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Environment Agency Active Pension Fund

Annual Report and Financial Statements 2007-2008

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ea/br/e/std/v1

We are the Environment Agency. It's our job to look after your environment and make it **a better place** - for you, and for future generations.

Your environment is the air you breathe, the water you drink and the ground you walk on. Working with business, Government and society as a whole, we are making your environment cleaner and healthier.

The Environment Agency. Out there, making your environment a better place.

The Environment Agency Active Pension Fund is registered with the Pension Schemes Registry No. 10079069

Environment Agency Active Pension Fund
Annual Report and Financial Statements 2007-2008

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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 2008. Please note that this year's accounts have been prepared using the new Statement of Recommended Practice (SORP) for pension funds issued by the Pensions Research Accountants Group (PRAG), which is recognised by the Accounting Standards Board as the appropriate body within the pensions industry for issuing statements of recommended practice governing the form and content of financial statements for pension schemes.

The new Local Government Pension Scheme (LGPS) came into effect on 1 April 2008. Communications with our members has been at the forefront of our activities during 2007/08. As well as internal communications, we have sent members three newsletters and provided employees with detailed briefing about the new contribution rates. Almost 2500 staff also attended face to face briefings in their own region during the year. Following the year end the new contribution rates were successfully implemented and generated only a very small number of queries.

I am pleased to say that over the last year, total membership of the Active Fund increased by 3.1% or 593 to 19,683. This comprises 11,348 employees, 4,839 deferred members and 3,496 pensioners. Whilst active membership fell by 578 during the year, due to changes within the Environment Agency, over 93% of eligible employees continue to contribute to the Fund.

The Fund's net assets fell by £29.8 million over the year to £1,496 million as at 31 March 2008 during a period of difficult and volatile global financial markets. The overall investment return for the Fund was a negative 3.1%, underperforming our strategic benchmark by 1.9% with disappointing returns from corporate bonds and US equities that were especially affected by the "credit crunch".

During the year our actuary completed our formal triennial valuation of the Fund's assets and liabilities. The solvency of the fund was assessed to be 103% as at 31 March 2007and 86% on 31 March 2008. Our actuary recommended the employer's contribution rate from 1 April 2008 onwards be increased from 15.0% in 2007/08 by 0.5% each year for the next three years, to a level of 16.5% to help meet the Active Fund's future liabilities.

During the year our innovative work in integrating financially material environmental issues into our investment strategy was externally recognised. We were the proud winners of the Triple Bottom Line Investing Environmental Social Governance Leaders Award 2007, the Local Government Chronicle Corporate Governance Award, Pensions Management's Most Innovative Investment Strategy and Engaged Investor's Best Scheme Governance (Public Sector) awards.

In December 2007, UK Social Investment Forum, Local Authority Pension Fund Forum and Chartered Institute of Public Finance and Accountancy Sustainable Pensions Project launched a self assessment designed to help local government schemes meet their environmental and social governance (ESG) targets. The Environment Agency Pension Fund was commended as the only UK-based local authority pension fund that currently demonstrates best practice towards responsible investment. We were assessed as meeting 'best practice at level 4' which is the highest level.

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.

John Edmonds
Chairman
Environment Agency Pensions Committee
10 July 2008

Report by the Pensions Committee

Governance

Chairman and members
John Edmonds served as Chairman of the Pensions Committee throughout the year. In May 2007 the Board re-appointed Active Member Alan Broughall for a further two year term until 10 May 2009 and in June 2007 David Edwell was appointed from Executive Management of Environment Agency, Wales. In March 2008 John Edmonds' appointment as Chairman was extended by one year to 31 May 2009, Brian Engel's appointment as Pensioner was extended by two years until 21 May 2010. On 31 March 2007 Active Members David Cowley and Chris Galvin retired from the Pensions Committee and on 1 April 2008 Jackie Hamer and Dominic Trepess were appointed to the Pensions Committee as Active Members for an initial three year term.

Committee governance
During the past year the Pensions Committee met on three occasions to fulfil its responsibilities as a sub-committee of the Environment Agency Board. The Board appoints members in accordance with the Governance Compliance Statement. The Committee has delegated responsibility to manage the investment and administration of the Environment Agency's pension funds. The Committee's Investment Sub-Group and an ad-hoc working group on Local Government Pension Schemes (LGPS) changes each met four times.

In March 2008 the Environment Agency Board approved a new LGPS Governance Compliance Statement which took effect on 1 April 2008. It incorporates a statement of compliance with Government guidance, the Pensions Committee Terms of Reference and Standing Orders and the Pension Funds Scheme of Delegation. The statement takes account of changes to the LGPS and clarifies the scope and accountability for the delivery of responsibilities. The statement of compliance with Government guidelines, may be found at Annex 2 and the full Governance Compliance Statement may be found at www.environment-agency.gov.uk/pensions .

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

	Committee business	Committee training	Investment Sub Group	LGPS Changes Working Party	TOTAL
Number of meetings	3	2	4	4	13
Chairman					
John Edmonds	3	2	4		9
Board members					
Richard Percy	2	2			4
Suzanne Warner	2	2			4
Larry Whitty	3	2			5
Chief Executive					
Barbara Young	2	0	1		3
Executive management					
Nigel Reader	3	2	4		9
Graham Ledward	2	1			3
Ric Navarro	2	1			3
David Edwell	3	1			4
Howard Pearce	3	2	4	4	13
Active members					
Alan Broughall	3	2	4	4	13
Dave Cowley	3	2			5
Chris Galvin	3	2		4	9
Phil Chappell	2	2			4
Aileen Parry	3	2		1	6
Pensioner					
Brian Engel	2	1			3

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

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. All new members receive a comprehensive Pensions Committee Handbook and a half-day induction session before attending their first meeting. They are also given the opportunity to attend more specialist courses on specific core competencies and regional pension briefings for Environment Agency employees presented by Human Resources (HR) staff and Capita Hartshead. In each subsequent year of membership they are expected to undertake two to three days training aimed at building or refreshing their knowledge and skills in specific topics in greater depth. A self-assessment training needs questionnaire has been developed to help members to focus on the most important areas for their training. A detailed log of all training undertaken and planned by Committee members is maintained and is available for inspection on request.

Pensions changes

The Committee has, as in previous years, given priority to understanding and preparing for Government proposals to reform pensions and the LGPS in particular. It has set up an ad-hoc LGPS Changes Working Party to undertake the detailed planning and work required to inform all Fund members and to review relevant Environment Agency policies and administrative procedures at Capita Hartshead offices.

During the year, the following statutory instruments were made:

- *The Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (SI 2007 No. 1166)* – made on 3 April 2007, introduced the New Look Local Government Pension Scheme effective from 1 April 2008.
- *The Local Government Pension Scheme (Amendment) (No. 2) Regulations 2007 (SI 2007 No. 1488)* – made on 17 May 2007, contained minor amendments relating to the -
    1. Taxation changes, that had previously been introduced as a result of the Finance Act 2004, with retrospective effective from 6 April 2006, and
    2. Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 effective from 1 April 2008.
- *The Local Government Pension Scheme (Amendment)(No.3) Regulations 2007 (SI 2007 No. 1561)* – made on 30 May 2007 and effective from 1 April 2007, introduced:-
    1. A requirement for the Environment Agency to publish a Governance Compliance Statement and Pension Fund Annual Report, and
    2. A discretionary facility to enable the Environment Agency to prepare and publish a Pension Administration Strategy document.
- *The Local Government Pension Scheme (Administration) Regulations 2008 (SI 2008 No. 239)* – made on 6 February 2008, provided the administrative provisions of the Local Government Pension Scheme (Benefit, Membership and Contributions) Regulations 2007 effective from 1 April 2008.
- *The Local Government Pension Scheme (Transitional) Regulations 2008 (SI 2008 No. 238)* – made on 6 February 2008 and effective from 1 April 2008, carried forward the extant provisions of the Local Government Pension Scheme Regulations 1997 (as amended) applicable to active members of the Scheme on 31 March 2008.

Pension Updates Nos. 11 and 12 were issued in August 2007 and December 2007 respectively, giving details of proposed changes due to take place from 1 April 2008.

Pensions administration
The Environment Agency has a contractual arrangement with Capita Hartshead, a trading division of Capita Business Services Limited, to undertake the day-to-day administration of the Fund. We would like to express our thanks to Capita for resolving over 1,800 fund member queries, for successfully delivering 27 briefings to more than 2,500 Environment Agency employees and for paying pensions to over 3,400 pensioners.

External audit
The Comptroller and Auditor General is the appointed external auditor of the Fund under the Government Resources and Accounts Act 2000 (Audit of Public Bodies) Order 2003. He has contracted PricewaterhouseCoopers LLP to undertake the detailed audit work on his behalf.

Pension Fund Fraud/National Fraud Initiative
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. No Active Fund fraud cases have come to light as a result of this exercise but any cases where fraud is suspected will be pursued. We will seek to agree a repayment plan or, where necessary, take legal action or involve the police. The Fund will participate in the 2008 National Fraud Initiative.

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	36.4	Low-risk, multi-asset passive index tracker
Standard Life Investments	15.1	Active UK Equities
Sarasin & Partners	8.9	Active Global Equities
European Credit Management	8.0	Active Corporate Bonds
State Street Global Advisors	4.8	Active Global Equities
State Street Global Advisors	2.3	Low-risk, eco-enhanced UK index tracker
Morley Fund Management	4.7	UK Property
Capital International	4.6	Active Global Equities
Scottish Widows Investment Partnership	4.4	Active Emerging Markets Equities
Royal London Asset Management	4.3	Active Corporate Bonds
Robeco Alternative Investment	3.7	Private Equity
Informed Portfolio Management	1.7	Passive & Active Currency Management

The above excludes 1.1% due to Cash and AVC investments.

In July 2007 Royal London Asset Management were appointed to manage a new allocation of corporate bonds. In November 2007 Hermes withdrew from providing passive index tracking services to all its clients and the portfolio was transferred to Legal and General.

Corporate governance and environmental overlay strategy
The Corporate Governance Policy (Annex 6) and the Committee's Environmental Overlay Strategy (Annex 7) were in place across the whole Fund during the year. These set out the principles that the Committee expect 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 Local Authority Pension Fund Forum campaign to encourage environmental reporting by large companies. It has also actively supported the work of the UK Social Investment Forum, the Institutional Investors Group on Climate Change, United Nations Principles of Responsible Investment (UNPRI) and the Carbon Disclosure Project. Further information on extra-financial performance is included on page 14 and on our web site www.environment-agency.gov.uk/pensions.

Membership of the Pensions Committee and its advisers for the year ended 31 March 2008

Chairman

John Edmonds *Board Member*

Members

Richard Percy *Board Member*

Suzanne Warner *Board Member*

Larry Whitty *Board Member*

Barbara Young *Board Member and Chief Executive*

Nigel Reader *Director of Finance*

Graham Ledward *Director of Human Resources*

Ric Navarro *Director of Legal Services*

David Edwell *Environment Agency, Wales*

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

Alan Broughall *Member Representative*

Phil Chappell *Member Representative*

David Cowley *Member Representative* – retired 31 March 2008

Chris Galvin *Member Representative* – retired 31 March 2008

Aileen Parry *Member Representative*

Brian Engel *Retired Member Representative*

Jackie Hamer *Member Representative* – appointed 1 April 2008

Dominic Trepess *Member Representative* - appointed 1 April 2008

Advisers

Comptroller and Auditor General, National Audit Office – External Auditor

National Westminster Bank plc – Bankers
Cater Allen Private Bank Ltd

The Northern Trust Company – Custodian

Douglas Anderson, Hymans Robertson – Consulting Actuary

Capita Hartshead – Pensions Administrator

Osborne Clarke – Lawyers

Carolan Dobson – Independent Investment Adviser

Mercer Investment Consulting – Investment Consultants

bFinance Ltd – Fund Manager Selection Consultants

Rathbone Greenbank – Sustainable Responsible Investment Consultants

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, become active members of the Fund. The 12 months ended 31 March 2008 have seen an increase in total membership of 3.1% but a decrease in the Fund's active membership of 4.8%.

