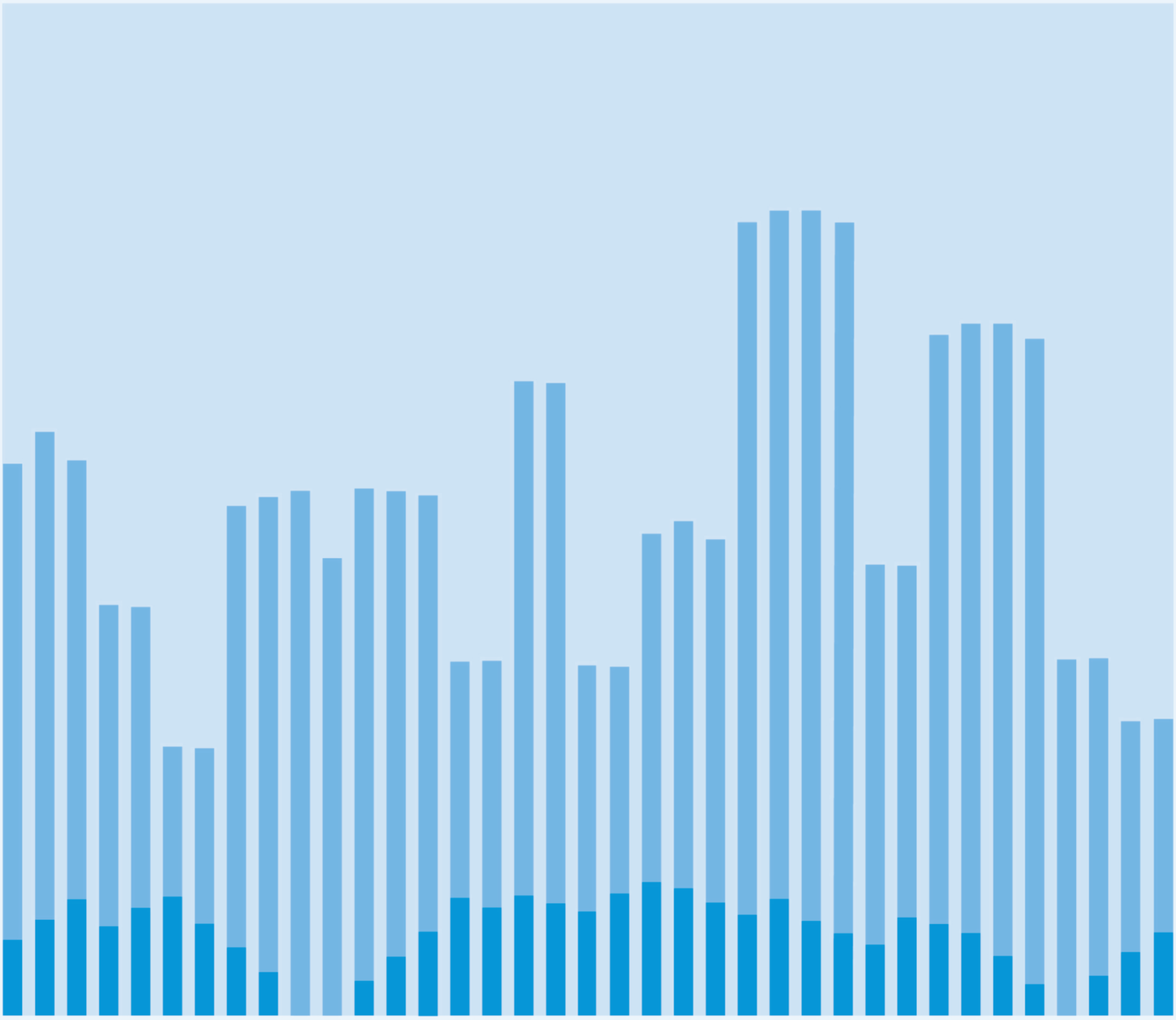
Environment Agency

Active Pension Fund
Annual Report and Financial Statements 2010 - 2011



Environment Agency Active Pension Fund
Annual Report and Financial Statements 2010 - 2011

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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 2011.

The financial statements have been prepared using the Statement of Recommended Practice for pension funds issued by the Pensions Research Accountants Group, 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.

Over the last year, total membership of the Active Fund increased by 10 to 21,605 members. This small increase was due to low levels of employee recruitment and an increase in early retirements arising from a voluntary early release scheme, resulting in more deferred members and pensioners. The membership comprises 10,954 employees, 6,130 deferred members and 4,521 pensioners. Over 93% of eligible Environment Agency employees continue to contribute to the Fund.

The formal triennial valuation of the Active Fund at 31 March 2010 was completed during the year. The funding level on 31 March 2010 was 94%, which is one of the highest in the Local Government Pension Scheme (LGPS). It is, however, a decrease of 9% from the 2007 valuation which reflected a funding level of 103%. This reduction is due to the adverse market conditions which the Fund investment portfolio has had to contend with including the global financial crisis in 2008/09.

Our estimated funding level as at 31 March 2011 was 96%, an increase of 2% from 2010. Following good market performance over the year, the market value of our net assets has increased by 10.7% from £1,595m at 31 March 2010 to £1,765m at 31 March 2011. The investment performance of the fund against its strategic benchmark was -0.7%.

Based on the results of the 2010 valuation, our actuary recommended the employer's contribution rate, from 1 April 2011, remain at an equivalent rate of 16.5% of pay each year to help meet the Active Fund's future liabilities. This has been formally agreed between the Pensions Committee and the Environment Agency and will continue until 2014. It will then be reviewed following the results of the 31 March 2013 valuation.

Lord Hutton's Independent Public Service Pension Commission (IPSPC) published its final report in March 2011. The Pensions Committee has been keeping an active watch on, and engaging with, his review over the past year and we submitted our views to him. The report makes a number of recommendations and we understand that in the autumn the Government will issue proposals for consultation on how intends to implement them. The Committee has also made representations to Government over a proposal to increase employee contributions by 3% from 2012 and how this would lead to increased opt outs and less people making financial provision for their retirement, which would ultimately put additional pressure on state benefits and the tax-payer.

The Pensions Committee understands the concern that members have about potential changes to the LGPS and we will keep fund members informed of future developments via newsletters.

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 by a professional award. The Fund has continued to support the work of the United Nations Principles of Responsible Investment (UNPRI) and I am delighted to report that all of our asset managers and principal investment and actuarial advisers are all co-signatories. We partnered Mercer, our investment advisers, in a global research project which considered the implications of climate change scenarios on strategic asset allocation (SAA). It has been hailed as pioneering and a significant step forward in helping pension funds to integrate climate change into their investment strategies, in order to reduce risk and maximise investment opportunities.

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
07 July 2011

Membership of the Pensions Committee and its advisers for the year ended 31 March 2011

Pensions Committee membership

	Date of appointment	Length of service	End of current appointment	Residual period of current appointment
Board members				
Larry Whitty (Chair)	18/09/06	4 yr 6 mth	17/09/12	1 yr 6 mth
Suzanne Warner	18/09/06	4 yr 6 mth	17/09/12	1 yr 6 mth
Robert Light	07/07/09	1 yr 9 mth	30/06/12	1 yr 3 mth
John Varley	01/11/09	1 yr 5 mth	30/09/12	1 yr 6 mth
Executive members				
Mark McLaughlin	01/11/09	1 yr 5 mth	n/a	n/a
Graham Ledward	03/01/06	5 yr 3 mth	n/a	n/a
Howard Pearce	12/02/03	8 yr 2 mth	n/a	n/a
Kevin Ingram	07/07/09	1 yr 9 mth	06/07/12	1 yr 3 mth
Active member nominees				
Jackie Hamer	01/04/08	3 yr 0 mth	31/03/14	3 yr 0 mth
Huw Williams	06/07/10	0 yr 8 mth	05/07/13	2 yr 4 mth
Stuart Martin	17/11/09	1 yr 5 mth	16/11/12	1 yr 7 mth
Phil Chappell	17/05/06	4 yr 10 mth	16/05/12	1 yr 2 mth
Aileen Parry	12/02/03	8 yr 2 mth	30/04/11	0 yr 1 mth
Pensioner member				
Brian Engel	22/05/05	5 yr 10 mth	22/05/13	2 yr 2 mth
Deferred member				
John Kerr	09/02/10	1 yr 2 mth	08/02/13	1 yr 10 mth
Chief Executive - ex officio attendee				
Paul Leinster	01/06/08	2 yr 10 mth	n/a	n/a

Professional advisers

External Auditor	Comptroller and Auditor General
Bankers	National Westminster Bank plc and Cater Allen Private Bank Ltd
Custodian	The Northern Trust Company
Pensions Administrator	Capita Hartshead Limited
Legal Adviser	Osborne Clarke (Mark Womersley)
Actuarial Adviser	Hymans Robertson (Douglas Anderson and Richard Warden)
Investment Adviser	Mercer Investment Consulting (Nick Sykes)
Independent Investment Adviser	Investment Trustee and Adviser Services Ltd. (Carolan Dobson)
Fund Manager Selection Adviser	bFinance Ltd. (Sam Gervaise-Jones)
Sustainable Responsible Investment Adviser	Rathbone Greenbank (Mark Mansley)

Report by the Pensions Committee

Governance

Chairman and members
There were no changes in Board appointed members during the year and Larry Whitty continued as Chairman of the Pensions Committee. However, John Varley became Chairman of the Investment Sub-Group and Robert Light became Chairman of the Benefits Sub-Group both with effect from November 2010. There were also no changes in executive members during the year.

Following the retirement of active member Alan Broughall on 31 March 2010, Huw Williams has been appointed as an active member for an initial three-year term until July 2013. Jackie Hamer has been re-appointed as an active member for a further three-year term until March 2014.

Committee governance
During the past year the Pensions Committee met on four occasions to fulfil its responsibilities as a sub-committee of the Environment Agency Board. There was also a training session to discuss the results of the initial report by the Independent Public Service Pensions Commission ("Hutton Report"). 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 four occasions. The Committee's Benefits Sub-Group met on three occasions.

In December 2008 the Government issued statutory guidance on the preparation of Governance Compliance Statements. 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.

Pensions Committee members must declare any conflicts of interest prior to each quarterly meeting. These are recorded and held on the register of interest by our Secretariat. The Chairman reviews the register annually and a further review is undertaken by Internal Audit as part of their annual pension compliance review.

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.

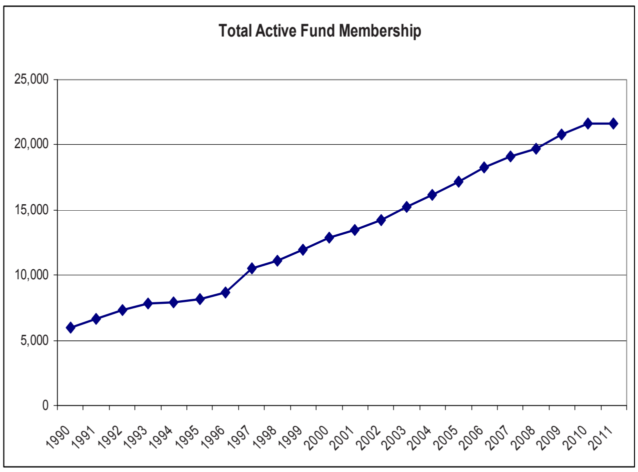
In each subsequent year of membership they are expected to undertake two to three days' training aimed at building or refreshing their knowledge and skills in specific topics in greater depth. A detailed log of all training undertaken and planned by Committee members is maintained and is available for inspection on request. During 2010/11 one special training session was held for the Pensions Committee on the initial report by the Independent Public Service Pensions Commission ("Hutton Report").

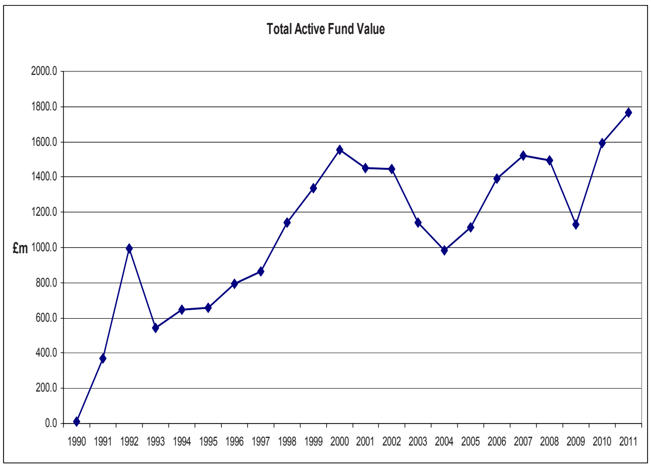
A record of members' attendance at Committee meetings through the year is shown below:

	Committee business	Committee training	Investment Sub Group	Benefits Sub Group	TOTAL
Number of meetings	4	1	4	3*	12
Board members					
Larry Whitty (Chair)	3	1	4	3	11
Suzanne Warner	4	1			5
Robert Light	2	1		3	6
John Varley	4	1	3		8
Executive members					
Mark McLaughlin	4	0	4	3	11
Graham Ledward	2	1		0	3
Howard Pearce	4	1	4	3	12
Kevin Ingram	3	1			4
Active members					
Phil Chappell	4	0	3		7
Jackie Hamer	4	1	3		8
Aileen Parry	4	1		3	8
Stuart Martin	4	1			5
Huw Williams *(from 6 July 2010)*	4	1			5
Pensioner member					
Brian Engel	3	1		3	7
Deferred member					
John Kerr	3	1		3	7
Chief Executive - ex officio attendee					
Paul Leinster	0	0			0

- ** Benefits Sub Group meeting on 26 August was cancelled but all papers circulated to allow comment from members*
- *Note – shaded areas above indicate non-membership of that sub-group*

Fund membership and value of assets





Pensions changes

Government pensions reform

- *The Local Government Pension Scheme (Amendment) Regulations 2010 (SI 2010/528) – applicable from 30 March 2010.*

  The above regulations were issued by Department for Communities and Local Government (DCLG) on 29 March 2010, effective from 30 March 2010 amending the LGPS (Benefit, Membership and Contributions) Regulations 2007 and the LGPS (Administration) Regulations 2008.

  The amendments contained within the above regulations include: accommodating the transfer of over 700 staff to local authorities from the Learning and Skills Council who were part of the Principal Civil Service Pension Scheme; and the merging of Probation boards to form a Probation Trust.

- *The Local Government Pension Scheme (Miscellaneous) Regulations 2010 (SI 2010/2090) – applicable from 30 March 2010.*

  The above regulations were issued by Department for Communities and Local Government (DCLG) on 25 August 2010, effective from 30 March 2010 amending the LGPS (Benefit, Membership and Contributions) Regulations 2007, the LGPS (Administration) Regulations 2008, the LGPS (Transitional Provision) Regulations 2008 and the LGPS 1997 Regulations.

