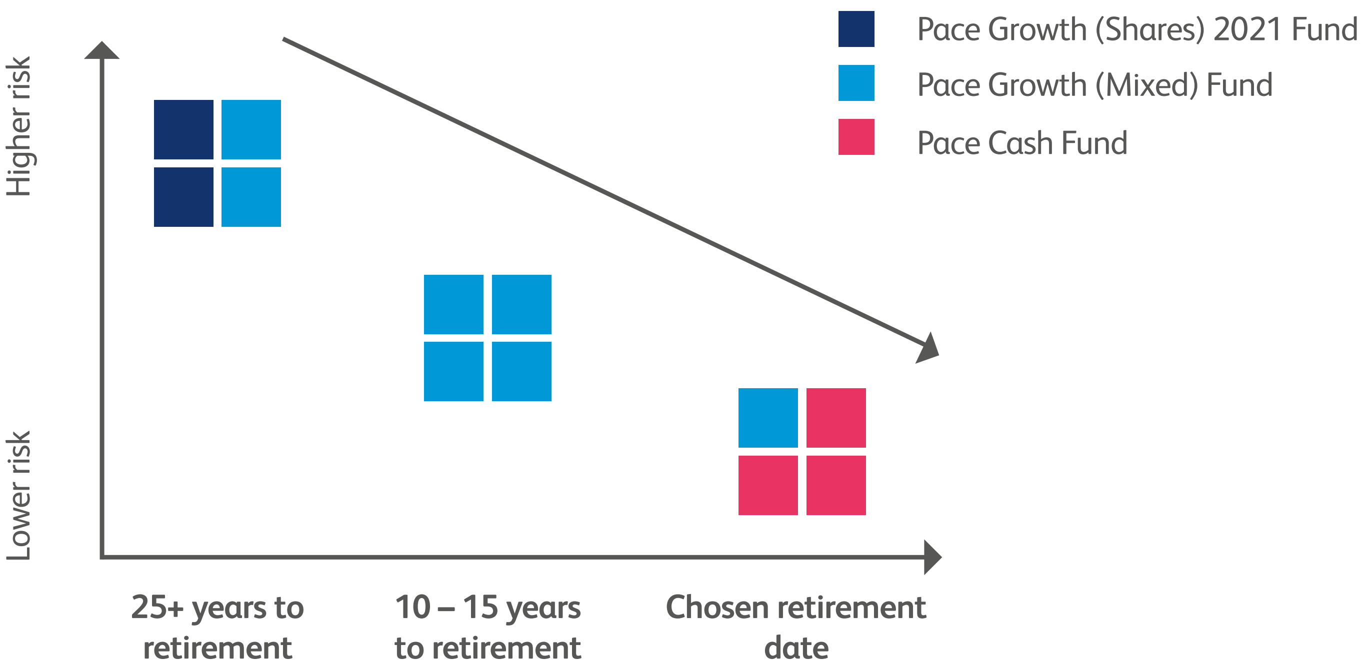
In addition, we have dedicated sections in our annual report and accounts and our shorter members' annual report focused on responsible investment.

5. What has the Trustee been doing this year?

<u>We changed the default investment strategy for Pace DC</u>

In 2019, with our advisers, we reviewed the lifestyle strategies available to members of Pace DC. Our conclusion was that in order to increase expected returns for younger members of the Scheme, we should introduce an equity component to the lifestyle strategies. Following further advice, this was implemented by the incorporation of a new equity fund, the Pace Growth (Shares) 2021 Fund, in the early years for Pace's three lifestyle strategies (including the default strategy). These changes were implemented in December 2020 for new joiners to Pace, and in February 2021 for existing members; the new fund has also been made available as a self-select option, with members in the old Pace Growth (Shares) Fund transferred into the new fund unless they opted out of the switch.

How does the new fund fit into the Target: Lump Sum lifestyle strategy?



The new fund invests in a diversified range of businesses in the UK and overseas. The fund also 'tilts' investments towards companies that have higher governance standards, and aims to achieve positive social and environmental impacts, including companies which are less carbon-intensive or earn green revenue; it also excludes investment in companies that manufacture controversial weapons or that derive a sizeable revenue from mining coal or using coal for power generation.

This approach is similar to the Pace Growth (Mixed) Fund (which forms a large part of the default investment strategy for Pace DC), which in 2019 was changed to explicitly reflect ESG factors within the default investment strategy offered to members, given the long-term nature of members' investments, and which we felt was better aligned with our Responsible Investment Policy.

We responded to market-wide risk, including climate change and the pandemic

Our approach to climate risk

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

In December 2020 we ran a Trustee training session with the other Co-op sponsored pension schemes, in particular looking at climate risk and opportunities, and the different metrics for carbon footprinting investments (and the benefits and drawbacks of each).

We also considered advice from our investment consultants and Scheme actuary on the potential sensitivity of the funding position of Pace to climate shocks – specifically an accelerated and dramatic governmental and financial market response to the climate crisis (resulting in falling government bond yields as the transition is seen as a strain on the economy; rising inflation from increased tariffs and transportation costs; falling equity prices; and widening credit spreads). The analysis showed that the impact on the DB sections' funding position in this scenario would be limited, as a result of the low-risk investment strategy and high levels of interest rate and inflation protection in place; nonetheless this is only one plausible scenario and we recognise that how the climate crisis will develop is unknown.

As noted above, we have made changes to Pace DC's investment strategy to reduce our carbon footprint and reduce our exposure to less sustainable companies; we've also taken steps to limit our exposure in Pace DB by appointing asset managers with long-term horizons and engaging with them on climate risk, and through excluding some potential investments (see page 12).

We'll be continuing this work over 2021 and 2022 as we work towards reporting under the Task Force on Climate-Related Financial Disclosures (TCFD)'s framework by November 2022.

The TCFD framework and associated reporting covers four areas:

Figure 1. Core elements of TCFD framework

- **Governance:** an organisation's governance around climate-related risks and opportunities (i.e., establishing processes for assessing and managing climate-related risks and opportunities).
- **Strategy:** the actual and potential impact of climate-related risks on investment strategy and funding strategy (including scenario analysis).
- **Risk management:** the processes used by the organisation to identify, assess and manage climate-related risks (e.g., monitoring voting/engagement on climate, and considering investment choices).
- **Metrics and targets:** the metrics and targets used to assess and manage relevant climate-related risks and opportunities. Trustees must report on a minimum of one absolute emissions metric, one emissions intensity metric and one additional climate change metric.

The role of the TCFD Working Group will initially be to understand the requirements of TCFD for Pace and to support work towards ensuring Pace complies with those requirements, and to undertake any other actions delegated to the Working Group by the Trustee or its sub-committees.

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

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

Responding to the pandemic
The other key market-wide risk identified over the year was the impact of Covid-19.