Active membership		**2008 No.**	**2007 No.**
At 1 April 2007		**11,926**	11,844
Entrants	New starters	764	1,066
	Late notifications	45	245
		809	1,311
Less:			
Exits	Late notification of previous year leavers	(110)	(76)
	Options pending	(9)	(9)
	New retirement pensions	(339)	(181)
	Deaths in service	(10)	(12)
	Deferred benefits	(892)	(665)
	Transfers in/(out)	(2)	(250)
	Refunds of contributions	(23)	(36)
	Commuted	(2)	-
		(1,387)	(1,229)
At 31 March 2008		**11,348**	11,926

Age profile at 31 March		**2008**		**2007**	
		No	**%**	**No.**	**%**
Under 50	Male	4,703	41.44	5,015	42.05
	Female	3,701	32.61	3,880	32.53
		8,404	74.05	8,895	74.58
50 to 59	Male	1,800	15.86	1,911	16.02
	Female	567	5.00	590	4.95
		2,367	20.86	2,501	20.97
60 and over	Male	483	4.26	454	3.81
	Female	94	0.83	76	0.64
		577	5.09	530	4.45
Total		**11,348**	**100.0**	**11,926**	**100.0**

	2008	2007
The Fund also has:		
Current pensioners (*including spouses' and children's pensions)*	3,496	3,114
Deferred pensioners	4,839	4,050
Total members	**19,683**	19,090

Based on data supplied by Capita Hartshead on 2 April 2008. Capita Hartshead's contact details are included on the back cover.

The figure for Deferred Pensioners includes 336 cases (2007: 322) where there is no entitlement to a deferred pension, and the only entitlement is to a refund of contributions. These are former employees whom we are unable to trace, with refunds being paid as and when we do make contact with them.

Communications

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

Our main focus for communications during the year was ensuring that members were well informed about the new LGPS and how it would affect them. Information was sketchy in the early part of the year so much of the activity took place between December 2007 and March 2008. In addition to our normal communications programme we carried out internal briefings for senior managers, HR professionals and HR and Payroll administration staff between January and March 2008. We also used our internal cascade briefing process several times during the year to highlight information about the new LGPS. Details of specific communications are shown below:

Pension Updates 10 – Active members was issued in April 2007. It covered changes to the LGPS regulations, some changes to Environment Agency pensions policy and an update on progress towards the introduction of the "new look" LGPS.

Pensions Update 11 - Active Members was issued in July 2007. It described recent changes to the Environment Agency pension arrangements and outlined the main benefits of the new-look LGPS.

Pensions Update 12 - All members was issued in December 2007. It expanded on the summary information included in Update 11 by explaining how the new contribution rates would be calculated and how benefits would be calculated from 1 April 2008.

Further newsletters are planned to keep members informed of pension developments.

Active and deferred members will receive an annual statement of their accrued pension benefits during the year.

Fundfare 2008 will be mailed to active and deferred members and pensioners in the autumn. It will summarise the Fund's Annual Report and Financial Statements as at 31 March 2008 and provide information on other pension-related matters.

In May 2007 we launched a *Short guide to the LGPS* to introduce new starters to the benefits of the scheme. The full *Members Guide*, which we updated twice during the year, to take account of changes to the LGPS regulations, remained available electronically to all members. Since the end of the year we have issued a new Short guide and, subject to clarification on some of the outstanding issues with the new LGPS, we hope to publish a new Members Guide in the summer of 2008.

DVD about the new LGPS - In February/March 2008 we distributed 450 copies of the DVD, produced by the Local Government Employers Organisation to Agency managers to cascade to their teams

Contributions letter - In March 2008 we sent all employees a letter explaining how their new contribution rate would be calculated and shown on their monthly pay slip.

The pensions administration contract with Capita Hartshead includes the provision of annual presentations for employees on pensions and related matters at each Region and Head Office. These are known as Pensions Briefings and for 2007/8 focussed on the new LGPS. A total of 27 briefings took place and almost 2500 (around 1300 in 2006/7) Environment Agency staff attended.

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.capitahartshead.co.uk.

Pensions increase

Pensions in payment and deferred benefits are subject to annual review under the Pensions (Increase) Act 1971. The Pensions Increase (Review) Order 2008 required an increase of 3.9% (2007: 3.6%) to be awarded from 7 April 2008 (9 April 2007). This is reduced proportionately for pensions in payment for less than 12 months. As usual, the increase corresponds to the increase applied to State benefits and pensions paid by other public service pension schemes. It reflects the rise in the Retail Prices Index during the 12 months ended 30 September 2007.

Pension Fund investment

Funding strategy statement

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

Investment limits

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended) require the Environment Agency to invest any monies not needed to make payments from the Fund. In doing so, they prescribe the limits on the type and extent of investments which the Environment Agency may pursue.

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.

However, of the total value of the Fund's investments no more than the percentages shown below can be invested in the form of investment described:

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% - deposits with local authorities;
- 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 securities (shares, stocks, debentures, etc) which the Environment Agency transfers or agrees to transfer under stock lending arrangements.
- all investments in unit trust schemes;
- 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.

Statement of investment principles

All LGPS funds are required to publish a Statement of Investment Principles. A new Statement of Investment Principles was adopted by the Pensions Committee on 21 June 2007 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. Details of this strategy can be found in Annex 7.

Investment strategy

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

The investment strategy developed by the Committee aims to maximise the return of the Fund, within an acceptable level of risk, by diversifying its investments throughout world markets, with overseas currency risks relative to pounds sterling managed by a passive currency hedging overlay strategy. 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% to both property and private equity. The Committee believes that this diversification of the Fund's assets will reduce risk whilst enhancing potential returns.

Custody arrangements

With the exception of managed fund units, The Northern Trust Company ("Northern Trust") acts as global custodian on behalf of the Fund's assets. All assets are held in the name of Nortrust Nominees.

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.

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 sub-prime debt, collateralised debt obligations (CDOs) or collateralised loan obligations (CLOs). During the difficult market conditions, we have kept the fund managers' processes and performance under close scrutiny, particularly our bond managers with exposure to the credit markets.

Fund benchmark

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

UK equities	31.5%	FTSE All Share index
Global 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
Property	5.0%	IPD UK Monthly
Private equity	5.0%	Absolute Return

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		
Hermes/ Legal & General	Passive UK equities	FTSE All Share
Hermes/ Legal & General	Passive UK index-linked gilts	FTSE UK Gilts Indexed > 5 yrs
Hermes/ Legal & General	Passive UK conventional gilts	FTSE >15yr Gilt
Hermes/ Legal & General	Passive North American equities	FTSE World North America
Hermes/ Legal & General	Passive European equities	FTSE World Europe ex UK
Hermes/ Legal & General	Passive Japanese equities	FTSE World Japan
Hermes/ Legal & General	Passive Asia Pacific equities	FTSE World Asia Pacific ex Japan
State Street	Passive UK equities low risk eco-enhanced	FTSE 350 index
Active Management		
European Credit	Active corporate bonds	iBoxx Sterling all non-gilt
Royal London	Active corporate bonds	iBoxx Sterling all non-gilt
Standard Life	Active UK equities	FTSE All Share index
Capital International	Active global equities	MSCI All Country World
State Street	Active global equities	MSCI All Country World
Sarasin & Partners LLP	Active global equities (SRI)	MSCI All Country World
Morley	Active property	IPD UK Monthly
Scottish Widows	Active emerging markets equities	MSCI Emerging Markets
Robeco	Active private equity	Absolute Return
Informed Portfolio Management	Active currency	FTSE 100

During November 2007 all assets under management with Hermes were transferred to Legal & General.

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

Hermes/ Legal & General	to match their benchmarks
European Credit	to beat their benchmark by 1% per annum
Royal London	to beat to beat their benchmark by 1% per annum
Standard Life	to beat their benchmark by 2% per annum
Sarasin & Partners LLP	to beat their benchmark by 2% per annum
Capital International	to beat their benchmark by 3% per annum
State Street	to beat their benchmark by 3% per annum (global equities) and to track the FTSE 350 Index (UK equities)
Scottish Widows	to beat their benchmark by 3% per annum
Morley	to beat their benchmark by 1%
Robeco	minimum internal rate of return of 10% per annum or 5% greater than the return on MSCI World index
Informed Portfolio Management	to generate in excess of the gross return of the FTSE100 Index

Financial performance

The Fund's overall return in the year was -3.1% (2007: +7.1%) compared to the benchmark return of -1.2% (2007: +5.9%). During the period the headline rate of the Retail Prices Index rose by 3.8% (2007: 4.8%).

Over the three years to 31 March 2008 the annualised rate of return was +8.3% (2007: +13.4%). The annualised benchmark return was +8.4% (2007: +12.9%).

The table below shows the performance of the managers during 2007/08.

	2007/8			2006/7		
Manager	**Bench mark return %**	**Fund return %**	**Performance relative to benchmark %**	**Benchmark return %**	**Fund return %**	**Performance relative to benchmark %**
Passive Management						
Hermes / L&G (UK equities)	-7.7	-8.5	-0.8	+11.1	+11.1	+0.0
Hermes/ L&G (UK index-linked gilts)	+13.5	+13.9	+0.4	+2.6	+2.6	+0.0
Hermes/ L&G (UK conventional gilts)	+0.0	+0.0	+0.0	+1.7	+1.7	+0.0
Hermes/ L&G (North American equities)	-4.8	-4.7	+0.1	-0.9	-0.9	+0.0
Hermes/ L&G (Europe ex UK equities)	+2.8	+2.2	-0.6	+12.2	+12.2	+0.0
Hermes/ L&G (Japanese equities)	-15.4	-15.2	+0.2	-9.9	-9.9	+0.0
Hermes/ L&G (Asia Pacific ex-Japan equities)	+11.2	+9.7	-1.5	+20.3	+20.3	+0.0
State Street (UK equities)	-7.2	-8.5	-1.3	+11.1	+11.2	+0.1
Active Management						
European Credit Management (Corporate bonds)	-0.6	-11.3	-10.7	+1.1	+1.7	+0.6
Royal London (Corporate bonds) (since August 2007)	+1.6	-0.4	-2.0	-	-	-
Standard Life (UK equities)	-7.7	-7.7	-0.0	+11.1	+13.2	+2.1
Capital International (Global equities)	-2.5	-4.5	-2.0	+2.5	+1.3	-1.2
State Street (Global Equities)	-2.5	-7.1	-4.6	+2.5	+3.0	+0.5
Sarasin & Partners LLP (Global equities/ Environmental Specialist)	-2.5	+1.1	+3.6	+2.5	+9.0	+6.5
Scottish Widows (Emerging market equities) (from July 2006)	+19.7	+15.2	-4.5	+16.8	+14.4	-2.4
Morley (UK property)	-10.7	-6.9	+3.8	+15.6	+18.2	+2.6
Total Fund	**-1.2**	**-3.1**	**-1.9**	**+5.9**	**+7.1**	**+1.2**

The total Fund financial result includes Robeco and IPM for completeness. It is not appropriate to put their detailed figures on this table because their performance is measured differently to the main asset classes and managers above who manage over 95% of our assets.

Hermes withdrew from providing passive index tracking services to all its clients in late 2007, and the portfolio was transferred to Legal and General in November 2007. The performance figures above are a composite of the two managers and the unusual performance relative to benchmark is due to the differing approaches to performance measurement.

Royal London's performance figures only relate to the period since appointment, August 2007.

