Environment Agency

Active Pension Fund
Annual Report and Financial Statements 2011 - 2012

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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 2012.

This year our annual report and financial statements has, for the first time, been prepared using the new CIPFA guidance on narrative reporting and accounting disclosures for LGPS pension funds, and I am pleased to say they are compliant with the CIPFA guidance.

Over the last year, total membership of the Active Fund increased by 372 to 21,977 members. This relatively small increase was due to low levels of employee recruitment and an increase in early retirements arising from a voluntary early release scheme, resulting in more deferred members and pensioners. The membership comprises 10,628 employees, 6,425 deferred members and 4,924 pensioners. Over 92% of eligible Environment Agency employees continue to contribute to the Fund.

As at 31 March 2012 the Fund's net assets had increased in value by £96m to £1,861m (2011: £1,765m). The Fund's liabilities increased in value to £2,216m (2011: £1,829m) this increase being largely due to decrease in gilt yields used to value the fund's liabilities. The investment performance of the fund was +5.1% (2011:+7.9%) which was -0.2% (2011: -0.7%) against the fund's strategic benchmark. The average return for LGPS funds for 2011/12 was +2.6%.

The most recent triennial valuation of the Active Fund on 31 March 2010 indicated a funding level of 94%. Our estimated funding level as at 31 March 2012 is 84% which remains as one of the highest in the Local Government Pension Scheme (LGPS).

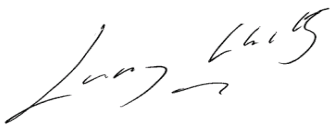
Based on the results of the 2010 triennial valuation, our actuary recommended the employer's contribution rate, from 1 April 2011, remain at an equivalent rate of 16.5% of pay until 31 March 2014 to help meet the Active Fund's future liabilities. The contribution rate from 1 April 2014 will be reviewed following the results of the 31 March 2013 valuation.

The Committee has discussed developments in respect of the Government's policy on public sector pensions at each of its meetings. The Committee made representations to Government over a proposal to increase employee contributions by 3% from 2012 that has not proceeded. The Committee understands the concern that members have about potential future changes to the LGPS in 2014 and we will keep fund members informed of future developments via newsletters and the pension fund website www.eapf.org.uk .

Whilst improving the Fund's financial performance is paramount, during the year our innovative work in integrating financially material environmental issues into our investment strategy was externally recognised by several professional awards and commendations, including one from the Financial Times and International Finance Corporation. The Fund continues to support the work of the United Nations Principles for Responsible Investment (UNPRI) and all of our asset managers and investment and actuarial advisers are all co-signatories. We have also continued to work with Mercer, our investment advisers, to take account of the implications of climate change scenarios in our future strategic asset allocation, in order to reduce risk and maximise investment opportunities.

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

This will be my last Annual Report for the Fund. In the three year's I have been Chair, and indeed in the six years I have been on the Pensions Committee, we have seen some of the most dramatic times for Pensions – the global financial crisis and its effect on stock markets, the new Government's proposals on public sector pensions, the Hutton Report, and the, yet to be finalised, future of the LGPS, of which the EA pension funds are a part. We have also had a valuation of the scheme in 2010 and some dramatic swings in the asset/liability funding ratios of the fund reflecting both financial markets swings effect on assets and the changing discount rate for valuing our liabilities. In net terms the fund has weathered the storm well; the level of membership has remained high and our investment strategy has coped well with the storms surrounding all funds. We are in a viable position, considerably better than most pension funds public and private, with the benefits to our pensioners and members largely maintained and at a manageable cost to the Environment Agency as employer. I pass the baton to the next Chairman of the Committee knowing the Fund is in good hands but knowing also that there will continue to be serious challenges.



Larry Whitty
Chairman
Environment Agency Pensions Committee
12 July 2012

Membership of the Pensions Committee for the year ended 31 March 2012

	Date of appointment	Length of service	End of current appointment	Residual period of current appointment
Board members				
Larry Whitty (Chair)	18/09/06	5 yr 6 mth	17/09/12	0 yr 6 mth
Suzanne Warner	18/09/06	5 yr 6 mth	17/09/12	0 yr 6 mth
Robert Light	07/07/09	2 yr 9 mth	30/06/12	0 yr 3 mth
John Varley	01/11/09	2 yr 4 mth	30/09/12	0 yr 6 mth
Executive members				
Mark McLaughlin	01/11/06	2 yr 5 mth	n/a	n/a
Graham Ledward *	03/01/09	6 yr 3 mth	n/a	n/a
Howard Pearce	12/02/03	9 yr 2 mth	n/a	n/a
Kevin Ingram	07/07/09	2 yr 9 mth	06/07/15	3 yr 3 mth
Active member nominees				
Jackie Hamer	01/04/08	4 yr 0 mth	31/03/14	2 yr 0 mth
Huw Williams	06/07/10	1 yr 8 mth	05/07/13	1 yr 4 mth
Stuart Martin	17/11/09	2 yr 5 mth	16/11/15	3 yr 7 mth
Phil Chappell	17/05/06	5 yr 10 mth	16/05/15	3 yr 2 mth
Simon Peate	07/07/11	0 yr 8 mth	06/07/14	2 yr 4 mth
Pensioner member				
Brian Engel	22/05/05	6 yr 10 mth	22/05/15	3 yr 2 mth
Deferred member				
John Kerr	09/02/10	2 yr 2 mth	08/02/16	3 yr 10 mth
Chief Executive - ex officio				
Paul Leinster	01/06/08	3 yr 9 mth	n/a	n/a

** Left the Environment Agency on 30 April 2012*

Committee member biographies

The biographies of Committee members included below demonstrate the past and current experience of the membership and form the basis for decisions on future training needs as part of our adoption of the CIPFA Knowledge and Skills Framework for LGPS funds.

Larry Whitty has been a member of the Committee since 2006 and Chairman since 2009. He has received training on actuarial valuations, investment strategy and the LGPS. Larry has extensive knowledge of public sector pensions as trade union negotiator and in his work for Consumer Focus. He also has extensive experience of strategic financial investment from his experience as a Government Environment Minister.

Suzanne Warner has been a member of the Committee since she joined the Board in 2006. She is Chair of the Environment Agency Audit and Risk Committee which has oversight of the management and accounts of the Committee. At an earlier stage in her career she was the senior manager in the Department of Health and Social Security with responsibility for national pension policy and worked closely with the National Association of Pension Funds. She has been an Accounting Officer for an Executive Agency and for a Non-Departmental Public Body. She has undertaken specific training on the LGPS as well as attending relevant events to keep her knowledge up to date on developments in pension policy.

Robert Light has been a member of the Committee since 2009 and chaired the Benefits Sub-Group since 2010. He has 19 years' experience of the LGPS as a member of Kirklees Council and as Leading member for 12 years. In addition, he has knowledge of the Firefighters Pension Scheme as a member for 15 years of the West Yorkshire Fire Service and a former Chair & Deputy Chair. Being a member of the Local Government Association (LGA) Board, he actively contributes to the development of policy on the LGPS. He is also a member of the Audit Commission which audits most LGPS funds. He was also a contributing member to the West Yorkshire LGPS fund.

John Varley has been a member of the Committee since 2009 and chaired the Investment Sub Group since 2010. In these roles he has undertaken actuarial and investment training. John has previously undertaken business finance courses as part of a Masters Degree at McGill University in Montreal and in programmes at the Institute of Management Development (IMD) in Lausanne. Previously, John chaired the Audit Committee of both the Countryside Agency and Commission for Rural Communities. In his current role as Director of Clinton Devon Estates, John chairs the Investment Committee and works closely with external fund managers in achieving investment objectives. John is also a trustee of Clinton Devon Estates pension scheme.

Mark McLaughlin is a CIPFA qualified accountant. He was a Director of Finance in Local Government and the Senior Civil Service before he joined the Environment Agency in 2009. Between 1998 and 2007 he was responsible for, and was Section 151 Officer for, two LGPS pension funds, the London Borough of Hammersmith and Fulham, and the London Borough of Enfield. Mark has been an active contributing member of the LGPS since 1987.

Graham Ledward has been a member of the Committee since 2006. Prior to this, Graham chaired the Investment Sub-Committee of a FTSE100 bank for 6 years and was throughout that time, a member of the bank's Pensions Committee, including a 12 month stint as Chair. Until 20 April 2012 Graham was Director of Resources at the Environment Agency and was an active contributing member of LGPS between January 2006 and March 2012. He undertook appropriate training, as necessary, throughout this period.

Howard Pearce has been a member of LGPS since 1988. As Head of Corporate Planning for the National Rivers Authority (1989-1996) and Environment Agency (1996-2002) he was involved in the transfer and development of their pension fund management arrangements. Howard has been Head of the Pension Fund Management Team and member of the Committee since 2003 to date. Howard has received extensive training on pension fund governance, investments, benefits administration and communications to fund members. He is a member of the DCLG LGPS Policy Review Group, Technical Group, Procurement Group, and Investment Regulations Review Group.

Kevin Ingram has been a member of the fund since 2007. He is a qualified accountant (ACA) with a background in audit and financial management in both the public and private sectors. His substantive role is as Finance Manager for EA Wales, and he is currently working on the set up of the new Single Body for Wales. Kevin has been a member of the Committee since 2009 and during this period has received training on the LGPS and pension fund management.

Jackie Hamer has been an active member of the fund since 1985, and an active member nominee since 2008. She has undertaken training on a range of pensions issues, including outsourcing, bulk transfers, cost sharing, funding strategies and investment strategy, as well as the 3 day LGPS Trustee Training Fundamentals course. As a lead lay negotiator within UNISON Jackie also has significant involvement with pensions issues within the trade union movement, and has dealt with pensions issues on behalf of her members.

Huw Williams has been a member of the Committee since July 2010 as a member representative. He has attended the Committee's induction training on the new LGPS. During 2011 he received some investment strategy training and spent 2 days at the LGPS "Trustees" conference. Huw has been a member of the pension scheme since 2007.

Philip Chappell has been a member of the Committee since 2006. He is a Regional Incident and Emergency Planning Manager in the Environment Agency and has been an active member of the LGPS for 24 years. To keep his knowledge up to date Phil has attended numerous training events and conferences on the LGPS and on pension fund investment and management over the last 6 years. He has been the Pensions Representative of Prospect Union's Environment Agency Branch since 2005.

Simon Peate has been a member of the Committee since 2011. He has worked for the Environment Agency as an Environment Officer since 2001. Prior to this, over a period of 25 years, he held a number of senior management positions in the coal industry. He has been active in Unison since 2004 and is currently the Branch Secretary of the Environment Agency Midlands Branch. He is member of the British Coal Staff Superannuation Scheme, the Industry Wide Coal Staff Superannuation Scheme and the EAPF. He has attended the 3 day LGPS Trustee Training Fundamentals course.

Brian Engel has been a member of the Committee since April 2005, as the pensioner representative. He was a contributing member of the LGPS from 1975 and has been a pensioner since 2001. He qualified as a Chartered Civil and Structural Engineer and worked on the design and project management of a range of heavy civil engineering construction projects in both the private and public sector and the Waste Management field. Since joining the Committee he has attended courses and conferences and undertaken a range of training in the LGPS on governance, investments, and benefits administration.

John Kerr has been a deferred member of the Environment Agency's Closed Fund since 1976 following employment with the Anglian Water Authority and joined the Committee in 2009. John qualified as a chartered surveyor and was Chief Executive of two legal businesses for 8 years until 2010. With a broad knowledge of the financial and property markets, he has 7 years' private sector, final salary, pension scheme management experience of 3 occupational schemes plus personal experience of a further 2 and 3 personal pension plans. He has represented two employers on their occupational pension schemes as Chief Executive and Trustee, restoring low funding back to acceptable levels. In 2004 he oversaw an increase in the employees' contributions to their final salary scheme through extensive consultation and by agreement with the workforce. He has received training on many aspects of pensions management and investment regularly since 1989.

Professional advisers to the Committee

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

Report by the Pensions Committee

Governance

Chairman and members

There were no changes in Board appointed members during the year and Larry Whitty continued as Chair of the Committee. John Varley is Chair of the Investment Sub-Group and Robert Light is Chair of the Benefits Sub-Group.

There were no changes in executive members during the year but following the resignation of Graham Ledward, Director of Resources, from the Environment Agency in April 2012, Jonathan Robinson, Director of Resources and Legal Services, was appointed to the Committee. Following the retirement of active member Aileen Parry at the end of April 2011, Simon Peate has been appointed as an active member for an initial three-year term from July 2011 until July 2014.

At the end of 2011 the Committee reviewed its membership to ensure continuity over this continuing period of pensions change and at the February 2012 Board meeting the following extensions to Committee appointments were agreed. Executive member Kevin Ingram's membership was extended to July 2015. Active members Phil Chappell and Stuart Martin were extended to May 2015 and November 2015 respectively. Deferred member nominee John Kerr's membership was extended to February 2016 and pensioner nominee Brian Engel's membership was extended to May 2015, at which time he will have served 10 years on the Committee.

Committee governance

The Environment Agency is responsible for the administration of the Environment Agency Active and Closed Pension Funds and the disbursement of their benefits. The Board has assigned responsibility for pension strategy, administration of both Funds' benefits and the investment and custody of both Funds' assets to the Pensions Committee and its sub-groups.

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

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

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

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

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

During the past year the Committee met on four occasions to fulfil its responsibilities as a sub-committee of the Environment Agency Board. There were also some training sessions which are detailed below in the section on Committee training. The Board appoints members in accordance with the Governance Compliance Statement. The Committee has delegated responsibility to manage the investment and administration of the Environment Agency's pension funds. The Committee's Investment Sub-Group met on four occasions. The Committee's Benefits Sub-Group met on three occasions.

In December 2008 the Government issued statutory guidance on the preparation of Governance Compliance Statements. Our own statement, which incorporates the Pensions Committee Terms of Reference and Standing Orders and the Pension Funds Scheme of Delegation, demonstrates our compliance with this guidance. The statement of compliance with Government guidelines has been updated this year and may be found at page 32. The full Governance Compliance Statement may be found at www.eapf.org.uk and www.environment-agency.gov.uk/pensions.

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

Committee training

As an administering authority of the LGPS, the Committee recognises the importance of ensuring that all staff and members charged with the financial management and decision making with regard to the pension scheme are fully equipped with the knowledge and skills to discharge those responsibilities. The Committee seeks to ensure that membership is both capable and experienced and will provide/arrange training for its members so that they can acquire and maintain an appropriate level of expertise, knowledge and skills

The Committee's training strategy currently 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 the role of trustees, the principles of scheme funding and investment and the management and administration of pension scheme benefits. Following the issue of CIPFA guidance “Pensions Finance Knowledge and Skills Frameworks”, the training strategy will seek to ensure that, going forward, it will fully reflect how the recommended knowledge and skills level requirements set out in the CIPFA guidance are to be acquired.

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

In each subsequent year of membership they are expected to undertake two to three days’ training aimed at building or refreshing their knowledge and skills in specific topics in greater depth. A detailed log of all training undertaken and planned by Committee members is maintained and is presented on the next page. During 2011/12 one special training session was held for the Committee on strategic asset allocation.

Committee training log

Member name	Training log
Larry Whitty (Board Member) Appointed to PC: 18/09/2006	2006 2 days EA PC induction training and special PC meeting on new LGPS proposals 2007 2 days actuarial valuation training 2008 1 day training on the new LGPS 2009 1 day training on outsourcing and pension issues 2009 1 day training on bulk transfers and admitted bodies 2009 Half day training on cost sharing 2009 Half day training on Active Fund funding strategy review 2011 Investment strategy 2011 Strategic asset allocation/investment strategy
Suzanne Warner (Board Member) Appointed to PC: 18/09/2006	2006 2 days EA PC induction training and special PC meeting on new LGPS proposals 2007 2 days actuarial valuation training 2007 1 day IIGCC training seminar - climate change and investments 2008 1 day training on the new LGPS 2008 2 day 6th Annual LGPS Trustees' Conference 2009 1 day training on outsourcing and pension issues 2009 1 day training on bulk transfers and admitted bodies 2009 Half day training on cost sharing 2009 Half day training on Active Fund funding strategy review 2011 Investment strategy 2011 Strategic asset allocation/investment strategy
John Varley (Board Member) Appointed to PC: 01/11/2009	2009 Half day induction training 2009 Half day training on cost sharing 2009 Half day training on Active Fund funding strategy review 2011 Investment strategy 2011 Strategic asset allocation/investment strategy
Robert Light (Board Member) Appointed to PC: 07/07/2009	2009 Half day induction training 2009 Half day training on cost sharing 2009 Half day training on Active Fund funding strategy review 2011 Investment strategy
Phil Chappell (Member Rep) Appointed to PC: 17/05/2006	2006 6 days EA PC Induction training, special PC meeting for briefing on New Look LGPS, annual LGPS Trustees Conference, LGE Trustee Fundamentals 2007 2 day actuarial valuation training 2008 1 day training on the new LGPS 2009 1 day training on outsourcing and pension issues 2009 1 day training on bulk transfers and admitted bodies 2009 Half day training on cost sharing 2009 Half day training on Active Fund funding strategy review 2011 Investment strategy 2011 Strategic asset allocation/investment strategy
Stuart Martin (Member Rep) Appointed to PC: 17/11/2009	2009 Half day training on cost sharing 2009 Half day training on Active Fund funding strategy review 2011 Half day PC induction training on the new LGPS 2011 Investment strategy 2011 2 day LGPS "Trustees" conference 2011 Strategic asset allocation/investment strategy
Jackie Hamer (Member Rep) Appointed to PC: 01/04/2008	2008 1 day PC induction training on the new LGPS 2009 1 day training on outsourcing and pension issues 2009 1 day training on bulk transfers and admitted bodies 2009 Half day training on cost sharing 2009 Half day training on Active Fund funding strategy review 2011 3 days LGPS trustee training fundamentals 2011 Investment strategy 2011 Strategic asset allocation/investment strategy
Huw Williams (Member Rep) Appointed to PC: 06/07/2010	2010 1 day PC induction training on the new LGPS 2011 Investment strategy 2011 2 day LGPS "Trustees" conference

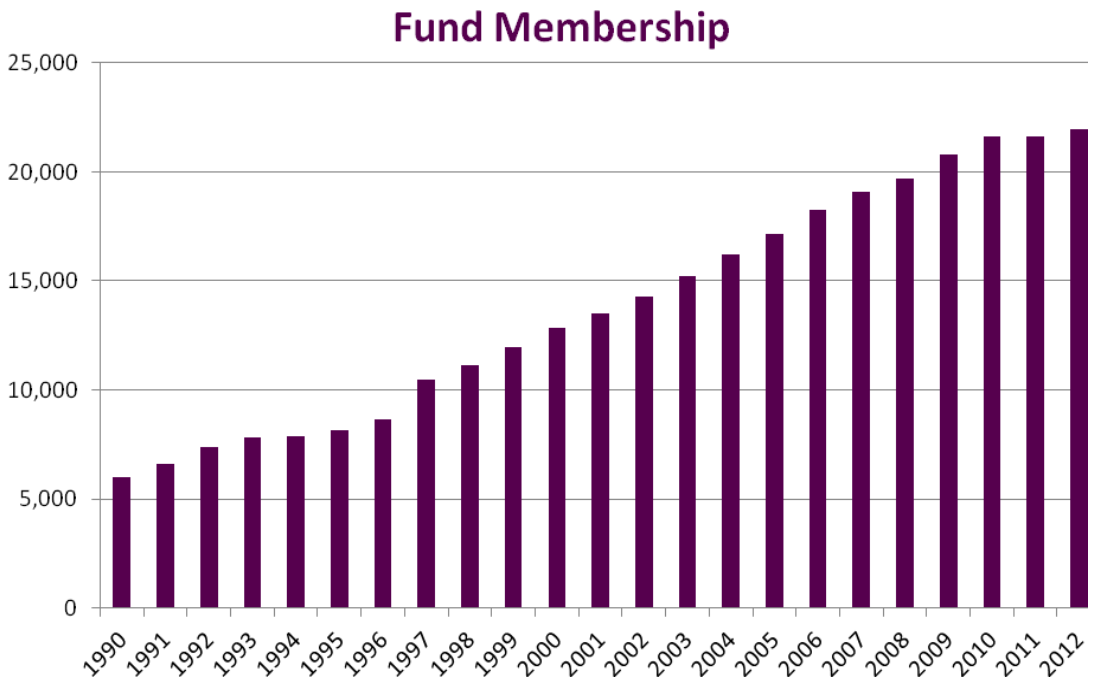
Member name	Training log
Simon Peate (Member Rep) Appointed to PC: 07/07/2011	2011 3 days LGPS trustee training fundamentals 2011 Investment strategy 2012 Half day induction training 2011 Strategic asset allocation/investment strategy
Brian Engel (Pensioner Rep) Appointed to PC: 22/05/2005	2005 3 days EA PC induction training and LGPS trustee fundamentals course 2006 Half day Defra seminar on changes to the LGPS 2006 1 day special PC meeting for briefing on New Look LGPS 2007 1 day Hymans Robertson actuarial valuation training. 2008 1 day training on the new LGPS 2008 2 day 6th Annual LGPS Trustees' Conference 2009 1 day training on outsourcing and pension issues 2009 1 day training on bulk transfers and admitted bodies 2009 Half day training on cost sharing 2009 Half day training on Active Fund strategy review 2011 Investment strategy 2011 Strategic asset allocation/investment strategy
John Kerr (Deferred Member Rep) Appointed to PC: 09/02/2010	2011 Half day training on the new LGPS 2011 3 days LGPS trustee training fundamentals 2011 Investment strategy 2011 Strategic asset allocation/investment strategy
Mark McLaughlin (Management Rep) Appointed to PC: 01/11/2009	2009 Half day induction training 2009 Half day training on cost sharing 2009 Half day training on Active Fund strategy review 2011 Investment strategy 2011 Strategic asset allocation/investment strategy
Graham Ledward (Management Rep) Appointed to PC: 03/01/2006	2006 2.5 days Pension Committee induction training, actuarial training, and special PC briefing on new LGPS proposals 2007 1 day actuarial training and briefing on 2008 triennial valuation results 2008 1 day visit to, and refresher briefing on, the work of Capita Hartshead 2008 1 day New LGPS 2009 1 day Hymans Robertson training on outsourcing and pension issues 2009 1 day training on bulk transfers and admitted bodies 2009 Half day training on cost sharing 2009 Half day training on Active Fund funding strategy review
Kevin Ingram (Management Rep EA Wales) Appointed to PC: 07/07/2009	2009 Half day training on cost sharing 2009 Half day training on Active Fund strategy review 2011 3 days LGPS trustee training fundamentals 2011 Investment strategy 2011 Strategic asset allocation/investment strategy
Howard Pearce (Management Rep) Appointed to PC: 12/02/2003	2004 3+ days CPD on LGPS changes, investment strategy and SRI. 2005 3+ days CPD on LGPS changes, investment strategy and SRI. 2006 4+ days CPD on LGPS changes, actuarial and investment matters 2007 4+ days CPD on LGPS changes, actuarial and investment matters 2008 1 day visit to, and refresher briefing on, the work of Capita Hartshead 2008 Specialist fund investment, accounting and benefits administration training 2009 1 day Hymans Robertson training on outsourcing/pension issues 2009 1 day training on bulk transfers and admitted bodies 2009 Half day training on cost sharing 2009 Half day training on Active Fund funding strategy review 2010 Investment strategy reviews 2011 Investment strategy 2011 Strategic asset allocation/investment strategy