When the effect of the pandemic became clear in 2020, we made sure that our suppliers and advisers had processes in place to continue to run Pace efficiently, and monitored this on an ongoing basis throughout the year to identify potential issues, and reflected this in our risk register and business continuity planning.

We adapted our internal processes to make sure we were comfortable Pace would continue to be resilient in potential periods of market volatility – we reviewed our collateral positions, increased the short-term bank account holdings and were in dialogue with our asset managers around our currency hedging positions in light of the volatility of currency markets; we also engaged with our asset managers to understand any investments they had which they were concerned might default or become stressed and the actions they were taking to mitigate this risk. Through the Co-op Pensions Department, we were in regular dialogue with our property managers, given the direct exposure to the hospitality and student accommodation sectors in particular, and more detail is set out on page 23 on the approach taken by PGIM.

Other systemic and market risks

We recognise that pension schemes face a wide range of investment risks. Our Statements of Investment Principles (SIPs) for the two sections cover our policies on market-wide risks such as changes in interest rates and currency fluctuations, as well as our approach to other systemic risks such as climate risk. Our SIPs are available on the **Scheme website**.

We maintain a risk register to help review and monitor these risks; including a heat map to aid us in identifying and focusing attention on the risks for which controls need to be implemented. The risk register also shows a summary of the top key residual risks, current mitigations, developments and ongoing actions to help us put further controls in place.

Other than the risk register, over the year, in order to identify and respond to market-wide and systemic risks, we have had engagement with the wider industry through membership of the UK Sustainable Investment and Finance Association (UKSIF) and involvement in their policy round tables throughout the year, and by responding to industry consultations including:

- HM Treasury's consultation on the reform of the Retail Prices Index methodology;
- The Department for Work and Pensions' consultation on the Review of the Default Fund Charge Cap and Standardised Cost Disclosure Consultation; and
- The Department for Work and Pensions' consultation on taking action on climate risk: improving governance and reporting by occupational pension schemes.

Following the year end, alongside other UK private and public sector pension funds, Pace also became an inaugural member of the Occupational Pensions Stewardship Council, a forum established by the Department for Work and Pensions and supported by the Financial Reporting Council to promote and facilitate high standards of stewardship of UK pension scheme assets.

The forum aims to support occupational pension schemes in sharing best practice and to allow them to collaborate on engagement with the companies they invest in.

We continued to monitor our investment managers' approaches to incorporating environmental, social and governance (ESG) factors in their investment processes

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

When we appoint a new investment manager for Pace, we also consider the manager's approach to incorporating ESG factors and climate change issues into their investment strategy. While no new investment managers were appointed over the year, LGIM's capabilities were a consideration in selecting the new fund for Pace DC as noted on page 8.

We meet with each of our investment managers at least annually (at Trustee meetings or via our quarterly Manager Monitoring Investment Committee (MMIC) meetings), and ESG considerations and developments are a standing agenda item for each manager to provide an update on. Furthermore, our investment adviser assigns a rating to each manager according to the extent to which ESG issues and active ownership practices are integrated into their investment processes. The investment adviser's ESG-related ratings are reported to the Trustee and MMIC each quarter, and are used as a factor in manager evaluation and selection (noting that no new managers were appointed during the year).

We implemented a list of excluded investments for Pace DB

We continued to work with MSCI, a leading provider of investment tools and research, to implement an exclusions list to help us avoid investing in assets (as far as possible) that do not fit with our core beliefs.

We developed this exclusions list so that it is practical to apply and does not constrain our investment managers in securing the investment returns needed to pay members' benefits. The investment exclusions we agreed in April 2017 are:

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

Throughout the year, we worked with MSCI to keep the exclusions list up to date, to reflect their latest research updates. As at April 2021, the exclusions list covered:

- Corporate bonds issued by 492 companies in the extractive industries with poor environmental ratings (2020: 483 companies);
- Corporate bonds issued by five companies (2020: five companies) involved in the manufacture or distribution of controversial weapons; and
- Government bonds issued by 74 countries (2020: 71 countries) with poor human rights scores.

Over the year, we changed our approach to excluding securities under the first bullet slightly, strengthening it to require excluded investments to demonstrate four quarters of improved scores before removing the restriction.

These exclusions are applied to Pace DB's assets, covering the corporate bond and Liability Driven Investment mandates which made up over 77% of the Co-op Section's assets and over 95% of the Bank Section's assets as at 31 March 2021 (both excluding insurance policies). This means that approximately £7.0bn of Pace's assets were screened using the exclusions list.

We monitor the implementation of these exclusions, and over the year (as instructed), our bond managers have not made any purchases prohibited by the exclusions lists. A small amount of residual holdings (just over 0.6% of Pace's total assets, excluding the insured assets) are in investments on the exclusions list. This is broadly unchanged compared to 2020 (0.6%).

We have discussed ways to reduce these small residual holding over time with our asset managers; we will be considering this further alongside and as part of the work later in 2021 and into 2022 to quantify climate risk and to work to manage it.

6. What have our investment managers been doing?

Our investment managers put a lot of work into investing responsibly and considering ESG factors in their investment processes, and some go as far as extending this to how they run their own businesses. The following sections cover in more detail the policies and approach to responsible investment taken by Pace's main investment managers for Pace DB – LGIM, RLAM, Insight Investment, PGIM and BlackRock – where target holdings are at least 5 % of total assets, and for Pace DC's assets.

We've also tried to highlight specific examples of how these managers engage with the companies we invest in on our behalf.

With the exception of PGIM, who as a real estate manager engages in initiatives specific to that asset class (see page 23), over the year each of these managers became a signatory of the Net Zero Asset Managers Initiative.

The Net Zero Asset Managers Initiative is a group of international asset managers committed to supporting the goal of net zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius; and to supporting investing aligned with net zero emissions by 2050 or sooner.

It is an initiative designed to mobilise action by the asset management industry that demonstrates leading practice in driving the transition to net zero and delivers the ambitious action and investment strategies that will be necessary to achieve the goal of net zero emissions. It also provides a forum to share best practice and overcome barriers to aligning investments to that net zero goal.

The initiative will be managed globally by six Founding Partner investor networks, namely: Asia Investor Group on Climate Change (AIGCC), CDP, Ceres, Investor Group on Climate Change (IGCC), Institutional Investors Group on Climate Change (IIGCC) and Principles for Responsible Investment (PRI). In turn, the initiative is endorsed by The Investor Agenda, of which the investor networks are all founding partners.

We also engage with our other asset managers routinely on their exercise of stewardship of the companies they invest in, or the properties they own on behalf of the Scheme and their interaction with tenants; in some instances, for example asset backed securities, this is less directly applicable as they invest in instruments such as Collateralised Loan Obligations (CLOs) which themselves invest in tranches of underlying debt rather than individual businesses. In these cases, we would expect our asset managers to meet with the underlying managers of the vehicles they invest in, and the companies involved in servicing those investments.

Over the period, our managers' stewardship activities met with our expectations.