Portfolio analysis

Distribution of net assets at market value as at 31 March 2008

	Legal & General £m	Standard Life £m	Sarasin & Partners £m	ECM £m	State Street £m	Morley £m	Capital International £m	Scottish Widows £m	Royal London £m	Robeco £m	IPM (Active) £m	Other £m	IPM (Passive) £m	Total £m	% of Fund %
UK equities	144.8	219.3	10.8		38.9		5.8							**419.6**	28.0
Pooled UK equities	0.5				0.3									**0.8**	0.1
Pooled fixed interest	198.6			119.9					3.3					**321.8**	21.5
UK fixed interest									45.3					**45.3**	3.0
Overseas fixed interest									14.6					**14.6**	1.0
Overseas equities	198.4		120.2		66.4		61.7	63.6						**510.3**	34.1
North America	*110.8*		*37.7*		*31.0*		*24.9*	*0.8*						***205.2***	*13.7*
Europe	*51.4*		*69.7*		*18.0*		*19.1*	*2.4*						***160.6***	*10.7*
Japan	*17.5*		*9.7*		*6.0*		*8.8*							***42.0***	*2.8*
Asia Pacific	*18.5*		*1.9*		*3.4*		*2.7*	*13.5*						***40.0***	*2.7*
Emerging Markets	*0.2*		*1.2*		*8.0*		*6.2*	*46.9*						***62.5***	*4.2*
Pooled property						67.6								**67.6**	4.5
Private equity										50.1				**50.1**	3.3
Pooled currency											41.4			**41.4**	2.8
Derivatives													(16.0)	**(16.0)**	(1.1)
Cash (including current assets)	0.5	2.5	0.3		0.3	2.5	1.4	2.1	0.8	5.9		11.5		**27.8**	1.9
AVC investments												5.4		**5.4**	0.4
Other net investments	1.3	4.4	0.6		0.5	0.1	0.3	(0.6)	0.7					**7.3**	0.5
Total	**544.1**	**226.2**	**131.9**	**119.9**	**106.4**	**70.2**	**69.2**	**65.1**	**64.7**	**56.0**	**41.4**	**16.9**	**(16.0)**	**1,496.0**	**100.0**

Geographical distribution of quoted and pooled equity investments

	2008		2007	
	£M	%	£M	%
United Kingdom	420.5	45.2	488.3	47.8
North America	205.2	22.0	224.6	22.0
Europe (excluding UK)	160.6	17.3	147.0	14.4
Emerging markets	62.5	6.7	63.1	6.2
Asia Pacific (excluding Japan)	40.0	4.3	42.9	4.2
Japan	42.0	4.5	54.7	5.4
Total	**930.8**	**100.0**	**1,020.6**	**100.0**

Top 20 holdings of the Fund

		2008	
Holding	**Asset class**	**Total £m**	**% of Fund**
Legal & General over 5year I-L Gilt	Unit Trust bond	198.6	13.4
Legal & General North American Pooled Fund	Unit Trust equity	110.6	7.5
European Credit (Luxembourg) 03/2015	Corporate bonds	102.9	6.9
Legal & General European Pooled Fund	Unit Trust equity	51.4	3.5
IPM Global Currency Fund	Unit Trust equity (currency)	41.4	2.8
SSGA International Equities	Unit Trust equity	30.9	2.1
BP	UK equities	29.9	2.0
HSBC Holdings	UK equities	24.8	1.7
Vodafone	UK equities	21.0	1.4
Legal & General Asia Pacific Pooled Fund	Unit Trust equity	18.4	1.2
Legal & General Japan Pooled Fund	Unit Trust equity	17.5	1.2
European Credit (Luxembourg) 06/2016	Corporate bonds	17.0	1.1
Royal Dutch Shell	UK equities	16.1	1.1
Royal Bank of Scotland	UK equities	15.0	1.0
GlaxoSmithKline	UK equities	15.0	1.0
BG Group	UK equities	13.8	0.9
Anglo American	UK equities	13.3	0.9
Xstrata Plc	UK equities	12.4	0.8
Morley Pooled Pensions Property Fund	Property	9.8	0.7
Hermes Property Unit Trust	Property	9.5	0.6
		769.3	**51.8**

Note – Our holdings in the individual stocks above arise because these companies form a large part of the market capitalization of the UK stock market indices which our passive/active fund managers seek to track or exceed as part of their mandates. Our investment strategy favours investing on a positive best in class basis, and use of corporate engagement and voting, rather than negative screening.

UK equities by sector

	2008			2007	
Sectors	**£M**	**%**	**Sectors**	**£M**	**%**
Oil & Gas	81.6	19.4	Banks	85.8	17.6
Banks	65.6	15.6	Oil & Gas	65.2	13.4
Industrial Goods & Services	45.4	10.8	Industrial Goods & Services	56.3	11.6
Basic Resources	42.9	10.2	Basic Resources	38.8	7.9
Telecommunications	26.9	6.4	Healthcare	32.8	6.7
Healthcare	24.0	5.7	Telecommunications	28.9	5.9
Insurance	23.5	5.6	Insurance	26.0	5.3
Food & Beverage	17.2	4.1	Travel & Leisure	23.2	4.8
Financial Services	16.4	3.9	Retail	19.8	4.1
Other	77.0	18.3	Other	111.5	22.8
Total	**420.5**	**100.0**	**Total**	**488.3**	**100.0**

Note – The relative movements in this table are largely due to market movements in 2007/08 due to global economic conditions rather than any shift in investment strategy.

Top 10 UK equity holdings

	2008			2007	
Company	**Total £m**	**% of UK equity**	**Company**	**Total £m**	**% of UK equity**
BP	29.9	6.6	BP	30.0	6.1
HSBC Holdings	24.8	5.4	HSBC Holdings	24.3	5.0
Vodafone	21.0	4.6	Royal Bank of Scotland	23.7	4.9
Royal Dutch Shell	16.1	3.5	GlaxoSmithKline	21.3	4.4
Royal Bank of Scotland	15.0	3.3	Vodafone	19.1	3.9
GlaxoSmithKline	15.0	3.3	HBOS	14.6	3.0
BG Group	13.8	3.0	Anglo American	13.9	2.9
Anglo American	13.3	2.9	Royal Dutch Shell	13.5	2.8
Xstrata	12.4	2.7	Barclays	12.4	2.5
Rio Tinto	9.5	2.1	Aviva	8.9	1.8

Note – The relative movements in this table are largely due to market movements in 2007/08 due to global economic conditions rather than any shift in investment strategy.

Top 10 global equity holdings

		2008				2007	
Company	**Country**	**£m**	**% of equities**	**Company**	**Country**	**£m**	**% of equities**
BHP Billiton	Australia	9.5	0.9	Petrobras	Brazil	4.0	0.4
Encana Corp	Canada	6.2	0.6	Encana Corp	Canada	3.9	0.4
East Japan Railway	Japan	4.3	0.4	Firstrand	South Africa	3.6	0.4
International Business Machines	United States	4.1	0.4	Vale Do Rio Doce	Brazil	3.6	0.4
ABB Ltd	Switzerland	4.1	0.4	Tokyo Gas	Japan	3.4	0.3
Q-Cells	Germany	4.0	0.4	International Business Machines	United States	3.3	0.3
Solarworld	Germany	3.9	0.4	Skanska	Sweden	3.2	0.3
Synthes	Switzerland	3.8	0.4	Itau Holdings	Brazil	3.2	0.3
Veolia Environmental	France	3.8	0.4	Lukoil	Russian Federation	2.9	0.3
Vale Do Rio Doce	Brazil	3.5	0.3	Solarworld	Germany	2.8	0.3

Extra-financial Performance

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

Corporate governance, engagement and voting

We believe that well governed companies produce better and more sustainable returns than 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.

For example, BP is one of the UK's largest listed companies by market capitalisation and the largest company in the FTSE 100 index. As the Pension Fund has nearly 40% of its investments in index passive investments BP, by default, is one of the fund's largest holdings. Since the introduction of our new strategy its relative proportion in our overall fund has fallen by approximately 50% over the last 6 years. BP has had a turbulent year in 2007/8 and we have continued to engage with the company via our fund managers on a wide range of environmental and social issues, we monitor their performance closely.

We aim to vote on all environmental resolutions in the UK, Europe and North America and, where practical, world-wide. During the year we have voted on 93 environmental resolutions, this was an increase of 72% on the previous year. The vast majority was, as usual, in North America, but there were 27 environmental resolutions all relating to nuclear power generation in Japan compared to none in 2006/7 and only 2 the year before.

Resolutions relating to climate change and greenhouse gas emission increased by a 100% from the previous year. Our voting record on environmental resolutions and management exceptions is available on our website at www.environment-agency.gov.uk/pensions.

United Nations Principles of Responsible Investment

The Fund's Corporate Governance and Environmental Overlay strategies set out how we achieve or seek to achieve all of the stated principles. We are delighted that most of our fund managers, including our new corporate bond manager, Royal London, have signed up to the principles directly and the others have committed to support our implementation. We completed the second annual survey on progress in implementing the principles, and the results are available on our website, www.environment-agency.gov.uk/pensions.

Environmental Overlay

The Committee's Environmental Overlay Strategy applies across all of the Fund's mandates and we monitor and report on the progress of its implementation every quarter. We work in collaboration with our fund managers on developing tools, techniques and awareness of extra-financial issues impact on investment decision making cross asset classes.

Public equity: Sarasin have *a sustainable global equity* mandate where ESG issues are at the core of the investment decision making. In April 2007 we increased their mandate by £20m following two very successful years. Despite the challenging market conditions Sarasin exceeded their performance target for the third year in a row, making them our most successful equity manager. One of most successful partnerships in 2007/8 was with our UK equity fund manager Standard Life in producing *Carbon Neutrality and Carbon Offsetting in the FTSE All-share 2007,* a follow-up to last year's *Carbon Management and Carbon Neutrality in the FTSE All-share.* This research has been well received by the media, companies and the investment community. Standard Life are using the research in targeting companies for their engagement programme.

Private Equity: In December 2007 we published, jointly with Robeco, a case study using the Environment Agency mandate to demonstrate the added value of integrating ESG issues in private equity. The case study can be downloaded from our website www.environment-agency.gov.uk/pensions.

Property: Morley has recently completed the third environmental survey for pooled property funds. As part of our aim to increase awareness of ESG issues across the sector, we extended the scope of the survey to include all funds in the IPD PPFI (UK) index and any other funds Morley multi-manager clients invest in (UK and Continental Europe). An executive summary of the results of the survey will be available on our website by autumn 2008.

Bonds: The integration of extra financial issues is less well developed for corporate bonds than for equities. However our new bond manager Royal London are using EIRIS, an ESG research company, to use best in class principles in investment decision making.

We were delighted that our work in integrating financially material environmental issues was again recognised during the year.

December 2007 – UK Social Investment Forum/Local Authority Pension Fund Forum/Chartered Institute of Public Finance and Accountancy Sustainable Pensions Project
Best practice in Environmental Social Governance – National Leader
The Environment Agency Pension Fund was commended as the only UK-based local authority pension fund that currently demonstrates best practice towards responsible investment. We were assessed as meeting 'best practice' at level 4 of a new initiative designed to help local government schemes meet their environmental and social governance (ESG) targets. Rankings are defined as: weak (1), fair (2), good (3) and best practice (4). The study on 99 pension funds found only 10% of local government pension funds rank at level 3, with remaining funds divided evenly between levels 2 and 1. This study is part of the wider UKSIF Sustainable Pensions Project, launched in 2006 to assist UK occupational pension funds adopt more sustainable and responsible investment strategies, and formulated through work with LAPFF and the Chartered Institute of Public Finance and Accounting (CIPFA).

November 2007 – Investment Pensions Europe/Brooklyn Bridge/Triple Bottom Line Investing Environmental Social Governance (ESG) Leaders Award 2007
This prestigious award was open to institutional capital holders, including pension funds, foundations, insurance companies and charities, across the world so we are delighted to be named this year's winner. The judges said "The Environment Agency has long stood out, not just in the UK, but worldwide, as running a pension scheme that puts its money where its mouth is and adheres to a strict but highly successful investment strategy. Once considered a sideline to 'regular' investment styles and criteria, environmentally and socially responsible investments are become increasingly significant, as governments and international conferences seek to control climate change and the impact of carbon emissions and pollution from industrial manufacturing and means of transport. With its solid success record, this enhances The Environment Agency's claim to be a leader as it strives to research ESG for the benefit of pension schemes and their asset managers worldwide, not just its own."