  The miscellaneous regulations are extensive and introduce a number of significant changes to either correct or improve regulations in order to make clear the original intention of the current 2007 and 2008 Regulations. In particular, the protections for Her Majesty's Inspectorate of Pollution (HMIP) members of the Fund have been re-introduced. The intention behind the amendments is to make some corrections and cross-references to clarify detailed aspects of the Scheme's extant provisions, to restore minor omitted aspects of the 1997 Scheme, to provide clearer definitions and to introduce some new provisions.

  The significant changes are as follows:

  - Allow pension credit members access to their benefits from age 60 (actuarially reduced), as opposed to age 65 in all cases (with the exception of serious ill health);
  - Exclusion of any compensation paid as a result of achieving equal pay from being pensionable (note: arrears of pay are deemed pensionable, it is the compensation which is not pensionable);
  - Where a member defers payment of his deferred benefits beyond age 65, the benefits are actuarially uplifted when brought into payment;
  - Where a member joins the scheme after normal retirement date, when he eventually retires the benefits are actuarially uplifted;
  - Where flexible retirement takes place on or after age 65, the benefits paid are actuarially uplifted;
  - Allow an Administering Authority to recover contributions arising through pensions increase from those employers who no longer have active members in the scheme;
  - Remove the reference to the Secretary of State from Admission Agreements;
  - Introduce a time limit by when contributions may be back-dated following the extension of a short-term contract;
  - Introduce new terms for aggregation for new members and a one-off facility to allow current members 1 year to aggregate all benefits (though the latter part of this amendment is awaiting clarification);
  - Allow the Secretary of State to calculate assumptions within the cap and Share arrangements in conjunction with GAD and any other persons as deemed necessary;
  - Interest on the late payment of any lump sums payable under the 1974, 1986, 1995 and 1997 regulations and 1997 transitional regulations is to be calculated from the BCE date and not the date of leaving;
  - A new provision giving Administering Authorities the power to make payments to a person having the care of the person entitled to an LGPS but who are incapable of handling their own affairs as a result of incapability or mental disorder;
  - Various changes covering the Tiered Ill Health Provisions; and
  - Re-introduction of the protections covering Civil Servants who transferred to the Environment Agency in 1996.

- *The Occupational, Personal and Stakeholder Pension Schemes (Disclosure of Information) (Amendment) Regulations 2010 – applicable from 1 December April 2010.*

  On 11 November 2010, the Occupational, Personal and Stakeholder Pension Schemes (Disclosure of Information) (Amendment) Regulations 2010 were released and effective from 1 December 2010. The revisions are as follows:

  - Communications with members can be by email or via a website, but if individuals wish to have the information by post, then the trustees must comply with their wishes; and

- Allow Statutory Money Purchase Illustration (SMPI) information to be signposted (pointing the member to a website instead of all the information being included on the actual SMPI statement).

- *The Local Government Pension Scheme (Benefits, Membership and Contributions) (Amendment) Regulations 2011 (SI 2011/561) – applicable from 1 April 2011.*

  The above amendment regulations were issued to stakeholders on 8 March 2011 by the Department for Communities and Local Government (DCLG) and came into force on 1 April 2011. They amend the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007.

  The Regulation makes a small number of minor technical amendments to the ill health provisions that have been necessitated by an error in the recent miscellaneous regulations (SI 2010.2090) together with a small clarifying amendment to death grants and dependants' benefits for active members.

- *Retail Prices Index to Consumer Prices Index – applicable April 2011.*

  In June 2010 the Government announced that it would change the method of indexation that it uses for public sector pensions from April 2011. This means that increases to pensions in payment, deferred pensions, active member contribution bands and factors under the Local Government Pension Scheme (LGPS) will be linked to the rise in the Consumer Prices Index (CPI), rather than to the rise in the Retail Prices Index (RPI).

Pensions administration
After an EU competitive tender exercise completed during the year, the Pensions Committee has awarded a new contract to Capita Hartshead Limited (a subsidiary of Capita Group plc) to provide the day-to-day administration services for our Closed and Active pension funds and other unfunded liabilities. The contract covers a wide range of pension fund management services including membership services, financial accounting services, pension payroll services and communication services.

As part of the implementation of this new contract, the Environment Agency Pensions Committee wants to improve all aspects of our pension administration. One of the key features of the new contract will be the development of increased electronic service delivery to produce significant efficiency and costs savings, especially in relation to printing and postage of fund member communications. This will include further development of the pension fund web-site www.eapf.org.uk over the next few years so that it provides user-friendly and secure on-line member self-service.

We would like to express our thanks to Capita Hartshead for resolving 12,693 Fund member requests/queries and for paying pensions to over 4,500 pensioners during the year. The 5 largest case types processed by Capita Hartshead for the Active Pension Fund over the year were:

Case type	2011	2010
Retirement estimates	1,314	1,094
Leavers with deferred pensions	850	510
Retirements	582	233
Transfers into the Fund	440	1,101
Transfers out of the Fund	245	371

As part of the contract with Capita Hartshead, the Pensions Committee has a service level agreement for the delivery of all work which is reported on in detail every quarter. Over the year, Capita Hartshead achieved the required service levels for 99% of casework processed. The Environment Agency Pension Fund also has formal process for dealing with complaints. Out of 12,693 cases processed throughout the year, 21 formal complaints from members were received and these have all been resolved. During the year there were 4 Stage 1 & 1 Stage 2 Internal Dispute Resolution Procedure (IDRP) determinations compared with 19 Stage 1 determinations in 2009/10.

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 and an updated version of this policy was approved by the Pensions Committee during the year. As part of this policy it participates in the Audit Commission's biennial National Fraud Initiative (NFI) 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. 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. The results of the 2010 NFI were made available in January 2011 and reflected only one Active Fund pensioner death, with an overpayment of £480, that required investigation. This case has now been resolved.

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	40.4	Passive index tracking Funds
Standard Life Investments	12.6	Active UK Equities
Sarasin & Partners	8.0	Active Global Equities
Generation Investment Management	6.2	Active Global Equities
Royal London Asset Management	5.5	Active Corporate Bonds
Robeco Alternative Investment	5.2	Active Private Equity
Comgest Asset Management	4.9	Active Emerging Markets Equities
RCM	4.6	Active Global Equities
Impax Asset Management	3.5	Active Global Equities
Aviva Investors	3.3	Active UK Property Funds
Informed Portfolio Management	3.1	Passive & Active Currency Management
Other[1]	2.7	
Total	**100.0**	

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

In June 2010 we transferred £25m from RCM to Generation Investment Management. The assets remain in active global equities. In November 2010 we terminated our investment mandate with Scottish Widows Investment Partnership. The proceeds of £77m were invested with Comgest Asset Management commencing 24 November 2010, in active emerging markets equities.

Corporate Governance and Environmental Overlay Strategy

The Corporate Governance Strategy (Annex 7) and the Committee's Environmental Overlay Strategy (Annex 8) 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) and is delighted that 100% of our asset managers and principal investment and actuarial advisers are co-signatories. We continue to work collaboratively with other asset owners and managers, particularly supporting initiatives aimed at improving reporting including the Carbon Disclosure Project, Forestry Footprint Disclosure Project and the Water Disclosure Project. Institutional Investors Group on Climate Change are key partners as we continue to integrate climate change into our investment strategy.

We partnered Mercer in their research which considered the implications of climate change scenarios on Strategic Asset Allocation (SAA). It has been hailed as pioneering and a significant step forward in helping pension funds to integrate climate change into their investment strategies in order to reduce risk and maximise investment opportunities. Further information on extra-financial performance is included on page 20 and on our web site www.environment-agency.gov.uk/pensions.

Unfunded benefits
As part of the 2010 actuarial valuation, a number of pension benefits that were classed as unfunded and recharged separately to the Environment Agency from the normal employer contribution have been converted into funded benefits by agreement with the actuary. These pension benefits mainly cover old compensatory added years and gratuity payments and will now be paid from the Active Fund.

Awards
We were delighted that our work in integrating financially material environmental issues was externally recognised during the year. In the five years since the inception of our new investment strategy in 2005 we have achieved 22 awards and citations.

November 2010 - LGC Finance Awards 2010 - Corporate Governance Award – Winner - This was the third time we had won this award (previously won in 2007 and 2005). The judges felt we continued to set new standards in governance and were particularly impressed by our support for best practice in corporate environmental governance. The awards are devoted to acknowledging and rewarding exceptional achievement in local authority pensions and investment recognising accomplishments across different markets and for the quality of their funds, service and corporate governance.

December 2010 – Funds Europe Awards 2010 - European Public Sector Investor of the Year – Highly commended - This was the first time we had entered these awards and only two submissions were short-listed. The judges felt that our approach was "remarkably professional" and we were highly commended. The judges particularly commented on the reduction we have achieved in our environmental footprint with our active equity portfolio.

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 2011 have seen an 8.6% decrease in the Fund's active membership (2010: increase of 2.1%). This decrease is due to lower levels of recruitment compared to last year and a large number of deferred leavers and retirements following an Environment Agency led voluntary early release scheme. Consequently there was an increase of 11.1% in deferred members and 10.6% increase in pensioners.

Movement in number of members and pensioners	Active members	Deferred members	Current pensioners	Total
At 1 April 2010	**11,990**	**5,518**	**4,087**	**21,595**
Adjustment for late notifications	(49)	29	15	(5)
Revised opening balance	11,941	5,547	4,102	21,590
Add:				
New active members	173	-	-	
New deferred members	-	759	-	
New pensioners	-	-	448	
New spouses pensions	-	-	36	
New children's pensions	-	-	8	
	173	**759**	**492**	**1,424**
Less:				
Deferred benefits	(759)	-	-	
New retirement pensions	(388)	-	-	
Deaths in service	(8)	-	-	
Refunds of contributions	(4)	-	-	
Options pending	(1)	-	-	
Transfers out	-	(110)	-	
New retirement pensions	-	(60)	-	
Deaths in deferment	-	(5)	-	
Commutation of pension	-	(1)	-	
Death in retirement	-	-	(67)	
Suspended/Ineligible pensions	-	-	(6)	
	(1,160)	**(176)**	**(73)**	**(1,409)**
At 31 March 2011	**10,954**	**6,130**	**4,521**	**21,605**

Based on data supplied by Capita Hartshead as at 1 April 2011.

Age profile of active members at 31 March	**2011**		2010	
	No.	**%**	No.	%
15 - 19	2	0.1	9	0.1
20 - 24	209	1.9	362	3.0
25 - 29	1,126	10.3	1,438	12.0
30 - 34	1,809	16.5	1,911	15.9
35 - 39	1,736	15.8	1,822	15.2
40 - 44	1,741	15.9	1,865	15.5
45 - 49	1,528	13.9	1,557	13.0
50 - 54	1,216	11.1	1,255	10.5
55 - 59	1,061	9.7	1,183	9.9
60 - 64	512	4.7	556	4.6
65 - 69	14	0.1	32	0.3
Total	**10,954**	**100.0**	11,990	100.0

Age profile of deferred members at 31 March	2011		2010	
	No.	**%**	No.	%
15 - 19	4	0.1	3	0.1
20 - 24	68	1.1	91	1.6
25 - 29	548	8.9	551	10.0
30 - 34	1,021	16.7	930	16.8
35 - 39	1,153	18.8	1,058	19.2
40 - 44	1,246	20.3	1,143	20.7
45 - 49	993	16.2	818	14.8
50 - 54	579	9.4	476	8.6
55 - 59	417	6.8	358	6.5
60 - 64	87	1.4	80	1.5
65 - 69	9	0.1	7	0.1
70 - 74	3	0.1	2	0.1
75 - 79	2	0.1	1	0.0
Total	**6,130***	**100.0**	5,518*	100.0

**The figure for deferred members includes 337 cases (2010: 339) where there is no entitlement to a deferred pension only 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	2011		2010	
	No.	**%**	No.	%
Child dependants	54	1.2	50	1.2
Pensioners and spouses				
Under 50	63	1.4	76	1.9
50 - 54	99	2.2	123	3.0
55 - 59	333	7.4	270	6.6
60 - 64	1,220	26.9	1,093	26.7
65 - 69	1,263	27.9	1,151	28.2
70 - 74	816	18.0	747	18.3
75 - 79	444	9.8	403	9.8
80 - 84	197	4.4	159	3.9
85 - 89	30	0.7	13	0.3
90 - 94	2	0.1	2	0.1
Total	**4,521**	**100.0**	4,087	100.0
Total membership	**21,605**		21,595	

Based on data supplied by Capita Hartshead as at April 2011.

Summary of active member retirements	2011	2010
Ill Health Retirements (all ages) Tier 1	12	14
Ill Health Retirements (all ages) Tier 2	0	2
Ill Health Retirements (all ages) Tier 3	2	4
Early Retirements - efficiency/redundancy over age 55	198	40
Flexible retirements - over age 55	21	36
Early Retirements - age 60 and under age 65	78	86
Normal Retirements - age 65	57	33
Late Retirements - over age 65	35	31
Total retirements	**403**	**246**

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 2010/11 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 2011/12 are shown below:

Our Environment Agency Pension Funds static website continues 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 amongst the documents available on the website. More information will continue to be added during 2011/12.

Review of public sector pensions – Members have been kept regularly informed on the progress of the "Hutton Review" of public sector pensions. Updates have been issued in our 'Your pension' newsletters throughout the year, with other notices and links added to our website. This will continue to be a focus of communications during 2011/12.

Your pension – issue 3 - This was issued to all members in April 2010 and covered a number of topics including employee contribution rates for 2010/11, details of a new additional voluntary contribution (AVC) provider and a number of changes to various LGPS regulations and information on pension tax changes.

Your pension – issue 4 - This was issued to all members in October 2010 and covered a number of topics including the review of public sector pensions, change to the basis for pension increases and changes to the previous Government's legislation on tax relief for pension contributions.

Your pension – issue 5 - This was issued to all members in December 2010 with Fundfare. It provided updates on new restrictions to tax relief on pensions, the next stage in the "Hutton review" of public sector pensions and recent announcements regarding the Equitable life compensation scheme.

Your pension – issue 6 - Following the year end, in May 2011, this was issued to all members providing updates on pay ranges for contributions from 1 April 2011, more information on the tax relief changes from 1 April, the final report from Lord Hutton's Pensions Commission and proposals for pension contribution increases.

Annual Benefit Statements – These were issued to all active and deferred members in October 2010. For the first time, the active statement included information on members' service history and transfers into the Fund with positive feedback being received on this improvement. The 2011 benefit statements for active and deferred members will be issued in late summer.

Fundfare 2010 – This was issued to all active, deferred and pensioner members in December 2010 summarising the Fund's Annual Report and Financial Statements as at 31 March 2010 and providing information on other pension related matters. Fundfare 2011 will be issued to all members in Autumn 2010.

Topping up your LGPS pension – this booklet was released in April 2010 and details options for members to increase their Fund benefits through methods including Additional Regular Contributions (ARCs) and Additional Voluntary Contributions (AVCs).

Guide for new deferred members – We have published a number of new guides for members throughout the year including a guide for members leaving the Environment Agency that helps explain their deferred benefits.

Guide to pension increase for the LGPS – We have published a guide for pensioners to help explain how their annual pension increase is calculated. This has been publicised through our pension increase letter and pensioner member briefings.

