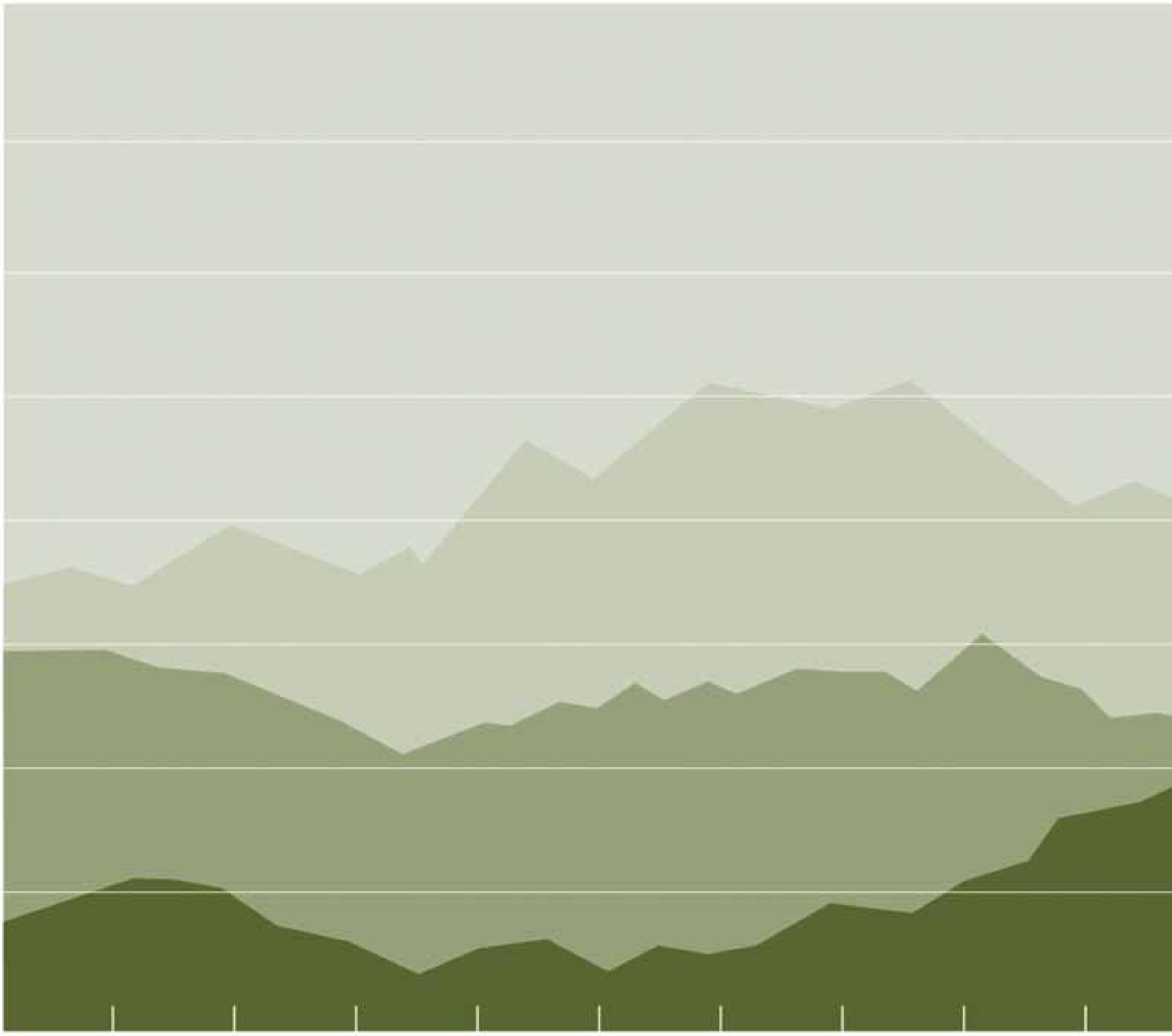
Environment Agency

Active Pension Fund
Annual Report and Financial Statements 2009 - 2010



Environment Agency Active Pension Fund
Annual Report and Financial Statements 2009-2010

Presented to Parliament pursuant to Section 46 of the Environment Act 1995 as amended by the Government Resources and Accounts Act 2000 (Audit of Public Bodies) Order 2003

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Contents

Chairman's statement

As Chairman of the Environment Agency's Pensions Committee, which is responsible for overseeing the management and administration of the Environment Agency Active Pension Fund ("the Fund"), I am pleased to present the Fund's Annual Report and Financial Statements for the year ended 31 March 2010.

I am pleased to say that over the last year, total membership of the Active Fund increased by 3.8% or 794 to 21,595. This comprises 11,990 employees, 5,518 deferred members and 4,087 pensioners. Over 93% of eligible Environment Agency employees continue to contribute to the Fund.

These accounts have been prepared using the Statement of Recommended Practice (SORP) for pension funds issued by the Pensions Research Accountants Group (PRAG), which is recognised by the Accounting Standards Board as the body within the pensions industry for issuing statements of recommended practice governing the form and content of financial statements for pension schemes.

Last year, we were reporting on the global financial and banking crisis which had reduced the market value of our assets to £1,132m as at 31 March 2009. This year we are pleased to say the markets have rallied substantially and the net asset value has increased by £463m (up 40.9%) to £1,595m as at 31 March 2010. The investment performance of the fund against it strategic benchmark was -0.7%.

The estimated funding level on 31 March 2010 was 78%, which is an increase of 16% from the value of 62% last year. Following our 2007 triennial valuation, our actuary recommended the employer's contribution rate, from 1 April 2008, be increased from 15% in 2007/08 by 0.5% each year for the next three years, to a level of 16.5% in 2010/11 to help meet the Active Fund's future liabilities. The 31 March 2010 triennial valuation will determine future employer contributions for the three years from 2011/12 to 2013/14.

Whilst improving the Fund's financial performance is paramount, during the year our innovative work in integrating financially material environmental issues into our investment strategy was externally recognised. We were the proud winners of a prestigious EU wide award for responsible investment and corporate governance for the third year running.

Our commitment to responsible investment was demonstrated in the publication of our Responsible Investment Review in July 2009. The review was structured round the United Nations Principles for Responsible Investment (UNPRI) with the aim of the report being to demonstrate to our fund members and other stakeholders that the our fund is managed responsibly, with strategies and policies for the investment and management of the funds assets that are both financially robust and environmentally credible.

Finally I would like to take this opportunity to thank everyone involved, both Environment Agency staff and external contractors, for helping the Pensions Committee to manage the Active Fund over the last year.

Larry Whitty
Chairman
Environment Agency Pensions Committee
06 July 2010

Report by the Pensions Committee

Governance

Chairman and members

Larry Whitty was re-appointed to the Pensions Committee for a second term by the Board and became Chairman of the Pensions Committee with effect from 1 June 2009, following the retirement of John Edmonds on 31 May 2009. In July 2009, the Board re-appointed Suzanne Warner for a second three-year term to September 2012 and appointed Robert Light for an initial three-year term until 30 June 2012 to replace John Edmonds. John Varley was appointed by the Board in November 2009 for an initial three-year term following the retirement of Richard Percy in October 2009.

In October 2009 Environment Agency Director of Finance Nigel Reader retired from the Environment Agency and the Pensions Committee and was replaced by the new Director of Finance Mark McLaughlin with effect from 1 November 2009. Ric Navarro, Director of Legal Services, retired from the Committee on 30 June 2009. Kevin Ingram was appointed in July 2009 as the Executive Management nominee for Environment Agency Wales for an initial three-year term until July 2012 following the resignation of David Edwell in March 2009.

In May 2009, active member Alan Broughall was re-appointed for a further one-year term until his retirement from the Committee on 31 March 2010. In November 2009, following the resignation of Gary Barker in July 2009, Stuart Martin was appointed as an active member for an initial three-year term until November 2012 and pensioner member Brian Engel was re-appointed for a third term to May 2013. In February 2010 John Kerr was appointed as the new deferred member of the Committee for an initial three-year term until February 2013.

Committee governance

During the past year the Pensions Committee met on four occasions to fulfill its responsibilities as a sub-committee of the Environment Agency Board. The Board appoints members in accordance with the Governance compliance statement. The Committee has delegated responsibility to manage the investment and administration of the Environment Agency's pension funds. The Committee's Investment Sub-Group met on five occasions, including one special meeting to consider Active Fund investment issues. The Committee's Benefits Sub-Group met on four occasions.

In December 2008 the Government issued statutory guidance on the preparation of Governance compliance statements. With the appointment of a deferred member nominee, our own statement, which incorporates the Pensions Committee Terms of Reference and Standing Orders and the Pension Funds Scheme of Delegation, demonstrates our compliance with this guidance. The statement of compliance with Government guidelines has been updated this year and may be found at Annex 2. The full Governance compliance statement may be found at www.environment-agency.gov.uk/pensions.

Committee training

The Pensions Committee's training strategy takes account of the requirements of the Pensions Act 2004. The Act requires that trustees of occupational pension schemes should have knowledge and understanding of the law relating to pensions and role of trustees, the principles of scheme funding and investment, and the management and administration of pension scheme benefits.

The training needs of Pension Committee members are assessed on an individual basis and take account of members' existing expertise, and interests in specific areas. Within this flexible framework the following structure is operated. New members receive a comprehensive Pensions Committee Handbook and a half-day induction session before attending their first meeting. They are also given the opportunity to attend more specialist courses on specific core competencies and regional pension briefings for Environment Agency employees presented by Human Resources (HR) staff and Capita Hartshead.

In each subsequent year of membership they are expected to undertake two to three days training aimed at building or refreshing their knowledge and skills in specific topics in greater depth. A self-assessment training needs questionnaire has been developed to help members to focus on the most important areas for their training. A detailed log of all training undertaken and planned by Committee members is maintained and is available for inspection on request. During 2009/10 two special training sessions were held for the Pensions Committee, the first covered part one of the Active Fund investment strategy review and the second covered the new cost sharing proposals within the LGPS.

A record of members' attendance at Committee meetings through the year is shown below:

	Committee business	Committee training	Investment Sub Group	Benefits Sub Group	TOTAL
Number of meetings	4	2	5	4	15
Board members					
Larry Whitty (Chair) *from 1/6/09*	4	2	4	4	14
John Edmonds (Chair) *to 31/05/09*	0	0	2	1	3
Suzanne Warner	4	2			6
Richard Percy *to 31/10/09*	2	0	2		4
Robert Light *from 01/07/09*	3	2		2	7
John Varley *from 01/11/09*	2	2	2		6
Executive members					
Nigel Reader *to 31/10/09*	1	0	2	2	5
Mark McLaughlin *from 01/11/09*	3	2	3	3	11
Graham Ledward	4	2		0	6
Ric Navarro *to 30/06/09*	1	0			1
Howard Pearce	4	2	5	4	15
Active members					
Alan Broughall *to 31/03/10*	4	2	5	2	13
Phil Chappell	4	2	3		9
Jackie Hamer	4	2	0		6
Aileen Parry	4	2		2	8
Kevin Ingram *from 07/07/09*	3	2			5
Stuart Martin *from 17/11/09*	2	2			4
Gary Barker *to 31/07/09*	0	0			0
Pensioner member					
Brian Engel	4	2		4	10
Deferred member					
John Kerr *from 09/02/10*	1	0			1
Chief Executive - ex officio attendee					
Paul Leinster	1	0			1

Note – shaded areas above indicate non-membership of that sub-group

Pensions changes

Government pensions reform

During the year, the following statutory instruments were made:

- *The Local Government Pension Scheme (Amendment) Regulations 2009 (SI 2009/1025) – applicable from 1 April 2009.*

  The amending regulation was issued to stakeholders on 24 April 2009 by Department for Communities and Local Government (CLG) and was effective from 1 April 2009.

  CLG are committed to the introduction of “cost sharing” between employers and scheme members to ensure that the LGPS remains affordable, viable and fair to all. “All” represents employees, employers and taxpayers. The LGPS (Amendment) Regulations 2009 are based upon the responses received following the statutory consultation, further consideration of key issues from the recent Policy Review Group (PRG) and subsequent meetings with other key interested parties and introduce a cost sharing mechanism to facilitate this process.

- *The Local Government Pension Scheme (Amendment) Regulations 2008 (SI 2008/1083) – Correction – applicable from 1 April 2008*

  The amending regulation was issued by CLG on 7 October 2009 and was effective from 1 April 2008.

  The amending regulation corrects some erroneous dates and references to over-riding legislation and correctly re-inserts indents to paragraphs within the benefit regulations.

- *The Local Government Pension Scheme (Miscellaneous) Regulations 2009 (SI 2009/3150) – applicable from 1 April 2008*

  The amending regulation was issued by CLG on 23 December 2009 and is effective in parts from 1 April 2008. A summary of the main amendments is listed below:

  Technical amendments to the: -
  - LGPS (Early Termination of Employment) (Discretionary Compensation) (England and Wales) Regulations 2006 including, an amendment to prevent the award of discretionary compensation where the employing authority has granted the member additional membership or additional pension
  - LGPS (Benefits, Membership and Contributions) Regulations 2007 including amendments to the definition of Pensionable Pay, Final Pay Reductions.
  - LGPS (Transitional Provisions) Regulations 2008 allowing for the inclusion of Pre 6 April 1988 periods of membership when calculating a Civil Partner’s pension.
  - LGPS (Administration) Regulations covering payments in relation to the purchase of Additional Survivor Benefits and the payment of Guaranteed Minimum Pensions

  New regulations permitting: -
  - Employing authorities to resolve, before 31 March 2012, to convert periods of Compensatory Added Years, annual compensation or annuities awarded under Discretionary Compensation Regulations into membership
  - Members with nominated co-habiting partners to elect, before 1 April 2011, to pay additional survivor benefit contributions so that pre 6 April 1988 membership can count in the calculation of the nominated co-habiting partner’s benefits.

- *The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009(SI 2009/3093) – applicable from 1 January 2010*

  The amending regulation was issued by CLG on 14 December 2009 and was effective from 1 January 2010 revoking the previous Management and Investment of Funds Regulations and subsequent amendments. A summary of the main amendments is listed below: -

  The 2009 investment regulations require that from 1 April 2011, administering authorities must hold all monies for the purpose of the pension fund in a separate account with a deposit-taker. A deposit taker is defined as the Bank of England, the central bank of any other EEA state, the National Savings Bank, a person who has permission under Part 4 of the Financial Services and Markets Act 2000 to accept deposits or an EEA firm which can accept deposits by virtue of paragraphs 5(b), 12 and 15 of Schedule 3 to the Financial Services and Markets Act 2000.

  The accompanying letter from CLG highlighted that administering authorities should refer to the guidance published by CIPFA on 11 December 2009 when showing in their Statement of Investment Principles the extent to which they have complied with guidance or, to the extent the authority does not so comply, the reasons for not complying. The CIPFA guidance is entitled “Investment Decision-Making and Disclosure in the Local Government Pension Scheme: A Guide to the Application of the Myners Principles”. The new guidance supersedes the previous CIPFA guidance on the application of the original Myners principles issued in 2002.

Pensions administration
The Environment Agency has a contractual arrangement with Capita Hartshead, a trading division of Capita Business Services Limited, to undertake the day-to-day administration of the Fund. We would like to express our thanks to Capita for processing over 7,000 Fund member requests/queries, for successfully delivering 16 briefings to almost 500 Environment Agency employees including HR and payroll staff and for paying pensions to over 4,000 pensioners.

External audit
The Comptroller and Auditor General is the appointed external auditor of the Fund under the Government Resources and Accounts Act 2000 (Audit of Public Bodies) Order 2003.

National Fraud Initiative
The Fund has a formal policy and procedure for handling frauds linked to the unreported deaths of pensioners. As part of this policy It participates in the Audit Commission's bi-ennial National Fraud Initiative and undertakes life certificate exercises for pensioners who live overseas or in care homes as well as those where power of attorney is held by a third party. One Active Fund case required further investigation as a result of the 2008/09 National Fraud Initiative and a repayment plan has been agreed. As a general principle, where we investigate cases and fraud is suspected, we will pursue the case and will seek to agree a repayment plan or, where necessary, take legal action or involve the police.

Fund management and investment

Fund managers
Responsibility for managing the Fund's investments has been allocated to 11 managers. Our managers, their investment styles and the division of the portfolio is as follows:

Manager	% of Portfolio	Investment style
Legal & General Investment Management	39.6	Passive index tracking Funds
Standard Life Investments	13.3	Active UK Equities
Sarasin & Partners	8.7	Active Global Equities
RCM	6.6	Active Global Equities
Royal London Asset Management	5.6	Active Corporate Bonds
Robeco Alternative Investment	5.2	Active Private Equity
Scottish Widows Investment Partnership	5.1	Active Emerging Markets Equities
Generation Investment Management	4.8	Active Global Equities
Impax Asset Management	3.5	Active Global Equities
Aviva Investors	3.4	Active UK Property Funds
Informed Portfolio Management	2.4	Passive & Active Currency Management
Other[1]	1.8	
Total	**100.0**	

Note[1] 'Other' in the above table represents AVC investments, cash and current assets and liabilities.

In November 2009:

- we terminated our investment mandate with ECM. The proceeds are now invested in the Legal & General Investment Grade Corporate Bond Fund which is passively managed;
- the investment in Legal and General Over 5 year Index-linked Gilts Fund was switched from the pooled fund to a segregated fund; and
- an investment of £50k was made into Legal and General Pooled Cash Fund and this was added to in March 2010 with a further investment of £20m.

Corporate governance and environmental overlay strategy
The Corporate Governance Policy (Annex 6) and the Committee's Environmental Overlay Strategy (Annex 7) were in place across the whole Fund during the year. These set out the principles that the Committee expects our Fund managers to adhere to. In line with our fiduciary duty, our fund managers are required to take account of financially material environmental risks and to seek out investment opportunities to enhance their prospective investment performance. The Fund has continued to support the work of the United Nations Principles of Responsible Investment (UNPRI) as detailed in our Responsible Investment Review, published in July 2009. We have also supported work undertaken by the Carbon Disclosure Project, UK Social Investment Forum and the Institutional Investors Group on Climate Change. Further information on extra-financial performance is included on page 18 and on our web site www.environment-agency.gov.uk/pensions.

Membership of the Pensions Committee and its advisers for the year ended 31 March 2010

Chairman and Board members

Larry Whitty *Chairman – appointed 1 June 2009*

John Edmonds *Chairman – retired 31 May 2009*

Suzanne Warner *Board member*

Richard Percy *Board member – retired 31 October 2009*

Robert Light *Board member – appointed 1 July 2009*

John Varley *Board member – appointed 1 November 2009*

Executive members

Mark McLaughlin *Director of Finance – appointed 1 November 2009*

Nigel Reader *Director of Finance – retired 31 October 2009*

Graham Ledward *Director of Resources*

Ric Navarro *Director of Legal Services – retired 30 June 2009*

Howard Pearce *Head of Environmental Finance and Pension Fund Management*

Kevin Ingram *Environment Agency Wales Finance Manager – appointed 7 July 2009*

Active member

Alan Broughall *Member nominee – retired 31 March 2010*

Phil Chappell *Member nominee*

Jackie Hamer *Member nominee*

Aileen Parry *Member nominee*

Gary Barker *Member nominee – resigned 31July 2009*

Stuart Martin *Member nominee – appointed 17 November 2009*

Pensioner member

Brian Engel *Pensioner member nominee*

Deferred member

John Kerr *Deferred member nominee – appointed 9 February 2010*

Chief Executive – ex officio attendee

Paul Leinster *Board member* and Chief Executive - ex officio attendee *of PC as Accounting Officer*

Professional advisers

External Auditor - National Audit Office (Comptroller and Auditor General)

Bankers - National Westminster Bank plc and Cater Allen Private Bank Ltd

Custodian - The Northern Trust Company

Pensions Administrator - Capita Hartshead

Legal Adviser - Osborne Clarke (Mark Womersley)

Actuarial Consultants - Hymans Robertson (Douglas Anderson and Richard Warden)

Investment Consultants – Mercer Investment Consulting (Nick Sykes)

Independent Investment Adviser – Investment Trustee and Adviser Services Ltd. (Carolan Dobson)

Fund Manager Selection Consultants - bFinance Ltd. (Sam Gervaise-Jones)

Sustainable Responsible Investment Consultants – Rathbone Greenbank (Mark Mansley)

Pension Fund membership

Unless they have elected in writing not to be members, all full and part-time employees of the Environment Agency, whether permanent or temporary (over 3 months), become active members of the Fund. The 12 months ended 31 March 2010 have seen an increase in the Fund's active membership of 2.1% (2009: An increase of 3.5%).

Active membership		**2010**	2009
		No.	No.
At 1 April		**11,741**	11,348
Entrants	New starters	985	1,253
	Late notifications	-	22
		985	1,275
Less:			
Exits	Late notification of previous year leavers	(9)	-
	Options pending	(4)	(11)
	New retirement pensions	(233)	(263)
	Deaths in service	(9)	(9)
	Deferred benefits	(449)	(565)
	Transfers in/(out)	(1)	(2)
	Refunds of contributions	(31)	(32)
		(736)	(882)
At 31 March		**11,990**	11,741

Age profile of active members at 31 March	**2010**		2009	
	No.	**%**	No.	%
15 - 19	9	0.1	9	0.1
20 - 24	362	3.0	415	3.5
25 - 29	1,438	12.0	1,464	12.5
30 - 34	1,911	15.9	1,847	15.7
35 - 39	1,822	15.2	1,746	14.9
40 - 44	1,865	15.5	1,821	15.5
45 - 49	1,557	13.0	1,475	12.6
50 - 54	1,255	10.5	1,229	10.5
55 - 59	1,183	9.9	1,162	9.9
60 - 64	556	4.6	545	4.6
65 - 69	32	0.3	28	0.2
Total	**11,990**	**100.0**	11,741	100.0

Based on data supplied by Capita Hartshead on 1 April 2010.

Age profile of deferred members at 31 March	**2010**		2009	
	No.	**%**	No.	%
15 - 19	3	0.1	1	0.0
20 - 24	91	1.6	98	1.9
25 - 29	551	10.0	606	11.5
30 - 34	930	16.8	891	17.0
35 - 39	1,058	19.2	1,031	19.6
40 - 44	1,143	20.7	1,084	20.7
45 - 49	818	14.8	704	13.4
50 - 54	476	8.6	422	8.1
55 - 59	358	6.5	331	6.3
60 - 64	80	1.5	66	1.3
65 - 69	7	0.1	7	0.1
70 - 74	2	0.1	2	0.1
75 - 79	1	0.0	1	0.0
Total	**5,518***	**100.0**	5,244*	100.0

**The figure for deferred members includes 339 cases (2009: 343) where there is no entitlement to a deferred pension, and the only entitlement is to a refund of contributions. These are former employees whom we are unable to trace, with refunds being paid as and when contact is made with them.*

Age profile of current pensioners at 31 March	**2010**		2009	
	No.	**%**	No.	%
Child dependants	50	1.2	50	1.3
Pensioners and spouses				
Under 50	76	1.9	79	2.1
50 - 54	123	3.0	129	3.4
55 - 59	270	6.6	290	7.6
60 - 64	1,093	26.7	1,046	27.4
65 - 69	1,151	28.2	1,044	27.4
70 - 74	747	18.3	687	18.0
75 - 79	403	9.8	364	9.5
80 - 84	159	3.9	122	3.2
85 - 89	13	0.3	5	0.1
90 - 94	2	0.1	0	0.0
Total	**4,087**	**100.0**	3,816	100.0
Total membership	**21,595**		20,801	

Based on data supplied by Capita Hartshead on 1 April 2010.

Communications

Our summary statement of policy on communications can be found at Annex 3 and a more detailed version is available on our website at www.environment–agency.gov.uk/pensions and www.eapf.org.uk.

In 2009/10 our focus continued to be ensuring that members were well informed about their benefits from the Environment Agency Pension Fund: Details of specific communications for the year and some of our plans for 2010/11 are shown below:

Our new Environment Agency Pension Funds static website was launched in September 2009 to provide our members with more access to information online via the internet. One of the website's main aims is to give members a better understanding of the benefits of the national Local Government Pension Scheme (LGPS) and the Environment Agency Pension Funds. Information about the LGPS, Your pension newsletters, Fundfare, the latest Annual Report and Financial Statements and a Responsible Investment Review are available on the new website. More information will be added during 2010/11 including secure online access to personal information for members.