November 2007 – Local Government Chronicle Finance Awards 2007
Corporate Governance Award - Winner
This award is open to Government pension funds in the UK and this is the second time our groundbreaking work has been recognised – we won the same award in 2005. This time the judges said " This fund has embraced Ethical Investing to a level seldom seen in the whole UK pensions industry and placed it central to the whole investment process. Through an ethical overlay strategy each manager is measured not only on investment performance but against a variety of ethical benchmarks and active engagement is not just strongly encouraged, it is mandatory. This policy is pursued at no detriment to the overall investment return achieved. We were particularly impressed at the quality of this Fund's research and their willingness to share with other interested schemes."

October 2007 – Pensions Management Awards 2007
Most Innovative Investment Strategy – Winner
The awards were open to all UK pension funds and the judges felt that a number of entries included good ideas but many were let down by poor performance. In making the award to our Fund, the judges cited our clear statement on sustainable investment, which requires investment managers to invest in clean technologies and environmentally friendly businesses because it makes financial sense as well as being aligned with the Environment Agency's business.

July 2007 – Engaged Investor Trustee Awards 2007
Best Scheme Governance (Public Sector) - Winner
The judges cited our "impressive stand-alone governance policy with clearly laid out lines of communication, decision making authority and delegation lines" They also commented on our "unique focus on risk, not only looking at investment risk but also environmental risk".

April 2007 – United Nations Environment Programme Report
The EAPF was the only UK pension fund case study in the United Nations Environment Programme Finance Initiative report on good practice in responsible investment by public pension funds from around the world.

Measuring the Environmental Footprint of our investments

We have undertaken Environmental Footprint analysis using Trucost's methodology for each of our active equity funds against their respective benchmarks for the last three 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% less than that of benchmark on 31 March 2008. We are one of the first funds in the world to decrease our environmental footprint.

Class actions

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

Further information

By the autumn of 2008 we are aiming to publish our first Responsible Investment report which will include more information about what we have undertaken to implement our Environmental Overlay Strategy and the UNPRI.

Statement of compliance with the Myners principles

In October 2001 the Government published its response to the review carried out by Paul Myners into institutional investment in the UK.

In its response to the review, the Government confirmed that the ten investment principles promulgated by Myners would be applied to the Local Government Pension Scheme by means of a combination of a one-off amendment to the LGPS regulations and authoritative guidance developed by CIPFA (Chartered Institute of Public Finance and Accountancy).

The regulation requires administering authorities, such as the Environment Agency, to state their compliance (or otherwise), with the ten principles and to justify non-compliance.

Myners Principle/CIPFA Checklist

Effective decision-making		**Explicit mandates**	
Define who takes investment decisions	✓	Written mandate included in management contract containing elements specified	✓
Consider whether members have sufficient skills	✓	Constraints on the types of investments are in line with regulations	✓
Determine whether appropriate training is being provided	✓	Reasons stated if soft commissions permitted	✓
Assess whether in-house staffing support is sufficient	✓	**Activism**	
Establish an investment committee with suitable terms of reference	✓	Incorporate US principles on activism into mandates	*Note 2*
Draw up a business plan	✓	Engage external voting agencies if appropriate	✓
Clear objectives		Review manager strategies	✓
Set overall investment objective specific only to the Fund's liabilities	✓	Establish means to measure effectiveness	✓
Determine parameters for employer contributions	✓	**Appropriate benchmarks**	
Specify attitude to risk and limits	✓	Consider whether index benchmarks selected are appropriate	✓
Identify performance expectations and timing of evaluation	✓	Limits on divergence from index are relevant	✓
Peer group benchmark in use for comparison purposes only	✓	Active or passive management considered	✓
Focus on asset allocation		Targets and risk controls reflect performance expectations	✓
Priority is given to strategic asset allocation decisions	✓	**Performance measurement**	
All asset classes permitted within the regulations have been considered	✓	Formal structure for regular monitoring in operation	✓
Asset allocation is compatible with liabilities and diversification requirements	✓	Arrangements in place to assess procedures and decisions of members	✓
Expert advice		Similar arrangements established for advisers and managers	✓
Separate contracts in place for actuarial services and investment advice	✓	**Transparency**	
Terms of reference specified	✓	SIP updated as necessary	✓
Specify role of Section 151 officer in relation to advisers	*Note 1*	Consultation undertaken on amendments	✓
Tender procedures followed without cost constraint	✓	Changes notified to stakeholders	✓
		Regular reporting	
		Publish changes to SIP and its availability	✓
		Identify monitoring information to report	✓
		Inform scheme members of key monitoring data and compliance with principles	✓

Notes

1. Whilst the best value process and the statutory responsibilities of Section 151 of the Local Government Act 1972 do not apply to the Environment Agency, it nevertheless abides by and aspires to the principles of best practice.
2. In common with many other Local Government Pension Scheme Funds, the Pensions Committee has delegated engagement with companies to its fund managers. This engagement may not be in line with the US principles.

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 Regulations 1997 (as amended) – (“the 1997 regulations”). New regulations govern the Local Government Pension Scheme with effect from 1 April 2008; however the 1997 regulations were in force for the period covered by these financial statements.

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

Roles and responsibilities of the Pensions Committee

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

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

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

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

The Committee is responsible for keeping records of contributions received in respect of active members of the Fund and for ensuring that contributions are made to the Fund in accordance with the Pensions Act 1995, the 1997 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 are available on the Environment Agency’s website. The maintenance and integrity of the website is the responsibility of the Environment Agency. The work carried out by the Auditors and the Scheme Administrator does not involve consideration of these matters. Accordingly, the Auditors and Administrator accept no responsibility for any changes that may have occurred to the information contained in the financial statements since they were initially presented on the website.

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 £11.1m to £72.0m (2007: risen by £6.5m to £60.9m). The increase for the year ended 31 March 2008 was due mainly to the increase in the employer’s contributions.

Net income from all transfer values received in the year has decreased by £1.0m to £5.0m (2007: decreased by £0.6m to £6.1m).

Retirement benefits and other payments made to or in respect of members during the year have increased by £13.4m to £45.8m (2007: increased by £2.5m to £32.4m).

In overall terms the net additions from dealings with members during the year have decreased by £4.1m to £25.8m (2007: increased by £4.7m to £29.8m).

The value of the net assets of the Fund at 31 March 2008 has decreased by £29.8m to £1,496.0m (2007: increased by £129.0m to £1,525.9m as restated). This is primarily due to a decrease in the market value of its investments.

Accounting Officer's statement on internal control

Scope of responsibility

I was appointed as Accounting Officer of the Environment Agency with effect from 1 June 2008. Prior to this date, the Accounting Officer was Barbara Young. In making this statement, I am reliant upon the commitment and discipline that she exercised in carrying out the role of Accounting Officer during the financial year. I have taken advice from the Head of Internal Audit and the Director of Finance before making this statement. I have also discussed with staff from the National Audit Office, issues arising from their audit of these accounts.

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. To that end I share with the Board of the Environment Agency responsibility for maintaining a sound system of internal control and the mechanism by which both the Board and I assure ourselves that it is working effectively. I am personally accountable to the Board and to Parliament, and the Board is accountable to Government.

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

The Committee is supported by its Investment Sub-Group, a Working Group on Local Government Pension Scheme (LGPS) changes, officers of the Environment Agency and external fund managers who operate in accordance with the Local Government Pension Scheme Regulations 1997 (as amended) and the Local Government Pension Scheme (Management and Investment of Funds) 1998 Regulations (as amended). New regulations replace the Local Government Pension Scheme Regulations 1997 with effect from 1 April 2008. However the 1997 regulations were in force for the period covered by these financial statements.

The roles and responsibilities of the Environment Agency Accounting Officer in respect of propriety and regularity of management of the administration of the Funds are the same as for the Environment Agency as a whole.

The responsibilities and duties of those responsible for management of the Fund and its 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*- details the level of compliance with Government Guidance*;*
- *The Pensions Committee Terms of Reference and Standing Orders* – details the status, composition and responsibilities of Pensions Committee and Members; and
- *Pension Funds Scheme of Delegation* - prescribes the arrangements for, and limitations to, the delegation of powers and duties within the Environment Agency under the LGPS Regulations 1997 (as amended) and (Management and Investment of Funds) Regulations 1998 (as amended) in its capacity as Administering Authority and encompassing the Employing Authority Discretions.

The Pensions Committee reviews its Governance Policy Statement annually before the start of each financial year to take account of regulatory changes and operational needs to comply with the LGPS Regulations. The latest update was approved by the Pensions Committee on 26 February 2008 and ratified by the Environment Agency Board on 19 March 2008. It takes some account of the new Local Government Pension Scheme Regulations which took effect on 1 April 2008 but further revisions will be made during 2008/9.

Members of the Pensions Committee, its Investment Sub-Group and officers and advisers who manage and administer the Funds, are required to pay due regard to the nature of their responsibilities and the need to avoid 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 Chairmen of the Environment Agency Pensions Committee and Audit Committee annually.

The purpose of the system of internal control

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

The system of internal control has been in place within the Environment Agency and in the operation of the Funds for the year ended 31 March 2008 and up to the date of approval of the annual report and accounts. It accords with Defra and Treasury guidance and best practice and has identified the significant issues set out on pages 23 and 24.

Capacity to handle risk

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

The 2004 Pension 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 exempted from these requirements, the Funds have a structured training programme covering from new member induction to those with extended periods of service. Training of Pensions Committee members is assessed on an individual needs basis, taking account of members' existing expertise, and their interests in specific areas. All Pensions Committee members identify their personal training needs and a training log is maintained. Officers' training needs are identified in training and personal development plans.

The risk and internal control environment

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

Pensions administration

The Environment Agency has a contractual arrangement with Capita Hartshead for third-party administration of the Funds. This includes administration of all member and pensioner records, maintenance of LGPS and Fund rules, processing of contributions, payment of benefits, communications and scheme accounting in accordance with the Local Government Pension Scheme Regulations 1997 (as amended). Arrangements are in place for checking the validity of pension claims to avoid fraud and ensure propriety. Quarterly reports are provided to the Agency. More information about Capita Hartshead's risk and control environment is provided in its AAF01/06 report which is reviewed annually by officers and as part of the external audit process.

Global custody

The Environment Agency also has a contractual arrangement with the Northern Trust Company who, with the exception of managed fund units, 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. 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 and as part of the external audit process.

In addition to the above, the key elements of the internal control environment include:

Procedures for the setting and monitoring of the achievement of the Fund's 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 Statements to prepare the triennial actuarial valuation of the Fund, and, in the case of the Active Fund, to set the common contribution rate for the employer. The

Fund's strategic 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 members' handbook, Financial Scheme of Delegation and performance management arrangements, which authorise officers to act on behalf of the Funds 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 pensions function, together with a more detailed Key Risks document which highlights the top risks. These documents assist the Pensions Committee in managing strategic risks across all pensions activities. This has been enhanced for ongoing risk management purposes and will form the basis of future internal audit strategy and planning. Management actions have been taken to mitigate the prioritised risks, and these are being monitored and reported to the Pensions Committee on a regular basis.

The facilitation of policy making and decision making
The Pensions Committee, and senior management of the Environment Agency together with external advisers, jointly contribute to the Funds' 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 for fund managers are set by the Investment Sub-Group, including financial commitments, for approval by the Pensions Committee. Lead Officers cascade Pensions Committee strategy requirements to managers, teams and individuals through policies and procedures, performance appraisal and personal development plans.

Ensuring compliance with established policies, procedures, laws and regulations
The Pensions Committee and its Investment Sub-Group meet regularly to consider plans, performance and the strategic direction of the Funds 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 advisors. Qualitative and quantitative information is provided on their compliance with the Myners principles for good investment management.