We also recently issued other guides entitled *Things to consider before opting out of the EAP*F and *Our pension fund – why join?* explaining the benefits of Fund membership.

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

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 *Pension briefings* and are taking place between May and September 2011 focusing on the review of public sector pensions, state pension changes, pension tax changes and the benefits of Fund membership.

We arranged *Pension briefings* in May 2011 for our pensioner members in Manchester and London following our successful pensioner briefing held in Birmingham in late 2009 and held a pilot deferred member briefing for members based in the South East during May 2011.

The Pensions Committee has agreed a new strategy to move to an increased use of e-communications with members where appropriate. This will allow members to access a variety of pension publications and pension pay slips via the internet instead of receiving a paper copy which has significant environmental and financial benefits for the Fund. A key development of this will be the launch of secure online access to personal pension information and calculations for members via our website www.eapf.org.uk during 2011/12.

Key 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 increased under the provisions of the Pensions (Increase) Act 1971 and Section 59 of the Social Security Pensions Act 1975.

In June 2010 the Government announced a change the method of indexation used for public sector pensions from April 2011. This means that increases to pensions in payment and deferred pensions under the Local Government Pension Scheme (LGPS) will be linked to the rise in the Consumer Prices Index (CPI), rather than to the rise in the Retail Prices Index (RPI).

This change applied to EAPF pension increases from April 2011 and pensions in payment and deferred pensions were increased by 3.1% with effect from 11 April 2011 (12 April 2010: 0%). Any pension which was in payment for less than a year was increased by a proportionate amount depending upon the number of months it has been in payment.

The following table shows the rate of increases that have applied to pensions in payment and deferred pensions since 1989:

Year (April)	Rate of Increase %	Year (April)	Rate of Increase %	Year (April)	Rate of Increase %
1989	5.9	1997	2.1	2005	3.1
1990	7.6	1998	3.6	2006	2.7
1991	10.9	1999	3.2	2007	3.6
1992	4.1	2000	1.1	2008	3.9
1993	3.6	2001	3.3	2009	5.0
1994	1.8	2002	1.7	2010	0.0
1995	2.2	2003	1.7	**2011**	**3.1**
1996	3.9	2004	2.8		

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 is reproduced in Annex 4 to this document.

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 22 June 2011 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 8.

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 (10.6% 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
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
Comgest Asset Management	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
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
Comgest Asset Management	to beat their benchmark by 3% per annum
Robeco	to beat their benchmark by 5% 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 +7.9% (2010: +38.0%) this was -0.7% (2010: -0.7%) compared to our strategic benchmark of +8.6% (2010: +38.7%). Compared to target the Fund was -1.6% (2010: -1.6%) below target over 2010/11. Over the three years to 31 March 2011 the annualised performance of the Fund was +3.1% (2010: -0.5%), this was -3.7% (2010: -3.9%) compared to our strategic benchmark performance of +6.8% (2010: +3.4%).

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 and in some years it detracts. This year it helped account for +0.6% (2010: +1.2%) of the Fund's performance against our strategic benchmark.

Funding level
The historical funding level and asset allocation for the last four triennial valuations and for comparison estimated 2011 are shown in the tables below:

Valuation results	**2001**	**2004**	**2007**	**2010**	***Estimated 2011***
Value of assets £m	937	983	1,521	1,589	*1,768*
Value of liabilities £m	840	1,050	1,455	1,684	*1,841*
Funding level %	112	94	103	94	*96*

Asset allocation (%)	**2001**	**2004**	**2007**	**2010**	**2011**
Equities	86	71	67	58	58
Bonds	8	15	9	12	13
Gilts	2	7	14	15	13
Property	0	0	5	3	3
Private equity	0	0	2	5	5
Cash	4	7	3	7	8
Total	**100**	**100**	**100**	**100**	**100**

The funding level of the Active Fund is estimated at 96% at 31 March 2011. The major reason for this increase has been the positive return on the fund investments over the year. It is very important that it is recognised that the funding level of pension funds will vary over different time periods. The value of the Fund's liabilities is sensitive to financial and other assumptions used, and the maturity of the Fund.

The Active Fund Funding Strategy recognises that the funding objective is to achieve and maintain assets equal to 100% or more of the present value of projected accrued liabilities over the long term. In the short term, recent events have shown that the funding level can be very sensitive to extreme volatility in financial markets.

The Active Fund also has positive cash flows from the employer and members' contributions that should exceed fund outgoings for circa 20 more years, and the future size of the Active Fund will be affected by the amount of risk taken in the investment of the funds assets.

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

Manager	Date appointed / (closed)	Asset class	Value £m	Fund %	Benchmark	Target %	2010/11 Fund return %	2010/11 Benchmark return %	2010/11 Performance relative to benchmark %	2010/11 Performance relative to target %	2009/10 Fund return %	2009/10 Benchmark return %	2009/10 Performance relative to benchmark %	2009/10 Performance relative to target %
Passive Management														
Legal & General	Nov-07	UK Equity	138.4	8.0	FTSE All Share	+0.0	+8.6	+8.1	+0.5	+0.5	+54.1	+52.3	+1.8	+1.8
Legal & General	Nov-07	North America Equity	103.9	5.9	FTSE Developed World North America		+9.6	+9.5	+0.1	+0.1	+43.3	+42.4	+0.9	+0.9
Legal & General	Nov-07	Europe ex UK Equity	49.6	2.8	FTSE Developed World Europe Ex UK		+7.4	+7.0	+0.4	+0.4	+47.8	+46.9	+0.9	+0.9
Legal & General	Nov-07	Japan Equity	15.3	0.9	FTSE World Japan		-3.8	-4.0	+0.2	+0.2	+29.8	+29.6	+0.2	+0.2
Legal & General	Nov-07	Asia Pacific ex Japan Equity	17.1	1.0	FTSE Developed World Asia Pacific ex Japan		+14.4	+14.0	+0.4	+0.4	+70.1	+69.6	+0.5	+0.5
Legal & General	Nov-07	UK Index Linked Gilts	229.4	13.1	FTSE Index Linked Gilt > 5 Year		+6.8	+6.7	+0.1	+0.1	+10.6	+10.4	+0.2	+0.2
Legal & General	Nov-09	UK Corporate Bonds	131.8	7.5	iBoxx £ Non Gilt all bonds		+5.2	+5.2	+0.0	+0.0	+3.5	+3.6	-0.1	-0.1
Legal & General	Nov-09	UK Cash Fund	20.2	1.1	7 day LIBID		+0.6	+0.4	+0.2	+0.2	+0.2	+0.1	+0.1	+0.1
Active Management														
Standard Life	Apr-05	UK Equity	221.5	12.6	FTSE All Share	+2.0	+8.4	+8.7	-0.3	-2.3	+50.5	+52.3	-1.8	-3.8
Sarasin	Apr-05	Global Equity	139.9	8.0	MSCI AC World	+2.0	+3.4	+8.0	-4.6	-6.6	+44.5	+46.9	-2.4	-4.4
RCM	Aug-08	Global Equity	80.6	4.6	MSCI AC World	+3.0	+4.6	+8.0	-3.4	-6.4	+36.9	+46.9	-10.0	-13.0
Generation	Aug-08	Global Equity	109.6	6.3	MSCI Developed World	+3.0	+6.9	+7.4	-0.5	-3.5	+54.1	+44.0	+10.1	+7.1
Impax	Aug-08	Global Equity	60.8	3.5	MSCI AC World	+3.0	+10.6	+8.0	+2.6	-0.4	+52.8	+46.9	+5.9	+2.9
SWIP	(Nov 2010)	Emerging Markets Equity	-	-	MSCI Emerging markets	+3.0	n/a	n/a	n/a	n/a	+75.0	+71.1	+3.9	+0.9
Comgest	Nov-10	Emerging Markets Equity	85.6	4.9	MSCI Emerging markets	+3.0	-3.4	-3.9	+0.5	-0.5	n/a	n/a	n/a	n/a
European Credit Mangement	(Nov-09)	Corporate Bonds	-	-	iBoxx £ Non Gilt all bonds	+1.0	n/a	n/a	n/a	n/a	+43.3	+15.7	+27.6	+26.9
Royal London	Jul-07	Corporate Bonds	96.8	5.5	iBoxx £ Non Gilt all bonds	+1.0	+8.2	+5.2	+3.0	+2.0	+33.6	+20.9	+12.7	+11.7
Aviva	Jul-05	Property	57.3	3.3	IPD UK Monthly Property	+1.0	+8.0	+10.7	-2.7	-3.7	+10.2	+16.3	-6.1	-7.1
Robeco	Aug-05	Private Equity	91.7	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	55.5	3.2	FTSE 100 (Capital only)	+6.0	+11.4	+4.0	+7.4	+1.4	+45.1	+44.7	+0.4	-5.6
AVC and other net assets			48.9	2.6			n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Total Fund			**1,753.9**	**100.0**	Strategic	**+0.9**	**+7.9**	**+8.6**	**-0.7**	**-1.6**	**+38.0**	**+38.7**	**-0.7**	**-1.6**

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).
Scottish Widows Investment Partnership (SWIP) was terminated in November 2010 so there are no performance figures for the year ended 31 March 2011. Following Comgest's appointment in November 2010, their performance figures for 2010/11 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. An additional £16m was allocated to the Royal London mandate and £97.3m was invested in the Legal & General Investment Grade Corporate Bond All Stocks Index
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 2011

	Legal & General	Standard Life	Sarasin & Partners	Generation	Royal London	Robeco	Comgest	RCM	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	
Overseas equities (including pooled)	185.9		123.8	104.6			78.9	70.1	54.9					**618.3**	35.2
North America	*103.9*		*42.1*	*46.6*			*5.5*	*36.9*	*24.1*					***259.1***	*14.8*
Europe	*49.6*		*65.8*	*34.0*			*3.4*	*15.7*	*18.6*					***187.1***	*10.7*
Other geographical areas			*11.9*	*3.4*			*45.2*	*4.0*	*1.1*					***65.6***	*3.7*
Asia Pacific	*17.1*		*4.0*	*16.2*			*24.8*	*7.9*	*7.7*					***77.7***	*4.4*
Japan	*15.3*			*4.4*				*5.6*	*3.4*					***28.7***	*1.6*
UK equities	138.4	220.3	13.4	1.8			4.5	8.4	4.6					**391.4**	22.3
UK fixed interest	229.4				63.2									**292.6**	16.7
Pooled fixed interest	131.8				3.8									**135.6**	7.7
Private equity						90.6								**90.6**	5.2
Cash	1.3	1.7	2.5	4.1	0.3	1.1	1.5	2.0	1.2	1.0		41.5		**58.2**	3.3
Pooled property										56.2				**56.2**	3.2
Pooled currency											55.5			**55.5**	3.2
Overseas fixed interest					27.8									**27.8**	1.6
Pooled cash	20.2													**20.2**	1.2
AVC investments												6.2		**6.2**	0.3
Other net investments	1.4	(0.5)	0.2	(0.2)	1.7		0.7	0.1	0.1	0.1				**3.6**	0.2
Derivatives	0.1			(0.7)									(1.6)	**(2.2)**	(0.1)
Total	**708.5**	**221.5**	**139.9**	**109.6**	**96.8**	**91.7**	**85.6**	**80.6**	**60.8**	**57.3**	**55.5**	**47.7**	**(1.6)**	**1,753.9**	**100.0**

Geographical distribution of quoted and pooled equity investments

	2011		2010	
	£m	% of Fund	£m	% of Fund
United Kingdom	391.4	38.8	361.9	39.4
North America	259.1	25.7	246.3	26.8
Europe (excluding UK)	187.1	18.5	157.2	17.1
Asia Pacific (excluding Japan)	77.7	7.7	34.4	3.7
Other geographical areas	65.6	6.5	68.0	7.4
Japan	28.7	2.8	51.7	5.6
Total	**1,009.6**	**100.0**	**919.5**	**100.0**

Top 20 holdings of the Fund

		2011	
Holding	**Asset class**	**£m**	**% of Fund**
L&G Investment Grade Corporate Bond All Stocks Index Fund	Pooled fixed interest - UK corporate bonds	131.8	7.5
L&G Developed North America Equity Index	Pooled equities - Overseas	103.9	5.9
IPM Global Currency Fund Class D	Pooled currency	55.5	3.2
L&G Developed Europe (ex UK) Equity Index	Pooled equities - Overseas	49.5	2.8
HSBC Holdings ordinary shares	Equities - UK	26.4	1.5
UK Government 2.5% index-linked 26/07/16	Fixed interest - UK index linked gilts	25.3	1.4
UK Government 2.5% index-linked 16/04/20	Fixed interest - UK index linked gilts	21.2	1.2
L&G Cash Fund	Pooled cash	20.3	1.2
Vodafone	Equities - UK	20.2	1.2
Royal Dutch Shell	Equities - UK	19.3	1.1
UK Government 2.5% index-linked 17/07/24	Fixed interest - UK index linked gilts	19.3	1.1
BP	Equities - UK	18.4	1.1
UK Government 1.25% index-linked 22/11/27	Fixed interest - UK index linked gilts	18.3	1.0
BG Group	Equities – UK	17.7	1.0
UK Government 1.875% index-linked 22/11/22	Fixed interest - UK index linked gilts	17.0	1.0
L&G Developed Asia Pacific (ex Japan) Equity Index	Pooled equities – Overseas	17.0	1.0
Rio Tinto	Equities - UK	16.5	0.9
UK Government 2% index-linked 26/01/35	Fixed interest - UK index linked gilts	16.2	0.9
UK Government 1.25% index-linked 22/11/55	Fixed interest - UK index linked gilts	15.7	0.9
UK Government 1.25% index-linked 22/11/17	Fixed interest - UK index linked gilts	15.4	0.9
Total		**644.9**	**36.8**

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

2011			2010		
Sectors	£m	% of Fund	Sectors	£m	% of Fund
Industrial Goods & Services	145.8	8.3	Industrial Goods & Services	105.9	6.6
Oil & Gas	109.9	6.3	Oil & Gas	95.9	6.0
Banks	72.7	4.2	Banks	86.1	5.4
Healthcare	62.0	3.5	Healthcare	78.1	4.9
Basic Resources	61.2	3.5	Technology	60.9	3.8
Technology	53.4	3.0	Basic Resources	54.8	3.4
Telecommunications	41.5	2.4	Telecommunications	44.3	2.8
Personal & Household Goods	35.4	2.0	Personal & Household Goods	34.6	2.2
Food & Beverages	35.2	2.0	Utilities	32.2	2.0
Utilities	35.2	2.0	Retail	30.6	1.9
Total	**652.3**	**37.2**	**Total**	**623.4**	**39.0**

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 UK equity holdings

2011			2010		
Company	£m	% of UK equity	Company	£m	% of UK equity
HSBC Holdings	26.4	6.8	HSBC Holdings	25.5	7.0
Vodafone	20.2	5.2	BP	24.5	6.8
Royal Dutch Shell	19.3	5.0	Vodafone	20.1	5.6
BP	18.4	4.7	Royal Dutch Shell	14.9	4.1
BG Group	17.7	4.5	Rio Tinto	14.5	4.0
Rio Tinto	16.5	4.2	Glaxosmithkline	13.9	3.8
Glaxosmithkline	12.1	3.1	Standard Chartered	12.5	3.4
BHP Billiton	11.4	2.9	BG Group	12.0	3.3
Standard Chartered	10.3	2.6	BHP Billiton	10.4	2.9
Xstrata	9.8	2.5	Barclays	8.9	2.5
Total	**162.1**	**41.5**	**Total**	**157.2**	**43.4**

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

2011				2010			
Company	Country	£m	% of overseas equity	Company	Country	£m	% of overseas equity
Gerberit	Switzerland	6.5	1.1	Hewlett Packard	United States	7.2	1.3
Taiwan Semiconductor Manufacturing Co Ltd	Taiwan	5.2	0.8	Cisco Systems Inc	United States	7.0	1.3
Henry Schein Inc	United States	5.1	0.8	ABB Ltd	Switzerland	5.8	1.0
Unilever NV	Netherlands	5.1	0.8	International Business Machines	United States	5.1	0.9
International Business Machines Corp	United States	5.0	0.8	Nestle	Switzerland	4.7	0.8
Banco Bilbao Vizcaya Argentaria	Spain	4.9	0.8	Teva Pharmaceutical Industries	Israel	4.6	0.8
ABB ltd	Switzerland	4.7	0.8	Novo-Nordisk	Denmark	4.4	0.8
Henkel AG & Co KGaA	Germany	4.7	0.8	Amer Movil SAB	Mexico	4.2	0.8
Nalco Holding Co	United States	4.5	0.7	Vale SA	Brazil	4.2	0.8
Pentair Inc	United States	4.3	0.7	Quanta SVCS Inc	United States	4.1	0.7
Total		**50.0**	**8.1**	**Total**		**51.3**	**9.2**

Extra-financial performance

Environmental overlay
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.