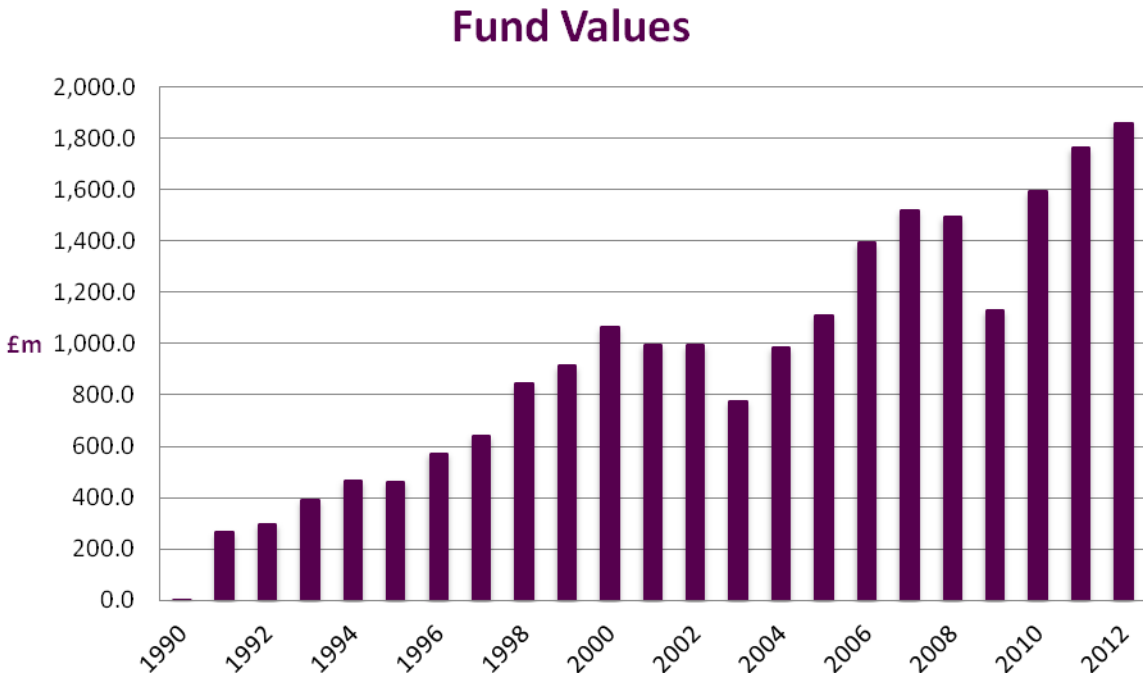
Members' attendance at Committee meetings through the year

	Committee business	Committee training	Investment Sub Group	Benefits Sub Group	TOTAL
Number of meetings	**4**	**1**	**4**	**3**	**12**
Board members					
Larry Whitty (Chair)	4	1	3	3	11
Suzanne Warner	4	1			5
Robert Light	3	0		3	6
John Varley	4	1	4		9
Executive members					
Mark McLaughlin	4	1	4	3	12
Graham Ledward	1	0		0	1
Howard Pearce	4	1	4	3	12
Kevin Ingram	3	1			4
Active members					
Phil Chappell	3	1	4		8
Jackie Hamer	3	1	4		8
Stuart Martin	3	1		3	7
Aileen Parry (to 30/04/11)	0	0	0	0	0
Simon Peate (from 07/07/11)	3	1			4
Huw Williams	3	0			3
Pensioner member					
Brian Engel	4	1		3	8
Deferred member					
John Kerr	4	1		2	7
Chief Executive - ex officio attendee					
Paul Leinster	0	0			0

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

Fund membership and value of assets





Pension Fund membership

Unless they have elected in writing not to be members, all full and part-time employees of the Environment Agency, whether permanent or temporary (over 3 months), become active members of the Fund. The 12 months ended 31 March 2012 have seen a 3.0% decrease in the Fund's active membership (2011: decrease of 8.6%). This decrease is due to lower levels of recruitment and additional deferred leavers and retirements following completion of an Environment Agency led voluntary early release scheme. Consequently there was an increase of 4.8% in deferred members and 8.9% increase in pensioners.

Movement in number of members and pensioners	Active members	Deferred members	Current pensioners	Total
At 1 April 2011	**10,954**	**6,130**	**4,521**	**21,605**
Adjustment for late notifications	(14)	8	19	13
Revised opening balance	10,940	6,138	4,540	**21,618**
Add:				
New active members	503	-	-	
New deferred members	-	453	-	
New pensioners	-	-	413	
New spouses pensions	-	-	47	
New children's pensions	-	-	12	
	503	**453**	**472**	**1,428**
Less:				
Deferred benefits	(452)	-	-	
New retirement pensions	(347)	-	-	
Deaths in service	(12)	-	-	
Refunds of contributions	(3)	-	-	
Options pending	(1)	-	-	
Transfers out	-	(94)	-	
New retirement pensions	-	(66)	-	
Deaths in deferment	-	(5)	-	
Commutation of pension	-	(1)	-	
Death in retirement	-	-	(77)	
Suspended/Ineligible pensions	-	-	(11)	
	(815)	**(166)**	**(88)**	**(1,069)**
At 31 March 2012	**10,628**	**6,425**	**4,924**	**21,977**

Based on data supplied by Capita Hartshead as at 1 April 2012.

Age profile of active members at 31 March	2012		2011	
	No.	**%**	No.	%
15 - 19	2	0.1	2	0.1
20 - 24	181	1.7	209	1.9
25 - 29	1,019	9.6	1,126	10.3
30 - 34	1,747	16.4	1,809	16.5
35 - 39	1,695	16.0	1,736	15.8
40 - 44	1,713	16.1	1,741	15.9
45 - 49	1,564	14.7	1,528	13.9
50 - 54	1,246	11.7	1,216	11.1
55 - 59	970	9.1	1,061	9.7
60 - 64	460	4.3	512	4.7
65 - 69	30	0.2	14	0.1
70 - 74	1	0.1	0	0.0
Total	**10,628**	**100.0**	10,954	100.0

Age profile of deferred members at 31 March	2012		2011	
	No.	%	No.	%
15 - 19	2	0.1	4	0.1
20 - 24	45	0.7	68	1.1
25 - 29	473	7.4	548	8.9
30 - 34	1,063	16.5	1,021	16.7
35 - 39	1,170	18.2	1,153	18.8
40 - 44	1,285	20.0	1,246	20.3
45 - 49	1,153	17.9	993	16.2
50 - 54	676	10.5	579	9.4
55 - 59	458	7.1	417	6.8
60 - 64	85	1.3	87	1.4
65 - 69	9	0.1	9	0.1
70 - 74	4	0.1	3	0.1
75 - 79	2	0.1	2	0.1
Total	**6,425***	**100.0**	6,130*	100.0

**The figure for deferred members includes 334 cases (2011: 337) where there is no entitlement to a deferred pension only to a refund of contributions. These are former employees whom we are unable to trace, with refunds being paid as and when contact is made with them.*

Age profile of current pensioners at 31 March	2012		2011	
	No.	%	No.	%
Child dependants	58	1.2	54	1.2
Pensioners and spouses				
Under 50	66	1.4	63	1.4
50 - 54	69	2.2	99	2.2
55 - 59	401	7.4	333	7.4
60 - 64	1,277	26.9	1,220	26.9
65 - 69	1,394	27.9	1,263	27.9
70 - 74	881	18.0	816	18.0
75 - 79	505	9.8	444	9.8
80 - 84	223	4.4	197	4.4
85 - 89	49	0.7	30	0.7
90 - 94	1	0.1	2	0.1
Total	**4,924**	**100.0**	4,521	100.0

Total membership	**21,977**	21,605

Based on data supplied by Capita Hartshead as at April 2012.

Summary of active member retirements	2012	2011
Ill Health Retirements (all ages) Tier 1	7	12
Ill Health Retirements (all ages) Tier 2	1	0
Ill Health Retirements (all ages) Tier 3	4	2
Early Retirements - efficiency/redundancy over age 55	204	198
Flexible retirements - over age 55	19	21
Early Retirements - age 60 and under age 65	64	78
Normal Retirements - age 65	31	57
Late Retirements - over age 65	17	35
Total retirements	**347**	403

Benefit administration

Administration

The Environment Agency is responsible for administering the current and future pension benefits for over 21,900 members of the Active Pension Fund.

While the Committee (and Benefits Sub-Group) provides strategic direction and regular oversight, day to day pension fund administration is delivered through our third party pension administrator, Capita Hartshead Limited (a subsidiary of Capita Group Plc). We do this because it involves specialist knowledge, complex activity and significant investment in IS/IT which is considered beyond the core business of the Environment Agency. Capita Hartshead is the largest UK third party administrator and was awarded a new contract by the Environment Agency in 2010 following an EU procurement exercise.

The breadth and volume of work delivered by Capita Hartshead is significant, and includes administering members' historical records, handling all fund members' queries, distributing newsletters and annual benefit statements, issuing monthly pension payslips, making lump sum and pension payments, fraud prevention and debt collection, undertaking all HMRC returns, producing audited annual accounts for Parliament, provision of LGPS technical advice and a wide range of other tasks.

Performance measurement

The Committee measures the performance of Capita Hartshead through monthly, quarterly and annual reports showing progress against the contractual Service Level Agreement (SLA). The perspectives by which the Committee assesses the performance include accuracy, timeliness, quality, helpfulness, feedback, service improvements and complaints.

We would like to express our thanks to Capita Hartshead for resolving 15,685 Fund member requests/queries and for paying pensions to over 4,900 pensioners during the year. Over the year, Capita Hartshead achieved the required service levels for 99% of casework processed.

The 5 largest case types processed by Capita Hartshead for the Active Pension Fund during 2011/12 were:

Case type	2012	2011
Retirements	518	582
Retirement estimates	480	1,314
Leavers with deferred pensions	447	850
Joiners	490	200
Transfers out of the Fund	267	245

The total number of staff allocated by Capita Hartshead to the EAPF administration contract is 23, of which 13 deal solely with pension benefits administration. Based on a membership of 41,624 across Active and Closed Funds at 31 March 2012, this represents an average of 3,202 members per administrator. This compares favourably with the CIPFA LGPS average of 3,500 (2011).

Active Fund administration costs for the year to 31 March 2012 were £520k (2011: £597k) including member communications and postage costs.

New administration contract implementation

Over the last 18 months, the Environment Agency has been working with Capita Hartshead to implement our new pension administration contract. This has now been successfully completed with a large number of new initiatives introduced including: lower annual fees; more challenging service levels; new detailed monthly reports; better complaints reporting; revised quarterly reporting; free phone member helpline; data quality/integrity improvements; a member survey; fiche scanning; plus a significant number of new member guides.

In addition, work on the Committee approved new e-communications strategy through www.eapf.org.uk has been completed, with a "live" launch of EAPFOnline later in 2012. Part of this e-communications strategy includes the ceasing of pension payslips for new pensioners and the phased optional removal of pension payslips for all existing pensioners.

Internal controls

The Environment Agency system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of the Fund's policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically.

The system of internal control has been in place in the Environment Agency and in the operation of the Fund for the year ended 31 March 2012. In accordance with LGPS and Treasury guidance and best practice, no significant issues have been identified throughout the year.

Two independent reviews by Environment Agency Internal Audit on the adequacy and effectiveness of internal controls conducted in accordance with Government Internal Audit Standards were carried out during the year.

The Pension Fund compliance audit concluded that the governance framework in place to manage the Fund is well designed, covers all the main areas of activity and meets all statutory requirements.

The Pension Fund risk audit evaluated the overall pension funds' risk management process and specific risks covering funding, investment, regulation and administration controls including Environment Agency internal administration such as the maintenance and supply of current employee pension data to Capita Hartshead. This audit indentified that good risk management processes are embedded in work practices and a broad range of mitigations are in place including timely engagement with regulatory networks and detailed monitoring of 3rd parties. Whilst some actions have been identified to improve internal administration in HR and payroll, it found that their records and databases are maintained effectively.

Data quality

Good quality data is vital to the efficient and accurate payment of retirement benefits and general administration of the Active Pension Fund. This is achieved primarily through the use of electronic interfaces between the Environment Agency and Capita Hartshead on a weekly and monthly basis.

Guidance issued by the Pensions Regulator (tPR) requires the Committee to regularly assess the quality of EAPF member data by December 2012.

Common data is defined by tPR as the key data items that are essential to the identification of the member's identity and are common to all schemes including items such as National Insurance number, surname, gender and address. The Committee must ensure that the Common data is 95% complete (in compliance with the tests specified by tPR) for data created prior to June 2010 and 100% for new data post June 2010.

Data quality testing has been carried out for the Active Fund during 2011/12 and a certificate issued reflecting compliance with tPR guidance. Our post June 2010 data is 100% with pre June 2010 data at 96.21%. The missing data was mainly missing/incorrect addresses and an exercise has been carried out to update these records.

More member specific data called "Conditional data" has also been reviewed with positive results and both these tPR data checks will be tested again on an annual basis.

Data security

The Environment Agency and Pensions Committee take data security very seriously.

Ownership and accountability for the transmission of Environment Agency employees' pensions related data to Capita Hartshead is assigned to the human resources and payroll functions. This is mainly through the secure transmission of monthly and weekly electronic data interface files.

Capita Hartshead holds member data in line with the requirements of the Data Protection Act and complies with the Cabinet Office Security Policy Framework. All Capita Hartshead employees are required to undertake annual data protection training which covers "Personal Data" and actions required taken to protect this.

Government pensions reform

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

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

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

Pensions increase

LGPS pensions in payment and deferred benefits are reviewed under the provisions of the Pensions (Increase) Act 1971 and Section 59 of the Social Security Pensions Act 1975 and linked to the change in the Consumer Prices Index (CPI).
This change applied to EAPF pensions from April 2012 and pensions in payment and deferred pensions were increased by 5.2% with effect from 9 April 2012 (12 April 2011: 3.1%). Any pension which had been in payment for less than a year was increased by a proportionate amount depending upon the number of months it has been in payment.

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

Year (April)	Rate of Increase %	Year (April)	Rate of Increase %	Year (April)	Rate of Increase %
1989	5.9	1997	2.1	2005	3.1
1990	7.6	1998	3.6	2006	2.7
1991	10.9	1999	3.2	2007	3.6
1992	4.1	2000	1.1	2008	3.9
1993	3.6	2001	3.3	2009	5.0
1994	1.8	2002	1.7	2010	0.0
1995	2.2	2003	1.7	2011	3.1
1996	3.9	2004	2.8	2012	5.2

National Fraud Initiative/mortality checks

The Fund has a formal policy and procedure for handling frauds linked to the unreported deaths of pensioners. As part of this policy it participates in the Audit Commission's biennial National Fraud Initiative (NFI) and undertakes life certificate exercises for pensioners who live overseas or in care homes as well as those where power of attorney is held by a third party. In 2012 we also undertook, for the first time, a mortality checking exercise via Capita racing as part of the administration contract with Capita Hartshead. As a general principle, where we investigate cases and fraud is suspected, we will pursue the case and will seek to agree a repayment plan or, where necessary, take legal action or involve the police. There are no unresolved cases for the Active Fund.

Communications

Our summary statement of policy on communications can be found at Annex 7 and a more detailed version is available on our website at www.environment–agency.gov.uk/pensions and www.eapf.org.uk.
In 2011/12 our focus continued to be ensuring that members were well informed about their benefits from the Environment Agency Pension Fund. Details of specific communications for the year and some of our plans for 2012/13 are shown below:

Short Guide and Member Guide – These key member guides provide summary and comprehensive information about LGPS benefits and were reviewed and updated as necessary during the year. The short guide is mailed to all new starters at the Environment Agency and both guides are available at www.eapf.org.uk .

Review of public sector pensions – Members have been kept regularly informed on the progress towards the Government's public sector pension reform. Updates have been issued in our 'Your pension' newsletters throughout the year, with other notices and links added to our website. This will continue to be an important part of our communication work for 2012/13 as the Government's plans for the LGPS become clearer.

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

Your pension – issue 7 – This was issued in December 2011 to all members providing updates on changes to public sector pensions including the latest LGPS consultation and a recently announced plan to change the state pension age.

Your pension – issue 8 - This was issued to active members in March 2012. It provided updates on the pay bands for pension contributions, the timing for the reform of public sector pensions, a reminder about the reduction to the annual allowance, an update to Prudential's in-house AVC charging structure and an update on the Equitable Life compensation scheme.

Annual Benefit Statements – These were issued to all active members in July 2011 and deferred members in August 2011. Active member statement included information on members' service history and transfers into the Fund. The 2012 benefit statements for active and deferred members will be issued around the end of July.

Fundfare 2011 – This was issued to all active, deferred and pensioner members in December 2011 summarising the Fund's Annual Report and Financial Statements as at 31 March 2011 and providing information on other pension related matters. Fundfare 2012 will be issued to all members in autumn 2012.

Topping up your LGPS pension – This booklet details the options available to members for increasing their Fund benefits through means such as Additional Regular Contributions (ARCs) and Additional Voluntary Contributions (AVCs) and was updated as necessary during the year.

Pension briefings - The pension administration contract with Capita Hartshead includes the provision of annual presentations for employees and HR staff on pensions and related matters in our Regions and at Head Office. These are known as *Pension briefings* and took place between May and September 2011 focusing on the review of public sector pensions, state pension changes, pension tax changes and the benefits of Fund membership. Pension briefings for our pensioner members took place in Manchester and London and we held a pilot deferred member briefing for members based in the South East during May 2011. For 2012 we plan to hold briefings between July and October which will focus on new starters, those employees who have opted out and those members considering opting out. We will also hold combined briefings for deferred and pensioner members in North East and South West.

E-communications – Last year the Committee agreed a new strategy that will see the Fund move to an increased use of e-communications with members. The plans include allowing members to access a variety of pension publications and pension pay slips via the internet instead of receiving paper copies, with significant environmental and financial benefits for the Fund. Key to introducing this change was improving the information available via www.eapf.org.uk and launching secure online access to personal pension information and calculations. Work has been progressing well towards this objective and this first stage will be completed during 2012.

Our Environment Agency Pension Funds static website www.eapf.org.uk provides our members with access to an increasing range of information. We aim give members a better understanding of the benefits of the national Local Government Pension Scheme (LGPS) and the Environment Agency Pension Funds. To that end we have developed and published more factsheets and short guides covering various aspects of the LGPS. Topics include:

- The latest contribution bands;
- Transferring benefits in or out of the EAPF;
- A summary of the key benefits of membership;
- Things members should consider before opting out;
- Final pay protections;
- Reductions that apply for early payment of pension;
- The key points about flexible retirement;
- The latest tax controls on pensions;
- How pension increases are applied in the LGPS; and
- A guide to the Internal Dispute Resolution Procedure.

Since the year end we have added two new short guides to help people thinking about retirement and those who have just retired.

We are finalising a complete review of the site layout and content and the new look site will be launched in the summer alongside the launch of our interactive service for members that will enable all members to access information about their benefits including benefit statements for active and deferred members and payslips for pensioner members.

Accessibility - key pension publications for members are provided in bilingual versions in order to satisfy the Environment Agency's Welsh Language Scheme. Electronic versions are available at www.eapf.org.uk.

Complaints

The Fund has formal process for dealing with complaints. The Committee defines a 'complaint' as any expression of oral or written dissatisfaction from members, the EAPF, its employer(s) and/or third parties, with regard to how a service a service has been carried out.

In addition, the Internal Dispute Resolution Procedure (IDRP) is a formal two stage procedure for settling disputes under the Local Government Pension Scheme (Administration) Regulations 2008 (as amended).

At Stage 1 the dispute will be reviewed by a person nominated by the Environment Agency to investigate complaints regarding decisions made under LGPS regulations, known as the 'specified person'. If you disagree with the Stage 1 decision you can apply to Stage 2 where the dispute will be reviewed by a representative of the Administering Authority. If you still cannot agree with the decision you can apply to the Pensions Ombudsman who will make a binding decision and who has the power to award compensation if he feels this is justified.

Out of 10,281 cases processed in 2011/12 by Capita Hartshead, 14 formal complaints from members were received and these have all been resolved. There were 5 cases raised and resolved under Stage 1 of the IDRP during the year by Fund members. No cases went to Stage 2 or the Pensions Ombudsman.

Pension Fund investment

Funding Strategy Statement

All LGPS funds are required to publish a Funding Strategy Statement. This statement is used by the Actuary to inform his valuation and is reproduced in Annex 2 to this document.

Investment limits

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

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

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

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

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

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

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

Statement of Investment Principles

All LGPS funds are required to publish a Statement of Investment Principles. The current Statement of Investment Principles was adopted by the Committee on 26 June 2012 and is reproduced in Annex 3 to these financial statements.

Responsible investment and Environmental Overlay Strategy

We have updated our Corporate Governance Strategy to incorporate it within our Responsible Investment Strategy (Annex 5). Together with the Committee's Environmental Overlay Strategy (Annex 6), this is applied across the whole Fund and set out the principles that the Committee expects us and our Fund managers to follow. In line with our fiduciary duty, we require our fund managers to take account of financially material environmental risks and to seek out investment opportunities to enhance their prospective investment performance.

The Fund has continued to support the work of the United Nations Principles for Responsible Investment (UNPRI) and is delighted that all of our asset managers and principal investment and actuarial advisers are co-signatories. We continue to work collaboratively with other asset owners and managers, particularly supporting initiatives aimed at improving reporting, including the Carbon Disclosure Project, Forestry Footprint Disclosure Project and the Water Disclosure Project. Institutional Investors Group on Climate Change is a key partner as we continue to integrate climate change into our investment strategy. Further information on responsible investment is included on page 89 and at www.environment-agency.gov.uk/pensions.

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 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. For 2011/12, the Committee initially set a strategic asset allocation of 31.5% in UK equities, 31.5% in global equities, 13.5% in index-linked

gilts, 13.5% in corporate bonds, and 5% in both property and private equity. Early in the year the Committee decided it would be appropriate to change the balance between UK and global equities to 37.5 : 62.5 (from the 50:50 initial split) so increasing Global equities to 39.4% of the fund and decreasing UK equities to 23.6%. The Committee believes that this diversification of the Fund's assets will reduce risk whilst enhancing potential returns. During the year the Committee has been reviewing the Fund's investment strategy and has decided to adopt a more flexible approach to asset allocation, but operating within strict guidelines, set out in an investment strategy framework. This new strategy is outlined in the Statement of Investment Principles in Annex 3.