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

The Funds have 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 life certificate exercises. Where fraud is suspected full repayment is sought and the police and courts involved as required.

The financial management and reporting of the Funds
The system of financial management is based on a financial control framework that includes the Environment Agency's procurement, purchase order management and financial accounting systems, the Environment Agency's Financial Memorandum and Scheme of Delegation, and the Funds' Scheme of Delegation (now 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
- 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 Funds and the reporting of performance management
The performance of the Funds is reported quarterly to the Investment Sub-Group and Pensions Committee and annually to the Board. Team Business Plans are monitored and the Head of Environmental Finance & Pension Fund Management monitors individual performance, continually and annually.

Review of effectiveness

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the Environment Agency managers of the Funds who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Board and the Audit Committee and a plan to address weaknesses and ensure continuous improvement of the system is 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 that sets strategic direction, approves the Funds' investment and administration strategies and reviews performance. The Board receives reports from the Pensions and Audit Committees on the standards of corporate governance and internal control operating in the Funds.

b) The operation of the Audit Committee that reviews standards of internal control and financial reporting. It also considers audit reports and advises on the Funds' 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. These reviews are informed by an analysis of the risks to which the Funds are exposed and are conducted in accordance with Government Internal Audit Standards.

d) Officers of the Environment Agency act on the recommendations made by external and internal auditors.

Significant internal control issues

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

The Pensions Committee has continued to use a Pension Fund risk register to assist in the management of strategic risks across all pension activities. Actions are taken to ensure these risks, once recognised, are appropriately managed by Environment Agency officers.

Ownership and accountability for the transmission of employee data to Capita Hartshead (the third party pension fund administrator) is assigned to Human Resources under the Pensions Committee governance structure.

Previously reported issues over the quality and timeliness of this data have been improved in 2007/08 through procedural changes and training to enhance employee pensions related data collection, data maintenance, data integrity and the timely submission of membership data to Capita via the implementation of electronic interface reports on a monthly basis. The improvements enabled benefit statements to be issued earlier in 2007.

Additional improvements to the provision of employee related pension data to Capita Hartshead via the implementation of weekly data transfer and the Environment Agency’s centralised Human Resources Service Centre, including increased personal data security are to be completed in 2008/09. The Funds’ risk register in this area will be reviewed and further action taken as necessary. These revised procedures will be reviewed by Internal Audit during 2008/09.

As a result of monitoring reports during 2007/08 by Capita Hartshead to the Pensions Committee of the late payment of special contributions to the Active Fund to fund the costs of an increased number of early retirements, a review was carried out by the Environment Agency and a number of process improvements and new controls were introduced. The amount outstanding from the Environment Agency to the Active Fund at the 31 March 2008 was only £0.2m. Additional monitoring will be undertaken during 2008/09 to ensure that special contributions are paid into the Active Fund within the timescales required by the LGPS regulations.

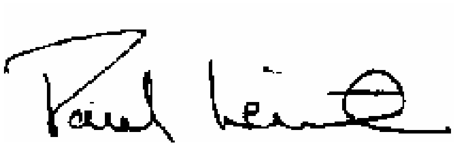
Defra have confirmed receipt of the Management Letter for 2006/07 and the Environment Agency's formal response to the External Audit Report for 2006/07. They have also confirmed their receipt of the Internal Audit Compliance Review completed in May 2007.

The Internal Audit Compliance Review for 2008 highlights two issues.

Two Pensions Committee members had completed their declaration of interests but had not signed the forms, these had not been signed off by the Chairman of the Audit and Risk Committee because they were incomplete. In addition, evidence of review by the Chairman of the Audit and Risk Committee could not be provided for two other declarations.

Board Secretariat controls over the documentation and incomplete annual review of declarations of Pensions Committee members' register of interest needs to be resolved to ensure the governance of the scheme cannot be questioned. The Head of Committee Services will review the process for obtaining and reviewing the declarations of interest to ensure returns are completed properly, reviewed within the timescales necessary and can be easily located once complete. The action is already in progress and will be completed in 2008.

The current Financial Memorandum and its annex on Pensions do not reflect changes to the Local Government Pensions Scheme (LGPS) in 2006/07 or the new LGPS Regulations that came into force on 1 April 2008. This is because the Department for Communities and Local Government (CLG) has not fully communicated and issued all the regulations and statutory guidance. Once this is done the Financial Memorandum will be reviewed and updated by Defra, in consultation with the Environment Agency.



Paul Leinster
Accounting Officer
Environment Agency
10 July 2008

Statement by the Consulting Actuary

Actuarial statement for the purpose of Regulation 77 of the Local Government Pension Scheme Regulations 1997.
As required by regulations, an actuarial valuation of the Fund's assets and liabilities was carried out as at 31 March 2007.

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

- Employees – Contributions in accordance with the Local Government Pension Scheme Regulations 1997.

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

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

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

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

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

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

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

Full details of the method and assumptions are described in my valuation report dated 26 March 2008.
The 2007 valuation revealed that the Fund's assets were sufficient to meet 103% (94% at 31 March 2004) of the liabilities accrued up to that date. Assets were taken into account at their then market value of £1,521m (£983m at 31 March 2004). Actual investment returns in the three years to 31 March 2007 were 13.2% p.a. (-2.5% p.a. in the three years to 31 March 2004).

The Environment Agency's contributions have been set in accordance with the Fund's Funding Strategy Statement. The Environment Agency's contributions have risen from 15% of pay in 2007/08 to 15.5% of pay in 2008/09. The Environment Agency's contributions will rise to 16% of pay in 2009/10. A further increase to 16.5% of pay will occur in 2010/11. Contribution levels after this date will be influenced by many factors, including the proposed implementation of cost sharing in 2011, changes to market conditions, actual demographic experience and future investment strategy.

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

Experience since April 2007
The financial experience that affects the Fund's assets and liabilities since the valuation at 31 March 2007 has been poor. Assets have underperformed in relation to the assumptions set at the valuation whilst the value of liabilities will have risen due predominantly to increases in inflation expectations. This rise in inflation expectations will have a significant impact on the cost of new accrual of benefits, which is particularly important in the Active Fund given its youthful liability profile.

Investment returns in the year to 31 March 2008 were -3.1% p.a. Assets and liabilities as at 31 March 2008 are estimated to be £1,491m (excluding AVC's) and £1,734m respectively, implying that the Fund's assets were sufficient to meet 86% of the liabilities accrued up to that date.

W Douglas B Anderson
Fellow of the Institute of Actuaries
For and on behalf of Hymans Robertson LLP
28 May 2008

Hymans Robertson LLP
20 Waterloo Street
GLASGOW
G2 6DB

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

I have examined the summary of contributions to the Environment Agency Active Pension Fund for the Fund year ended 31 March 2008 which is set out on page 28.

Respective responsibilities of the Environment Agency, its Pensions Committee and the Auditors
As described in the statement of the Pensions Committee's responsibilities, the Pensions Committee is responsible for ensuring that contributions are made to the Fund in accordance with the Local Government Pension Scheme Regulations 1997 and the recommendations of the Consulting Actuary. It is my responsibility to provide a statement about contributions paid in accordance with the Local Government Pension Scheme Regulations 1997 and with the recommendations of the Consulting Actuary and to report my opinion to you.

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

Statement about contributions
In my opinion contributions for the Fund year ended 31 March 2008 as reported in the attached summary of contributions payable have been paid, in all material respects, in accordance with the Local Government Pension Scheme Regulations 1997 and the recommendations of the Consulting Actuary with the exception of the late payment of special contributions as disclosed in note 14 to these accounts.

T J Burr
Comptroller and Auditor General
National Audit Office
151 Buckingham Palace Road
Victoria
London
SWIW 9SS

18 July 2008

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 2008 were as follows:

	Notes	Employee £'000	Employer £'000
Required by the LGPS regulations			
Normal contributions		18,285	45,680
Special contributions		-	6,780
Total		**18,285**	**52,460**
Other contributions payable			
Purchase of added years		597	
Additional voluntary contributions (AVCs)		665	-
		1,262	-
Sub-totals		**19,547**	**52,460**
Total employee and employer contributions (as per Fund Account)	3		**72,007**

As more fully disclosed in Note 14 to the accounts, during the year special contributions of £5.7m were not paid over to the Fund by the due date.

Signed on behalf of the Environment Agency Pensions Committee

John Edmonds
Chairman
Environment Agency Pensions Committee
10 July 2008

Paul Leinster
Accounting Officer
Environment Agency
10 July 2008

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 2008 under the Government Resources and Accounts Act 2000 (Audit of Public Bodies) Order 2003. 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 and the auditor

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

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

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

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

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

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

Basis of audit opinions

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

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

Opinions
In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act 2000 and under Schedule 8 to the Environment Agency Financial Memorandum issued by Defra in accordance with the Local Government Pension Schemes Regulations 1997, of the state of the scheme's affairs as at 31 March 2008, of the financial transactions of the Fund for the year ended 31 March 2008 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 Schemes Regulations 1997.

Opinion on Regularity

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

Report

I have no observations to make on these financial statements.

T J Burr
Comptroller and Auditor General
National Audit Office
151 Buckingham Palace Road
Victoria
London
SWIW 9SS

18 July 2008

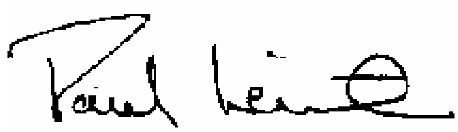
Financial statements for the year ended 31 March 2008

	Notes	2008 £000	As restated 2007 £000
Fund account			
Contributions and transfers			
Contributions receivable	3	72,007	60,865
Transfer values received	4	5,020	6,057
		77,027	66,922
Benefits and other payments			
Benefits payable	5	(45,758)	(32,403)
Payments to and on account of leavers	6	(4,274)	(3,401)
Administration expenses	7	(1,243)	(1,289)
		(51,275)	(37,093)
Net additions from dealings with members		**25,752**	29,829
Return on investments			
Investment income	8	29,905	25,817
Change in market value of investments	9 (a)	(79,676)	78,178
Investment management expenses	10	(5,829)	(4,905)
Net returns on investments		**(55,600)**	99,090
Net (decrease)/ increase in the Fund during the year		**(29,848)**	128,919
Opening net assets of the Fund at 1 April		1,525,855	1,396,936
Net assets of the Fund at 31 March		**1,496,007**	1,525,855
Net assets statement			
Investment assets	9 (c)	1,515,219	1,526,602
Investment liabilities	9 (c)	(19,253)	(4,462)
Current assets	11	4,838	6,193
Current liabilities	11	(4,797)	(2,478)
Net assets of the Fund at 31 March		**1,496,007**	1,525,855

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 pages 25 to 26 and these financial statements should be read in conjunction with it. The Actuary's statement, dated 28 May 2008, is based on a valuation as at 31 March 2007.

The notes on pages 32 to 41 form part of these Financial Statements.

John Edmonds
Chairman
Environment Agency Pensions Committee
10 July 2008



Paul Leinster
Accounting Officer
Environment Agency
10 July 2008

Notes to the financial statements

1. Basis of preparation

The financial statements have been prepared in accordance with the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 and with the guidelines set out in the Statement of Recommended Practice, ‘Financial Reports of Pension Schemes’ (Revised May 2007) (the "SORP").

2. Accounting policies

The following principal accounting policies have been applied consistently in the preparation of the financial statements, except for the following changes required as a result of the Fund adopting the revised SORP.

Changes to accounting policies

Investments previously valued at mid prices are now valued at bid prices for assets where there is a bid/offer spread. This is a change in accounting policy but the difference in valuation is immaterial to the financial statements and therefore comparatives have not been restated.

As a result the comparative figures for investments are reported on a mid price basis and the adjustment in valuation from mid to bid is included in current year change in market value. Had bid prices been used, the overall fund valuation at 31 March 2007 would have been £0.9m lower.