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 develop tools, techniques and awareness of how extra-financial issues impact on investment decision making across asset classes.

In 2010, we partnered other asset owners globally, as part of the Mercer-led research which considered the implications of climate change scenarios on strategic asset allocation (SAA). It has been hailed as pioneering and a significant step forward, helping pension funds to integrate climate change into their investment strategies in order to reduce risk and maximise investment opportunities. This year we also included our active bond mandate in our annual footprint exercise.

United Nations Principles of Responsible Investment
We continue to be an active member of the United Nations Principles for Responsible Investment (UNPRI) supporting other signatories and developing and improving ESG tools that could be used by all pension funds. The highlight of 2010/11 was working with L&G to become a co-signatory, which now means that all of our managers are UNPRI co-signatories as well as all our primary investment and actuarial service providers. We completed the third annual survey on progress in implementing the principles, and the results are available on our website at www.environment-agency.gov.uk/pensions.

UK Stewardship Code
We were one of the first asset owners to publish our Statement of Compliance with the UK Stewardship Code on our website at the end of September 2010. We also co-signed a letter of support, with 11 other asset owners, to Mr. Stephen Haddrill, Chief Executive, Financial Reporting Council. We are in the process of integrating the requirements of the UK Stewardship Code into our reporting and compliance mechanisms for 2011. A copy of our statement is in Annex 6 and is available on our website at www.environment-agency.gov.uk/pensions.

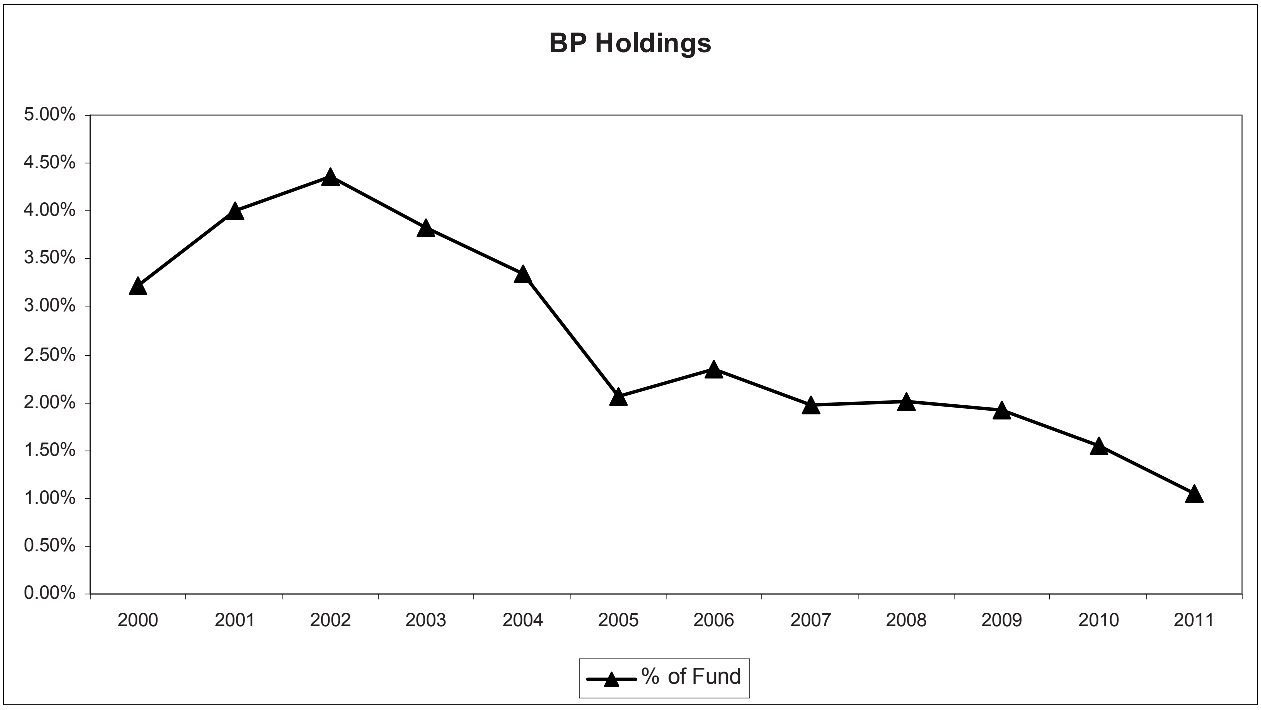
Shareholder activism for stock specific risks
Our investment strategy includes allocations to be invested in the UK stock market indices which are dominated by some mega-companies, meaning we have stock specific risks. For example, BP is a large component of FTSE All-share and for some time we have asked our fund manager's to engage with BP over various health & safety and environmental concerns and their impact on shareholder value.

In April 2010 the Pensions Committee supported a shareholder resolution against BP in respect of their annual report disclosures and strategy regarding Canadian tar sands. We were one of only a few UK pension funds that did so.

Since the Deepwater Horizon oil spill we asked our fund managers to increase their engagement with the Board of BP to ensure the adequacy of BP's management response to the incident. In light of that engagement and the lack of adequate disclosure in the Annual Report and Accounts with respect to the Deepwater incident and its financial impact on shareholder value, we voted against the Annual Report and Accounts at the 2011 AGM.

We have gradually been investing less in BP since we have changed our investment strategy in 2004 when BP was over 4% of the fund. It has declined by 75% to about 1% ,which is less than the average UK pension fund. The table on the next page illustrates the change in our level of holdings in BP since 2000.

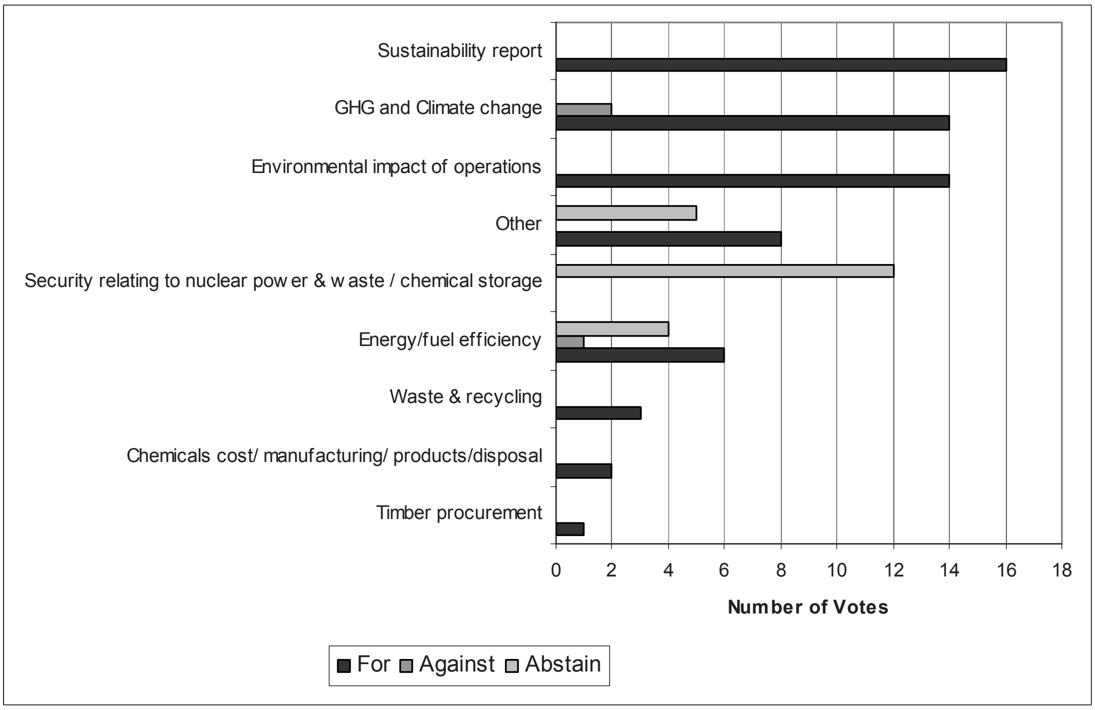
Class actions
Where shareholder value has been eroded by wrongful action by company directors, sometimes it is possible for monies to be recovered via the courts by a shareholder class action against the company or its directors. We have retained Northern Trust to monitor these class actions and to recover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



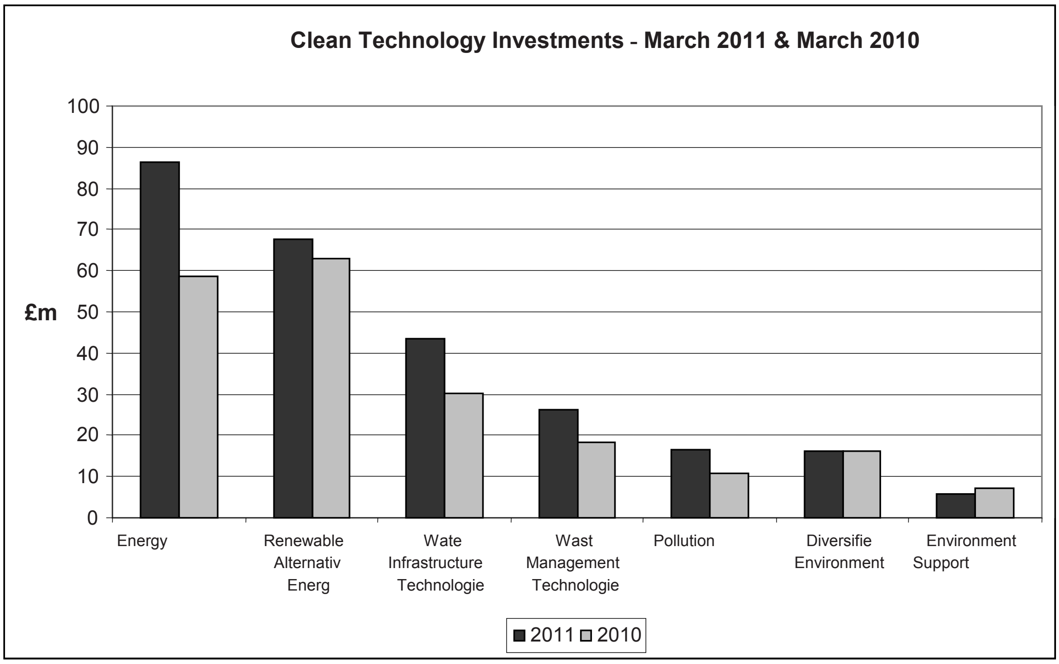
Voting on environmental resolutions

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 88 shareholder environmental resolutions. As these are shareholder resolutions a vote *for* the resolution or to *abstain* is *against* the management recommendation. In total 97% of our votes were *against* management, comprising of 73% of votes *for* the resolution and we *abstained* for the remaining 24%. A breakdown is presented below. Our voting record on environmental resolutions is available on our website at www.environment-agency.gov.uk/pensions.

Environmental Votes 2010/11



Maximising investment returns by investment in clean technologies
For the second year, using the FTSE Environmental Markets classification, with the help of Impax Asset Management (our global equity manager who focuses on environment technologies), we analysed our entire Fund (public and private equity holdings including the pooled funds). The fund now has assets to the value of £262m invested in clean technology companies, this represents 15% of the fund and is an increase of 2% from 2009/10. 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 against last year is illustrated below.



Minimising financial risks from environmental issues
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.

In 2010 (for consistency with our UNPRI submission) our manager undertook 606 ESG corporate engagements and an additional 315 via our specialist provider, Hermes Equity Ownership Services. In addition we worked with other asset owners and asset managers on the:

- Carbon Disclosure Project (4,700 companies of which we followed up 9 companies specific to our portfolio via our managers);
- Water Disclosure Project (302 companies of which we followed up 32 companies specific to our portfolio);
- Forestry Footprint Disclosure Project (285 of which we followed up 29 companies specific to our portfolio via our managers); and
- UN Global Compact (130 companies).

We also supported the “Sustainable Stock Exchanges” initiative led by Aviva, which focused on the 30 largest Stock exchanges to urge them to improve their listing rules in relation to ESG risks.

Collaborative projects, which aim to support other asset owners, included the UNPRI publication *on Responsible Investment in Passive Management Strategies* and the IIGCC *Property Reporting Guide* which complemented the *Property Trustee Guide* published in 2009. In the consultancy area the EAPF supported a European project to look at ESG integration by investment Consultants. At a policy level the EAPF was a signatory of the *Investor Statement on Climate Change* which was presented to the Climate Change summit at Copenhagen.

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. The average ESG score for 2010 is 68.5% demonstrating a further improvement over previous years (66.1% in 2009, 64.1% in 2008 and 63.9% in 2007).

