Environment Agency
Pension Fund

April 2017

Environment Agency Closed Pension Fund

# Investment Strategy Statement

## Introduction

The Environment Agency Closed Pension Fund (the Fund or 'EAPF') is a closed, final salary (defined benefit) pension scheme with around 15,000 members and assets of approximately £280m as at 31 March 2017. Full details of the Environment Agency Pension Funds and our activities can be found on **www.eapf.org.uk**.

This Investment Strategy Statement (ISS) sets out the principles and strategy that govern our process for investing the assets of the Fund as required by Regulation 7 of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016. This Statement was made and approved by the Environment Agency Pension Committee on 23 March 2017, which acts on the delegated authority of the Environment Agency's Board, after taking advice from its investment staff, investment consultants, independent investment adviser and consulting actuary.

We will refer to this Statement when making investment decisions to ensure they are consistent with our investment principles and strategy. 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.

The Closed fund is governed and managed by the same Pensions Committee and officers as the Environment Agency Active Pension Fund. Although the circumstances of the Closed Fund are always taken account of whenever appropriate, on certain matters both Funds are considered together ("the combined EAPF"). The Statement should be read and will be implemented in conjunction with the Fund's Governance Policy, Funding Strategy Statement, Responsible Investment Policy and Global Stewardship Statement. These provide and state our more detailed requirements and supplementary guidance on these specific topics as appropriate.

## Fund governance: Investment

Our Governance Policy sets out how the Fund is governed and the role of the Pensions Committee; Pension Board; Investment Sub-Committee; and Environment Agency officers on investment matters. The Environment Agency Board appoints the Pensions Committee and Pension Board, 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 advisers. The Environment Agency Board approves the Annual Report and Financial Statements of the Fund, which includes the policies under which the Fund is governed.

The Investment Sub-Committee normally consists of seven representatives of the Pensions Committee and receives advice from professional investment officers, specialist investment consultants, an independent investment adviser, the Fund actuary, and other professional advisers as required.

The Investment Sub-Committee has received delegated responsibility to prepare and recommend the investment strategy to the Pensions Committee and, within the context of the agreed investment strategy, to decide on the structure of mandates and their specification, to appoint fund managers, to monitor the performance of fund managers, and to terminate or alter mandates.

We have appointed a performance measurer independent of the fund managers to calculate risk and return measures for each manager and the Fund overall. We have also appointed a global custodian who is responsible for the safe-keeping of the directly-held assets of the Fund and who works in close liaison with each fund manager.

The Fund's actuary is responsible for performing a formal valuation of the Fund every three years in order to assess the extent to which the assets cover accrued liabilities and to inform the development of an appropriate Funding Strategy Statement. The Funding Strategy takes account of, and informs the development of, our investment strategy and this ISS.

In all matters, our fiduciary obligations to Fund members are paramount, and neither the Fund's committees nor the Fund's officers would take any action which would be in conflict with these obligations. Similarly, fund managers are required to invest in the best interest of the Fund.

## High Level Investment Principles

Working with our colleagues in the Brunel Partnership, we have agreed a set of investment principles with the intention that they provide a framework for the investment strategy, operations, manager selection, monitoring and reporting. The principles are also designed to meet the Department for Communities and Local Government's Local Government Pension Scheme: Investment Reform Criteria and Guidance and the requirements and expectations of Financial Conduct Authority. They can be applied to all asset classes, although the detail of operation will vary by asset class.

The principles do not impose any restrictions on type, nature of companies or assets held within the portfolios. The principles do place an expectation that recognised best practice standards in governance, risk management, stewardship and value for money will be delivered.

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| **Long term investors** | We are long term investors: we implement our funds investment strategies that require productive assets that contribute to economic activity, such as equities, bonds and real assets. This may include the delegated responsibility to provide sustainable and sufficient return on their assets. |
| **Responsible investors** | We are responsible investors: we believe that in the long term we will generate better financial returns by investing in companies and assets that demonstrate they contribute to the long term sustainable success of the global economy and society. |
| **Best practice governance** | We adopt best practice collective governance with appropriate oversight, prioritisation, delegation and decision making at the right level, and clear accountability. |
| **Decisions informed through experts and knowledgeable officers and committee** | We make our decisions based on extensive expertise including trained and insightful operations' governance members, experienced and professional officers and high quality, knowledgeable advisors. |
| **Evidence and research at heart of investments** | We take an evidence and research based approach to investment: continually learning and reappraising from academic research, investment professionals, and our peers, and seek continual development in our understanding of investment. |
| **Leadership and innovation** | We are prepared to be innovative and demonstrate thought leadership in collective investment, within the requirement of prudence and our joint fiduciary duty. |
| **Right risk for right return** | We will make our collective investments work as hard as possible to meet our funds' objectives: we will provide the right structure of sub funds and managers within asset classes. While we take account of market and economic levels in our decision making, we will avoid making decisions on purely a short term basis. |