To maintain the percentage of the quoted equity and bonds close to the target percentages, the Fund has adopted a rebalancing programme that automatically brings the Fund back in line with the agreed allocation if market movements change the asset allocation within the Fund. This programme was active on several occasions during the year. The Fund also manages overseas currency risks relative to pounds sterling by using a passive currency hedging overlay strategy for 60% of the overseas currency exposure. This strategy is intended to reduce risks long term without affecting returns. It is currently under review together with other approaches to managing and hedging risks.

Custody arrangements

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. Where the assets held are unit linked insurance contracts or other collective investment vehicles, the underlying assets are held by the relevant insurance company or collective investment vehicle.

As part of its normal procedures Northern Trust holds all assets in safe custody, collects dividend income and interest, provides data for corporate actions, liaises closely with the investment managers and reports on all activity during the period.

Northern Trust is a strong company that is 'AA-' rated by Standard and Poor's. Also the Fund's assets are not held in the name of Northern Trust and so are segregated from those of Northern Trust, safeguarding them in the event of a failure by Northern Trust. Cash held by the Fund at Northern Trust in sterling, euros and dollars is invested in Northern Trust Global Cash Funds, which would not be affected in the event of a failure by Northern Trust. Only small amounts of cash are left on deposit at Northern Trust. The Northern Trust Global Cash Funds are rated 'Aaa' by Moody's and are invested in short term money instruments to preserve capital and liquidity. These cash funds are also closely monitored by Environment Agency officers.

Regular service reviews are held with Northern Trust to ensure continuous monitoring of service commitments. Other procedures and controls are reviewed by an independent reporting accountant in accordance with the American Institute of Certified Public Accountants Statement on Standards for Attestation Engagements No. 16 (SSAE 16).

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 Fund has no investment in US sub-prime mortgages, collaterised debt obligations (CDOs) or collaterised loan obligations (CLOs) and does not allocate any money to hedge funds. The Fund does not support or directly engage in stock-lending although the L&G overseas pooled equity pension funds in which the Fund invests (10.6% of the Fund), do engage in stock lending, which is outside our control.

Fund benchmark

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

UK equities	23.6%	FTSE All Share index*
Overseas equities	39.4%	FTSE All World ex UK*
Index-linked gilts	13.5%	FTSE Actuaries Over 5 Year index-linked gilts
Corporate bonds	13.5%	iBoxx Sterling all non-gilt
Private equity	5.0%	Absolute Return
Property	5.0%	IPD UK Monthly

* Allocation changed from 31.5% each effective 8 June 2011.

Fund managers

Responsibility for managing the Fund's investments has been allocated to 10 managers. Our managers, their investment styles and the division of the portfolio is as follows:

Manager	% of Portfolio	Investment style
Legal & General Investment Management	51.9	Passive index tracking Funds
Standard Life Investments	7.5	Active UK Equities
Sarasin & Partners	7.3	Active Global Equities
Generation Investment Management	7.2	Active Global Equities
Royal London Asset Management	6.5	Active Sterling Corporate Bonds
Robeco Alternative Investment	4.7	Active Private Equity
Comgest Asset Management	4.3	Active Emerging Markets Equities
Impax Asset Management	2.9	Active Global Equities
Aviva Investors	3.2	Active UK Property Funds
Informed Portfolio Management	3.0	Passive & Active Currency Management
AVC investments and cash	1.5	
Total	**100.0**	

In June 2011 we transferred £78m from Standard Life to passive global (ex UK) equities at L&G and part of a strategic shift. In August 2011 we terminated the global equities mandate at RCM because of significant underperformance, transferring the funds (£72m) to passive global (ex UK) equities at L&G again. In November 2011 we transferred £25m out of passive global (ex UK) equities at L&G into our active global equity mandate with Generation Investment Management.

Manager benchmark

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

Passive Management	Asset Class	Benchmark
Legal & General	UK equities	FTSE All Share
Legal & General	European equities	FTSE Developed World Europe ex UK
Legal & General	North American equities	FTSE Developed World North America
Legal & General	Japanese equities	FTSE World Japan
Legal & General	Asia Pacific equities	FTSE Developed World Asia Pacific ex
Legal & General	Global equities	FTSE World (ex UK) Index
Legal & General	UK index-linked gilts	FTSE UK Indexed Linked Gilts > 5 yrs
Legal & General	Corporate bonds	iBoxx Sterling Non Gilts
Legal & General	£UK cash	7 Day Libid

Active Management	Asset Class	Benchmark
Royal London Asset Management	Corporate bonds	iBoxx Sterling Non Gilts
Standard Life	UK equities	Customised capped Index*
Sarasin	Global equities	MSCI All Country World
Impax	Global equities	MSCI All Country World
Generation	Global equities	MSCI All Country World**
Comgest Asset Management	Emerging market equities	MSCI Emerging Markets
Aviva	Property	IPD UK Monthly
Robeco	Private equity	Higher of 10% IRR or MSCI World + 5%***
Informed Portfolio Management	Currency	FTSE 100 (Total return)**

* New customised benchmark from January 2012, using similar constituents and methodology to the FTSE All Share but with individual constituents capped at 2%.
**Benchmark changed in the year from the MSCI Developed World to the MSCI AC World from 31 December 2011.
***Benchmark and target adjusted for performance monitoring purposes as measured differently to the other main asset classes and managers.

Performance target

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

Legal & General	to match their benchmarks
Aviva	to beat their benchmark by 1% per annum
Royal London	to beat their benchmark by 1% per annum
Standard Life	to beat their benchmark by 2% per annum
Sarasin	to beat their benchmark by 2% per annum
Impax	to beat their benchmark by 3% per annum
RCM	to beat their benchmark by 3% per annum
Generation	to beat their benchmark by 3% per annum
Comgest Asset Management	to beat their benchmark by 3% per annum
Robeco	to beat their benchmark by 5% per annum
IPM (Active management)	to beat their benchmark by 6% per annum

Financial performance

The total return of the Fund over the year and over three years to 31 March 2012 is as follows:

Financial performance	**2012**	2011
1 year		
Fund performance %	+5.1	+7.9
Benchmark performance %	+5.3	+8.6
Active Fund Relative performance %	-0.2	-0.7
Average LGPS Fund performance %	+2.6	+8.2
Relative performance %	+2.5	-0.3
3 year		
Fund performance %	+16.1	+3.1
Benchmark performance %	+16.5	+6.8
Active Fund Relative performance %	-0.4	-3.7
Average LGPS Fund performance %	+14.5	+5.4
Relative performance %	+1.6	-2.3

We have a policy to manage the fluctuations in the value of different financial currencies by using a passive currency overlay strategy. In some years this works in favour of our overall Fund returns and in some years it detracts. This year it helped account for +0.6% (2011: +0.6%) of the Fund's performance against our strategic benchmark. Details of financial performance per Fund managers available on page 22.

Funding level

The historical funding level and asset allocation for the last four triennial valuations and for comparison estimated 2012 are shown in the tables below:

Valuation results	**2001**	**2004**	**2007**	**2010**	***Estimated 2011***	***Estimated 2012***
Value of assets £m	937	983	1,521	1,589	*1,745*	*1,917*
Value of liabilities £m	840	1,050	1,455	1,684	*1,809*	*2,287*
Funding level %	112	94	103	94	*96*	*84*
Asset allocation (%)	**2001**	**2004**	**2007**	**2010**	**2011**	**2012**
Equities	86	71	67	58	58	59
Bonds	8	15	9	12	13	14
Gilts	2	7	14	15	13	14
Property	0	0	5	3	3	3
Private equity	0	0	2	5	5	5
Cash	4	7	3	7	8	5
Total	**100**	**100**	**100**	**100**	**100**	**100**

The funding level of the Active Fund is estimated at 84% at 31 March 2012. The major reason for this decrease has been the fall in the real yield on Index linked government bonds, which is used to value our liabilities. This fall has lead to a significant increase in the current value of our liabilities. It is very important that it is recognised that the funding level of pension funds will vary over different time periods. The value of the Fund's liabilities is sensitive to financial and other assumptions used, and the maturity of the Fund.

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

The Active Fund also has positive cash flows, which should continue for around 13 years, as the employer and members' contributions should continue to exceed fund outgoings. The future size of the Active Fund will also be affected by the amount of risk taken in the investment of the fund's assets.

Awards

We were delighted that our work in integrating financially material environmental issues was externally recognised during the year. In the six years since the inception of our new investment strategy in 2005 we have achieved 25 awards and citations.

June 2011 – Financial Times/International Finance Sustainable Finance Awards 2011 - Sustainable Asset Owner of the Year – Special commendation

The Sustainable Finance Awards highlight groundbreaking achievement in sustainable investment and recognise innovation and leadership in creating environmental, social and financial value. The award recognises all forms of social and environmental investment, and is open to all types of asset owners and not just pension funds. This was the first time we had entered these prestigious worldwide awards which, overall, had 187 entries from 61 countries and we were delighted to receive a special commendation particularly as we were the smallest fund that entered by a long way.

November 2011 – Funds Europe Awards 2011 - European Public Sector Investor of the Year – Special commendation

This was the second time we had entered these awards and we received our second special commendation award for our commitment to sustainable investment. The award was won by Universities Superannuation Scheme.

December 2011 - LGC Finance Awards 2011 - Corporate Governance Award - Winner

This was the fourth time we had won this prestigious award (previously won in 2010, 2007 and 2005). The judges said "The winner this year continues to have excellent returns as evidenced by a high funding level and a relatively low employer contribution rate while giving particular attention to Governance issues. They are renowned for their achievements on sustainability issues as well as ensuring full representation for all membership types on their committees. They have worked closely with other funds to jointly procure a number of investment advisory services leading to substantial economies and are once again reviewing their basic procedures on administration issues to maintain the quality of their service."

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

Manager	Date appointed / (closed)	Asset class	Value	Fund	Benchmark	2011/12 Performance					2010/11 Performance			
						Target	Fund return	Benchmark return	Relative to benchmark	Relative to target	Fund return	Benchmark return	Relative to benchmark	Relative to target
			£m	%		%	%	%	%	%	%	%	%	%
Passive Management														
Legal & General	Nov-07	UK Equity	154.4	8.3	FTSE All Share	+0.0	+1.5	+1.4	+0.1	+0.1	+8.6	+8.1	+0.5	+0.5
Legal & General	Jun-11	World (ex UK) Equity	133.8	7.2	FTSE World (ex UK) Equity	+0.0	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Legal & General	Nov-07	North America Equity	152.1	8.2	FTSE Dev. World North America	+0.0	+6.8	+6.9	-0.1	-0.1	+9.6	+9.5	+0.1	+0.1
Legal & General	Nov-07	Europe (ex UK) Equity	70.8	3.8	FTSE Dev. World Europe (ex UK)	+0.0	-11.4	-11.2	-0.2	-0.2	+7.4	+7.0	+0.4	+0.4
Legal & General	Nov-07	Japan Equity	22.8	1.2	FTSE World Japan	+0.0	+1.0	+0.9	+0.1	+0.1	-3.8	-4.0	+0.2	+0.2
Legal & General	Nov-07	Asia Pacific Equity	23.0	1.2	FTSE Dev. World Asia Pacific	+0.0	-5.2	-5.1	-0.1	-0.1	+14.4	+14.0	+0.4	+0.4
Legal & General	Nov-07	UK Index Linked Gilts	251.7	13.6	FTSE Index Linked Gilt > 5 Year	+0.0	+21.4	+21.1	+0.3	+0.3	+6.8	+6.7	+0.1	+0.1
Legal & General	Nov-09	UK Corporate Bonds	140.4	7.6	iBoxx £ Non Gilt all bonds	+0.0	+8.8	+8.8	+0.0	+0.0	+5.2	+5.2	+0.0	+0.0
Legal & General	Nov-09	UK Cash Fund	10.3	0.6	7 day LIBID	+0.0	+0.7	+0.6	+0.1	+0.1	+0.6	+0.4	+0.2	+0.2
Active Management														
Standard Life	Apr-05	UK Equity	138.8	7.5	FTSE All Share	+2.0	+1.6	+3.4	-1.8	-3.8	+8.4	+8.7	-0.3	-2.3
Sarasin & Partners	Apr-05	Global Equity	135.0	7.3	MSCI AC World	+2.0	-1.0	-0.4	-0.6	-2.6	+3.4	+8.0	-4.6	-6.6
RCM	(Aug-11)	Global Equity	-	-	MSCI AC World	+3.0	n/a	n/a	n/a	n/a	+4.6	+8.0	-3.4	-6.4
Generation	Aug-08	Global Equity	133.7	7.2	MSCI AC World	+3.0	+0.0	+0.9	-0.9	-3.9	+6.9	+7.4	-0.5	-3.5
Impax	Aug-08	Global Equity	53.9	2.9	MSCI AC World	+3.0	-10.5	-0.4	-10.1	-13.1	+10.6	+8.0	+2.6	-0.4
Comgest	Nov-10	Emerging Markets Equity	79.8	4.3	MSCI Emerging markets	+3.0	-4.3	-8.2	+3.9	+0.9	-3.4	-3.9	+0.5	-0.5
Royal London	Jul-07	Corporate Bonds	121.5	6.5	iBoxx £ Non Gilt all bonds	+1.0	+9.5	+8.8	+0.7	-0.3	+8.2	+5.2	+3.0	+2.0
Aviva	Jul-05	Property	59.9	3.2	IPD UK Monthly Property	+1.0	+4.9	+6.6	-1.7	-2.7	+8.0	+10.7	-2.7	-3.7
Robeco	Aug-05	Private Equity	87.0	4.7	MSCI World (Gross)	+5.0	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
IPM	Oct-06	Active Currency	54.8	3.0	FTSE 100 (Total Return)	+6.0	-1.7	+1.2	-2.9	-8.9	+11.4	+4.0	+7.4	+1.4
AVC & other net assets			31.7	1.7			n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Total Fund			**1,855.4**	**100.0**	Strategic Benchmark	**+0.9**	**+5.1**	**+5.3**	**-0.2**	**-1.1**	**+7.9**	**+8.6**	**-0.7**	**-1.6**

Notes:

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

No performance figures are applicable for the year to 31 March 2012 for L&G World (ex UK) Equity as units were purchased on 8 June and 1 September 2011 after transitions from Standard Life and RCM respectively.

Standard Life's benchmark was revised to a customised index based on FTSE All Share Index capped at 2% from 12 January 2012.

The IPM Active Currency benchmark was revised from a Capital Only to a Total Return basis from 1 April 2011.

The RCM mandate was terminated on 31 August 2011 so there are no performance figures for the year to 31 March 2012.

Generation's benchmark was revised from the MSCI Developed World to the MSCI AC World from 31 December 2011.

An additional £15m was allocated to the Royal London mandate on 24 August 2011 and an additional £25m was allocated to the Generation mandate on 1 December 2011.

Robeco's return is included in Total Fund performance but excluded from this table as it is measured differently to the main asset classes and managers above who manage over 95% of the Fund's assets.

Portfolio analysis

Distribution of net assets by market value as at 31 March 2012

	Legal & General	Standard Life	Sarasin & Partners	Generation	Royal London	Robeco	Comgest	Aviva	IPM (Active)	Impax	Cash/Other	IPM (Passive)	Total	% of Fund
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	
Overseas equities (including pooled)	402.6		118.6	124.8			74.2			48.3			**768.5**	41.4
North America	*227.5*		*63.1*	*63.1*			*1.7*			*21.7*			***377.1***	*20.3*
Europe	*95.3*		*40.5*	*38.2*			*4.7*			*17.1*			***195.8***	*10.5*
Asia Pacific	*34.9*		*1.5*	*14.5*			*19.7*			*6.4*			***77.0***	*4.2*
Other geographical areas	*10.6*		*12.3*	*4.0*			*48.1*			*0.3*			***75.3***	*4.1*
Japan	*34.3*		*1.2*	*5.0*						*2.8*			***43.3***	*2.3*
UK fixed interest	251.7				79.9								**331.6**	17.9
UK equities	154.4	135.7	14.9	1.6			2.6			4.2			**313.4**	16.9
Pooled fixed interest	140.4				3.9								**144.3**	7.8
Private equity						83.6							**83.6**	4.5
Pooled property								59.2					**59.2**	3.2
Pooled currency									54.8				**54.8**	3.0
Overseas fixed interest					35.2								**35.2**	1.9
Cash	1.8	2.8	0.6	7.5	0.5	3.4	2.6	0.6		1.0	13.0		**33.8**	1.8
Pooled cash	10.3												**10.3**	0.6
Derivatives	(0.1)			(0.4)								8.7	**8.2**	0.4
AVC investments											6.3		**6.3**	0.3
Other net investments	1.8	0.3	0.9	0.2	2.1		0.4	0.1		0.4			**6.2**	0.3
Total	**711.2**	**138.8**	**135.0**	**133.4**	**121.6**	**87.0**	**79.8**	**59.9**	**54.8**	**53.9**	**19.3**	**8.7**	**1,855.4**	**100.0**

Top 20 holdings of the Fund

Holding	Asset class	2012 £m	2012 % of Fund
L&G Developed World North America Equity Index	Pooled equities - Overseas	152.1	8.2
L&G Investment Grade Corporate Bond All Stocks Index Fund	Pooled fixed interest - UK corporate bonds	140.4	7.6
L&G AE – World (ex UK) Equity Index	Pooled equities - Overseas	133.8	7.2
L&G Developed Europe (ex UK) Equity Index	Pooled equities - Overseas	70.8	3.8
IPM Global Currency Fund Class D	Pooled currency	54.8	3.0
L&G Developed World Asia Pacific (ex Japan) Equity Index	Pooled equities – Overseas	23.0	1.2
L&G Developed World Japan Equity Index	Pooled equities – Overseas	22.8	1.2
UK Government 2.5% index-linked 16/04/20	Fixed interest - UK index linked gilts	21.0	1.1
UK Government 1.25% index-linked 22/11/27	Fixed interest - UK index linked gilts	20.6	1.1
UK Government 1.875% index-linked 22/11/22	Fixed interest - UK index linked gilts	20.4	1.1
UK Government 2.5% index-linked 17/07/24	Fixed interest - UK index linked gilts	19.4	1.0
UK Government 1.25% index-linked 22/11/55	Fixed interest - UK index linked gilts	17.3	0.9
UK Government 1.25% index-linked 22/11/32	Fixed interest - UK index linked gilts	17.0	0.9
UK Government 1.125% index-linked 22/11/37	Fixed interest - UK index linked gilts	17.0	0.9
UK Government 2.0% index-linked 26/01/35	Fixed interest - UK index linked gilts	16.9	0.9
UK Government 1.25% index-linked 22/11/17	Fixed interest - UK index linked gilts	15.1	0.8
UK Government 4.125% index-linked 22/07/30	Fixed interest - UK index linked gilts	14.2	0.8
HSBC Holdings ordinary shares	Equities - UK	14.1	0.8
UK Government 0.625% index-linked 22/11/42	Fixed interest - UK index linked gilts	13.2	0.7
Standard Chartered ordinary shares	Equities - UK	13.0	0.7
Total		**816.9**	**43.9**

Geographical distribution of quoted and pooled equity investments

	2012		2011	
	£m	% of Fund	£m	% of Fund
North America	377.1	34.8	259.1	25.7
United Kingdom	313.4	29.0	391.4	38.8
Europe (excluding UK)	195.8	18.1	187.1	18.5
Asia Pacific (excluding Japan)	77.0	7.1	77.7	7.7
Other geographical areas	75.3	7.0	65.6	6.5
Japan	43.3	4.0	28.7	2.8
Total	**1,081.9**	**100.0**	1,009.6	100.0

Top 10 Global equities by sector

Sectors	2012 £m	2012 % of Fund	Sectors	2011 £m	2011 % of Fund
Industrial Goods & Services	120.5	6.5	Industrial Goods & Services	145.8	8.3
Oil & Gas	66.1	3.6	Oil & Gas	109.9	6.3
Healthcare	56.9	3.1	Banks	72.7	4.2
Technology	48.6	2.6	Healthcare	62.0	3.5
Banks	45.1	2.4	Basic Resources	61.2	3.5
Food & Beverages	39.9	2.1	Technology	53.4	3.0
Basic Resources	39.6	2.1	Telecommunications	41.5	2.4
Personal & Household Goods	36.7	2.0	Personal & Household Goods	35.4	2.0
Retail	36.3	2.0	Food & Beverages	35.2	2.0
Insurance	30.4	1.6	Utilities	35.2	2.0
Total	**520.1**	**28.0**	**Total**	652.3	37.2

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

Top 10 UK equity holdings

Company	2012 £m	2012 % of UK equity	Company	2011 £m	2011 % of UK equity
HSBC Holdings	14.1	4.5	HSBC Holdings	26.4	6.8
Standard Chartered	13.0	4.2	Vodafone	20.2	5.2
BP	11.0	3.5	Royal Dutch Shell ('B' Ordinary)	19.3	5.0
BG Group	10.6	3.4	BP	18.4	4.7
Vodafone	9.9	3.2	BG Group	17.7	4.5
GlaxoSmithKline	9.2	2.9	Rio Tinto	16.5	4.2
Rio Tinto	8.2	2.6	GlaxoSmithKline	12.1	3.1
British American Tobacco	7.6	2.4	BHP Billiton	11.4	2.9
Royal Dutch Shell ('B' Ordinary)	7.4	2.3	Standard Chartered	10.3	2.6
Royal Dutch Shell ('A' Ordinary)	6.9	2.2	Xstrata	9.8	2.5
Total	**97.9**	**31.2**	**Total**	162.1	41.5

Top 10 overseas equity holdings

Company	Country	2012 £m	2012 % of overseas equity	Company	Country	2011 £m	2011 % of overseas equity
Henry Schein Inc	United States	7.7	1.0	Gerberit	Switzerland	6.5	1.1
Danaher Corp	United States	7.0	0.9	Taiwan Semiconductor Manufacturing Co Ltd	Taiwan	5.2	0.8
Unilever NV	Netherlands	6.9	0.9	Henry Schein Inc	United States	5.1	0.8
Becton Dickinson & Co	United States	5.9	0.8	Unilever NV	Netherlands	5.1	0.8
eBay Inc	United States	5.8	0.7	International Business Machines Corp	United States	5.0	0.8
Legrand SA	France	5.3	0.7	Banco Bilbao Vizcaya Argentaria	Spain	4.9	0.8
International Business Machines Corp	United States	5.2	0.7	ABB ltd	Switzerland	4.7	0.8
Novo-Nordisk	Denmark	4.8	0.6	Henkel AG & Co KGaA	Germany	4.7	0.8
Pentair Inc	United States	4.7	0.6	Nalco Holding Co	United States	4.5	0.7
Taiwan Semiconductor Manufacturing Co Ltd	Taiwan	4.5	0.6	Pentair Inc	United States	4.3	0.7
Total		**57.8**	**7.5**	**Total**		50.0	8.1

Responsible investment

The Environment Agency Pension Fund seeks to manage its investments in a financially robust and environmentally responsible way.