PACE DB
Investment Grade Credit Mandates

Mandate managers: Legal & General Investment Management; Royal London Investment Management; and Insight Investment Management.
Allocation: c34% of the Co-op Section and c43% of the Bank Section assets as at March 2021.
Objectives of mandates: Pace invests in corporate bonds through 'Buy & Maintain' approaches, which seek to hold bonds to maturity where possible, avoiding defaults through strong stock selection and limited trading, while building diversified portfolios.
Voting rights: No, but managers are expected to provide updates on their engagement with the companies in which they invest on our behalf.

Legal & General Investment Management (LGIM)
LGIM believes that by bringing together the sector expertise from across its active investment and stewardship teams, it can influence and change company and market behaviours to achieve positive societal impacts.

It does this through:

- Company engagement;
- Using its voting rights;
- Integrating environmental, social and governance factors into portfolio management;
- Addressing systemic risks and opportunities;
- Influencing governments, regulators and policy makers;
- Collaborating with other investors and stakeholders.

LGIM is committed to addressing ESG issues by developing and carrying out corporate governance and responsible investment activities, including Active Ownership, Advocacy, ESG Integration and Product Development. LGIM prioritises company engagement over exclusion, believing that this can effect change through collaborative efforts with companies in a more positive way. LGIM believes that combining this method with engagement and voting and targeted exclusions can be a very powerful tool to assess ESG issues.

LGIM is a signatory to the UNPRI and the UK Stewardship Code, and in December 2020 joined the Net Zero Asset Managers initiative. As part of this initiative, LGIM has committed to:

- Work in partnership with asset owner clients on decarbonisation goals, consistent with an ambition to reach net zero emissions by 2050 or sooner across all assets under management;
- Set, review and aim to increase over time, a target for the proportion of assets to be managed in line with the attainment of net zero emissions by 2050 or sooner.

Over the year, LGIM continued to enhance how it uses ESG information in credit research, and how its analysts form an assessment of an issuer's ESG profile. It believes that incorporating a qualitative element is essential to capture the ESG risks embedded within each company. This has been done through LGIM's proprietary ESG tools, which cover areas such as:

- Workers' rights and fair remuneration;
- Climate change / the environment; and
- Controversial weapons.

Specifically, for Pace's Buy & Maintain credit portfolios, LGIM uses its bespoke investment framework to help with its investment process, with the below objectives in mind:

- Encouraging companies to improve their behaviour and the quality of their ESG disclosures – this enables LGIM to raise the standards of entire markets, and helps generate sustainable, long-term returns;
- Assessing a company's ESG risks – LGIM sees unmanaged ESG factors of companies as posing potential risks and opportunities, which can have a material adverse impact on the performance of investments; and
- Identifying the winners of the future – the companies to which investors will allocate ever-larger amounts of capital.

To achieve their objectives, ESG factors are integrated into the investment process using top-down and bottom-up approaches. Once LGIM has identified a long-term driver of returns, its next step is to identify the companies which are best placed to benefit or lose out from it within the value chain. This is supported by LGIM's fundamental bottom-up research, which includes ESG assessment and company engagement. This helps LGIM to understand key drivers impacting that business.

In addition, LGIM's Corporate Governance and Index teams have developed a rules-based and transparent methodology by which to score companies against ESG metrics. This LGIM ESG Score is used universally across their business, including for their Future World funds.

ESG scores are assigned to companies based on the following themes:

- Environmental – assessing the exposure of companies to climate change and the shift to a low-carbon economy; comprising carbon emissions, the level of carbon reserves and green revenues;
- Social – comprising of diversity (representation of women in company boards, executive, management and workforce); and human capital (policies to ensure companies have the right culture and treat workers fairly);
- Governance – a range of criteria that indicate 'best practice' in terms of investor rights, board diversity and high-quality audits; and
- Transparency – assessing the quality of company disclosures. These indicators give LGIM insight into the quality of the ESG disclosure and the level of disclosure in relation to ESG-related data points.

As well as ESG scores, LGIM also uses an 'Active ESG View' which incorporates additional inputs and assessments in order to reflect a fuller picture of the ESG risks and opportunities embedded within each company. LGIM believes this helps with its analysis when picking investments to mitigate ESG risks and increases the probability of better long-term outcomes. LGIM's corporate credit ESG analysis is driven by each analyst's view on the significance of each factor.

LGIM also considers climate risk factors, mainly through the integration of ESG factors in the credit quality assessment as described above. In addition, LGIM believes that over the medium to long term, physical as well as transition climate risk (which are risks resulting from policy and regulation, differences in consumer preferences, technology adoption, etc.) would become much more pronounced and therefore LGIM approaches them through a combination of climate risk scenario modelling, using their Destination@Risk model to analyse scenarios for how the energy system may evolve over the next 30 years and their investment implications. This toolkit takes a bottom-up approach to model the energy system by making choices in the lowest-cost and most efficient way, which allows a robust measurement of the climate risk embedded in investors' portfolios and their climate alignment. Destination@Risk also allows LGIM to measure and manage carbon exposure, as well as identifying underlying climate risks across the capital structure.

In addition to its ESG policy, LGIM has implemented a separate policy for controversial weapons to exclude those companies involved in the manufacture and production of cluster munitions, antipersonnel landmines, and biological and chemical weapons. LGIM also has a separate policy on Climate Change (see box).

LGIM's policy and engagement on climate change

LGIM is committed to addressing the issue of climate change and has a specific climate change policy. It engages with companies that it invests in to ensure its strategies are aligned with global climate goals. It has done so through its **Climate Impact Pledge**, through which LGIM assesses over 1,000 of the world's largest companies across 15 climate-critical sectors, engaging with them to improve their strategies to address the climate emergency.

These companies' climate performance is published in a 'traffic light' system on LGIM's dedicated website. Published annually, companies are 'named and famed' or 'named and shamed' as LGIM encourages firms to take action to move towards net zero carbon emissions by 2050.

Companies are held to account through LGIM's voting activity and, where LGIM deems it appropriate, have been divested from selected funds where permitted (including in the Pace Growth (Mixed) Fund used by Pace DC – see page 24). Sanctioned companies currently include ExxonMobil, Hormel, Kroger, Sysco, Rosneft Oil, KEPCO, Loblaw, MetLife, Japan Post Holdings and China Construction Bank. Companies can come off this list and be reinstated to funds through tangible improvements and engagement.

LGIM believes that the process works, as seven of the ten companies that have registered the largest improvements since last year (2019) were those they had named as 'laggards' in previous publications.

Climate alignment example – SSE

SSE generates, transmits and distributes electricity in the UK. LGIM has been closely monitoring SSE's approach to reduce its energy mix from oil/gas and coal (currently 66% and 2% respectively) and have been seeking a credible decarbonisation plan from the issuer. In 2020, SSE announced revised Science Based Targets to reduce scope 1 greenhouse gases by 60% by 2030 and plans to invest £7bn+ in low-carbon construction projects such as offshore wind farms. Given the increased focus on renewables (reducing business risk) and credible de-leveraging plan via the disposal of non-core assets, LGIM was comfortable holding and adding exposure to SSE within Buy & Maintain portfolios such as those held by Pace.

