Active Pension Fund
Responsible Investment Review
2012
We are the Environment Agency. We protect and improve the environment and make it a better place for people and wildlife.

We operate at the place where environmental change has its greatest impact on people’s lives. We reduce the risks to people and properties from flooding; make sure there is enough water for people and wildlife; protect and improve air, land and water quality and apply the environmental standards within which industry can operate.

Acting to reduce climate change and helping people and wildlife adapt to its consequences are at the heart of all that we do.

We cannot do this alone. We work closely with a wide range of partners including government, business, local authorities, other agencies, civil society groups and the communities we serve.
Foreword

Our pension fund exists to provide a retirement income for our fund members. Some members will be living well into the next century, and we want our future pensioners to enjoy their retirement in a clean and safe environment that is at least as good as the one we have today. To meet this long-term goal, we must ensure that the fund is managed in a responsible way.

What do we mean by responsible? We believe it means ensuring that our fund is both financially robust and environmentally credible. To do this, we take into account financially material environmental risks and by seeking environmentally sustainable investments to maximize our risk adjusted returns.

This Responsible Investment Review explains – for our fund members and other key audiences – how this approach works in practice. We set out our investment policies and practices for all the asset classes in which we invest. We have included examples of our work and investments since our last Review, in 2009.

Three years ago we were the first public pension fund in the UK, and one of the first in the world, to publish a Responsible Investment Review. This second Review marks the latest chapter in an unfolding and developing story for our pension fund. This second Review is again based on the UN Principles for Responsible Investment (UNPRI), and reflects the change to reporting by asset class in line with the UNPRI’s new global reporting framework.

Before 2003, the Environment Agency pension fund followed a fairly traditional investment approach. We took little or no account of environmental, social and corporate governance (ESG) issues. In 2003 our investment decisions began to actively take account of ESG issues. Today taking account of ESG issues are a key factors in our fund’s investment processes.

This report documents our progress since 2003. We now monitor our fund’s environmental and carbon footprints, we have developed new ways to assess the environmental risks in our property portfolio; and all our service providers and fund managers have signed up to the UNPRI.

There is still more to be done. By 2015/16, we aim to invest 25 per cent of our fund in companies that make a positive contribution to the global ‘green’ economy.

None of this progress would have been possible without the support of the Environment Agency’s Pension Committee, the skills and dedication of colleagues in the Environmental Finance and Pension Fund management team, and the advice of our fund managers, consultants and independent investment advisors who have helped to implement our investment strategy.

Howard Pearce, Head of Environmental Finance and Pension Fund Management, Environment Agency.

July 2012
# Contents

## Responsible Investment highlights

<table>
<thead>
<tr>
<th>Contents</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>6</td>
</tr>
<tr>
<td>About our fund</td>
<td>9</td>
</tr>
<tr>
<td>Context</td>
<td>9</td>
</tr>
<tr>
<td>Fund as at 31 December 2011</td>
<td>9</td>
</tr>
<tr>
<td>Our fund’s governance</td>
<td>11</td>
</tr>
<tr>
<td>Environmental Overlay Strategy</td>
<td>13</td>
</tr>
<tr>
<td>Mandate from our employer and fund members</td>
<td>13</td>
</tr>
<tr>
<td>Benchmarking against other funds</td>
<td>16</td>
</tr>
<tr>
<td>Responsible investment: our story so far</td>
<td>17</td>
</tr>
<tr>
<td>Some highlights in our implementation of our responsible investment strategy</td>
<td>21</td>
</tr>
</tbody>
</table>

## Implementation phase

<table>
<thead>
<tr>
<th>Contents</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selecting and monitoring fund managers</td>
<td>22</td>
</tr>
<tr>
<td>Voting for corporate change</td>
<td>25</td>
</tr>
<tr>
<td>Implementation by asset class</td>
<td>28</td>
</tr>
<tr>
<td>Public equity</td>
<td>28</td>
</tr>
<tr>
<td>Seeking returns from clean technology</td>
<td>29</td>
</tr>
<tr>
<td>Bringing down our environmental footprint</td>
<td>30</td>
</tr>
<tr>
<td>Improving business performance</td>
<td>32</td>
</tr>
<tr>
<td>Better disclosure to minimise risk</td>
<td>35</td>
</tr>
<tr>
<td>Private equity</td>
<td>39</td>
</tr>
<tr>
<td>Property</td>
<td>42</td>
</tr>
<tr>
<td>Passively managed funds</td>
<td>45</td>
</tr>
<tr>
<td>Enhanced passive indexes</td>
<td>47</td>
</tr>
<tr>
<td>Fixed income</td>
<td>48</td>
</tr>
</tbody>
</table>

## Next Steps

<table>
<thead>
<tr>
<th>Contents</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusting our asset allocation</td>
<td>51</td>
</tr>
<tr>
<td>Monitoring our progress and updating the strategy</td>
<td>55</td>
</tr>
</tbody>
</table>

## Annexes

<table>
<thead>
<tr>
<th>Contents</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>UNPRI Index</td>
<td>55</td>
</tr>
<tr>
<td>Our awards</td>
<td>57</td>
</tr>
</tbody>
</table>
Responsible Investment highlights

- 10.6% – the three-year rolling financial return from our fund, higher than many peer funds.
- 868 – the number of engagements with companies on environmental, social and corporate governance (ESG) issues in 2011.
- 78 – shareholder environmental resolutions voted in 2011.
- £223 million – the amount invested in clean technology companies (December 2011).
- 68.5% – the average sustainability score for our private equity funds last year, up for the fourth consecutive year.
- 16.0% – the amount we have reduced the environmental footprint of our active public equity investments since 2006.
- 6.7% – more carbon efficient in our active corporate bond portfolio than the benchmark in 2011.
- First LGPS Fund to sign up to the UN Principles for Responsible Investment (UNPRI) – on 14 July 2006.
- 100% – of our fund managers and investment service providers have now signed up to UNPRI
- In top 25% – our position since 2006 among responsible investment performers, in a global benchmark backed by the UN.
- 25 – UK, EU and international recognition awards won by our pension fund since 2005 for our responsible investment strategy.

‘Many investors believe that doing good and making money are polar opposites, but our active pension fund shows that’s not the case. In a tough market the fund is succeeding in both generating returns and in encouraging businesses to act responsibly. We are proving that investors can have a positive role in fighting the growing pressures of climate change and environmental degradation.’