In the prior year the Fund's exposure to equity derivatives contracts of £3.6m was included in UK equities along with a corresponding derivative offset. The opening assets of the Fund have therefore increased by £0.089m, being the unrealised gain on these contracts not recognised in the prior year. The unrealised gain on forward currency contracts was included in other investment balances, and this has been restated as a derivative balance in accordance with the revised SORP. Prior year comparatives have been restated as follows:

	Previously reported £’000	**Prior year adjustment** £’000	**As restated** £’000
Equities	1,042,817	-	1,042,817
Fixed Interest	342,702	-	342,702
Derivatives	-	3,563	3,563
Other Investments	136,532	(3,474)	133,058
Total	**1,522,051**	**89**	**1,522,140**

Investments

Investments are included at their market values, which are determined as follows:

(i) Quoted securities listed on recognised stock exchanges are valued at bid prices at the year end.

(ii) Pooled investment vehicles are stated at the bid price as quoted by the relevant fund managers, which reflect the underlying investments.

(iii) Unquoted securities including private equity investments are valued by fund managers on the basis of latest dealings, professional valuations and financial information at the year end.

(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) Derivative contracts are valued at fair value. Derivative contract assets are fair valued at bid price and liabilities are fair valued at offer price.

(ii) Derivative contracts' changes in fair value are included in change in market value where the economic purpose of the contracts relates to assets. Where the economic purpose relates to income the change in fair value is included in investment income.

(iii) Futures contracts' fair value is determined using exchange prices at the reporting date. The fair value is the unrealised profit or loss at the current bid or offer market quoted 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.

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

(vi) 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.

(iv) Surpluses and deficits arising on conversion or translation are dealt with as part of the change in market value of investments.

Contributions

Normal contributions, both from the members and from the employer, are accounted for as they fall due under the Schedule of Contributions. The employer’s contributions are made at a rate determined by the Consulting Actuary necessary to ensure that the Fund is able to meet its existing and prospective liabilities including indexation.

Special contributions made by the employer are payments in accordance with regulation 80(1) of the Local Government Pension Scheme Regulations 1997 (as amended) to cover the cost of additional membership awarded to leavers aged 50 and over by the Environment Agency under regulation 52 of those regulations. Special contributions are accounted for in accordance with the agreement under which they are paid, or, in the absence of such an agreement, when paid.

Contributions from members for the purchase of added years and additional voluntary contributions are accounted for in the month deducted from the payroll.

Benefits payable

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

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

Other expenses

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

Taxation

UK income tax and capital gains tax

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

Value added tax

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

US withholding tax

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

Overseas tax deductions

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

3. Contributions receivable

	2008 £000	2007 £000
Employer		
Normal	45,680	40,801
Special contributions	6,780	961
	52,460	41,762
Members		
Normal	18,285	18,109
Purchase of added years	597	557
Additional voluntary contributions (AVCs)	665	437
	19,547	19,103
Total	**72,007**	60,865

4. Transfer values received

	2008 £000	2007 £000
Individual transfers from other schemes	5,005	6,018
AVC transfers	15	39
	5,020	6,057

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 approved by the Pensions Committee 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. Benefits payable

	2008 £000	2007 £000
Retirement and dependants' pensions	27,193	23,844
Lump sum retirement grants	17,639	7,710
Lump sum death grants	920	843
Life assurance through AVC provider	6	6
	45,758	32,403

Benefits payable exclude £1.7m (2007: £1.6m) 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.

6. Payments to and on account of leavers

	2008 £000	2007 £000
Individual transfers to other schemes	4,224	3,334
Refunds of contributions	2	38
Payments to SERPS	-	2
AVC transfers	48	27
	4,274	3,401

7. Administration expenses

	2008 £000	2007 £000
Scheme administration	596	612
Professional fees:		
Actuarial	152	135
Audit	38	31
Legal	71	83
Consultancy	27	47
Other administration costs:		
Environment Agency administration	284	291
Communications to members	45	46
Miscellaneous	30	44
	1,243	1,289

The auditors remuneration in respect of non-audit services for 2007/08 was nil (2006/07 nil).

8. Investment income

	2008 £000	2007 £000
Income from fixed-interest securities	2,505	-
Dividends from equities	21,850	21,677
Income from pooled investment vehicles	2,077	1,653
Interest on cash deposits	2,583	2,342
Income from private equity	890	145
	29,905	25,817

9. Investments

(a) Investment movements summary

	As restated market value at 01.04.07	Purchases at cost and derivative payments	Sales proceeds and derivative receipts	Change in market value	Market value at 31.03.08
	£000	£000	£000	£000	£000
Equities	786,241	302,883	(296,510)	(105,687)	686,927
Pooled Equities	234,385	2,086	(19,926)	27,331	243,876
Pooled Fixed Interest	342,702	5,260	(32,810)	6,656	321,808
Fixed Interest	-	78,856	(16,888)	(2,088)	59,880
Pooled Property	76,415	4,735	(4,718)	(8,840)	67,592
Private Equity	22,191	27,205	(3,056)	3,721	50,061
Pooled Currency	21,667	20,000	-	(272)	41,395
Derivatives	3,563	751,577	(770,606)	(504)	(15,970)
AVC investments	5,253	738	(606)	7	5,392
	1,492,417	**1,193,340**	**(1,145,120)**	**(79,676)**	**1,460,961**
Cash deposits & instruments	25,417				27,741
Other	4,306				7,264
	1,522,140				**1,495,966**

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 Scheme such as fees, commissions, stamp duty and other fees. Transaction costs incurred during the year amounted to £1,282,933 (2007: £1,296,479). 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 Scheme.

9. *Investments continued*

(b) Investment value details

Investment assets	2008 £000	As restated 2007 £000
Equities		
UK quoted	419,741	477,327
Overseas quoted	267,186	308,914
	686,927	786,241
Pooled Equities		
UK unit trusts equities	775	10,973
Overseas unit trusts equities	243,101	223,412
	243,876	234,385
Pooled Fixed Interest		
UK unit trusts - index linked gilts	198,588	175,466
UK Unit trusts – conventional gilts	3,305	32,115
Overseas corporate bonds	119,915	135,121
	321,808	342,702
Fixed Interest		
UK corporate quoted	41,759	-
Overseas corporate quoted	14,597	-
UK government quoted	3,524	-
	59,880	-
Pooled Property		
UK unit trusts	51,589	59,668
UK managed funds	9,837	11,463
UK unquoted - collective limited partnership investments	6,166	5,284
	67,592	76,415
Private Equity		
Overseas - unquoted	**50,061**	22,191
Pooled Currency	**41,395**	21,667
Derivative Contracts		
Futures	48	89
Forward foreign exchange	(16,018)	3,474
	(15,970)	3,563
AVC Investments	**5,392**	5,253
Cash deposits and instruments		
Cash margin with brokers	213	64
Cash with custodian and fund managers	27,528	25,353
	27,741	25,417
Other		
Income tax recoverable	282	161
Accrued income	6,000	4,355
Due from trade and currency brokers	4,217	3,690
Due (to) trade and currency brokers	(3,235)	(3,900)
	7,264	4,306
Net investment assets	**1,495,966**	**1,522,140**

(c) Financial assets and liabilities

	2008 £000	As restated 2007 £000
Financial assets		
Equities (includes pooled and private equity)	980,864	1,042,817
Bonds (includes pooled and gilts)	381,688	342,702
Property	67,592	76,415
Currency	41,395	21,667
Cash	27,741	25,417
Derivatives – Futures and forward foreign exchange	48	4,125
AVC	5,392	5,253
Other	10,499	8,206
Total financial assets	**1,515,219**	1,526,602
Financial liabilities		
Derivative Contracts - Forward foreign exchange	(16,018)	(562)
Other - Due (to) trade and currency brokers	(3,235)	(3,900)
Total financial liabilities	**(19,253)**	(4,462)
Net financial assets	**1,495,966**	**1,522,140**

The fund managers operating the pooled investment vehicles are registered in the United Kingdom.

The Fund's global custodian is not authorised to enter into stock lending arrangements and no stock lending has taken place in the year.

(d) Derivative contracts

Derivatives	**2008 Asset £'000**	**2008 Liability £'000**	2007 Asset £'000	2007 Liability £'000
Futures contacts	48	-	89	-
Forward foreign currency contracts	-	(16,018)	4,036	(562)
	48	**(16,018)**	4,125	(562)
Net derivatives	**-**	**(15,970)**	3,563	-

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. Examples of derivatives include 'futures' and 'forwards'.

As recommended by our investment consultant, derivatives are used to a limited extent, primarily for efficient portfolio management and reducing currency risk. For example, our passive manager will set up a series of '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 stock purchases under the futures contracts is the economic exposure and the value subject to market movements at 31 March 2008.

Futures

Type of contract	Expiration	2008 Nominal value	**2008 Asset £'000**	**2008 Liability £'000**	2007 Asset £'000	2007 Liability £'000
FTSE 100 UK exchange traded June 2008 (Hermes)	3 months	-	**-**	**-**	83	-
FTSE 100 UK exchange traded June 2008 (L&G)	3 months	1,397	**30**	**-**	-	-
FTSE 100 UK exchange traded June 2008 (SSGA)	3 months	610	**18**	**-**	6	-
		2,007	**48**	**-**	89	-

Six month rolling 'forward' contracts are used by our currency manager. These fix the exchange rates of the main overseas currencies the Fund is exposed to and help minimise the adverse effect of volatility of those currencies on the value of the Fund.

The relative value of sterling will move during the contract period resulting in either short term unrealised gains or losses. Over time these should balance to have a neutral financial impact. In 2006/07 the strength of sterling at 31 March 2007 resulted in an unrealised gain of £3.5m to the Fund. However the subsequent weakening of sterling by 31 March 2008 resulted in an unrealised loss of £16m. Whilst the 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 exchange

Type of Contract	**Settlement dates**	**Currency bought**	**Currency sold**	**2008 Asset £'000**	**2008 Liability £'000**	2007 Asset £'000	2007 Liability £'000
Forward OTC	1 to 6 months	Sterling	Euros	**-**	**(9,854)**	-	(562)
Forward OTC	1 to 6 months	Sterling	Japanese Yen	**-**	**(3,364)**	837	-
Forward OTC	1 to 6 months	Sterling	US Dollars	**-**	**(2,800)**	3,199	-
				-	**(16,018)**	4,036	(562)

(e) AVC investments

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

	2008 £000	2007 £000
The Equitable Life Assurance Society		
Equitable with-profits funds	562	650
Equitable unit-linked funds	836	929
Equitable building society funds	233	257
	1,631	1,836
Clerical Medical		
With-profits funds	536	504
Unit-linked funds	1,112	918
	1,648	1,422
Standard Life	**2,113**	1,995
Total AVC investments	**5,392**	5,253

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

(f) Investments exceeding 5% of net assets

At 31 March 2008 the holding in European Credit (Luxembourg) S.A. Medium Term Note was valued at £119.9m; this represents 8.0% of the net assets of the Fund (2007: £116.0m and 7.6%).

10. Investment management expenses

	2008 £000	2007 £000
Fund manager base fees	3,976	4,016
Fund manager performance fees	1,556	631
Global custody	114	114
Investment advisers	105	48
Performance and risk measurement	78	96
	5,829	4,905

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

11. Current assets and liabilities

	2008 £000	2007 £000
Current assets		
Debtors		
Environment Agency	651	85
Standard Life	9	49
Overpaid pensions to be refunded	10	-
	670	134
Cash at bank	4,168	6,059
	4,838	6,193
Current liabilities		
Creditors		
Administration and investment expenses	(1,639)	(1,234)
Benefits payable	(2,802)	(931)
PAYE	(356)	(310)
Tax payable on refunds	-	(3)
	(4,797)	(2,478)
Net current assets	**41**	3,715

Amounts due from the Environment Agency are:

(i) employers' and employees' contributions of £148,000 (2007: £12,000) and £NIL (2007: £NIL) respectively outstanding in the normal course of collection at the year end and subsequently paid over within the statutory time limit; and

(ii) invoices for £503,000 (2007: £70,000) for special contributions due in respect of augmentations to members' benefits and £nil (2007: £3,000) for invoices in respect of pensions paid but not chargeable to the Fund.