LGIM aims to actively engage with companies, and it believes this direct engagement helps its analysts to identify ESG risks and opportunities. Ongoing dialogue with companies is a fundamental aspect of LGIM's approach to responsible investment. The outcomes from these engagements with companies are also fed back into LGIM's ESG tools.

LGIM sets clear objectives and timelines when it first engages with companies where issues have been identified, and these are reviewed throughout the engagement process to allow their management to oversee the progress of engagement activities.

To effectively tackle ESG issues that impact the value of their clients' assets, LGIM applies a multi-layered escalation strategy. Where the initial engagement does not lead to an appropriate outcome, LGIM may choose to adopt a stronger stance by using different escalation tools – for example, through voting against individual directors' reappointments (where LGIM has investments elsewhere within their business that do have voting rights), direct engagement with regulators, divesting from the securities of an unresponsive company or through applying pressure by means of public statements and press releases.

LGIM monitors investee companies over the long term and the progress on engagement activity is regularly reviewed by its dedicated team using company disclosures, independent research providers, its investment teams and the media.

Example of LGIM's engagement with an issuer in Pace's Buy & Maintain credit portfolio

Proctor & Gamble (P&G) – forest pulp and palm oil
P&G uses both forest pulp and palm oil as raw material within its household goods products, which are both considered leading drivers of deforestation and forest degradation. Over the year, LGIM engaged with P&G as both a bondholder (including on behalf of Pace) and a shareholder, and with the Natural Defence Counsel, to understand the issues and concerns.

As a result, LGIM voted in favour of a motion at P&G's 2020 AGM to encourage more transparency; further details are included on page 27 as we have also identified this as a significant vote for Pace DC.

Royal London Asset Management (RLAM)
RLAM is committed to being a responsible investor. It believes that seeking to integrate material ESG information into its decision-making is in the best long-term interests of its clients and can help to deliver better returns.

RLAM believes that corporate bond investing demands a bespoke fixed-income and ESG approach, and as a result has developed an approach that is intended to be both credible and realistic, with an emphasis on redressing bondholders' traditionally weak control. It aims to generate sustainable, risk-adjusted returns that reflect a wider understanding of what will drive economic performance in the future. As part of that commitment, RLAM seeks to identify and understand ESG risks and opportunities as part of their investment process. To achieve this, it engages with companies and industry regulators to understand the issues and to promote best practice.

For credit portfolios, RLAM's ESG analysis focuses on factors which might mitigate or exacerbate the potential for downside loss or risk of default. This includes specific considerations of where debt sits in the capital structure, the duration of the position, and any security associated with the bonds. RLAM has a dedicated responsible investment team to identify and evaluate ESG issues that might impact a sector, along with detailed investigations of the ESG profile of specific issuers and bonds, which feed into its credit analysis and the credit team's bond evaluation.

RLAM considers a company's treatment of its staff is a key social factor when assessing a company's wider exposure to ESG risks. At a minimum, RLAM would look for a company to have a publicly available modern slavery statement, and more generally would consider any evidence of workers' rights being violated in their ESG analysis. In addition, as part of its ESG analysis, RLAM reviews the gender pay gap reporting regime of UK-based issuers, as well as issuers' broader workforce diversity.

RLAM also confirmed it reflects Pace's exclusions list when choosing securities to invest in.

RLAM's policy and engagement on climate change and the environment
RLAM is committed to addressing the issue of climate change and in December 2020 published its first Climate Risk Policy, addressing how it approaches climate risks and opportunities when making investment decisions; including how it manages the risk of investee companies' operations and the risk this poses to investors' capital. During the first quarter of 2021, RLAM also became a signatory of the Net Zero Asset Managers Initiative (see page 13).

RLAM doesn't explicitly exclude companies involved in fossil fuel production above and beyond Pace's exclusions list, but it notes its credit research process and ESG analysis tends to lead to it having low exposure to companies which extract fossil fuels. For utilities with exposure to coal-based power production, RLAM regularly engages with companies on their approach to the energy transition, including their timelines and targets for decarbonising their generation portfolios.

In addition, RLAM does not have any exposure to companies with involvement in palm oil production or rubber production.

RLAM focuses on engaging with investee companies by having a long-term investment outlook and closely monitoring companies where they consider they will be able to have the greatest influence. It also focuses on areas where existing research is not well established, and on companies with a particular reliance on debt capital markets, privately held issuers and those where their lending is secured against underlying assets. In particular, RLAM continues to target engagement around decarbonisation of portfolios across their utility holdings, the climate resilience of its water holdings and the strategic response to energy efficiency regulation that its Commercial Mortgage Backed Securities (CMBS) investments and other real estate issuers are taking. RLAM believes that engaging with these issuers is particularly important because they have a greater reliance on debt markets than other companies (who may be more reliant on equity for capital and so less inclined to engage with bondholders).

RLAM takes an active approach to stewardship by engaging with issuers in their fixed-income portfolios. RLAM regularly monitors its investee companies using its own research and also through regular engagement meetings with management and non-executive directors to discuss issues relating to strategy and governance. Through dialogue with investees' management teams, RLAM aims to satisfy itself with the effectiveness and efficiency of the boards of investee companies, and to ensure that they are aware of, and are appropriately managing, all material risk factors, including environmental and social risks.

In terms of voting rights, although as a bondholder RLAM does not have voting rights at a company's annual general meeting, its focus on lending where it has security or protective covenants does give it a significant degree of pre-emptive control, which means it is engaged in a much higher level of bondholder voting (and direct agenda) than is typical for most corporate bond investments.

Examples of RLAM's engagement with issuers in Pace's Buy & Maintain credit portfolio

Rolling Stock Companies
Over the year, RLAM engaged with UK Rolling Stock Companies (ROSCOs), the firms which own most of the UK's locomotives and coaches/freight wagons, which are leased out to train and freight operating companies. Two of the three major UK ROSCO companies are in Pace's credit portfolio.

As privately owned companies with limited third-party ESG research available, RLAM felt that these companies were a strong opportunity for targeted engagement, with the potential for meaningful outcomes. As well as being impacted by the UK's 2050 net zero targets, the ROSCOs are also constrained by a government aim for the removal of diesel-powered passenger trains by 2040, which is likely to require significant electrification of the remaining network. With bondholders secured on train assets, there is a risk that diesel assets could become stranded before the end of their economic life as lines electrify, impairing collateral values.

From this engagement, RLAM was comfortable that the ROSCOs' current asset portfolios are reasonably well positioned to meet the 2040 diesel target, with existing diesel trains set to reach the end of their economic lives before the deadline.