Chairman, Environment Agency Pensions Committee
Introduction

The purpose of this responsible investment review
This report is primarily for our fund members. We want to clearly explain:

- the changes we have made – and are continuing to make
- the thinking behind the decisions we take on your behalf
- our plans for the future.

We also want to share our experiences with other assets owners and managers, and so promote best practice in responsible investment.

Environmental issues as investment issues
Why do environmental issues such as resource scarcity, climate change and biodiversity matter, either to financial investors or to our pension fund? They matter because they affect all mankind and have significant implications for our financial returns. Such issues are described as being ‘financially material’.

Just to look after our current members, we will need to be able to pay retirement pensions well into the 21st century. Over such a long time frame, we expect future trends in global climate, population and economics to have a major effect on the financial value of our fund’s investments.

These issues also matter because we want our pensioners to live in a clean and healthy environment which is at least as good as the one we enjoy today. For many members, their pension will be their main source of income when they retire. We want them to have a happy retirement in a world where the environment is not deteriorating.

Our pension fund benefits from being part of the wider Environment Agency: our staff have expertise in both financial and environmental management.

The latest step in a demanding journey
Taking account of financially-material significant environmental risks – and of opportunities in the investment process – is easier said than done. We have a legal duty to our members to protect, maintain and grow our fund and to factor in environmental risks and opportunities. This means we need comparable, high quality, quantitative (where appropriate) information on the funds we invest in and the businesses they invest in.

Ten years ago it would have been highly unlikely to see any pension fund report discussing issues such as climate change, natural resource scarcity, energy efficiency, or biodiversity. Nor would such reports have looked at the need to link senior executive reward with environmental performance. For our pension fund it wasn’t until 2003 that we began to reshape our whole investment strategy to take these issues into account.
Our journey is explained in detail in the ‘Story so far’ (from page 17). This sets out how we have

- transformed our investment strategy
- compared it to international best practice
- changed how we invest our money
- changed what we invest our money in.

This has been, and continues to be a challenging journey. It has not been made easier by the global financial crisis of 2008, which was followed by the Euro-zone crisis in 2011. This has affected investors and pensioners all around the world. It is worth noting that the underlying cause of the 2008 crisis was a social issue – arising from the mis-selling of mortgage products to borrowers unable to pay them back.

The last nine years have also seen our pension fund move from a narrow, largely UK investment portfolio to a much more global one. Around 50 per cent of our investments are now outside the UK. This figure increases to nearly 70 per cent if you look at equities alone.

Our fund investment strategy is also more diverse. We now invest in other asset classes – such as property and private equity – in order to increase our returns and to spread and reduce the risk of our investments.

In the future, natural resources are likely to become increasingly scarce. We also face a potential ‘carbon crunch’, the point at which the impacts from climate change have significant, direct and immediate financial cost. This is likely to make ESG issues even more important when we decide:

- how much to invest in what type of assets
- which investments are the best choice over the longer term.

**What you'll find in this review**

This report starts with a financial overview of our investment strategy. This explains the legal and organisational context of our fund. It then describes how we use policies and strategies, such as our Environmental Overlay Strategy (EOS), to guide the way all our assets are managed.

We invest in many different types of assets, known as ‘asset classes’. These currently include:

- public equities (from page 28)
- private equity (from page 39)
- property (from page 42)
- fixed income (bonds and gilts) (from page 48)

Each asset class has its own set of issues and opportunities in terms of responsible investment. This report discusses each asset class separately.
We were the first pension fund in Europe to establish the environmental footprint of our portfolio. We explain how we monitor the environmental impact of all our investments – from large household names, such as Vodafone, HSBC and GlaxoSmithKline, to companies dedicated to green technologies. These include Vestas Wind Systems and ECO Plastics, the UK’s leading re-processor of recyclable materials.

We explain how we try to use our influence as a shareholder to improve corporate environmental performance across all our investments.

‘We were the first pension fund in Europe to establish the environmental footprint of our portfolio’

We structured our last Responsible Investment Review to show how we had implemented the six Principles of the UNPRI (see page 55). In order to keep up with best practice and match the new global UNPRI reporting standard, this year’s review looks at what we do in each asset class. This structure also better reflects how we work on a day-to-day basis.

In order to provide some continuity, and to help other UNPRI signatories to use this report, we also have included a ‘UNPRI Index’ and pointers. These show which Principles are being complied with. The UNPRI index is at the end of the document.

UNPRI Pointers  P1  P2  P3  P4  P5  P6

Further information
You can find many more details and information about our pension fund and the Environment Agency online. These include:

- **Pension Fund Management** – the starting point for all information about our pension fund.
- **An Environment Vision** – this report sets out the long-term vision of the Environment Agency.
- **Creating a Better Place** – our corporate plan 2011-2015.
About our fund

Fund as at 31 December 2011

- Assets under management: £1.7 billion
- Annualised 3 year performance: plus 10.6%
- Defined benefit: 100%
- Number of fund members: 21,856
  - Active members: 10,591
  - Deferred members: 6,392
  - Pensioners: 4,873
- Funding level: 96% (when valued in March 2011)
- Public website: [www.environment-agency.gov.uk/pensions](http://www.environment-agency.gov.uk/pensions)
- Members website: [www.EAPF.org.uk](http://www.EAPF.org.uk)

Employing body: The Environment Agency is the environmental regulator for England and Wales. Our principal aims are to protect and improve the environment, and to promote sustainable development.

Membership eligibility: All full and part-time employees – unless they have elected in writing not to join.

Context

The fund is a final salary (defined benefit) pension scheme open to all Environment Agency employees. It is one of the largest funds in the statutory public sector Local Government Pension Scheme (LGPS) and one of the top 200 in the UK. At the end of 2011, our assets were valued at £1.7 billion and we had over 21,000 members. Our fund assets are diversified both in terms of asset classes and geography. The figures below provide further details on our current structure and our move to being a more global investor.
The Local Government Pension Scheme (LGPS) regulations provide the legal framework within which the fund operates. They place some limits on certain types of investment. Our fund also complies with the Myners Principles, which were developed to strengthen institutional investment in the UK. Our Annual Report and Accounts has a summary of the LGPS investment restrictions and a checklist demonstrating our compliance with the Myners Principles. We also publish our Statement of Investment Principles on our website.
Our fund’s governance

The body with ultimate responsibility for the management of the fund is the Board of the Environment Agency (appointed by the Department for Environment, Food and Rural Affairs and the Welsh Government\(^1\)). This Board appoints a Pensions Committee and acts according to our Governance Policy. The Pensions Committee has Board members and senior officers from the Environment Agency. However, almost half of the committee are nominated members. These include employees, trade union nominees, a pensioner representative and a deferred member nominee. This proportion of nominated members is very high compared with similar bodies in other UK public pension funds. The Environmental Finance and Pension Fund Management team provides specialist support.