The Committee's Responsible Investment Policy and Environmental Overlay Strategy apply across all of the Fund's mandates and we monitor and report on the progress of its implementation every quarter.

United Nations Principles of Responsible Investment

We continue to be an active member of the United Nations Principles for Responsible Investment (UNPRI), which is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios and therefore must be given appropriate consideration by investors if they are to fulfil their fiduciary duty. The UN Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment and anti-corruption.

We completed the annual report on progress in implementing the principles, and the results are available on our website at www.environment-agency.gov.uk/pensions. The reporting framework is undergoing a significant change and we have supported the UNPRI in this work, as part of their technical committee. The revised framework will be mandatory in 2013 with organisations reporting against a pilot questionnaire during 2012. All of our managers and all of our primary investment and actuarial service providers are UNPRI co-signatories.

UK Stewardship Code

We have published our Statement of Compliance with the UK Stewardship Code on our website and continue to promote its effective implementation in the fund management industry and for more asset owners to draft their own statement. A copy of our statement is in Annex 4 and is available on our website at www.environment-agency.gov.uk/pensions.

Climate change

In 2010, we partnered with other asset owners globally, as part of the Mercer-led research considering the implications of climate change scenarios on strategic asset allocation. In 2011-12 we integrated the findings into our own review of our strategic asset allocation to inform the development of a robust portfolio, where the investment strategy is positioned to reduce risk and maximise investment opportunities presented by climate change.

We were also a signatory to the 2011 Global Investor Statement on Climate Change which is a joint statement stressing the urgent need for policy action to stimulate private sector investment in climate change solutions, create jobs, and is essential for ensuring the long-term sustainability and stability of the world economic system. This year's investor statement is the biggest ever with 285 signatories managing over $20 trillion in assets.

Throughout the year we supported the IIGCC through their IIGCC Policy Group which leads on EU level advocacy on public policies relating to climate change and the IIGCC Property Working Group which aims to raise awareness amongst trustees, and encourage fund managers, in considering climate change risks property portfolios.

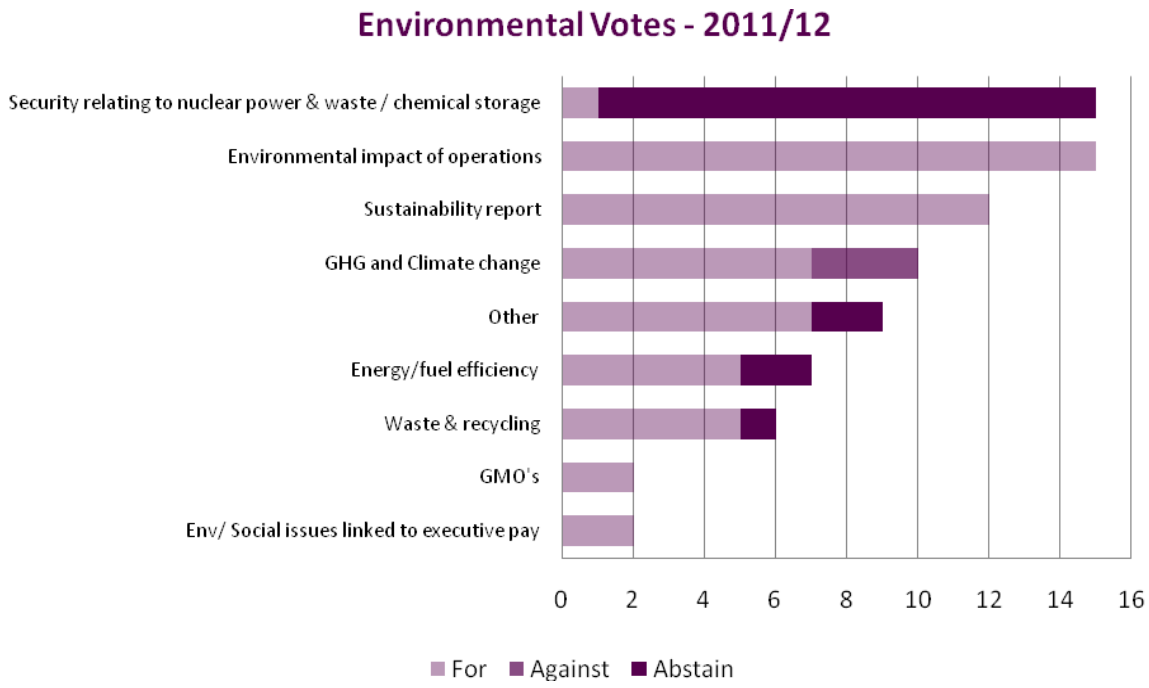
Class actions

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. The total amount received for the year 2011-12 was £126k.

Voting on environmental resolutions

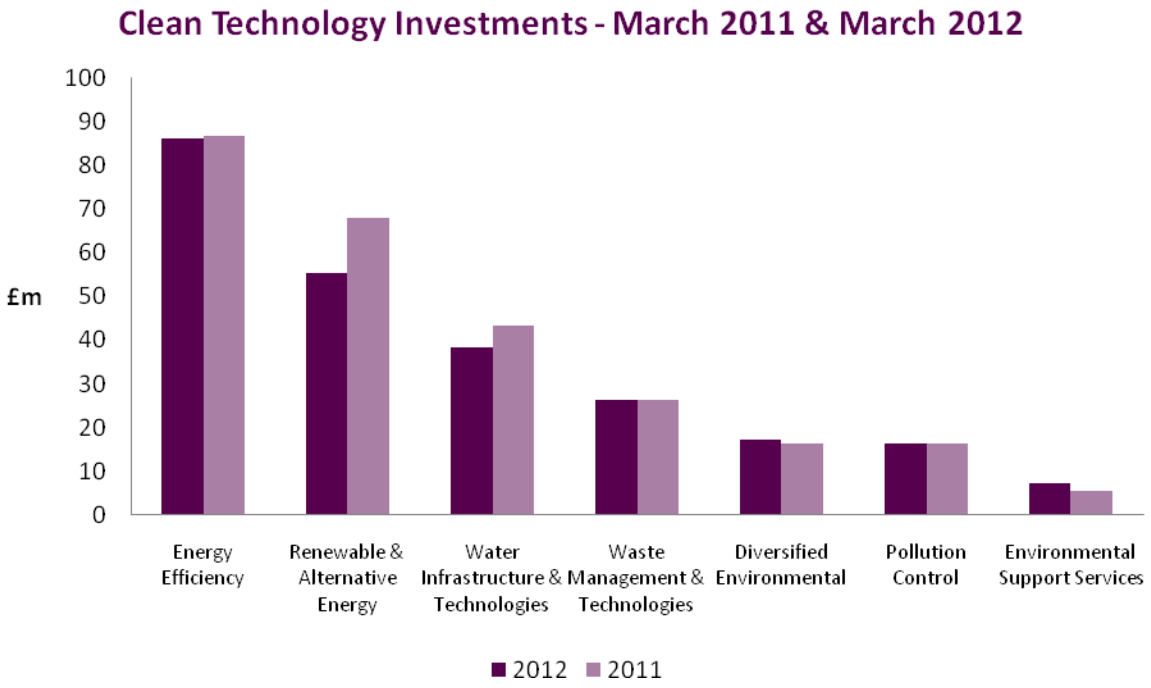
We aim to vote the Fund's shares in all markets and estimate this to be in excess of 40,000 votes per annum. To come to a view on each one requires very detailed knowledge of the company's management, its sector and the regulatory environment in the country it which it operates. Due to the complexity and volume of work, the Committee delegates all voting to our external fund managers (or specialist provider for our passive investments). Our fund managers vote at their discretion and must confirm that they subscribe to the principles of good corporate governance and, when exercising their vote, take this into account.

For all environmental resolutions in the UK, Europe and North America and, where practical, world-wide, we have voted on 78 environmental shareholder resolutions. This is a slight decrease (11%) on the same period last year. As these are shareholder resolutions, a vote for the resolution or to abstain is against the management recommendation. In total, 96% of our votes were against management, comprising 72% of votes for the resolution and we abstained for the remaining 24%. A breakdown is presented below and our voting record on environmental resolutions is available on our website at: www.environment-agency.gov.uk/pensions.



Maximising investment returns by investment in clean technologies

For the third year, using the FTSE Environmental Markets classification and with the help of Impax Asset Management (our global equity manager who focuses on environment technologies), we analysed our entire Fund (public and private equity holdings including the pooled funds). The fund now has assets to the value of £247m invested in clean technology companies. This represents 13.3% of the fund. Our target for 2015 is to be able to demonstrate that 25% of the Fund is invested in clean and green technology. A breakdown of the current investment against last year is illustrated below.



Minimising financial risks from environmental issues

We believe that well governed companies reduce the risk to shareholder value and will, over time, produce more sustainable returns compared to poorly governed companies. All our equity fund managers regularly engage with companies either directly or through a specialist provider, to assess policies, processes and practices. Our fund managers undertook 223 ESG corporate engagements and there were an additional 771 via our specialist provider, Hermes Equity Ownership Services. It is important to recognise that although our fund value is £1.8bn, our largest equity shareholding represents only 0.01% of the total shares issued for that company so working in collaboration with other investors is the most effective means of influencing company behaviour and protecting shareholder interests. In 2011-12 we supported a number of collaborative engagements; the main areas are detailed below;

- ***Carbon Disclosure Project*** aims to improve corporate disclosure on material carbon and engaged with a total of 6000 companies on levels of carbon disclosure. We focused on 12 companies that are held in our portfolio and are part of our ongoing engagement programme via our managers.
- ***Water Disclosure Project*** aims to improve corporate disclosure on material water use, disposal and risks. It engaged with a total of 425 companies on levels of water disclosure. We focused on 6 companies that are held in our portfolio and are part of our ongoing engagement programme via our managers.
- ***Forestry Footprint Disclosure Project*** aims to improve corporate disclosure on material impacts on forestry including use of raw materials and clearance for agriculture. It engaged with 357 companies on levels of forestry disclosure. We focused on 14 companies that are held in our portfolio and are part of our ongoing engagement programme via our managers.
- ***Global Compact*** we co-signed 33 letters to those publicly listed Global Compact signatories who have not reported to enable them to regain full participant status.
- ***The Sustainable Stock Exchanges initiative*** is a forum for exploring how exchanges can work together with investors, regulators, and companies to enhance corporate transparency and, ultimately, performance on ESG issues as well as encouraging responsible long-term approaches to investment. Linked to this, we co-signed submissions to both the FTSE and UKLA consultations with the aim of identifying changes we believe will protect minority shareholder interests.

Private equity

Robeco, our private equity manager, undertakes an annual survey of the underlying funds in which we invest against a wide range of governance, social and environmental criteria. It is a pre-requisite of investment that the funds sign up to the Robeco Sustainable Private Equity (RSPE) programme developed by Robeco with its investment partner, the Dutch bank Rabobank. The average ESG score for 2011 is 74.3% demonstrating a further improvement over previous years (68.5% in 2010, 66.1% in 2009, 64.1% in 2008 and 63.9% in 2007).

Property

Aviva Investors, on our behalf, is one of the partners in the Global Real Estate Sustainability Benchmark (GRESB) initiative and has a seat on the GRESB Advisory Board. During 2011/12 Aviva not only engaged with all our UK holdings but also with all of their underlying funds globally, with regard to their results on the 2011 GRESB survey. Bespoke written feedback was sent to each fund by its respective asset manager. The feedback detailed their performance against their respective peer group in three areas and focused on:

- funds having a sustainability resource (part-time or full-time dedicated member of staff);
- having a company or fund level policy (covering the following environmental aspects: Energy; Water; GhG emissions; Waste; Materials; Transportation; Land use/contamination; Biodiversity; and Certification);
- the annual measurement of energy and water consumption of standing investments.

The 2012 GRESB survey opened on in April and all Aviva's underlying funds globally have been asked to fill out the survey.

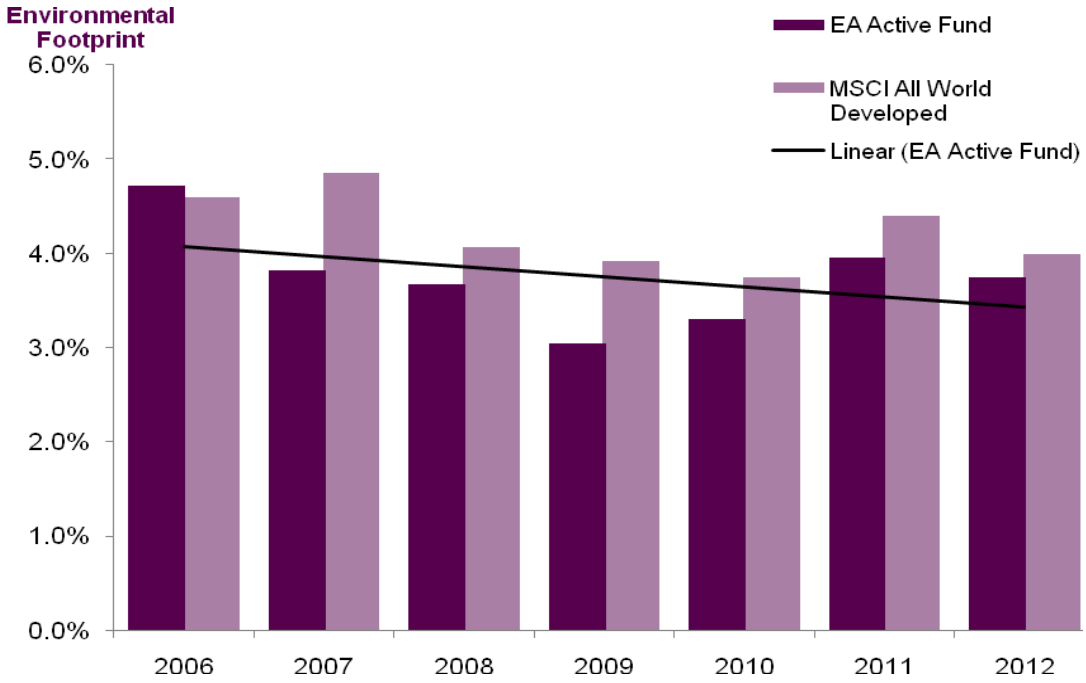
Monitoring the environmental footprint of our investments

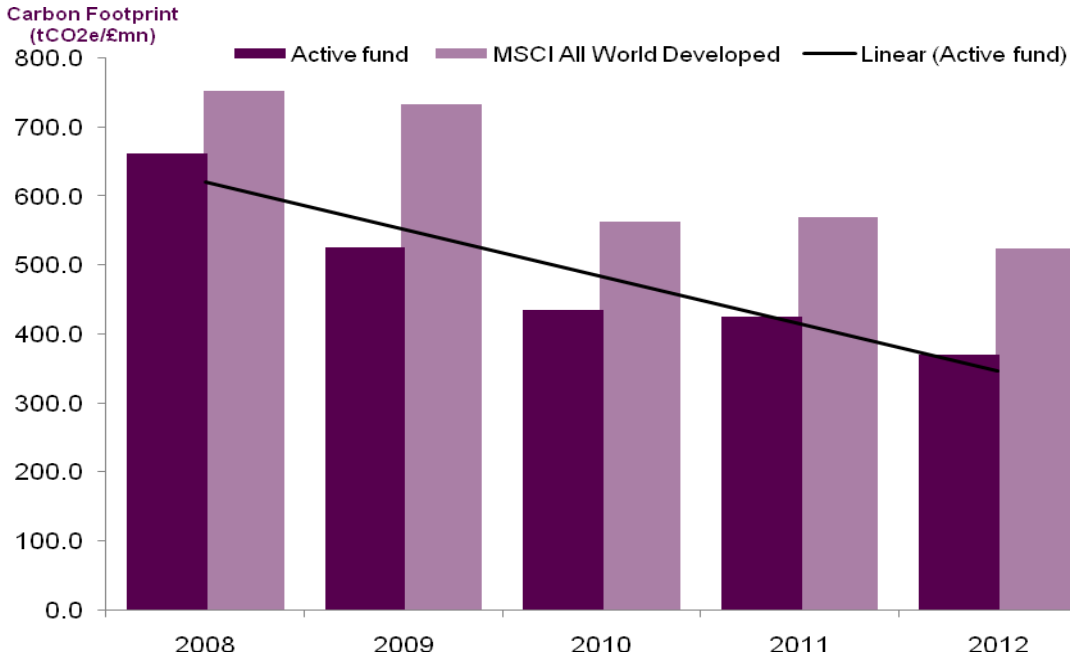
We have undertaken environmental footprint analysis, using Trucost's methodology, for each of our active equity funds against their respective benchmarks for the last seven years. By measuring our footprint we aim to provide a fresh perspective on risk, stock selection and sector exposures. The Footprint 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 6.0% less than that of the benchmark on 31 March 2011. We are one of the first funds in the world to decrease our environmental footprint.

We have also undertaken a carbon footprint for the last four years. This year our carbon footprint is 25.4% below the benchmark (2011 – 10.3%, 2010 -22.7%, 2009 -28.4%, 2008 -12.0% - all below the benchmark).

Working with our active UK Corporate Bond manager, Royal London Asset Management (RLAM), we have made further progress on using footprinting methodology for fixed interest. The environmental footprint of RLAM's portfolio in March 2012 was 23.0% more efficient than the IBOXX benchmark and the carbon footprint 29.8% more efficient. RLAM have found the analysis useful in identifying bonds that are linked to high impact activities and, where practical, replacing them in the portfolio where another bond can meet the same portfolio needs but with less impact. We aim to continue to refine and promote the use of the footprinting technique within fixed interest in 2012/13.





The financial statements

Foreword to the financial statements

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

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

Roles and responsibilities of the Pensions Committee

With a membership of nominated Environment Agency Board members, senior officers, member nominees, a pensioner member nominee and a deferred member nominee, the 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 Committee and Accounting Officer is responsible for obtaining audited financial statements for each financial year which give a true and fair view of the financial transactions of the Fund and the disposition of its assets and liabilities at the year end, other than the liabilities to pay pensions and benefits after the scheme year end. In preparing the financial statements the Committee has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that are reasonable and prudent; and
- followed applicable accounting standards, in particular the in particular the new CIPFA guidance on narrative reporting and accounting disclosures for LGPS funds.

The Committee and Accounting Officer 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 Defra. However, responsibility for the regulations governing the LGPS lies with the Local Government Pensions Unit at DCLG.

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

The Committee and Accounting Officer 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.

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

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

Summary of the financial statements

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

Contribution income has fallen by £19.5m to £85.1m (2011: risen by £21.4m to £104.6m). The decrease for the year ended 31 March 2012 was due to a reduction in the number of contributing members following the Environment Agency time limited release scheme and lower recruitment levels.

Net income from all transfer values received in the year has decreased by £2.6m to £1.4m (2011: decreased by £5.3m to £4.0m).

Retirement benefits and other payments made to or in respect of members during the year have increased by £10.4m to £67.1m (2011: increased by £5.8m to £56.7m).

In overall terms the net additions from dealings with members during the year have decreased by £29.5m to £15.4m (2011: increased by £9.1m to £44.9m).

The value of the net assets of the Fund at 31 March 2012 has increased by £95.8m to £1,860.7m (2011: increased by £169.9m to £1,764.9m). This is primarily due to an increase in the market value of its investments.

Governance Compliance Statement

Introduction

Under Regulation 31 of the Local Government Pension Scheme (Administration) Regulations 2008 (as amended) an administering authority must, after consultation with such persons as it considers appropriate, prepare, publish and maintain a Governance Compliance Statement.

This statement is required to set out:

(a) whether the administering authority delegate its function or part of its function in relation to maintaining a pension fund to a committee, a sub-committee or an officer of the administering authority;

(b) if it does—
- (i) the terms of reference, structure and operational procedures of the delegation;
- (ii) the frequency of any committee or sub-committee meetings; and
- (iii) whether the committee or sub-committee includes representatives of employing authorities (including non-Scheme employers) or members, and if so, whether those representatives have voting rights;

(c) the extent to which a delegation, or absence of delegation, complies with guidance given by the Secretary of State and, if it does not comply, the reason for not complying.

The first such statement was required to be published on or before 1 April 2006.

The statement must be revised and published by the administering authority following a material change in their policy on any of the matters referred to above.

This Statement was made and approved by the Environment Agency Pensions Committee on 13 March 2012 and will be reviewed again in 2013.

Compliance status – We are compliant with all 20 standards.

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	The responsibilities of the Pensions Committee (PC) and its Sub-Groups are set out in the Pensions Committee Terms of Reference and Standing Orders approved by the EA Board.
b) That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.	Compliant	Our PC has 15 members, appointed by the EA Board and includes: 4 Non-Executive EA Board members 4 Executive members 5 EA Employees (Trades Union nominees) 1 Pensioner nominee 1 Deferred member nominee. 2 Employee nominees are also members of the Investment Sub-Group (ISG) 1 Employee nominee and the deferred and pensioner nominees are members of the Benefits Sub-Group (BSG).
c) That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Compliant	The Chairman of the Pensions Committee reports to each EA Board meeting. Reports of the ISG and BSG meetings are circulated to all PC members. Recommendations from the ISG and BSG are presented to the main Committee.
d) That where a secondary committee or panel has been established, at least one seat on the main committee is allocated for a member from the secondary committee or panel.	Compliant	The membership of our ISG and BSG comprises members of the main PC.

Statutory Guidance Governance Standards and Principles	Our compliance status	Evidence of compliance and justification for non-compliance
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	The employers of our Closed Fund members no longer exist. Our Active Fund is currently a single employer fund and the EA is represented on the main PC, the ISG and BSG. It is likely we will become a multi-employer fund in 2013 arising from the splitting off of the EA Wales into the Natural Resource Body for Wales. The current representation of EA Wales on the PC will be reviewed in order to accommodate this change.
ii) scheme members (including deferred and pensioner scheme members);	Compliant	The main PC has 11 scheme members on it, including 5 EA Employees (Trades Union nominees), 1 pensioner nominee and 1 deferred member nominee. Our ISG includes 2 EA Employees (Trades Union nominees) and our BSG includes 1 EA Employee (Trades Union nominees) and 1 deferred member and 1 pensioner nominee. Our deferred member and pensioner nominees are members of our decision making main PC.
iii) independent professional observers; and	Compliant	Our independent investment adviser attends all ISG and all relevant main PC meetings. Our other professional advisers also regularly attend our PC, ISG and BSG meetings.
iv) expert advisers (on an ad-hoc basis).	Compliant	We invite our expert advisers to attend our PC, ISG and BSG meetings as needed. This includes our actuary, legal adviser, investment consultants, pension fund administration consultants, and external auditors.
a) That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers, meetings and training and are given full opportunity to contribute to the decision making process, with or without voting rights.	Compliant	All members of the PC, ISG and BSG receive equal access to the papers and training and have full and equal speaking and voting rights in our meetings and 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	New PC members receive induction training and a handbook that describes the role of the PC, ISG and BSG. Our PC members understand that their primary fiduciary duty of care is our funds' beneficiaries, in whose best interests they are required to act 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 either a financial or non-financial nature arising from any other roles they may perform and abstain from participation in that item on the agenda.