Responsible Investment Review – Active Fund – In 2009 we published a detailed Responsible Investment Review, which we believe to be the first of its kind for a UK public pension fund. Its aim is to demonstrate to our Fund members and other stakeholders that the Environment Agency's Active Pension Fund is managed responsibly, with strategies and policies for the investment and management of the Fund's assets that are both financially robust and environmentally credible. The report details examples of how we have implemented the Active Fund's environmental overlay strategy.

Your pension – issue 2 – Active members - This was issued in September 2009 with the new annual benefit statements and outlined some of the main changes to member benefits introduced with new LGPS in 2008 and how these were reflected in benefit statements.

Annual Benefit Statements – To reflect the changes in the LGPS 2008 benefits, a new benefit statement was designed for active and deferred members in 2009. These were issued to all members in September 2009 with positive feedback being received on the new format. The 2010 benefit statements for active and deferred members will be issued in late Summer.

Short Guide, Member Guide and Retirement Guide – Member guides were reviewed and updated during the year and posted on to our website www.eapf.org.uk.

Fundfare 2009 – This was issued to all active, deferred and pensioner members in May 2010 summarising the Fund's Annual Report and Financial Statements as at 31 March 2009 and providing information on other pension related matters including promoting the new member website. Fundfare 2010 will be issued to all members in Autumn 2010.

The pensions administration contract with Capita Hartshead includes the provision of *annual presentations for employees and HR staff* on pensions and related matters in our Regions and at Head Office. These are known as Pensions Briefings and for 2009/10 focussed on recent joiners (within 5 years) to the Environment Agency and those who had opted–out of becoming a member of the Fund. A total of 13 member briefings took place and 323 employees attended.

Since the year end we have published "Topping up your LGPS pension" – a booklet which details options for members to increase their Fund benefits through methods including Additional Regular Contributions (ARCs) and Additional Voluntary Contributions (AVCs).

Pensions publications for members are provided in bi-lingual versions in order to satisfy the Environment Agency's Welsh Language Scheme. Electronic versions are available on our pensions web site www.eapf.org.uk.

Pensions increase

Pensions in payment and deferred benefits are subject to annual review under the Pensions (Increase) Act 1971. This review is based on the annual change in the Retail Prices Index (RPI) for the 12 months to 30 September each year and applies to all public sector pensions schemes. Any review is reduced proportionately for pensions in payment for less than 12 months.

HM Treasury confirmed the Pre Budget statement that there would be no increase to members' pensions from 12 April 2010 (6 April 2009: 5%). This is because the change in the Retail Prices Index (RPI) during the 12 months ended 30 September 2009 was a negative 1.4%. There is no provision in the regulations to reduce pensions in the event of a reduction in RPI.

The following table shows the rate of increases that have applied over the last 10 years to pensions in payment and deferred pensions:

Year (April)	Rate of Increase %
2001	3.3
2002	1.7
2003	1.7
2004	2.8
2005	3.1
2006	2.7
2007	3.6
2008	3.9
2009	5.0
2010	0.0

Pension Fund investment

Funding strategy statement

All LGPS funds are required to publish a Funding strategy statement. This statement is used by the Actuary to inform his valuation and the extant version is reproduced in Annex 4 to these financial statements.

Investment limits

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 which came into force on 1 January 2010 require the Environment Agency to invest in accordance with its investment policy, any Fund money that is not needed immediately to make payments from the Fund.

Although it may vary the types of investment, the Environment Agency's policy must be formulated with a view to the advisability of investing Fund money in a wide variety of investments; and the suitability of types of investments and particular investments.

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 prescribe extended limits (Schedule 1 Column 2) on the type and extent of investments which the Environment Agency may pursue. The total value of the Fund's investments can be no more than the percentages shown below:

5%
- a single sub-underwriting contract, i.e. a contract with a person who is underwriting a share issue to acquire the shares from him/her if that is what he/she requires, but with the total value of all sub-underwriting contracts not exceeding 15%;
- as a limited partner in any single partnership (but not exceeding more than a total of 15% in such partnerships).

10%
- total deposits with any single bank, or similar institution except the National Savings Bank;
- any single holding unless the investment is made by an external investment manager in a unit trust scheme.

15%
- total investments in unlisted securities, i.e. securities not quoted on a recognised stock exchange.

35%
- all investments in unit trust schemes managed by any one body;
- all investments in open-ended investment companies where the collective investment schemes constituted by the companies are managed by any one body;
- all investments in unit trust schemes and open-ended investment companies where the unit trust schemes and the collective investment schemes constituted by those companies are managed by any one body;
- the value of any single insurance contract
- all securities transferred under stock lending arrangements.

Statement of investment principles

All LGPS funds are required to publish a Statement of investment principles. The current Statement of investment principles was adopted by the Pensions Committee on 23 June 2010 and is reproduced in Annex 5 to these financial statements.

Environmental overlay strategy

The Pensions Committee has adopted an Environmental overlay strategy, which is applied across all of the Fund's assets. It has been reviewed this year and can be found in Annex 7.

Investment strategy

Although the management of the Fund's investments is vested in the Environment Agency, responsibility for altering its investment policy is delegated to the Pensions Committee.

The investment strategy developed by the Committee aims to maximise the return of the Fund, within an acceptable level of risk, by diversifying its investments throughout world markets, with overseas currency risks relative to pounds sterling managed by a passive currency hedging overlay strategy for 60% of the overseas currency exposure. This will, we believe, in the long term reduce risk as it is impossible to forecast whether sterling is likely to appreciate or depreciate. The Committee has agreed a strategic asset allocation of 31.5% in UK equities, 31.5% in global equities, 13.5% in index-linked gilts, 13.5% in corporate bonds, and 5% in both property and private equity. The Committee believes that this diversification of the Fund's assets will reduce risk whilst enhancing potential returns. To maintain the percentage of the quoted equity and bonds close to these percentages the Fund has adopted a rebalancing programme.

Custody arrangements

The Environment Agency has a contractual arrangement with the Northern Trust Company who act as global custodian of the Funds' assets. As part of its normal procedures Northern Trust holds all assets in safe custody, collects dividend income, provides data for corporate actions, liaises closely with all of the investment managers and reports on all activity during the period. Where the assets held are unit linked insurance contracts or other collective investment vehicles, the underlying assets are held by the relevant insurance company or collective investment vehicle.

Regular service reviews are held with Northern Trust to ensure continuous monitoring of service commitments. Other procedures and controls are reviewed by an independent reporting accountant in accordance with the Statement on Auditing Standards - SAS 70.

Investment management

The Fund's investment managers implement the Committee's investment strategy. Each manager has full discretion in the management of their portfolios, subject to complying with statutory limits and the Statement of investment principles. Each manager is required to take due regard of the Active Fund Corporate governance policy and the Environmental overlay strategy.

The Committee has set the overall investment objective for the Fund in the light of the triennial actuarial valuation. It has considered the Fund’s net contribution inflows and the maturity profile of its liabilities.

The Environment Agency Active Pension Fund has no investment in US sub-prime mortgages, collaterised debt obligations (CDOs) or collaterised loan obligations (CLOs) and does not allocate any money to hedge funds. The Fund does not support or directly engage in stock-lending although the L&G overseas pooled equity pension funds in which the Fund invests (9.7% of the Fund), do engage in stock lending, which is outside our control.

Fund benchmark

The Committee has set the following strategic benchmark for the Fund:

UK equities	31.5%	FTSE All Share index
Overseas equities	31.5%	FTSE All World ex UK
Index-linked gilts	13.5%	FTSE Actuaries Over 5 Year index-linked gilts
Corporate bonds	13.5%	iBoxx Sterling all non-gilt
Private equity	5.0%	Absolute Return
Property	5.0%	IPD UK Monthly

Manager benchmark

Each manager has been set a specific benchmark that reflects the asset class being managed. The benchmarks of the managers are:

Passive Management	Asset Class	Benchmark
Legal & General	UK equities	FTSE All Share
Legal & General	European equities	FTSE Developed World Europe ex UK
Legal & General	North American equities	FTSE Developed World North America
Legal & General	Japanese equities	FTSE World Japan
Legal & General	Asia Pacific equities	FTSE Developed World Asia Pacific ex Japan
Legal & General	UK index-linked gilts	FTSE UK Indexed Linked Gilts > 5 yrs
Legal & General	Corporate bonds	iBoxx Sterling Non Gilts
Legal & General	UK index-linked gilts	7 Day Libid
Active Management		
Robeco	Private equity	Higher of 10% IRR or MSCI World plus 5%
Aviva	Property	IPD UK Monthly
Royal London Asset Management	Corporate bonds	iBoxx Sterling Non Gilts
Standard Life	UK equities	FTSE All Share index
Sarasin	Global equities	MSCI All Country World
Impax	Global equities	MSCI All Country World
RCM	Global equities	MSCI All Country World
Generation	Global equities	MSCI Developed World
SWIP	Emerging market equities	MSCI Emerging Markets
Informed Portfolio Management	Currency	FTSE 100 (Capital only)

Performance target
Each manager has been set a performance target over three-year rolling periods as follows:

Legal & General	to match their benchmarks
Robeco	to beat their benchmark
Aviva	to beat their benchmark by 1% per annum
Royal London	to beat their benchmark by 1% per annum
Standard Life	to beat their benchmark by 2% per annum
Sarasin	to beat their benchmark by 2% per annum
Impax	to beat their benchmark by 3% per annum
RCM	to beat their benchmark by 3% per annum
Generation	to beat their benchmark by 3% per annum
SWIP	to beat their benchmark by 3% per annum
IPM (Active management)	to beat their benchmark by 6% per annum

Financial performance
The total return of the Fund over the period was +38.0% (2009: -26.4%) this was -0.7% (2009: -8.5%) compared to our strategic benchmark of +38.7% (2009: -19.0%). Compared to target the Fund was -1.6% (2009 -8.3%) below target over 2009/10. Over the three years to 31 March 2010 the annualised performance of the Fund was -0.5% (2009: -8.9%), this was -3.9% (2009: -3.5%) compared to our strategic benchmark performance of +3.4% (2009: -5.4%).

In 2009/10 there was a rise in the value of sterling (which is the currency used to value all our investments). After taking investment advice and because we invest in overseas assets to diversify our investments, we have a policy to manage the fluctuations in the value of different financial currencies by using a passive currency overlay strategy. In some years this works in favour of our overall Fund returns (like this year) and in some years it detracts (like last year). This year it helped account for +1.2% (2009: -5.2%) of the Fund's performance against our strategic benchmark.

Some of our equity managers had a poor year. RCM performed badly with an underperformance of -10.0% and the Aviva property portfolio underperformed by -6.1%. Others had a good year. Generation was outstanding with a return of +10.1% over benchmark, and Impax at +5.9%. The passive equity funds also performed well. The corporate bond funds managed by Royal London Asset Management performed exceptionally outperforming the index by 12.7%.

The table below shows the performance of the total Fund and the individual managers.

Manager	Date appointed / (closed)	Asset class	Value	Fund	Benchmark	Target	2009/10 Fund return	2009/10 Benchmark return	2009/10 Performance relative to benchmark	2009/10 Performance relative to target	2008/09 Fund return	2008/09 Benchmark return	2008/09 Performance relative to benchmark	2008/09 Performance relative to target
			£m	%		%	%	%	%	%	%	%	%	%
Passive Management														
Legal & General	Nov-07	UK Index Linked Gilts	239.8	15.0	FTSE Index Linked Gilt > 5 Year		+10.6	+10.4	+0.2	+0.2	-2.9	-2.8	-0.1	-0.1
Legal & General	Nov-07	UK Equity	116.5	7.3	FTSE All Share		+54.1	+52.3	+1.8	+1.8	-28.9	-29.3	+0.4	+0.4
Legal & General	Nov-07	North America Equity	86.4	5.4	FTSE Developed World North America		+43.3	+42.4	+0.9	+0.9	-14.0	-14.6	+0.6	+0.6
Legal & General	Nov-07	Europe ex UK Equity	39.9	2.5	FTSE Developed World Europe Ex UK		+47.8	+46.9	+0.9	+0.9	-31.1	-31.4	+0.3	+0.3
Legal & General	Nov-07	Japan Equity	13.6	0.8	FTSE World Japan	+0.0	+29.8	+29.6	+0.2	+0.2	-10.6	-10.8	+0.2	+0.2
Legal & General	Nov-07	Asia Pacific ex Japan Equity	13.4	0.8	FTSE Developed World Asia Pacific ex Japan		+70.1	+69.6	+0.5	+0.5	-21.9	-22.1	+0.2	+0.2
Legal & General	Nov-09	UK Corporate Bonds	100.2	6.3	iBoxx £ Non Gilt all bonds		+3.5	+3.6	-0.1	-0.1	-	-	-	-
Legal & General	Nov-09	UK Cash Fund	20.1	1.3	7 day LIBID		+0.2	+0.1	+0.1	+0.1	-	-	-	-
State Street	(Jul-08)	UK Equity		-	FTSE 350 index		-	-	-	-	-9.0	-4.9	-4.1	-4.1
Active Management														
Standard Life	Apr-05	UK Equity	210.8	13.2	FTSE All Share	+2.0	+50.5	+52.3	-1.8	-3.8	-32.2	-29.3	-2.9	-4.9
Sarasin	Apr-05	Global Equity	138.1	8.7	MSCI AC World	+2.0	+44.5	+46.9	-2.4	-4.4	-23.0	-21.1	-1.9	-3.9
RCM	Aug-08	Global Equity	105.3	6.6	MSCI AC World	+3.0	+36.9	+46.9	-10.0	-13.0	-20.4	-18.0	-2.4	-4.4
Generation	Aug-08	Global Equity	75.9	4.8	MSCI Developed World	+3.0	+54.1	+44.0	+10.1	+7.1	-1.1	-17.3	+16.2	+14.2
Impax	Aug-08	Global Equity	55.4	3.5	MSCI AC World	+3.0	+52.8	+46.9	+5.9	+2.9	-27.1	-18.0	-9.1	-11.1
SWIP	Jul-06	Emerging Markets Equity	81.3	5.1	MSCI Emerging markets	+3.0	+75.0	+71.1	+3.9	+0.9	-25.9	-26.6	+0.7	-2.3
European Credit Mangement	(Nov-09)	Corporate Bonds	-	-	iBoxx £ Non Gilt all bonds	+1.0	+43.3	+15.7	+27.6	+26.9	-35.4	-6.2	-29.2	-30.2
Royal London	Jul-07	Corporate Bonds	89.4	5.6	iBoxx £ Non Gilt all bonds	+1.0	+33.6	+20.9	+12.7	+11.7	-15.1	-6.2	-8.9	-9.9
Aviva	Jul-05	Property	53.4	3.3	IPD UK Monthly Property	+1.0	+10.2	+16.3	-6.1	-7.1	-30.5	-25.5	-5.0	-6.0
Robeco	Aug-05	Private Equity	82.6	5.2	MSCI World (Gross) +5% / IRR 10%	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
IPM	Oct-06	Active Currency	49.6	3.1	FTSE 100 (Capital only)	+6.0	+45.1	+44.7	+0.4	-5.6	-18.3	-31.1	+12.8	+6.8
Capital International	(Jul-08)	Global Equity	-	-	MSCI AC World	+3.0	-	-	-	-	-17.0	-3.8	-13.2	-14.2
State Street	(Jul-08)	Global Equity	-	-	MSCI AC World	+3.0	-	-	-	-	-4.4	-3.8	-0.6	-1.6
AVC and other net assets			23.3	1.5			-	-	-	-	-	-	-	-
Total Fund			**1,595.0**	**100.0**	Strategic	**+0.9**	**+38.0**	**+38.7**	**-0.7**	**-1.6**	**-26.4**	**-19.0**	**-7.4**	**-8.3**

Notes:

These performance numbers are based on mid price valuations and performance relative to benchmark is shown as fund return less benchmark return (arithmetic basis).

State Street (UK Equities), State Street (Global Equities) and Capital International (Global equities) were terminated in July 2008 so performance figures for 2008/09 are only part year. Following RCM, Generation and Impax's appointment in August 2008, their performance figures in 2008/09 only relate to the part year since appointment.

The European Credit Management mandate was terminated in November 2009 so performance figures for 2009/10 are only part year. £16m was allocated to the existing Royal London mandate and £97.3m was invested in the Legal & General Investment Grade Corporate Bond All Stocks Index Fund. Accordingly the performance figures for the Legal & General Investment Grade Corporate Bond Fund in 2009/10 relate only to the part year since appointment.

The Legal and General Cash Fund was opened with an initial amount of £0.1m in November 2009 and there was a further £20m investment in March 2010. The 2009/10 performance for the Legal and General Cash Fund for 2009/10 are only part year.

Portfolio analysis

Distribution of net assets by market value as at 31 March 2010

	Legal & General	Standard Life	Sarasin & Partners	RCM	Royal London	Robeco	SWIP	Generation	Impax	Aviva	IPM (Active)	Cash/Other	IPM (Passive)	Total	% of Fund
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	
UK equities	114.1	208.9	18.1	9.6				5.1	6.1					**361.9**	22.7
Overseas equities (including pooled)	153.3		117.3	92.7			79.0	68.4	46.9					**557.6**	34.9
North America	*86.4*		*53.8*	*49.3*				*36.1*	*20.7*					***246.3***	*15.4*
Europe	*39.9*		*52.8*	*21.4*			*2.7*	*24.3*	*16.1*					***157.2***	*9.9*
Other geographical areas			*1.1*	*6.3*			*55.5*	*4.3*	*0.8*					***68.0***	*4.3*
Asia Pacific	*13.4*		*0.8*	*7.2*			*20.8*	*2.9*	*6.6*					***51.7***	*3.2*
Japan	*13.6*		*8.8*	*8.5*				*0.8*	*2.7*					***34.4***	*2.1*
UK fixed interest	238.7				54.9									**293.6**	18.4
Pooled fixed interest	100.2				3.3									**103.5**	6.5
Overseas fixed interest					29.1									**29.1**	1.8
Pooled property										49.7				**49.7**	3.1
Private equity						81.0								**81.0**	5.1
Pooled currency											49.6			**49.6**	3.1
Pooled cash	20.1													**20.1**	1.3
Derivatives								0.2					(11.4)	**(11.2)**	(0.7)
Cash	1.9	1.2	2.2	3.3	0.5	1.6	2.2	1.5	2.0	3.7		22.3		**42.4**	2.7
AVC investments												5.6		**5.6**	0.3
Other net investments	1.6	0.7	0.5	(0.3)	1.6		0.1	0.7	0.4			6.8		**12.1**	0.8
Total	**629.9**	**210.8**	**138.1**	**105.3**	**89.4**	**82.6**	**81.3**	**75.9**	**55.4**	**53.4**	**49.6**	**34.7**	**(11.4)**	**1,595.0**	**100.0**

Geographical distribution of quoted and pooled equity investments

	2010		2009	
	£m	%	£m	%
United Kingdom	361.9	39.4	263.3	40.2
North America	246.3	26.8	175.4	26.8
Europe (excluding UK)	157.2	17.1	114.0	17.4
Emerging markets	68.0	7.4	41.0	6.3
Japan	51.7	5.6	35.6	5.5
Asia Pacific (excluding Japan)	34.4	3.7	25.1	3.8
Total	**919.5**	**100.0**	**654.4**	**100.0**

Top 20 holdings of the Fund

		2010	
Holding	**Asset class**	**£m**	**% of Fund**
L&G Investment Grade Corporate Bond All Stocks Index Fund	Pooled fixed interest - UK corporate bonds	100.2	6.3
L&G North America Equity Index	Pooled equities - Overseas	86.4	5.4
IPM Global Currency Fund Class D	Pooled currency	49.6	3.1
L&G Europe (ex UK) Equity Index	Pooled equities - Overseas	39.9	2.5
UK Government 2.5% index-linked 26/07/16	Fixed interest - UK index linked gilts	31.1	2.0
UK Government 2.5% index-linked 16/04/20	Fixed interest - UK index linked gilts	25.8	1.6
HSBC Holdings ordinary shares	Equities - UK	25.5	1.6
BP ordinary shares	Equities - UK	24.5	1.5
UK Government 2.5% index-linked 17/07/24	Fixed interest - UK index linked gilts	23.7	1.5
Vodafone Group	Equities - UK	20.1	1.3
L&G Cash Fund	Pooled cash	20.1	1.3
UK Government 2% index-linked 26/01/35	Fixed interest - UK index linked gilts	20.0	1.3
UK Government 1.25% index-linked 22/11/27	Fixed interest - UK index linked gilts	17.5	1.1
UK Government 4.125% index-linked 22/07/30	Fixed interest - UK index linked gilts	17.3	1.1
UK Government 1.125% index-linked 22/11/37	Fixed interest - UK index linked gilts	16.8	1.1
UK Government 1.25% index-linked 22/11/17	Fixed interest - UK index linked gilts	16.7	1.0
UK Government 1.875% index-linked 22/11/22	Fixed interest - UK index linked gilts	15.5	1.0
Royal Dutch Shell	Equities - UK	14.9	0.9
Rio Tinto	Equities - UK	14.5	0.9
UK Government 1.25% index-linked 22/11/32	Fixed interest - UK index linked gilts	13.9	0.9
Total		**594.0**	**37.4**

Note: This table shows our largest holdings are in pooled funds and in equities. We have some holdings in UK equities because they represent a large proportion of the UK stock market we invest in, via index funds.

Top 10 Global equities by sector

Sectors	2010 £m	2010 % of Fund	Sectors	2009 £m	2009 % of Fund
Industrial Goods & Services	105.9	6.6	Oil & Gas	77.6	6.9
Oil & Gas	95.9	6.0	Healthcare	66.2	5.9
Banks	86.1	5.4	Industrial Goods & Services	57.0	5.1
Healthcare	78.1	4.9	Banks	38.4	3.4
Technology	60.9	3.8	Technology	35.7	3.2
Basic Resources	54.8	3.4	Telecommunications	30.0	2.7
Telecommunications	44.3	2.8	Retail	28.1	2.5
Personal & Household Goods	34.6	2.2	Basic Resources	28.0	2.5
Utilities	32.2	2.0	Personal & Household Goods	24.1	2.1
Retail	30.6	1.9	Insurance	18.3	1.6
Total	**623.4**	**39.0**	**Total**	**403.4**	**35.9**

Note: The relative movements in this table are largely due to market movements from global economic conditions in 2009/10 and 2008/09 rather than any shift in strategic investment. The amounts have been adjusted from mid price valuations and the percentages may not add exactly due to rounding.

Top 10 UK equity holdings

Company	2010 £m	2010 % of UK equity	Company	2009 £m	2009 % of UK equity
HSBC Holdings	25.5	7.0	BP	21.7	8.2
BP	24.5	6.8	Vodafone	16.9	6.4
Vodafone	20.1	5.6	Royal Dutch Shell	14.5	5.5
Royal Dutch Shell	14.9	4.1	BG Group	12.6	4.8
Rio Tinto	14.5	4.0	Glaxosmithkline	12.0	4.6
Glaxosmithkline	13.9	3.8	HSBC Holdings	11.1	4.2
Standard Chartered	12.5	3.4	Astrazeneca	8.8	3.3
BG Group	12.0	3.3	BHP Billiton	7.3	2.8
BHP Billiton	10.4	2.9	Rio Tinto	6.5	2.5
Barclays	8.9	2.5	Standard Chartered	6.1	2.3
Total	**157.2**	**43.4**		**117.5**	**44.6**

Note: The relative movements in this table are largely due to market movements from global economic conditions rather than any shift in strategic investment.

Top 10 overseas equity holdings

Company	Country	2010 £m	2010 % of overseas equity	Company	Country	2009 £m	2009 % of overseas equity
Hewlett Packard	United States	7.2	1.3	Novo-Nordisk	Denmark	4.3	1.1
Cisco Systems Inc	United States	7.0	1.3	Becton Dickinson & Co	United States	4.1	1.0
ABB Ltd	Switzerland	5.8	1.0	International Business Machines	United States	4.1	1.0
International Business Machines	United States	5.1	0.9	Oest Elektrizitats	Austria	3.7	0.9
Nestle	Switzerland	4.7	0.8	Nestle	Switzerland	3.6	0.9
Teva Pharmaceutical Industries	Israel	4.6	0.8	China Mobile Inc	China	3.5	0.9
Novo-Nordisk	Denmark	4.4	0.8	Cisco Systems Inc	United States	3.3	0.8
Amer Movil SAB	Mexico	4.2	0.8	ABB Ltd	Switzerland	3.3	0.8
Vale SA	Brazil	4.2	0.8	Teva Pharmaceutical Industries	Israel	3.3	0.8
Quanta SVCS Inc	United States	4.1	0.7	Gilead Sciences Inc	United States	3.2	0.8
Total		**51.3**	**9.2**	**Total**		**36.4**	**9.0**

Extra-financial performance

The Environment Agency Pension Fund seeks to manage its investments in a financially robust and environmentally responsible way. Extra-financial issues are increasingly important in assessing the quality of management and its management of risks relating to environmental, social and governance (ESG) issues, which may impact on the future performance and prospects of a company.

