

## Performance monitoring and reporting

- 24 We will assess the compliance of external fund managers' investment processes and decisions with our SIP policy statements and IMA requirements as part of regular review meetings to discuss quarterly fund management performance and company engagement and voting reports.
- 25 We will receive an annual report on fund managers' compliance with the SIP's "green" policies, and report on our environmentally related activities, and these will be summarised in the Pension Fund Annual Report and Accounts.

## Performance benchmarking and assessment

- 26 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, and take action as required to improve our relative performance.

## Research and development

- 27 We will (resources permitting) undertake some SRI research in-house and/or support joint studies with other pension funds and organisations, with interests in environmental/sustainable investment to inform our own policies.

## Collaboration

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

## Communication and disclosure

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

## Continuous improvement

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

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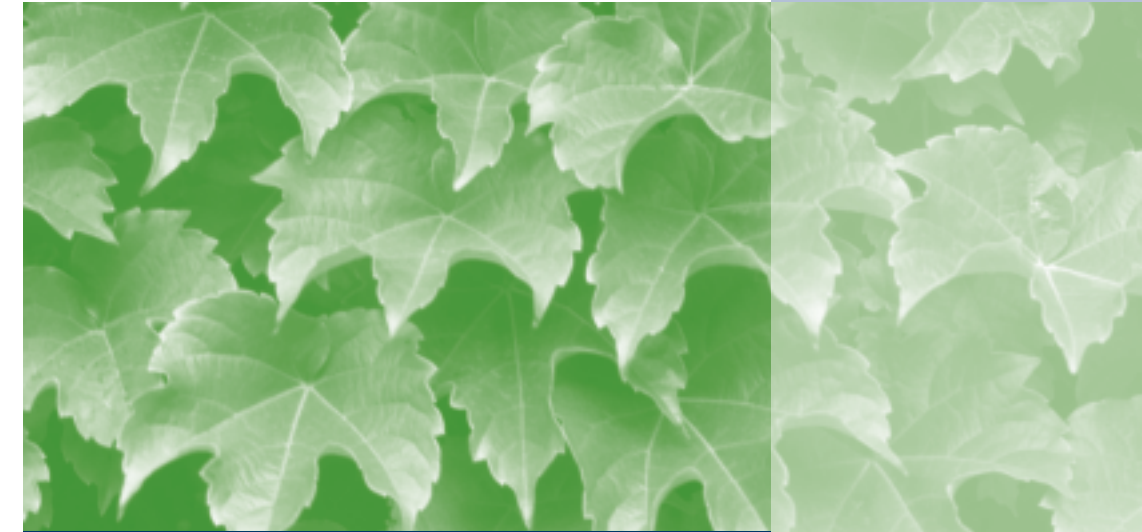
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1 References to the Agency, we or our in this paper are to the Environment Agency acting through its Pensions Committee as an administering authority of the Environment Agency Active Fund under the Local Government Pension Scheme Regulations 1997

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



[www.environment-agency.gov.uk](http://www.environment-agency.gov.uk)

## Environmental overlay strategy

Active Pension Fund

## Vision

1 The Environment Agency (“the Agency” / “We”)<sup>1</sup> 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

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

## Legal compliance

3 We will seek to fully comply with the regulatory requirement<sup>2</sup> to include in the statement of investment principles (SIP) details of its policies on social, ethical, environmental (SEE) issues in respect of the selection, retention, realisation of investments and exercise of voting rights.

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

## Fiduciary duty

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

## Capability

6 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

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

## Investment strategy

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

9 We will seek to overlay this environmental strategy across our investment portfolio that recognizes there are different approaches, constraints, risks and opportunities, and potential benefits in respect of its application to equities, bonds, gilts, property, and private equity.

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

11 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 that may be attributable to environmental issues (eg climate change) and that could negatively impact on investment returns.

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

## Asset allocation

13 We will periodically review our asset allocation strategy between different investments. We will investigate and financially evaluate 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.

14 We currently allocate 2% of our assets (c.£24m) to a low-risk eco-enhanced FTSE 350 index-tracking fund with a maximum tracking error of 2.5%. This allocation is less than other comparative pension funds in the UK and the EU. A far higher allocation to sustainable responsible investment is planned for 2005.

15 Subject to further review, this might include various types of sustainability funds, environmental funds, low carbon funds, green energy funds, green technology funds, green property funds, and sustainable forestry funds. After researching and evaluating the financial/environmental pros and cons of these funds through normal due diligence processes, we may consider investing in these alone, or with other like minded pension funds via a “fund of funds” approach in order both to stimulate such “green” investment styles and share the risks/returns.

## Fund manager selection

16 When selecting our 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.

17 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.

## Investment Management Agreements

18 We will seek to contract managers using our own form of investment management agreement (IMA). It has been drafted to meet industry best practice standards, and will ensure the use of consistent terms and conditions, fund valuation methods, manager fee calculation and payment mechanisms in respect of the various investment mandates. It will also include our corporate governance/environmental policies and disclosure and reporting requirements. It will be a condition of their appointment that external fund managers agree to comply with such requirements.

## Performance benchmarks

19 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 (ie FTSE4Good Index, Dow Jones SD Index, Domino Social Index, or Impax ET50) or specially constructed versions of these to assess our own and various other investment styles. Some assets (like property and private equity) will need their own “specialised” benchmarks.

## Investment management processes

20 We will inform our asset managers (and their company research information providers) about publicly available environmental data and information obtainable from us on environmental risks (eg. operator performance risk assessment scores), emissions (eg. Pollution Inventory) and performance (eg. Spotlight) which are potentially financially significant (eg. climate change) to help inform, but not interfere with, their independent investment management processes. We affirm that the purpose of such information exchange with managers is to help deliver sustainable high financial returns on our investments.

## Shareholder activism, engagement and voting

21 We will aim to comply with the Myners activism principle and to become more engaged as an active investor, especially in respect of companies whose environmental behaviour and performance is currently/or could in the future impact negatively on short or long-term investment returns. While reserving the right to act independently where necessary, we will normally do this through partnership and alliances with other pension fund groups (eg. LAPFF, IIGCC, UKSIF) to increase the impact of our policies.

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

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