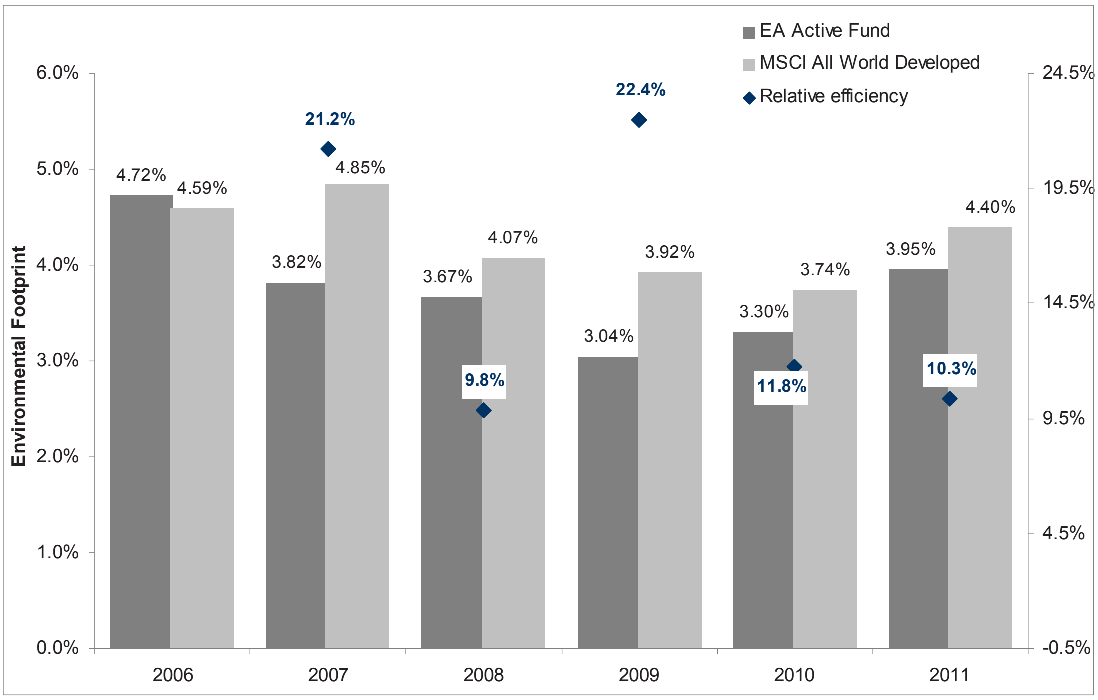
In collaboration with Aviva Investors, our property fund of funds manager, we survey property funds to assess how well these funds address financially material environmental issues. The financial returns from property can be affected by flooding, subsidence, drought arising from climate change, as well 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. Following the completion of our 2010 sustainability questionnaire, which surveyed all of our unlisted real estate holdings, Aviva has begun to systematically engage with all funds surveyed to give feedback on how each fund performed and what our key focus areas were. There are four areas of focus for the engagement, funds having a sustainability resource (a dedicated member of staff or a sustainability group), regular reporting to investors on the fund's environmental practices, annual data collection and reporting of specific environmental metrics and having a real estate or fund specific sustainability policy.

Monitoring 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 six 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 10.3% less than that of benchmark on 31 March 2011. We are one of the first funds in the world to decrease our environmental footprint.

We have also undertaken a carbon footprint for the last four years, this year our carbon footprint is 25.4% below the benchmark (2010 -22.7%, 2009 -28.4%, 2008 -12% - all below the benchmark). For the first time we have experimented with environmental and carbon footprints of our active UK Corporate Bond mandate. The Environmental footprint for active bonds with RLAM was 7.2% less than the benchmark; the carbon footprint was 6.7% less than the benchmark.



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 members of the Fund are contracted out of the State Second Pension Scheme ("S2P") and the Fund 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 Environment Agency Pensions 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 judgements and estimates that are reasonable and prudent; and
- followed applicable accounting standards, in particular the Statement of Recommended Practice *"Financial Reports of Pension Schemes (Revised May 2007)"*.

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 (DCLG).

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 Fund's 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 Auditor and the Scheme Administrator does not involve consideration of these matters. Accordingly, the Auditor accepts 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 £21.4m to £104.6m (2010: risen by £3.1m to £83.2m). The increase for the year ended 31 March 2011 was due mainly to advanced contributions paid by the employer to fund historical past service deficit. £10.9m (2011/12) was paid in advance for EA England and £3.2m for EA Wales (2011/12 - 2013/14).

Net income from all transfer values received in the year has decreased by £5.3m to £4.0m (2010: increased by £6.4m to £9.3m).

Retirement benefits and other payments made to or in respect of members during the year have increased by £5.8m to £56.7m (2010: increased by £4.8m to £50.9m).

In overall terms the net additions from dealings with members during the year have increased by £9.1m to £44.9m (2010: increased by £3.2m to £35.8m).

The value of the net assets of the Fund at 31 March 2011 has increased by £169.9m to £1,764.9m (2010: increased by £463.4m to £1,595.0m). 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 and Welsh ministers.

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 pensions strategy, administration of both Funds' benefits and the investment and custody of both Funds' assets to the Pensions Committee ("the Committee").

The Committee is supported by Investment and Benefits Sub-Groups, as well as by Environment Agency officers, external advisers, 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 (as amended) 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 £65.4m employer contributions to the Fund is the same as for other funding from Government for the Environment Agency as a whole.

The Pensions Committee maintains a Board approved statutory Governance Policy and Compliance Statement to ensure compliance with the 2007 and 2008 LGPS Regulations and associated statutory guidance. These are reviewed annually to take account of new and amended LGPS regulations and associated statutory guidance issued during the year. The latest update was approved by the Pensions Committee in June 2011 and the Board in July 2011. In addition, the Pensions Committee approved a revised fraud policy in September 2010 in line with the Environment Agency's overall revised fraud policy which was approved by the Accounting Officer in December 2010. Following the triennial actuarial valuation as at March 2010, updates to the statutory Funding Strategy Statement and Statement of Investment Principles were approved by the Pensions Committee in March 2011 and June 2011 respectively.

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. I 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 in the Environment Agency and in the operation of the Fund for the year ended 31 March 2011 and up to the date of approval of the annual report and financial statements and accords with LGPS and Treasury guidance and best practice. It has identified the significant issues set out on page 30.

Capacity to handle risk

The Environment Agency has a statement setting out its strategic approach to risk management that has been agreed with Pensions Committee and 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, an 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 our 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 in place 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. Monthly, quarterly and annual performance reports are provided to the Environment Agency and reviewed by officers and 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.

Following an EU tendering exercise, a new administration contract commenced on 1 October 2010 with Capita Hartshead. It includes a range of key improvements including better monthly, quarterly and annual reporting, a tighter Service Level Agreement with more detailed monitoring and reporting, better complaints handling, remote access to Capita Hartshead IS/IT systems, launching of the interactive EAPF website to members and a move to more use of e-communications. The fees paid to Capita Hartshead under this new contract are linked to the satisfactory provision of all of the required services.

As required by the Cabinet Office, under the Security Policy Framework, our Pension Funds administrator, Capita Hartshead, has completed a detailed questionnaire covering every aspect of data security. They met the required standards.

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 sterling, euros and dollars is invested in Northern Trust Global Cash Funds, which would not be affected in the event of a failure by Northern Trust. 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.

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 directly 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 and its sub-groups 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 are 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, supported by 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 Financial Reporting Council UK Stewardship Code and 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 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 Benefits and Investment Sub-Groups 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.

A significant portion of the Fund (19.2%) is held in pooled vehicles managed by Legal and General. 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 Legal & General overseas pooled equity pension funds, in which the Fund invests, do engage in stock lending, which is outside our control.

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 auditor and the Environment Agency managers of the Fund, who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditor in their management letter and other reports. I have been advised on the system of internal control 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.

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 Fund's 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.

Defra have confirmed receipt of the External Audit Management Letter for 2009/10 and the Environment Agency's formal response to the External Audit Report for 2009/10. They have also confirmed their receipt of the Internal Audit Compliance Review.

Work on the Environment Agency's overall anti-fraud policy and processes, and the Pension Funds' experience were taken into account in a review of the Pension Funds' fraud policy. We also expanded the policy to outline the fraud prevention tools in place for both member and service provider related frauds. The revised policy was issued to all service providers in February 2011.

At the beginning of 2011 Capita Hartshead used their DatA+ Essentials reporting to undertake a review of pension fund data to ensure compliance with the Pension Regulator's guidance on data quality, with positive results. Prior to June 2010 10 types of 'common data' were over 95% compliant and the figure is 99% compliance for the tighter post June 2010 requirements. Further work is being undertaken on a suite of 'conditional data' and the outcome will be reported to the Pensions Committee later in 2011.

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 there was an issue with the monthly pay data interface related to the transmission of data for additional voluntary contribution deductions. No data was lost and the necessary changes to the file were implemented from October 2010. This file otherwise operated successfully. The weekly employee related pension data interface operated throughout the year and has been subject to some updates to improve the information transferred.

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 started in 2009/10 was completed during 2010/11 to ensure that historical personal data held by Capita Hartshead is consistent with that held by the Environment Agency. This was followed up in December 2010 when the benefit statement mailing invited members to review their own service histories. This generated only 156 queries which were resolved quickly by Capita Hartshead in conjunction with HRSC and the Benefits Team.

A service level agreement for pension related activities was updated and re-issued to the HRSC and the Finance Service Centre (FSC). HRSC carry out manual monitoring each quarter and have reported good compliance. Work is underway with Capita Hartshead to set up automated mechanisms to monitor the performance of the HRSC and the FSC.

A payroll audit was undertaken by Internal Audit during the second half of 2010/11 with the objective of ensuring the Environment Agency pays all staff accurately, in a timely way, and complies with all relevant payroll requirements. The report identified a number of issues around the deduction of pension contributions and the calculation of final pay used to determine pensions by the FSC. Action is being taken during 2011 to mitigate the issues raised.

Significant internal control issues

The Internal Audit Compliance Review for 2011 found that the Environment Agency has complied with the provisions of Schedule 8, paragraph 10 of the Financial Memorandum issued to the Environment Agency in 2005. However it noted that the Memorandum needs updating in line with the 2008 and 2009 Local Government Pension Scheme (LGPS) Regulations and subsequent statutory guidance. This work will be completed in 2011. Evidence was provided to support all compliance statements in the statutory Governance Compliance Statement with one exception regarding the lack of member briefings in 2010/11. This is being rectified with briefings for active members held between May and September 2011 and deferred and pensioner members held in May 2011.

Paul Leinster
Accounting Officer
Environment Agency
07 July 2011

Statement by the Consulting Actuary

This statement has been prepared in accordance with Regulation 34(1) of the Local Government Pension Scheme (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2010/11.

Description of Funding Policy
The funding policy is set out in the Administering Authority's Funding Strategy Statement (FSS), dated 17 March 2011. In summary, the key funding principles are as follows:

- ensure that sufficient resources 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 employer contributions to be kept as stable 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 FSS sets out how the Administering Authority seeks to balance the aims of securing the solvency of the Fund and keeping employer contributions stable. Asset-liability modelling has been carried out which demonstrates that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is a better than 67% chance that the Fund will return to full funding over 21 years.

Funding Position as at the last formal funding valuation
The most recent actuarial valuation carried out under Regulation 36 of the Local Government Pension Scheme (Administration) Regulations 2008 was as at 31 March 2010. This valuation revealed that the Fund's assets, which at 31 March 2010 were valued at £1,589 million, were sufficient to meet 94% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2010 valuation was £95 million.

The Environment Agency's contributions for the period 1 April 2011 to 31 March 2014 were set in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities
Full details of the methods and assumptions used are described in my valuation report dated 31 March 2011.

Method
The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

Assumptions
A market-related approach was taken to valuing the liabilities, for consistency with the valuation of the Fund assets at their market value.

The key financial assumptions adopted for the 2010 valuation were as follows:

Financial Assumptions	31 March 2010	
	% p.a. Nominal	% p.a. Real
Discount Rate	6.1%	3.1%
Pay Increases*	4.8%	1.8%
Price Inflation / Pension Increases	3.0%	

* plus an allowance for promotional pay increases. Short term pay growth was assumed to be 1% p.a. for 2010/11 and 2011/12, reverting to 4.8% p.a. thereafter.

The key demographic assumption was the allowance made for longevity. The baseline longevity assumptions adopted at this valuation were a bespoke set of VitaCurves that were specifically tailored to fit the membership profile of the Fund. Longevity improvements were in line with standard PXA92 year of birth mortality tables, with medium cohort projections and a 1% p.a. underpin effective from 2007. Based on these assumptions, the average future life expectancies at age 65 are as follows:

Pensioners	**Males**	**Females**
Current Pensioners	21.3 years	23.3 years
Future Pensioners	23.3 years	25.2 years

A copy of the Funding Strategy Statement is included within the Fund's Annual Report.

Experience over the year since April 2010
The Administering Authority monitors the funding position on a regular basis as part of its risk management programme. The most recent funding update was produced as at 31 March 2011. Investment returns for the year to 31 March 2011 were +7.9% and assets had a market value of £1,765m as at 31 March 2011. Liabilities were estimated to be £1,829m on an ongoing funding basis as at 31 March 2011, implying that the Fund's funding level (excluding the effect of any membership movements) had improved to 96% over 2010/11.

The next actuarial valuation will be carried out as at 31 March 2013. The Funding Strategy Statement will also be reviewed at that time.

Richard Warden
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
11 July 2011

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 year ended 31 March 2011 which is set out on page 34.

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 active members of the Fund 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 contributions as reported in the attached summary of contributions payable for the Fund year ended 31 March 2011 and to report my opinion to you.

Scope of work on Statement about contributions
My examination involves obtaining evidence sufficient to give reasonable assurance that contributions reported in the attached summary of contributions have in all material respects been paid at least in accordance with the relevant requirements. This includes an examination, on a test basis, of evidence relevant to the amounts of contributions payable 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.

Statement about contributions
In my opinion, contributions for the Fund year ended 31 March 2011 as reported in the attached summary of contributions 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

08 July 2011

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 2011 were as follows:

	Notes	Employee £'000	Employer £'000
Required by the LGPS regulations			
Normal contributions		22,703	55,900
Special contributions to fund early retirements		-	10,272
Total		**22,703**	**66,172**
Other contributions payable			
Purchase of added years		839	-
Additional voluntary contributions (AVCs)		817	-
Contributions to fund historical past service deficit		-	14,039
		1,656	14,039
Sub-totals		**24,359**	**80,211**
Total employee and employer contributions (as per Fund account)	3		**104,570**

Signed on behalf of the Environment Agency

Larry Whitty
Chairman
Environment Agency Pensions Committee
07 July 2011

Paul Leinster
Accounting Officer
Environment Agency
07 July 2011

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 2011 under the Environment Agency Act 1995. 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

As explained more fully in the section entitled Roles and Responsibilities of the Pensions Committee, the Accounting Officer and the Pensions Committee are responsible for preparing the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with relevant legal and regulatory requirements. I conducted the audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Department; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

In addition, I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income reported in the financial statements have been applied to the purposes intended by Parliament and that the financial transactions conform to the authorities which govern them.

Opinion on Regularity

In my opinion, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and conform to the authorities which govern them.

Opinions on the financial statements

In my opinion:

- the financial statements show a true and fair view of the financial transactions of the Fund during the year ended 31 March 2011, 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.