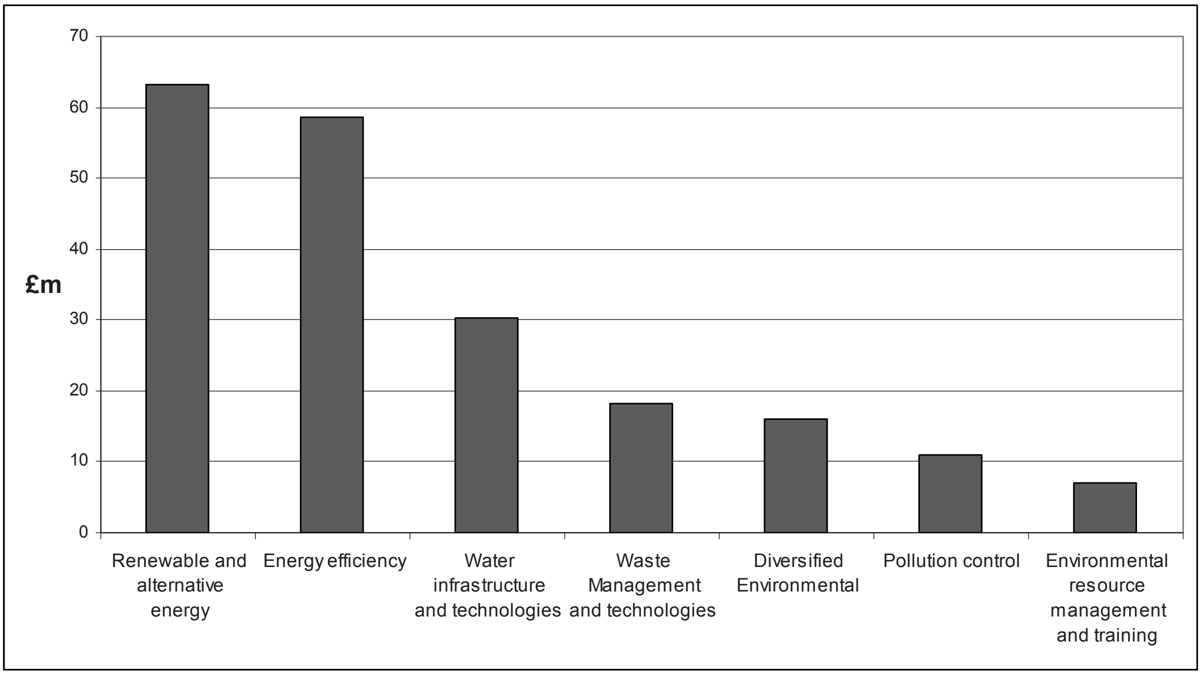
Environmental overlay
The Committee's Environmental overlay strategy applies across all of the Fund's mandates and we monitor and report on the progress of its implementation every quarter. We work in collaboration with our Fund managers to develope tools, techniques and awareness of how extra-financial issues impact on investment decision making across asset classes. In 2009 we published, and reprinted due to demand, our first Responsible Investment Review which details the work we have undertaken in implementing the Environmental overlay strategy and is structured around the six Principles for Responsible Investment (PRI). Specifically it addresses the disclosure and transparency requirements of Principle Six.

United Nations Principles of Responsible Investment
The Fund's Corporate Governance and Environmental Overlay strategies set out how we achieve or seek to achieve all of the stated principles. We have participated in a number of collaborative engagements with other PRI signatories, particularly on a drive to engage with large non-signatory fund managers.

We completed the third annual survey on progress in implementing the principles, and the results are available on our website, www.environment-agency.gov.uk/pensions.

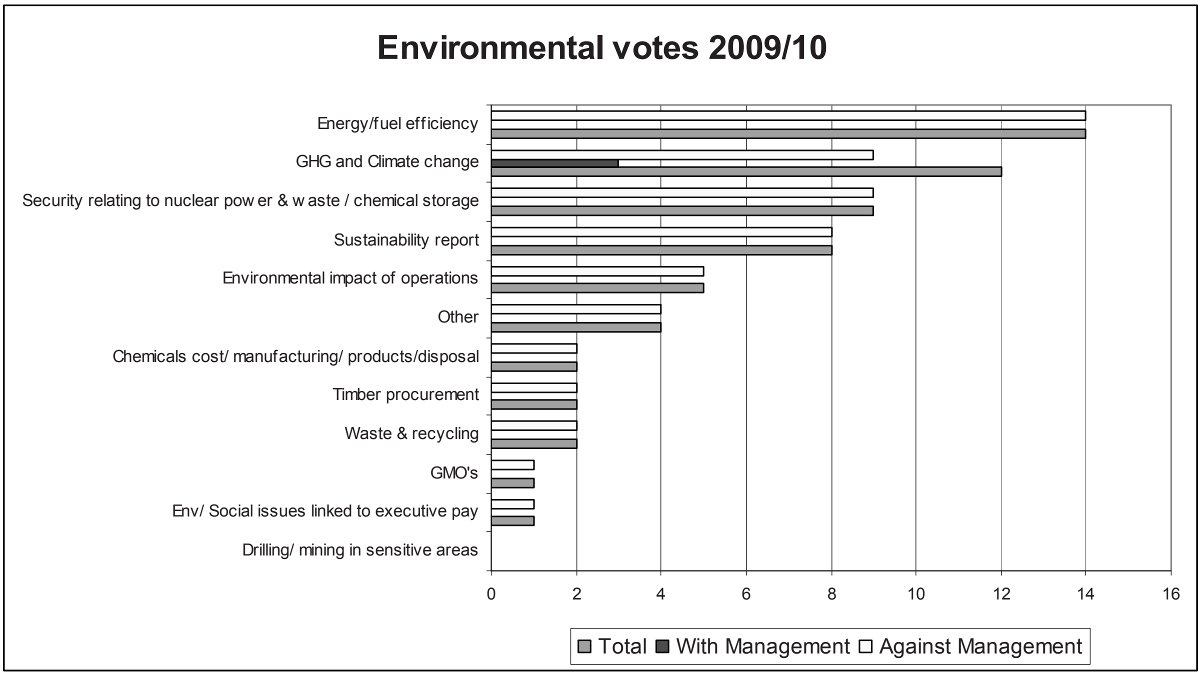
Maximising opportunities
Whilst, quite rightly, much is made of the risks of climate change and other environmental issues to businesses and investment returns, our strategy also embraces the opportunity to invest in sustainable companies and those whose products and services that actively contribute to c*reating a better place*.

Using the FTSE Environmental Markets classification, with the help of Impax Asset Management Ltd (our global equity manager who focus on environment technologies), we analysed our entire Fund to establish the full extent of our commitment to green economy. Currently we have invested £205m (13% of the Fund) in clean and green technology. Our target for 2015 is to be able to demonstrate that 25% of the Fund is invested in clean and green technology. A breakdown of the current investment is detailed below.



Minimising risks
We believe that well governed companies reduce the risk to shareholder value and will, over time, produce more sustainable returns compared to poorly governed companies. All of our equity fund managers regularly engage with companies either directly or through a specialist provider, to assess polices, processes and practices.
The majority of our engagement activity with the companies in which we invest is undertaken by our managers. Over 1,000 engagements were conducted by our managers and engagement services, on our behalf, covering our equity and bond holdings. In addition, we participated in a number of collaborative engagements, most notably in 2009, with the Carbon Disclosure Project and the Forestry Footprint Disclosure Project.

We aim to vote on all environmental resolutions in the UK, Europe and North America and, where practical, world-wide. During the year we voted on 60 shareholder environmental resolutions. As these are shareholder resolutions a vote *for* the resolution or to *abstain* is *against* the management recommendation. In total ninety five percent of our votes were *against* management, comprising of 62% of votes *for* the resolution and we *abstained* for the remaining 33%. A breakdown is presented below. Our voting record on environmental resolutions is available on our website at www.environment-agency.gov.uk/pensions.

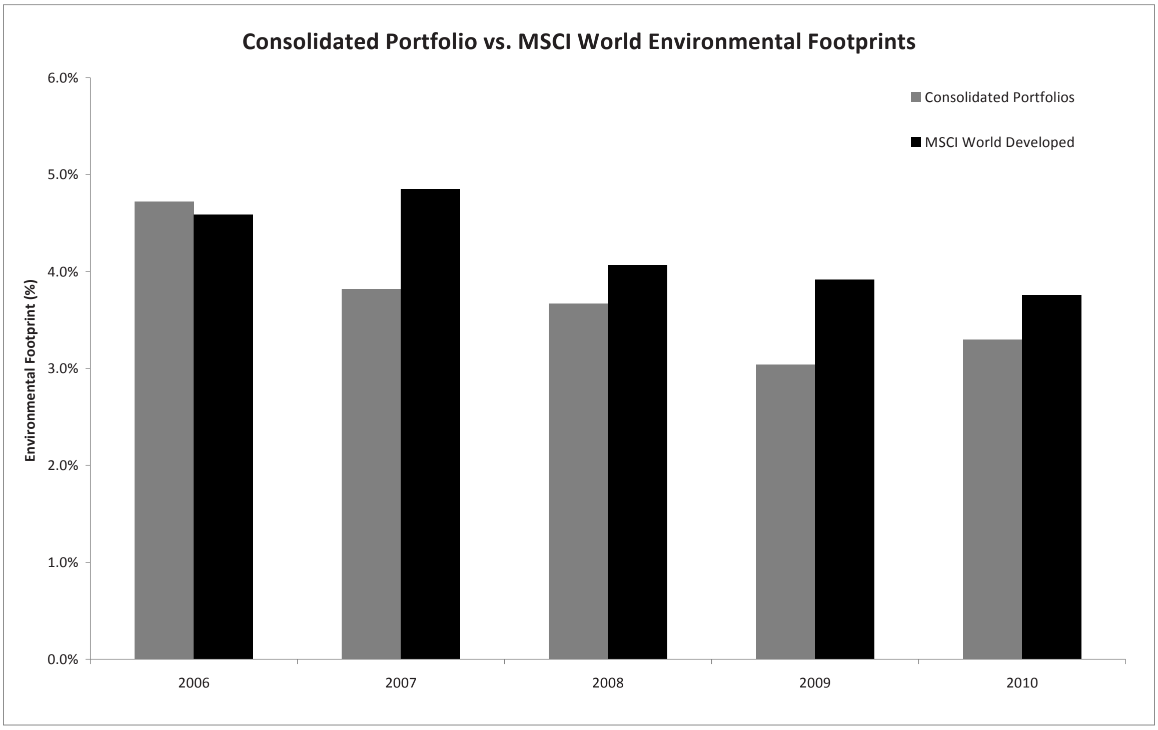


Robeco our private equity manager, undertakes an annual survey of the underlying funds in which we invest, against a wide range of governance, social and environmental criteria. It is a pre-requisite of investment that the funds sign up to the Robeco Sustainable Private Equity (RSPE) programme developed by Robeco with its investment partner, the Dutch bank Rabobank. For 2009, the average ESG score was 66.1% higher than in 2008 64.1% and 2007 63.9%, in spite of the higher requirements. Specific environmental, social and governance improvements within portfolio companies was 210 in 2009, up from 178 in 2008 and 66 in 2007.

In collaboration with Aviva Investors, our property fund of funds manager, we survey property funds to assess how well these funds address financially material environmental issues. The financial returns from property can be affected by flooding, subsidence, drought arising from climate change, as well as inefficient energy usage leading to high carbon emissions. These present both risks and opportunities for investment returns. As property accounts for 50% of all UK CO2 emissions, the UK Government has taken action through a number of regulatory measures, including the implementation of Energy Performance Certificates. These are now mandatory for all new, sold or let commercial properties.

Measuring the Environmental Footprint of our investments
We have undertaken Environmental Footprint analysis using Trucost's methodology for each of our active equity funds against their respective benchmarks for the last five years. By measuring our Footprint we aim to provide a fresh perspective on risk, stock selection and sector exposures. The Footprint methodology looks at companies' environmental impacts, for example, the amount of raw materials, water and energy used and the waste and carbon emitted. Trucost evaluates over 700 factors in assessing a company's environmental impact.

The Footprint for each equity manager, in relation to the EAPF, is compiled by allocating a proportion of the environmental impact of each company relative to the amount of stock that is held. Similarly, we have evaluated the environmental impact of our combined active equity holdings compared to the benchmark, the MSCI World Developed Countries Index. The Fund's Environmental Footprint for combined active equities was 12% less than that of benchmark on 31 March 2010. We are one of the first funds in the world to decrease our environmental footprint.



Class actions
Where shareholder value has been eroded by wrongful action by company directors, sometimes it is possible for monies to be recovered via the courts by a shareholder class action against the company or its directors. We have retained Northern Trust to monitor these class actions and to recover for the Fund any monies due, although the total involved is currently not significant.

Awards
We were delighted that our work in integrating financially material environmental issues was again recognised during the year. In the five years since the inception of our new investment strategy in 2005 we have achieved 20 awards and citations

November 2009 – Investment & Pensions Europe - Environmental Social Governance (ESG) Leaders Awards 2009 – Best investor in ESG award. Our pension Fund has won this EU wide award for the third year in a row for our approach to financially and environmentally responsible investment -We were named the best investor in ESG.

The judges said “The Environment Agency has long stood out as running a pension scheme that adheres to a strictly ESG-based investment strategy – rather than pay mere lip service to its principles. This is an investor that ensures ESG and SRI criteria govern every aspect of its operations and it continues to demand its investment managers engage actively on its behalf so that these principles extend way beyond its own territory. The Environment Agency has always been at the forefront of ethical pension scheme investing, and its work during 2009 will ensure it remains at the top for some time to come.”

July 2009 – Engaged Investor Trustee Awards 2009
Best Scheme Governance (Public Sector) – Highly commended The EAPF was “highly commended” in this category which we have won in the two previous years. This award is open to all public sector funds and this year Strathclyde Pension Fund, which also has a well-developed SRI policy was the winner. Engaged Investor said “It was difficult to choose between these two schemes – the EA scheme operates at a very high standard.”

The financial statements

Foreword to the financial statements

The Environment Agency Active Pension Fund (“the Fund”) is a statutory public service pension scheme (as defined by the Pension Schemes Act 1993) under the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007(as amended), the Local Government Pension Scheme (Transitional Provisions) Regulations 2008 (as amended), the LGPS (Administration) Regulations 2008 (as amended) (“the 2007 regulations”) and the Local Government Pension Scheme Regulations 1997 and earlier regulations (saved provisions).

Being part of the Local Government Pension Scheme the Fund is contracted out of the State Second Pension Scheme (“S2P”) and is a Registered Pension Scheme under Chapter 2 of Part 4 of the Finance Act 2004. Full tax relief is granted on members’ and the Environment Agency’s contributions paid to the Fund and on all United Kingdom investment income other than dividends arising from UK equities.

Roles and responsibilities of the Pensions Committee

With a membership of nominated Environment Agency Board members, senior officers, member nominees a pensioner member nominee and a deferred member nominee, the Committee (which is a sub-committee of the Environment Agency Board) has been delegated the responsibility for Fund matters. It receives advice from its external advisers and is charged with appointing managers and agents required for the effective management of the duties outlined below.

The Environment Agency Pensions Committee (“the Committee”) is responsible for obtaining audited financial statements for each financial year which give a true and fair view of the financial transactions of the Fund and the disposition of its assets and liabilities at the year end, other than the liabilities to pay pensions and benefits after the scheme year end. In preparing the financial statements the Committee has:

- selected suitable accounting policies and then applied them consistently;
- made judgments and estimates that are reasonable and prudent; and
- followed applicable accounting standards, in particular the Statement of Recommended Practice “*Financial Reports of Pension Schemes”*.

The Committee is responsible for keeping proper accounting records which disclose, with reasonable accuracy, at any time, the financial position of the Fund and enable it to ensure that the financial statements comply with Schedule 8 to the Financial Memorandum issued by the Department for Environment, Food and Rural Affairs (Defra). However, responsibility for the regulations governing the Local Government Pension Scheme (LGPS) lies with the Local Government Pensions Unit at Department for Communities and Local Government.

The Committee is responsible for keeping records of contributions received in respect of active members of the Fund and for ensuring that contributions are made to the Fund in accordance with the Pensions Act 1995, the 2008 regulations and with the recommendations of the Consulting Actuary.

The Committee is also responsible for safeguarding the assets of the Fund and hence for taking reasonable steps for the prevention and detection of error, fraud and other irregularities, including the maintenance of an appropriate system of internal control.

This Annual Report and Financial Statements is available on the Pension Funds website and the Environment Agency’s website. The maintenance and integrity of the website is the responsibility of the Environment Agency. The work carried out by the Auditors and the Scheme Administrator does not involve consideration of these matters. Accordingly, the Auditors accept no responsibility for any changes that may have occurred to the information contained in the financial statements since they were initially presented on the websites.

Legislation in the United Kingdom governing the preparation and dissemination of the financial statements and other information included in annual reports may differ from legislation in other jurisdictions.

Summary of the financial statements

The financial statements have been prepared on a market value basis.

Contribution income has risen by £3.1m to £83.2m (2009: risen by £8.1m to £80.1m). The increase for the year ended 31 March 2010 was due mainly to the increase in the employer's contributions.

Net income from all transfer values received in the year has increased by £6.4m to £9.3m (2009: decreased by £2.0m to £3.0m).

Retirement benefits and other payments made to or in respect of members during the year have increased by £4.8m to £50.9m (2009: increased by £0.3m to £46.1m).

In overall terms the net additions from dealings with members during the year have increased by £3.2m to £35.8m (2009: increased by £6.8m to £32.6m).

The value of the net assets of the Fund at 31 March 2010 has increased by £463.4m to £1,595.0m (2009: decreased by £364.4m to £1,131.6m). This is primarily due to an increase in the market value of its investments.

Accounting Officer's statement on internal control

Scope of responsibility

As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of the Environment Agency's policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Managing Public Money. I am personally accountable to the Board and Parliament, and the Board is accountable to central Government.

The Environment Agency is responsible for the administration of the Environment Agency Active and Closed Pension Funds and the disbursement of their benefits. The Board has assigned responsibility for the investment and custody of both Funds' assets and administration of both Funds' benefits to the Pensions Committee ("the Committee").

The Committee is supported by its Investment Sub-Group and Benefits Sub-Group, as well as by Environment Agency officers, external fund managers and fund administrators who operate in accordance with the Local Government Pension Scheme (Benefits, Membership and Contribution) Regulations 2007 (as amended), The Local Government Pension Scheme (Transitional Provisions) Regulations 2008 (as amended), The Local Government Pension Scheme (Administration) Regulations 2008 (as amended) and the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 together with saved provisions from earlier regulations.

The responsibilities and duties of the Board, Pensions Committee, Environment Agency officers and external administrators who are responsible for the management and investment of the Fund and the administration and disbursement of their assets are set out in the following governance documents:

a) *Schedule 8 of the Environment Agency's Financial Memorandum*

b) *Pension Funds Governance Compliance Statement* which includes:

- *The Statement of Compliance* which details the level of compliance with Government Guidance*;*
- *The Pensions Committee Terms of Reference and Standing Orders* which details the status, composition and responsibilities of Pensions Committee members;
- *Pension Funds Scheme of Delegation* which prescribes the arrangements for, and limitations to, the delegation of powers and duties within the Environment Agency under The Local Government Pension Scheme (Administration) Regulations 2008 (as amended), and The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 in its capacity as Administering Authority and encompassing the Employing Authority Discretions.

The responsibilities of the Environment Agency Accounting Officer in respect of propriety and regularity in the use of Grant-in-Aid from the Government to fund contributions to the Fund is the same as for other funding from Government for the Environment Agency as a whole.

The Pensions Committee reviewed, and the Board approved, the statutory Governance Policy and Compliance Statement in April 2008 to ensure compliance with the 2007 and 2008 LGPS Regulations and associated statutory guidance. A further review to take account of some new and amended LGPS regulations and associated statutory guidance issued since 1 April 2008 was undertaken during 2009/10 and approved by the Board.

Members of the Committee, its Sub-Groups and the Environment Agency officers and specialist advisers who manage and administer the Fund, are required to pay due regard to the nature of their responsibilities and the need to avoid potential conflicts of interest. Written guidance is issued to each member and adviser on the meaning of, and procedures for dealing with, conflicts of interest. A register of interests is maintained and reviewed by the Chairs of the Environment Agency Pensions Committee, and Audit and Risk Committee annually.

The purpose of the system of internal control

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of the Fund's policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically.

The system of internal control has been in place within the Environment Agency and in the operation of the Fund for the year ended 31 March 2010 and up to the date of approval of the annual report and accounts and accords with LGPS and Treasury guidance and best practice. It has identified the significant issues set out on pages 26 and 27.

Capacity to handle risk

The Environment Agency has a statement setting out its strategic approach to risk management that has been agreed with its Board.

The 2004 Pensions Act requires trustees of occupational pension schemes to have training, knowledge and understanding of the law relating to pensions and the role of trustees, the principles of scheme funding and investment, and the management and administration of pension scheme benefits.

Whilst the LGPS is exempt from these requirements, the Committee has a structured training programme covering new member induction and ongoing training for those with extended periods of service. Training for Committee members is assessed on an individual needs basis, taking account of existing expertise, and individual's interests in specific areas and a training log is maintained. Environment Agency officers' training needs are identified in individual performance plans.

The risk and control environment

The Environment Agency's risk management strategy recognises that effective risk management is a key component for the delivery of its objectives. The strategy promotes the taking of well-managed risks when necessary to meet the needs of stakeholders. The strategy recognises the importance of prioritising how the Fund responds to risk, to reduce the residual risk to an acceptable and justifiable level. Clear accountability for risk ownership and the regular monitoring and reporting of progress to management are mandated to ensure risk management plans are delivered.

Pensions administration

The Environment Agency has a contractual arrangement with Capita Hartshead for third-party administration of the Fund. This includes administration of all member and pensioner records, maintenance of LGPS and the Fund's rules, processing of contributions, payment of benefits, communications and scheme accounting in accordance with the applicable Local Government Pension Scheme Regulations. Arrangements are in place for checking the validity of pension claims to avoid fraud and ensure propriety. Quarterly and annual performance reports are provided to the Environment Agency and reviewed by the Benefits Sub-Group with summary reporting to the Pensions Committee. More information about Capita Hartshead's risk and control environment is provided in its AAF01/06 report which is reviewed annually by Environment Agency officers.

Global custody

The Environment Agency also has a contractual arrangement with the Northern Trust Company who act as global custodian of the Fund's assets. As part of its normal procedures Northern Trust holds all assets in safe custody, collects dividend income, provides data for corporate actions, liaises closely with all of the investment managers and reports on all activity during the period. Where the assets held are unit linked insurance contracts or other collective investment vehicles, the underlying assets are held by the relevant insurance company or collective investment vehicle.

Northern Trust is a strong company that is 'AA' rated by Standard and Poor's. Also the Fund's assets are not held in the name of Northern Trust and so are segregated from those of Northern Trust, safeguarding them in the event of a failure by Northern Trust. Cash held by the Fund at Northern Trust in euros, dollars and sterling (over £/Euro/US$1000) is invested in Northern Trust Global Cash Funds, which would not be affected in the event of a failure by Northern Trust as they reside off the Northern Trust balance sheet. Only small amounts of cash are left on deposit at Northern Trust. The Northern Trust Global Cash Funds are rated AAA by Moody's and are invested in short term money instruments to preserve capital and liquidity. These cash funds are also closely monitored by Environment Agency officers. During 2009/10, £20.1m cash was placed with the L&G Cash Fund pending further investment. This further diversifies our cash holdings. Of the cash held by the active currency manager (IPM) 86% is held in Treasury Bills (US and UK).

Regular service reviews are held with Northern Trust to ensure continuous monitoring of service commitments. More information about Northern Trust's internal control framework is included in its service level agreement, risk management document and SAS 70 report which is reviewed annually by officers. The Fund does not engage in stock lending.