Through targeted engagement, RLAM was able to evaluate the potential impact of decarbonisation on the UK rail network and also able to make informed investment decisions.

E.ON – Just Transition strategies
RLAM recognises the importance of climate transition risk and has engaged with a wide range of companies to support a just transition and to minimise the associated negative impacts to nature and society. RLAM has engaged, alongside the Friends Provident Foundation, with utility companies in particular to encourage the adoption of a 'Just Transition' strategy.

In February 2021, RLAM met with European energy company E.ON following public calls for utility companies to develop Just Transition strategies ahead of this year's COP26. RLAM discussed its expectations regarding decarbonisation on workers, communities, supply chain and customers, and E.ON agreed to add a section on Just Transition strategy in their decarbonisation plan, which establishes their forward-looking vision and strategy to achieve net zero.

As a result, E.ON published a policy on 26 March 2021 that includes the Just Transition statement, to illustrate their thinking and actions to support a Just Transition. This made E.ON the first utility company in continental Europe to address this issue through a written approach, and the second globally following RLAM's successful engagement with SSE in 2020.

RLAM is expecting additional formal commitments from other top utility companies to be put in place by November 2021.

Insight Investment Management

Insight is committed to addressing stewardship and engagement and believes doing so can drive change and support effective investment. Insight participates in a range of associations and collaborative initiatives including the UK Sustainable Investment and Finance Association, the Institutional Investors Group on Climate Change, Climate Action 100+ and the International Capital Market Association (ICMA) – Green and Social Bond Principles. In 2020, it has supported the proposal from the International Financial Reporting Standards Foundation (IFRS) to take leadership in developing globally consistent sustainability reporting standards, which Insight believes was a positive move in tackling sustainability disclosure problems for investors.

Insight also committed to fulfilling the reporting and transparency requirements of the updated 2020 UK Stewardship Code, publishing a full response (link on page 29).

Insight works to support a stable and resilient social, environmental and economic system and efficient, well-managed financial markets. It believes in integrating ESG issues into its investment processes, together with active engagement with issuers and other stakeholders to support better investment decisions. It believes that this in turn will help to achieve its clients' targeted investment outcomes.

Insight's Responsible Investment Policy focuses on six beliefs, broadly aligned with Pace's own policies:

- Putting responsibility at the heart of how they do business;
- Integrating material ESG factors into their investment process;
- Acting as effective stewards of companies and other entities;
- Supporting efforts that seek to improve the operation, resilience and stability of financial markets;
- Collaborating with others on ESG issues; and
- Exercising transparency and disclosing their activities.

Insight uses a number of external ESG research sources to support its ESG analysis, and over the year has strengthened its ESG analysis as it had identified inconsistencies and gaps in externally available information. This has led Insight to develop a proprietary model that aligns with its approach to corporate fixed income.

This proprietary model covers 95 % of investment grade corporate bond indices. The framework considers 33 key ESG issues, including carbon emissions, environmental controversy, water management, raw material and controversial sourcing, human capital and corruption.

These focuses are applied in the credit evaluation of all assets at Insight and are components of its checklist to better quantify long-term risks. As well as applying Pace's exclusions list, Insight's own ESG framework overlaps with Pace's Responsible Investment Policy in a number of areas:

- Insight has a policy to not have any exposure to companies involved in the manufacture or distribution of incendiary/illegal arms or weapons.
- When building long-term Buy & Maintain portfolios (like Pace's mandate), Insight focuses on secure, sustainable investments and would not therefore typically invest significant amounts in companies in the extractive sectors.
- Insight closely monitors risks from the extractive, utilities and energy sectors as it believes they are most vulnerable to a transition to a low-carbon economy and have a big impact on climate change.
- Insight expects companies to uphold minimum standards on labour and health and safety. It will engage with companies that fail to meet these minimum standards on a case-by-case basis. New issues such as equal pay are becoming more relevant for how they evaluate corporate culture and over time it expects to use this data as part of its issuer due diligence.

- Insight believes corporate governance is a critical component of issuer risk. Insight evaluates corporate governance for every company that it invests in and will engage on governance risk wherever it considers this to be material.

Insight's policy and engagement on climate change

Insight believes climate change presents a systemic investment risk. Its engagement policy for climate change is to advocate for action at a policy level. Insight believes that all issuers within its investment universe are susceptible to the consequences of climate change through potential impacts on supply chains, regulatory uncertainty and resource scarcity.

Insight considers a global legislative framework endorsed by policymakers to be the most effective mechanism to mitigate climate change and create investment certainty. To achieve this, Insight has joined a number of annual investor campaigns to push for a global climate agreement. Through its membership of the Institutional Investors Group on Climate Change (IIGCC), Insight has signed up to the 2021 global investor statement on climate change and advocates for action in a collaborative process.

Insight has also developed a proprietary 'Prime climate risk rating' for corporate debt which aims to analyse and quantify the risks due to 14 key climate change-related issues for approximately 1,700 issuers, drawing from over 200 individual data inputs. In 2020, this quantitative assessment of climate risks was formally integrated into Insight's credit analysis process, aiming to help its analysts and portfolio managers consider material climate risks in their investment decisions and to identify potential issuers for engagement. The Prime climate risk ratings expand on the principles of the Task Force on Climate-Related Financial Disclosures (TCFD), and Insight believes this rating can more accurately indicate how fixed-income corporate credit issuers manage their climate change-related risks and opportunities and shows how they are positioning themselves for the transition to a low-carbon economy.

Insight uses this as part of its credit analysis process, and its aim is for it to provide full coverage across the holdings in its Buy & Maintain credit strategies (including Pace). At present, the majority of Pace's bonds managed by Insight are covered by the index.

Insight takes an active approach to voting and stewardship. For its fixed-income portfolio where it does not have voting rights, Insight aims to engage with all companies prior to investing to review performance, strategy, risk management and ESG issues. Over 2020, Insight has conducted 1,210 engagements, of which 90% incorporated discussions of ESG issues (up from 82% and 1,151 engagements in 2019).

Insight focuses on the areas where companies have received low scores in its sustainability checklist. The issues Insight engages on include the oversight and effectiveness of boards of directors, environmental performance, health and safety events, accounting deficiencies and strategic changes. In 2020, Insight added climate risk to its checklist as a discrete risk alongside ESG and other credit-material factors to strengthen the tool. If Insight identifies issues and is unhappy with management's responses to their engagement on these issues, it would reduce or completely sell these holdings.

Examples of Insight's engagement with issuers in Pace's Buy & Maintain credit portfolio

1. Deutsche Telekom
Insight's research team met with the Vice President of Financial Markets of Deutsche Telekom (DT) in 2020 to discuss ESG issues, in particular cybersecurity and corporate responsibility. Insight noted that DT had adopted industry best practices such as certification of security management systems to the ISO 27001 standard, and a privacy policy that addresses varying categories of consumer data, strengthening its ability to mitigate the risk of potential GDPR violations. It also noted that DT continued to demonstrate its commitment to alleviate unethical corporate behaviour, with an organisation-wide compliance management system and collaborating with 16 other companies in monitoring suppliers.