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

08 July 2011

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 2011

Fund account

	Notes	2011 £000	2010 £000
Contributions and transfers			
Contributions	3	104,570	83,202
Transfer values received	4	4,030	9,349
Other income	5	56	701
		108,656	**93,252**
Benefits and other payments			
Benefits	6	(56,690)	(50,870)
Leavers	7	(5,539)	(4,243)
Administration expenses	8	(1,512)	(2,383)
		(63,741)	**(57,496)**
Net additions from dealings with members		**44,915**	**35,756**
Return on investments			
Investment income	9	30,453	27,300
Change in market value of investments	10 (a)	99,653	404,373
Investment management expenses	11	(5,078)	(3,974)
Net returns on investments		**125,028**	**427,699**
Net increase in the Fund during the year		**169,943**	**463,455**
Opening net assets of the Fund at 1 April		1,595,042	1,131,587
Net assets of the Fund at 31 March		**1,764,985**	**1,595,042**

Net assets statement

	Notes	2011 £000	2010 £000
Investment assets	10 (c)	1,768,082	1,604,037
Investment liabilities	10 (c)	(14,167)	(15,712)
Current assets	12	17,867	9,913
Current liabilities	12	(6,797)	(3,196)
Net assets of the Fund at 31 March		**1,764,985**	**1,595,042**

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 31 and these financial statements should be read in conjunction with it. The Actuary's statement, dated 8 June 2011, is based on a valuation as at 31 March 2010.

The notes on pages 38 to 49 form part of these financial statements.

Larry Whitty
Chairman
Environment Agency Pensions Committee
07 July 2011

Paul Leinster
Accounting Officer
Environment Agency
07 July 2011

Notes to the financial statements

1. Basis of preparation

The financial statements have been compiled in accordance with the CIPFA code of practice on local authority accounting in the United Kingdom 2010/11 and following the guidance in the Statement of Recommended Practice "Financial Reports of Pension Schemes (revised May 2007)" ("the SORP"). They are prepared on a going concern basis having a strong covenant with Defra and the Welsh Government who are the financial sponsors of the Environment Agency under the Environment Agency Act 1995 and the DCLG as the statutory guarantors of the LGPS. The accounting policies have been drawn up in line with recommended accounting principles as specified in the Code of Practice on Local Authority Accounting and as disclosed below.

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 of 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 financial statements 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 was exempt approved under Chapter I of Part XIV of the Income and Corporation Taxes Act 1988 and became a registered pension scheme under Chapter 2 Part 4 of the Finance Act 2004 with effect from 6 April 2006. It 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.

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

	2011 £000	2010 £000
Employer		
Normal	55,900	55,431
Special	10,272	3,122
Advanced	14,039	-
	80,211	58,553
Members		
Normal	22,703	23,055
Purchase of added years	839	832
Additional voluntary contributions (AVCs)	817	762
	24,359	24,649
Total	**104,570**	83,202

Normal contributions are regular employer and employee contributions paid across by the Environment Agency. Special contributions are additional amounts paid by the Environment Agency in respect of early retirements. Advanced contributions are upfront contributions paid by the Environment Agency in relation to the historical past service deficit.

4. Transfer values received

	2011 £000	2010 £000
Individual transfers from other schemes	3,984	9,349
AVC transfers	46	-
	4,030	9,349

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

	2011 £000	2010 £000
Reimbursements of additional payments made	**56**	701

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 £56,000 (2010: £701,000) shown represents reimbursements to the Fund by Capita Hartshead of administration expenses incurred during this rectification process.

6. Benefits

	2011 £000	2010 £000
Retirement and dependants' pensions	38,864	35,772
Lump sum retirement grants	16,688	13,920
Lump sum death grants	1,134	1,173
Life assurance through AVC provider	4	5
	56,690	50,870

Benefits payable exclude £1.8m (2010: £1.8m) 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.

7. Leavers

	2011 £000	2010 £000
Individual transfers to other schemes	3,589	4,094
Bulk transfer to other schemes*	1,926	-
Refunds of contributions	8	27
AVC transfers	16	122
	5,539	4,243

*This amount is in respect of a bulk transfer due to be paid out in June 2011 following the outsourcing of the Environment Agency CIS service in July 2010.

8. Administration expenses

	2011 £000	2010 £000
Environment Agency Pension Fund Management	477	489
External professional fees:		
Scheme administration	597	661
Legal	208	453
Actuarial	182	602
Audit	36	36
Investment	12	142
	1,512	2,383

The auditor remuneration does not include any fees in respect of non-audit services for 2011 and 2010.

As described in note 5, of the £56,000, £36,000 (2010: £368,000) legal and £4,000 (2010: £333,000) actuarial expenses have been reimbursed to the Fund.

9. Investment income

	2011 £000	2010 £000
Dividends from equities	18,315	17,866
Income from fixed interest securities	9,143	7,202
Income from pooled investment vehicles	2,274	1,765
Income from private equity	394	221
Interest on cash deposits	327	246
	30,453	27,300

10. Investments

(a) Investment movements summary

	Market value at 01.04.10 £000	Purchases at cost and derivative payments £000	Sales proceeds and derivative receipts £000	Change in market value £000	Market value at 31.03.11 £000
Equities	766,211	668,380	(649,287)	38,605	823,909
Fixed interest	322,686	90,470	(104,911)	12,212	320,457
Pooled equities	153,328	38,942	(22,646)	16,063	185,687
Pooled fixed interest	103,458	26,726	-	5,355	135,539
Private equity	80,957	13,574	(10,864)	6,905	90,572
Pooled property	49,705	5,117	(1,019)	2,378	56,181
Pooled currency	49,555	268	(1,188)	6,864	55,499
Pooled cash	20,052	-	-	114	20,166
AVC investments	5,633	834	(691)	442	6,218
Derivatives	(11,222)	1,849,432	(1,850,911)	10,462	(2,239)
	1,540,363	**2,693,743**	**(2,641,517)**	**99,400**	**1,691,989**
Cash deposits & instruments	42,439			253	58,285
Other investment balances	5,523			-	3,641
	1,588,325			**99,653**	**1,753,915**

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 £1,469,389 (2010: £1,145,309). 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	**2011 £000**	2010 £000
Equities		
Overseas quoted	432,506	404,292
UK quoted	391,403	361,919
	823,909	766,211
Fixed interest		
UK index linked gilts	229,423	238,702
UK corporate quoted	63,231	54,893
Overseas corporate quoted	27,803	29,091
	320,457	322,686
Pooled equities		
Overseas equities	185,687	153,328
	185,687	153,328
Pooled fixed interest		
UK corporate quoted	131,764	100,225
Overseas corporate quoted	3,775	3,233
	135,539	103,458
Private equity		
Overseas – unquoted	84,980	79,102
UK – unquoted	5,592	1,855
	90,572	80,957
Pooled property		
UK unit trusts	44,585	38,580
UK managed funds	7,368	6,712
UK unquoted - collective limited partnership investments	4,228	4,413
	56,181	49,705
Pooled currency	**55,499**	49,555
Pooled cash	**20,166**	20,052
AVC investments	**6,218**	5,633
Derivative contracts		
Futures	75	19
Forward foreign exchange	(2,314)	(11,241)
	(2,239)	(11,222)
Cash deposits and instruments		
Cash with custodian and fund managers	58,169	42,123
Cash margin with brokers	116	316
	58,285	42,439
Other investment balances		
Due from trade and currency brokers	6,067	2,330
Accrued income	5,074	5,210
Income tax recoverable	574	428
Due to trade and currency brokers	(8,074)	(2,445)
	3,641	5,523
Net investment assets	**1,753,915**	1,588,325

(c) Financial assets and liabilities

	2011 £000	2010 £000
Financial assets		
Equities (includes pooled and private equity)	1,100,168	1,000,496
Bonds (includes pooled and gilts)	455,996	426,144
Cash (includes pooled)	78,451	62,491
Pooled property	56,181	49,705
Pooled currency	55,499	49,555
Derivatives – Futures and forward foreign exchange	3,854	2,045
AVC	6,218	5,633
Other investment assets	11,715	7,968
Total financial assets	**1,768,082**	1,604,037
Financial liabilities		
Derivative contracts - Forward foreign exchange	(6,093)	(13,267)
Other investment liabilities – Due to trade and currency brokers	(8,074)	(2,445)
Total financial liabilities	**(14,167)**	(15,712)
Net financial assets	**1,753,915**	1,588,325

(d) Derivative contracts

Derivatives	**2011 Asset £000**	**2011 Liability £000**	2010 Asset £000	2010 Liability £000
Futures contacts	75	-	19	-
Forward foreign currency contracts	3,779	(6,093)	2,026	(13,267)
	3,854	**(6,093)**	2,045	(13,267)
Net derivatives	**-**	**(2,239)**	-	(11,222)

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 2011. The 'Fair value' is the unrealised profit or loss of the futures as at 31 March 2011.

Futures

Type of contract	**Expiration**	**2011 Nominal value £'000**	**2011 Fair Value £'000**	2010 Fair value £'000
FTSE 100 UK exchange traded June 2011 (L&G)	3 months	**1,765**	**54**	19
E-mini S&P 500 US exchange traded June 2011 (L&G)	3 months	**618**	**21**	-
Total		**2,383**	**75**	19

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 2011 there was an unrealised loss of £2.3m on the currency forwards (2010 -£11.3m). 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 over the counter contracts

Settlement dates	**Currency bought**	**Currency sold**	**2011 Asset £'000**	**2011 Liability £'000**	2010 Asset £'000	2010 Liability £'000
4 days to 6 months	Sterling	US Dollars	**3,332**	**(1,675)**	582	(12,115)
28 days to 6 months	Sterling	Euros	**-**	**(3,417)**	889	(385)
1 day to 6 months	Sterling	Japanese Yen	**382**	**(52)**	328	(715)
1 day	Sterling	South African Rand	**-**	**(10)**	-	-
1 to 6 days	Sterling	Canadian Dollars	**-**	**-**	-	(1)
1 to 15 days	US Dollars	Euro	**-**	**(337)**	37	-
1 to 15 days	US Dollars	Danish Krona	**-**	**(151)**	129	(2)
4 to 15 days	US Dollars	Swiss Franc	**-**	**(436)**	61	(25)
1 to 4 days	US Dollars	Sterling	**2**	**-**	-	-
1 to 4 days	US Dollars	Japanese Yen	**32**	**-**	-	-
5 to 15 days	Japanese Yen	US Dollars	**29**	**-**	-	(16)
1 to 76 days	Japanese Yen	Sterling	**-**	**-**	-	(7)
1 to 15 days	Swiss Franc	US Dollars	**-**	**(14)**	-	-
1 to 4 days	Canadian Dollars	Sterling	**-**	**(1)**	-	-
1 to 4 days	Euro	Sterling	**2**	**-**	-	(1)
			3,779	**(6,093)**	2,026	(13,267)

(e) AVC investments

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

	2011 £000	2010 £000
Standard Life		
Unit-linked funds	2,750	2,425
	2,750	2,425
Clerical Medical		
Unit-linked funds	1,525	1,348
With-profits funds	555	567
	2,080	1,915
The Equitable Life Assurance Society		
Unit-linked funds	723	656
With-profits funds	422	486
Deposit accounts	136	151
	1,281	1,293
Prudential		
Unit-linked funds	9	-
With-profits funds	32	-
Deposit accounts	66	-
	107	-
Total AVC investments	**6,218**	5,633

The Environment Agency holds assets with Standard Life, Clerical Medical, The Equitable Life Assurance Society and Prudential. 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 2011 confirming amounts held in their account and movements in the year.

(f) Investments exceeding 5% of net investment assets

A significant portion of the Fund (19.2%) is held in pooled pension funds managed by Legal and General (L&G). At 31 March 2011 the holding in L&G Investment Grade Corporate Bond Fund is valued at £131.8m (2010: £100.2m) and the holding in L&G North America Equity Index Fund valued at £103.9m (2010: £86.4m), representing 7.5% (2010: 6.3%) and 5.9% (2010: 5.4%) of the net investment assets of the Fund.

11. Investment management expenses

	2011 £000	2010 £000
Fund manager base fees	3,938	3,794
Fund manager performance fees	754	(179)
Investment advisers	188	166
Global custody	137	132
Performance and risk measurement	61	61
	5,078	3,974

Total fund manager fees include management charges for Informed Portfolio Management that are settled directly within the portfolio in accordance with the investment management agreements.

12. Current assets and liabilities

	2011 £000	2010 £000
Current assets		
Receivables		
Environment Agency	6,843	796
Standard Life	-	26
Equitable Life	-	6
Capita Hartshead - administration expense to be refunded	1	23
Overpaid pensions on death to be refunded to the Fund	1	-
	6,845	851
Cash at bank	11,022	9,062
	17,867	**9,913**
Current liabilities		
Payables		
Benefits payable	(5,010)	(1,259)
Administration and investment expenses	(1,303)	(1,493)
PAYE	(483)	(442)
Tax payable on refunds	(1)	(2)
	(6,797)	**(3,196)**

Amounts due from the Environment Agency are:

(i) employers' and employees' contributions of £2,000 (2010: £405,000) and £301,000 (2010: £173,000) respectively outstanding in the normal course of collection at the year end and subsequently paid over within the statutory time limit; and

(ii) £6,102,000 (2010: £218,000) for special contributions due in respect of augmentations to members' benefits and £438,000 (2010: nil) in respect of shortfall funding for a bulk transfer payment.

13. Investment commitments

In accordance with authorised investment strategy and mandates the outstanding investment commitments at 31 March 2011 are Private equity £21.3m (2010: £34.1m), and Property £0.5m (2010: £4.3m).

14. Related party transactions

During the year ended 31 March 2011 there have been the following related party transactions:

(i) pensions administration costs of £370,000 (2010: £327,000) recharged to the Fund by the Environment Agency;

(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 (2010: £1,800,000) recharged to the Environment Agency by the pensions administrator (see note 6).

15. Employer related investment

During the year, special contributions totalling £396,043 (2010: £175,383) were not paid over to the Fund in line with statutory timescales. As at the year end, no special contributions were outstanding. The Fund did not hold any other employer-related investments during the year.

16. IAS26: 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 £1,846m (2010: £2,099m). 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:

	2011 **%**	2010 %
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 22 June 2011, and were approved and signed at a meeting of the Board on 7 July 2011.There are no adjusting or non-adjusting events that need to be recognised in the financial statements after the net asset statement date. The authorised date for issue is the 08 July 2011.

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 valid 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 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 months' 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 pensions are reviewed each year in line with the increase in the Consumer Prices Index.

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

Compliance status – Of the 20 standards, we are fully compliant on 19 and partially compliant on 1.

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 (EA) 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 has 15 members, appointed by the EA Board and 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 deferred and pensioner nominees 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 1 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, 1 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 deferred member and 1 pensioner nominee. Our deferred member and pensioner nominees are members of our decision making main PC.