Key elements of the system of internal control

Procedures for the setting and monitoring of the achievement of the Fund objectives
The Fund has an established strategic planning process in place. The Pensions Committee prepares triennial Funding Strategy Statements after taking advice from the Actuary, investment advisers and officers. The Actuary uses the Funding Strategy Statement to aid preparation of the triennial actuarial valuation of the Fund, and set the common contribution rate for the employer. The Fund's investment strategies are established taking into account the results of the triennial actuarial valuations.

The Fund operates within a framework of common procedures and control points as a means of ensuring all staff work towards, and identify with, common aims. This includes the Pensions Committee members' handbook, Financial Scheme of Delegation and performance management arrangements, which authorise officers to act on behalf of the Fund within a defined framework of procedural control.

A risk management process is used to identify the principal risks to the achievement of the Fund's objectives, to evaluate the nature and extent of those risks and to manage them efficiently, effectively and economically.

A detailed risk register has been developed by officers covering all aspects of the Fund's management, together with a key risks document which highlights the top risks for the Pensions Committee. These documents assist the Pensions Committee in managing strategic risks across all pension activities. This has been enhanced for ongoing risk management purposes and informs the basis of internal and external audit strategy and planning. Management actions have been taken to mitigate the prioritised risks, and these are monitored and reported to the Pensions Committee on a regular basis.

The facilitation of policy making and decision making
The Pensions Committee and senior management of the Environment Agency, together with external advisers, contribute to the Fund's strategic planning process including reviews of strengths, weaknesses, opportunities, threats and risks combined with consideration of the impact of updated, new or proposed legislation.

Key performance targets and benchmarks, including financial commitments, for fund managers are set by the Investment Sub-Group, for approval by the Pensions Committee. Lead Officers cascade Pensions Committee strategy requirements to managers, teams and individuals through policies and procedures, performance appraisals and individual performance plans.

Ensuring compliance with established policies, procedures, laws and regulations
The Pensions Committee and its Investment and Benefits Sub-Groups meet regularly to consider plans, performance and the strategic direction of the Fund through formal monitoring reports.

An annual report is submitted to the Environment Agency Board on the performance of the fund managers, pensions administrator, and other professional advisers. Qualitative and quantitative information is provided on their compliance with the Myners principles for good investment management.

Ensuring the economical, effective and efficient use of resources and for securing continuous improvement in the way in which the functions of the Fund are exercised
The Pensions Committee is committed to optimising the efficiency and effectiveness of the Fund's administration and investment management through continuous improvement of key processes, regular contract reviews, competitive tendering and benchmarking exercises.

The Fund has a formal policy and procedure for handling frauds linked to the unreported deaths of pensioners. It also participates in the Audit Commission's bi-annual National Fraud Initiative and undertakes life certificate exercises. Where fraud is suspected, full repayment is sought and the police and courts are involved as required.

The financial management and reporting of the Fund
The system of financial management is based on a financial control framework that includes the Environment Agency's procurement, purchase order management and financial accounting systems, the Environment Agency's Financial Memorandum and Scheme of Delegation, and the Funds' Scheme of Delegation (included in the Funds' Governance Compliance Statement), together with administrative procedures, and management supervision. This includes:

- comprehensive annual budget setting process and monitoring systems;

- setting targets to measure financial and other performance; and
- regular reviews of periodic and annual financial reports which include administration and investment expenses and returns against budgets, targets and forecasts.

The system of internal financial control can provide only reasonable and not absolute assurance that assets are safeguarded, that transactions are authorised and properly recorded, and that material errors or irregularities are either prevented or would be detected in a timely manner.

The performance management of the Fund and the reporting of performance management
The performance of the Fund is reported quarterly to the Investment Sub-Group and Pensions Committee and annually to the Board. Team Business Plans are monitored and the Head of Environmental Finance and Pension Fund Management monitors individual performance, continually and annually.

Review of effectiveness

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the Environment Agency managers of the Fund who have responsibility for the development and maintenance of the internal control framework, and by comments made by the external auditors in their management letter and other reports. I have been advised on the implications of the result of my review by the Board and the Audit and Risk Committee and plans to address weaknesses and ensure continuous improvement of the system are in place.

The process that has been applied in maintaining and reviewing the effectiveness of the system of internal control includes:

a) The operation of the Environment Agency Board and Pensions Committee who set strategic direction, approve the Fund's investment and administration strategies and review performance. The Board receives reports from the Pensions and Audit and Risk Committees on the standards of corporate governance and internal control operating in the Fund.

b) The operation of the Audit and Risk Committee that reviews standards of internal control and financial reporting. It also considers audit reports and advises on the Fund's approach to risk management and corporate governance, and discusses with the appointed external and internal auditors the nature and scope of forthcoming audits.

c) The independent reviews by Internal Audit on the adequacy and effectiveness of the internal controls which are informed by an analysis of the risks to which the Fund is exposed and are conducted in accordance with Government Internal Audit Standards.

d) Action taken by Environment Agency officers in response to the recommendations made by external and internal auditors.

Significant internal control issues

The annual reviews undertaken and reported by internal audit have concluded that the governance framework in place to manage the Fund is well designed and covers all the main areas of activity.

The Pensions Committee, Investment Sub Group and Benefit Sub Group have continued to use the Pension Funds risk register to assist in the management of strategic risks across all the Fund's pension activities. Actions are taken to ensure these risks, once recognised, are appropriately managed by Environment Agency Officers.

A significant portion of the Fund (17.2%) is held in pooled vehicles managed by Legal and General (L&G). This is less than in 2008/09 when we held 26%, and has been reduced by moving our index linked gilt holdings to a segregated account. The pooled funds are held under an insurance contract between the Environment Agency Active Fund and Legal & General (Pensions Management) Limited, and the assets in the pooled pension funds are held by HSBC and Citibank as custodian. As Legal & General (Pensions Management) Limited is a separate legal entity within the Legal & General Group, with assets ring fenced from the rest of the Legal & General Group, the assets would not be affected by a failure of Legal & General Group.

The Fund does not support or directly engage in stock lending although the L&G overseas pooled equity pension funds in which the Fund invests (9.7% of the Fund), do engage in stock lending, which is outside our control.

Last year we noted that we were reviewing the ECM mandate. It was concluded that we should exit the mandate and this was completed in November 2009.

Defra have confirmed receipt of the External Audit Management Letter for 2008/09 and the Environment Agency's formal response to the External Audit Report for 2008/09. They have also confirmed their receipt of the Internal Audit Compliance Review.

Ownership and accountability for the transmission of Environment Agency employees' pensions related data to Capita Hartshead (the Fund's third party pension fund administrator) is assigned to the human resources and payroll functions. During the year the monthly pay data interface operated successfully and the weekly employee related pension data interface completed its pilot phase and was implemented. Its usefulness is being evaluated.

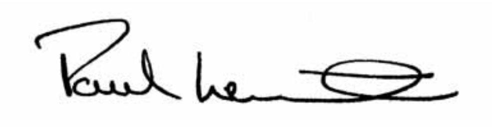
The Environment Agency Pensions Committee and Board continued to be briefed during the year about an Environment Agency officers' led project to ensure the rectification of historic service credit errors by Capita Hartshead, as required by the LGPS regulations. By the end of 2009/10 the cases had been fully resolved by Capita Hartshead apart from three remaining cases where delay was due to either the member or the Pensions Advisory Service. The Pensions Regulator has expressed satisfaction with the Environment Agency's actions.

After taking professional advice regarding the late payment of special contributions by the Environment Agency to the Active Fund to fund the costs of early retirements that occurred during the first half of 2008/9 we self-reported to the Pensions Regulator, who confirmed that the corrective action we had taken was appropriate and sufficient.

The Human Resources Service Centre (HRSC) and payroll functions received further training during the year to improve the management of data. A data synchronisation exercise commenced during the second half of the year and continues into 2010/11 to ensure that historical personal data held by Capita Hartshead is consistent with that held by the Environment Agency. This exercise will assure the accuracy of personal information accessible to members via the pensions website in 2010/11.

As required by the Cabinet Office, under the Security Policy Framework, we have arranged for our Pension Funds administrator Capita Hartshead to complete a detailed questionnaire covering every aspect of data security. They met the required standards.

The Internal Audit Compliance Review for 2010 highlights one issue. The current Financial Memorandum Pensions Schedule, issued in 2005, does not reflect the current requirements of the LGPS. Substantial changes have taken place in the LGPS, especially since 2008, and there were delays reflecting these changes in statutory guidance issued by the Department for Communities and Local Government (CLG). The Financial Memorandum is being reviewed and updated by Defra, in consultation with the Environment Agency.



Paul Leinster
Accounting Officer
Environment Agency
06 July 2010

Statement by the Consulting Actuary

Actuarial statement for the purpose of Regulation 36 of the Local Government Pension Scheme (Administration) Regulations 2008.
As required by regulations, an actuarial valuation of the Fund's assets and liabilities was carried out as at 31 March 2007.

Security of Prospective Rights
In my opinion, the resources of the Fund are likely in the normal course of events to meet the liabilities of the Fund, as required by the Regulations. In giving this opinion I have assumed that the following amounts will be paid to the Fund: -

- Employees – Contributions in accordance with the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2008.

- Employer – Contributions as recommended in my report on the actuarial valuation as at 31 March 2007, dated 26 March 2008.

Summary of Methods and Assumptions Used
My opinion on the security of the prospective rights is based on the projected unit valuation method. This assesses the cost of benefits accruing to existing members during the year following the valuation, allowing for future salary increases. The resulting contribution rate is adjusted to allow for any difference in the value of accrued liabilities (allowing for future salary increases) and the market value of assets.

Since I have taken assets into account at their market value it is appropriate for me to take my lead from the market when setting the financial assumptions used to value the ongoing liabilities, to ensure consistency of the asset and liability valuation bases.

The key financial assumptions adopted for this valuation were as follows:

Financial Assumptions	**Mar 2007**	
	% p.a. Nominal	**% p.a. Real**
Discount Rate (Assumed to be 1.6% above yield on fixed interest Government bonds)	6.1%	2.9%
Pay Increases	4.7%	1.5%
Price Inflation/Pension Increases	3.2%	-

In order to value both those liabilities which have accrued at the valuation date and those accruing in respect of future service, the stream of future liability payments is converted into a capital value today by assuming a return on Fund assets of 6.1% a year.

Recent medical advances, changes in lifestyles and generally greater awareness of health-related matters have resulted in life expectancies improving in recent years at a faster pace than most experts had foreseen. The Fund is relatively immature, with the bulk of the liabilities relating to non-pensioner members, and will be exposed over a long time period to any increases in life expectancies. A longevity reserve of £62m, arising from the adoption of longer life expectancy assumptions than were used at the 2004 valuation, was set up at the 2007 valuation to act as a buffer against these potential increases. The ongoing adequacy of this reserve will be reviewed at future valuations.

Full details of the method and assumptions are described in my valuation report dated 26 March 2008.

The 2007 valuation revealed that the Fund's assets were sufficient to meet 103% (94% at 31 March 2004) of the liabilities accrued up to that date. Assets were taken into account at their then market value of £1,521m (£983m at 31 March 2004). Actual investment returns in the three years to 31 March 2007 were 13.2% p.a. (-2.5% p.a. in the three years to 31 March 2004).

The Environment Agency's contributions have been set in accordance with the Fund's Funding strategy statement. The Environment Agency's contributions have risen from 15.5% of pay in 2008/09 to 16.0% of pay in 2009/10. The Environment Agency's contributions will rise to 16.5% of pay in 2010/11. Contributions payable in the three years starting 2011/12 will be determined during the 2010 formal valuation exercise.

Future contribution levels to the Active Pension Fund will be influenced by a range of factors. This will include the proposed implementation of a new statutory cost sharing regime (between employer and employees) to be introduced by Government in 2011/12, changes to the Active Fund investment strategy in 2011/12 following the 2010 triennial valuation, changes in financial market conditions affecting the value of the fund's assets and liabilities, and the actual demographic experience of the fund in respect of longevity and mortality.

Separate valuations are carried out in respect of the Closed Fund.

Copies of the valuation report are available on request from the Finance Department of the Environment Agency. The next valuation of the Fund will be carried out as at 31 March 2010.

Experience since April 2007

The financial experience that affects the Fund's assets and liabilities since the valuation at 31 March 2007 has been poor. The value of the assets has grown by 4.6% since the 2007 valuation which is less than the assumed increase of 26.2%. This is because in 2007 and 2008 asset values were negatively impacted by the global financial crisis. In 2009/10 the fund assets have recovered with strong growth of 41.0%. The value of liabilities will have risen due to an increase in long term inflation expectations. This rise in inflation expectations will increase the cost of new accrual of benefits, which is particularly important in the Active Fund given its youthful liability profile.

Investment returns in the year to 31 March 2010 were +38.0%. As at 31 March 2010, assets were £1,595m and liabilities were estimated on an ongoing funding basis to be £2,042m implying that the Fund's assets were sufficient to meet 78% of the liabilities accrued up to that date.

Richard Warden
Fellow of the Institute of Actuaries
For and on behalf of Hymans Robertson LLP
8 June 2010

Hymans Robertson LLP
20 Waterloo Street
GLASGOW
G2 6DB

The Comptroller and Auditor General's statement about contributions to the Houses of Parliament, the Board of the Environment Agency and the Secretary of State for Environment, Food and Rural Affairs.

I have examined the summary of contributions to the Environment Agency Active Pension Fund for the Fund year ended 31 March 2010 which is set out on page 31.

Respective responsibilities of the Environment Agency, its Pensions Committee and the auditor
As described in the section entitled Roles and responsibilities of the Pensions Committee, the Pensions Committee is responsible for keeping records in respect of contributions received in respect of any active member of the scheme and for monitoring whether contributions are made to the Fund by the Environment Agency in accordance with the Local Government Pension Scheme Regulations 1997, the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended) and other related regulations and the recommendations of the Consulting Actuary.

It is my responsibility to provide a statement about whether contributions as reported in the attached summary of contributions payable for the Fund year ended 31 March 2010 have in all material respects been paid at least in accordance with the Local Government Pension Scheme Regulations 1997, the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007(as amended) and other related regulations and with the recommendations of the Consulting Actuary and to report my opinion to you.

Basis of statement about contributions
I planned and performed my work so as to obtain the information and explanations which I considered necessary in order to give reasonable assurance that contributions reported in the attached summary of contributions payable have in all material respects been paid at least in accordance with the relevant requirements. For this purpose the work that I carried out included examination, on a test basis, of evidence relevant to the amounts of contributions paid to the Fund and the timing of those payments in accordance with the Local Government Pension Scheme Regulations 1997, the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended) and other related regulations and the recommendations of the Consulting Actuary. My statement about contributions is required to refer to those breaches of the Local Government Pension Scheme Regulations 1997, the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended) and other related regulations and the recommendations of the Consulting Actuary which come to my attention in the course of my work.

Statement about contributions
In my opinion, contributions as reported in the attached summary of contributions payable for the Fund year ended 31 March 2010, have in all material respects been paid at least in accordance with the Local Government Pension Scheme Regulations 1997, the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007(as amended) and other related regulations and with the recommendations of the Consulting Actuary.

Amyas C E Morse
Comptroller and Auditor General
National Audit Office
157-197 Buckingham Palace Road
Victoria
London
SWIW 9SP

14 July 2010

Summary of contributions payable in the year

During the year, the contributions payable to the Scheme in accordance with the Local Government Pension Scheme Regulations 1997 (as amended) by the Employee and Employer for the year ended 31 March 2010 were as follows:

	Notes	Employee £'000	Employer £'000
Required by the LGPS regulations			
Normal contributions		23,055	55,431
Special contributions*		-	3,122
Total		**23,055**	**58,553**
Other contributions payable			
Purchase of added years		832	-
Additional voluntary contributions (AVCs)		762	-
		1,594	-
Sub-totals		**24,649**	**58,553**
Total employee and employer contributions (as per Fund account)	3		**83,202**

* these are costs to the employer of capital payment for additional pensions and early retirements.

Signed on behalf of the Environment Agency

Larry Whitty
Chairman
Environment Agency Pensions Committee
06 July 2010

Paul Leinster
Accounting Officer
Environment Agency
06 July 2010

The Certificate and Report of the Comptroller and Auditor General to the Houses of Parliament, the Board of the Environment Agency and the Secretary of State for Environment, Food and Rural Affairs.

I certify that I have audited the financial statements of the Environment Agency Active Pension Fund for the year ended 31 March 2010 under the Government Resources and Accounts Act 2000. These comprise the Fund Account, the Net Assets Statement and the related notes. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Accounting Officer of the Environment Agency, the Pensions Committee and the auditor

The Accounting Officer of the Environment Agency and the Pensions Committee are responsible for preparing an annual report and financial statements under Schedule 8 to the Environment Agency Financial Memorandum issued by Defra, in accordance with the Local Government Pension Scheme Regulations 1997, the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended) and other related regulations and for ensuring the regularity of financial transactions. These responsibilities are set out in the section entitled Roles and responsibilities of the Pensions Committee.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the Environment Agency Financial Memorandum issued by Defra. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

In addition, I report to you if the Pension Fund has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by HM Treasury regarding transactions is not disclosed.

I review whether the Statement on Internal Control reflects the Pension Fund's compliance with HM Treasury's guidance, and I report if it does not. I am not required to consider whether this statement covers all risks and controls, or to form an opinion on the effectiveness of the Pension Fund's corporate governance procedures or its risk and control procedures.

I read the other information contained in the annual report, which comprises the Chairman's statement, the Report by the Pensions Committee, the Pension Fund investment report and the Statement by the Consulting Actuary, and consider whether it is consistent with the audited financial statements. I consider the implications for my certificate if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinions

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the scheme's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error, and that in all material respects the financial transactions conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinions
In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act 2000 and under Schedule 8 to the Environment Agency Financial Memorandum issued by Defra, in accordance with the Local Government Pension Schemes Regulations 1997, the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007(as amended), and other related regulations, of the state of the scheme's affairs as at 31 March 2010, of the financial transactions of the Fund for the year ended 31 March 2010 and of the amount and disposition at that date of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Fund year; and

- the financial statements have been properly prepared in accordance with Schedule 8 to the Environment Agency Financial Memorandum issued by Defra, in accordance with the Local Government Pension Scheme Regulations 1997, the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007(as amended) and other related regulations.

Opinion on Regularity
In my opinion, in all material respects, the financial transactions conform to the authorities which govern them.

Report
I have no observations to make on these financial statements.

Amyas C E Morse
Comptroller and Auditor General
National Audit Office
157-197 Buckingham Palace Road
Victoria
London
SWIW 9SP

14 July 2010

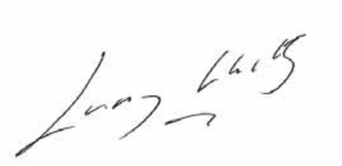
The maintenance and integrity of the Environment Agency's website is the responsibility of the Accounting Officer; the work carried out by the auditors does not involve consideration of these matters and accordingly the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

Financial statements for the year ended 31 March 2010

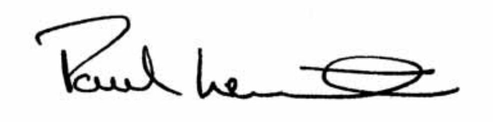
	Notes	2010 £000	2009 £000
Fund account			
Contributions and transfers			
Contributions	3	83,202	80,061
Transfer values received	4	9,349	2,998
Other income	5	701	654
		93,252	83,713
Benefits and other payments			
Benefits	6	(50,870)	(46,148)
Leavers	7	(4,243)	(2,694)
Administration expenses	8	(2,383)	(2,243)
		(57,496)	(51,085)
Net additions from dealings with members		**35,756**	32,628
Return on investments			
Investment income	9	27,300	30,542
Change in market value of investments	10 (a)	404,373	(421,725)
Investment management expenses	11	(3,974)	(5,865)
Net returns on investments		**427,699**	(397,048)
Net increase/(decrease) in the Fund during the year		**463,455**	(364,420)
Opening net assets of the Fund at 1 April		1,131,587	1,496,007
Net assets of the Fund at 31 March		**1,595,042**	1,131,587
Net assets statement			
Investment assets	10 (c)	1,604,037	1,145,895
Investment liabilities	10 (c)	(15,712)	(17,482)
Current assets	12	9,913	6,861
Current liabilities	12	(3,196)	(3,687)
Net assets of the Fund at 31 March		**1,595,042**	1,131,587

The financial statements summarise the transactions and net assets of the Fund. The financial statements do not take account of liabilities to pay pensions and other benefits that fall due after the end of the Scheme year. The actuarial position of the Fund, which does take account of such liabilities, is dealt with in the statement by the Consulting Actuary on page 28 and these financial statements should be read in conjunction with it. The Actuary's statement, dated 8 June 2010, is based on a valuation as at 31 March 2007.

The notes on pages 35 to 46 form part of these financial statements.



Larry Whitty
Chairman
Environment Agency Pensions Committee
06 July 2010



Paul Leinster
Accounting Officer
Environment Agency
06 July 2010

Notes to the financial statements

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 and with the guidelines set out in the Statement of Recommended Practice, 'Financial Reports of Pension Schemes' (Revised May 2007) (the "SORP").

2. Accounting policies

The following principal accounting policies have been applied consistently in the preparation of the financial statements.

Investments
Investments are included at their market values, provided by the Fund's global custodian, which are determined as follows:

(i) Quoted securities listed on recognised stock exchanges are valued at bid prices at the year end. UK Government securities are valued at Gilt-edged Market Makers Association (GEMMA) closing prices.
(ii) Pooled investment vehicles are stated at the bid price as quoted by the relevant fund managers, which reflect the underlying investments. In the case of single priced pooled investment vehicles, the closing single price is used as the best estimate of fair value.
(iii) Unquoted securities are valued by fund managers on the basis of latest dealings, professional valuations and financial information at the year end. In the case of private equity limited company funds, the investments are valued at latest values which are previous quarter (generally end December) values, updated for new investment and distributions. For private equity direct investments the price taken is that as provided by the Fund Manager, which reflect the prices at the latest round of financing if available, or book cost, unless impaired when this value is reduced.
(iv) Acquisition costs are included in the purchase cost of investments.
(v) Investment management fees are accounted for on an accruals basis.
(vi) The Fund's global custodian is not authorised to enter into stock lending arrangements.

Derivatives
(i) Futures contracts' fair value is determined using exchange prices at the year end date. The fair value is the unrealised profit or loss at the closing price of the contract. Amounts due from the broker represent the amounts outstanding in respect of the initial margin (representing collateral on the contracts) and any variation margin which is due to or from the broker. The amounts included in change in market value are the realised gains and losses on closed futures contracts and the unrealised gains and losses on open futures contracts.
(ii) The fair value of the forward currency contracts is based on market forward exchange rates at the year end date.

Investment income
(i) Income from fixed interest and index linked securities and other interest receivable is taken into account on an accruals basis. Income from all other marketable securities is taken into account on an accruals basis on the date when stocks are quoted ex-dividend.
(ii) Income from overseas investments is recorded net of any withholding tax where this cannot be recovered.
(iii) Accrued interest is excluded from the market value of fixed interest securities but is included in investment income receivable.
(iv) Income on investments in pooled investment vehicles with accumulation units is reflected in the unit price. Income on investments in property pooled investment vehicles is distributed and recognised on an accruals basis.
(v) Income from cash and short-term deposits is accounted for on an accruals basis.

Exchange rates

(i) Where forward contracts are in place for assets and liabilities in foreign contracts, the contract rate is used.

(ii) Other assets and liabilities in foreign currencies are translated into sterling at the rates of exchange ruling at the year end.

(iii) Overseas dividends are valued at rates of exchange on the date when stocks are quoted ex-dividend. Surpluses and deficits arising on conversion or translation are dealt with as part of the change in market value of investments.

Contributions

Standard contributions, both from the members and from the employer, are accounted for under the Schedule of Contributions received each month by the Pension Fund and are in compliance with the following:

(i) Regulation 39 of the Local Government Pension Scheme (Administration) 2008 (as amended), stipulates that the employer's standard contributions must be made at a rate as noted in the rates and adjustments certificate as determined by the Pension Fund Actuary under regulations 36 or 38 of those same regulations. The employer's standard contributions are necessary to ensure that the Fund is able to meet its existing and prospective liabilities including indexation.

(ii) The employee's standard contributions are determined with reference to the table shown in regulation 3 of the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended).

Employer's further contributions may be made to cover the costs of. -

(i) Awarding additional years and days to an active member or making such an award within 6 months of leaving to a member who has left his employment on the grounds of Redundancy or in the interests of efficiency under Regulation 12 of the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended). The costs for such an award are calculated and paid in accordance with Regulations 38 and 40 of the Local Government Pension Scheme (Administration) Regulations 2008 (as amended).

