Environment Agency
Pension Fund

October 2019

Responsible Investment Strategy (2020 - 2025)

Using our investments to build a better future

Introduction

Responsible investment makes business sense. For over 15 years now we have seen that our Fund generates strong financial returns by investing in companies that contribute to the long term sustainable success of the economy and society.

But with investment comes responsibility – responsibility for a wide range of environmental, social and governance issues, with none bigger and more urgent than climate change. Climate change is the biggest threat to our economy, environment, health, way of life and our future. We will use our investments to help bring about positive change, make a difference to the future and inspire others.

We are doing this for our members, who work tirelessly, and with pride to improve the environment. Asking them to participate in our pension fund scheme means to ask for their trust over the long term. We want to repay that trust and make them proud of what their pension fund stands for. That is why, as well as investing responsibly, we make sure that those investments are also the right investments financially, which will deliver the right returns to make the pension fund secure and fit for the long term.

Summary

Building on our achievements to date, these are our priorities for the next 5 years:

1. We invest to build a better future by:

- investing significantly in sustainable and low carbon assets
- calculating the impact on, and impact of, our fund on climate change
- exploring opportunities for investing responsibly in all asset classes and in particular in fixed income

2. We work with the investment community to help build a better future by:

- supporting the development of the Transition Pathway Initiative (TPI)
- raising the importance of managing the physical risks from climate change
- challenging company boards directly on their performance
- taking part in campaigns to deliver changes in company and investor behaviour

3. We make our members proud of their pension fund by:

- telling members about the positive impact their pension fund is making
- encouraging members' feedback on how our responsible investment approach can be improved

For more detailed information on how we will implement this strategy, please see our **Policy on Responsible Investment** and **Policy to Address the Impacts of Climate Change**.

Responsible investment and ethical investment

The Environment Agency Pension Fund is a responsible investor, as opposed to an ethical investor.

An ethical investor will generally exclude certain investments from the outset, and this decision may be more important than financial considerations.

A responsible investor will invest across the full range of listed companies, but will use the power of ownership to influence companies to improve their environmental, social and corporate governance performance to manage risk and generate long term returns.

For example, an ethical investor may completely rule out investing in fossil fuels but a responsible investor may consider investing in oil and gas companies and support their diversification into cleaner forms of energy.

Working in partnership with Brunel Pension Partnership

This strategy takes into account the introduction of pooling across the Local Government Pension Scheme and what the EAPF's role is as part of Brunel Pension Partnership.

As asset owners, we set out how we want our money invested, in line with our **Investment Strategy**, and in which asset classes. This is known as our strategic asset allocation. We also set our strategy and ambition on responsible investment, engage externally on issues which are key to us, and retain responsibility for engaging with our members and representing their views.

Brunel Pension Partnership (Brunel) will manage our investments in line with our strategic objectives and those of 9 local government funds: Avon, Buckinghamshire, Cornwall, Devon, Dorset, Gloucestershire, Oxfordshire, Somerset and Wiltshire.

This makes Brunel and our 9 fellow Funds key partners in ensuring that individual assets in our pension fund are being invested responsibly. We have strong links with Brunel and our common approach and thinking is reflected in **Brunel's responsible investment policy**.

Aim 1. We invest to build a better future

Over the last 10 years, we have made great strides in considering environmental, social and governance issues in our investments.

This has included which funds we invest in and how we monitor their performance.

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

This is key to helping us meet our legal obligations to fund our members' pensions in the short and long term. Yet there is more we can do and lots we need to carry on doing.

1.1 We invest significantly in sustainable and low carbon assets

Today, the case for investing for the long term and acting to address climate change is more important than ever, and more of an opportunity than ever. We do this by investing in sustainable and low carbon assets, in line with our strategic asset allocation and our Investment Strategy.

We aim to always have at least 33% of our investments in sustainable assets

In the absence of a common classification system, we have worked with our existing fund managers and investment consultants to define how we determine the sustainability credentials of our investments.

In summary, sustainable investments include those in energy efficiency, alternative energy, water and waste treatment, public transport, property, infrastructure, agriculture or forestry investments with a low carbon or strong sustainability criteria, and companies with progressive environmental, social or governance practices.

By 2025 17% of our investments will directly tackle climate change

Assets which we assess as directly tackling climate change include those in the fields of renewable energy, energy efficiency and other mitigation opportunities, as well as those which help address and manage climate change adaptation. These assets are a subset of our wider sustainable assets.