Statutory Guidance Governance Standards and Principles	Our compliance status	Evidence of compliance and justification for non-compliance
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.
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 auditor.
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 member handbook that describes the role of the PC, ISG and BSG. Our PC members understand that their primary role is to adopt and maintain a duty of care to our funds' 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		
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 regularly. On appointment to the PC we provide general induction training and 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, ISG & BSG 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 4 times a year, for normal business and at least once for briefing or training. 7 of the 15 PC members (including at least 1 Board member and 1 employee nominee) constitute a quorum.
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 4 times a year before the PC so they can report to and make recommendations to the full PC.
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. 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 we hold briefings which provide a forum for all of our stakeholders to be informed about changes to the LGPS and to allow them to ask questions. All active fund members are invited to attend regional pensions briefings each year, we hold around 20 at different regional locations around England and Wales. In addition, in 2011 all pensioners were invited to attend one of two briefings and a pilot briefing for deferred members was held. The briefings are presented by Capita Hartshead (Pension Fund Administrator), with either administering authority or HR staff also in attendance. PC members chair or attend some briefings. **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.
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 information and 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 also receive summary 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.

Statutory Guidance Governance Standards and Principles	Our compliance status	Evidence of compliance and justification for non-compliance
H – Scope		
a) That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Compliant	Our BSG and ISG meet quarterly and each meeting of our PC receives a report on the performance of our pension funds benefits administration and investments. Our BSG & ISG review their risk register at all meetings and the PC also carries out a regular review of its key strategic risks and our statutory governance and communications policy statements. It has also carried out a review of its own effectiveness.
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 in our Annual Report and Financial Statements which is also available in hard copy from our Pension Fund Management Team. We have an agreed procedure for our recognised Trades Unions to nominate new employee nominees to our PC when vacancies arise. We have also advertised in pensioners' and deferred members' newsletters for nominees when vacancies arose.

Approved by the Pensions Committee 22 June 2011 – next review 2012

Annex 3 – Communications Policy Statement

Introduction

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

The Active Fund is open to all Environment Agency employees with a contract of three months or more and has 11,000 active members – 1,100 manual and 9,900 non manual, 6,100 deferred members and 4,500 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, 4,000 deferred members and 16,400 pensioners.

This is the sixth Communications Policy Statement for the Environment Agency Pension Funds and is effective from 22 June 2011.

We have an agreed strategy for implementing a move to more electronic communication which will be implemented over the next 2 years. These changes will be reflected in this policy statement in 2012 and 2013. In particular we will be developing our websites www.environment-agency.gov.uk/pensions and www.eapf.org.uk as well as our internal intranet (Easinet).

Any enquiries in relation to this Communication Policy Statement should be sent to:

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Tel: 0117 934 5094

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 regulation 106B of the Local Government Pension Scheme Regulations 1997.

(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.*

(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 timescales rather than quality.

A summary of our expected timescales 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.

Representation

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, the deferred member nominee and the pensioner nominee on the Benefits Sub-Group.

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, HR Benefits team and Capita Hartshead's Technical Consultants and Communications team.

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 £100k per annum, which equates to approximately £2.25 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 Funds' administrator;
- Professional advisors and Funds' 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 (DCLG);
- Pensions and Investment Media; and
- 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 will substantially increase 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 intranet (Easinet). We accept e-mail communication and respond electronically where possible.

Capita Hartshead provide a freephone telephone helpline and a dedicated email address for all Fund members. These are widely publicised in Fund literature.

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 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 notification	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
Pension Fund Annual Report and Financial Statements	All	Within two months of request	Within five working days (once published)
Fundfare	All	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 financial statements 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 websites at www.eapf.org.uk and www.environment-agency.gov.uk/pensions .Paper copies are available on request.

Approved by the Pensions Committee on 22 June 2011 and reviewed annually.

Annex 4 – Funding Strategy Statement

1. Introduction

In accordance with 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"). This statement has been reviewed and updated as part of the 2010 actuarial valuation process.

The Active Fund is part of the Local Government Pension Scheme (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 Active Pension Fund. Since then, 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 2010, the Active Fund contained 11,933 active members, 4,089 pensioners and 5,215 deferred pension members whose benefits have yet to come into payment.

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

Regulation 35 of the respective legislation referred to above provides 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 Active 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 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (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 Administration Regulations";
- The Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended) – "the Benefit Regulations";
- The Local Government Pension Scheme (Transitional Provisions) Regulations 2008 (as amended) – "the Transitional Regulations"; and The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended) – "the Investment Regulations".

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 of the Administration Regulations) which require that the actuary completes an actuarial valuation, including a rates and adjustments certificate, every three years. Contributions to the Active 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.

Following the 2010 actuarial valuation, and subject to ministerial approval, the cost of the scheme will be potentially shared between the employer and employees as part of a locally applied national LGPS ‘cap and share’ arrangement introduced under Regulation 36A of the Local Government Pension Scheme (Administration) Regulations 2008. However it is not yet clear how the ‘cap and share’ arrangements will work in practice given that:

- the benefits available under public service schemes such as the LGPS are likely to be subject to reform as part of the Hutton Review; and
- the Chancellor of the Exchequer’s announcement in the 2010 Spending Review that contributions payable by employees to public service pension schemes are to be increased over the next three years.

The interaction of ‘cap and share’ with the aims of the Hutton Review and the 2010 Spending Review should become clearer during 2011. The FSS does not make any allowance for these changes.

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 near 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 resources 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 employer contributions to be kept as stable 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 to the fund, 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 pension benefits, and early retirement strain costs;
- 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. Long-term funding

When considering the adequacy of funding, the primary focus of the Pension Committee should be on the long-term because:
- liabilities are paid over a long period, rather than crystallising on a single day;
- market prices of assets with growth potential can be volatile;
- pension liabilities are significant compared to the employer's payroll; and
- cuts in employer contributions are easy to implement, but very slow to reverse.

To meet the requirements of the Regulations the Administering Authority's long term funding objective is to achieve and then maintain assets equal to at least 100% or more of the present value of projected accrued liabilities, assessed on an ongoing basis including allowance for projected final pay. The Administering Authority, after taking advice from the Fund actuary, uses 'stochastic' modelling techniques to project future asset and liability values forward from the valuation date to assess the likelihood that this long-term funding objective will be met.

Funding levers
The Administering Authority, in conjunction with the Fund actuary, reviewed the Fund's funding strategy in the early part of 2010. The review identified a number of possible funding levers that could be used to refine the funding strategy at the 2010 valuation. The following table shows the funding levers that the Active Fund has adopted for the 2010 actuarial valuation.

Funding Lever	
1	Reduced level of assumed future pay growth (over long term) at maximum of RPI + 1% pa (0.5% pa reduction from 2007 assumptions). Set to 1% p.a. for first two years only.
2	Change derivation of pension increase assumption to allow for benefits being linked to CPI rather than RPI (deduct 0.5% p.a. from market derived RPI figure).
3	Change derivation of pension increase assumption to allow for inflation risk premium by deducting 0.3% p.a. from CPI-linked assumption.
4	Tailor baseline longevity assumptions to particular characteristics of Fund members, using pay levels and postcode based influence indicators.
5	Larger reserve for longevity improvements by moving from 'Original 92 Series' to 'Medium Cohort' with 1% p.a. minimum underpin. This increases average future life expectancies at age 65 by around 1½ years for current pensioners and by around 2 years for future pensioners.
6	Increase average age of retirements for active members aged around 50 or less who have no Rule of 85 protections.
7	Increase allowance for converting pension to cash lump sum (commutation) up to HMRC limits at retirement from 25% to 50%.
8	Stabilise employer contributions by limit on annual changes in employer contributions of +/-0.5% of pay from April 2014 (hereafter referred to as the "contribution stability overlay").
9	To complement the contribution stability overlay, include a safety check at each future actuarial valuation to ensure that the probability that the stabilised contributions will be sufficient to achieve a funding level on the ongoing basis of above 100% in 21 years (equivalent to seven actuarial valuations) is at least two in three or 67%. If this test is not passed, the contribution stability overlay would be switched off.
10	Introduce an annual check on the impact of pay awards on the value of accrued liabilities, compared to assumptions made at the most recent actuarial valuation. The Environment Agency will be able to pay additional top-up contributions at its discretion.
11	In order to protect against the risk of a reducing payroll delaying the deficit recovery plan, the employer's contributions have been re-expressed such that that the future service element depends on a percentage of payroll and the past service deficit recovery element is covered by fixed monetary amounts.

Key assumptions
The key assumptions making up the funding strategy and as adopted for the 2010 actuarial valuation are:

	31 March 2010
Past Service (Current Yields Basis)	
Asset Valuation	£1,589m
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%
Breakeven Retail Price Inflation (RPI)	3.8%
Pension Increases *	3.0%
Earnings Inflation **	4.8%
Future Service (Current Yields Basis)	
Discount rate (pre retirement)	6.1%
Discount rate (post retirement)	6.1%
Breakeven Retail Price Inflation (RPI)	3.0%
Earnings Inflation **	4.8%

* based on breakeven RPI less 0.5% pa (following the Government's announcement in June 2010 that future pension increases in the LGPS will be based on the Consumer Prices Index rather than on RPI) less 0.3% pa (the premium that investors are prepared to pay for inflation protection in current bond markets).

** 1% pa in the first two years and 4.8% pa thereafter, with an allowance for age-related promotional increases currently worth around 1.2% pa made in addition.

Underlying these assumptions are the following two tenets:

- that the Active 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 way in which longevity assumptions are set has changed at the 2010 valuation. Instead of relying on a single base table and specific age ratings per class of member, at the 2010 valuation the post retirement mortality base tables are a suite of bespoke assumptions which reflect the characteristics of the Fund membership. These bespoke assumptions are based on pooled experience from occupational pension schemes during the period 2005 to 2007 and allow for observed variations in mortality according to age, gender, salary and postcode based lifestyle group. The assumptions adopted vary according to the individual characteristics of each individual Fund member. The assumptions for 31 March 2010 also incorporate an improvement to mortality figures, over those assumptions used in the 2007 actuarial valuation. The Actuary has allowed for future longevity improvements by using Medium Cohort projections with a 1% p.a. minimum underpin from 2010.

Solvency and Target Funding Levels

The Active 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 2010, the ongoing funding level was 94% and at 31 December 2010 it was estimated to have remained at 94%.

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 membership of employees matures (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 Active 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 retail price inflation 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 pension increase assumption is based on break-even inflation, but reduced by 0.5% a year to allow for consumer price inflation and by a further 0.3% a year to allow for the inflation risk premium (the premium that investors are prepared to pay for inflation protection in current gilt markets).

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

Derivation of Employer Contributions (before stability overlay)

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 the remaining working lifetime of scheme members (calculated to be 9 years at the 2010 actuarial valuation).

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.

The Environment Agency is paying 16.5% of pay in 2010/11. The 2010 valuation delivered a very similar result and the Active Fund's actuary recommended that contributions at the current level should continue. However, given the uncertainties about the size of the Environment Agency's payroll in future, it was further recommended that the elements relating to future accruals and to deficit recovery be separated into two parts:

(a) 13% of pensionable pay for future accruals; and
(b) £12m a year, or £1m a month for deficit recovery. The latter element would be increased in April 2012 and April 2013 to allow for the increases to pensionable pay which had been assumed in the actuarial valuation to £12.12m and £12.70m.

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	-11%	-13%	+11%	+13%
Pension increases	+7%	+7%	-7%	-7%
Salary Growth	+4%	+5%	-4%	-5%

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 11%, 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 1,000 per year), would be expected to reduce the value of the accrued liabilities by between £1m and £1.5m, equivalent to 0.1% to 0.15% 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 7% (or £117m) for future longevity improvement;
- there is allowance for approximately 50 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
A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, long term view of funding and ensure the solvency of the Active Fund. With this in mind, there are a number of prudent strategies that the Administering Authority may deploy in order to maintain employer contribution rates at as nearly a constant rate as possible. These include:

- the use of extended deficit recovery periods;
- the phasing in of contribution increases/decreases; and
- capping of employer contribution rate increases/decreases within a pre-determined range ("the contribution stability overlay").

Contribution stability overlay
There can be occasions when, despite the deployment of contribution stabilising mechanisms such as phasing and the extension of deficit recovery periods, the theoretical employer contribution rate is not affordable or achievable. This can occur in times of tight fiscal control or where budgets have been set in advance of new employer contribution rates being available.

In view of this possibility, the Administering Authority commissioned the Fund Actuary to carry out extensive modeling to explore the long term effect on the Fund of capping future contribution increases. The results of this modeling indicate that it is justifiable to limit annual changes to contributions payable by the Environment Agency, as employer, to no more than +0.5% / -0.5% of pay from 1 April 2014.

In the interests of stability and affordability of the Environment Agency's contributions, the Administering Authority, on the advice of the Active Fund Actuary, believes that the results of the modeling demonstrate that stabilising contributions can be viewed as a prudent longer-term approach. In addition, as the theoretical rate at the 2010 valuation is below the minimum contribution rate of 16.5% of pay that is currently payable to the Fund by the Environment Agency as the Employer, the Administering Authority has agreed that the current level of contributions should be maintained for financial years 2011/12, 2012/13 and 2013/14 until the results of the 2013 valuation are available.

The Active Fund currently has a strong net cash inflow and can therefore take a medium to long term view on determining employer contribution rates to meet future liabilities through operating a fund with an investment strategy that reflects this long term view. It allows short term investment markets volatility to be managed so as not to cause volatility in employer contribution rates. The LGPS Regulations require the longer-term funding objectives to be achieved and the Fund to maintain assets to meet the projected accrued liabilities. The role of the Active Fund Actuary in performing the necessary calculations and determining the key assumptions used is an important feature in determining the funding requirements.

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.

Employees who joined before 1 October 2006 (and are subject to Rule of 85 protections on their pre April 2008 benefits) but reach age 60 after 31 March 2020, plus all employees who joined after 1 October 2006, are assumed to take all of their benefits at age 65. Otherwise 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.

New employers participating in the Fund
Unlike most other LGPS funds, the Fund currently has only a single employer. It is however possible that more than one employer will participate in the Fund in future. There are a number of ways in which new bodies can participate in the LGPS such as a scheduled body or an admission body.

In general, the following principles will apply when a new employer enters the Fund:

- starting assets and liabilities will be notionally ring-fenced within the Fund and the funding level of the new employer tracked over time based on its own experience, cash flows in and out and membership movements;
- the new employer will have its own individual contribution rate separate from any other employer in the Fund and based on its own membership profile, with a surplus/deficit spreading period no greater than the average future working lifetime of its active employees;
- any deficit left behind if past service benefits are transferred from a ceding employer in the Fund to the new employer as result of a fully funded transfer should be met via either an up-front capital payment or over a suitable spreading period, which should be no longer than that applied to the Environment Agency, as agreed with the paying body;
- any deficit that the new body inherits at commencement (e.g. as a result of a “share of fund” transfer from another employer within or outside the Fund) would be expected to be met via an up-front capital payment from the new employer or over some suitable spreading period, which should be no longer than that applied to the Environment Agency;
- any deficit left behind if the new employer ceases in the Fund at a later date should normally be met by a capital payment at point of departure. The assumptions used to carry out the cessation valuation will depend on the reason for departure but typically if the departure is unexpected (e.g. due to insolvency or abolition of the employer) then more conservative assumptions than those used for ongoing funding purposes would be used in order to provide some protection to other employers left within the Fund; and
- the calculation of all up-front capital payments are based on market conditions at the date that the new employer joins the Fund (i.e. the vesting or transfer date) or leaves the Fund in the case of cessations, with payment due from the paying body as soon as sufficient information is available to fully identify all affected members and the associated assets and past service liabilities.