12. Investment commitments

In accordance with authorised investment strategy and mandates, outstanding Investment commitments at 31 March 2008 included:

	2008 £000	2007 £000
Private equity	56,900	66,742
Property	-	621
Currency	-	20,000
Total investment commitments	**56,900**	87,363

13. Related party transactions

During the year ended 31 March 2008 there have been the following related party transactions:

(i) pensions administration costs of £284,000 (2007: £291,000) recharged to the Fund by the Environment Agency (see Note 7);

(ii) eleven 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 Regulations 1997 (as amended) (“the 1997 regulations”) and the recommendations of the Consulting Actuary; and

(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.

(iv) payment of unfunded liabilities of £1,700,000 (2007: £1,600,000) recharged to the Environment Agency by the pensions administrator (see note 5)

14. Employer related investment

During the year, special contributions totalling £5,742,151 (2007: £331,000) were not paid over to the Fund by the due date. £223,367 (2007: £69,537) was still outstanding at the year end, which represented less than 0.01% of the Fund’s net assets as at 31 March 2008. Apart from this, the Fund did not hold any employer-related investments during the year or at the year-end.

15. Apportionment of common expenditure

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

	2008 %	2007 %
Custodial arrangements	80/20	80/20
Other (e.g. Environment Agency administration costs)	60/40	60/40

16. Events after the balance sheet date

The financial statements were approved by the Pensions Committee on 25 June 2008, and were approved and signed at a meeting of the Board on 10 July 2008. There are no adjusting events that need to be recognised in the financial statements after the balance sheet date. The authorised date for issue is the 18 July 2008.

Annex 1 – Scheme rules and benefits

On 1 April 2008 the Scheme rules and benefits changed and become subject to the Local Government Pension Scheme (Benefits, Membership and Contribution) Regulations 2007(as amended) and the following reflects the regulations in place during the year to 31 March 2008.

Scheme membership and income

(a) All employees of the Environment Agency are eligible for membership of the Local Government Pension Scheme (LGPS). 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 from pensionable pay are 6%, except for employees who were carrying out manual duties immediately before 1 April 1998. For as long as they remain on manual duties their contributions is 5% of pensionable pay.

Subject to limits set by the Her Majesty's Revenue and Customs (HMRC), members can pay additional voluntary contributions (AVCs) 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).

(b) Transfer payments for pension rights in almost any other scheme can be accepted by EAPF to increase benefits which may eventually become payable.

(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' normal contributions 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 1998 (as amended).

Benefits available

Three months membership or more (or a transfer value has been received):

A. Retirement pension and tax-free lump sum awarded:
   1. Payable immediately on cessation of employment:
      (i) voluntarily from age 55 onwards (with the Environment Agency's consent if under age 60); or
      (ii) through permanent incapacity at any age; or
      (iii) as a result of redundancy or efficiency after age 50.
   2. Deferred and payable from normal retirement age in any other circumstances.

B. Spouses' 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):

A. Retirement pension and lump sum on retirement at age 65.
B. Spouses' short term pension and lump sum death grant on death in employment.
C. Children's continuing pensions (based on a minimum of 10 years membership).
D. Refund of contributions when no other benefit payable.

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

Pensions increase awards

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

Transfers to other schemes

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

Annex 2 Governance compliance statement

Statutory Guidance Governance Standards and Principles	Our compliance status	Evidence of compliance and justification for non-compliance
A – Structure		
a) The management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing council.	Compliant	Our Financial Memorandum and the Pensions Committee Terms of Reference, Standing Orders, and Scheme of Delegation set out responsibilities of the Environment Agency Board and Pensions Committee (PC) respectively.
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.	Partially compliant	Our PC includes 4 Non-Executive Environment Agency Board members, 4 Executive Directors (CEO, DoF, DoHR, DoLS), 2 Executive Manager (HoPFM and FM EAW), 5 Active Fund Employee Representatives 1 Pensioner Representative. 2 Active Fund Employee reps are also members of the Investment Sub-Group (ISG) and LGPS Working Party (WP). **Area of non compliance** - Deferred members are currently represented by the Active Fund employee representatives on the main PC and Sub-groups. We think our employee reps can represent deferred members interests and finding deferred members reps would be a challenge. However, we intend to keep this under review linked to any change to the number of deferred members in our funds (currently 21%).
c) That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Compliant	The minutes of the ISG are circulated to all PC members. Recommendations from the ISG and WP 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 WP are made up of members of the main PC supported by officers
B – Representation		
a) That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include:		
i) employing authorities (including non-scheme employers, eg, admitted bodies);	Compliant	We have only one employer the Environment Agency who is represented on both the main PC and ISG. The employers of our Closed Fund members no longer exist.
ii) scheme members (including deferred and pensioner scheme members);	Partially compliant	Our main PC membership includes 5 Trade Union nominated Active Fund employee representatives and one pensioner representative. Our ISG includes 2 Trade Union nominated representatives. **Area of non compliance** – we do not have deferred and pensioner members on our ISG. Our pensioner rep is a member of our decision making main PC, and deferred members interests on our main PC, ISG and WG are represented by our employee reps.

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

Statutory Guidance Governance Standards and Principles	Our compliance status	Evidence of compliance and justification for non-compliance
F – Meetings (frequency/quorum)		
a) That an administering authority's main committee or committees meet at least quarterly.	Compliant	Our PC usually meets four times a year, for normal business (3 meetings) and normally once for briefing or training (1 meeting).
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 meetings are synchronised to meet four times a year before the PC so they can report to and make recommendations to the full Committee.
c) That administering authorities who do not include lay members in their formal governance arrangements, provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Partially compliant	We have 6 "lay" members on our main PC, comprising 5 employee reps and 1 pensioner rep. We hold annual Pensions Briefings (at least 20 at different regional locations around England and Wales) to be inform active members about changes to the LGPS and to ask questions of HR staff and Capita Hartshead (Pension Fund Administrator). **Area of non compliance** Due to the geographical spread of our organisation and fund membership across England and Wales we do not hold an AGM. We do not feel this is necessary as 10-20% of active fund members attend a regional pensions briefing each year.
G – Access		
a) That subject to any rules in the council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Compliant	All members of our PC and ISG receive the same agenda and papers containing advice for each meeting. Members of the PC who are not members of the ISG can request full ISG papers and they receive all the minutes. All our PC and ISG members can ask questions of our professional advisors who attend the PC and ISG.
H – Scope		
a) That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Compliant	Each meeting of our PC receives a report on the performance of our pension funds benefits administration. Our Committee also carries out an annual review of its key strategic risks and our statutory governance and communications policy statements. It also has carried out a review of its own effectiveness.
I – Publicity		
a) That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Compliant	We publish our Governance Compliance Statement on our website, and it is available in hard copy from our Pension Fund Management Team. With effect from 2007/8 it will also be included in our Annual Report & Accounts. We have an agreed procedure for our recognised Trades Unions to nominate new employee representatives to our PC when a vacancy arises. We also advertised in a pensioners' newsletter for a pensioner representative when a vacancy arose.

Approved by the Pensions Committee 26 February 2008 and reviewed annually.

Annex 3 – Communications policy statement

Introduction

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

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

The Active Fund is open to all Environment Agency employees and has 11,300 active members – 1,300 manual and 10,000 non manual, 4,800 deferred members and 3,500 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, 4,800 deferred members and 18,300 pensioners.

The Environment Agency performs the roles of Administering and Employing Authorities with the Pensions Committee, supported by the Finance Director and the Pension Fund Management team and a variety of external advisors, taking overall responsibility for Administering Authority functions. The Environment Agency's Director of Human Resources and the Employee Relations 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 16 members made up of 5 Board members, 5 senior officers, 5 employee/Trades Union reps and one pensioner rep. The Committee is supplemented by Sub-Groups, such as the Investment Sub Group and the LGPS Changes Working Party, where specific advice can be provided by Officers, and external advisors. There are two Trade Union representatives on each sub-group.

This is the third Communications Policy Statement for the Environment Agency Pension Funds and is effective from 1 April 2008.
Any enquiries in relation to this Communication Policy Statement should be sent to:

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Regulatory framework

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

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

(2) *The authority—*

(a) must keep the statement under review,

(b) make such revisions as are appropriate following a material change in its policy on any of the matters mentioned in paragraph (3); and

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

(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 time-scales rather than quality.

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

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

Responsibilities and resources

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

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

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

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

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

Our expenditure on our hard copy and electronic communications is £120k per annum, which equates to approximately £2.50 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 & Payroll;
- the Board and executive managers;
- Pensions Committee members;
- Recognised Trades Union representatives;
- Pensions staff in Finance & HR and at the Fund administrator;
- Professional advisors and Fund investment managers
- Our sponsors - Department for Environment Food & Rural Affairs (Defra) & Welsh Assembly Government (WAG);
- Our auditors - National Audit Office (NAO), PricewaterhouseCoopers and Audit Committee;
- The LGPS Scheme regulator - Department for Communities and Local Government (CLG) –;
- Pensions and investment Media;
- Other stakeholders/interested parties and external bodies.

How we communicate

General communication

We use paper-based communication as one of our main means of communicating, for example, by sending letters to our scheme members. However, we will increasingly complement this by greater use of electronic means such as our websites www.environment-agency.gov.uk/pensions and www.eapf.capitahartshead.co.uk and our internal Easinet. We also accept e-mail communication and respond electronically where possible.

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

Branding

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

Accessibility

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

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

Performance measurement

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

Timeliness

We will measure against the following target delivery timescales:

Communication	Audience	Statutory delivery period	Target delivery period
Scheme 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	30 September each year	30 September each year
Telephone calls	All	Not applicable	90% within 15 seconds
Issue of retirement benefits (at Normal retirement date)	Active members retiring	Within one months of retirement	95% of retirement benefits to be issued within 5 working days of retirement
Issue of retirement benefits (early retirements)	Active members retiring	Within two months of retirement	95% of retirement benefits to be issued within 5 working days of retirement
Issue of deferred benefits	Leavers	Within two months of withdrawal	Within two months
Transfers in	Joiners/active members	Within two months of request	Within two months
Transfers out	Leavers/ deferred members	Within two 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 two months of change coming into effect
Annual Pension Fund Report and Accounts	All	Within two months of request	Within five working days (once published)
Fundfare	Active members	Not applicable	30 September each year
Fundfare	Deferred & pensioner members	Not applicable	By 31 December each year
Pensioner payslips	Pensioners	On change to pension amount due	Monthly 5 days before pay date

Quality

We make use of Informal mechanisms to monitor the quality of our communications. All our publications and our web site include invitations for comment on content and offer suggestions for future editions and contact details are provided.
Comments received in the past have provided many useful suggestions that we have been able to incorporate in later publications.

Results

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

Review process

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

Approved by the Pensions Committee on 26 February 2008 and reviewed annually.

Annex 4 – Funding strategy statement

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

1. Introduction

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

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

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

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

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

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

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

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

The Fund is a defined benefit final salary scheme under which the benefits are specified in the governing legislation (the Regulations). "The Regulations" are defined as:
The Local Government Pension Scheme (Administration) Regulations 2008 (as amended);
The Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended);
The Local Government Pension Scheme (Transitional Provisions) Regulations 2008 (as amended); and
The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended).

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

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

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

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

2. Purpose of the FSS in policy terms

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

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

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

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

3. Aims and purpose of the Pension Fund

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

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

as defined in the Regulations.