We aim to meet these targets through investing in line with our strategic asset allocation and working with Brunel to ensure that their portfolios integrate environmental, social and governance issues. We will report on our progress in meeting these targets every year in our annual report.

While these targets are very important to us, they will not be an artificial constraint on individual investments or our long term duty to ensure that our pension fund is well financed.

We are aware of proposed changes to how sustainable assets may be classified in the future. We will review our target annually, to make sure our calculations are in line with the commonly-adopted approach and can be readily understood and compared.

Fossil fuel investment presents climate change and financial risks.

We will decarbonise our equity portfolio, reducing our exposure to future emissions by 95% for coal and 90% for oil and gas by 2025 compared to the exposure in our underlying benchmark as at 31 March 2015.

'Future emissions' refers to assets in the ground owned by companies we invest in and is the amount of greenhouse gases that would be emitted should these reserves be extracted and ultimately burnt, expressed in tonnes of carbon dioxide equivalent.

We expect our exposure to coal to be minimal by 2025 but we believe that overall the right approach at this stage is to continue to decarbonise the fund but not to disinvest fully from fossil fuel companies. This is partly because some energy companies have significant renewable energy assets and also the resources to contribute to a low carbon future. Instead, the EAPF will continue to put pressure on oil and gas companies to bring about change to their business model, so that they play their role in a low carbon transition. We will also follow developments on carbon pricing closely.

Investment Case Study

Examples from one of our sustainable investments through Generation Investment Management. M-Kopa Solar is a provider of pay-as-you-go solar power for off-grid households in Africa. Providing affordable access for low-income households to solar power instead of burning kerosene for lighting.

"I am happy to share a meal with my family. We get to catch up on our day's activities after dark, without worrying about the lights going off".

Jackson Onyango, Kenya

1.2 We calculate the impact on, and impact of, our fund on climate change

The scientific evidence is overwhelming that by the end of this century, we need to keep changes in global temperature to below 2 degrees Celsius (2°C), compared to pre-industrial levels, to avoid the worst impacts from climate change.

> **"Damaging climate impacts are already being felt. Every degree matters"**
>
> - UK Committee of Climate Change

There are 3 elements to climate change that we need to understand as a fund:

- How our investments are positioned in a warming world

We estimate from our modelling (Mercer's Investing in a time of Climate Change) that our portfolio is relatively well positioned to benefit from the opportunities presented by a low carbon transition and withstand the financial risks from climate change. We also know that keeping to a 2°C scenario or lower, is most beneficial from a long term investor perspective, as there are likely to be less physical risks to our investments. We will continue to monitor this.

- How much our investments are contributing to the warming

We need to understand the contribution our investments are making in relation to keeping the temperature rise below 2°C. We hope that by investing significantly in sustainable and low carbon assets, our contribution will be a favourable one but we need to measure this to understand more. We will work with others to see if we can do this to inform our approach and help improve understanding more broadly across the investment community.

- How climate change may impact on our future liabilities

As a pension fund, we need to make sure we are able to pay our members' pensions (future payments are known as our liabilities). We have started to consider with our actuaries Hymans Robertson, the impact of climate change on our liabilities. We are keen to develop this further.

Investment Case Study

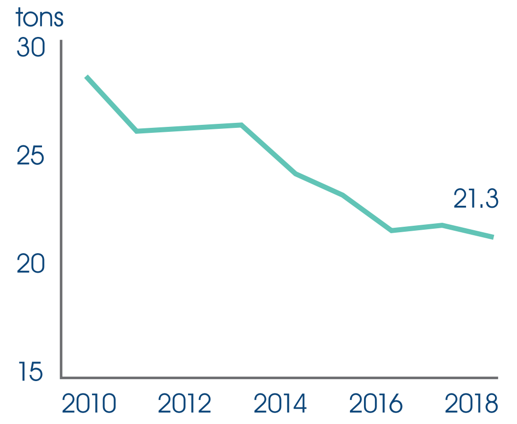
One of our investment managers is Ownership Capital who work proactively with company management teams towards achieving a more sustainable business.

One example of this is their engagement with a global industrial manufacturer of weighing equipment. The company lacked any environmental sustainability strategy, which presented urgent risks to its long term business model and cost structure. Ownership Capital worked with the company to identify the steps needed for it to become a sustainability leader.

Over the course of the investment, Ownership Capital met regularly with the company to provide feedback and monitor progress.

The company is now recognised as one of the leaders in its industry, decreasing its carbon emissions and improving its profitability.