The Pensions Committee Governance Policy Statement sets out:

- how the Active Fund is governed
- the role of the Pensions Committee Investment Sub-Group and Environment Agency officers with respect to investment matters.

The Pensions Committee is responsible for:

- compliance with legislation and best practice
- overall strategic asset allocation
- investment policy
- the appointment of investment advisors and fund managers.
- Benefits administration
- Communication to members

The Investment Sub-Group has five representatives from the Pensions Committee. It receives advice from professional investment staff employed by the Environment Agency, specialist investment consultants, an independent investment adviser, 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 management structure, recommends the appointment of fund managers, monitors the performance of fund managers, and reports back to the committee.

\(^1\)The Welsh Government appoints the Welsh representative on the Board.
Working in partnership

We recognize working in collaboration can be more effective in protecting shareholder interests and protecting the environment. The diagram below illustrates some examples.
**Day-to-day management of our fund**

Once appointed, fund managers are responsible for the day-to-day management of the fund’s assets. They carry out this role in accordance with their investment management agreement with us. We have appointed a performance measurer independent of the fund managers to calculate ‘risk and return’ measures for each manager and for the fund overall. We have also appointed a global custodian who is responsible for the safe-keeping of the directly held assets of the Active Fund and who works closely with each fund manager.

We have put in place a number of strategies and policies that govern our asset allocation, manager structure, manager selection, performance benchmarks, monitoring, and reporting. One of the most important, in terms of how we approach responsible investment, is our Environmental Overlay Strategy.

**Environmental Overlay Strategy**

The Environmental Overlay Strategy (EOS) provides guidance to our team and service providers in every asset class from property to private equity. It sets out how they should evaluate financially material environmental risks and opportunities. The strategy ensures that they consider both the financial and environmental implications of decisions made on our behalf – so that we contribute to creating a ‘greener’ business world.

The EOS requires our fund managers to:

- research financially materially environmental risks and opportunities
- collaborate with other bodies where appropriate
- take steps to minimise our fund’s exposure to financially material environmental risks.

For example, when considering a new investment, our fund managers must analyse and rate how the company manages environmental, social and corporate governance (ESG) risks as well as evaluating actual environmental performance. Each fund manager must report quarterly on their implementation of our EOS.

The EOS also commits us to working with other pension funds and investors around the world so that we investigate new and better ways to integrate environmental considerations into our working practices. A good example of this is the collaborative research into how climate change scenarios can affect strategic asset allocation ([Climate Change Scenarios – Implications for Strategic Asset Allocation](#)).

**Mandate from our employer and fund members**

The principal aims of our employer organisation, the Environment Agency, and thereby the employees (our active membership), are to protect and improve the environment, and to promote sustainable development. This provides the fund with a strong mandate to invest responsibly in our pursuit of financial results.
The Environmental Finance and Pension Fund Management team come from environmental backgrounds as well as from finance and pensions. As a result, the team has a mix of economic, social and environmental expertise which supports our approach to sustainable development.

The day-to-day work of individual team members covers all areas. We believe this multi-disciplinary approach ensures that our decisions take proper account of all relevant issues.

The team is based in the national office of the Environment Agency – Horizon House in Bristol. The building itself reflects the environmental principles at the heart of our work. In 2010, Horizon House won the Building Research Establishment’s Environmental Assessment Method (BREEAM) Office Award for being one of the most environmentally friendly offices in the UK (see box below).

### Horizon House

Throughout the building process, we have minimised our carbon footprint by insisting on sustainability in our building materials, methods and supply chain. Every aspect of Horizon House has been built with the environment in mind:

- We recycled more than 85 per cent of the building that formerly occupied the site.
- A natural ventilation and cooling system circulates fresh air from under the floor. This reduces the need for mechanical cooling and cuts our energy use.
- Adjustable external blinds (brise soleil solar shading technology) help to stop overheating.
- Solar panels convert energy from sunlight into electricity and hot water.
- A ground source heat pump provides about 17 per cent of the building’s energy needs.
- A rainwater harvesting system reduces mains water consumption by collecting and storing rainwater. This water is used to flush toilets.
- Shower facilities and bike storage encourage people to cycle and walk to work.

The design and construction of Horizon House has already reduced both our environmental impact and our running costs:

- It uses 69 per cent less mains water and approximately 37 per cent less energy than the offices it replaced.
- Based on the level of energy consumption so far, the ground source heat pump will save around £29,000 a year in energy bills.
- We are much better served by public transport than at our previous sites – staff and visitors can reach us by bus, train, or even water taxi. Horizon House has very limited parking facilities in order to encourage staff and visitors to use public transport.
The Environment Agency is also accredited to ISO 14001 and the EMAS environmental management standards. These require us (EAPF) to report on the polices, assessments and monitoring we use to manage the environmental risks relating to the companies in which we invest. As an organisation, our approach to buying goods and services contributes significantly to our effect on the environment. In this context, our pension fund is one of the Environment Agency’s most significant environmental impacts. This underlines and reinforces our responsibility as a pension fund to consider the environmental performance of the companies and assets in which we invest.

Environment Agency environmental performance objectives

By March 2015, we plan to:

- reduce our carbon dioxide emissions by 33 per cent
- reduce our energy usage by 33 per cent
- reduce the amount of miles we drive by 25 per cent
- avoid sending any of our waste to landfill
- reduce the amount of water we use by 25 per cent.