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| **Full risk evaluation** | We will be comprehensive in our consideration of our funds' risks assessed on their liabilities and contributions; consider financial and non-financial risk as appropriate; offer a pooled structure to accommodate the need to diversify risk, but also recognise the limits of that diversification – as long term investors we accept that our investment success depends substantially on the sustainable growth of the economy. |
| **Responsible stewardship** | We will enable our funds' to exercise responsible stewardship of the assets they hold, and act as a collective responsible voice in the broader investment community. |
| **Cost effective solutions** | We will seek the most cost-effective solutions to achieving our funds' objectives and implementing these principles collectively: we recognise the impact of costs on the Funds, but we are prepared to pay for active management and other services when we believe that the costs incurred are likely to be justified by the benefits. We will seek to gain leverage from our collective status through reduction in fees and avoidance of cost through increased resilience and sharing our peoples' strengths, knowledge and expertise. |
| **Transparent and accountable** | We believe in the importance of being transparent and accountable, to ensure correct decisions are taken and to minimise risk. This applies both in our own operations, those we work with, and our investments |
| **Collaborate** | We will collaborate with others whenever possible, to share ideas and best practice; to improve effectiveness and to minimise costs. |

### Responsible Investment

We are long term investors who aim to deliver a truly sustainable Pension Fund; ensuring that it is affordable; delivers financially to meet the objectives of our scheme employers; and is invested responsibly.

Being responsible investors to us is to;

- Consider a wide range of issues e.g. environmental or social impacts and what financial impact they could have both in the short and long term.
- Look to work with and influence others.
- Act as good owners of the companies, assets and funds in which we invest.
- Operate in an open and transparent way.

Our fiduciary duty is to act in the best long-term interests of our members. To do so properly requires us to recognise that environmental, social and governance issues can positively and negatively impact on the Fund's financial performance and that they should be taken into account in our funding and investment strategies, and throughout the funding and investment decision-making process. Full details are contained in our **Responsible Investment Policy**, and other associated policies, notably our **Policy to Address the Impacts of Climate Change.** Managers are expected to comply with these policies when implementing the mandates on our behalf.

The Brunel Pension Partnership Investment Principles clearly articulate our commitment, and that of each Fund in the Partnership and its operator (Brunel Company), to be responsible investors and as such recognise that social, environment and corporate governance considerations are part of the processes in the selection, non-selection, retention and realisation of assets. One of the principal benefits, outlined in the BPP business case, achieved through scale and resources arising from pooling is the improved implementation of responsible investment and stewardship.

Every portfolio, in every asset class, under the Brunel Pension Partnership, explicitly includes responsible investment and which includes an assessment of how social, environment and corporate governance considerations may present financial risks to the delivery of the portfolio objectives. The approach undertaken will vary in order to be the most effective in mitigating risks and enhancing shareholder value in relation to each portfolio and its objectives. More information is on the BPP website.

Both our Pensions Committee and Pension Board have member representatives who actively engage with beneficiaries and other stakeholders to ensure the fund is aware and can respond effectively to all member concerns. We also actively use our website, newsletters and member webinars to engage directly. We also respond, track and report all member and stakeholder enquires as part of standard quarterly reporting. The fund is accredited with Customer Service Excellence which requires high standards of stakeholder engagement.

We became the first Local Government Pension Scheme (LGPS) signatory of the UNPRI in July 2006. The UNPRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact. The principles reflect the view that 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 do not exclude investments in order to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries, other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government.

## Investment objectives

This Statement is consistent with the Fund's funding strategy, which is set out in the Funding Strategy Statement adopted on 23 March 2017. The Fund's solvency is guaranteed by the Government, in the form of the Secretary of State for Environment, Food and Rural Affairs ("the Guarantor"). The level of the Guarantor's contributions is reviewed every six months.

The Fund's invested assets are fairly small relative to the value of its prospective liabilities. Working on the basis that the Guarantor will meet pension payments until the value of the remaining liabilities is equivalent to the Fund's remaining assets, the investment objective of the Fund is to ensure that in due course that the Fund's assets will equate to its liabilities in as low a risk manner as possible. From that point onwards the Fund should be able to meet its pension payments directly.