(ii) Awarding additional pension to an active member under Regulation 13 of the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended). The costs for such an award are calculated and paid in accordance with Regulations 40 of the Local Government Pension Scheme (Administration) Regulations 2008 (as amended).

(iii) Any extra charge to the pension Fund as a result of a member retiring on the grounds of ill health (Regulation 20), early retirement with employer consent (Regulation 31) or flexible retirement (Regulation 18) of the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended). The costs for such an award are calculated and paid in accordance with regulation 41 of the Local Government Pension Scheme (Administration) Regulations 2008 (as amended).

(iv) Any extra charge to the Pension Fund as a result of benefits immediately becoming payable as a result of a member been dismissed on the grounds of redundancy or in the interests of efficiency under regulation 19 of the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended). The costs for such an award are calculated and paid in accordance with regulation 41 of the Local Government Pension Scheme (Administration) Regulations 2008 (as amended).

Additional contributions from members are accounted for in the month deducted from the payroll and may relate to the:

(i) Purchase of additional years payable under regulation 55 of the Local Government Pension Scheme 1997 Regulations (as amended), and/or

(ii) Purchase of additional pension payable under regulation 14 of the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended), and/or

(iii) Payment of additional voluntary contributions (AVCs) payable under regulation 15 of the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended).

Benefits
Members can choose whether to take a proportion of their retirement benefits as a pension and/or lump sum. Pensions and lump sums are accounted for on an accruals basis from the date the option is exercised. Lump sum death grants and refunds of contributions are included from the date of death or date the member leaves the Scheme.

Transfers to and from other schemes are those amounts paid to, or received from, other pension schemes relating to previous periods of pensionable employment. Individual transfers are included in the accounts when paid or received, but bulk transfers are accounted for on an accruals basis when the amounts have been agreed.

Other expenses
Investment management and administration expenses are accounted for on an accruals basis. Expenses are recognised net of any recoverable VAT. The fees of the Fund's external investment managers reflect their differing mandates. Fees are generally linked to the market value of the Fund's investments and therefore may increase or reduce as the value of the investment changes. Fees are also payable to the Fund's global custodian.

Taxation
UK income tax and capital gains tax
The Fund is exempt approved under Chapter I of Part XIV of the Income and Corporation Taxes Act 1988 and is therefore not liable to UK income tax on interest and dividend income (other than dividends arising from UK equities), or to capital gains tax. The Fund became a registered pension scheme under Chapter 2 Part 4 of the Finance Act 2004 with effect from 6 April 2006.

Value added tax
As the Environment Agency is the administering authority for the Fund, VAT input tax is recoverable on all Fund activities including expenditure on investment and property expenses. The accounts are shown exclusive of VAT.

US withholding tax
The income earned from investments in stocks and securities in the United States is exempt from US tax pursuant to Section 892 of the Income Tax Code and is not subject to the withholding of any tax under Section 1441. This exemption has continued to be applied thus far under the US Tax Reform Act of 1986.

Overseas tax deductions
Where possible, tax deducted at source is recovered by the investment managers.

3. Contributions

	2010	2009
	£000	£000
Employer		
Normal	55,431	49,391
Special contributions	3,122	8,040
	58,553	57,431
Members		
Normal	23,055	21,141
Purchase of added years	832	676
Additional voluntary contributions (AVCs)	762	813
	24,649	**22,630**
Total	**83,202**	80,061

4. Transfer values received

	2010 £000	2009 £000
Individual transfers from other schemes	**9,349**	2,998

Transfer values have been paid ("cash equivalents" within the meaning of Part 1 of Schedule 5 to the Pensions Scheme Act 1993), and service credits given for transfers received, calculated in accordance with the method and assumptions on the advice of the Actuary and based on guidelines issued by the Institute and Faculty of Actuaries.
No discretionary benefits have been included in the calculation of transfer values.

5. Other income

	2010 £000	2009 £000
Reimbursements of additional payments made	**701**	654

During 2008/09 historical service credits granted for transfers into the Fund were found to have been calculated incorrectly. This resulted in incorrect payments of pensions, lump sums and subsequent transfers. These amounts have been corrected by Capita Hartshead to the Fund. The figure of £701,000 shown in respect of 2009/10 represents reimbursements to the Fund by Capita Hartshead of administration expenses incurred during this rectification process. The 2008/09 figure of £654,000 represents £561,000 in respect of administration expenses reimbursed and £93,000 in respect of benefits reimbursed.

6. Benefits

	2010 £000	2009 £000
Retirement and dependants' pensions	35,772	31,602
Lump sum retirement grants	13,920	13,578
Lump sum death grants	1,173	962
Life assurance through AVC provider	5	6
	50,870	46,148

Benefits payable exclude £1.8m (2009: £1.7m) for historic unfunded pensions liabilities of the Environment Agency in respect of compensatory added years paid via the pensions administrator. These have been recharged to the Environment Agency and funded by Grant-in-Aid from Defra.

As described in note 5, £nil (2009: £16,000) in respect of the lump sum retirement grants and £nil (2009: £47,000) in respect of pensions shown above have been reimbursed to the Fund.

7. Leavers

	2010 £000	2009 £000
Individual transfers to other schemes	4,094	2,668
Refunds of contributions	27	26
AVC transfers	122	-
	4,243	2,694

8. Administration expenses

	2010 £000	2009 £000
Scheme administration	661	625
Professional fees:		
Actuarial	602	502
Legal	453	387
Investment and administration	142	156
Audit	36	44
Other administration costs:		
Environment Agency administration	327	348
Communications to members	56	53
Miscellaneous	106	128
	2,383	2,243

The auditors remuneration in respect of non-audit services for 2009/10 was £nil (2008/09 £nil).

As described in note 5, of the £701,000.00, £368,000 (2009: £261,000) legal and £333,000 (2009: £300,000) actuarial expenses have been reimbursed to the Fund.

9. Investment income

	2010 £000	2009 £000
Income from fixed interest securities	7,202	4,068
Dividends from equities	17,866	21,999
Income from pooled investment vehicles	1,765	2,543
Interest on cash deposits	246	1,835
Income from private equity	221	97
	27,300	30,542

10. Investments

(a) Investment movements summary

	Market value at 01.04.09 £000	Purchases at cost and derivative payments £000	Sales proceeds and derivative receipts £000	Change in market value £000	Market value at 31.03.10 £000
Equities	527,353	249,286	(271,587)	261,159	766,211
Pooled equities	127,037	164,423	(184,379)	46,247	153,328
Fixed interest	50,087	285,162	(137,594)	125,031	322,686
Pooled fixed interest	241,246	147,813	(229,107)	(56,494)	103,458
Pooled property	35,027	17,019	(8,874)	6,533	49,705
Private equity	71,516	18,185	(6,122)	(2,622)	80,957
Pooled currency	33,980	211	-	15,364	49,555
Pooled cash	-	20,050	-	2	20,052
Derivatives	(14,369)	1,625,942	(1,631,038)	8,243	(11,222)
AVC investments	4,794	783	(918)	974	5,633
	1,076,671	**2,528,874**	**(2,469,619)**	**404,437**	**1,540,363**
Cash deposits & instruments	45,681			(64)	42,439
Other investment balances	6,061			-	5,523
	1,128,413			**404,373**	**1,588,325**

The change in the market value of investments 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 during the year.

The derivatives in the above table represent futures contracts and forward foreign exchange contracts. The closing market values represent fair values at the year end date. In the case of futures contracts, which are traded on exchanges, this value is determined using exchange prices at the reporting date. Forward foreign exchange contracts are over the counter contracts and 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.

All contracts settled during the period are reported within the table as purchases and sales. As all contracts are settled individually, with an amount being paid to or from the broker in respect of all the foreign currency contracts, these transactions need to be disclosed as purchases and sales. As forward foreign exchange trades are settled gross they need to be included as gross receipts and payments and hence the volumes shown are high.

Transaction costs are included in the cost of purchases and sale proceeds. Transaction costs include costs charged directly to the Fund such as fees, commissions, stamp duty and other fees. Transaction costs incurred during the year amounted to £1,145,309 (2009: £1,420,226). In addition to the transaction costs disclosed above, indirect costs are incurred through the bid-offer spread on investments within pooled investment vehicles. The amount of indirect costs is not separately provided to the Fund.

10. Investments continued

(b) Investment value details

Investment assets	2010 £000	2009 £000
Equities		
UK quoted	361,919	263,315
Overseas quoted	404,292	264,038
	766,211	527,353
Pooled equities		
Overseas equities	153,328	127,037
	153,328	127,037
Fixed interest		
UK index linked gilts	238,702	-
UK corporate quoted	54,893	37,477
Overseas corporate quoted	29,091	12,610
	322,686	50,087
Pooled fixed interest		
UK index linked gilts	-	161,747
UK corporate quoted	100,225	-
Overseas corporate quoted	3,233	79,499
	103,458	241,246
Pooled property		
UK unit trusts	38,580	24,767
UK managed funds	6,712	5,378
UK unquoted - collective limited partnership investments	4,413	4,882
	49,705	35,027
Private equity		
UK – unquoted	1,855	1,975
Overseas – unquoted	79,102	69,541
	80,957	71,516
Pooled currency	**49,555**	33,980
Pooled cash	**20,052**	-
Derivative contracts		
Futures	19	4
Forward foreign exchange	(11,241)	(14,373)
	(11,222)	(14,369)
AVC investments	**5,633**	4,794
Cash deposits and instruments		
Cash margin with brokers	316	(105)
Cash with custodian and fund managers	42,123	45,786
	42,439	45,681
Other investment balances		
Income tax recoverable	428	616
Accrued income	5,210	3,513
Due from trade and currency brokers	2,330	3,176
Due to trade and currency brokers	(2,445)	(1,244)
	5,523	6,061
Net investment assets	**1,588,325**	1,128,413

10. Investments continued

(c) Financial assets and liabilities

	2010 £000	2009 £000
Financial assets		
Equities (includes pooled and private equity)	1,000,496	725,906
Bonds (includes pooled and gilts)	426,144	291,333
Pooled property	49,705	35,027
Pooled currency	49,555	33,980
Cash (includes pooled)	62,491	45,681
Derivatives – Futures and forward foreign exchange	2,045	1,869
AVC	5,633	4,794
Other investment assets	7,968	7,305
Total financial assets	**1,604,037**	1,145,895
Financial liabilities		
Derivative contracts - Forward foreign exchange	(13,267)	(16,238)
Other investment liabilities – Due to trade and currency brokers	(2,445)	(1,244)
Total financial liabilities	**(15,712)**	(17,482)
Net financial assets	**1,588,325**	1,128,413

(d) Derivative contracts

Derivatives	**2010 Asset £000**	**2010 Liability £000**	2009 Asset £000	2009 Liability £000
Futures contacts	19	-	4	-
Forward foreign currency contracts	2,026	(13,267)	1,865	(16,238)
	2,045	**(13,267)**	1,869	(16,238)
Net derivatives	**-**	**(11,222)**	-	(14,369)

Investment in derivative instruments may only be made if they contribute to a reduction of risks and facilitate efficient portfolio management. A derivative is a financial contract between two parties, the value of which is determined by the underlying asset.

Derivatives are used to a limited extent, primarily for efficient portfolio management and reducing currency risk. For example, our passive manager could buy ‘futures’, which are contracts to purchase equities in the relevant index at a given date. This allows the manager to smooth out index changes and track the index more efficiently.

In the table below, the ‘nominal value’ of the futures contracts is the ‘economic exposure’ of those futures as at 31 March 2010. The ‘Fair value’ is the unrealised profit or loss of the futures as at 31 March 2010

10. *Investments continued*

Futures

Type of contract	**Expiration**	**2010 Nominal value £'000**	**2010 Fair Value £'000**	2009 Fair value £'000
FTSE 100 UK exchange traded June 2010 (L&G)	3 months	**235**	**19**	-
FTSE 100 UK exchange traded June 2009 (L&G)	3 months	**-**	**-**	4
Total		**235**	**19**	4

A series of six month rolling 'forward' currency contracts are used by our currency manager to hedge 60% of the Fund's exposure to overseas currency movements back to Sterling. They help minimise the adverse effect of volatility of those currencies on the value of the Fund. For forward currency contracts that have not been realised at the year end date, the movement of sterling during the contract period will result in either short term unrealised gains or losses. Over time these should balance to have a neutral financial impact. At 31 March 2010 there was an unrealised loss of £11.3m on the currency forwards (2009 - £14m). Whilst this unrealised loss may appear significant, it is worth noting that the value of the assets denominated in overseas currencies will have increased as result of these currency movements.

Forward foreign currency contracts

Type of Contract	**Settlement dates**	**Currency bought**	**Currency sold**	**2010 Asset £'000**	**2010 Liability £'000**	2009 Asset £'000	2009 Liability £'000
Forward OTC	5 days to 6 months	Sterling	US Dollars	**582**	**(12,115)**	1,024	(8,304)
Forward OTC	5 days to 6 months	Sterling	Euros	**889**	**(385)**	-	(6,158)
Forward OTC	1 to 6 months	Sterling	Japanese Yen	**328**	**(715)**	538	(1,436)
Forward OTC	1 to 13 days	US Dollars	Euro	**37**	**-**	76	-
Forward OTC	6 to 14 days	US Dollars	Danish Krona	**129**	**(2)**	64	-
Forward OTC	1 to 13 days	US Dollars	Swiss Franc	**61**	**(25)**	162	-
Forward OTC	1 to 2 days	US Dollars	Sterling	**-**	**-**	1	(1)
Forward OTC	9 to 13 days	Japanese Yen	US Dollars	**-**	**(16)**	-	(256)
Forward OTC	1 to 76 days	Japanese Yen	Sterling	**-**	**(7)**	-	(46)
Forward OTC	9 days	Euro	US Dollars	**-**	**-**	-	(28)
Forward OTC	9 days	Swiss Franc	US Dollars	**-**	**-**	-	(8)
Forward OTC	1 days	Thai Baht	Sterling	**-**	**-**	-	(1)
Forward OTC	1 to 6 days	Sterling	Canadian Dollars	**-**	**(1)**	-	-
Forward OTC	1 to 6 days	Euro	Sterling	**-**	**(1)**	-	-
				2,026	**(13,267)**	1,865	(16,238)

10. Investments continued

(e) AVC investments

The aggregate amounts of AVC investments as at 31 March are as follows:

	2010 **£000**	2009 £000
The Equitable Life Assurance Society		
With-profits funds	486	488
Unit-linked funds	656	632
Deposit accounts	151	208
	1,293	1,328
Clerical Medical		
With-profits funds	567	544
Unit-linked funds	1,348	1,082
	1,915	1,626
Standard Life		
Unit-linked funds	2,425	1,840
	2,425	1,840
Total AVC investments	**5,633**	4,794

The Environment Agency holds assets with The Equitable Life Assurance Society, Clerical Medical and Standard Life. These are in the form of with-profits, unit-linked and deposit accounts and secure additional benefits on a money purchase basis for those members electing to pay additional voluntary contributions. Members participating in this arrangement receive an annual statement made up to 31 March 2010 confirming amounts held to their account and movements in the year.

(f) Investments exceeding 5% of net assets

A significant portion of the Fund (17.2%) is held in pooled pension funds managed by Legal and General (L&G). At 31 March 2010 the holding in L&G Investment Grade Corporate Bond Fund is valued at £100.2m (2009: £nil) and the holding in L&G North America Equity Index Fund valued at £86.4m (2009: £72.3m), represented 6.3% (2009: nil%) and 5.4% (2009: 6.4%) of the net assets of the Fund.

11. Investment management expenses

	2010 **£000**	2009 £000
Fund manager base fees	3,794	3,863
Fund manager performance fees	(179)	1,641
Global custody	132	122
Investment advisers	166	129
Performance and risk measurement	61	110
	3,974	5,865

Total fund manager fees include management charges for European Credit Management (until termination in November 2009) and Informed Portfolio Management that are settled directly within the portfolio in accordance with the investment management agreements.

12. Current assets and liabilities

	2010 £000	2009 £000
Current assets		
Debtors		
Environment Agency	796	642
Standard Life	26	161
Equitable Life	6	-
Capita Hartshead - administration expense to be refunded	23	-
- overpaid pensions to be refunded	-	1
- overpaid transfers to be refunded	-	131
	851	935
Cash at bank	9,062	5,926
	9,913	6,861
Current liabilities		
Creditors		
Administration and investment expenses	(1,493)	(1,849)
Benefits payable	(1,259)	(1,444)
PAYE	(442)	(394)
Tax payable on refunds	(2)	-
	(3,196)	(3,687)

Amounts due from the Environment Agency are:

(i) employers' and employees' contributions of £405,000 (2009: £4,000) and £173,000 (2009: £7,000) respectively outstanding in the normal course of collection at the year end and subsequently paid over within the statutory time limit; and

(ii) invoices for £218,000 (2009: £630,000) for special contributions due in respect of augmentations to members' benefits, and £nil (2009: £1,000) for invoices in respect of pensions paid but not chargeable to the Fund.

13. Investment commitments

In accordance with authorised investment strategy and mandates the outstanding investment commitments at 31 March 2010 are Private equity £34.1m (2009: £44.8m), and Property £4.3m (2009: £nil).

14. Related party transactions

During the year ended 31 March 2010 there have been the following related party transactions:

(i) pensions administration costs of £327,000 (2009: £348,000) recharged to the Fund by the Environment Agency (see Note 8);

(ii) ten members of the Pensions Committee are contributing members of the Fund and contributions are paid by the Environment Agency in accordance with the Local Government Pension Scheme (Administration) Regulations 2008 (as amended) ("the 2008 regulations") and the recommendations of the Consulting Actuary;

(iii) one member of the Committee is in receipt of a retirement pension payable from the Fund, calculated and paid in accordance with the 1997 regulations; and

(iv) payment of unfunded liabilities of £1,800,000 (2009: £1,700,000) recharged to the Environment Agency by the pensions administrator (see note 6).

15. Employer related investment

During the year, special contributions totalling £175,383 (2009: £3,583,458) were not paid over to the Fund by the due date. £nil (2009: £23,908) was still outstanding at the year end. Apart from this, the Fund did not hold any employer-related investments during the year or at the year-end.

16. IAS 26: Accounting and reporting by retirement benefit plans

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £2,099m (2009: £1,420m). This figure is used for statutory accounting purposes by the Environment Agency. The assumptions underlying the figure are set out in the Environment Agency's statutory accounts. The figure is only prepared for the purposes of IAS19 and has no validity in other circumstances. In particular, it is not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

17. Apportionment of common expenditure

In cases where expenditure relates to both the Active Fund and the Environment Agency Closed Pension Fund, this has been respectively apportioned during the year as follows:

	2010 %	2009 %
Custodial arrangements	80/20	80/20
Other (e.g. Environment Agency administration costs)	60/40	60/40

18. Events after the net asset statement date

The financial statements were approved by the Pensions Committee on 23 June 2010, and were approved and signed at a meeting of the Board on 6 July 2010. It was announced in the Budget on 22 June 2010 that the Government intends to adopt the Consumer Price Index (CPI) for the indexation of public service pensions from April 2011. This non-adjusting event will have an impact upon the future operation of the Active Fund. There are no adjusting events that need to be recognised in the financial statements after the net asset statement date. The authorised date for issue is the 14 July 2010.

The annexes

Annex 1 – Scheme rules and benefits

On 1 April 2008 the scheme rules and benefits became subject to the Local government Pension Scheme (Benefits, Membership and Contribution) Regulations 2007 (as amended).

Scheme membership and income

(a) All employees of the Environment Agency are eligible for membership of the Local Government Pension Scheme (LGPS) (excluding Environment Agency Board Members and those employees who are eligible to join another pension scheme) providing they are under the age of 75 and have a contract of employment that is for at least 3 months (or the aggregate of several continuous contracts is for at least 3 months). Providing the previous criteria are met, full and part-time employees, whether permanent or temporary, become members automatically with the right to opt out (back-dated to the start of membership if made within three months).

Members' contributions are deducted from pensionable pay and the rate is dependent on the value of the permanent pensionable earnings paid. The rate the member pays depends on which earnings band the members falls into, but the rate will fall between 5.5% and 7.5% of permanent pensionable earnings. If the member works part-time, the rate will be based on the full time equivalent permanent pensionable pay for the job, although the member will only pay contributions on the pensionable pay actually earned.

If the member was a former manual worker who joined the LGPS before 1 April 1998 and had a protected contribution rate of 5%, the member will pay a lower rate of scheme contributions until 1 April 2011 when these reduced contributions will be harmonised with that of the rest of the scheme members.

Subject to limits set by the Her Majesty's Revenue and Customs (HMRC), members can: -

- Pay additional voluntary contributions (AVCs) with one of the Environment Agency In House providers (Standard Life or Clerical Medical) to buy a larger retirement pension, to improve other specific benefits or to provide additional EAPF pension, or membership for pension purposes (if the employee has continuously paid additional voluntary contributions since prior to 13 Nov 2001), and/or
- Purchase additional EAPF pension

(b) Transfer payments for pension rights in almost any other scheme can be accepted by EAPF to increase benefits which may eventually become payable, providing the transfer payment is received within 12 months of joining the EAPF (or such a longer date that the Environment Agency may allow).

(c) The Environment Agency must make the balancing contribution required to keep the Fund solvent, having regard to existing and prospective liabilities. This is usually determined as a percentage of the members' pensionable pay by the Consulting Actuary following each triennial actuarial valuation of the Fund.

(d) Monies not immediately required for the payment of benefits and other outgoings have to be invested in accordance with the provisions of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

Benefits available

Three months membership or more (or a transfer value has been received or the member holds a deferred benefit in the LGPS in England & Wales):

A. ***Retirement pension and tax-free lump sum*** (tax-free lump sum only based upon membership accrued prior to 1 April 2008) awarded:

1. Payable immediately on cessation of employment:

- Voluntarily from age 55 onwards (with the Environment Agency's consent if under age 60); or
- Through permanent incapacity at any age with Environment Agency's consent; or
- As a result of redundancy or efficiency after age 55.

2. Deferred and payable from:

- Normal retirement age; or

- Voluntarily from age 55 onwards (with the Environment Agency's consent if under age 60);

- Through permanent incapacity at any age with the Environment Agency's consent.

B. ***Spouses', Civil Partners, Nominated Co-Habiting Partners and Children's pensions and a lump sum death grant*** following death:
1. During employment, or
2. Whilst in receipt of a retirement pension (a death grant lump sum may **not** always be payable), or
3. Before deferred benefits become payable.

Under three month's membership (and no transfer value has been received or member does not hold deferred benefit in the LGPS in England & Wales):

A. Retirement pension on retirement at age 65.

B. Lump sum death grant on death in employment.

C. Refund of contributions or Cash Equivalent Transfer Value, when no other benefit payable.

Although it will take into consideration the deceased person's wishes, the Environment Agency has absolute discretion in deciding who should receive any lump sum death grant payable.

Pensions increase awards

Retirement and dependants' pensions in payment and deferred are increased each year by the same Retail Prices Index percentage rate as that applied to State pensions.

Transfers to other schemes

When benefits are not payable immediately, a transfer can usually be made to another tax approved employer's pension scheme, or to a tax-approved personal pension, or stakeholder plan or to purchase an insurance annuity bond.

Annex 2 – Governance compliance statement

Statutory Guidance Governance Standards and Principles	Our compliance status	Evidence of compliance and justification for non-compliance
A – Structure		
a) The management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing council.	Compliant	Our Financial Memorandum, the Pensions Committee Terms of Reference, Standing Orders, and Pension Funds Scheme of Delegation set out responsibilities of the Environment Agency Board and Pensions Committee (PC) and its Sub-Groups.
b) That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.	Compliant	Our PC includes 4 Non-Executive Environment Agency Board members, 4 Executive members (Director of Finance, Director of Resources, Head of Environmental Finance & Pension Fund Management and Finance Manager EA Wales), 5 Active Fund Employee nominees 1 Pensioner nominee 1 Deferred member nominee. 2 Active Fund Employee nominees are also members of the Investment Sub-Group (ISG) 1 Active Fund Employee nominee and the pensioner nominee are also members of the Benefits Sub-Group (BSG).
c) That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Compliant	Reports from the ISG and BSG are circulated to all PC members. Recommendations from the ISG and BSG are presented to the main Committee.
d) That where a secondary committee or panel has been established, at least one seat on the main committee is allocated for a member from the secondary committee or panel.	Compliant	Our ISG and BSG are made up of members of the main PC supported by officers
B – Representation		
a) That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include:		
i) employing authorities (including non-scheme employers, eg, admitted bodies);	Compliant	We have only one employer, the Environment Agency, who is represented on the main PC, the ISG and the BSG. The employers of our Closed Fund members no longer exist.
ii) scheme members (including deferred and pensioner scheme members);	Compliant	Our main PC membership includes 5 Trade Union nominated Active Fund employee nominees, one pensioner nominee and 1 deferred member nominee. Our ISG includes 2 Trade Union nominated nominees and our BSG includes 1 Trade Union nominated Active Fund employee nominee and 1 pensioner nominees. Our deferred member and pensioner nominees are members of our decision making main PC.
iii) independent professional observers; and	Compliant	Our independent investment adviser attends all ISG and all relevant main PC meetings. Our other professional advisers also regularly attend our PC, ISG and BSG meetings.