Source: Environment Agency website

<table>
<thead>
<tr>
<th>Manager</th>
<th>Asset class</th>
<th>Benchmark</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal &amp; General</td>
<td>UK equities (passive)</td>
<td>FTSE All-Share</td>
<td>+0.0%</td>
</tr>
<tr>
<td></td>
<td>UK index-linked gilts (passive)</td>
<td>FTSE UK gilts indexed &gt;5yrs</td>
<td>+0.0%</td>
</tr>
<tr>
<td></td>
<td>North American equities (passive)</td>
<td>FTSE World North America</td>
<td>+0.0%</td>
</tr>
<tr>
<td></td>
<td>European equities (passive)</td>
<td>FTSE World Europe excluding UK</td>
<td>+0.0%</td>
</tr>
<tr>
<td></td>
<td>Japanese equities (passive)</td>
<td>FTSE World Japan</td>
<td>+0.0%</td>
</tr>
<tr>
<td></td>
<td>Asia Pacific equities (passive)</td>
<td>FTSE World Asia Pacific excluding Japan</td>
<td>+0.0%</td>
</tr>
<tr>
<td></td>
<td>Global (excluding UK) equities (passive)</td>
<td>FTSE AW-World (excluding UK)</td>
<td>+0.0%</td>
</tr>
<tr>
<td>RLAM</td>
<td>Corporate bonds (active)</td>
<td>iBoxx sterling Non Gilt All Bonds</td>
<td>+0.0%</td>
</tr>
<tr>
<td>Aviva Investors</td>
<td>Property (active)</td>
<td>IPD UK Monthly</td>
<td>+1.0%</td>
</tr>
<tr>
<td>Standard Life</td>
<td>UK equities (active)</td>
<td>FTSE All-Share</td>
<td>+2.0%</td>
</tr>
<tr>
<td>Sarasin &amp; Partners</td>
<td>Global equities (active)</td>
<td>MSCI all country world</td>
<td>+2.0%</td>
</tr>
<tr>
<td>Impax</td>
<td>Global equities (active)</td>
<td>MSCI all country world</td>
<td>+3.0%</td>
</tr>
<tr>
<td>Generation Investment</td>
<td>Global equities (active)</td>
<td>MSCI all country world</td>
<td>+3.0%</td>
</tr>
<tr>
<td>Management LLP</td>
<td>Global Equities (active)</td>
<td>MSCI all country World</td>
<td>+3.0%</td>
</tr>
<tr>
<td>Comgest</td>
<td>Private equity (active)</td>
<td>MSCI all country world</td>
<td>+5.0%</td>
</tr>
<tr>
<td>Robeco</td>
<td>Currency overlay (active)</td>
<td>FTSE 100</td>
<td>+6.0%</td>
</tr>
</tbody>
</table>

Responsible Investment Review 2012
We strive for high performance in the procurement of all our goods and services. This approach extends to our pension fund. In 2009, we won the European Eco-Management and Audit Scheme Award for excellence in green procurement.

Specific ESG requirements are built into our instructions for each type of investment. We also require all our suppliers, not just fund managers, to complete a questionnaire on their organisation’s performance on health, safety and the environment.

**Benchmarking against other funds**

When we reviewed our investment strategy in 2003, we commissioned Claros Consulting to benchmark our fund against others in terms of both financial performance and social and environmental criteria. We compared ourselves with other LGPS, public, private and NGO pension funds. This exercise showed that we could do better in terms of ESG issues and responsible investment. As a result, we decided to change how we manage our fund.

We consider this type of benchmarking important for measuring our progress. We now participate in a number of annual benchmarking exercises, including:

- the UNPRI global annual assessment and verification
- EU/UK peer-reviewed pension and investment award schemes
- the UKSIF and CIPFA survey of LGPS funds

The UNPRI assessment is the most far reaching. It compares our responsible investment performance against funds from over 40 countries around the world. In 2011, for the fifth consecutive year, UNPRI ranked our fund in the top quartile for all six Principles and for all the asset classes in which we invest\(^2\). This is very encouraging. However, we recognise that as the process relies on voluntary self-assessment there are some limitations to the UNPRI findings. Comparisons with peers are also subjective: each investor will follow their own strategy and have their own practices.

---

\(^2\) Scores have been calculated based on signatories’ self-assessment and using the scoring methodology approved by the UNPRI Assessment Group. Although a limited verification exercise was undertaken with a proportion of signatories, responses have not been independently audited by the UNPRI Secretariat, UNPRI Assessment Group, or any other third party. Individual results including comparisons to the overall results (quartiles) are indicative and do not imply an endorsement of signatory activity. While this information is believed to be reliable, no representations or warranties are made as to the accuracy of information presented, and no responsibility or liability can be accepted for any error, omission or inaccuracy in this information (UNPRI).
Responsible investment: our story so far

Our history

The 2001 Pensions Act was the catalyst for our move to responsible investment. It led us to pay closer attention to environmental risks and opportunities which could be financially significant for our pension fund.

The Act forced all pension funds to disclose in their ‘Statement of Investment Principles’ (SIP) the extent to which they considered environmental, social and governance risks in their investment strategy.

In 2002 our fund not only updated our SIP but we also piloted a passive UK portfolio which tilted the companies who formed part of the FTSE 350 to the environmental best in class companies in each sector. Our portfolio consisted of all the companies in the FTSE 350 but each holding was either increase, decrease or left the same depending on each companies ESG score. Over the next two years we also undertook strategic reviews to research the availability and performance of ‘green’ companies and investment funds.

Our strategic review concluded that we had a duty to take account of financially material environmental risks that could reduce investment returns. We also began to look for opportunities to invest in green businesses that were financially robust. In 2005, we changed our approach to asset allocation. We launched our Environmental Overlay Strategy (EOS) and introduced a new Corporate Governance Policy to put our new strategy into practice. In 2012 the Corporate Governance Policy was incorporated into a Responsible Investment Strategy. This is published in our annual report and accounts, available on our website.

Central to the change was the view that well-governed companies which reduce the financially material environmental risks that can diminish shareholder value would, over time, produce more sustainable returns than poorly governed companies would. Leading economists such as Sir
Nicholas Stern have also predicted that ‘lower carbon’ businesses may make up 40 per cent of the global economy after 2030.

Figure 4 below shows the timeline of our pension fund in terms of the number of years until retirement, mapped against the severity of the impacts of climate change.

There is now a much greater understanding of the importance of ESG issues in the mainstream pension fund and investment market. The active incorporation of material ESG issues into asset management is now recognised to be part of the legal duties of a pension fund or investment.

Previously, the concept of ‘responsible investment’ was associated with a niche set of investments. It consisted largely of not investing in certain companies or sectors (such as tobacco and arms). A different approach has now emerged. This asks investors to act responsibly by: factoring wider ESG issues into their investment decisions, engaging with companies where they see a problem, and being transparent and collaborative themselves.