## The suitability of different types of investment

The Fund may invest in any investment considered appropriate. However, after considering the exceptional nature of the Fund, specifically the grant in aid provided by Defra, the Government guarantee underpinning the Fund, and the low risk nature of the investment objective, we have decided to invest in index linked government bonds and cash only. The Committee considers these classes of investment to be suitable in the circumstances of the Fund. The range of assets we choose to invest in are always reviewed as part of our investment strategy review process.

## Social and sustainable Investments

Social investment can be defined to include a wide spectrum of investment opportunities[1]. The EAPF definition of social investment is an investment that addresses societal challenges but generates competitive financial returns. Societal challenges include all issues commonly regarded under social, environmental or governance headings.

Our wider definition of sustainable investments includes:

a) Social investments and those with significant revenues (in excess of 20%[2]) involved in energy efficiency, alternative energy, water and waste treatment, public transport together,

b) property, infrastructure, agriculture or forestry investments with a low carbon or strong sustainability criteria[3], and

c) companies (often equities and bonds) with a progressive[4] environmental, social or governance practices that may enhance investor value.

The Active fund has set itself the target to have over 25% of the fund invested, across all asset classes, in such opportunities. We report a breakdown of the types of investment in our Active Fund annual report and financial statements.

## Asset allocation

The Pensions Committee has translated its objectives into a suitable investment strategy for the Fund. The investment strategy takes due account of the specific liability profile of the Fund, together with the planned funding arrangements agreed with the Fund's Guarantor.

The strategy is consistent with the Committee's views on residual asset management on the appropriate balance between maximising the long-term return on investments and minimising volatility and risk. The Committee is adopting a low-risk approach by investing in index-linked government bonds. It is intended that the investment strategy will be reviewed at least every three years following actuarial valuations of the Fund. Thus the assets comprise:

- a portfolio of long dated index-linked government bonds, intended to broadly reflect the long tail of liabilities the Fund is exposed to;
- cash held at our custodian and administrator, sufficient to meet pension payments until the next grant in aid payment, together with a small reserve; and
- a small portfolio of legacy unquoted equities – the value of which has been written down to nil - which is managed internally and is currently being run down.

[1] See Global Impact investor Network for more information https://thegiin.org/

2 We use the FTSE Environmental Markets classification and with the help of Impax Asset Management (our global equity manager who focuses on environment technologies) to analyse our public and private equity holdings including the pooled funds.

[3] Strongly sustainable/ progressive are terms we use to describe companies or funds exceeding market norms and taking action on one or more areas of ESG that distinguishes their offering compared to their peers.

[4] As above

## Managers and Mandates

We have appointed an investment manager (currently Sarasin & Partners LLP), authorised under the Financial Services and Markets Act 2000 to undertake investment business, to manager the portfolio of index-linked government bonds. The chosen manager is Sarasin & Partners LLP who invest the portfolio on a low cost, non-discretionary basis. We have, after seeking appropriate investment advice, given the manager specific directions as to the securities to be held.

## Risk

We take the management of risk in our investments very seriously. However, because of the low risk nature of our investment approach the investment risks are considered low. The bonds are guaranteed by the UK Government and the returns are fixed in real (after inflation) terms. The current value of the bonds can change as long term real interest rates move, but this will be closely correlated to movements in the Fund's liabilities. There may be some mismatch between our assets and the longer dated part of our liabilities these assets are intended to match but this is limited and kept under review.

We provide a practical constraint on the Fund's investments deviating from the intended approach by specifying the particular bonds to be held. Because of the low risk guaranteed nature of the investments the need for diversification of investments is not applicable.

The Fund is exposed to a number of other risks which pose a threat to the Fund meeting its objectives, such as changing demographics and custody and counterparty risk.
The Committee keeps mortality and other demographic assumptions, which could influence the cost of benefits, under review. In addition, the Committee has a process of regular scrutiny and audit of providers to the Fund.

We believe that climate change presents a systemic risk to the ecological, societal and financial stability of every economy and country on the planet, with the potential to impact our members, employers and all our holdings in the portfolio. As such, climate change is potentially a long term material risk for the Fund, and which could impact our members, and employers. Our Policy to Address the Impact of Climate change and the dedicated area of our website provide further details with regard to how we take the climate related financials risks into account. However, the scope to implement this within the Closed Fund is limited.