CO_2 Emissions per Net Sales 2018



1.3 We explore opportunities for investing responsibly in all asset classes and in particular fixed income

We want to ensure that responsible investment is integrated across all asset classes and where it is less established, help to build opportunities.

We have a strong record of already integrating responsible investment into our investments and for working with asset managers to develop innovative approaches.

Following our review of the strategic asset allocation in 2019, we aim to invest in a new strategy for us: multi-asset credit. These are investments in a broad range of credit asset classes, for example corporate bonds and bank loans. We hope to make these investments to multi-asset credit as sustainable as possible. This will be of direct benefit to our investments and we hope the wider market. We will start engaging with Brunel and fixed income managers to develop a sustainable multi-asset credit fund which looks to make sustainable allocations and takes into account environmental, social and governance issues.

Our Targeted Opportunities Portfolio

In 2014 we started to develop our Targeted Opportunities Portfolio (TOP) to increase our allocation to sustainable private markets.

TOP enables the fund to invest directly in a few outstanding opportunities, which have strong financial and sustainability credentials. It offers us a broader scope than traditional private equity.

As of 31 March 2019 the fund had £77m invested in TOP (2% of our total fund).

We will work with Brunel to agree how best to manage this innovative portfolio and the rest of our private market allocations through the pooling arrangements.

Investment Case Study

Through our investment manager Actis, we are invested in Echo Energia who manage wind turbine projects in Brazil.

Echo Energia have a strong emphasis on social responsibility. Through their 'Winds that Transform' programme they finance conservation and education projects in local communities.

They also build local infrastructure and water facilities. Their current projects will directly benefit over 1200 families.

Aim 2. We work with the investment community to help build a better future

Investors have the power to influence and change behaviour globally. As the Environment Agency Pension Fund, there are specific priorities where we want to work with the investment community to bring about change. These are:

- **Climate Change** – helping investors understand and manage the financial risks from climate change
- **Using resources sustainably**, with a particular emphasis on reducing plastics in the environment
- **Water** – managing water quantity and water quality

For these priority areas, we will engage to bring about greater disclosure and improve environmental outcomes, including through the Taskforce on Climate-Related Financial Disclosures (TCFD). We will seek to support the Environment Agency's 5 year plan of action, the **Government's 25 year plan to improve the environment** and their **Green Finance Strategy** to help investors consider the impact of climate change within investments.

We will still support other environmental, social and governance issues which are important to us as responsible investors, for example food security, gender equality and human rights. However, these will be more resource-dependent and generally Brunel will lead on these issues on our behalf as part of the pool partnership.

Reducing plastic pollution

We have pledged financial support to an initiative to reduce the amount of plastic pellets lost in the supply chain.

Launching in late 2019, the initiative will allow the British Standards Institute to put in place an independent, auditable and accredited standard which should result in fewer plastic pellets being released to the environment.

It will be the first time that investors have combined with other stakeholders in the UK, such as Government, industry and NGOs to create a new standard.

Photo – plastic pellets on slipway at Lympstone, Devon.

2.1 We continue to support the development of the Transition Pathway Initiative (TPI)

The TPI is a great tool to help investors understand how successful individual companies are in managing their carbon emissions, and how they compare with peers in the same sector.

We are proud to have been one of the joint co-founders of TPI along with the Church of England. We are keen to see it developed further to cover a larger number of companies and sectors.

Photo - EA Chair and Chair of EAPF Investment Sub Committee, Emma Howard Boyd at the TPI Summit 2019 **www.lse.ac.uk/GranthamInstitute/tpi**

2.2 We work to raise the importance of managing the physical risks from climate change

Much of the focus in the investment community to date has been on the opportunities from reducing the causes of climate change by helping support the development of low carbon alternatives.

We are keen to develop wider market understanding of the physical risks from climate change and the need for investment in this area, including by sharing our experience to date.

This could help companies and investors avoid future losses, while generating social, environmental and economic benefits.

Photo - Grinton Moor, Yorkshire 2019

2.3 We challenge company boards directly on their performance

We aim to ask questions at 10 AGMs every year, in line with our priorities and the company's approach.

Where we can, we will use the Transition Pathway Initiative to help inform our views of individual companies, and seek to engage where appropriate where they are performing badly compared to their peers. Similarly, we will also offer encouragement and recognise progress where it has been made.

Where appropriate, we will support shareholder resolutions.

