

Investment Strategy Statement

Environment Agency Closed Pension Fund



Introduction

The Environment Agency Closed Pension Fund (the Fund or 'EAPF') is a closed, final salary (defined benefit) pension scheme with around 13,000 members at 31 March 2019 and assets of approximately £323m as 30 September 2019. 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 approved by the Environment Agency Pensions Committee on 18 December, which acts on the delegated authority of the Environment Agency's Board, after receiving input and 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 input and 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. State Street fulfils both of these functions.

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 partners in the Brunel Pension 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.

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 informed 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 seek 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 Portfolios 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.

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.
Be 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. We seek to be a leading responsible investor.

Being responsible investors to EAPF 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](#). Both the Brunel Pension Partnership and the Fund's underlying investment 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 Ltd), 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 potential principal benefits, outlined in the Brunel Pension Partnership 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 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. Brunel Pension Partnership has published a Responsible Investment Policy Statement which lays out our common approach in more detail. More information is on the [Brunel 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 and Brunel Ltd was the first asset pool in April 2018. 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.

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, it is currently invested 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.

Costs are also an important consideration when assessing the suitability of investments. When considering costs and charges, both transparency and the need to control these are important. Recurring annual costs and charges are a drag on performance.

Social and sustainable Investments

Social investment can be defined to include a wide spectrum of investment opportunities. 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 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, and
- c) companies (often equities and bonds) with a progressive environmental, social or governance practices that may enhance investor value.

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 index-linked government bonds, intended to broadly reflect an estimate of the duration of the 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.

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. Sarasin & Partners LLP 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 liabilities these assets are intended to match but this is 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.

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 financial 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 engage 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 UNPRI, 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.

The Environment Agency Active Pension Fund is active in supporting a number of responsible investment initiatives:

- The Fund is a signatory to the UK Stewardship code and a member of the 30% Club Investor group.
- EAPF co-founded the Transition Pathway Initiative (TPI), supports Climate Action 100+ and is committed to supporting the recommendations of the Taskforce for Climate-related Financial Disclosure (TCFD).
- We have a focus on plastics with our approach in this area aligned with the Defra 'A Green Future' plan and EAPF is pledged to the UN initiative on Ocean plastics #CleanSeas.

Implementation: Approach to Asset Pooling

We have worked with nine other Administering Authorities to implement the UK Government's requirement to pool the management and investment of our assets with other LGPS Funds, and have established the Brunel Pension Partnership and its operator, Brunel Pension Partnership Ltd. (Brunel Ltd). Brunel Ltd was launched on 18 July 2017 as a new company wholly owned by the ten Administering Authorities (including the EAPF) and obtained authorisation from the Financial Conduct Authority (FCA) in March 2018 to act as an investment manager and an investment advisor.

The arrangements for asset pooling for the Brunel Pension Partnership pool have been formulated to meet the requirements of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 and Government guidance. Importantly, Brunel Ltd has met the Government's requirement for the pool to become operational from April 2018 and the transition of assets to start.

Investment assets are expected to be transitioned across from our existing investment managers to the portfolios managed by Brunel Ltd between July 2018 and March 2020 in accordance with a timetable that has been agreed across the partnership. 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 Brunel Ltd where appropriate.

The EAPF, through the Pensions Committee, retains the responsibility for setting the detailed Strategic Asset Allocation for the Fund and allocating investment assets to the portfolios provided by Brunel Ltd. We are also able to suggest new portfolios to Brunel Ltd and engage with Brunel Ltd on the structure and nature of existing portfolios.

Brunel Ltd will be responsible for implementing the detailed Strategic Asset Allocations of its ten Client Funds by providing and implementing a suitable range of outcome focused investment "portfolios". In particular, it will research and select the professional external investment managers responsible for making the day to day investment decisions at the portfolios. In some cases, a portfolio will have a single external manager who provides the fund structure for a portfolio. In other cases, Brunel Ltd will allocate to a number of different externally managed funds. For active equities Brunel Ltd has sponsored the creation of an authorised contractual scheme (ACS), in conjunction with an external fund operator, as this structure in these markets offers significant cost and tax benefits. Brunel Ltd is the investment manager of the ACS and as above will delegate to its chosen sub managers.

The EAPF is a client of Brunel Ltd and as a client will have the right to expect certain standards and quality of service. A detailed service agreement has been agreed which sets out the duties and

responsibilities of Brunel Ltd, and our rights as a client. It includes a duty of care of Brunel Ltd to act in its clients' interests.

The governance of the Brunel Pension Partnership is of utmost important to us to ensure our assets are invested well and our needs and those of our beneficiaries are met. Governance controls exist at several levels within the partnership.

- As shareholders in Brunel Ltd we entered into a shareholder agreement with the company and the other shareholders. This gives us considerable control over Brunel Ltd – several matters, including significant changes to the operating model, are reserved matters requiring the consent of all shareholders.
- An Oversight Board, made up of representatives from each of the Administering Authorities and two Fund member representatives, has been established. Acting for the Administering Authorities, it has a primary monitoring and oversight function. Meeting quarterly, it can request papers from Brunel Ltd or interrogate its management. However, it cannot take decisions requiring shareholder approval, which will be remitted back to each Administering Authority individually.
- The Oversight Board is supported by the Client Group, comprised primarily of pension investment officers drawn from each of the Administering Authorities, but also drawing on finance and legal officers from time to time. It will have a leading role in reviewing the implementation of pooling by Brunel 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.
- A separate level of governance is provided by the Board of Directors at Brunel Ltd, which are appointed by ourselves and the other shareholders. It comprises four highly experienced and independent non-executive directors, chaired by Denise Le Gal and four executive directors.
- Finally, as an authorised firm, Brunel Ltd has to meet the extensive requirements of the Financial Conduct Authority, with cover areas such as training and competency, policy and process documents, and internal controls.

Following the completion of the transition plan outlined above, it is envisaged that all of our assets will be invested through Brunel Ltd. However, the Fund has certain commitments to long term illiquid investment funds which will take longer to transition across to the new portfolios to be set up by Brunel Ltd. These assets are expected to be managed in partnership with Brunel Ltd until such time as they are liquidated, and capital is returned.

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 18 December 2019.