Statutory Guidance Governance Standards and Principles	Our compliance status	Evidence of compliance and justification for non-compliance
iv) expert advisers (on an ad-hoc basis).	Compliant	We invite our expert advisers to attend our PC, ISG and BSG meetings as needed. This includes our actuary, legal adviser, investment consultants, pension fund administration consultants, and external auditors.
b) That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers, meetings and training and are given full opportunity to contribute to the decision making process, with or without voting rights.	Compliant	All members of the PC, ISG and BSG receive equal access to the papers and training and have equal speaking and voting rights in our decision making processes.
C – Selection and role of lay members		
a) That Committee or panel members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee.	Compliant	On appointment new PC members receive induction training and a detailed member handbook that describes the role of the Committee, ISG and BSG. Our PC members understand that their primary role is to adopt and maintain a duty of care to our fund's beneficiaries and they are required to act in their best interests at all times, particularly in terms of investment and financial decisions. They also understand that they are not there to represent or promote their own personal or political interests, and that they must declare any self-interest or conflicts of interest of a financial or non-financial nature and abstain from participation in that item on the agenda.
b) That at the start of any meeting, Committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Compliant	Declaration of interests is a standing agenda item at the start of all PC,ISG & BSG meetings. A register of interests is also maintained and audited annually.
D – Voting		
a) The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Compliant	Our PC makes decisions by discussion and by building and creating a consensus. All members have equal voting rights on our main Committee and BSG and ISG.
E – Training, facility time and expenses		
a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	Compliant	Our PC has a training strategy, which it reviews annually. On appointment to the PC we provide general induction training and they are provided with a comprehensive PC members handbook. The PC also has a policy that it and all its members should undergo further developmental, specialist, and/or "top-up" refresher training for 2-3 days each year during their terms of office. We maintain a log of all PC member training undertaken. Members of the main PC, the ISG and BSG are reimbursed the cost of travel and overnight hotel expenses. The cost of all PC, ISG and BSG training is met from the pension fund budget.

Statutory Guidance Governance Standards and Principles	Our compliance status	Evidence of compliance and justification for non-compliance
b) That where such a policy exists, it applies equally to all members of committees, sub-committees, advisery panels or any other form of secondary forum.	Compliant	All PC members have equal access and rights.
F – Meetings (frequency/quorum)		
a) That an administering authority's main committee or committees meet at least quarterly.	Compliant	Our PC usually meets four times a year, for normal business and at least once for briefing or training.
b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committee sits.	Compliant	Our ISG and BSG meetings are synchronised to meet four times a year before the PC so they can report to and make recommendations to the full Committee.
c) That administering authorities who do not include lay members in their formal governance arrangements, provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Partially compliant	We have 7 "lay" members on our main PC, comprising 5 employee nominees, 1 pensioner nominee and 1 deferred member nominee. We hold annual Pensions Briefings (around 20 at different regional locations around England and Wales) to inform active members about changes to the LGPS and to allow them to ask questions of HR staff and Capita Hartshead (Pension Fund Administrator). In 2009/10 we also held our first Pensioner Briefing. **Area of non compliance** We do not have any representation of pensioners in 52 other LGPS funds or the 8 Water Company schemes who are legally allowed to re-charge us their annual pension increase which is paid via the Closed Fund and funded by Defra GiA. Due to the geographical spread of our organisation and fund membership across England and Wales we do not hold an AGM. We do not feel this is necessary as 10-20% of active fund members attend a regional pensions briefing each year.
G – Access		
a) That subject to any rules in the council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Compliant	All members of our PC, ISG and BSG receive the same agenda and papers containing advice for each meeting. Members of the PC who are not members of the ISG or BSG can request full ISG or BSG papers and they receive reports of all meetings. All our PC, ISG and BSG members can ask questions of our professional advisers who attend the PC, ISG or BSG meetings.
H – Scope		
a) That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Compliant	Each meeting of our PC receives a report on the performance of our pension funds benefits administration. Our PC also carries out an annual review of its key strategic risks and our statutory governance and communications policy statements. It also has carried out a review of its own effectiveness.

Statutory Guidance Governance Standards and Principles	Our compliance status	Evidence of compliance and justification for non-compliance
I – Publicity		
a) That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Compliant	We publish our Governance Compliance Statement on our website, and it is available in hard copy from our Pension Fund Management Team. Since 2007/8 it has also been included in our Annual Report & Accounts. We have an agreed procedure for our recognised Trades Unions to nominate new employee nominee to our PC when a vacancy arises. We have also advertised in pensioners' and deferred member newsletters for nominees when vacancies arose.

Approved by the Pensions Committee 16 March 2010 and reviewed annually.

Annex 3 – Communications policy statement

Introduction

The Environment Agency Pension Funds (EAPF) are part of the Local Government Pension Scheme (LGPS).

The purpose of this document is to summarise the Communications policy for the Environment Agency Active and Closed Pension Funds as required by the Local Government Pension Scheme Regulations. A more detailed version is available on our websites at www.environment–agency.gov.uk/pensions and www.eapf.org.uk .

The Active Fund is open to all Environment Agency employees with a contract of three months or more and has 12,000 active members – 1,300 manual and 10,700 non manual, 5,500 deferred members and 4,000 pensioners. Unlike most LGPS funds the EAPF has only one employer – the Environment Agency.

The Closed Fund exists solely for the purpose of paying pensions and related benefits of a group of former employees in the water industry in England and Wales who did not transfer to one of the privatised water companies' pension schemes in 1989. It has no active members, 4,200 deferred members and 17,000 pensioners.

The Environment Agency performs the roles of Administering and Employing Authorities with the Pensions Committee, supported by the Finance Director and the Pension Fund Management team and a variety of external advisers, taking overall responsibility for Administering Authority functions. The Environment Agency's Director of Resources and the Employee Performance team perform the role of Employing Authority. The day-to-day administration of the funds is out-sourced to Capita Hartshead.

The Pensions Committee is a sub-committee of the Environment Agency Board with 15 members made up of 4 Board members, 4 Executive members, 5 employee/Trades Union nominees, 1 pensioner nominee and 1 deferred member nominee. The Committee is supplemented by the Investment Sub Group and the Benefits Sub-Group, where specific advice can be provided by Officers, and external advisers. There are 2 Trade Union nominees on the Investment Sub-Group and 1 Trade Union nominee and the pensioner nominee on the Benefits Sub-Group.

This is the fifth Communications Policy Statement for the Environment Agency Pension Funds.
Any enquiries in relation to this Communication Policy Statement should be sent to:

Howard Pearce
Head of Environmental Finance & Pension Fund Management
Rio House
Waterside Drive
Aztec West
Almondsbury
Bristol
BS32 4UD

Email: pensions.team@environment-agency.gov.uk
Tel: 01454 624333

Regulatory framework

With effect from 1 April 2005 regulation 106B of the Local Government Pension Scheme Regulations 1997 (as amended) required that administering authorities "*….prepare, maintain and publish a written statement setting out their policy concerning communications with members; representatives of members, prospective members and employing Authorities.*
Regulation 67 of the Local Government Pension Scheme (Administration) Regulations 2007, effective from 1 April 2008, states:

(1) This regulation applies to the written statement prepared and published by an administering authority under (1).

(2) *The authority—*

- *(a) must keep the statement under review,*
- *(b) make such revisions as are appropriate following a material change in its policy on any of the matters mentioned in paragraph (3); and*
- *(c) if revisions are made, publish the statement as revised.*

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1 Regulation 106B was inserted by S.I.2005/3199.

(3) *The matters are—*

- *(a) the provision of information and publicity about the Scheme to members, representatives of members and employing authorities;*
- *(b) the format, frequency and method of distributing such information or publicity; and*
- *(c) the promotion of the Scheme to prospective members and their employers.*

As a provider of an occupational pension scheme, we are also obliged to satisfy the requirements of the Occupational Pension Schemes (Disclosure of information) Regulations and other legislation, for example the Pensions Act 2004. The disclosure requirements are prescriptive, concentrating on time-scales rather than quality.

A summary of our expected time-scales for meeting the various disclosure of information requirements are set out in the section on performance measurement, alongside those defined by the Disclosure Regulations.

Communication will always be in accordance with the provisions of Data Protection legislation.

Responsibilities and resources

Administration of the Environment Agency Pension Funds is the responsibility of the Environment Agency but Capita Hartshead carries out the day-to-day administration of the Local Government Pension Scheme (LGPS) on our behalf.

Overall responsibility for communications rests with Directors of Finance and Resources supported by the Pension Fund Management team in Finance, the Benefits Team in Employee Performance and Capita Hartshead.

All communications including any web based or electronic material are developed jointly by the Pension Fund Management team, Employee Performance Benefits team and Capita Hartshead's Technical Consultants.

One or more of these groups is also responsible for arranging all forums, workshops and meetings covered within this statement. Either the Environment Agency or Capita Hartshead's contracted external suppliers carry out design work and printing.

Where appropriate we may use external consultants to assist with the preparation and design or with the translation into Welsh of communications.

Our expenditure on our hard copy and electronic communications is £120k per annum, which equates to approximately £2.75 per member.

Communication with key audience groups

Our Audience

As an LGPS Administering Authority, we communicate with a number of stakeholders. For the purposes of this communication policy statement, we are considering our communications with the following audience groups:

- active members;
- deferred members;
- pensioner members;
- prospective members;
- the Environment Agency as an employing authority – Human Resources (HR) & Payroll;
- the Board and executive managers;
- Pensions Committee members;
- Recognised Trades Union representatives;
- Pensions staff in Finance & HR and at the Fund administrator;
- Professional advisers and Fund investment managers;
- Our sponsors - Department for Environment Food & Rural Affairs (Defra) & Welsh Assembly Government (WAG);
- Our auditors - National Audit Office (NAO), Deloitte and Audit & Risk Committee;
- The LGPS Scheme regulator - Department for Communities and Local Government (CLG);
- Pensions and investment Media;
- Other stakeholders/interested parties and external bodies.

How we communicate

General communication

We currently still use paper-based communication as one of our main means of communicating, for example, by sending letters to our scheme members. Over the next two years we plan to start substantially increasing our use of electronic means to communicate with our members and other stakeholders. In particular we will be developing our websites www.environment-agency.gov.uk/pensions and www.eapf.org.uk as well as our internal Easinet. We accept e-mail communication and respond electronically where possible.

Capita Hartshead provide a telephone help line and a dedicated email address for all Fund members. Both are widely publicised in Fund literature. Each member of their team is responsible for a specific group of our scheme members. Any telephone calls are passed to the relevant person within the team.

Branding

All Pension Funds literature and communications conform to the corporate branding of the Environment Agency.

Accessibility

In accordance with the Welsh Language Act 1993, we provide all publications for pension scheme members in Wales in bilingual versions.

We do not have a policy of automatically translating our material into community languages. We do want to communicate with minority communities, so the Environment Agency promotes plain English for our printed and online materials. We believe this is the most effective way to communicate with people for whom English is not their first language but we will arrange translation on request.

Performance measurement

So as to measure the success of our communications with active, deferred and pensioner members, we will use the following methods:

Timeliness

We will measure against the following target delivery timescales:

Communication	Audience	Statutory delivery period	Target delivery period
Scheme short guide	New joiners to the LGPS	Within two months of joining	Within two weeks of joining the LGPS
Annual estimated Benefit Statements as at 31 March	Active & deferred members	By 1 April the following year	31 July each year
Telephone calls	All	Not applicable	90% within 15 seconds
Issue of retirement benefits (at Normal retirement date)	Active members retiring	Within one month of retirement	On day of retirement - 90% of estimate if final details not known. Balance within 5 days of receipt of information
Issue of retirement benefits (early retirements)	Active members retiring	Within two months of retirement	On day of retirement - 90% of estimate if final details not known. Balance within 5 days of receipt of information
Issue of deferred benefits	Leavers	Within two months of withdrawal	Within two months
Transfers in	Joiners/active members	Within three months of request	Within two months
Transfers out	Leavers/ deferred members	Within three months of request	Within two months
Issue of forms i.e. expression of wish	Active/Deferred members	Not applicable	Within five working days
Changes to scheme rules	Active/deferred and pensioner members, as required	Within three months of the change coming into effect	Within three months of change coming into effect
Annual Pension Fund Report and Accounts	All	Within two months of request	Within five working days (once published)
Fundfare	Active members	Not applicable	30 September each year
Fundfare	Deferred & pensioner members	Not applicable	By 31 December each year
Pensioner payslips	Pensioners	On change to pension amount due	Monthly 5 days before pay date

Quality
We make use of Informal mechanisms to monitor the quality of our communications. All our publications and our web site include invitations for comment on content and offer suggestions for future editions and contact details are provided.

Comments received in the past have provided many useful suggestions that we have been able to incorporate in later publications.

Results
We will publish an overview of how we are performing within our annual report and accounts and in our annual Fundfare. Full details will be reported regularly to our Pensions Committee.

Review process

We will review our communication policy to ensure it meets audience needs and regulatory requirements at least every two years. A current version of the policy statement is always available via our website at www.environment-agency.gov.uk/pensions and paper copies are available on request.

Approved by the Pensions Committee on 23 June 2010 and reviewed annually.

Annex 4 – Funding strategy statement

This Statement has been prepared by the Environment Agency (the Administering Authority) in collaboration with the Fund's actuary, Douglas Anderson of Hymans Robertson LLP, after consultation with the employer, and its investment consultant, Nick Sykes of Mercer Human Resource Consulting. In accordance with Regulation 76A of the Local Government Pension Scheme Regulations 1997 (as amended), Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008 and the guidance paper issued in March 2004 by the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel this statement sets out the funding strategy for the Environment Agency Active Pension Fund (the "Fund").

1. Introduction

The Fund is part of the family of Local Government Pension Schemes (LGPS) and was established as the National Rivers Authority Pension Fund in 1989 at the time of the privatisation of the water industry in England and Wales. The Fund inherited active members' accrued liabilities from the predecessor pension arrangements, but no pensioners or deferred pensioner liabilities. In 1996 it transferred to the Environment Agency and became the Environment Agency Pension Fund. Since 1989, the Fund has been gradually maturing.

A separate Closed Fund, which is guaranteed by the Department for the Environment, Food and Rural Affairs, exists for pensioners and deferred pensioners that did not transfer to one of the privatised water companies' pension schemes in 1989. The Closed Fund has its own Funding Strategy Statement.

As at 31 March 2007, the Fund contained 11,743 active members, 3,110 pensioners and 3,761 deferred pension members whose benefits have yet to come into payment.

Unlike typical LGPS funds, the Fund only has a single participant employer – the Environment Agency.

Regulations 76A and 35 of the respective legislation referred to above provide the statutory framework from which the Administering Authority is required to prepare and review a Funding strategy statement ("FSS"). The key requirements for preparing the FSS can be summarised as follows:

- After consultation with all relevant interested parties involved with the Fund the Administering Authority will prepare and publish their funding strategy;

- In preparing the FSS, the Administering Authority must have regard to:-
  - the guidance issued by CIPFA for this purpose; and
  - the Statement of investment principles (SIP) for the Fund published under Regulation 9A of the Local Government Pension Scheme (Management and Investment of Funds) Regulations1998 (as amended);

- The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the Statement of investment principles.

The Fund is a defined benefit final salary scheme under which the benefits are specified in the governing legislation (the Regulations). "The Regulations" are defined as:

The Local Government Pension Scheme (Administration) Regulations 2008 (as amended);
The Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended);
The Local Government Pension Scheme (Transitional Provisions) Regulations 2008 (as amended); and
The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended).

Benefits payable under the Fund are guaranteed by statute and thereby the pensions promise is secure. The required levels of employee contributions are also specified in the Regulations.

The Environment Agency, as the employer, pays the balance of the cost of delivering the benefits to members. Contributions payable by the Environment Agency as the Employer are determined in accordance with the Regulations (principally Regulation 36) which require that the actuary completes an actuarial valuation, including a rates and adjustments certificate, every three years. Contributions to the Fund should be set so as to "secure its solvency", whilst the actuary must also have regard to the desirability of maintaining as nearly constant a rate of contribution as possible.

From the 2010 actuarial valuation onwards, variations in the cost of the scheme will be shared between the employer and employees.

The FSS focuses on the pace at which these liabilities are funded, whilst at the same time, facilitating scrutiny and accountability through improved transparency and disclosure. The actuary must have regard to the FSS in carrying out the valuation.

2. Purpose of the FSS in policy terms

Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the Environment Agency Pensions Committee as the Administering Authority, acting on the professional advice provided by the actuary.

The purpose of this Funding strategy statement is to:
- establish a clear and transparent fund-specific strategy which will identify how the Environment Agency's employer pension liabilities are best met going forward;
- support the regulatory requirement to maintain as nearly constant employer contribution rates for the Environment Agency as employer as possible; and
- take a prudent longer-term view of funding those liabilities.

These objectives are desirable individually, but not necessarily deliverable together.

In developing this strategy which is intended to be both cohesive and comprehensive, the Environment Agency Pensions Committee as the Administering Authority has focused on balancing the desirability of affordability of contributions, transparency of processes, stability of the employer’s contributions, and prudence in the funding basis.

3. Aims and purpose of the Pension Fund

The aims of the Fund are to:
- ensure that sufficient assets are available to meet all benefits as they fall due for payment;
- recover any shortfall in assets, relative to the value of accrued liabilities, over broadly the future working lifetime of current employees;
- enable the Environment Agency's, as the employer, contribution rate to be kept as nearly constant as possible and at reasonable cost to the Environment Agency;
- manage the Environment Agency's, as the employer, liabilities effectively; and
- maximise the returns from investments within reasonable risk parameters.

The purpose of the Fund is to:
- receive monies in respect of contributions, transfer values and investment income; and
- pay out monies in respect of Fund benefits, transfer values, costs, charges and expenses;

as defined in the Regulations.

4. Responsibilities of the key parties

These are as set out in the Regulations as amended from time to time.

The Environment Agency Pensions Committee as the Administering Authority should:
- collect employer and employee contributions;
- invest surplus monies in accordance with the Regulations;
- ensure that cash is available to meet liabilities as and when they fall due;
- exercise discretions within the regulatory framework;
- manage the valuation process in consultation with the actuary;
- prepare and maintain an FSS and a SIP, both after due consultation with interested parties; and
- monitor all aspects of the Fund’s performance and funding and amend the FSS/SIP as necessary.

The Environment Agency as the Employer should:
- deduct contributions from employees’ pay correctly;
- pay all contributions, including their own as determined by the actuary, promptly by the due date;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of Fund benefits, early retirement strain;
- notify the Administering Authority promptly of all changes to membership or, as may be proposed, which affect future funding; and
- exercise discretions within the regulatory framework.

The Fund actuary should:

- prepare valuations including the setting of the employer's contribution rates after agreeing assumptions with the Administering Authority and having regard to the FSS;
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters; and
- advise on funding strategy, the preparation of the FSS, and the interrelationship between the FSS and the SIP.

5. Solvency issues and target funding levels

To meet the requirements of the Regulations the Administering Authority's long-term funding objective is to achieve and maintain assets equal to 100% or more of the present value of projected accrued liabilities, assessed on an ongoing basis including allowance for projected final pay.

The key assumptions making up the funding strategy and as adopted for the 2007 actuarial valuation are:

	31 March 2007
Past Service (Current Yields Basis)	
Asset Valuation	£1,521m
Asset out-performance assumption (pre retirement)	1.6%
Asset out-performance assumption (post retirement)	1.6%
Discount rate (pre retirement)	6.1%
Discount rate (post retirement)	6.1%
Price Inflation	3.2%
Pension Increases	3.2%
Earnings Inflation	4.7%
Future Service (Current Yields Basis)	
Discount rate (pre retirement)	6.1%
Discount rate (post retirement)	6.1%
Price Inflation	3.2%
General Earnings Inflation	4.7%

Underlying these assumptions are the following two tenets:

- that the Fund and the Environment Agency are expected to continue for the foreseeable future; and
- favourable investment performance can play a valuable role in achieving adequate funding over the longer term.

The assumptions for 31 March 2007 incorporate an improvement to mortality figures, over those assumptions used in the 2004 actuarial valuation. The Actuary has allowed for future longevity improvements by projecting the standard PMA92/PFA92 mortality tables to calendar year 2017 for pensioners and 2033 for non pensioners.

The current actuarial valuation of the Fund is effective as at 31 March 2007. The results of the valuation indicate that overall the assets of the Fund represented 103% of projected accrued liabilities at the valuation date.

Derivation of employer contributions
The Environment Agency's contributions as the Employer are normally made up of two elements:

- the estimated cost of future benefits being accrued, referred to as the "*future service rate*"; plus
- an adjustment for the funding position (or "solvency") of accrued benefits relative to the Fund's solvency target, "past service adjustment". If there is a surplus there may be a contribution reduction; if a deficit a contribution addition, with the surplus or deficit spread over an appropriate period.

The Fund's actuary is required by the regulations to report the *Common Contribution Rate*, for the Environment Agency as the Employer at each triennial valuation. It combines both of the items above and is expressed as a percentage of pay.

Solvency and target funding levels
The Fund's actuary is required to report on the "solvency" of the whole Fund at least every three years.

'Solvency' is defined to be the ratio of the market value of assets to the value placed on accrued benefits on the Fund actuary's *ongoing funding basis*. This quantity is known as a funding level.

As at 31 March 2007, the funding level was 103% and at 31 March 2008 it was 86%.

The employer's future service rate will be based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year. Technically these rates will be derived using the *Projected Unit Method* of valuation with a one-year control period.

The funding method is described in the Actuary's report on the valuation.

If future experience is in line with assumptions, and the employer's membership profile remains stable, this rate should be broadly stable over time. If the average age of employees increases (e.g. because of lower recruitment) the rate would rise.

The future service rate includes expenses of administration to the extent that they are borne by the Fund and an allowance for benefits payable on death in service and ill health retirement.

The ongoing funding basis is that used for each triennial valuation and the Fund actuary agrees the financial and demographic assumptions to be used for each such valuation with the Administering Authority.

The key financial assumption is the anticipated return on the Fund's investments. The investment return assumption makes an allowance for anticipated returns from equities being in excess of bonds. There is, however, no guarantee that equities will out-perform bonds but historical data demonstrates that over the long-term returns from investing in equities tend to be greater than those from investing in bonds. When returns are measured over short periods such as the three years between formal actuarial valuations, actual returns and assumed returns can deviate sharply.

Given the very long-term nature of the liabilities, a long-term view of prospective returns from equities is taken. For the 2007 valuation, it is assumed that the Fund's assets will, over the long-term, deliver an average additional return of 1.6% a year in excess of the return available from investing in index-linked government bonds at the time of the valuation.

The price inflation/pension increase assumption is taken to be "break-even" inflation i.e. the level of future inflation that would give an investor in a conventional (non-inflation protected) gilt the same return as another who invested in an index-linked gilt.

The assumptions are described in the Actuary's report on the valuation.

Sensitivity to assumptions
The table below illustrates the effect on the value of the liabilities if each of the assumptions shown was to vary by +/- 0.5% per annum.

Financial assumption	Effect on value of liabilities of varying assumption by			
	+ 0.5% p.a.		-0.5% p.a.	
	Past Service Liabilities	Future Service Liabilities	Past Service Liabilities	Future Service Liabilities
Discount Rate	-9.5%	-11.0%	+9.5%	+11.0%
Price Inflation	+5.0%	+5.0%	-5.0%	-5.0%
Salary Growth	+4.0%	+6.0%	-4.0%	-6.0%

It should be noted that the figures above consider the change to each assumption in isolation i.e. a reduction of 0.5% to the discount rate will increase the past service liabilities by approximately 9.5%, assuming the inflation and salary growth assumptions remain unchanged.