Statutory Guidance Governance Standards and Principles	Our compliance status	Evidence of compliance and justification for non-compliance
b) That at the start of any meeting, Committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Compliant	Declaration of interests is a standing agenda item at the start of all PC, ISG & BSG meetings. A register of interests is also maintained and audited annually.
D – Voting		
The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Compliant	Our PC makes decisions by discussion and by building and creating a consensus. All members have equal voting rights on our main Committee and BSG and ISG.
E – Training, facility time and expenses		
a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	Compliant	Our PC has a training strategy which is reviewed regularly. We provide induction training and a members handbook. All members 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. Members of the main PC, the ISG and BSG are reimbursed the cost of travel and overnight hotel expenses. The cost of all PC, ISG and BSG training is met from the pension funds 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, ISG & BSG members have equal access and rights.
F – Meetings (frequency/quorum)		
a) That an administering authority's main committee or committees meet at least quarterly.	Compliant	Our PC usually meets 4 times a year, for normal business and at least once for briefing or training. 7 of the 15 PC members (including at least 1 Board member and 1 employee nominee) constitute a quorum).
b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committee sits.	Compliant	Our ISG and BSG meetings are synchronised to meet 4 times a year before the PC so they can report to and make recommendations to the full PC.
c) That administering authorities who do not include lay members in their formal governance arrangements, provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Compliant	We have 7 "lay" members on our main PC, comprising 5 employee nominees, 1 pensioner nominee and 1 deferred member nominee. Due to the geographical spread of our organisation and fund membership across England and Wales we do not hold an AGM. We do not feel this is necessary as we hold annual briefings which provide a forum for fund members and stakeholders to be informed about changes to the LGPS and to allow them to ask questions. All active fund members are invited to attend regional pension briefings each year at different locations around England and Wales. We also organise an annual briefing for deferred and pensioner members. The briefings are presented by Capita Hartshead (Pension Fund Administrator), with either administering authority or HR staff also in attendance. PC members chair or attend some briefings.

Statutory Guidance Governance Standards and Principles	Our compliance status	Evidence of compliance and justification for non-compliance
G – Access		
a) That subject to any rules in the council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Compliant	All members of our PC, ISG and BSG receive the same agenda and papers containing information and advice for each meeting. Members of the PC who are not members of the ISG or BSG can request full ISG or BSG papers and they also receive summary reports of all meetings. All our PC, ISG and BSG members can ask questions of our professional advisers who attend the PC, ISG or BSG meetings.
H – Scope		
a) That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Compliant	Our PC, ISG and BSG meetings all have agenda items on wider LGPS scheme issues, future challenges and risks to our funds, as well as information on our funds' recent financial and administrative performance. Our BSG & ISG review their risk register at all meetings. The PC carries out annual reviews of fund performance, key strategic risks, and our statutory governance and communications policy statements. It also reviews its own effectiveness at the end of each meeting and annually.
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. It is also published in our Annual Report & Accounts. We have an agreed procedure for our recognised Trades Unions to nominate new employee nominees to our PC when vacancies arise. We have also advertised in pensioners' and deferred members' newsletters for nominees when vacancies arose.

Statement by the Consulting Actuary

This statement has been prepared in accordance with Regulation 34(1)(d) of the Local Government Pension Scheme (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2011/12.

Description of Funding Policy

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

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

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

Funding Position as at the last formal funding valuation

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

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

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in my valuation report dated 31 March 2011.

Method

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

Assumptions

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

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

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

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

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

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

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

Experience over the year since April 2011

The Pensions Committee monitors the funding position on a regular basis as part of its risk management programme. The most recent funding update was produced as at 31 March 2012. Investment returns for the year to 31 March 2012 were +5.1% and assets had a market value of £1,861m as at 31 March 2012. Liabilities were estimated to be £2,216m on an ongoing funding basis as at 31 March 2012, implying that the Fund's funding level (excluding the effect of any membership movements) had decreased to 84% over the year.

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

Richard Warden
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
27 June 2012

Hymans Robertson LLP
20 Waterloo Street
Glasgow
G2 6DB

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

I have examined the summary of contributions to the Environment Agency Active Pension Fund for the year ended 31 March 2012 which is set out on page 39.

Respective responsibilities of the Environment Agency, its Pensions Committee and the auditor
The Pensions Committee and Accounting Officer are responsible for keeping records in respect of contributions received in respect of active members of the Fund and for monitoring whether contributions are made to the Fund by the Environment Agency in accordance with the Local Government Pension Scheme Regulations 1997, the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended) and other related regulations and the recommendations of the Consulting Actuary.

It is my responsibility to provide a Statement about contributions as reported in the attached summary of contributions payable for the Fund year ended 31 March 2011 and to report my opinion to you.

Scope of work on Statement about contributions
My examination involves obtaining evidence sufficient to give reasonable assurance that contributions reported in the attached summary of contributions have in all material respects been paid at least in accordance with the relevant requirements. This includes an examination, on a test basis, of evidence relevant to the amounts of contributions payable to the Fund and the timing of those payments in accordance with the Local Government Pension Scheme Regulations 1997, the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended) and other related regulations and the recommendations of the Consulting Actuary.

Statement about contributions
In my opinion, contributions for the Fund year ended 31 March 2012 as reported in the attached summary of contributions have in all material respects been paid at least in accordance with the Local Government Pension Scheme Regulations 1997, the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended) and other related regulations and with the recommendations of the Consulting Actuary.

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

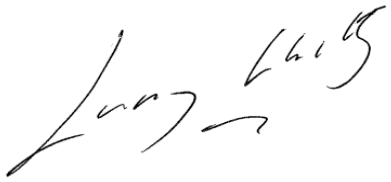
13 July 2012

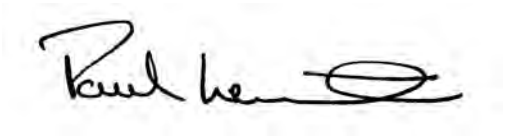
Summary of contributions payable in the year

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 2012 were as follows:

	Notes	Employee £'000	Employer £'000
Required by the LGPS regulations			
Normal contributions		20,879	40,887
Contributions to fund historical past service deficit		-	20,853
Special contributions to fund early retirements		-	968
		20,879	**62,708**
Other contributions payable			
Purchase of added years		725	-
Additional voluntary contributions (AVCs)		833	-
		1,558	**-**
Sub-totals		**22,437**	**62,708**
Total employee and employer contributions (as per Fund account)	7		**85,145**

Signed on behalf of the Environment Agency





Larry Whitty
Chairman
Environment Agency Pensions Committee
12 July 2012

Paul Leinster
Accounting Officer
Environment Agency
12 July 2012

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 2012 under the Environment Act 1995. These comprise the Fund Account, the Net Assets Statement and the related notes. These financial statements have been prepared under the accounting policies set out within them.

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

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

Scope of the audit of the financial statements

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

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

Opinion on Regularity

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

Opinions on the financial statements

In my opinion:

- the financial statements show a true and fair view of the financial transactions of the Fund during the year ended 31 March 2012, and of the amount and disposition at that date of its assets and liabilities, other than liabilities to pay pensions and benefits after the end of the Fund year; and

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

Report

I have no observations to make on these financial statements.

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

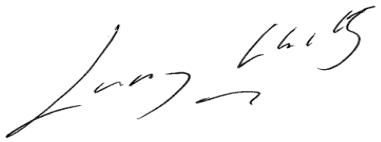
13 July 2012

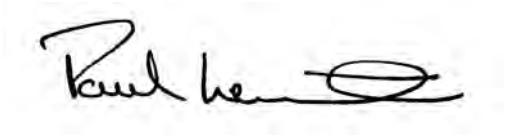
Financial statements for the year ended 31 March 2012

	Notes	2012 £000	2011 £000
Fund account			
Contributions and transfers			
Contributions	7	85,145	104,570
Transfer values received	8	1,354	4,030
Other income	9	1	56
		86,500	108,656
Benefits and other payments			
Benefits payable	10	(67,082)	(56,690)
Payments to and on account of leavers	11	(2,613)	(5,539)
Administration expenses	12	(1,427)	(1,512)
		(71,122)	(63,741)
Net additions from dealings with members		**15,378**	44,915
Return on investments			
Investment income	13	33,077	31,401
Taxes on income	14	(999)	(948)
Change in market value of investments	16 (a)	55,528	99,653
Investment expenses	15	(7,247)	(5,078)
Net returns on investments		**80,359**	125,028
Net increase in the Fund during the year		**95,737**	169,943
Opening net assets of the Fund at 1 April		1,764,985	1,595,042
Net assets of the Fund at 31 March		**1,860,722**	1,764,985
Net assets statement			
Investment assets	16 (c)	1,865,701	1,768,082
Investment liabilities	16 (c)	(10,258)	(14,167)
Current assets	21	7,854	17,867
Current liabilities	22	(2,575)	(6,797)
Net assets of the Fund at 31 March		**1,860,722**	1,764,985

The financial statements summarise the transactions and net assets of the Fund. The financial statements do not take account of liabilities to pay pensions and other benefits that fall due after the end of the Scheme year. The actuarial position of the Fund, which does take account of such liabilities, is dealt with in the statement by the Consulting Actuary on page 36 and these financial statements should be read in conjunction with it. The Actuary's statement dated 13 June 2012 is based on a valuation as at 31 March 2010.

The notes on pages 42 to 65 form part of these financial statements.





Larry Whitty
Chairman
Environment Agency Pensions Committee
12 July 2012

Paul Leinster
Accounting Officer
Environment Agency
12 July 2012

Notes to the financial statements

1. Description of the Fund

The Environment Agency Active Pension Fund is part of the Local Government Pension Scheme and is administered by the Environment Agency. The Environment Agency is the reporting entity for this pension fund. The Fund is overseen by the Environment Agency Pension Fund Committee.

The following description is a summary only. For more detail, reference should be made to the Funding Strategy Statement (Annex 2).

General

The Fund is governed by the Superannuation Act 1972. The Fund is administered in accordance with the following secondary legislation:

- the LGPS (Benefits, Membership and Contributions) Regulations 2007 (as amended);
- the LGPS (Administration) Regulations 2008 (as amended); and
- the LGPS (Management and Investment of Funds) Regulations 2009.

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

Membership

Unless they have elected in writing not to be members, all full and part-time employees of the Environment Agency, whether permanent or temporary (over three months), become active members of the Fund.

As at 31 March 2012, total membership of the Fund is 21,977, represented by 10,628 Active members, 6,425 deferred members and 4,924 current pensioners.

Funding

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

Benefits

Benefits payable under the Fund are guaranteed by statute and thereby the pensions promise is secure. 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.

2. Basis of preparation

The financial statements have been prepared in accordance with the CIPFA (2011) Accounting Disclosure checklist for LGPS pension funds which is sourced from the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector. They are prepared on a going concern basis having a strong covenant with Defra and the Welsh Government who are the financial sponsors of the Environment Agency under the Environment Agency Act 1995 and the DCLG as the statutory guarantors of the LGPS. The accounting policies have been drawn up in line with recommended accounting principles as specified in the Code of Practice on Local Authority Accounting and as disclosed below.

3. Summary of significant accounting policies

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

Investments

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

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

Derivatives

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

Investment income

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

Exchange rates

(i) Where forward contracts are in place for assets and liabilities in foreign contracts, the contract rate is used.
(ii) Other assets and liabilities in foreign currencies are translated into sterling at the rates of exchange ruling at the year end.
(iii) Overseas dividends are valued at rates of exchange on the date when stocks are quoted ex-dividend. Surpluses and deficits arising on conversion or translation are dealt with as part of the change in market value of investments.

Contributions

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

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

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

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

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

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

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

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

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

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

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

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

Benefits

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

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

Other expenses

Investment management and administration expenses are accounted for on an accruals basis. Expenses are recognised net of any recoverable VAT. The fees of the Fund's external investment managers reflect their differing mandates. Fees are generally linked to the market value of the

Fund's investments and therefore may increase or reduce as the value of the investment changes. Fees are also payable to the Fund's global custodian.

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

Apportionment of common expenditure	2012 %	2011 %
Custodial arrangements	80/20	80/20
Other (e.g. Environment Agency administration costs)	60/40	60/40

Taxation

UK income tax and capital gains tax

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

Value added tax

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

US withholding tax

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

Overseas tax deductions

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

4. Critical judgements in applying accounting policies

Unquoted private equity investments

It is important to recognise the highly subjective nature of determining the fair value of private equity investments. They are inherently based on forward-looking estimates and judgements involving many factors. Unquoted private equities are valued by the investment managers using guidelines set out by the British Venture Capital Association. The value of unquoted private equities at 31 March 2012 was £83.6 million (£90.6 million at 31 March 2011).

Pension fund liability

The pension fund liability is calculated every three years by the appointed actuary, with annual updates in the intervening years. The methodology used is in line with accepted guidelines and in accordance with IAS 19. Assumptions underpinning the valuations are agreed with the actuary and are summarised in Note 20. This estimate is subject to significant variances based on changes to the underlying assumptions.

5. Assumptions made about the future and other major sources of estimation

The Financial Statements contain figures that are based on assumptions made by our Private Equity manager. Estimates are made taking into account historical experience, current trends and other relevant factors.

The items in the net assets statement at 31 March 2012 for which there is a risk of material adjustment in the forthcoming financial year is as follows:

Item	Uncertainties	Effect of actual results differ from assumptions
Private equity	Private equity investments are valued at fair value in accordance with British Venture Capital Association guidelines. These investments are not publicly listed and as such there is a degree of estimation involved in the valuation.	There is a risk that this investment may be under- or overstated in the accounts.

6. Events after the net asset statement date

The financial statements were approved by the Pensions Committee on 25 June 2012, the Audit and Risk Committee on 26 June 2012 and were approved and signed at a meeting of the Board on 12 July 2012. There are no adjusting or non-adjusting events that need to be recognised in the financial statements after the net asset statement date. The authorised date for issue is the 13 July 2012.

7. Contributions receivable

	2012 £000	2011 £000
Employer		
Normal	40,887	55,900
Advanced	20,853	14,039
Special	968	10,272
	62,708	80,211
Members		
Normal	20,879	22,703
Additional voluntary contributions (AVCs)	833	817
Purchase of added years	725	839
	22,437	24,359
Total	**85,145**	104,570

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

8. Transfer values received

	2012 £000	2011 £000
Individual transfers from other schemes	1,344	3,984
AVC transfers	10	46
Total	**1,354**	4,030

Transfer values have been paid ("cash equivalents" within the meaning of Part 1 of Schedule 5 to the Pensions Scheme Act 1993), and service credits given for transfers received, calculated in accordance with the method and assumptions on the advice of the Actuary and based on guidelines issued by the Institute and Faculty of Actuaries.

No discretionary benefits have been included in the calculation of transfer values.

9. Other income

	2012 £000	2011 £000
Reimbursements of additional payments made	**1**	56

These amounts have been corrected by Capita Hartshead to the Fund in relation to historical past service credits. The figure of £1,000 (2011: £56,000) shown represents reimbursements to the Fund by Capita Hartshead of administration expenses incurred during this rectification process.

10. Benefits payable

	2012 £000	2011 £000
Retirement and dependants' pensions	46,763	38,864
Lump sum retirement grants	18,616	16,688
Lump sum death grants	1,699	1,134
Life assurance through AVC provider	4	4
Total	**67,082**	56,690

11. Payments to and on account of leavers

	2012 £000	2011 £000
Individual transfers to other schemes	2,784	3,589
AVC transfers	25	16
Refunds of contributions	1	8
Bulk transfer to other schemes*	(197)	1,926
Total	**2,613**	5,539

*This amount is in respect of a bulk transfer paid out in June 2011 following the outsourcing of the Environment Agency CIS service in July 2010. An accrual of £1,926k was made in the 31 March 2011 accounts based on actuarial estimates of the amount due to be paid. The actual amount paid across was £197k less than this, hence the negative figure shown in the 2012 accounts.

12. Administration expenses

	2012 £000	2011 £000
Environment Agency Pension Fund Management	468	477
External professional fees:		
Scheme administration	520	597
Specialist advice	397	402
External audit	42	36
Total	**1,427**	1,512

The external auditor remuneration does not include any fees in respect of non-audit services for 2012 and 2011.

13. Investment income

	2012 £000	2011 £000
Dividends from equities	20,224	19,157
Income from fixed interest securities	9,314	9,143
Income from pooled property	2,521	2,369
Interest on cash deposits	348	327
Income from pooled investment vehicles	343	11
Income from private equity	327	394
Total	**33,077**	31,401

14. Taxes on income

	2012 £000	2011 £000
Withholding tax - equities	(868)	(842)
Withholding tax – pooled property	(128)	(106)
Withholding tax – fixed interest	(3)	-
Total	**(999)**	(948)

15. Investment expenses

	2012 £000	2011 £000
Fund manager base fees	4,209	3,938
Fund manager performance fees	2,652	754
Global custody	139	137
Performance and risk measurement	124	61
Investment advisers	123	188
Total	**7,247**	5,078

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

16. Investments

(a) Investment movements summary

	Market value at 01.04.11 £000	Purchases at cost and derivative payments £000	Sales proceeds and derivative receipts £000	Change in market value £000	Market value at 31.03.12 £000
Equities	823,909	280,897	(399,694)	(25,792)	679,320
Pooled equities	185,687	369,153	(177,455)	25,171	402,556
Fixed interest	320,457	130,612	(129,350)	45,093	366,812
Pooled fixed interest	135,539	33,352	(34,600)	10,073	144,364
Private equity	90,572	12,492	(8,920)	(10,547)	83,597
Pooled property	56,181	6,656	(3,341)	(306)	59,190
Pooled currency	55,499	286	-	(940)	54,845
Pooled cash	20,166	-	(10,000)	133	10,299
Derivatives	(2,239)	2,000,313	(2,002,458)	12,592	8,208
AVC investments	6,218	861	(968)	220	6,331
	1,691,989	**2,834,622**	**(2,766,786)**	**55,697**	**1,815,522**
Cash deposits & instruments	58,285			(169)	33,807
Other investment balances	3,641			-	6,114
	1,753,915			**55,528**	**1,855,443**

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

The change in the market value of investments comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.

The derivatives in the above table represent futures contracts and forward foreign exchange contracts. The closing market values represent fair values at the year end date. In the case of futures contracts, which are traded on exchanges, this value is determined using exchange prices at the reporting date. Forward foreign exchange contracts are over the counter contracts and are valued by determining the gain or loss that would arise from closing out the contract at the reporting date by entering into an equal and opposite contract at that date.

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

Transaction costs are included in the cost of purchases and sale proceeds. Transaction costs include costs charged directly to the Fund such as fees, commissions, stamp duty and other fees. Transaction costs incurred during the year amounted to £1,284,992 (2011: £1,469,389). In addition to the transaction costs disclosed above, indirect costs are incurred through the bid-offer spread on investments within pooled investment vehicles. The amount of indirect costs is not separately provided to the Fund.

(b) Investment value details

Investment assets	2012 £000	2011 £000
Equities		
Overseas quoted	365,878	433,249
UK quoted	313,442	390,660
	679,320	823,909
Pooled equities		
Overseas	402,556	185,687
	402,556	185,687
Fixed interest		
UK index linked gilts public sector	251,705	229,423
UK corporate quoted	79,911	63,231
Overseas corporate quoted	32,723	27,597
Overseas public sector quoted	2,473	206
	366,812	320,457
Pooled fixed interest		
UK corporate quoted	140,419	131,764
Overseas corporate quoted	3,945	3,775
	144,364	135,539
Private equity		
Overseas unquoted	79,089	84,980
UK unquoted	4,508	5,592
	83,597	90,572
Pooled property		
UK unit trusts	47,118	44,585
UK managed funds	7,722	7,368
UK unquoted collective limited partnership investments	4,350	4,228
	59,190	56,181
Pooled currency	**54,845**	55,499
Pooled cash	**10,299**	20,166
Derivative contracts		
Forward foreign exchange	8,287	(2,314)
Futures	(79)	75
	8,208	(2,239)
AVC investments	**6,331**	6,218
Cash deposits and instruments		
Cash with custodian and fund managers	33,307	58,169
Cash margin with brokers	500	116
	33,807	58,285
Other investment balances		
Due from trade and currency brokers	9,081	6,067
Accrued income	5,915	5,074
Income tax recoverable	743	574
Due to trade and currency brokers	(9,625)	(8,074)
	6,114	3,641
Net investment assets	**1,855,443**	1,753,915

(c) Financial assets and liabilities

	2012 £000	2011 £000
Financial assets		
Equities (includes pooled and private equity)	1,165,473	1,100,168
Bonds (includes pooled and gilts)	511,176	455,996
Pooled property	59,190	56,181
Pooled currency	54,845	55,499
Cash (includes pooled)	44,106	78,451
Derivatives – Futures and forward foreign exchange	8,841	3,854
AVC	6,331	6,218
Other investment assets	15,739	11,715
Total financial assets	**1,865,701**	1,768,082
Financial liabilities		
Derivative contracts - Forward foreign exchange	(633)	(6,093)
Other investment liabilities – Due to trade and currency brokers	(9,625)	(8,074)
Total financial liabilities	**(10,258)**	(14,167)
Net financial assets	**1,855,443**	1,753,915

(d) Derivative contracts

	2012		2011	
Derivatives	**Asset £000**	**Liability £000**	Asset £000	Liability £000
Futures contacts	17	(96)	75	-
Forward foreign currency contracts	8,824	(537)	3,779	(6,093)
	8,841	**(633)**	3,854	(6,093)
Net derivatives	**8,208**	**-**	-	(2,239)

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

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

In the table below, the ‘nominal value’ of the futures contracts is the ‘economic exposure’ of those futures as at 31 March 2012. The ‘Fair value’ is the unrealised profit or loss of the futures as at 31 March 2012.