2. Home Depot
In 2020, Insight engaged with the senior management team from Home Depot, the largest home improvement retailer in the US. Insight's assessment was that Home Depot has strong governance practices and a robust governance structure with a majority independent board. Home Depot has a large workforce of over 415,000 employees, which presents relatively high exposure to challenges related to employee attrition, applying labour practices uniformly and labour discord, and therefore Insight highlighted labour management and human resources governance as an area for future engagement.

Insight has confirmed it reflects Pace's exclusions list when choosing securities to invest in, and will continue to work with Pace to ensure ESG is incorporated in its investment process for Pace's mandate.

Alternative Inflation-Linked Mandate

Mandate managers: PGIM Real Estate (PGIM).
Allocation: c4.5 % of Co-op Section assets as of March 2021.
Objectives of mandates: PGIM's alternative property strategy aims to provide an alternative to Long Dated Index Gilts to outperform the FTSE 5-25 Year Index-Linked Gilts index by 2.0 % p.a. (net of fees).
Voting rights: Not relevant.

Our holdings with PGIM are invested in long lease property (predominantly commercial ground leases and income strips on property such as hotels, student accommodation and affordable housing).

Throughout the year, the Co-op Pensions Department, on behalf of the Trustee, has held regular meetings with PGIM in relation to its mandate and rent collection, particularly given the Covid-19 impact on the specific sectors Pace is invested in, i.e., hospitality and student accommodation, which have been severely impacted by lockdowns. PGIM's policy has been to be consistent and collaborative with tenants in collecting rent, while recognising the unprecedented times and considering the best long-term outcome for Pace. As part of this, the PGIM asset management team has had direct dialogue with tenants where necessary, in some cases agreeing short-term rent deferral or rent repayment/restructuring plans to assist tenants with cashflow throughout the pandemic.

Liability Driven Investment Mandate

Mandate managers: BlackRock Investment Management (BlackRock).
Allocation: c43 % of Co-op Section assets / c52 % of Bank Section assets as of March 2021.
Objectives of mandates: BlackRock's objective is to match its overall benchmark which is based on Pace's liabilities using a gilt-based measure.
Voting rights: Not relevant.

Our holdings with BlackRock are in a UK government bond-based liability hedging portfolio, so responsible investment considerations do not as obviously impact on investment decisions for its mandate, and as such it does not form part of its investment process – Pace does however apply its exclusions list to the portfolio, as there is limited flexibility for BlackRock to also invest in some corporate or overseas bonds. In particular, we also note that we apply an exclusions list preventing investment in government bonds issued by countries that score poorly on human rights issues.

We recognise that investing in government bonds, and therefore having exposure to a country's wider economic growth and stability, does not come without a carbon footprint. We plan on working with BlackRock over 2021/22 to understand how this can be quantified.

PACE DC

Mandate manager: Legal & General Investment Management			
Pace Fund	**Proportion of Pace DC assets (Co-op Section)**	**Proportion of Pace DC assets (Bank Section)**	**Fund objective**
Growth (Mixed)	68.1 %	68.7 %	Long-term investment growth, using a diversified set of asset classes, while reflecting significant environmental, social and corporate governance (ESG) issues into the fund's investment strategy.
Growth (Shares) 2021	23.1 %	25.5 %	Invest in the equity of a diversified range of businesses in the UK and overseas, with strong and improving environmental, social and corporate governance (ESG) attributes.
Cash	8.1 %	5.0 %	Provide capital protection, with growth at short-term interest rates.
Growth (Ethical Shares)	0.6 %	0.6 %	Track the total return of the FTSE4Good Global Equity Index.
Growth (Shares)	0.1 %	0.0 %	Capture UK (30 %) and overseas (70 %) equity market returns.
Pre-retirement	0.1 %	0.0 %	Reflect diversified investment underlying a typical traditional annuity product.
Pre-retirement (inflation-linked)	0.0 %	0.1 %	Reflect diversified investment underlying a typical inflation-linked annuity product.

Pace DC is administered by Legal & General Assurance Society Ltd, and members have the option to invest in a range of funds, which are shown above, together with the proportion of members' assets invested in each fund as at 5th April 2021.

The most significant holding in Pace DC is the Pace Growth (Mixed) Fund, which forms the largest component of the default investment option. Since 2019, this fund has been invested in Legal & General's Future World Multi-Asset Fund. This fund invests in a range of assets which may include equities, bonds, cash and listed infrastructure, private equity and global real estate companies, aiming to provide long-term investment growth while also reflecting significant ESG issues into the fund's investment strategy through 'tilts' towards more sustainable companies.

LGIM publishes a number of metrics to quantify the impact of the Growth (Mixed) Fund. This has had a quantifiable impact on the companies which the fund invests in, in particular on climate change-related factors:

- The ‘carbon emissions intensity’ (which measures the relationship between carbon emissions of a company and its sales) is 49% lower for the Future World Multi-Asset Fund than the market as a whole (i.e., a similar fund without the ‘tilts’); and
- The carbon reserves of the companies LGIM invests in are almost 70% lower than for a fund without these ‘tilts’. Based on LGIM’s analysis, this means investing in the Future World Multi-Asset Fund reduced exposure to fossil fuel reserves by the equivalent of over 3,100,000 barrels of oil compared to an unadjusted index-tracking approach. This is based on the £420m Pace DC members had invested in the Future World Multi-Asset Fund (via the Pace Growth (Mixed) Fund) at 5 April 2021.

As noted on page 8, in late 2020 we launched a new equity fund, the Pace Growth (Shares) 2021 Fund. Similar to the approach taken by the Growth (Mixed) Fund, this fund aims to invest in companies with strong and improving environmental, social and corporate governance (ESG) attributes, and does not invest in companies that manufacture controversial weapons or that earn a sizeable revenue from mining coal or using coal for power generation.

LGIM’s exercise of voting rights

Pace DC offers options for investment to members which include exposure to shares (either through equity funds or the multi-asset fund). The Trustee does not directly exercise voting rights as these investments are through pooled funds with many other investors. Voting rights are exercised by LGIM using ISS’s ProxyExchange electronic voting platform, although voting decisions are retained by LGIM and strategic decisions are made by LGIM’s Corporate Governance Team in accordance with their governance policies for each region.

LGIM sees voting as a key way to make its voice heard and hold companies accountable. LGIM regularly reviews its voting policies and processes and believes that transparency over their voting activity is critical for its clients and other interested parties. Therefore, over 2020, it has created a new voting disclosure webpage which aims to:

- Provide daily updates of their vote instructions and disclosures of all votes within a day following a shareholder meeting; and
- Disclose vote rationales for all votes against management and include historic data from 1 January 2017.