4. Responsibilities of the key parties

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

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

The Environment Agency as the Employer should:
- deduct contributions from employees’ pay correctly;
- pay all contributions, including their own as determined by the actuary, promptly by the due date;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of Fund benefits, early retirement strain;

- notify the Administering Authority promptly of all changes to membership or, as may be proposed, which affect future funding; and
- exercise discretions within the regulatory framework;

The Fund actuary should:

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

5. Solvency issues and target funding levels

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

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

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

Underlying these assumptions are the following two tenets:

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

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

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

Derivation of Employer Contributions

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

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

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

Solvency and target funding levels

The Fund's actuary is required to report on the "solvency" of the whole fund at least every three years.

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

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

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

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

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

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

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

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

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

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

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

Sensitivity to assumptions

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

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

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

With regard to demographic sensitivities:

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

Stability of Employer Contributions

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

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

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

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

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

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

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

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

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

Funding For early retirement

Non ill health retirements
The actuary's funding basis makes no allowance for premature retirement except on grounds of ill health. The Environment Agency, as the Employer, is required to pay a lump sum contribution whenever an employee retires before attaining the age at which the valuation assumes that benefits are payable.

It is assumed that members' benefits on age retirement are payable from the earliest age that the employee could retire without incurring a reduction to their benefit and without requiring their employer's consent to retire.

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

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

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

Funding and investment strategies are inextricably linked.

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

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

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

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

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

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

Asset class	Benchmark index	Holding	Actuary's best estimate long term return from asset class[2] (in excess of gilts) %pa
UK equities	FTSE All Share index	31.5%	3%
Overseas equities	FTSE World ex UK	31.5%	3%
Index-linked gilts	FTSE Index-Linked Gilts All Stocks	13.5%	-
Corporate bonds	iBoxx Sterling all non-gilt index	13.5%	0.5%
Private equity	Absolute Return	5.0%	3%
Property	IPD Monthly	5.0%	1%
Total		100%	2.2%

The Fund's benchmark includes significant allocations to equities and property in the pursuit of long-term returns higher than those from investing in just index-linked gilts. It is the Administering Authority's belief that this strategy will, in the long term result in a better-funded and more affordable scheme.

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

The Fund actuary's current *best estimate* of the long-term return from equities is around 3% a year in excess of the return available from investing in index-linked government bonds.

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

In this way, the employer contributions anticipate returns from Fund assets which in the Fund actuary's opinion there is a better than 50:50 chance of delivering over the long-term (measured over periods in excess of 20 years). The Fund has set its investment managers performance targets so that the overall target return for the Fund is +0.9% per annum greater than the return on the strategic benchmark, after allowing for the active managers' fees. This target return is expected, in the medium to long-term, to result in a better-funded and more affordable scheme.

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

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

Balance between risk and reward

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

Intervaluation monitoring of funding position

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

7. Identification of risks and counter-measures

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

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

The following key risks have been identified:

Financial

Risk	Summary of control mechanism
Fund assets fail to deliver returns in line with the anticipated returns underpinning the valuation of liabilities over the long-term	Only anticipate long-term returns on a relatively prudent basis to reduce risk of under-performing. Analyse progress at three yearly valuations Inter-valuation roll-forward of liabilities between formal valuations on a quarterly basis
Inappropriate long-term investment strategy	Set Fund-specific benchmark, informed by Asset-Liability modelling.
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities	Inter-valuation monitoring, as above. Some investment in bonds helps to mitigate this risk.

Active investment manager under-performance relative to benchmark	Short term (quarterly) investment monitoring analyses market performance and managers relative to their index benchmark.
Pay and price inflation significantly more than anticipated	The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases. Inter-valuation monitoring, as above, gives early warning. Some investment in index-linked bonds also helps to mitigate this risk. Investment in other "real" assets (e.g. equities and property) also helps to mitigate risks
Effect of possible increase in employer's contribution rate on service delivery	Mitigate impact through deficit spreading and phasing in of contribution rises.

Demographic

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

Regulatory

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

Structural Changes in Employer

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

Governance

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

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

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

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

8. Monitoring and review

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

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

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

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

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

Annex 5 – Statement of investment principles

Regulatory context

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

2. This statement has been made under the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 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 investments. We have taken account of Guidance from CIPFA on SIPs for LGPS Fund in preparing this SIP.

3. This statement is required to cover the Environment Agency's policy on:

   - investment objective
   - choosing investments
   - the types of investment to be held
   - the balance between different types of investment
   - risk
   - 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
   - statement of compliance with the 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 21 June 2007, after taking advice from its investment staff, investment consultants, independent investment advisor, and consulting actuary.

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

6. The Environment Agency is also required by LGPS regulations to publish a separate Funding Strategy Statement for the Active Fund. It sets out the assumptions used by our Actuary in determining the solvency of the Fund and how these assumptions 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 advisor, 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 investment management agreement with the Environment Agency. The Environment Agency has appointed a performance measurers 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 assets of the Active Fund in close liaison with each fund manager.

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

Investment objectives

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

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

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

Choosing investments

Asset allocation

13. The Environment Agency is responsible for setting the strategic asset allocation of the Fund. It is set after considering the results of an asset and liability 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 considered to maximise the probability of maintaining as near as possible a constant rate of employer's contributions to the Fund as is required by the LGPS regulations.

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

Asset Class	%
UK equities	31.5
Overseas equities	31.5
Index-linked gilts	13.5
Corporate bonds	13.5
Private equity	5.0
Property	5.0

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 Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998.

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.

18. 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

19. 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

20. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 impose limits on certain types of investments which are complied with by the Fund.

21. 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.

22. Around 40% of the Fund will be managed on a passive index-tracking basis to deliver market returns. The portfolio will be spread across equities (UK and overseas) and 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.

23. 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.

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

Risk

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

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

27. Investment risk also includes the risk of under-performing the Fund's benchmark. This is called relative risk. Our investment managers can, to a large extent, control relative risk 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 the maximum amount of risk each manager can take.

28. 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.

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

30. The most fundamental risk is that the Fund's assets produce worse returns than those assumed 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.

31. 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

32. 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.

33. 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 and not overridden by other reasons.

Expected return on investments

34. 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 solvency. 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

35. 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.

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

37. 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 eg. 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.

38. 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.

39. 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.

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

41. 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.

42. 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

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

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

Compliance with Myners principles

45. The Fund aims to fully comply with the Myners activism principles with respect to corporate governance and especially with regard to companies whose environmental behaviour and performance is currently or could in the future impact negatively on our investment returns. We report on our compliance with the Myners principles in our Annual Report and Accounts.

Approved by the Pensions Committee on 21 June 2007 and will be reviewed in 2009 as part of an investment strategy review.

Annex 6 – Corporate governance strategy

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

In June 2004, the Pensions Committee reviewed our old fund managers' compliance with the Active Fund's policy on corporate governance. That is how they have engaged with and sought to influence the performance of companies they have invested in and how they have voted on resolutions at company AGM's, especially on environmental issues, on our behalf.

In light of this review the Committee supported the principle of increased shareholder activism by the Active Pension Fund (which is in line with the Myners' principles of best practice in investment management).

Existing policies
Investment managers can vote the Environment Agency's shares at their discretion and, as an important element of both the investment process and good corporate governance, should make regular contact at senior executive level with companies in which the Fund's assets are invested.

Investment managers should refer "environmental" resolutions to the Environment Agency for discussion prior to voting.

Whilst not necessarily voting on all issues the managers must confirm that they subscribe to the principles of good corporate governance and, when exercising their vote, take this into account.

All fund managers are required to adopt the Association of British Insurers (ABI) disclosure guidelines on Socially Responsible Investment (SRI), with particular emphasis on environmental matters for our mandates.

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

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

We will adopt the ISC and ABI standards in respect of best practice in corporate governance. We expect our new fund managers and/or an engagement/voting overlay service to follow these, 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;

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

We will 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 will 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;

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

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

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

Influencing partnerships
The Environment Agency will maintain and strengthen its liaison with bodies with similar activism goals including the UK Social Investment Forum (UKSIF), Institutional Investors Group on Climate Change (IIGCC), and Carbon Disclosure Project (CDP).

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

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

Approved October 2005 and will be reviewed in 2009 as part of an investment strategy review.

Annex 7 – 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
We will become recognised as a leader in the public sector in financially robust, environmentally responsible investment and pension fund management by 1 April 2007.

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

We will regularly update and develop new polices in light of any future changes to company law, pensions law, and codes of best practice in respect of corporate governance (eg. new Combined Code) and environmental issues (eg. new company annual reporting requirements).

Fiduciary duty
We will fulfil and comply with our overriding fiduciary duty to maximise investment returns on behalf of the pension fund members. As a result of which we affirm that we will assess and take account of existing and future financial risks (eg. climate change and cost of pollution clean ups and opportunities from environmental issues on clean ups), and the exploitation of green technology and services).

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

Statement of investment principles
When preparing and maintaining the SIP, we will be mindful of our overall corporate strategy (eg. "greening" business) and corporate environmental governance policies (eg. encouraging company environmental reporting and disclosure of environmental risks and performance). A revised SIP will be developed with the benefit of research into best practice in respect of environmental issues from other pension funds, and will be reviewed and published annually by the Pensions Committee.

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

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

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

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[1] The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998

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.

In 2001 we allocated 2% of the Fund’s assets to a low-risk, eco-enhanced FTSE 350 index-tracking fund with a maximum tracking error of 2.5%. This allocation is less than other comparative pension funds in the UK and the EU. A 7% allocation to sustainable responsible investment was implemented in 2005.

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 up to 5% of our assets in “clean technologies” 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.

Investment management agreements
We will seek to engage managers using our own form of 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 will also include our corporate governance/environmental policies and disclosure and reporting requirements. External fund managers will have to agree to comply with such requirements as a condition of their appointment.

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

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

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

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

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

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

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

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

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

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

Communication and disclosure
We will communicate our approach to sustainable environmentally responsible pension fund management, and report on the "green" performance of our pension fund. We will do this on our intranet (Easinet), our web site pages (www.environment-agency.gov.uk) and in publications such as the Pension Fund Annual Report and Fundfare, a members' booklet. Users of this information will include staff, pensioners, and other pension funds and policy makers in Government.

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

Approved April 2006 and will be reviewed in 2009 as part of an investment strategy review.

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	31.03.07	31.03.08
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
Pensioners	1,248	1,384	1,548	1,710	1,865	1,999	2,157	2,310	2,501	2,721	2,913	3,114	3,496
Deferred pensioners	652	752	921	1,130	1,291	1,548	1,834	2,426	2,668	2,801	3,521	4,050	4,839
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**

Employer Contributions to the Fund

Year	% of pay
1996/97	6.9
1997/98	6.9
1998/99	6.9
1999/00	8.4
2000/01	8.4
2001/02	8.4
2002/03	9.3
2003/04	10.2
2004/05	11.1
2005/06	12.0
2006/07	13.5
2007/08	15.0
2008/9	15.5
2009/10	16.0
2010/11	16.5

Financial summary	**31.3.96 £m**	**31.3.97 £m**	**31.3.98 £m**	**31.3.99 £m**	**31.3.00 £m**	**31.3.01 £m**	**31.3.02 £m**	**31.3.03 £m**	**31.3.04 £m**	**31.3.05 £m**	**31.3.06 £m**	**31.3.07 £m**	**31.03.08 £m**
Contributions, transfer values received and investment income less investment expenses	36	46	92	47	59	58	54	62	68	78	79	88	101
Benefits and other payments	(13)	(12)	(14)	(16)	(20)	(22)	(23)	(26)	(29)	(28)	(36)	(37)	(51)
Excess	23	34	78	31	39	36	31	36	39	50	43	51	50
Change in market value of investments	87	34	124	39	113	(105)	(34)	(254)	171	83	235	78	(80)
Net increase/ (decrease) in Fund value	110	68	202	70	152	(69)	(3)	(218)	210	133	278	129	(30))
Market value of Fund	**574**	**642**	**844**	**914**	**1,066**	**997**	**994**	**776**	**986**	**1,119**	**1,397**	**1,526**	**1,496**

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www.environment-agency.gov.uk/pensions
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