With regard to demographic sensitivities:

- each extra 100 early leavers (i.e. employees who became deferred pensioners) over and above that assumed in the valuation (approximately 1,100 per year), would be expected to reduce the value of the accrued liabilities by between £0.5m and £1m, equivalent to 0.05% to 0.1% of the active liabilities;
- each additional year of life expectancy adds approximately 3% to the value of accrued liabilities. The reserving basis includes an allowance of approximately 4% (or £62m) for future longevity improvement;
- there is allowance for approximately 45 ill-health retirements each year, at a cost in the contribution rate of approximately 2-3% of pay; and
- non-ill health early retirements have a neutral effect on funding as there is either a reduction to the member's pension or an extra employer contribution.

Stability of employer contributions
Deficit recovery period
Recovery of any deficit in respect of accrued benefits will be spread over a period equivalent to the expected future remaining working lifetime of active members, around 13 years as at 31 March 2007.

This period is used in calculating the Environment Agency's, as the Employer, minimum contributions.

The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2008 for the 2007 valuation). The Environment Agency Pensions Committee as the Administering Authority expects the same period to be used at successive triennial valuations, but reserves the right to propose alternative spreading periods, for example to improve the stability of contributions.

In determining the deficit recovery period the Environment Agency Pensions Committee as the Administering Authority has had regard to:

- the responses made to the consultation with the Environment Agency's Directors of Finance and Human Resources acting for the Environment Agency as the Employer on the FSS principles;
- the need to balance a desire to attain the target as soon as possible against the short-term cash requirements which a shorter period would impose; and
- the Environment Agency's Pensions Committee's, as the Administering Authority, views on the strength of the Environment Agency's, as the Employer, covenant in achieving the objective.

Surplus spreading period
If the Fund is deemed to be in surplus, the Environment Agency Pensions Committee as the Administering Authority is permitted to reduce the Environment Agency's, as the Employer, contribution rate to below the cost of accruing benefits. This is achieved by spreading the surplus element over a period of not less than the remaining working lifetime of scheme members.

However, to help meet the stability requirement, the Environment Agency, as the Employer, may prefer not to take such reductions.

Phasing in of contribution rises
In order to provide some added stability for the Environment Agency's, as the Employer, contributions, the Environment Agency Pensions Committee as the Administering Authority has agreed that contribution rises may be phased over a period of up to 4 years.

Phasing in of contribution reductions
Any contribution reduction will be phased in over a period of not less than 6 years.

Funding For early retirement

Non ill health retirements
The actuary's funding basis makes no allowance for premature retirement except on grounds of ill health. The Environment Agency, as the Employer, is required to pay a lump sum contribution whenever an employee retires before attaining the age at which the valuation assumes that benefits are payable.
It is assumed that members' benefits on age retirement are payable from the earliest age that the employee could retire without incurring a reduction to their benefit and without requiring their employer's consent to retire.

The additional costs of premature retirement are calculated by reference to these ages. The Environment Agency, as the Employer, is required to meet all costs of early retirement strain caused by early retirements other than on the grounds of ill health by immediate capital payments into the Fund.

Ill health monitoring
The Fund monitors the Environment Agency's employees' ill health experience on an ongoing basis. If the cumulative number of ill health retirements in any financial year exceeds the allowance at the previous valuation, the Environment Agency, as the Employer, may, after the Environment Agency's Pensions Committee (the Administering Authority) has consulted with the actuary, be charged additional contributions on the same basis as apply for non ill-health cases.

6. Link to investment policy set out in the Statement of investment principles

Funding and investment strategies are inextricably linked.

In assessing the value of the Fund's liabilities in the valuation, allowance has been made for asset out-performance as described in Section 5, taking into account the investment strategy adopted by the Fund, as set out in the SIP.

It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is possible to construct a portfolio that closely matches the liabilities and represents the least risk investment position. Such a portfolio would consist of a mixture of long-term index-linked gilts.

Investment of the Fund's assets in line with the least risk portfolio would minimise fluctuations in the Fund's ongoing funding level between successive actuarial valuations.

If, at the valuation date, the Fund had been invested in this portfolio, then in carrying out the valuation it would not be appropriate to make any allowance for out-performance of the investments. On this basis of assessment, the assessed value of the Fund's liabilities at the 2007 valuation would have been significantly higher and the declared funding level would be correspondingly lower.

Departure from a least risk investment strategy, in particular to include equity investments, gives the prospect that out-performance by the assets will, over time, reduce the contribution requirements. The funding target might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

The Administering Authority has adopted a benchmark, which sets the proportion of the Fund's assets to be invested in key asset classes. This is set out in the SIP and shown below:

Asset class	Benchmark index	Holding	Actuary's best estimate long term return from asset class[2] (in excess of gilts) %pa
UK equities	FTSE All Share index	31.5%	3.0%
Overseas equities	FTSE World ex UK	31.5%	3.0%
Index-linked gilts	FTSE Index-Linked Gilts All Stocks	13.5%	-
Corporate bonds	iBoxx Sterling all non-gilt index	13.5%	0.5%
Private equity	Absolute Return	5.0%	3.0%
Property	IPD Monthly	5.0%	1.0%
Total		100.0%	2.2%

The Fund's benchmark includes significant allocations to equities and property in the pursuit of long-term returns higher than those from investing in just index-linked gilts. It is the Administering Authority's belief that this strategy will, in the long term result in a better-funded and more affordable scheme.
The Fund actuary's current *best estimate* of the long-term return from equities is around 3% a year in excess of the return available from investing in index-linked government bonds.

In order to reduce the volatility of employers' contributions, the funding policy currently anticipates returns of 1.6% a year, that is around 0.6% a year less than the *best estimate* return from the Fund's portfolio of assets (if no active manager out-performance is achieved).

In this way, the employer contributions anticipate returns from Fund assets which in the Fund actuary's opinion there is a better than 50:50 chance of delivering over the long-term (measured over periods in excess of 20 years). The Fund has set its investment managers performance targets so that the overall

[2] Excludes any allowance for active manager out-performance of market.

target return for the Fund is +0.9% per annum greater than the return on the strategic benchmark, after allowing for the active managers' fees. This target return is expected, in the medium to long-term, to result in a better-funded and more affordable scheme.

However, in the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of this target. The stability measures described in Section 5 will dampen down, but not remove, the effect on employer's contributions.

The Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

Balance between risk and reward
In setting the investment strategy, the Environment Agency's Pensions Committee, as the Administering Authority, considered the balance between risk and reward by altering the level of investment in potentially higher yielding, but more volatile, asset classes such as equities. This process was informed by the use of Asset-Liability techniques to model the range of potential future funding levels and the impact on future contribution rates.

Intervaluation monitoring of funding position
The Administering Authority monitors investment performance relative to the change in the value of liabilities by means of quarterly inter-valuation monitoring reports.

7. Identification of risks and counter-measures

The funding of defined benefits is by its nature uncertain. Funding of the Fund is based on both financial and demographic assumptions. These assumptions are specified in the actuarial valuation report. When actual experience is not in line with the assumptions adopted a surplus or shortfall will emerge at the next actuarial assessment and will require a subsequent contribution adjustment to bring the funding back into line with the target.

The Environment Agency's Pensions Committee, as the Administering Authority, has been advised by the actuary that the greatest risk to the Fund's funding is the investment risk inherent in the predominantly equity based strategy, so that actual asset out-performance between successive valuations could diverge significantly from the overall 1.6% per annum assumed in the long term.

The following key risks have been identified:

Financial

Risk	Summary of control mechanism
Fund assets fail to deliver returns in line with the anticipated returns underpinning the valuation of liabilities over the long-term	Only anticipate long-term returns on a relatively prudent basis to reduce risk of under-performing. Analyse progress at three yearly valuations Inter-valuation roll-forward of liabilities between formal valuations on a quarterly basis.
Inappropriate long-term investment strategy	Set Fund-specific benchmark, informed by Asset-Liability modelling.
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities	Inter-valuation monitoring, as above. Some investment in bonds helps to mitigate this risk.
Active investment manager under-performance relative to benchmark	Short term (quarterly) investment monitoring analyses market performance and managers relative to their index benchmark.
Pay and price inflation significantly more than anticipated	The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases. Inter-valuation monitoring, as above, gives early warning. Some investment in index-linked bonds also helps to mitigate this risk. Investment in other "real" assets (e.g. equities and property) also helps to mitigate risks
Effect of possible increase in employer's contribution rate on service delivery	Mitigate impact through deficit spreading and phasing in of contribution rises.

Demographic

Risk	Summary of control mechanism
Pensioners living longer.	Actuary quantifies potential scale of risk associated with continuing improvements in longevity. Fund actuary monitors combined experience of around 50 funds to look for early warnings of lower pension amounts ceasing than assumed in the triennial valuation.
Deteriorating patterns of early retirements	Employers are charged the extra capital cost of non ill health retirements following each individual decision. Employer ill health retirement experience is monitored.

Regulatory

Risk	Summary of control mechanism
Changes to regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees	The Administering Authority is alert to the potential creation of additional liabilities and administrative difficulties for employers and itself. It considers all consultation papers issued by the DCLG and comments where appropriate.
Changes to national pension requirements and/or HM Revenue & Customs rules e.g. effect of abolition of earnings cap for post 1989 entrants from April 2006	It considers all applicable HM Revenue & Customs regulations and pensions legislation.

Structural Changes in Employer

Risk	Summary of control mechanism
Administering Authority unaware of structural changes in the employer's membership (e.g. large fall in employee members, large number of retirements).	The Administering Authority monitors membership movements on a quarterly basis, via a report from the administrator at quarterly meetings. The Actuary may be instructed to consider revising the rates and Adjustments certificate to increase an employer's contributions (under Regulation 38) between triennial valuations

Governance

The Environment Agency as the administering authority for the Environment Agency Active Pension Fund has delegated responsibility and accountability for overseeing the Fund to the Pensions Committee.

The Pensions Committee is made up of sixteen Members - five Environment Agency Board members, five management members, five union nominated members and a pensioner member.

The Pensions Committee meets 3 times a year and has set up an Investment Sub Group which also meets 3 times a year to monitor investment performance and developments.

The Committee has delegated powers to the Director of Finance for the day to day running of the Fund.

8. Monitoring and review

The Environment Agency's Pensions Committee, as the Administering Authority, has taken advice from the actuary and its investment consultants in preparing this Statement, and has also consulted with the employer.

A full review of this Statement will occur no less frequently than every three years, to coincide with completion of a full actuarial valuation. Any review will take account of then current economic conditions and will also reflect any legislative changes.

The Environment Agency's Pensions Committee, as the Administering Authority, will monitor the progress of the funding strategy between full actuarial valuations. If considered appropriate, the funding strategy will be reviewed (other than as part of the triennial valuation process), for example:

- if there has been a significant change in market conditions, and/or deviation in the progress of the funding strategy;
- if there have been significant changes to the Fund membership, or LGPS benefits;
- if there have been changes to the circumstances of any of the Environment Agency, as the Employer, to such an extent that they impact on or warrant a change in the funding strategy; and
- if there have been any significant special contributions paid into the Fund.

Approved by the Pensions Committee on 25 June 2008 and will be fully reviewed in 2010.

Annex 5 – Statement of investment principles

Regulatory context

1. This Statement has been prepared by the Pensions Committee of the Environment Agency Board. It sets out the principles that govern our decisions about the investment of the assets of the Active Fund. We will refer to the statement when making investment decisions to ensure they are consistent with these principles. Our fiduciary obligations to Fund members will take precedence if there was ever a conflict of interest with the Environment Agency's business objectives.

2. This statement has been made under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 ("The LGPS Investment Regs") Section 12 that requires that the Environment Agency must (after consultation with such persons as it considers appropriate) prepare, maintain and publish a written statement of the principles governing its decisions about the investment of Fund money. The statement must also state the extent to which the administering authority complies with guidance given by the Secretary of State, and the associated guidance issued by CIPFA in December 2009, entitled *Investment Decision-making and Disclosure in the Local Government pension Scheme: A Guide to the Application of the Myners principles* This can be found in the section 'Compliance with Myners Principles' at the end of this document

3. This statement is required to cover the Environment Agency's policy on:
   - the types of investment to be held
   - the balance between different types of investment
   - risk, including the ways in which risks are to be measured and managed
   - the expected return on investments
   - the realisation of investments
   - the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments
   - the exercise of the rights (including voting rights) attaching to investments, if there is any such policy
   - stock lending
   - statement of compliance with the six new Myners Principles.

Strategic and policy context

4. This Statement outlines the basic framework for investing the assets of the Environment Agency Active Pension Fund. This statement was made and approved by the Environment Agency Pensions Committee on 23 June 2010, after taking advice from its investment staff, investment consultants, independent investment adviser, and consulting actuary.

5. The statement should be read and implemented in conjunction with the Active Fund Corporate Governance Policy and Environmental Overlay Strategy. These provide and state our more detailed requirements and supplementary guidance on these specific topics for our external fund managers. It is also supplemented by the contents of our investment management agreements for each investment mandate. Details of the investment and performance objectives for each mandate are published in our annual report and accounts.

6. The Environment Agency is also required by Local Government Pension Scheme (Administration) Regulations 2008 section 35 and Local Government Pension Scheme (Administration) Regulations 1997 section 76A to publish a separate Funding Strategy Statement for the Active Fund. This sets out the assumptions used by our Actuary in determining the funding level, and sets out a fund-specific strategy for the Fund which are reflected in the investment strategy adopted by the Environment Agency for the Active Fund.

Fund governance

7. The Pensions Committee Governance Policy Statement sets out how the Active Fund is governed and the role of the Investment Sub-Group and Environment Agency officers with respect to investment matters. The Investment Sub-Group consists of five representatives of the Pensions Committee and receives advice from professional investment staff employed by the Environment Agency, specialist investment consultants, an independent investment adviser, a consulting actuary, and other professional advisers as required.
8. The Investment Sub-Group has delegated responsibility to advise the Pensions Committee on investment strategy and manager structure, to recommend the appointment of fund managers, and to monitor and report on the performance fund managers to the Committee.

9. Once appointed, fund managers are responsible for the day to day management of the Fund's assets in accordance with their investment management agreement with the Environment Agency. The Environment Agency has appointed a performance measurer independent of the fund managers to calculate risk and return measures for each manager and the Fund overall. The Environment Agency has also appointed a global custodian who is responsible for the safe-keeping of the directly held assets of the Active Fund and who works in close liaison with each fund manager.

10. The Active Fund's actuary is responsible for performing a formal valuation of the Active Fund every three years in order to assess the extent to which the assets cover accrued liabilities in order to inform the development of an appropriate Funding Strategy Statement.

Investment objectives

11. Our investment objectives are to achieve a return on Active Fund assets which:

(i) is sufficient to meet funding strategy statement objectives arising from triennial actuarial valuations of the Fund,
(ii) in overall terms, seeks to out-perform a fixed Fund-specific benchmark,
(iii) contribute towards achieving and maintaining a future funding level of 100%,
(iv) is set at a level which does not force the managers to take unnecessary risks.

12. In addition the Environment Agency Active Fund seeks to use its influence as a large institutional investor to support and develop best practice in corporate environmental governance and sustainable environmentally responsible investment.

Choosing investments

Asset allocation

13. The Environment Agency is responsible for setting the strategic asset allocation of the Fund. It is set after considering the results of an asset and liability modeling exercise. In setting the strategic asset allocation the Environment Agency seeks a medium term rate of returns sufficient to meet the expected growth in the Fund's liabilities at an acceptable level of risk. This is considered to maximise the probability of maintaining as near as possible a constant rate of employer's contributions to the Fund as is required by the LGPS regulations.

14. The investment strategy of the Active Fund was reviewed in 2004 and the following strategic asset allocation was set in 2005 :

Asset Class	%
UK Equities	31.5
Overseas Equities	31.5
Index-Linked Gilts	13.5
Corporate Bonds	13.5
Private Equity	5.0
Property	5.0

The Fund has not made an allocation to Hedge Funds that are involved in short selling equities or bonds.

15. In 2005 the Environment Agency moved to a specialist manager structure for the management of the Fund's assets and has delegated the management of the Fund's investments to external fund managers. These managers have each been given a specific benchmark and performance target. They are required to comply with the investment provisions and limits prescribed by the LGPS Investment Regulations 2009

16. Subject to these statutory constraints and compliance with both this statement of investment principles and the terms of their Investment Management Agreements, all the managers have full discretion over the choice of individual stocks and are expected to maintain a diversified portfolio.

17. In 2006 the Environment Agency considered the impact of currency movements on the returns earned from holding stocks listed on overseas Stock Exchanges and priced in currencies other than Sterling. It was noted that the additional volatility incurred by investing in non-Sterling priced securities increases investment risk and consequently a currency hedging programme was introduced. At the same time it was noted that there was an opportunity to earn returns from active currency management and an active currency manager was appointed. The passive currency hedge

operated to hedge between 50% and 70% of overseas currency exposure of the Fund. In 2009 this was fixed at 60% overseas currency exposure of the Fund.

18. In 2008 the Environment Agency put in place a mechanism to rebalance the actual public equity and bond weightings (which move with market levels) on a regular basis back to the strategic asset allocation (section 14). This works using ranges around some of the elements of the strategic benchmark.

19. The Fund's strategic benchmark and manager performance targets and their achievement thereof are publicly disclosed within the Active Fund Annual Report and Financial Statements.

Types of investment to be held

20. The Fund may invest in any category of investment permitted by LGPS regulations. In selecting categories of investments to invest in the Environment Agency will, inter-alia, have regard to return potential, risk, liquidity, management costs and environmental impact.

The balance between different types of investment

21 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 impose limits on certain types of investments which are complied with by the Fund. These limits are set in Column 1 of Schedule 1 of these Regulations. There is a provision in Section 15 for a fund to change these limits to the higher limits in Column 2 of Schedule 1, if certain conditions are met.

22. The Pensions Committee has decided that the Pension Fund should hold a 5% weighting in property and 5% in private equity. In order to make full allowance of this strategic decision taken The Pensions Committee has therefore decided to move the investment limits to Column 2 of Schedule 1 where this impacts these investments. This change is to apply to the property and private equity portfolios for the period in which the Fund has a strategic weighting to those investment types as shown in the table below. The Committee has considered the increased amount of risk associated with this change, and does not consider it to be material

	Column 1 (from)	Column 2 (to)
All contributions to any single partnership	2%	5%
All contributions to partnerships	5%	15%

23. The Fund will at all times hold a widely diversified portfolio of investments to reduce risk. Each investment manager will hold a suitably diversified portfolio, and within each asset class the Fund as a whole will seek to have a well-diversified portfolio. The policy implied by the strategic asset allocation results in a significant weight being given to equities, which the Environment Agency acknowledges as appropriate, given the current liability profile and funding position of the Fund.

24. Around 40% of the Fund will be managed on an index-tracking (passive) basis to deliver market returns. The portfolio will be spread across equities (UK and overseas), and bonds (including index-linked gilts). The equity portions will contain a very large number of stocks spread over a wide cross section of markets that seek to replicate the make-up of the underlying market indices. In order to accommodate this passive holding some portfolios will be held on a segregated basis, and others within pooled. Currently our passive provider is Legal & General who offer pooled passive products through Legal & General Assurance (Pensions Management) Limited. This means that all the different passive pooled funds we hold with Legal & General are held under one Insurance Contract. The LGPS Investment Regs 2009 Column 1 Schedule 1 limits the value of any single insurance contract to 25%. In order to increase flexibility to manage the Fund, we may from time to time require to hold more then 25% under this Insurance contract. As a result the Pensions Committee has agreed to increase the limit from 25% to 35%, moving form Column1 Schedule 1 to Column2 Schedule 1and for this to apply for the duration of the Fund holding this Insurance Product.

25. The remaining 60%, of the Fund will be managed on an active basis to obtain higher returns with an average out-performance target of +1.5% pa. This portion of the Fund is spread across UK equities, overseas equities, corporate bonds, property, currency and private equity. Specialist managers have been appointed to manage portions of this allocation. Each investment manager has been given a specific benchmark, performance and risk targets that are regularly monitored.

26. Taken together the passive and active portfolios equate to a combined out-performance target of 0.9% pa for the whole Active Fund.

Risk

27. Investment by its very nature is a risk based activity and the returns achieved will to a considerable extent reflect the risks taken. There are a variety of risks to be considered ranging from the risks of loss associated arising from default by brokers, banks or custodians. The Fund is careful only to deal with reputable service providers to minimise counter-party risks.

28. Investment risk includes the absolute risk of reduction in the value of assets through negative returns. It cannot be entirely avoided (for instance if all major investment markets were to decline in unison) but it can be mitigated by ensuring that the assets of the Fund are invested across a number of different assets and markets. Diversifying assets across different asset classes is widely recognised as being an effective way of minimising the risk of reductions in the value of the Fund's assets.

29. Investment risk also includes the risk of under-performing the Fund's benchmark. This is a relative risk. Our investment managers can, to a large extent, control relative risk within the portfolio relative to the benchmark of the mandate by using statistical techniques to forecast how volatile their performance is likely to be relative to their benchmark. The Pensions Committee has set each external fund manager a mandate-specific benchmark and agreed suitable targets above that benchmark to control the amount of risk each manager can take. Furthermore, for many of the mandates this is reinforced by the fee structure payable to the Manager, aligning the Fund and Fund Managers risk / reward decision.

30. Different types of investment have different risk characteristics and return potential. Historically the returns from equities have been higher than from bonds but they are more volatile and risky. In setting the investment strategy the Environment Agency pays regard to the expected risks and returns from various asset classes and the correlation between these returns to target an expected return within an acceptable level of risk.

31. The Environment Agency also believes that other financially material risks including, but not limited to, corporate governance, climate change, pollution and other environmental issues, need to be considered and controlled. Our active Fund manager's are required to consider these sources of risk (and opportunity) when evaluating investments on our behalf.

32. The most fundamental risk is that the Fund's assets produce worse returns than those measured by the Actuary, who values the assets and liabilities every three years, and that the solvency of the Fund deteriorates. To guard against these principles the Environment Agency seeks to control risk but not to eliminate it.

33. Thus the adoption of a strategic asset allocation and the explicit monitoring of performance and risk relative to targets constrains the investment managers from deviating greatly from the intended approach, while permitting flexibility to manage the portfolio in such a way as to enhance returns. Further, the decision to appoint more than one investment manager achieves a satisfactory level of diversification of manager risk.

Realisation of investments

34. The majority of the Fund's investments will be made in stocks that are listed on recognised Stock Exchanges and may be realised quickly if required. Some investments notably in private equity and pooled property funds have limited liquidity. However, given the strong positive cash in-flows of the Fund the Environment Agency is satisfied that a sufficient proportion of the Fund is held in liquid assets to meet any expected or unexpected demands for cash.

35. Investments (except private equity that makes capital payments) will normally yield regular income that will either be re-invested in existing or new mandates. The decision whether or not to hold an asset class that is considered to be suitable will only be made on investment grounds taking into account the fiduciary responsibilities of the Fund

Expected return on investments

36. It is not possible to control the absolute return on investments but over the long-term the Fund seeks to achieve the returns required to achieve the objectives of its funding strategy statement. In the short term returns are measured against a Fund specific benchmark and the Actuary prepares quarterly intra-valuation updates on the Fund's Funding Level. Further details on the expected returns from investments and how they interact with the Actuary's formal triennial valuation of the Fund's assets and liabilities are included in the Funding Strategy Statement.

Social, environmental and ethical considerations

37. The Environment Agency Active Fund recognises the importance of the principles relating to responsible investment and robust corporate governance to help achieve its investment objectives.

38. The Environment Agency Active Fund will research, analyse and understand responsible investment, including best practice and the various tools and approaches available to ensure its approach to environmental, social and ethical issues remains in the best interest of Fund members. To this end it is a signatory of the UN Principles of Responsible Investment and the Carbon Disclosure Project. Whilst reserving the right to act independently if it so wishes the Fund will normally act through partnerships and alliances with other pension funds or organisations. This will includes the UK Social Investment Forum, Local Authority Pension Fund Forum and Institutional Investors Group on Climate Change, or through its fund managers' membership of other bodies concerned with improving corporate governance.

39. The Environment Agency will comply with its fiduciary duty to maximise investment returns of the Fund at an acceptable level of risk. In this context, the Environment Agency recognises that financially material environmental issues e.g. climate change can adversely impact on the Fund's financial risks and investment returns and thus should be taken into account in the investment strategy and process.

40. Accordingly the Environment Agency has adopted an Environmental Overlay Strategy (EOS) which requires each of the Fund's investment managers to assess and evaluate environmental risks and opportunities when meeting the senior management of investee companies and before selecting investments for the Fund.