The extent to which these principles will apply will depend on the individual circumstances of the new employer. For example, the Fund will take into account the type of new body (e.g. admission or scheduled body), whether or not it is closed or open to new entrants, its financial covenant and the existence of any Crown guarantee. The Fund will also refer to its policy on the participation of new admission bodies and bulk transfers when agreeing its entry requirements.

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

If, at the valuation date, the Active 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 Active Fund's liabilities at the 2010 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 Active Fund's assets to be invested in key asset classes. This is set out in the SIP and shown below:

Asset Class	Benchmark Index	Current Strategic Benchmark Holding	Actuary's Best Estimate Long-Term Return from asset class[1] (in excess of gilts returns) %pa
UK Equities	FTSE All Share Index	31.5%	4.3%
Overseas Equities	FTSE World ex UK	31.5%	4.0%
Index-Linked Gilts	FTSE Over 5 Year Index-Linked Gilts	13.5%	-
Corporate Bonds	iBoxx Sterling all non-gilt index	13.5%	2.2%
Private Equity	Absolute Return	5.0%	5.5%
Property	IPD Monthly	5.0%	2.2%
Total		100%	3.3%

The Active 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 Active 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 1.7% a year less than the *best estimate* return from the Active Fund's portfolio of assets (if no active manager out-performance is achieved).

In this way, the employer contributions anticipate returns from Active 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 Active Fund has set its investment managers performance targets so that the overall target return for the Active 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 Active Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

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

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 Contribution stability overlay (from 2013 valuation) will reduce risk of volatile employer contributions .
Inappropriate long-term investment strategy	Set fund-specific benchmark, informed by asset-liability modelling. A mechanism for enabling strategy to be linked to funding level could enable asset outperformance relative to liabilities to be locked in.
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. New mechanism introduced at 2010 valuation where Environment Agency will additionally top-up contributions if future pay increases are in excess of the 2010 valuation salary increase assumption.
Effect of possible increase in employer's contribution rate on service delivery	Mitigate impact through deficit spreading and introduction of new contribution stability mechanism at 2013 valuation to increase employer's budgeting certainty.

Demographic

Risk	Summary of Control Mechanism
Pensioners living longer.	Actuary quantifies potential scale of risk associated with continuing improvements in longevity, and identifies separate reserve in the actuarial valuation. The reserve for future longevity improvements was increased in the 2010 actuarial valuation. Fund uses bespoke 'baseline' longevity assumptions, based on the pooled mortality experience of almost 100 large occupational pension schemes, to allow for the individual characteristics of each individual member in the Fund. Club Vita also provides annual monitoring of longevity experience movements, to give an early warning of the adequacy of the reserve for future longevity improvements.
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 CLG 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 Past service deficit recovery element of the Environment Agency's regular contribution rate to be based on monetary amounts (rather than a percentage of payroll) from April 2011 to protect the Fund against falling payroll.
New employers, Arm's Length Bodies (ALBs) review and bulk transfers in or out may crystallise funding deficits.	Administering Authority will manage this by adherence to Pensions Committee's policies on the participation of new admission bodies and bulk transfers.

Governance

The Environment Agency as the administering authority for the Environment Agency Active Pension Fund has delegated the responsibility and accountability for over seeing all aspects of management of the Active Fund to the Pensions Committee.

The Pensions Committee is made up of fifteen Members - four Environment Agency Board members, four executive management members, five trade union nominated members, a deferred member and a pensioner member nominated by the Pensions Committee.

The Pensions Committee meets 4 times a year and has set up a Benefits Group which meet 4 times a year to advise the Pensions Committee on LGPS regulatory changes and benefits administration and Investment Sub-Group to advise the Pensions Committee on the fund and fund managers investment performance.

The Pensions Committee has a Scheme of Delegation to enable the Fund administrator and Environment Agency officers and pension fund administrators to undertake 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 3 years, to coincide with completion of a full actuarial valuation. Any review will take account of the 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 e.g. as a result of the Government's Arm's Length Body review, or to LGPS benefits e.g. as a result of the Hutton Review;
- 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 17 March 2011 and will be reviewed in 2013.

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 takes precedence in the event of 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 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 22 June 2011, 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's 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 financial statements.

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) contributes towards achieving and maintaining a future funding level of 100%; and
(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 modelling 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 intended 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 decided to move to 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 Regulations 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 holding more then 25% under this Insurance contract. As a result the Pensions Committee has agreed to increase the limit from 25% to 35%, moving from Column 1 Schedule 1 to Column 2 Schedule 1 and 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 have a combined out-performance target that equates to 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 including 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 counterparty 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 asset classes 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 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 managers 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. Accordingly, the Environment Agency has made a statement of compliance with the UK Financial Reporting Council’s Stewardship Code and, in respect of investments in the United Kingdom, requires its managers to have due regard to the UK Corporate Governance Code and, in respect of overseas investments, have due regard to relevant recognised standards.

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, Investor Statement on Climate Change, the Carbon Disclosure Project and its sister projects Water Disclosure Project (WDP) and Forestry Footprint Disclosure Project (FFDP). 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 include the UNPRI, Institutional Investors Group on Climate Change (IIGCC) and UK Sustainable Investment and Finance Association (UKSIF), 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 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 that 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 wish 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 AGMs, 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 effect 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 are contained with the documents referenced in our Annual Report and Financial Statements and on our internet sites: www.environment-agency.co.uk/pensions and www.eapf.org.uk.

Myners principle	Evidence of compliance and justifications for non-compliance
Principle 1: Effective decision making	
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. • Those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.	**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 Financial Statements. 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 Financial Statements. • Managers are appointed to invest funds following a comprehensive due diligence process and with input from independent investment advisers.
Principle 2: Clear Objectives	
• 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.	**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 modelling 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.
Principle 3: Risk and liabilities	
• 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.	**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 31 and risks in the Funding Strategy Statement page 60.

Principle 4: Performance assessment	
• 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.	**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.
Principle 5: Responsible ownership	
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.	**Our Fund fully follows this principle** • We have published a statement of compliance with the UK Stewardship Code which, in respect of investments in the United Kingdom, requires its managers to have due regard to the UK Corporate Governance Code and, in respect of overseas investments, have due regard to relevant recognised standards. We also support 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 7) and our Environmental Overlay Strategy (Annex 8). We are a signatory of the UNPRI.
Principle 6:Transparency and reporting	
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.	**Our Fund fully follows this principle** • Our Annual Report and Financial Statements 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.

Approved by the Pensions Committee on 22 June 2011

Annex 6 – UK Stewardship Code Compliance Statement

Environment Agency Active Fund (EAPF) is fully committed to responsible investment. 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, can influence the Board/Directors of under-performing companies to improve the management and financial performance of those companies.

A summary of our compliance with the UK Stewardship code, published in 2010, is detailed below.

Principle 1 Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.	**Our Fund fully follows this principle** • The EAPF has a comprehensive suite of published policy documents which define how we discharge our Stewardship responsibilities, including but not limited to our Statement of Investment Principles, Corporate Governance and our Environmental Overlay Strategy. • All new Investment Management Agreements include requirements to observe the FRC's UK Corporate Governance Code and UK Stewardship Code.
Principle 2 Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.	**Our Fund fully follows this principle** • Declaration of conflict of interests is a standing agenda item at the start of all Pensions Committee and Investment Sub-Group meetings. A public register of Pension Committee members declaration of interests is also maintained and audited annually. • The need to avoid conflicts of interest is also highlighted in our Investment Management Agreements and contracts with external parties.
Principle 3 Institutional investors should monitor their investee companies.	**Our Fund fully follows this principle** • We include our Corporate Governance policy and ESG reporting requirements in all our Investment Management Agreements with all our fund managers and Service Level Agreement with our equity engagement overlay provider. • Monitoring of specific investee companies is detailed our quarterly reports and discussed regularly at fund manger review meetings.
Principle 4 Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.	**Our Fund fully follows this principle** • Our Corporate Governance Policy and Environmental Overlay Strategy details of our engagement policies. • During quarterly review meetings with our fund managers we review their engagement activity and planned escalation of activity.
Principle 5 Institutional investors should be willing to act collectively with other investors where appropriate.	**Our Fund fully follows this principle** • We actively work with other pension funds, asset managers and other organisations to promote responsible investment. These include but are not limited to the UNPRI, IIGCC, NAPF and UKSIF. • All our managers work collaboratively with other parties. Collaborative engagements, research and advocacy work is detailed in our quarterly and annual reports.
Principle 6 Institutional investors should have a clear policy on voting and disclosure of voting activity.	**Our Fund fully follows this principle** • We detail on what basis our votes are cast and the guidelines we direct our managers to use in voting in our Corporate Governance policy. We publish all the votes on environmental resolutions. • All our equity manager have voting polices and most are publicly available. Similarly, our larger managers publish voting records on their website and others on request.
Principle 7 Institutional investors should report periodically on their stewardship and voting activities.	**Our Fund fully follows this principle** • We include a comprehensive annual review of our activities in our Annual Report and Financial Statements and Fundfare. A more detailed review is provided in our periodic Responsible Investment Review.

Approved by the Pensions Committee on 28 September 2010 and will be reviewed as part of an investment strategy review.

Annex 7 – 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, can 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 distinguish ourselves as 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 fund complies with the UK Stewardship Code and subscribes to the Myners' principles of best practice in investment management. Our UK Stewardship Code Compliance Statement is available on our website.

We focus our attention on the quality of corporate governance (and especially corporate environmental governance) of UK, US, EU, Far East and emerging markets stocks, in that order and 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 each manager, in this area, is a key component of our selection and retention criteria. Once appointed, we monitor the 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", 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, where 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. 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 in these areas. We also publish our voting record for all environmental resolutions. We publish the guidelines we use for environmental resolutions and this is available on our website.

All managers are requested to vote all 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 request that 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 AGMs. 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) and its sister projects, Water Disclosure Project (WDP) and Forestry Footprint Disclosure Project (FFDP).

The Environment Agency continues to work with other asset owners to encourage companies to report on their environmental performance. In the UK we publish reports on the environmental disclosure of FTSE all-share companies and we use this in our engagement plan.

We have undertaken collaborative engagements with other asset owners and managers across the world. For example we were partnered the Mercer-led research which considered the implications of climate change scenarios on strategic asset allocation (SAA). It has been hailed as pioneering and a significant step forward in helping pension funds to integrate climate change into their investment strategies in order to reduce risk and maximise investment opportunities.

We expect all our fund managers and our 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 22 June 2011 and will be reviewed as part of an investment strategy review.

Annex 8 – Environmental Overlay Strategy

Vision
The Environment 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 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 fulfil and comply with our fiduciary duty to maximise risk-adjusted investment returns, in the long-term interest 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 (SIP)
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).

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 all our fund managers and principal service providers are co-signatories 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. 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 UK Stewardship Code, UK Corporate Governance Code and Myners principles to be 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. UNPRI, UKSIF and IIGCC) 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, Institutional Investors Group on Climate Change (IIGCC), UK Sustainable Investment and Finance Association (UKSIF), Carbon Disclosure Project (CDP) and its sister projects Water Disclosure Project (WDP) and Forestry Footprint Disclosure Project (FFDP) .

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.

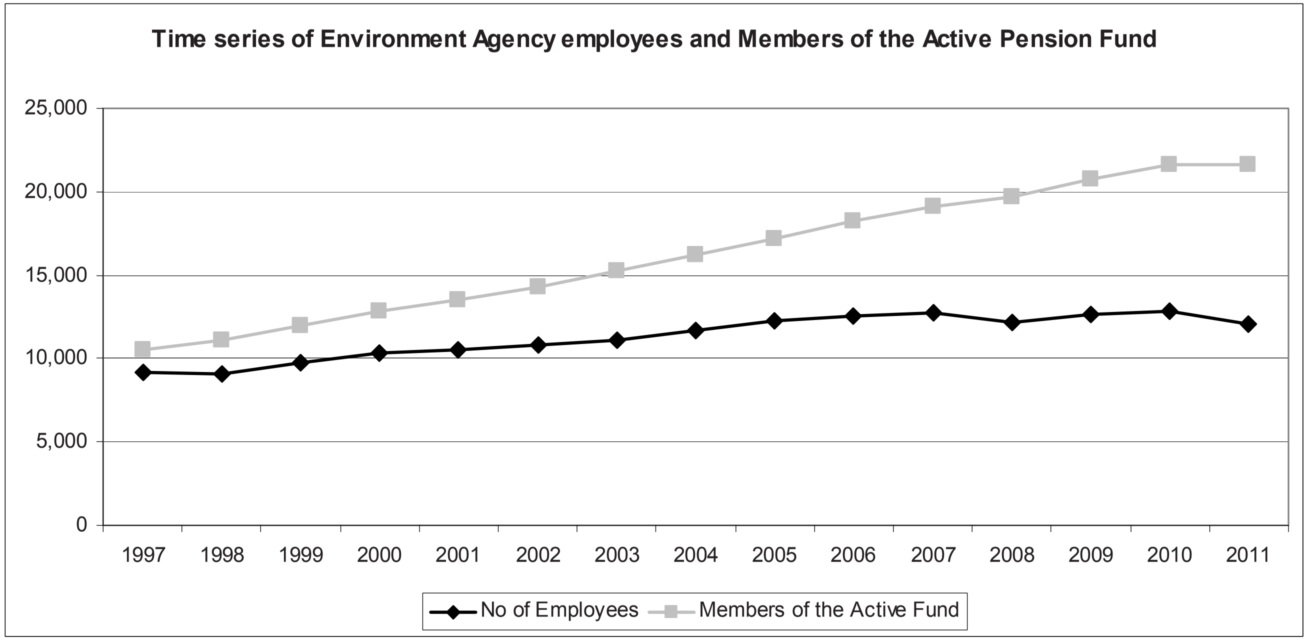
Continuous improvement
We will ensure our Pensions Committee is regularly advised and updated on external developments and on our own performance in this area. We will keep our policies and approach under continual review so as to improve their efficacy.

Approved by the Pensions Committee on 22 June 2011 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	31.3.11
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	10,954
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	6,130
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	4,521
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**	**21,605**



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**	**31.3.11 £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	116	133
Benefits and other payments	(13)	(12)	(14)	(16)	(20)	(22)	(23)	(26)	(29)	(28)	(36)	(37)	(51)	(51)	(57)	(64)
Excess	23	34	78	31	39	36	31	36	39	50	43	51	50	57	59	69
Change in market value of investments	87	34	124	39	113	(105)	(34)	(254)	171	83	235	78	(80)	(421)	404	101
Net increase/ (decrease) in Fund value	110	68	202	70	152	(69)	(3)	(218)	210	133	278	129	(30)	(364)	463	170
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**	**1,765**

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Tel: 0800 121 6593
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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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