In 2005, an acclaimed report was published by the United National Environment Programme Finance Initiative. This concluded that pension funds had a responsibility (‘fiduciary duty’) to consider ESG factors. This report led to the growth of investor groups such as the Institutional Investors Group for Climate Change (of which we were a founding member) and the UN Principles for Responsible Investment.

These developments in the global marketplace have chimed well with the changes we were making at our pension fund. We have been able to work with like-minded peers and other organisations to promoting a move to more sustainable capital markets that will help our strategy succeed.

“The assets of the Fund are invested in order to meet benefit payments many decades into the future. Over that timescale, environmental factors and climate change are likely to have a significant impact on the returns from different types of investment, particularly at an industry and company level. It is therefore sensible and prudent that the fund should consider these factors when setting its investment objectives and strategy.”

Richard Warden, Fund Actuary, Hymans Robertson.
‘Pension funds have the ability and influence to encourage greater integration of environmental stewardship and sustainability into investment practices. With their participation in the climate work, the Environment Agency has once again showed leadership among UK pension funds.’

Will Oulton, Head of Responsible Investment, Mercer Investment Consulting
Trillions of dollars at stake from climate change by 2030

We are all aware of the catastrophic threats which climate change poses to the natural world. However in 2010 we took part in a study which has confirmed the disastrous impacts climate change could have on the financial world.

The study was led by Mercer Consulting and we worked with 13 fellow investors from around the world. It concluded that a failure to introduce effective climate change policy on an international scale could cost institutional investors trillions of dollars over the coming decades.

Our partners included some of the world’s biggest funds – such as CalPERS in the US, AP1 in Sweden, VicSuper in Australia, and the Government of Singapore Investment Corporation. Together these funds manage more than US$2 trillion of assets – equivalent to the GDP of the entire UK.

The study’s final report analysed the potential financial impacts of climate change on the portfolios of pension funds such as ours, using a series of four climate change scenarios playing out to 2030. It also identified a series of pragmatic steps for institutional investors to consider in their strategic asset allocation. For example it found that:

- Climate change could contribute as much as 10 per cent to portfolio risk over the next 20 years.
- Investors could benefit from increasing the level of investment in infrastructure, real estate, private equity, agriculture land, timberland and sustainable assets.
- Investment opportunities in low-carbon technology could reach $5 trillion by 2030.

Climate change increases uncertainty for long-term investors such as our pension fund. We therefore need to take steps to manage this risk.

The project has been hailed as pioneering and a significant step forward. It is helping pension funds to build climate change into their investment strategies. We have used its findings in our review of our investment strategy: we monitor our fund’s exposure to climate change risk factors and have built it into our approach to asset allocation. We are taking these steps because we have a responsibility (‘fiduciary duty’) to manage the financial impact of climate change.

The report Climate Change Scenarios – Implications for Strategic Asset Allocation is available online.
Some highlights in our implementation of our responsible investment strategy

2001  Pensions Act; new Statement of Investment Principles includes reference to ESG

2002  Pilot Eco-titled mandate (2002-2008)

2003  Bench-marking against other ‘green’ funds

2004  Strategic review launched

                      We become a signatory to the Carbon Disclosure Project (CDP)

2005  Freshfields report for United Nations Environment Program Finance Initiative (UNEPFI) provides legal arguments supporting ESG issues being incorporated in all investment decision making

                      Environmental Overlay Strategy created and assets re-allocated

                      We open our sustainable private equity portfolio

2006  Launch of UNPRI; our fund is the first UK public pension fund to join

                      We launch our annual environmental footprinting of our actively managed public equities

2009  We sign the investor statement for UN Copenhagen Climate Summit

                      We publish our first Responsible Investment Review

2010  Our fund publishes a compliance statement for the new UK Stewardship Code

2011  We establish the environmental and carbon footprints for all our actively managed public equities and UK corporate bonds

                      Climate Change Scenarios integrated into our Strategic Asset Allocation process and reflected in the new active fund investment strategy

2012  We publish our second Responsible Investment Review

                      Future asset allocation to include sustainable infrastructure and other real assets such as farmland and forestry
Implementation phase

Over the last few years, we have worked hard to put our investment philosophy into practice – in an ever-changing global economy and volatile financial markets.

We only appoint fund managers who demonstrate ESG issues are an important part of their investment decision-making. We monitor their performance.

We have been measuring the environmental footprint of our actively managed equities since 2005. For the last two years, we have also measured the environmental footprints of our corporate bonds. We have also steadily increased our investments in clean technology companies. We explain all these steps in more detail later in this report review.

At the end of September 2010, we became one of the first UK pension funds to publish our Statement of Compliance with the UK Stewardship Code. This new framework aims to improve how companies engage with their shareholders on issues such as climate change. A copy of our Stewardship Code statement is available online.

Selecting and monitoring fund managers

Our managers are responsible for day-to-day investments. We are therefore careful about the methods we use in their recruitment and retention. All our managers must show they have the potential to perform well, not just financially but also in implementing our Environmental Overlay Strategy.

The recruitment and retention process requires us to consider financially material environmental risks and opportunities at every stage – from the moment we think about hiring a manager to our regular ongoing reviews. For example, there are key issues to consider in the:

- selection of managers
- appointment of managers
- monitoring of managers.

When selecting a manager

We ask candidates to explain their technical capacity to take account of environmental, social and corporate governance (ESG) issues at the Expression of Interest, Request for Proposal and interview stages.

We interview the key decision-makers in the candidate’s investment team. These include:

- the fund manager who will be responsible for the portfolio on a day-to-day basis
- the ESG lead
- the client contact.
We firmly request that potential managers avoid providing generic marketing material about their company’s strengths and experiences. Our selection process focuses on the particular details that are relevant to us. We question them in great depth about their experience and approach to ESG issues. In particular we look at:

- their practical experience
- their level of understanding

![Sarasin Sustainability-Matrix®](image)

This is a snapshot of how one of our managers ranks the sustainability performance of more than 50 of the companies in which we invest. We have left in the names of some companies for reference. This sort of analysis feeds into the overall decisions we make about our equity investments.

**When appointing a manager**

Contracts require managers to consider the environmental risks and opportunities that are financially significant for our fund. Managers must carry out our annual environmental footprinting exercise.