Futures

Type of contract	Expiration	2012 Nominal value £'000	2011 Nominal value £'000	2012 Fair Value £'000	2011 Fair value £'000
FTSE 100 UK exchange traded June 2012 (L&G)	3 months	**2,578**	1,765	**(69)**	54
E-mini S&P 500 US exchange traded June 2012 (Generation)	3 months	**1,976**	618	**17**	21
Eurostoxx 50 index exchange traded June 2012 (Generation)	3 months	**683**	-	**(27)**	-
Total		**5,237**	2,383	**(79)**	75

A series of six month rolling 'forward' currency contracts are used by our currency manager to hedge 60% of the Fund's exposure to overseas currency movements back to Sterling. They help minimise the adverse effect of volatility of those currencies on the value of the Fund. For forward currency contracts that have not been realised at the year end date, the movement of sterling during the contract period will result in either short term unrealised gains or losses. Over time these should balance to have a neutral financial impact. At 31 March 2012 there was an unrealised gain of £8.3m on the currency forwards (2011: unrealised loss of £2.3m). Whilst this gain may appear significant, it is worth noting that the value of the assets denominated in overseas currencies will have decreased as a result of these currency movements.

Forward foreign currency contracts over the counter

Currency bought	Currency sold	Settlement dates	2012 Asset £000	2012 Liability £000	2011 Asset £000	2011 Liability £000
Brazilian Real	Sterling	2days	-	(1)	-	-
Canadian Dollar	US Dollar	20days	38	-	-	-
Canadian Dollar	Sterling	4days	-	-	-	(1)
Euro	Sterling	2 to 3days	-	(3)	2	-
Hong Kong Dollar	Sterling	2days	-	(1)	-	-
Japanese Yen	US Dollar	20days	-	(344)	29	-
Sterling	US Dollar	2days to 6mths	4,003	(25)	3,332	(1,675)
Sterling	Euro	2days to 6mths	2,681	-	-	(3,417)
Sterling	Japanese Yen	27days to 6mths	2,091	(14)	382	(52)
Sterling	Canadian Dollar	3days	1	-	-	-
Sterling	Australian Dollar	2 to 3days	1	-	-	-
Sterling	South African Rand	1day	-	-	-	(10)
Swedish Krona	Sterling	3days	-	(1)	-	-
Swiss Franc	Sterling	3days	-	(3)	-	-
Swiss Franc	US Dollar	15days	-	-	-	(14)
US Dollar	Danish Krona	15days	-	-	-	(151)
US Dollar	Swiss Franc	4 to 15days	-	-	-	(436)
US Dollar	Sterling	1 to 4days	1	-	2	-
US Dollar	Japanese Yen	2 to 4days	-	(2)	32	-
US Dollar	Brazilian Real	20days	8	-	-	-
US Dollar	Euro	20days	-	(143)	-	(337)
Total			**8,824**	**(537)**	**3,779**	**(6,093)**

(e) Investments exceeding 5% of net investment assets

A significant portion of the Fund (19.2%) is held in pooled pension funds managed by Legal and General (L&G). The following table represents the investments of the Fund that exceed 5% of the total net investment assets.

Holding	2012		2011	
	Market value £m	**% of net assets**	Market value £m	% of net assets
L&G North America Equity Index Fund	**152.1**	**8.2%**	103.9	5.9%
L&G Investment Grade Corporate Bond Fund	**140.4**	**7.5%**	131.8	7.5%
L&G World (ex UK) Equity Index Fund	**133.8**	**7.2%**	-	-

17. Financial Instruments

(a) Classification of financial instruments

The accounting policies describe how different asset classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of financial assets and liabilities by category and net assets statement heading. No financial assets were reclassified during the accounting period.

31 March 2012	Designated as fair value through profit and loss £000	Receivables £000	Financial liabilities at amortised cost £000
Financial assets			
Equities	679,320	-	-
Fixed interest	366,812	-	-
Pooled equities	402,556	-	-
Pooled fixed interest	144,364	-	-
Private equity	83,597	-	-
Pooled property	59,190	-	-
Pooled currency	54,845		
Pooled cash	10,299	-	-
AVC investments	6,331	-	-
Derivatives	8,841	-	-
Cash deposits and instruments	-	40,791	-
Other investment balances	15,739	-	-
Debtors	-	870	-
	1,831,894	**41,661**	-
Financial liabilities			
Derivative contracts	(633)	-	-
Other investment liabilities	(9,625)	-	-
Creditors	-	-	(2,575)
	(10,258)	**-**	**(2,575)**
Total	**1,821,636**	**41,661**	**(2,575)**

31 March 2011	Designated as fair value through profit and loss £000	Receivables £000	Financial liabilities at amortised cost £000
Financial assets			
Equities	823,909	-	-
Fixed interest	320,457	-	-
Pooled equities	185,687	-	-
Pooled fixed interest	135,539	-	-
Private equity	90,572	-	-
Pooled property	56,181	-	-
Pooled currency	55,499		
Pooled cash	20,166	-	-
AVC investments	6,218	-	-
Derivatives	3,854	-	-
Cash deposits and instruments		69,307	-
Other investment balances	11,715	-	-
Debtors	-	6,845	-
	1,709,797	**76,152**	**-**
Financial liabilities			
Derivative contracts	(6,093)	-	-
Other investment liabilities	(8,074)	-	-
Creditors	-	-	(6,797)
	(14,167)	**-**	**(6,797)**
Total	**1,695,630**	**76,152**	**(6,797)**

(b) Net gains and losses on financial instruments

	2012 £000	2011 £000
Financial assets		
Fair value through profit and loss	42,936	81,191
Financial liabilities		
Fair value through profit and loss	12,592	10,462
Total	**55,528**	91,653

(c) Fair value of financial instruments and liabilities

The following table summarises the carrying values of the financial assets and financial liabilities by class of instrument compared with their fair values:

	2012		2011	
	Carrying value £'000	**Fair value £'000**	Carrying value £'000	Fair value £'000
Financial assets				
Fair value through profit and loss	1,635,229	1,816,155	1,523,782	1,698,082
Receivables	57,400	57,400	87,867	87,867
Financial liabilities				
Fair value through profit and loss	(633)	(633)	(6,093)	(6,093)
Financial liabilities at amortised cost	(12,200)	(12,200)	(14,871)	(14,871)
Total	**1,679,796**	**1,860,722**	1,590,685	1,764,985

The authority has not entered into any financial guarantees that are required to be accounted for as financial instruments.

(d) Valuation of financial instruments carried at fair value

The valuation of financial instruments has been classified into three levels, according to the quality and reliability of information used to determine fair values.

Level 1
Financial instruments at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as Level 1 comprise quoted equities, quoted fixed securities, quoted index-linked securities and unit trusts.

Listed investments are shown at bid prices. The bid value of the investment is based on the bid market quotation of the relevant stock exchange.

Level 2
Financial instruments at Level 2 are those where quoted market prices are not available, for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

Level 3
Financial instruments at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data.

Such instruments would include unquoted equity investments and hedge fund of funds, which are valued using various techniques that require significant judgement in determining appropriate assumptions.

The values of the investment in private equity are based on valuations provided by the general partners to the private equity funds in which Environment Agency Active Pension Fund has invested.

These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines, which follow the valuation principles of IFRS and US GAAP. Valuations are usually undertaken annually at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

The values of the investment in hedge funds are based on the net asset value provided by the fund manager. Assurances over the valuation are gained from the independent audit of the value.

The following table provides an analysis of the financial assets and liabilities of the pension fund grouped into Levels 1 to 3, based on the level at which the fair value is observable:

Values at 31 March 2012	Quoted market price Level 1 £000	Using observable inputs Level 2 £000	With significant unobservable inputs Level 3 £000	Total £000
Financial assets				
Financial assets at fair value through profit and loss	1,698,562	25,154	92,438	1,816,154
Receivables	57,401	-	-	57,401
Total financial assets	**1,755,963**	**25,154**	**92,438**	1,873,555
Financial liabilities				
Financial liabilities at fair value through profit and loss	-	-	(633)	(633)
Financial liabilities at amortised cost	(12,200)	-	-	(12,200)
Total financial liabilities	**(12,200)**	**-**	**(633)**	**(12,833)**
Net financial assets	**1,743,763**	**25,154**	**91,805**	**1,860,722**

Values at 31 March 2011	Quoted market price Level 1 £000	Using observable inputs Level 2 £000	With significant unobservable inputs Level 3 £000	Total £000
Financial assets				
Financial assets at fair value through profit and loss	1,599,429	4,228	94,426	1,698,083
Receivables	87,867	-	-	87,867
Total financial assets	1,687,296	4,228	94,426	1,785,950
Financial liabilities				
Financial liabilities at fair value through profit and loss	-	-	(6,093)	(6,093)
Financial liabilities at amortised cost	(14,871)	-	-	(14,871)
Total financial liabilities	(14,871)	-	(6,093)	(20,964)
Net financial assets	**1,672,425**	**4,228**	**88,333**	**1,764,986**

18. Nature and extent of risks arising from financial instruments

Risk and risk management

The Fund's primary long-term risk is that the fund's assets will fall short of its liabilities (i.e. promised benefits payable to members). Therefore the aim of investment risk management is to minimise the risk of an overall reduction in the value of the Fund and to maximise the opportunity for gains across the whole Fund's portfolio. The Fund achieves this through asset diversification to reduce exposure to market risk (price risk, currency risk and interest rate risk) and credit risk to an acceptable level. In addition, the Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Fund's forecast cash flows. The Fund manages these investment risks as part of its overall pension fund risk management programme.

Considerations of investment risk are integrated into the Fund's Investment strategy, responsibility for which rests with the Pension Fund Committee. In addition, the Fund maintains a Register of risks which includes investment risks, and the Fund, working with its advisers, regularly monitors investment risks within the Fund, enabling the pension committee to consider risk as required.

(a) Market risk

Market risk is the risk of loss from fluctuations in equity and commodity prices, interest and foreign exchange rates and credit spreads. All securities investments present a risk of loss of capital. The Fund is exposed to market risk from its investment activities, particularly through its equity holdings. The level of risk exposure depends on market conditions, expectations of future price and yield movements and the asset mix.

The objective of the Fund's risk management strategy is to identify, manage and control market risk exposure within acceptable parameters, whilst optimising the potential for long term return within a given risk framework – long term investment returns fundamentally depend on the willingness to take on risk.

In general, excessive volatility in market risk is managed through the diversification of the portfolio in terms of geographical and industry sectors and individual securities. Specific risks on individual investments, caused by factors specific to the individual instrument, can be largely managed and reduced through diversification. Broader market risk, arising from factors affecting all instruments in the market, can only be reduced to a limited extent through diversification without affecting long term returns.

To mitigate specific market risk, the Fund and its investment advisers undertake appropriate monitoring of individual manager's selection of securities, their performance against benchmarks and their compliance with their individual Investment Management Agreement and the Fund's overall investment strategy. Broader market risk, analysed below, is regularly monitored by the Fund and its advisers, and is a key consideration in determining the Fund's overall Asset Allocation. The Fund also considers the use of risk management tools such as currency hedging. However, the Fund does not attempt to manage market risk by short term shifts in asset allocation, as this may increase rather than reduce risk.

Market risk – sensitivity analysis

Following analysis of historical data and expected investment return movement during the financial year, in consultation with the Fund's advisers, the Fund has determined that the following movements in market price risk are reasonably possible for the 2012/13 reporting period:

Asset Class	1 Year Expected volatility %	% of Fund %
UK equities	17.0	19.9
Global equities (ex UK)	19.7	41.4
Private equity	28.5	4.5
Property	14.5	3.2
Corporate bonds	10.3	14.1
UK index linked gilts (medium term)	5.9	13.8
Cash and other	0.8	3.1
Total Fund volatility	**12.4**	**100.0**

*includes exposure to overseas bonds

The potential price changes disclosed above are broadly consistent with a one-standard deviation movement in the value of the assets. The sensitivities are consistent with the assumptions contained in the investment adviser's most recent review. The Total Fund volatility takes into account the expected interactions between the different asset classes shown, based on the underlying volatilities and correlations of the assets, in line with mean variance portfolio theory.

Due to the approach taken to determine the Total Fund volatility (in which the impact of diversification is recognised), the monetary impact on the total fund assets is determined using the total fund volatility rather than the sum of the monetary impact for each asset class.

Had the market price of the Fund's investments increased/decreased in line with the above, the change in the net assets available to pay benefits in the market price would have been as follows (the prior year comparator is shown below):

	31 March 2012	31 March 2011
Total Fund (£000)	1,855,443	1,753,915
Percentage change (%)	12.4	12.4
Value on increase (£000)	2,085,517	1,971,400
Value on decrease (£000)	1,625,368	1,536,430

Asset Class	Potential change in value from market risk	
	31 March 2012 £,000	31 March 2011 £,000
UK equities	62,609	75,847
Global equities (ex UK)	151,381	121,930
Private equity	23,825	25,813
Property	8,583	8,146
Corporate bonds	26,958	23,337
UK index linked gilts (medium term)	15,066	13,536
Cash	467	639
(Less impact of diversification)	(58,866)	(52,534)
Total fund volatility	**230,023**	216,714

Interest rate risk

Many investments are subject to interest rate risks, which represent the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Fund's direct interest rate risk exposure is primarily due to its fixed income holdings. The Fund may also have indirect interest rate exposure through its holdings of other assets, however, it is not possible to quantify these. Note that interest rate risk is also included in the overall estimate of market risk earlier. There is a small interest rate exposure arising from the Fund's cash holdings, where changes in interest rates will change the income received from cash, however, capital values will not be affected.

More significantly, the Fund's liabilities are also estimated using long term interest rates. The interest rate exposure in the Fund's liabilities is materially greater than, and in an opposite direction to, the exposures in the fixed interest portfolios. Thus the overall impact of interest rate movements on the funding level of the Fund is significantly different from that implied below. Effectively, the holdings of fixed income assets provide a partial hedge to the interest rate risk in the Fund's liabilities. The Fund monitors this position through regular estimation of its funding position which includes sensitivity analysis of these risks.

	As at 31 March 2012 £000	As at 31 March 2011 £000	Interest rate sensitivity duration
UK Index Linked Gilts	251,705	229,423	19.6
Pooled Sterling bonds Indexed	140,419	131,764	7.7
Sterling bonds Actively managed	119,052	94,809	7.6
Total	**511,176**	455,996	n/a

Interest rate risk sensitivity analysis

The Fund recognises that interest rates can vary and can affect both income to the Fund and the value of the net assets available to pay benefits. A 1% movement in interest rates provides an appropriate indication of the sensitivity of the fixed interest portfolio and the Fund's Net Assets to a change in interest rates. The Fund advisers have indicated that long term average interest rates are expected to move less than 1% from one year to the next. This interest rate exposure has to be multiplied by the modified duration of the investments to obtain the risk to capital values.

The analysis that follows assumes that all other variables remain constant, and shows the effect in the year on the net assets available to pay benefits of a +/- 1% change in interest rates. Note that changes on rates on Index linked Gilts do not necessarily correspond with changes in rates on other sterling bonds, so total figures are provided for information only.

	Carrying amount as at 31 March 2012	**Possible change in the net assets available to pay benefits**	
		+1%	**-1%**
	£000	**£000**	**£000**
UK Index Linked Gilts	251,705	(49,385)	49,385
Pooled Sterling bonds Indexed	140,419	(10,868)	10,868
Sterling bonds Actively managed	119,052	(9,048)	9,048
Total	**511,176**	**(69,301)**	**69,301**

	Carrying amount as at 31 March 2011	**Possible change in the net assets available to pay benefits**	
		+1%	**-1%**
	£000	**£000**	**£000**
UK Index Linked Gilts	229,423	(45,013)	45,013
Pooled Sterling bonds Indexed	131,764	(10,199)	10,199
Sterling bonds Actively managed	94,809	(7,205)	7,205
Total	**455,996**	**(62,417)**	**62,417**

Currency risk

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Fund is exposed to currency risk on financial instruments that are denominated in any currency other than the functional currency of the Fund (£UK).

Currency risk is also included in the overall estimate of market risk earlier. Most of the Fund's currency risk is through exposure to overseas equities, which are exposed to a complex range of risk factors of which currency is only one. There may also be some indirect currency exposure in the Fund's sterling denominated assets, such as UK equities, but these are impossible to quantify. Most of the Fund's currency risk is offset by the Fund's passive currency hedging strategy which maintains a currency hedge of approximately 60% of the non-sterling denominated assets. The gross amount of the Fund's currency hedging position was approximately £531m at 31 March 2012.

The Pension Fund's currency rate risk and passive currency hedging strategy are routinely monitored by the Fund and its investment advisors including monitoring the range of exposure to currency fluctuations.

The following table summarises the Fund's currency exposure as at 31 March 2012 and as at the previous period end:

Currency exposure – asset type	**Asset value as at 31 March 2012 £000**	Asset value as at 31 March 2011 £000
Overseas quoted securities	362,654	433,249
Overseas pooled equities	402,556	185,687
Overseas unquoted private equity	79,089	84,980
Total overseas assets	**844,299**	703,916
Less currency hedging	**(531,000)**	(403,000)
Net unhedged overseas assets	**313,299**	300,916

The Fund also has awarded an active currency mandate, value at 31 March 2012 £54,845,000 (2011: £55,499,000) which has significant currency exposures (up to four times the total value of the mandate.) However, these exposures are actively managed in a carefully risk controlled fund which aims to keep total risk in a range of 9 - 12% of the portfolio. This equates to a possible risk, on a 12 month view, of approximately £6.6m. This figure is independent of the general direction of Sterling (£GBP), so not included in the table above.

Currency risk – sensitivity analysis

Following analysis of historical data in consultation with the Fund's advisers, the Fund considers the likely volatility associated with foreign exchange rate movements to be 13% (as measured by one year expected standard deviation).

This analysis assumes that all other variables, in particular interest rates, remain constant.

A 13% strengthening/weakening of the pound against the various currencies in which the Fund holds investments would increase/decrease the net assets available to pay benefits as follows:

Currency exposure – asset type	Asset value as at 31 March 2012	Possible change to net assets available to pay benefits	
		+13%	-13%
	£000	£000	£000
Overseas quoted securities	362,654	47,145	(47,145)
Overseas pooled equities	402,556	52,332	(52,332)
Overseas unquoted private equity	79,089	10,282	(10,282)
Total change in assets available	**844,299**	**109,759**	**(109,759)**
Less currency hedging	(531,000)	(69,030)	69,030
Net unhedged overseas assets	**313,299**	**40,729**	**(40,729)**

Currency exposure – asset type	Asset value as at 31 March 2011	Possible change to net assets available to pay benefits	
		+13%	-13%
	£000	£000	£000
Overseas quoted securities	433,249	56,322	(56,322)
Overseas pooled equities	185,687	24,139	(24,139)
Overseas unquoted private equity	84,980	11,047	(11,047)
Total change in assets available	**703,916**	**91,508**	**(91,508)**
Less currency hedging	(403,000)	(52,390)	52,390
Net unhedged overseas assets	**300,916**	**39,118**	**(39,118)**

(b) Credit risk

Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Fund to incur a financial loss. The market values of investments generally reflect an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Fund's financial assets and liabilities.

Credit risk also arises inevitably with transactions and trading. However, the selection of high quality counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner.

To minimise credit risk exposure most of the Fund's cash is held in money market funds run by the Fund's custodian Northern Trust and the Fund's index fund provider Legal & General – these funds invest in a wide range of cash instruments and have limited exposure to any individual institution, Furthermore they are legally separate from the manager, which should safeguard the Fund's investments in the case of the default of the manager.

The Fund believes it has managed the Fund's exposure to credit risk, and has had no experience of default in cash deposits or uncollectible deposits over the past five financial years. The Fund's cash holding under its cash management arrangements at 31 March 2012 was £51 million (31 March 2011: £89 million), This was held with the following institutions:

Summary	**Rating by Moody's**	**Balances as at 31 March 2012 £000**	Balances as at 31 March 2011 £000
Money market funds			
Legal & General	None *	12,124	21,468
Northern Trust	Aaa	31,983	56,983
Bank deposit accounts			
National Westminster Bank plc	A2	-	4
Cater Allen Private Bank Ltd	A2	2,177	5,510
Bank current accounts			
National Westminster Bank plc	A2	4,807	5,508
Total		**51,091**	**89,473**

* Legal & General is not rated by Moody's. This Fund holds sterling term deposits with a range of high quality financial institutions, and is subject to its own extensive credit risk management policies.

(c) Liquidity risk

Liquidity risk represents the risk that the Fund will not be able to meet its financial obligations as they fall due. The Pension Fund therefore takes steps to ensure that it has adequate cash resources to meet its commitments. This will particularly be the case for cash from the cash flow matching mandates from the main investment strategy to meet the pensioner payroll costs; and also cash to meet investment commitments.

The Pension Fund has immediate access to its cash holdings, with the exception of holdings with the Legal & General Cash Fund where dealing days occur approximately weekly.

The Fund defines liquid assets that can be converted to cash within three months. Illiquid assets are those assets which will take longer than three-months to convert in to cash, and are assumed to be the private equity and property holdings. As at 31 March 2012, the value of potentially illiquid assets was £142.8m, which represented 7.7% of the total Fund assets (31 March 2011: £146.8m, which represented 8.3% of the total fund assets).

Management prepares periodic cash flow forecasts to understand and manage the timing of the Fund's cash flows. The appropriate strategic level of cash balances to be held forms part of the Fund's investment strategy.

All financial liabilities at 31 March 2012 are due within one year.

Refinancing risk

The key risk is that the Fund will be bound to replenish a significant proportion of its pension fund financial instruments at a time of unfavourable interest rates. The Fund does not have any financial instruments that have a refinancing risk as part of its investment strategy.

19. Funding arrangements

In line with the Local Government Pension Scheme (Administration) Regulations 2008, the fund's actuary undertakes a funding valuation every three years for the purpose of setting employer contribution rates for the forthcoming triennial period. The last such valuation took place as at 31 March 2010. The next valuation will take place as at March 2013.

The key elements of the funding policy are as follows:

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

At the 2010 actuarial valuation, the fund was assessed as 94% funded (103% at the March 2007 valuation). This corresponded to a deficit of £95m (2007 valuation: surplus of £38m) at that time.

The aim is to achieve 100% solvency over a period of nine years by continuing to contribute the equivalent of 16.5% of which 13% is for future service and 3.5% of pay towards the repayment of the funding deficit. Solvency is achieved when the funds held, plus future expected investment returns and future contributions, are sufficient to meet expected future pension benefits payable.

The Environment Agency's contribution rate over the three-year period ending 31 March 2014 remains unchanged throughout at 16.5% of pay. The following table shows the minimum contributions payable after allowing for discretionary lump sum payments that were paid to the fund during March 2011, i.e. shortly before the start of the three-year period.