LGIM continues to develop and follow its own policies rather than adopt those of third parties, as it believes that by using its own policies it can better align with its own engagement activity and apply a truly global approach (as it believes some third-party policies may focus on a particular country or region and so not apply more broadly). While LGIM’s stock lending policies differ according to each market, LGIM retains the right of immediate recall of its shares, should it deem this necessary. For example, if there is a potential takeover of a company that LGIM owns at a price which it does not believe is in the best interests of shareholders, it would then recall the stock that is out on loan in order to vote with 100% of their holding.

LGIM votes consistently in line with its policies across all pooled funds; the table below summarises how LGIM voted across shares held in the Pace Growth (Mixed) Fund and Pace Growth (Shares) 2021 Fund over the year (the two funds in the default option which invest in shares) – note that the data for the Growth (Shares) 2021 Fund covers the entire year based on LGIM’s voting for the underlying fund, despite the Growth (Shares) 2021 Fund itself only launching in late 2020.

	LGIM fund	
	Pace Growth (Shares) 2021 Fund	**Pace Growth (Mixed) Fund**
Underlying fund	L&G MSCI ACWI Adaptive Capped ESG Index Fund	L&G Future World Multi-Asset Fund
Number of equity holdings in the fund (at 31 March 2021)	2,396	6,404
Number of meetings at which LGIM was eligible to vote over the year	3,523	8,622
Number of resolutions LGIM was eligible to vote on over the year	40,566	89,374
% of resolutions LGIM was eligible to vote on where it exercised that vote	99.95 %	99.8 %
% of resolutions where LGIM voted for management / voted against management / abstained from voting*	For: 81.5 % Against: 17.9 % Abstained: 0.6 %	For: 80.7 % Against: 19.0 % Abstained: 0.4 %
% of meetings at which LGIM voted at least once against management	5.8 %	6.7 %
% of meetings at which LGIM voted against the recommendation of the proxy adviser	0.25 %	0.22 %

Votes that are considered most significant by LGIM

In LGIM's quarterly ESG impact reports, it provides LGIM's votes together with details of 'significant votes'. The Pace DC Committee reviews the report quarterly, with any comments or questions fed back to LGIM via the Co-op Pensions Department.

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

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

Significant votes identified during the year for the Pace Growth (Shares) 2021 Fund and Pace Growth (Mixed) Fund included:

- On 7 May 2020, LGIM voted to support a management resolution at Barclays (supported by ShareAction) outlining its target to align the entire business to the goals of the Paris Agreement through plans to shrink its carbon footprint to net zero by 2050; this was deemed 'significant' because of the interest across LGIM's clients in relation to the AGM and voting intentions. The resolution was supported by 99.9 % of shareholders.
- On 30 July 2020, LGIM voted against the election of the most senior member of the board at Olympus Corporation in line with LGIM's policy for companies in the TOPIX100 to vote against the chair of the nomination committee or the most senior board member if there were no women on their boards or at executive level, to support greater diversity at board level. This was deemed 'significant' as LGIM considers it imperative that the boards of Japanese companies increase their diversity. Approximately 95 % of shareholders supported the election of the nominated director, although LGIM has noted that it will continue to engage to achieve the required increased diversity on all Japanese company boards.
- On 13 October 2020, LGIM voted to support a shareholder proposal at the Proctor and Gamble (P&G) AGM in relation to increasing transparency around palm oil and wood pulp, to limit deforestation. The resolution received the support of over two thirds of shareholders (including LGIM), and LGIM will continue to engage with P&G on the issue and will monitor its Carbon Disclosure Project disclosures for improvement. This was deemed 'significant' as it was linked to LGIM's five-year strategy to tackle climate change, and attracted a great deal of interest from LGIM's clients.
- On 11 February 2021, LGIM supported a shareholder resolution that requested that Tyson Foods produce a report on their human rights due diligence process. This was a result of the potential deficiencies highlighted in the application of their human rights policies during the pandemic, including strict attendance policies, insufficient access to testing and social distancing, and non-comprehensive Covid-19 reporting. An ISS AGM benchmark report noted there had been over 10,000 positive Covid-19 cases and 35 worker deaths. This is in conjunction with additional litigation and regulatory investigations in the US. LGIM believes companies should uphold their duty to ensure the health and safety of employees over profits. The resolution failed to get a majority support as only 17 % of shareholders supported it; LGIM has noted that it will continue to monitor the company.

Appendix 1

The following table summarises each of Pace DB's investment managers' compliance with the UK Stewardship Code for the 6 April 2020 - 5 April 2021 period, and whether they are a signatory to the UNPRI and the Net Zero Asset Managers Initiative:

Investment manager	Mandate	Approach	Signatory to the UNPRI	UK Stewardship Code Signatory	Net Zero Asset Managers Initiative Signatory	DB Co-op Section Assets (31 March 2021)	DB Bank Section Assets (31 March 2021)
LGIM	Corporate Bonds	Buy & Maintain	Yes	Yes	Yes	9.0 %	14.6 %
RLAM	Corporate Bonds	Buy & Maintain	Yes	Yes	Yes	10.2 %	14.1 %
Insight	Corporate Bonds	Buy & Maintain	Yes	Yes	Yes	15.2 %	14.7 %
24AM	Asset Backed Securities	Active	Yes	Yes	No	4.1 %	3.9 %
PGIM	Alternative Inflation-Linked Property	Active	Yes	No[1]	No[2]	4.5 %	-
BlackRock	Liability Driven Investment	Active	Yes	Yes	Yes	43.0 %	52.2 %
Insight	Illiquid Credit	Active	Yes	Yes	Yes	5.1 %	-
ICG	Illiquid Credit	Active	Yes	No[3]	No	4.4 %	-
M&G	Illiquid Credit	Active	Yes	Yes	Yes	3.7 %	-
LaSalle	UK Property	Active	Yes	No[1]	No[2]	0.2 % (in the process of being disinvested)	-
Mercer	Alternative Growth	Active	Yes	Yes	No[4]	0.6 % (in the process of being disinvested)	0.5 % (in the process of being disinvested)

[1]LaSalle and PGIM Real Estate manage investments in real estate, and not UK listed securities to which the 2012 UK Stewardship Code currently applies. PGIM is currently looking into the requirements to apply as a signatory ahead of the 30th October 2021 deadline.

[2]LaSalle and PGIM have aligned with Urban Land Institute's Greenprint Center for Building Performance goal to reduce landlord-controlled operational carbon emissions of their global portfolio of managed properties to net zero carbon by 2050.

[3]ICG generally supports the objectives that underline the Code but as they do not invest in shares of listed companies in the UK, the provisions of the 2012 code are not deemed to be sufficiently relevant.

[4]Mercer has announced to commit to a target of net zero absolute carbon emissions by 2050 for UK, European and Asian clients with discretionary portfolios and the majority of its multi-client, multi-asset funds domiciled in Ireland.