We have our own model investment management agreement (IMA). This makes it clear how managers should implement our EOS and Corporate Governance Policy – as well as our disclosure and reporting requirements. It is straightforward to use our own IMA in segregated mandates. When we use collective investment vehicles (pooled funds) we work with the providers to make sure we are able to monitor such portfolios from an ESG perspective.

**When monitoring a manager**

We require all our managers (except those who deal with currency) to report quarterly and annually on their implementation of the EOS. We will ask for different information for different types of asset – such as equities, bonds, property. However, in general we require:

- an account of their engagement and voting undertaken on environmental issues
- in-house or external broker research on environmental issues that are currently financially material
- updates on our investments in ‘green’ businesses.

We may also ask managers to explain and justify financially any investment decisions that we consider to be environmentally controversial.
Using our influence to support mainstream responsible investment

Since we appointed Comgest\(^1\) to manage our emerging market investments, the company has established a responsible investment training programme for all its global investment professionals. They said,

‘In 2010 we were appointed by the Environment Agency to manage their Emerging Markets portfolio and this provided a springboard to move our responsible investment programme forward.’

‘Governance issues have been a key factor in our process for many years and the emerging markets investment team already identify material environmental and social risks, however we want to formally integrate environmental and social issues into the roots and branches of all our investment process.

‘In 2011 therefore we decided it would be valuable to commission a training programme for our 30-strong investment professionals across all regions to better manage ESG risks of the companies they closely follow. We have brought in a training provider in September 2011 to run a flexible training program which looks at different responsible investment tools and best practices. Our experience with the Environment Agency has been very helpful so far in showing the importance of responsible investment to the future of asset management.

Overall, we feel providing tools and a replicable methodology to “ESG-trained” members of each regional research team should provide them the resources to spot, and appropriately respond to unacceptable environmental, social and governance factors.’

**William Holmberg, Comgest.**

\(^1\) Comgest is an asset manager based in Europe and Asia. It has six offices: two in Europe (Paris, Dublin) and four in Asia (Hong Kong, Singapore, Tokyo, Mumbai).
Voting for corporate change

A shareholder resolution is a recommendation, by a shareholder or group of shareholders, which specifies a change in corporate policy. Shareholders can vote for or against such resolutions at a company’s annual general meeting.

It is a valuable way for investors to influence corporate behaviour, and we exercise our right to vote on shareholder resolutions. Most of the time we allow our fund managers to decide how to vote. We see voting and engagement as key parts of their role. However, if a resolution deals with an environmental issue, managers must refer it to us before voting.

Our active pension fund voting policy on environmental issues guides our managers on a wide range of environmental issues. We also work within the voting guidelines of the Institutional Shareholders’ Committee and the National Association of Pension Funds. We require our managers to follow the Stewardship Code in the UK and relevant recognised standards for overseas investments.

We aim to vote on all environmental resolutions in the UK, Europe and North America – and, where practical, worldwide. During 2011 we voted on 78 shareholder environmental resolutions. These resolutions covered many environmental issues, including:

- sustainability reporting
- climate change and targets and reporting on greenhouse gas emissions
- environmental impact of operations
- nuclear power
- energy efficiency
- waste and recycling.

A document detailing all these votes is available on our website. The charts below give a full breakdown of issues. There are also examples of some of the votes.

For our passive holdings, where we own a small amounts of lots of companies and there is no option to sell the stock as the amount held is linked to the proportion in the index e.g. FTSE All-share, we work with Hermes Equity Ownership Services (Hermes EOS), a specialist provider in engagement and voting. We appointed Hermes EOS to enhance the engagement with the companies due to the scale and number of issues to be covered.
Figure 5: Number of environmental resolutions cast by the pension fund

Figure 6: Environmental votes by category
Figure 7: Examples of votes cast last year

<table>
<thead>
<tr>
<th>Country</th>
<th>Company</th>
<th>Issue</th>
<th>Resolution cast</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>Starbucks Corporation</td>
<td>Improved recycling</td>
<td>We supported a resolution that called for the company to consider a comprehensive strategy for recycled content – including plastic, glass, paper and metal containers. We believed this would be of value to the company and shareholders due to regulatory requirements and customer expectations.</td>
</tr>
<tr>
<td>UK</td>
<td>BP</td>
<td>Inadequate health and safety</td>
<td>We voted against the Annual Report and Accounts in 2011 due to the lack of adequate disclosure on the Deepwater incident and its financial impact on shareholder value.</td>
</tr>
<tr>
<td>UK</td>
<td>BSkyB</td>
<td>Corporate governance lapses</td>
<td>Hermes EOS voted on our behalf against the re-election of the chair. This formed part of a wider, long-term engagement with the company over board structure.</td>
</tr>
<tr>
<td>Japan</td>
<td>Chubu Electric Power Company</td>
<td>Improved use of renewable energy</td>
<td>We supported a resolution referring to the adaptation of renewable small distributed energy generation. We believe that a move to more environmentally friendly alternative energy sources would benefit both shareholders and the environment.</td>
</tr>
</tbody>
</table>
Implementation by asset class

Public equity

We invest in several different types of assets, known as ‘asset classes’. However, more than 60 per cent of our portfolio is invested in public equity.

Public equity is the umbrella term for our investments in the shares of more than 500 listed companies, in the UK and globally. (This figure rises to several thousand if you include our passively managed equity investments – see page 45).

Actively managed equities are company shares which our managers evaluate and either choose to buy, hold or sell. With a passively managed fund, the aim is to mirror the progress of a specified index (such as the FTSE 100). Decisions to buy and sell shares reflect general patterns on that index.

We invest in large multinationals and smaller specialist companies. Of all the asset classes in which we invest, public equity is perhaps the most developed when it comes to responsible investment.

We use several managers to invest in public equity. We expect all of them to take full account of environmental, social and corporate governance (ESG) issues. Some managers may:

- identify specific environmental themes, such as water availability, loss of biodiversity, energy and resource efficiency, and then look for companies doing better than their peers in those areas.
- select companies that are ‘best-in-class’ – namely they are better than their peers and how they manage sustainability issues e.g. environmental performance, supplier audits, employee and community relations and these can help the company’s overall financial performance.
- use specialist ESG research to analyse how a company operates – and then work with them to understand how the company manages ESG issues.
From pollution to poverty: investing in companies that are part of the solution

Generation Investment Management manages a portfolio of global equity investments for our fund. It uses ESG performance as a vital part of the way it identifies value in a company.