## Liquidity and the realisation of investments

The Fund's investments are in UK government bonds that are widely traded and liquid, and may be realised quickly if required.

## Stewardship and the exercise of our rights as owners

As the Fund invests in index linked government bonds there are no voting rights or issues of stewardship matters to consider. Similarly social, environment and governance considerations are of limited relevance.

## Collaboration

The combined EAPF actively engages in collaboration with other pension funds, investors, asset managers, advisers, industry bodies and associated organisations to share best practice, improve efficiencies, promote product development and save money. We actively participate in the Cross-Pool Group and its subgroups, of which we lead the sub-group on responsible investment, to be resource efficient and share best practice.

The Cross Pool (RI) Group's purpose is to provide practical support and tools to assist nominated leads to co-ordinate the implementation of the consideration of RI (including ESG integration and stewardship), risks and communications for the pool and the Funds within each pool, whilst recognising the diversity in the approaches by Funds and pools.

To deliver our Responsible Investment policies we work closely with organisations including the UN Principles for Responsible Investment, IIGCC (institutional Investors Group on Climate Change), UKSIF (UK Sustainable Investment and Finance Association), and the CDP (Carbon Disclosure Project). We also share our understanding and experience through speaking at investment industry events and publishing articles on-line.

## Implementation: Approach to Asset Pooling

We are working with nine other Administering Authorities to pool investment assets through the Brunel Pension Partnership Ltd. (BPP Ltd). This is currently work in progress with the intention of meeting the Government's requirement for the pool to become operational and for the first assets to transition to the pool from April 2018.

Once the Brunel Pension Partnership Ltd. is established the EAPF, through the Pensions Committee, will retain the responsibility for setting the detailed Strategic Asset Allocation for the Fund and allocating investment assets to the portfolios provided by BPP Ltd.

The Brunel Pension Partnership Ltd will be a new company wholly owned by the Administering Authorities. The company will seek authorisation from the Financial Conduct Authority (FCA) to act as the operator of an unregulated Collective Investment Scheme. It will be responsible for implementing the detailed Strategic Asset Allocations of the participating funds by investing Funds assets within defined outcome focused investment portfolios. In particular it will research and select the Manager Operated Funds needed to meet the requirements of the detailed Strategic Asset Allocations. These Manager Operated Funds will be operated by professional external investment managers. The EAPF will be a client of BPP Ltd and as a client will have the right to expect certain standards and quality of service. A detailed service agreement is being drafted which will set out the duties and responsibilities of BPP ltd, and our rights as a client. It includes a duty of care of BPP to act in its clients' interests.

An Oversight Board will be established. This will comprise representatives from each of the Administering Authorities. It will be set up by them according to an agreed constitution and terms of reference. Acting for the Administering Authorities, it will have ultimate responsibility for ensuring that BPP Ltd delivers the services required to achieve investment pooling. It will therefore have a monitoring and oversight function. Subject to its terms of reference, it will be able to consider relevant matters on behalf of the Administering Authorities, but will not have delegated powers to take decisions requiring shareholder approval, which will be remitted back to each Administering Authority individually.

The Oversight Board will be supported by the Client Group, comprised primarily of pension investment officers drawn from each of the Administering Authorities, but will also draw on finance and legal officers from time to time. It will have a primary role in reviewing the implementation of pooling by BPP ltd, and provide a forum for discussing technical and practical matters, confirming priorities, and resolving differences. It will be responsible for providing practical support to enable the Oversight Board to fulfil its monitoring and oversight function.

The proposed arrangements for asset pooling for the Brunel pool have been formulated to meet the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 and Government guidance. Regular reports have been made to Government on progress towards the pooling of investment assets, and the Minister for Local Government has confirmed that the pool should proceed as set out in the proposals made.

We has approved the full business case for the Brunel Pension Partnership. It is anticipated that investment assets will be transitioned across from our existing investment managers to the portfolios managed by BPP Ltd between April 2018 and March 2020 in accordance with a timetable that will be agreed with BPP Ltd. Until such time as transitions take place, we will continue to maintain the relationship with our current investment managers and oversee their investment performance, working in partnership with BPP Ltd. where appropriate.

Following the completion of the transition plan outlined above, it is envisaged that all of our assets will be invested through BPP Ltd.

### 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. Evidence is contained within the documents referenced in our Annual Report and Financial Statements and on our website **www.eapf.org.uk**.

Approved by the Pensions Committee on 23 March 2017.