Appendix 2

Our managers' statements of compliance with the UK Stewardship Code

The 2020 UK Stewardship Code took effect on 1 January 2020, with the FRC accepting applications from Q1 2021; given the timing of Pace's report, not all of our asset managers will have published reports under the new code and so we have set out links to their reporting under the 2012 code below where required (and available), in anticipation that our report next year will reference reporting evidencing compliance with the 2020 code.

Legal & General Investment Management:
https://www.lgim.com/landg-assets/lgim/_document-library/capabilities/uk-stewardship-code.pdf

Royal London Asset Management:
https://www.royallondon.com/globalassets/docs/shared/investment/77491-stewardship-report-2021.pdf

Insight Investment:
Will be available via https://www.insightinvestment.com/investing-responsibly/

Twenty Four Asset Management:
https://www.twentyfouram.com/uk-stewardship-code

BlackRock Investment Management
https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-statementoncompliance-uk-stewardshipcode.pdf

M&G Investments:
https://www.mandgplc.com/~/media/Files/M/MandG-Plc/documents/responsible-investing/stewardship/31-03-2021-MGINV-Stewardship-Report-2020.pdf

Mercer Ltd:
https://investment-solutions.mercer.com/content/dam/mercer-subdomains/delegated-solutions/CorporatePolicies/uk-stewardship-code-statement-of-commitment.pdf

Appendix 3
UK Stewardship Code 2020

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

To help readers, we have signposted where we have covered the 12 principles in this report below.

Principles	Document reference
Purpose and Governance	
1 Purpose, strategy and culture	'How do we invest' (page 4)
2 Governance, resources and incentives	'How do we exercise stewardship?' (page 6)
3 Conflicts of interest	'Managing conflicts of interest 7' (page 7)
4 Promoting well-functioning markets	'Tackling market-wide risk' (page 9)
5 Review and assurance	'Introduction' (page 2); 'How do we invest' (page 4) and 'What has the Trustee been doing this year?' (page 8)
Investment approach	
6 Clients and beneficiary needs	'About us' (page 5) and 'How do we invest' (page 4)
7 Stewardship, investment and ESG integration	'How do we exercise stewardship' (page 6) 'What has the Trustee been doing this year?' (page 8) 'What have our investment managers been doing' (pages 13 – 27)
8 Monitoring managers and service providers	'What have our investment managers been doing' (pages 13 – 27) Appendices 1 and 2
Engagement	
9 Engagement	'How do we exercise stewardship?' (page 6) 'What have our investment managers been doing' (pages 13 – 27)
10 Collaboration	'Tackling market-wide risk' (page 9) 'What have our investment managers been doing' (pages 13 – 27)
11 Escalation	'How do we exercise stewardship' (page 6) 'What have our investment managers been doing' (pages 13 – 27)

Exercising rights and responsibilities	
12 Exercising rights and responsibilities	'What have our investment managers been doing' (pages 13 – 27); in particular 'LGIM's exercise of voting rights' (pages 25 – 26)

Appendix 4

Myners Compliance Statement 2021

In 2000, the UK Government commissioned Paul Myners to undertake a review of institutional investment, publishing a report in 2001 which became established as the Myners' Principles on good investment governance. The principles were updated through a Treasury report in October 2008, 'Updating the Myners' Principles: A Response to Consultation'.

Pace aims to comply with all of the Myners' Principles, recognising it is in all parties' interests if the Scheme operates to standards of investment decision-making and governance identified as best practice.

	Principle	Pace Policy and Practice
1	Effective decision-making: • Trustees should ensure that decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to take them effectively and monitor their implementation. • Trustees should have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.	- The Trustee dedicates specific time within Trustee meetings to provide the appropriate focus and skills on investment decision-making. - The Trustee Directors have appointed independent and suitably qualified investment advisers to advise on investment strategy and monitor implementation. - The Trustee Directors are professionals and are provided with training on investment and other relevant issues. - The Scheme operates a conflicts of interest policy.
2	Clear objectives: • Trustees should set an overall investment objective(s) for the fund that takes account of the Scheme's liabilities, the strength of the sponsor covenant, and the attitude to risk of both the Trustees and the sponsor; and clearly communicate these to advisers and investment managers.	- The Trustee Directors have set an overall investment objective for each section of Pace after considering appropriate advice and consultation with the sponsors. Benchmarks and objectives are in place for the funding and investment of the Scheme. - Investment managers have clear, written mandates, including return and risk benchmarks and clear time horizons for performance measurement and evaluation. - The strength of the employers' covenant is independently formally assessed by the Scheme's appointed covenant adviser on an annual basis, with quarterly updates provided to the Trustee Directors.

3	Risks and liabilities: • In setting and reviewing their investment strategy, Trustees should take account of the form and structure of liabilities. • These include the strength of the sponsor covenant, the risk of sponsor default and longevity risk.	- Each section's liability profile is independently assessed at each periodic strategy review, and the Trustee Directors take into account the risks associated with the liability valuation when reviewing and setting the investment strategy for each section. - The strength of the support provided by the employers' covenant and longevity risk is assessed regularly. - Since the execution of the insurer buy-in policies with Aviva and Pension Insurance Corporation (PIC), both sections are exposed to the insurers' covenants. The Trustee Directors review the financial positions of the insurers regularly.
4	Performance assessment: • Trustees should arrange for the formal measurement of the performance of investments, investment managers and advisers. • Trustees should also periodically make a formal policy assessment of their own effectiveness as a decision-making body, and report this to Scheme members.	- The global custodian, appointed by the Trustee, undertakes independent measurement of investment performance. - Investment managers' performance is assessed by the in-house investment team and independent investment adviser. - The Trustee Directors have set objectives for the investment adviser and will review performance against the objectives on a regular basis. - The Trustee Directors review all Scheme adviser appointments periodically. - The Trustee Directors periodically consider the effectiveness of Trustee decision-making.
5	Responsible ownership: • Trustees should adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholder and agents. (In July 2010, the FRC published its original UK Stewardship Code, of which the ISC Statement of Principles formed the basis.) • A statement of the Scheme's policy on responsible ownership should be included in the Statement of Investment Principles.	- The Trustee reviews its Responsible Investment Policy annually and published an updated Policy on the **Scheme's website** in Q2 2020. - The Policy is referenced in each section's Statement of Investment Principles. - Under the Policy, the Trustee is committed to disclose details of its managers' voting and engagement activities to members on an annual basis, via the **Scheme website**. - The Trustee reports on its compliance with the UK Stewardship Code via the **Scheme website** and reviews this annually. - Investment managers are encouraged to adhere to the code, and compliance is a factor in manager evaluation and selection.

6	Transparency and reporting: • Trustees should act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives. • Trustees should provide regular communication to members in the form they consider most appropriate.	- The Statement of Investment Principles for each section is compliant with the Myners' Principles and is available on the **Scheme website**. - Reports are compiled in a way that ensures the Scheme operates transparently and is accountable to members.