‘For us, sustainability issues encompass not just environmental risks but a number of other factors including healthcare, demographics, water, poverty, corporate governance and resource scarcity. Identifying and investing in companies that are part of the solution to the ever-growing list of sustainability challenges is a critical part of our approach at Generation. We consider the relevant and material sustainability challenges within a particular sector and seek to identify companies that are well-positioned to drive shareholder value and competitive advantage by managing well the risks and opportunities associated with them.

An example of a company that we invest in is Novo Nordisk, a pharmaceutical company which is managed according to the principles of the Triple Bottom Line and with a stated corporate mission to defeat diabetes. Novo Nordisk runs its business this way because it believes that it plays a key role in earning and maintaining Novo Nordisk’s licence to operate and innovate. They reason that it helps build reputation and earn trust among stakeholders, attract talent and engage people, build customer loyalty and drive innovation. Ultimately, Generation believes that this commitment to pursue ambitious long-term targets for socially, environmentally and ethically responsible conduct strengthens the company’s competitive position in its markets. Novo Nordisk’s reported operating profit increased 18% in 2011.’

Esther Gilmore, Director, Generation Investment Management LLP.

Seeking returns from clean technology

Through our various equity managers we invest in a wide range of clean technology companies. These are companies working in areas such as renewable energy, recycling or waste minimisation technology. Such companies help mankind to adapt to and reduce the effects of climate change.

For the last two years, Impax Asset Management has analysed all our equity investments (both public and private equity holdings), and quantified the extent to which we invest in clean technology companies. For this report we completed an interim analysis at December 2011.

3 Companies which generate at least 20% of their revenues from ‘clean technology’ qualify for inclusion.
This analysis showed that our fund had £223 million of assets invested in clean technology companies. This represents 12 per cent of the fund. Our target for 2015 is to be able to demonstrate that 25 per cent of the fund is invested in clean and green technology.

‘our fund had £223 million assets invested in clean technology’

The chart below shows a breakdown of the investments in clean technology at 31 December 2011 compared with the year end March 31 2011.

Figure 8: Investments in clean technology

Bringing down our environmental footprint

For the last six years we have measured the environmental footprint of our actively managed public equity investments. This helps us to quantify the level of financial risk to our portfolio posed by climate change and other environmental issues. In addition, it also gives us a fresh perspective on stock selection.

It also helps us to practice what we preach. We ask the companies we invest in to measure their environmental performance: we should do the same, to the best of our abilities.

We use specialist researcher Trucost to measure our footprint. It evaluates more than 700 factors to assess a company’s environmental impact, including the amount of raw materials, water and energy
used and the waste and carbon emitted. It calculates the footprint for each equity manager, in relation to our fund, by allocating a proportion of the environmental impact of each company relative to the amount of stock that is held. Trucost does the same for all the companies in the ‘MSCI World Developed Countries Index’ in order to give us a benchmark for comparison. In 2011 our environmental footprint was less than the benchmark for the fifth consecutive year (see Figure 8).

In 2010 we analysed our footprint performance and financial performance for the active equities over the period. Over the five years to 2010, our active equities financially outperformed the benchmark index by +2.5 per cent – while their environmental footprint shrank by 30 per cent.

‘We are one of the first funds in the world to decrease our environmental footprint.’

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 assets. Further information on this is provided in the fixed interest chapter later in the report.

Figure 9: Environmental footprint
Improving business performance

We use our influence as shareholders to improve corporate environmental performance if we believe a company’s current behaviour will have a negative effect on short or long-term investment returns. This is often called ‘active investment’ or simply ‘engagement’.

In our view there are benefits to investing in well-governed companies which understand that environmental risks and opportunities may have a significant effect on financial results – and which act accordingly. Our research suggests that this approach is more likely to safeguard shareholder value and will, over time, produce more stable returns.

We therefore encourage all our equity fund managers to:

- engage regularly with the top management of companies, either directly or through a specialist provider
- assess each company’s environmental practices
- ensure these practices are in line with our values.

The fund manager must also identify issues for engagement. However, we are also involved in identifying issues. We look at information from our footprint work, collaborative engagements, prosecutions and company environmental news.

Our managers and external service providers typically undertake about 800 engagements a year on our behalf.
In 2011 our fund managers carried out 84 corporate engagements on environmental issues and a further 156 on wider sustainability risks. Our specialist provider, Hermes Equity Ownership Services (Hermes EOS), undertook 127 corporate engagements on environmental issues and a further 501 on wider sustainability risks.

There also need to be consequences when engagements fail. For example, after the 2010 Deepwater Horizon oil spill we asked our fund managers to increase their engagement with the board of BP to ensure the adequacy of BP’s management response to the incident. That engagement did not produce satisfactory results. In our view there was also a lack of adequate disclosure in their Annual Report and Accounts about the Deepwater incident and its financial impact on shareholder value. Since the Gulf incident the BP share price has stayed 30% below its previous value.

We voted against the Annual Report and Accounts at the 2011 AGM. Our investment in BP is now around 75 per cent smaller than it was in 2004 and is less than one per cent of the fund. This is noticeably less than the average UK pension fund holding. We, and others, continue to work with BP to improve the company’s disclosure and transparency on these issues – so that ongoing risks and management can be adequately assessed.

Figure 11: BP holdings
Our own engagement activity focuses on environmental issues. However we also work with other investors on a number of social and corporate governance matters. This makes the best use of each investor’s own knowledge and expertise. Working together increases the impact and effectiveness of our engagement. In the last few years this approach has led us to work collaboratively on issues such as bribery and corruption, human rights abuses and corporate governance (as is the case with BSkyB, see page 38)

Protecting environmental standards through shareholder engagement

Standard Life manages our UK-quoted public equities. It is part of its job to identify companies that we might need to work with on environmental and social issues that are financially significant. Standard Life then has to engage with the companies identified.

Since our last Responsible Investment Review, one of the companies which Standard Life has highlighted to us is Vedanta. This is a UK-listed mining company, although many of its operations are carried out abroad. This is a common feature in UK indexes. Vedanta has good potential earnings growth but its operations in Orissa, India, have been widely criticised for their effects on the environment and human rights.

Standard Life engaged with the company to request that it move towards international best practice on environmental issues, human rights and community consultation standards. It also encouraged the company to:

- participate in international sustainability initiatives, such as the International Council on Mining and Metals
- build relationships with critics, such as concerned non-governmental organisations (NGOs)
- provide clear and immediate responses to criticism.