Photo - Craig Martin, Chief Pensions Officer at Barclays AGM, 2019

2.4 We take part in campaigns to deliver changes in company and investor behaviour

In addition to the above, we will also take part in at least 2 extra campaigns a year to help bring about change in company and investor behaviour, in line with our priorities.

Engaging on fossil fuels

We supported a resolution, which was led by the Church of England at the Shell AGM in 2018. This called for Shell to have targets to reduce the carbon footprint from the way their products are used (scope 3 emissions). The resolution did not get enough support to pass but a few months later, Shell invited us to meet with them, the Church of England and others to talk about their future approach. We were pleased to see that Shell subsequently agreed to set carbon emissions targets, integrate these into executive pay, and to update their ambition as technology and regulation advances.

We will monitor the progress of Shell and the wider oil and gas industry in reducing emissions. If our engagement approach does not bring about wider change, we will work with our partners in Brunel to consider alternative approaches. This may include disinvesting from a particular sector or company, where there is no change to that sector or company's approach.

We also recognise that it is not just the production of oil and gas which contributes to climate change, but also its use. We support initiatives that encourage the supply chains and the general public to move to low carbon alternatives.

Engaging to support environmental disclosure

CDP (formerly the Carbon Disclosure Project) runs a global disclosure platform. This allows individual companies to report on their environmental impact to the investment community and their customers.

In 2018, 19 investors, including Environment Agency Pension Fund (EAPF) targeted 239 companies that had failed to report on water issues previously. KOSÉ Corporation (KOSÉ), the Japanese cosmetics company, had been asked to disclose on water security since 2014 but had never responded to any of the information requests.

The EAPF holds shares in KOSÉ through one of our investment managers as does Comgest, a fund manager we worked with on other markets. CDP, Comgest and EAPF, worked together to engage with KOSÉ. As a result, KOSÉ disclosed not only on water issues but also in relation to climate change and deforestation.

Aim 3. We make our members proud of their pension fund

All of our members have spent at least part of their career improving the environment, or providing support services to those that do.

3.1 We tell members about the positive impact their pension fund is making

We want to help members understand that their pension is well financed, is being managed responsibly, and it is helping to build a better future for them and others.

While many of our members may know we have a responsible investment approach, we want them to really understand what this means.

We will endeavour to provide members with interesting information which easily allows them to understand the types of investments we are making and the sorts of campaigns we are involved in.

As our approach is all about building a better future, we are keen to engage and recruit the next generation of members. We believe our responsible investment approach is one of the attractions for new staff to the Environment Agency to join a pension fund and we will make this a highlight at induction days.

EAPF representatives of current employees (left) and of deferred members and pensioners (right) at a Pensions Committee meeting.

3.2 We encourage members' feedback on how our responsible investment approach can be improved

Many of our members hold passionate views about the environment and sustainability more broadly.

Every other year we will hold a members' general meeting webinar, where we will get feedback on our responsible investment approach and encourage new ideas.

We will also include responsible investment issues in member surveys, regular webinars and on our website where we will encourage feedback.

Investment Case Study

We asked Impax Asset Management, who make investments on our behalf in resource efficiency and environmental markets, what was the environmental impact of our investments with them. This is what they told us.

Environmental impact of total portfolio
65,800 tCO_2 of net CO_2 emissions avoided **Equivalent to taking 35,790 cars off the road in 2018**
22,700 Mwh of renewable electricity generated **Equivalent to 5,970 households' electricity consumption in 2018**
27,800 megalitres of water treated, saved or provided **Equivalent to 177,290 households' water consumption in 2018**
14,620 tonnes of materials recovered/waste treated **Equivalent to 15,120 households' waste arising in 2018**

Figures based on an investment with Impax of approximately £115m, which equates to about 3% of the overall value of our investment fund (as of March 2019).

Investment Case Study

We partner with The Townsend Group to ensure our real asset investments are as sustainable as possible. An example of this is an investment through them in industrial property operated by Charter Hall, a market leader in sustainable real estate management.

Charter Hall works with tenants to maximise the sustainability of buildings. Standard features of industrial properties include energy efficient LED lighting, water efficient amenities, rain water tanks, solar hot water, skylights, and low toxin interiors. Roof structures generally include solar panels.

Charter Hall recently installed Australia's largest industrial solar power system at a new distribution centre. With 3,800 solar panels, the system will meet 20% of the property's energy needs and will cover its costs within 5 years.

Such initiatives result in both better building for tenants and the environment.