Employer name	Minimum contributions for the year ending:					
	31 March 2012		31 March 2013		31 March 2014	
	% payroll	£(000)	% payroll	£(000)	% payroll	£(000)
EA (England)	13.0%	-	13.0%	10,803	13.0%	11,328
EA (Wales)	13.0%	-	13.0%	-	13.0%	-

Full details of the contribution rates payable can be found in the 2010 actuarial valuation report and the funding strategy statement on the fund's website.

The valuation of the fund has been undertaken using the projected unit method under which the salary increase for each member is assumed to increase until they leave active service by death, retirement or withdrawal from service. The principal assumptions were:

Financial assumptions

Financial assumptions	% per annum	Description
Investment Return (Discount Rate)	6.1%	Yield on long term fixed interest Government bonds plus an Asset Outperformance Assumption of 1.6%
Retail Price Inflation (RPI)	3.8%	The difference between yields on long term fixed and index-linked Government bonds
Salary Increases*	4.8%	RPI plus 1%
Pension Increases	3.0%	CPI (assumed to be 0.8% less than RPI)

*An allowance is also made for promotional pay increases. Note that the assumption at 31 March 2010 is actually 1% p.a. for 2010/11 and 2011/12, reverting to 4.8% p.a. thereafter.

Longevity assumptions

Life expectancy is based on the Fund's Vita Curves with improvements from 2007 in line with the Medium Cohort and a 1% p.a. underpin. Based on these assumptions, the average future life expectancies at age 65 are summarised below:

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

* Figures assume members aged 45 as at the last formal valuation date.

20. Actuarial present value of promised retirement benefits

IAS26: Accounting and reporting by retirement benefit plans

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £2,074m (2011: £1,846m). This figure is used for statutory accounting purposes by the Environment Agency. The assumptions underlying the figure are set out in the Environment Agency's statutory accounts. The figure is only prepared for the purposes of IAS19 and has no validity in other circumstances. In particular, it is not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

Assumptions used

Year ended 31 March 2012	% p.a.
Pension increase rate	2.2
Salary increase rate *	4.3
Discount rate	4.8

* Salary increases are assumed to be 1% p.a. until 31 March 2015 reverting to the long term assumptions thereafter.

21. Current assets

	2012 £000	2011 £000
Debtors		
VAT to be reimbursed to the Fund	668	-
Administration expenses to be reimbursed to the Fund	97	1
Sundry - amount due from Closed Fund	75	-
Contributions due - employers	29	6,542
Contributions due - employees	1	301
Overpaid pensions on death to be refunded to the Fund	-	1
	870	6,845
Cash at bank	6,984	11,022
Total	**7,854**	17,867

Analysis of debtors

	2012 £000	2011 £000
Central government bodies - HMRC	668	-
Government Agencies – Environment Agency	202	6,843
Other entities and individuals – Projects recharge	-	2
Total	**870**	6,845

Amounts due from the Environment Agency, shown above under Government Agencies, are:

(i) employers' and employees' contributions of £1,000 (2011: £2,000) and £2,000 (2011: £301,000) respectively outstanding in the normal course of collection at the year end and subsequently paid over within the statutory time limit;

(ii) £27,000 (2011: £6,102,000) for special contributions due in respect of augmentations to members' benefits and £nil (2011: £438,000) in respect of shortfall funding for a bulk transfer payment;

(iii) £64,000 in respect of administration expenses paid by the Fund on behalf of the Environment Agency; and

(iv) £108,000 is due from them Environment Agency Closed Fund in respect of member and administration expenses.

22. Current liabilities

	2012 £000	2011 £000
Creditors		
Administration and investment expenses	(1,711)	(1,303)
PAYE	(506)	(483)
Benefits payable	(358)	(5,010)
Tax payable on refunds	-	(1)
Total	**(2,575)**	(6,797)

Analysis of creditors

	2012 £000	2011 £000
Other entities and individuals – Benefits and admin fees	(1,936)	(6,198)
Central government bodies – HMRC	(506)	(484)
Government Agencies – Environment Agency	(93)	(79)
Independent Parliamentary Bodies – NAO fees	(40)	(36)
Total	**(2,575)**	6,797

23. Additional Voluntary Contributions

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

	2012 £000	2011 £000
Standard Life		
Unit-linked funds	2,853	2,750
	2,853	2,750
Clerical Medical		
Unit-linked funds	1386	1,525
With-profits funds	605	555
	1,991	2,080
The Equitable Life Assurance Society		
Unit-linked funds	632	723
With-profits funds	369	422
Deposit accounts	121	136
	1,122	1,281
Prudential		
Unit-linked funds	26	9
With-profits funds	110	32
Deposit accounts	229	66
	365	107
Total AVC investments	**6,331**	6,218

The Environment Agency holds assets with Standard Life, Clerical Medical, The Equitable Life Assurance Society and Prudential. These are in the form of unit-linked, with-profits 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 2012 confirming amounts held in their account and movements in the year.

24. Related party transactions

During the year ended 31 March 2012 there have been the following related party transactions:

(i) pensions administration costs of £340,000 (2011: £370,000) recharged to the Fund by the Environment Agency;

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

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

(iv) payment of unfunded liabilities of £347,000 (2011: £1,800,000) recharged to the Environment Agency and funded by grant-in-aid from Defra in respect of compensatory added years; and

(v) During the year, special contributions totalling £127,056 (2011: £396,043) were not paid over to the Fund in line with statutory timescales. As at the year end, no special contributions were outstanding.

25. Contingent liabilities

In accordance with authorised investment strategy and mandates, the outstanding investment commitments at 31 March 2012 are Private equity £19.0m (2011: £21.3m). There are no Property commitments at the year end (2011: £0.5m).

26. Contingent assets

There are no contingent assets as at 31 March 2012 (2011: £nil).

27. Impairment losses

For the year to 31 March 2012 the Fund has recognised an impairment loss of less than £0.1m (2011:less than £0.1m) for the non-recovery of pensioner death overpayments.

The annexes

Annex 1 – Scheme rules and benefits

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

Scheme membership and income

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

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

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

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

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

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

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

Benefits available

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

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

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

2. Deferred and payable from:

- Normal retirement age; or
- Voluntarily from age 55 onwards (with the Environment Agency's consent if under age 60); or
- Through permanent incapacity at any age with the Environment Agency's consent.

B. ***Spouses', Civil Partners', Nominated Co-Habiting Partners' and Children's pensions and a lump sum death grant*** following death:

1. During employment; or
2. Whilst in receipt of a retirement pension (a death grant lump sum may **not** always be payable); or
3. Before deferred benefits become payable.

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

A. Retirement pension on retirement at age 65.

B. Lump sum death grant on death in employment.

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

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

Pensions increase awards

Retirement and dependants' pensions in payment and deferred pensions are reviewed each year in line with the increase in the Consumer Prices Index.

Transfers to other schemes

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

Annex 2 – Funding Strategy Statement

1. Introduction

In accordance with Regulation 35 of the Local Government Pension Scheme (Administration) Regulations 2008 and the guidance paper issued in March 2004 by the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel, this statement sets out the funding strategy for the Environment Agency Active Pension Fund (the "Fund"). This statement has been reviewed and updated as part of the 2010 actuarial valuation process.

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

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

As at 31 March 2010, the Active Fund contained 11,933 active members, 4,089 pensioners and 5,215 deferred pension members whose benefits have yet to come into payment.

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

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

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

- In preparing the FSS, the Administering Authority must have regard to:
  - the guidance issued by CIPFA for this purpose; and
  - the Statement of Investment Principles (SIP) for the Fund published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended); and

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

The Fund is a defined benefit final salary scheme under which the benefits are specified in the governing legislation (the Regulations). "The Regulations" are defined as:
- The Local Government Pension Scheme (Administration) Regulations 2008 (as amended) – "the Administration Regulations";
- The Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended) – "the Benefit Regulations";
- The Local Government Pension Scheme (Transitional Provisions) Regulations 2008 (as amended) – "the Transitional Regulations"; and
- The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended) – "the Investment Regulations".

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

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

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

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

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

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

2. Purpose of the FSS in policy terms

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

The purpose of this Funding Strategy Statement is to:

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

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

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

3. Aims and purpose of the Pension Fund

The aims of the fund are to:

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

The **purpose** of the fund is to:

- receive monies in respect of contributions, transfer values and investment income; and
- pay out monies in respect of Fund benefits, transfer values, costs, charges and expenses;

as defined in the Regulations.

4. Responsibilities of the key parties

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

The Environment Agency Pensions Committee as the Administering Authority should:

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

The Environment Agency as the Employer should:

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

The Fund actuary should:

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

5. Long-term funding

When considering the adequacy of funding, the primary focus of the Pension Committee should be on the long-term because:

- liabilities are paid over a long period, rather than crystallising on a single day;
- market prices of assets with growth potential can be volatile;
- pension liabilities are significant compared to the employer's payroll; and
- cuts in employer contributions are easy to implement, but very slow to reverse.

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

Funding levers

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

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

Key assumptions

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

	31 March 2010
Past Service (Current Yields Basis)	
Asset Valuation	£1,589m
Asset out-performance assumption (pre retirement)	1.6%
Asset out-performance assumption (post retirement)	1.6%
Discount rate (pre retirement)	6.1%
Discount rate (post retirement)	6.1%
Breakeven Retail Price Inflation (RPI)	3.8%
Pension Increases *	3.0%
Earnings Inflation **	4.8%
Future Service (Current Yields Basis)	
Discount rate (pre retirement)	6.1%
Discount rate (post retirement)	6.1%
Breakeven Retail Price Inflation (RPI)	3.0%
Earnings Inflation **	4.8%

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

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

Underlying these assumptions are the following two tenets:

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

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

Solvency and Target Funding Levels

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

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

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

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

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

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

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

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

The key financial assumption is the anticipated return on the Fund's investments. The investment return assumption makes an allowance for anticipated returns from equities being in excess of bonds. There is,

however, no guarantee that equities will out-perform bonds but historical data demonstrates that over the long-term returns from investing in equities tend to be greater than those from investing in bonds. When returns are measured over short periods such as the three years between formal actuarial valuations, actual returns and assumed returns can deviate sharply.

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

The retail price inflation assumption is taken to be "break-even" inflation i.e. the level of future inflation that would give an investor in a conventional (non-inflation protected) gilt the same return as another who invested in an index-linked gilt. The pension increase assumption is based on break-even inflation, but reduced by 0.5% a year to allow for consumer price inflation and by a further 0.3% a year to allow for the inflation risk premium (the premium that investors are prepared to pay for inflation protection in current gilt markets).

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

Derivation of Employer Contributions (before stability overlay)

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

- the estimated cost of future benefits being accrued, referred to as the "*future service rate*"; plus
- an adjustment for the funding position (or "solvency") of accrued benefits relative to the Fund's solvency target, "past service adjustment". If there is a surplus there may be a contribution reduction; if a deficit a contribution addition, with the surplus or deficit spread over the remaining working lifetime of scheme members (calculated to be 9 years at the 2010 actuarial valuation).

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

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

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

Sensitivity to assumptions

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

Financial Assumption	Effect on value of liabilities of varying assumption by			
	+0.5% p.a.		-0.5% p.a.	
	Past Service Liabilities	Future Service Liabilities	Past Service Liabilities	Future Service Liabilities
Discount Rate	-11%	-13%	+11%	+13%
Pension increases	+7%	+7%	-7%	-7%
Salary Growth	+4%	+5%	-4%	-5%

It should be noted that the figures above consider the change to each assumption in isolation i.e. a reduction of 0.5% to the discount rate will increase the past service liabilities by approximately 11%, assuming the inflation and salary growth assumptions remain unchanged.

With regard to demographic sensitivities:

- each extra 100 early leavers (i.e. employees who became deferred pensioners) over and above that assumed in the valuation (approximately 1,000 per year), would be expected to reduce the value of the accrued liabilities by between £1m and £1.5m, equivalent to 0.1% to 0.15% of the active liabilities;
- each additional year of life expectancy adds approximately 3% to the value of accrued liabilities. The reserving basis includes an allowance of approximately 7% (or £117m) for future longevity improvement;
- there is allowance for approximately 50 ill-health retirements each year, at a cost in the contribution rate of approximately 2-3% of pay; and
- non-ill health early retirements have a neutral effect on funding as there is either a reduction to the member's pension or an extra employer contribution.

Stability of Employer Contributions

A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, long term view of funding and ensure the solvency of the Active Fund. With this in mind, there are a number of prudent strategies that the Administering Authority may deploy in order to maintain employer contribution rates at as nearly a constant rate as possible. These include:

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

Contribution stability overlay

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

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

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

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

Funding for Early Retirement

Non Ill health retirements

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

Employees who joined before 1 October 2006 (and are subject to Rule of 85 protections on their pre April 2008 benefits) but reach age 60 after 31 March 2020, plus all employees who joined after 1 October 2006, are assumed to take all of their benefits at age 65. Otherwise it is assumed that members' benefits on age retirement are payable from the earliest age that the employee could retire without incurring a reduction to their benefit and without requiring their employer's consent to retire.

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

Ill health monitoring

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

New employers participating in the Fund

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

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

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

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

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

Funding and investment strategies are inextricably linked.

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

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

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

If, at the valuation date, the Active Fund had been invested in this portfolio, then in carrying out the valuation it would not be appropriate to make any allowance for out-performance of the investments. On this basis of assessment, the assessed value of the Active Fund’s liabilities at the 2010 valuation would have been significantly higher and the declared funding level would be correspondingly lower.

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

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

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

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

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

In order to reduce the volatility of employers' contributions, the funding policy currently anticipates returns of 1.6% a year, that is around 1.7% a year less than the *best estimate* return from the Active Fund's portfolio of assets (if no active manager out-performance is achieved).

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

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

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

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.

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

7. Identification of risks and counter-measures

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

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

The following key risks have been identified:

Financial

Risk	Summary of Control Mechanism
Fund assets fail to deliver returns in line with the anticipated returns underpinning the valuation of liabilities over the long-term	Only anticipate long term returns on a relatively prudent basis to reduce risk of under-performing. Analyse progress at three yearly valuations Inter-valuation roll-forward of liabilities between formal valuations on a quarterly basis. Contribution stability overlay (from 2013 valuation) will reduce risk of volatile employer contributions.
Inappropriate long-term investment strategy	Set fund-specific benchmark, informed by asset-liability modelling. A mechanism for enabling strategy to be linked to funding level could enable asset outperformance relative to liabilities to be locked in.
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities	Inter-valuation monitoring, as above. Some investment in bonds helps to mitigate this risk.
Active investment manager under-performance relative to benchmark	Short-term (quarterly) investment monitoring analyses market performance and managers relative to their index benchmark.
Pay and price inflation significantly more than anticipated	The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases. Inter-valuation monitoring, as above, gives early warning. Some investment in index-linked bonds also helps to mitigate this risk. Investment in other "real" assets (e.g. equities and property) also helps to mitigate risks. New mechanism introduced at 2010 valuation where Environment Agency will additionally top-up contributions if future pay increases are in excess of the 2010 valuation salary increase assumption.
Effect of possible increase in employer's contribution rate on service delivery	Mitigate impact through deficit spreading and introduction of new contribution stability mechanism at 2013 valuation to increase employer's budgeting certainty.

Demographic

Risk	Summary of Control Mechanism
Pensioners living longer.	Actuary quantifies potential scale of risk associated with continuing improvements in longevity, and identifies separate reserve in the actuarial valuation. The reserve for future longevity improvements was increased in the 2010 actuarial valuation. Fund uses bespoke 'baseline' longevity assumptions, based on the pooled mortality experience of almost 100 large occupational pension schemes, to allow for the individual characteristics of each individual member in the Fund. Club Vita also provides annual monitoring of longevity experience movements, to give an early warning of the adequacy of the reserve for future longevity improvements.
Deteriorating patterns of early retirements.	Employers are charged the extra capital cost of non ill health retirements following each individual decision. Employer ill health retirement experience is monitored.

Regulatory

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

Structural Changes in Employer

Risk	Summary of Control Mechanism
Administering Authority unaware of structural changes in the employer's membership (e.g. large fall in employee members, large number of retirements).	The Administering Authority monitors membership movements on a quarterly basis, via a report from the administrator at quarterly meetings. The Actuary may be instructed to consider revising the rates and Adjustments certificate to increase an employer's contributions (under Regulation 38) between triennial valuations Past service deficit recovery element of the Environment Agency's regular contribution rate to be based on monetary amounts (rather than a percentage of payroll) from April 2011 to protect the Fund against falling payroll.
New employers, Arm's Length Bodies (ALBs) review and bulk transfers in or out may crystallise funding deficits.	Administering Authority will manage this by adherence to Pensions Committee's policies on the participation of new admission bodies and bulk transfers.

Governance

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

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

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

The Pensions Committee has a Scheme of Delegation to enable the Fund administrator and Environment Agency officers and pension fund administrators to undertake the day-to-day running of the Fund.

8. Monitoring and Review

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

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

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

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

Approved by the Pensions Committee on 17 March 2011 and will be reviewed in 2013.

Annex 3 – Statement of Investment Principles

The fund is a final salary (defined benefit) pension scheme with almost 22,000 members and assets of £1.85bn as at 31 March 2012. Full details of the Environment Agency Pension Fund and our activities can be found on our website www.eapf.org.uk .

Regulatory context

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 take precedence in the event of a conflict of interest with the Environment Agency's business objectives. As set out in the regulations, the Pensions Committee will review the statement from time to time, but at least every three years following the triennial valuation of the fund.

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

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

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

Strategic and policy context

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 25 June 2012, after taking advice from its investment staff, investment consultants, independent investment adviser and consulting actuary.

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

The statement should be read and implemented in conjunction with the Active Fund's Funding Strategy Statement, Pensions Committee Governance Policy Statement, Responsible Investment Policy, statement of compliance to the UK Stewardship Code and Environmental Overlay Strategy. These provide and state our more detailed requirements and supplementary guidance on these specific topics for our external fund managers. It is also supplemented by the contents of our investment management agreements for each investment mandate. Details of the investment and performance objectives for each mandate are published in our annual report and financial statements.

Fund governance

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 Environment Agency Board appoints Pensions Committee and delegates responsibility for compliance with legislation and best practice, overall strategic asset allocation, investment policy, budgets and the appointment of fund managers and investment advisors. The Environment Agency Board approves the annual report and accounts of the fund, which sets out the policies under which the fund is governed.

The Investment Sub-Group consists of five representatives of the Pensions Committee and receives advice from professional investment staff employed by the Environment Agency, specialist investment consultants, an independent investment adviser, plus our fund actuary, and other professional advisers as required.

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.

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

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

Our return investment objective is to achieve 100% funding on an ongoing basis by 2031, with a reasonable probability of reaching 90% funded by 2022; and

Our risk objective is to limit the likelihood of a fall in the funding level to below 80% by 2016 and subsequent actuarial valuations.

The aim of these objectives is to achieve a return on our assets which:

- is sufficient to meet Funding Strategy Statement objectives arising from triennial actuarial valuations of the Fund;
- in overall terms, seeks to out-perform a fund-specific benchmark;
- contributes towards achieving and maintaining a future funding level of 100%;
- is set at a level which does not force the managers to take unnecessary risks; and
- acknowledges the risks inherent in making investments and have regard to best practice in managing those risks.

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

Choosing investments

Asset allocation

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 investment objective, which has been determined as a return of +3.25% over the expected return on gilts. In setting the asset allocation the Environment Agency has also to consider the challenges presented by volatile market conditions, changes to the benefit structure of the LGPS, potential changes to the investment regulations all of which potentially impact on opportunity set for investment, contribution levels, future accruals and opt-outs.

Therefore, after reviewing the investment strategy in 2012, the Environment Agency has adopted a flexible approach to asset allocation, which consists of a broad framework and process for determining specific asset allocation on a more frequent basis.

The broad framework sets out acceptable ranges for specific assets classes rather than fixed amounts. These are set out in the table below. The asset allocation is subject to a range of risk control measures. The framework is intended to be fairly fixed, and to ensure asset allocation remains within acceptable limits but can also be responsive to changes in funding levels, market conditions and other factors.

The asset allocation will be reviewed at least annually by the Pensions Committee who will set a more tightly defined asset allocation, within the ranges below and with reference to the return requirements and acceptable risk, as well as the current funding levels, market conditions and valuations, and with the input of the Fund's advisors. Changes in allocations to lower risk (fixed income) assets in particular will be scrutinised to ensure that the timing and the impact on risk is appropriate. As part of this process the strategic benchmark will be updated.

Previous %	Asset Class	Framework Range %	Direction 2013
63	Public Global Equities *of which* - *emerging markets*	50-63 *5-12*	Decrease Increase
10 *5* *5* - -	Alternatives *of which:* - *private equity* - *property* - *infrastructure,* - *farmland-timberland*	9-20 *4-6* *3-6* *0-4* *0-4*	 Maintain Maintain Increase Increase
13.5 13.5	Fixed Income - Index-Linked gilts - Corporate bonds	5-20 13-28	Decrease Increase
	Cash	<3	

The Environment Agency has 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 in LGPS Investment Regulations 2009.

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.

The Environment Agency regularly rebalances the actual public equity and fixed income weightings (which move with market levels) back to the strategic asset allocation. This works using ranges around some of the elements of the strategic benchmark. The Fund's strategic benchmark and manager performance targets and their achievement are publicly disclosed within the Active Fund Annual Report and Financial Statements.

Types of investment to be held

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, financial risk, liquidity, management costs and any environmental impacts. The Fund has not made an allocation to hedge funds that are involved in short selling equities or bonds.

The balance between different types of investment

The Fund will at all times hold a widely diversified portfolio of investments to reduce risk. Each investment manager will hold an appropriate spread of investments, and within each asset class the Fund as a whole will seek to have a well-diversified portfolio. The Investment Strategy Framework and asset allocation results in a significant weight being given to equities, which the Environment Agency considers appropriate given the current liability profile and funding position of the Fund, but this will be spread across a range of managers with different approaches and styles.

The Fund's preference is for segregated portfolio's, where the Fund is the direct beneficial owner of the underlying investments, but the Fund also uses collective investments (pooled) funds when we consider them to be appropriate, based on considerations including speed of implementations, costs, flexibility, ease of administration and impact on voting and active ownership.

The fund uses a combination of passive (indexed), enhanced indexed and active approaches to investment management, based on consideration of availability, cost, flexibility and returns potential. Passive approaches aim to deliver the market return of the underlying index and consequently contain a very large number of holdings that seek to replicate the make-up of the underlying market indices. They are used for gilts, equities and corporate bonds, in both pooled and segregated approaches. With global equities, an allocation may also be made to enhanced index and low volatility approaches, which aim to provide improved risk/return characteristics over conventional passive approaches.

The remainder of the Fund will be managed on an active basis, using investment managers to select the investments they consider to have the best return potential, 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/real assets, currency and private equity. Specialist managers are appointed to manage specific portfolios within each asset class. Each investment manager is given an individual benchmark, performance and risk targets that are regularly monitored.