41. The ability of managers to comply with the EOS is assessed as part of the appointment process. The environmental assessment criteria includes the relative quality, integration, and impact of environmental research and information used in external managers' investment management and performance reporting processes, and also the amount of resource they have available to do this.

42. Each fund manager is required to submit a regular quarterly compliance report to the Environment Agency, to outline any environmental considerations or analysis that have arisen, and to explain any environmentally controversial investments, as well as any engagement and voting on environmental issues it has conducted with investee companies. Each equity manager is also required to assist the Environment Agency in assessing the environmental footprint of the Fund.

43. The Environment Agency also seeks to take advantage of environmental investment opportunities as they arise, subject to their offering acceptable levels of return/risk. To that end it has appointed one manager to manage an environmentally focused mandate investing in global equities and allocated a proportion of its mandates in venture capital and property to environmental opportunities.

44. Our fund managers are also expected to assess the impact of any financially material social and ethical issues in relation to future prospects of investee companies, and to take this into account in their decision-making processes. When appropriate, such issues should also be addressed in the managers' regular contact and engagement with the senior executives of companies in which the Fund's assets are invested.

Exercise of rights

45. Our external fund managers can generally vote all the Active Fund's shares at their discretion, however in our investment management agreements we reserve the right to do this ourselves if we want to do so. Before appointment our fund managers have to confirm that they subscribe to the principles of good corporate governance and, when voting at company AGMs, take them into account. They are also encouraged to follow the Association of British Insurers disclosure guidelines on Socially Responsible Investment. All managers are requested to vote all the Fund's shares and quarterly monitoring reports are provided by our global custodian Northern Trust.

46. When specific environmental resolutions are proposed at company AGM our fund managers are required, wherever possible, to refer such resolutions to the Environment Agency who will direct the investment manager how to vote the Fund's shares on that resolution. The Environment Agency's policy is to be generally supportive of resolutions calling for greater disclosures of a company's environmental performance or for improvements in environmental practice. Each resolution is considered on its own validity and merits, and due regard is paid to any possible adverse affect on investment performance that our voting may have.

Stock lending

47. The Fund does not support or directly engage in stock lending although some pooled funds in which the Fund invests may have a different policy.

Compliance with Myners principles

48. **Statement of compliance with the Myners principles**

In 2000 the UK Government commissioned a review of institutional investment in the UK. The review, undertaken by Lord Myners, set out ten principles codifying a model of best practice in pension fund governance, investment decision making and disclosure. In 2008 the Government published a revised set of six principles against which we have compared ourselves and provided a summary below. Further details and evidence is contained with the documents referenced in our Annual Report and Accounts and on our internet sites: www.environment-agency.co.uk/pensions and www.eapf.org.uk.

<table>
<tr><th>Myners Principle</th><th>Evidence of compliance and justifications for non-compliance</th></tr>
<tr><td colspan="2">Principle 1: Effective decision making</td></tr>
<tr><td>Administering authorities should ensure that;
• Decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation and
• Those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.</td><td>Our Fund fully follows this principle
• Our Financial Memorandum, the Pensions Committee Terms of Reference, Standing Orders and Scheme of Delegation, clearly set out the governance structure and levels of responsibility of the Committee, Sub-Groups, officers and external suppliers. Our statutory governance Compliance Statement (Annex 2) provides further detail.
• All the above documents and other supporting material are contained in a Pensions Committee handbook which is updated annually.
• The Pensions Committee retains overall responsibilities for Fund and investment strategy.
• The Pension Committee appoints a number of professional external advisers for investment, legal advice, actuarial services, and fund management. These are detailed in our Annual Report and Accounts. A report on their performance is presented to the Pensions Committee and the Board annually.
• The Pensions Committee has a training strategy which is reviewed annually. Conflicts of interest are identified and records maintained and form part of an annual audit. A record of meeting attendance and training is published in our Annual Report and Accounts
• Managers are appointed to invest funds following a comprehensive due diligence process and with input from independent investment advisers.</td></tr>
<tr><td colspan="2">Principle 2: Clear Objectives</td></tr>
<tr><td>• An overall investment objective(s) should be set for the Fund taking account of the scheme's liabilities, the potential impact on local tax payer, the strength of the covenant for non-local authority employer, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisers and investment managers.</td><td>Our Fund fully follows this principle
• In setting the investment objective(s), the Pensions Committee, as the Administering Authority, addresses the balance between risk and reward by altering the level of investment in potentially higher yielding, but more volatile, asset classes such as equities. This process is informed by actuarial and investment advice and the use of asset-liability modeling techniques to model the range of potential future funding levels and the impact on future contribution rates (reference Funding Strategy Statement (Annex 4) and Statement of Investment Principles, detailed above.</td></tr>
<tr><td colspan="2">Principle 3: Risk and liabilities</td></tr>
<tr><td>• In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.
• These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.</td><td>Our Fund fully follows this principle
• In setting the investment strategy, the Pensions Committee, as the Administering Authority, is informed by actuarial and investment advice and asset-liability modeling with inter-valuation monitoring, providing an early warning to the Committee. A summary of the assumptions is detailed in the statement of the Consulting Actuary page 28 and risks in the Funding Strategy Statement page 57.</td></tr>
</table>

<table>
<tr><th colspan="2">Principle 4: Performance assessment</th></tr>
<tr><td>Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisers.
Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision-making body and report on this to scheme members.</td><td>Our Fund fully follows this principle
The Environment Agency has delegated responsibility and accountability for overseeing the Fund to the Pensions Committee.
The Pensions Committee meets 4 times a year and has set up an Investment Sub Group which also meets at least 4 times a year to monitor investment performance and developments.
These bodies and officers monitor investment performance relative to benchmarks and the change in the value of liabilities by means of quarterly inter-valuation monitoring reports.
The Pension Committee reviews its effectiveness at each meeting and periodically the outcomes are reported to the Board of the Environment Agency.</td></tr>
<tr><th colspan="2">Principle 5: Responsible ownership</th></tr>
<tr><td>Administering authorities should:
Adopt, or ensure their investment manager adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents
Include a statement of their policy on responsible ownership in the statement of investment principle.</td><td>Our Fund fully follows this principle
We have adopted the Institutional Shareholders' Committee and Association of British Insurers standards in respect of best practice in corporate governance. We expect our new fund managers and/or an engagement and voting overlay service to follow these standards, subject to our specific instructions, failure to do so could be a breach of the Investment Management Agreement.
In addition to including responsible ownership in our Statement of Investment Principles above, we have separate, published policies covering Corporate Governance (Annex 6) and our Environmental Overlay Strategy (Annex 7). We are a signatory of the UNPRI.</td></tr>
<tr><th colspan="2">Principle 6:Transparency and reporting</th></tr>
<tr><td>Administering authorities should:
Act in a transparent manner, communicate with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives
Provide regular communications to scheme members in the form they consider most appropriate.</td><td>Our Fund fully follows this principle
Our Annual Report and Accounts details all the material issues relating to the Fund, its investments and administration. It is publicly available in hard copy and via our websites.
Fundfare is our annual publication to members, which includes financial information about the Fund and its investments. Two editions are published - one covering the Active Fund and one for the Closed Fund.
Our Communications Policy Statement (Annex 3) details the stakeholders we have identified. It also details the communication channels and delivery targets for member communications.</td></tr>
</table>

Approved by the Pensions Committee on 23 June 2010

Annex 6 – Corporate governance strategy

Introduction
We believe there is a considerable body of evidence that well governed companies produce better and more sustainable returns than poorly governed companies. We also think investors, including pension fund managers and shareholders, could influence the Board/Directors of under-performing companies to improve the management and financial performance of those companies.

Our strategy and approach is driven by our fiduciary duty to deliver financial returns on our investments. We do not undertake negative screening. We invest in index funds holding shares in most companies, in most stock markets. We therefore distinguish ourselves to be a responsible investor, by being an active owner.

The Environment Agency Pension Fund believes in shareholder activism and being an active owner directly, through our managers and dedicated governance overlay providers. The funds subscribes to the Myners' principles of best practice in investment management.

We focus our attention on the quality of corporate governance (and especially corporate environmental governance) of UK, US, EU, Far East stocks in that order, linked to the relative size of our holdings

We delegate much of the day to day corporate governance activities to our managers and overlay service provider. The capability and performance of our manager in this area is a key component of our selection and retention criteria. Once appointed, we monitor activity and success of our managers and overlay service provider on a quarterly basis.

Engagement
We focus our engagement efforts on corporate environmental governance, Corporate Social Responsibility "CSR", and sustainability issues and their associated resolutions at company meetings and other engagement opportunities.

We work in partnership with other like minded investors, fund managers, bodies, and service providers with similar objectives, to influence the business and investment world on these and other issues.

We delegate the large volume of non-environmental corporate research, engagement, and voting to our fund managers or a third party/parties and monitor, assess and externally report on this activity.

In partnership with our fund managers we set out engagement priorities, including collaborative engagements, for the forthcoming year.

Voting
We aim to vote the Fund's shares in all markets were practicable. Our fund managers vote at their discretion and must confirm that they subscribe to the principles of good corporate governance and, when exercising their vote, take this into account.

We have adopted the Institutional Shareholders' Committee and the National Association of Pension Fund Corporate Governance Policy and Voting Guidelines. In respect of investments in the United Kingdom, we require our managers to have due regard to the UK Corporate Governance Code and in respect of overseas investments have due regard to relevant recognised standards.

Regular contact, at senior executive level, with companies, in which the Fund's assets are invested, is an important element of both the investment process and good corporate governance and we require our managers to report, quarterly, on their engagement and the outcomes achieved.

Our fund managers refer "environmental" resolutions to us for advice on voting policy on these areas. We also published our voting record for all environmental resolutions.

All managers are presently requested to vote the Fund's shares and quarterly monitoring reports are provided by our global custodian Northern Trust.

Monitoring
We monitor our fund manager's adoption of our corporate governance policies and requested they comply with it and inform us of any future environmental resolutions.

We also meet with our global custodian Northern Trust and their contractor the Institutional Shareholder Service (ISS), through whom our fund managers vote our shares at company AGM's. We also have electronic access to their VOTEX system, through which we can monitor fund managers voting actions.

Disclosure
We believe disclosure underpins good corporate and environmental governance.

We promote the Environment Agency's Active Pension Fund approach and voting actions on environmental corporate governance, sustainability, CSR, and environmental issues.

Working in partnerships
The Environment Agency liaises with bodies with similar activism goals including the UK Sustainable Investment and Finance Association (UKSIF), Institutional Investors Group on Climate Change (IIGCC), and Carbon Disclosure Project (CDP).

The Environment Agency continues to work with the Local Authority Pension Fund Forum (LAPFF) to encourage FTSE 100 companies to report on their environmental performance. We will also publish reports on the environmental disclosure of FTSE all-share companies.

The Environment Agency monitors the California Public Employees Retirement System (CALPERS) which is the largest pension fund in the world and the French Pensions Reserve (FRR) who are also implementing environmental investment strategies.

We expect all our fund managers and engagement and voting overlay service to follow our strategies and policies subject to any Environment Agency specific instructions which should be followed in full, failure to do so could be a breach of the Investment Management Agreement.

Approved by the Pensions Committee on 23 June 2010 and will be reviewed as part of an investment strategy review.

Annex 7 – Environmental overlay strategy

Vision
The Environment Agency ("the Agency" / "We") will seek to ensure that its future strategy and policies for the investment and management of pension fund assets are financially robust and environmentally credible, and where feasible, through their implementation, will seek to contribute to creating a "greener" business world.

Aim
To be one of the leading public sector pension funds in respect of the implementation of financially robust and environmentally responsible investment policies.

Legal compliance
We will seek to comply fully with the regulatory requirement(1) to include in the statement of investment principles (SIP) details of our policies on social, ethical, environmental (SEE) issues in respect of the selection, retention, realisation of investments and exercise of voting rights.

We will regularly update and develop new polices in light of any future changes to company law, pensions law, and codes of best practice in respect of corporate governance and environmental management.

Fiduciary duty
We will fulfill and comply with our fiduciary duty to maximise risk-adjusted investment returns in the best long term interested of pension fund members. As a result of which we affirm that we will assess and take account of existing and future financial risks (e.g. climate change and cost of pollution clean ups and opportunities from environmental issues on clean ups), and financial opportunities from the exploitation of green technology and services.

Capability
We will seek to ensure our pension fund management team possesses high-quality knowledge, skills, and experience in respect of financially and environmentally responsible investment, and has access to external research, expertise, and training to maintain and develop this capability.

Statement of investment principles
When preparing and maintaining the SIP, we will be mindful of our overall corporate strategy (e.g. "greening" business) and corporate environmental governance policies (e.g. encouraging company environmental reporting and disclosure of environmental risks and performance). A revised SIP will be developed with the benefit of research into best practice in respect of

1. the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009; and
2. environmental issues from other pension funds, and will be reviewed and published annually by the Pensions Committee.

Investment strategy
Our investment strategy will seek to take account of the relationship between good environmental management and long-term sustainable business profitability.

We will seek to overlay this environmental strategy across our investment portfolio. We recognise that when the strategy is applied to investments in equities, bonds, gilts, property and private equity, this will involve considering different approaches, constraints, risks, opportunities and potential benefits.

Our main influence will be through our strategic asset allocation, manager structure, manager selection, performance benchmarks, monitoring, and reporting – and not by getting involved in the day-to-day investment decisions, which is the role of our fund managers.

We will encourage our fund managers to use research on various environmental risk and/or "green" performance rating/ranking tools to identify and avoid financial risks attributable to environmental issues, such as climate change, that could impact negatively on investment returns.

We will, through monitoring their performance, ask our fund managers to explain and justify financially any investment decisions, for example on stock selection, which in our view are environmentally controversial. We will favour investing on a positive "best in class" selection basis, and encourage the use of engagement rather than negative screening.

Asset allocation
We will periodically review our asset allocation strategy between different investments. We will investigate and evaluate financially the risks/opportunities and performance/potential returns from investing more assets in various types of “green”/SRI funds, taking into account their financial performance relative to other funds.

Based on financial returns we have incrementally increased our allocation to funds and/or fund managers that integrate sustainable responsible investment into their investment decision making. The details of our investments, the benchmarks and targets are all disclosed in our Pension Fund Annual Report.

We will also examine various types of private equity funds including sustainability funds, environmental funds, low carbon funds, green energy funds, green technology funds, green property funds, and sustainable forestry funds. After researching and evaluating the financial/environmental pros and cons of these funds through normal due diligence processes, we will invest a proportion of our assets in these fund types in order both to stimulate such “green” investment styles and to share the returns.

Fund manager selection
When selecting the Fund’s investment advisers and appointing external fund managers, we will use our standard procurement process. This includes environmental assessment tools and criteria, as well as financial performance criteria and value for money.

The environmental criteria include the relative quality, integration and impact of environmental research; the information used in external managers’ investment management and performance reporting processes; and the amount of resource that external managers have available for this work.

We are committed to responsible investment and are striving for all our fund managers and investment service providers to be cosignatories of the United Nations Principles for Responsible Investment.

Investment management agreements
We engage managers using our own model investment management agreement. This has been drafted to meet industry standards of best practice, and will ensure the use of consistent terms and conditions, fund valuation methods, manager fee calculation and payment mechanisms in respect of the various investment mandates. It also includes our corporate governance/environmental policies and disclosure and reporting requirements. External fund managers agree to comply with such requirements as a condition of their appointment.

Performance benchmarks
We will measure our fund managers’ investment performance using either industry standard indices/benchmarks or “customised” versions to track/monitor performance targets. Where appropriate we may separately monitor other indices, such as FTSE4Good Index, Dow Jones SD Index or Domino Social Index. We may also use specially constructed versions of these indices to assess our own and various other investment styles. Some assets (such as property and private equity) will need their own “specialised” benchmarks.

Investment management processes
We will inform our asset managers (and those who provide their company research information) about our own environmental data, be it publicly available or obtainable from us, which is potentially financially significant (e.g. on climate change). Such information could relate to environmental risks (e.g. our operator performance risk assessment scores), emissions (e.g. our Pollution Inventory) and performance (e.g. our Spotlight publication). Our aim is to help inform, but not interfere with, independent investment management processes. We affirm that the purpose of all such information exchange with managers is to help deliver sustainable high financial returns on our investments.

Shareholder activism, engagement and voting
We will aim to comply with the Myners activism principle and to become more engaged as an active investor, especially with companies whose environmental behaviour and performance are currently impacting negatively on short or long-term investment returns – or could do so in the future. We will normally do this through partnership and alliances with other pension fund groups (e.g. UKSIF, IIGCC, LAPFF) to increase the impact of our policies. However, we reserve the right to act independently where necessary.

We will encourage our asset managers (or an engagement or voting overlay service provider) to actively engage with the top management of those companies they invest in. This is to help improve the companies’ performance in both financial and environmental terms. We will also encourage voting on key resolutions concerned with corporate governance and environmental issues.

We will provide our asset managers (or an engagement and voting overlay service provider) with details of our corporate governance, environmental policies and preferred voting stances, for example, in respect of companies that do not report on their green house gas emissions and environmental performance in their annual reports and accounts.

Performance monitoring and reporting
We will assess the compliance of both the investment processes and the decisions of external fund managers with our SIP policy statements and IMA requirements. This will be part of regular review meetings to discuss quarterly fund management performance and company engagement and voting reports.

We will receive an annual report on fund managers' compliance with the SIP's "green" policies. We will also report on our own environmentally related activities. These reports will be summarised in the Pension Fund Annual Report.

Performance benchmarking and assessment
We will periodically benchmark the environmental investment performance of our fund managers, and also this environmental investment strategy, against other public sector and private pension funds. We will take action as required to improve both their relative performance and this strategy.

Research and development
Resources permitting, we will undertake some SRI research in-house and/or support joint studies with other pension funds and organisations that have interests in environmental or sustainable investment. We will do this to inform our own policies.

Collaboration
We will join and/or collaborate with other organisations with environmental goals. Such organisations include the UNPRI, UK Social Investment Forum (UKSIF), Carbon Disclosure Project (CDP), Local Authority Pension Fund Forum (LAPFF) campaign on environmental reporting, and Institutional Investors Group on Climate Change (IIGCC).

Communication and disclosure
We will communicate our approach to sustainable environmentally responsible pension fund management, and report on the "green" performance of our pension fund.

We will do this on our intranet (Easinet), our web site pages (www.environment-agency.gov.uk) and in publications such as the Pension Fund Annual Report and Fundfare, a members' booklet. Users of this information will include staff, pensioners, and other pension funds and policy makers in Government.

Continuous improvement
We will ensure our Pensions Committee is regularly advised and updated on external developments and on our own performance in this area. We will keep our policies and approach under continual review so as to improve their efficacy.

Approved by the Pensions Committee on 23 June 2010 and will be reviewed as part of an investment strategy review.

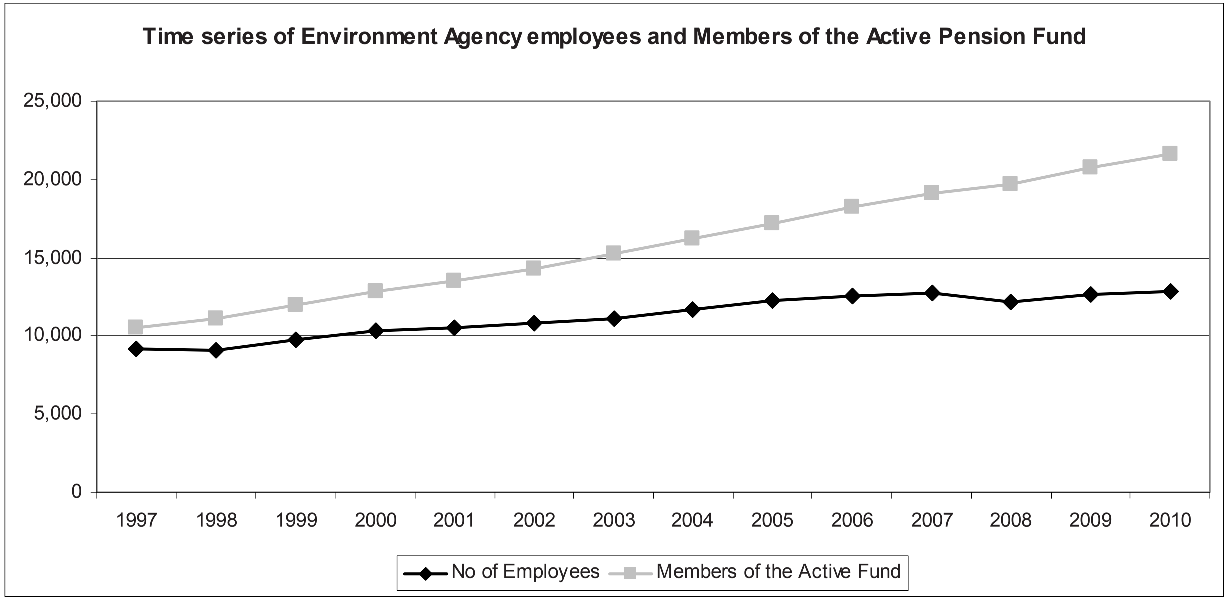
Additional information

Statistical summary of Fund membership and value

Fund membership	31.3.96	31.3.97	31.3.98	31.3.99	31.3.00	31.3.01	31.3.02	31.3.03	31.3.04	31.3.05	31.3.06	31.3.07	31.3.08	31.3.09	31.3.10
Members	6,740	8,346	8,670	9,142	9,692	9,936	10,264	10,494	11,031	11,615	11,844	11,926	11,348	11,741	11,990
Deferred members	1,248	752	921	1,130	1,291	1,548	1,834	2,426	2,668	2,801	3,521	4,050	4,839	5,244	5,518
Pensioners	652	1,384	1,548	1,710	1,865	1,999	2,157	2,310	2,501	2,721	2,913	3,114	3,496	3,816	4,087
Total	**8,640**	**10,482**	**11,139**	**11,982**	**12,848**	**13,483**	**14,255**	**15,230**	**16,200**	**17,137**	**18,278**	**19,090**	**19,683**	**20,801**	**21,595**

Employer Contributions to the Fund

Year	% of pay
1996/97	6.9
1997/98	6.9
1998/99	6.9
1999/00	8.4
2000/01	8.4
2001/02	8.4
2002/03	9.3
2003/04	10.2
2004/05	11.1
2005/06	12.0
2006/07	13.5
2007/08	15.0
2008/09	15.5
2009/10	16.0
2010/11	16.5



Financial summary	31.3.96 £m	31.3.97 £m	31.3.98 £m	31.3.99 £m	31.3.00 £m	31.3.01 £m	31.3.02 £m	31.3.03 £m	31.3.04 £m	31.3.05 £m	31.3.06 £m	31.3.07 £m	31.3.08 £m	31.3.09 £m	31.3.10 £m
Contributions, transfer values received and investment income less investment expenses	36	46	92	47	59	58	54	62	68	78	79	88	101	108	149
Benefits and other payments	(13)	(12)	(14)	(16)	(20)	(22)	(23)	(26)	(29)	(28)	(36)	(37)	(51)	(51)	(57)
Excess	23	34	78	31	39	36	31	36	39	50	43	51	50	57	92
Change in market value of investments	87	34	124	39	113	(105)	(34)	(254)	171	83	235	78	(80)	(421)	371
Net increase/ (decrease) in Fund value	110	68	202	70	152	(69)	(3)	(218)	210	133	278	129	(30)	(364)	463
Market value of Fund	**574**	**642**	**844**	**914**	**1,066**	**997**	**994**	**776**	**986**	**1,119**	**1,397**	**1,526**	**1,496**	**1,132**	**1,595**

Any enquiries regarding this Report should be addressed to:

Mr H. Pearce
Head of Environmental Finance and
Pension Fund Management
Environment Agency
Rio House
Waterside Drive
Aztec West
Almondsbury
BRISTOL
BS32 4UD

Tel: 01454 62 4332
Email: pensions.team@environment-agency.gov.uk

Enquiries concerning the Environment Agency Pension Scheme or entitlement to benefits should be addressed to:

Environment Agency Pensions Team
Capita Hartshead
2 Cutlers Gate
SHEFFIELD
S4 7TL

Tel: 0114 273 7331
Fax: 0114 273 0299
Email: info@eapf.org.uk

This Annual Report and Financial Statements is also available on the Environment Agency's websites:

www.eapf.org.uk
www.environment-agency.gov.uk/pensions
www.environment-agency.wales.gov.uk/pensions

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