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

The Pensions Committee considered the increased amount of risk associated with Column 1 and 2 and they do not think it is material and so decided to adopt Column 2.

	Column 1 (from)	Column 2 (to)
All contributions to any single partnership	2%	5%
All contributions to partnerships	5%	15%
Any single insurance contract	25%	35%

In order to meet the LGPS requirements our holdings in passive pooled funds are divided between two insurance contracts, each operating to a limit to the upper limit (35%) defined in Column 2 Schedule 1 and for this to apply for the duration of the Fund holding this insurance product.

Risk

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

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

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

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.

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

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

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.

The fund uses a currency hedging programme to assist in the management of the volatility incurred in investing in non-sterling priced securities. Any overseas fixed interest exposure would normally be hedged. Currency exposure in equities is partially hedged, with the proportion currently set at 60% but reviewed regularly.

Realisation of investments

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. Our only materially illiquid assets within the fund are those categorised as alternatives and we do not intend to exceed a 20% allocation in aggregate.

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

Expected return on investments

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

Each active manager has an out-performance target, and taken together the entire fund is expected to out-perform the strategic benchmark for the fund.

Social, environmental and ethical considerations

The Environment Agency Active Fund recognises the importance of the principles relating to responsible investment and robust corporate governance to help achieve its investment objectives. Accordingly, the Environment Agency has made a statement of compliance with the UK Financial Reporting Council's Stewardship Code and, in respect of investments in the United Kingdom, requires its managers to have due regard to the UK Corporate Governance Code and, in respect of overseas investments, have due regard to relevant recognised standards.

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 financial interest of fund members.

The Environment Agency Active Fund it is a signatory of the United Nations Principles of Responsible Investment (UNPRI), which is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios and therefore must be given appropriate consideration by investors if they are to fulfil their fiduciary duty. The UN Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment and anti-corruption.

The Environment Agency will comply with its fiduciary duty to maximise the risk adjusted investment returns of the Fund. In this context, the Environment Agency recognises that financially material environmental issues, e.g. climate change can adversely impact on the Fund's financial risks and investment returns and thus should be taken into account in the investment strategy and process. 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. To further support the integration of environmental governance in our fund and in the securities in which we invest, we are signatories to the Investor Statement on Climate Change, the Carbon Disclosure Project (CDP) and its sister projects Water Disclosure Project (WDP) and Forestry Footprint Disclosure Project (FFDP).

Whilst reserving the right to act independently, if it so wishes, the Fund will normally act through partnerships and alliances with other institutional pension funds, shareholder bodies, and asset owner organisations. This will include the UNPRI, Institutional Investors Group on Climate Change (IIGCC) and UK Sustainable Investment and Finance Association (UKSIF), or through its fund managers' membership of other bodies concerned with improving corporate governance such as International Corporate Government Network.

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.

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

The Environment Agency also seeks to take advantage of environmental investment opportunities as they arise, subject to their offering acceptable levels of return/risk. Environmental investment opportunities may form part of our global equity, fixed interest, private equity and other portfolios.

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 our managers' regular contact and engagement with the senior executives of companies in which the Fund's assets are invested.

Exercise of rights

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 or via a specialist service provider, if we wish to do so. Before appointment, our fund managers have to confirm that they subscribe to the principles of good corporate governance and, when voting at company AGMs, take them into account. In respect of investments in the United Kingdom, this requires its managers to have due regard to the UK Corporate Governance Code and, in respect of overseas investments, have due regard to relevant recognised standards. We require our managers apply the UK Stewardship Code and to adopt the Institutional Shareholders' Committee Statement of Principles on the Responsibilities of Institutional Shareholders and Agents. All managers are requested to vote all the Fund's shares and quarterly monitoring reports are provided by our global custodian Northern Trust.

When specific environmental resolutions are proposed at company AGMs, our fund managers are required, wherever possible, to refer such resolutions to the Environment Agency, who will direct the investment manager how to vote the Fund's shares on that resolution. The Environment Agency's policy is to be generally supportive of resolutions calling for greater disclosures of a company's environmental performance or for improvements in environmental practice. Each resolution is considered on its own validity and merits, and due regard is paid to any possible adverse effect on investment performance that our voting may have. Further information is provided in our Voting Policy on Environmental Issues, available at www.environment-agency.gov.uk/pensions.

Stock lending

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

Statement of compliance with the Myners principles

We fully comply with Lord Myners' six principles codifying a model of best practice in pension fund governance, investment decision making and disclosure. Further details and evidence are contained with the documents referenced in our Annual Report and Financial Statements and on our internet sites: www.environment-agency.co.uk/pensions and www.eapf.org.uk.

Myners principle	Evidence of compliance and justifications for non-compliance
Principle 1: Effective decision making	
Administering authorities should ensure that: • Decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation. • Those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.	**Our Fund fully follows this principle** • Our Financial Memorandum, the Pensions Committee Terms of Reference, Standing Orders and Pension Funds Scheme of Delegation, clearly set out the governance structure and levels of responsibility of the Committee, Sub-Groups, officers and external suppliers. Our statutory Governance Compliance Statement provides further detail. • All the above documents and other supporting material are contained in a Pensions Committee handbook which is updated annually. • The Pensions Committee retains overall responsibilities for Fund and investment strategy. • The Pension Committee appoints a number of professional external advisers for investment, legal advice, actuarial services and fund management. These are detailed in our Annual Report and Financial Statements. A report on their performance is presented to the Pensions Committee and the Board annually. • The Pensions Committee has a training strategy which is reviewed annually. Conflicts of interest are identified and records maintained and form part of an annual audit. A record of meeting attendance and training is published in our Annual Report and Financial Statements. • Managers are appointed to invest funds following a comprehensive due diligence process and with input from independent investment advisers.

Myners principle	Evidence of compliance and justifications for non-compliance
Principle 2: Clear Objectives	
An overall investment objective(s) should be set for the Fund taking account of the scheme's liabilities, the potential impact on local tax payers, the strength of the covenant for non-local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisers and investment managers.	**Our Fund fully follows this principle** • In setting the investment objective(s), the Pensions Committee, as the Administering Authority, addresses the balance between risk and reward by altering the level of investment in potentially higher yielding, but more volatile, asset classes such as equities. This process is informed by actuarial and investment advice and the use of asset-liability modelling techniques to model the range of potential future funding levels and the impact on future contribution rates with reference to the Funding Strategy Statement and Statement of Investment Principles, detailed above.
Principle 3: Risk and liabilities	
• In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities. • These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.	**Our Fund fully follows this principle** • In setting the investment strategy, the Pensions Committee, as the Administering Authority, is informed by actuarial and investment advice and asset-liability modelling with inter-valuation monitoring, providing an early warning to the Committee. A summary of the assumptions is detailed in the statement of the Consulting Actuary and risks in the Funding Strategy Statement.
Principle 4: Performance assessment	
• Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisers. • Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision-making body and report on this to scheme members.	**Our Fund fully follows this principle** • The Environment Agency has delegated responsibility and accountability for overseeing the Fund to the Pensions Committee. • The Pensions Committee meets 4 times a year and has set up an Investment Sub Group which also meets at least 4 times a year to monitor investment performance and developments. • These bodies and officers monitor investment performance relative to benchmarks and the change in the value of liabilities by means of quarterly inter-valuation monitoring reports. • The Pension Committee reviews its effectiveness at each meeting and periodically the outcomes are reported to the Board of the Environment Agency.
Principle 5: Responsible ownership	
Administering authorities should: • Adopt, or ensure their investment manager adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents. • Include a statement of their policy on responsible ownership in the statement of investment principle.	**Our Fund fully follows this principle** • We have published a statement of compliance with the UK Stewardship Code which, in respect of investments in the United Kingdom, requires its managers to have due regard to the UK Corporate Governance Code and, in respect of overseas investments, have due regard to relevant recognised standards. We also support the Institutional Shareholders' Committee and Association of British Insurers standards in respect of best practice in corporate governance. We expect our new fund managers and/or an engagement and voting overlay service to follow these standards, subject to our specific instructions. Failure to do so could be a breach of the Investment Management Agreement. • In addition to including responsible ownership in our Statement of Investment Principles above, we have separate published policies covering Responsible Investment and our Environmental Overlay Strategy. We are a signatory of the UNPRI.

Myners principle	Evidence of compliance and justifications for non-compliance
Principle 6:Transparency and reporting	
Administering authorities should: • Act in a transparent manner; communicate with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives. • Provide regular communications to scheme members in the form they consider most appropriate.	**Our Fund fully follows this principle** • Our Annual Report and Financial Statements details all the material issues relating to the Fund, its investments and administration. It is publicly available in hard copy and via our websites. • Fundfare is our annual publication to members, which includes financial information about the Fund and its investments. Two editions are published - one covering the Active Fund and one for the Closed Fund. • Our Communications Policy Statement details the stakeholders we have identified. It also details the communication channels and delivery targets for member communications.

Approved by the Pensions Committee on 25 June 2012

Annex 4 – UK Stewardship Code compliance statement

The Environment Agency Active Pension Fund (EAPF) is fully committed to responsible investment. We believe there is a considerable body of evidence that well governed companies produce better and more sustainable returns than poorly governed companies. We also think investors, including pension fund managers and shareholders, could influence the Board/Directors of under-performing companies to improve the management and financial performance of those companies. A summary of our compliance with the UK Stewardship Code, is detailed below.

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

Approved by the Pensions Committee on 25 June 2012 and will be reviewed in 2013.

Annex 5 – Responsible investment strategy

Introduction

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

Our strategy and approach is driven by our fiduciary duty to deliver financial returns on our investments. We do not undertake negative screening. We invest in index funds holding shares in most companies, in most stock markets. We distinguish ourselves as a responsible investor, by being an active, responsible owner. As such this policy is addressed to our members, employer(s), regulators, fund managers, service providers and other interested parties.

The fund complies with the UK Stewardship Code and subscribes to the Myners' principles of best practice in investment management. This policy should be reviewed should read and implemented in conjunction with the Pensions Committee Governance Policy Statement, Statement of Investment Principles (including Myners), Statement of Compliance to the UK Stewardship Code and Environmental Overlay Strategy. These provide more detailed requirements and supplementary guidance on these specific topics for our external fund managers. It is also supplemented by the contents of our investment management agreements for each investment mandate. Details of the investment and performance objectives for each mandate are published in our annual report and financial statements. All these documents are available on our website.

Scope

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

The Environment Agency Pension Fund believes in shareholder activism and being an active owner directly, through our managers and dedicated governance overlay providers. We delegate much of the day-to-day environmental. social and governance activities to our managers and overlay service provider. The capability and performance of each manager, in this area, is a key component of our selection and retention criteria. Once appointed, we monitor the activity and success of our managers and overlay service provider on a quarterly basis.

United Nations Principles of Responsible Investment

We continue to be an active member of the United Nations Principles for Responsible Investment (UNPRI), which is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios and therefore must be given appropriate consideration by investors if they are to fulfil their fiduciary duty. The UN Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment and anti-corruption.

We complete the annual report on progress in implementing the principles and publish it at www.environment-agency.gov.uk/pensions.

Engagement

We believe that well governed companies reduce the risk to shareholder value and will, over time, produce more sustainable returns compared to poorly governed companies. All of our fund managers regularly engage with companies either directly or through a specialist provider, to assess policies, processes and practices. In partnership with our fund managers, we set out engagement priorities, including collaborative engagements, for the forthcoming year.

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

Voting

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

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

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

Our fund managers refer "environmental" resolutions to us for advice on voting policy in these areas. We also publish our voting record for all environmental resolutions. We publish the guidelines we use for environmental resolutions and this is available on our website.

Monitoring

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

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

Disclosure

We believe disclosure underpins good corporate and environmental governance.

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

Working in partnerships

The Environment Agency liaises with bodies with similar activism goals, including the UK Sustainable Investment and Finance Association (UKSIF), Institutional Investors Group on Climate Change (IIGCC) and Carbon Disclosure Project (CDP) and its sister projects, Water Disclosure Project (WDP) and Forestry Footprint Disclosure Project (FFDP).

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

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

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

This policy incorporates the existing Corporate Governance Policy requirements as specified in our Fund Managers Investment Management Agreements.

Approved by the Pensions Committee on 25 June 2012 and will be reviewed in June 2013.

Annex 6 – Environmental overlay strategy

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

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

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

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

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

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

Statement of Investment Principles (SIP)
When preparing and maintaining the SIP, we will be mindful of our overall corporate strategy (e.g. "greening" business) and corporate environmental governance policies (e.g. encouraging company environmental reporting and disclosure of environmental risks and performance).

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

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

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

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

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

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

In 2010 we partnered other asset owners globally, as part of the Mercer-led research which considered the implications of climate change scenarios on strategic asset allocation (SAA). We have integrated the findings into our review of our strategic asset allocation to inform the development of a robust portfolio, where the investment strategy is positioned to reduce risk and maximise investment opportunities presented by climate change.

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

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

Fund manager selection

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

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

We are committed to responsible investment and all our fund managers and principal service providers are co-signatories of the United Nations Principles for Responsible Investment, which is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios and therefore must be given appropriate consideration by investors if they are to fulfil their fiduciary duty. The UN Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment and anti-corruption.

Investment management agreements

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

Performance benchmarks

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

Investment management processes

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

Shareholder activism, engagement and voting

We will aim to comply with the UK Stewardship Code, UK Corporate Governance Code and Myners principles to be an active investor, especially with companies whose environmental behaviour and performance are currently impacting negatively on short or long-term investment returns – or could do so in the future. We will normally do this through partnership and alliances with other pension fund groups (e.g. UNPRI, UKSIF and IIGCC) to increase the impact of our policies. However, we reserve the right to act independently where necessary.

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

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

Performance monitoring and reporting

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

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

Performance benchmarking and assessment

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

Research and development

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

Collaboration

We will join and/or collaborate with other organisations with environmental goals. Such organisations include the UNPRI, Institutional Investors Group on Climate Change (IIGCC), UK Sustainable Investment and Finance Association (UKSIF), Carbon Disclosure Project (CDP) and its sister projects Water Disclosure Project (WDP) and Forestry Footprint Disclosure Project (FFDP) .

Communication and disclosure

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

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

Continuous improvement

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

Approved by the Pensions Committee on 25 June 2012 and will be reviewed in 2013.

Annex 7 – Communications Policy Statement

Introduction

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

The Active Fund is open to all Environment Agency employees with a contract of three months or more and has 10,700 active members, 6,400 deferred members and 4,900 pensioners.

Unlike most LGPS funds the EAPF currently has only one employer – the Environment Agency. Following confirmation on 22 May 2012 from Welsh Government Minister for the Environment and Sustainable Development that he is proceeding with his proposal to create a Natural Resource Body for Wales by 1 April 2013, the next update to this statement will reflect a second employer.

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, 3,600 deferred members and 15,900 pensioners.

This is the seventh Communications Policy Statement for the Environment Agency Pension Funds and is effective from 25 June 2012.

We have an agreed strategy for implementing a move to more electronic communication which will be implemented by 2013. These changes are reflected in this policy statement. In particular we are developing our website www.eapf.org.uk to try to provide everything members want to know about their pensions in one place, we will continue to maintain a range of information at www.environment-agency.gov.uk/pensions. Our internal intranet (Easinet) contains details of the employer related aspects of pensions such as policies on contributions, use of discretions etc.

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

Howard Pearce
Head of Environmental Finance & Pension Fund Management
Horizon House
Deanery Road
Bristol BS1 5AH

Email: info@eapf.org.uk Tel: 0117 934 5094

Regulatory framework

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

> *This regulation applies to the written statement prepared and published by an administering authority under regulation 106B of the Local Government Pension Scheme Regulations 1997.*
>
> (1) *The authority—*
>
> *(a) must keep the statement under review,*
>
> *(b) make such revisions as are appropriate following a material change in its policy on any of the matters mentioned in paragraph (3); and*
>
> *(c) if revisions are made, publish the statement as revised.*
>
> (2) *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 is set out in the section on performance measurement, alongside those defined by the Disclosure Regulations. Communication will always be in accordance with the provisions of Data Protection legislation.

Representation

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

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

Responsibilities and resources

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

Overall responsibility for communications rests with the pensions Committee supported by the Pension Fund Management team in Finance, the HR Pensions team in Resources and Legal Services and Capita Hartshead.

All communications including any web based or electronic material are developed jointly by the Pension Fund Management team, Capita Hartshead's Technical Consultants and Communications team, with support from the HR Pensions team..

One or more of these groups is also responsible for arranging all forums, workshops and meetings covered within this statement. Either the Environment Agency or Capita Hartshead arranges 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 inclusive in our administration contract but we estimate that it currently equates to approximately £3.00 per member.

Communication with key audience groups

Our audience

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

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

How we communicate

General communication

We currently still use paper-based communication as one of our main means of communicating, for example, by sending letters to our scheme members.

During 2012/13 we will continue to increase our use of electronic means to communicate with our members and other stakeholders. In particular, we will be complete refresh of our website www.eapf.org.uk it easier to navigate and adding a range of new short guides for members as well as more information about the management of the funds. We will also add a link to a new section called EAPFonline, giving members access to their own personal information, including benefit statements and pensioner payslips. Alongside this work we will be reviewing the content we currently have at www.environment-agency.gov.uk/pensions and ensuring that our internal intranet (Easinet) holds all the employer related information that members and non-members need. We accept e-mail communication and respond electronically where possible.

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

Branding

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

Accessibility

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

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

Our website is compliant with Shaw Trust's usability standards.

Performance measurement

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

Timeliness

We will measure against the following target delivery timescales:

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

Quality

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

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

Results

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

Review process

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

Approved by the Pensions Committee on 25 June 2012 and reviewed annually.

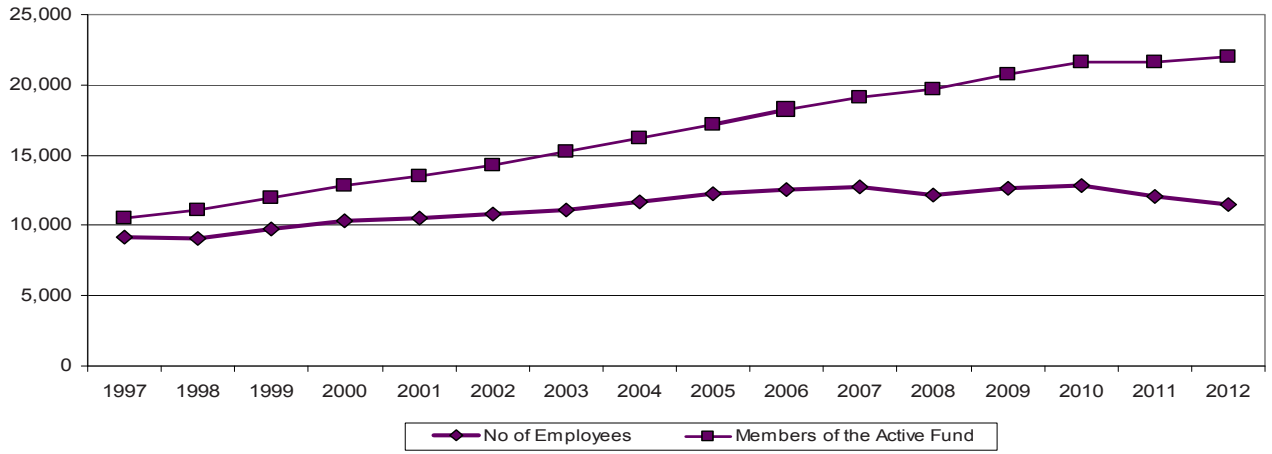
Additional information

Statistical summary of Fund membership, total employees and value

Fund membership	31.3.97	31.3.98	31.3.99	31.3.00	31.3.01	31.3.02	31.3.03	31.3.04	31.3.05	31.3.06	31.3.07	31.3.08	31.3.09	31.3.10	31.3.11	31.3.12
Members	8,346	8,670	9,142	9,692	9,936	10,264	10,494	11,031	11,615	11,844	11,926	11,348	11,741	11,990	10,954	10,628
Deferred members	752	921	1,130	1,291	1,548	1,834	2,426	2,668	2,801	3,521	4,050	4,839	5,244	5,518	6,130	6,425
Pensioners	1,384	1,548	1,710	1,865	1,999	2,157	2,310	2,501	2,721	2,913	3,114	3,496	3,816	4,087	4,521	4,924
Total	**10,482**	**11,139**	**11,982**	**12,848**	**13,483**	**14,255**	**15,230**	**16,200**	**17,137**	**18,278**	**19,090**	**19,683**	**20,801**	**21,595**	**21,605**	**21,977**

No. of employees	31.3.97	31.3.98	31.3.99	31.3.00	31.3.01	31.3.02	31.3.03	31.3.04	31.3.05	31.3.06	31.3.07	31.3.08	31.3.09	31.3.10	31.3.11	31.3.12
Total	**9,123**	**9,073**	**9,707**	**10,296**	**10,476**	**10,824**	**11,087**	**11,714**	**12,261**	**12,577**	**12,700**	**12,142**	**12,600**	**12,849**	**12,054**	**11,471**

Time series of Environment Agency employees and members of the Active Pension Fund



Financial summary	31.3.96 £m	31.3.97 £m	31.3.98 £m	31.3.99 £m	31.3.00 £m	31.3.01 £m	31.3.02 £m	31.3.03 £m	31.3.04 £m	31.3.05 £m	31.3.06 £m	31.3.07 £m	31.3.08 £m	31.3.09 £m	31.3.10 £m	31.3.11 £m	31.3.12 £m
Contributions, transfer values received and investment income less investment expenses	36	46	92	47	59	58	54	62	68	78	79	88	101	108	116	133	111
Benefits and other payments	(13)	(12)	(14)	(16)	(20)	(22)	(23)	(26)	(29)	(28)	(36)	(37)	(51)	(51)	(57)	(64)	(71)
Excess	23	34	78	31	39	36	31	36	39	50	43	51	50	57	59	69	40
Change in market value of investments	87	34	124	39	113	(105)	(34)	(254)	171	83	235	78	(80)	(421)	404	101	56
Net increase/ (decrease) in Fund value	110	68	202	70	152	(69)	(3)	(218)	210	133	278	129	(30)	(364)	463	170	96
Market value of Fund	**574**	**642**	**844**	**914**	**1,066**	**997**	**994**	**776**	**986**	**1,119**	**1,397**	**1,526**	**1,496**	**1,132**	**1,595**	**1,765**	**1,861**

Any enquiries regarding this Report should be addressed to:

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Head of Environmental Finance and
Pension Fund Management
Environment Agency
Horizon House
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BRISTOL
BS1 5AH

Tel: 0117 934 5094
Email: info@eapf.org.uk

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

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

Tel: 0800 121 6593
Email: info@eapf.org.uk

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

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

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