As part of this process Standard Life has met with numerous staff, including the chief executive and his executive team.

Vedanta has taken steps that we regard as positive. For example, the company has taken on a highly qualified chief sustainability officer who is developing best practice across the business. The company has also agreed to implement the recommendations from an independent strategic sustainability review.

Vedanta has now agreed to ensure that all future impact assessments comply with host country legislation and the requirements of the IFC (the development arm of the World Bank). It is also considering taking part in international sustainability initiatives and meeting with and listening to its critics.
Better disclosure to minimise risk

We engage frequently with companies and public policy advisors regarding adequate corporate disclosure of ESG information, such as energy use. If the information that investors receive from companies is shallow and short term, then these characteristics will define investors’ decisions. If companies do not assess and report on the wider ESG risks and opportunities of their business, how can the market assess the sustainability of that entity?

More businesses are providing information in line with reporting frameworks. However the levels of reporting and the quality of disclosures vary across countries and within sectors. There is still much work needed before the adequate disclosure of ESG information becomes standard practice.

To help with this challenge, we have collaborated with researchers from Trucost to assess the extent of environmental reporting in annual reports and accounts. We looked at the reports and accounts of some of the UK’s largest companies (those quoted in the FTSE All-share index) since 2004.

Our last review, completed in 2009, found that 99 per cent of FTSE-listed companies made at least some qualitative environmental disclosure. Qualitative disclosures are descriptive. Based on observation or deduction, they can provide valuable insights and information. However the lack of measurable data makes it harder to make comparisons over time and with peers.

Only 62 per cent of FTSE-listed companies made quantified disclosures on energy use and climate change, only 41 per cent did so for waste and only 25 per cent for water use.

It is important to recognise that although our fund value is £1.7bn, our largest equity shareholding represents only 0.01% of the total shares issued for that company. 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 emissions and engaged with a total of 6000 companies on levels of carbon disclosure. We focused on twelve companies that are held in our portfolio and are part of our ongoing engagement programme via our managers, including Tullow Oil and Ormat Technologies.

- **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 six companies that are held in our portfolio and are part of our ongoing engagement programme via our managers, including Scottish & Southern Energy, BG Group.

- **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, including Balfour Beatty, Colgate-Palmolive and Tesco (see below)
Working through our UK equity manager, Standard Life, we engaged with Tesco PLC to encourage them to participate in the Forestry Footprint Disclosure Project (FFDP). Tesco co-chairs (with Unilever who did respond to the 2010 survey) the Consumer Goods Forum project on deforestation. However it had not taken part in the FFDP 2010 survey.

We were keen for Tesco to participate in the project as this reports across different forestry-related commodities – and includes details of management actions and assurance processes.

Tesco recognised both the importance of rainforests in tackling climate change and the demand for rainforest products by the food and retail sector. It responded to the 2011 survey. The results were published in the FFDP report on 7 February 2012.

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.
Engaging with Shell on environmental and social standards in Nigeria

Our pension fund holds a small stake in Royal Dutch Shell (2.5 per cent of our equities and 1.4 per cent of our overall portfolio). We use specialist engagement providers Hermes EOS to engage with the company about its operations in Nigeria.

Shell has operated in Nigeria for several decades. It has the largest presence of any foreign-owned oil company in the country. Oil is crucial to the Nigerian economy, accounting for more than 90 percent of tax revenues and foreign exchange. However, the industry and the company have been accused of being complicit in allowing poor environmental standards and not channelling sufficient benefit to the people of the Niger Delta. This has led to poor community relations and the theft and sabotage of the company’s assets.

In 2009 Hermes EOS stepped up its engagement with Shell on these issues. From a meeting with the Head of Shell’s Nigerian upstream operations in Lagos, it was clear that the company had significantly improved its practices in the country. Over the next year further progress was made.

Shell has become far more open about its Nigerian operations. It now publishes more detailed data on spills and environmentally harmful gas flaring, as well as releasing the environmental impact assessments for new projects. It has:

- stated publicly that all spills from its operations are its responsibility
- developed a system for swifter spill detection
- introduced more effective prevention of damage from attempted theft and sabotage.

This has helped bring about an improved relationship with the people of the Niger Delta.

The engagement with Shell continues to be intensive in nature.
News Corporation and BSkyB engagement

Hermes EOS has been engaging with global media giants News Corp on a number of issues for several years. It does this on behalf of our clients including the Environment Agency.

In early 2011 EOS intensified this work, primarily because of concerns over board independence, the board structure and arrangements for succession planning, as the UK phone hacking scandal made front pages across the world. The primary focus of engagement has been the issues at the heart of the scandal: corporate governance and ethics.

Key issues on which Hermes EOS has been challenging News Corp include:

- the acceptance of a family dynasty and a lack of transparency around succession planning for its ageing chairman / CEO, Rupert Murdoch
- the disproportionate influence of Rupert Murdoch and the Murdoch family over News Corp
- the ethical standards of the company – as highlighted by the controversy around alleged UK telephone hacking and the broader concerns about ethical conduct and standards.

Concerns about leadership at News Corp led EOS to file a shareholder proposal in 2011 requesting that the Board enhance its reporting on the company’s succession planning. EOS continues to be involved in intensive ongoing discussions with News Corp.

BSkyB

At the same time, EOS has also been engaging with BSkyB. Following a number of meetings, EOS voted against the re-election of chairman James Murdoch at the 2011 Annual General Meeting.

Many independent shareholders took the same stance. James Murdoch eventually received support from only 55 per cent of the independently held shares. Even with News Corp’s large shareholding in BSkyB, he received support from just 76 per cent of the shareholder base. It would appear that the level of dissent was much larger than the company was expecting. Following the AGM, Hermes EOS continued to meet with the board of BSkyB to press for an independent chair to be put in place. In April 2012 the company announced that James Murdoch has stepped down as chairman whilst remaining a non-executive director. The company’s senior independent director, with whom EOS have been in close dialogue, took the chair.
Private equity

‘By the time I retire it will be a different world. There will be a larger population and an increased demand for food, water and energy, and more climate change impacts will have arisen. So it’s reassuring to know that some of the fund upon which my pension depends is being invested in businesses that are developing more sustainable solutions to these challenges.’

Phil Chappell MBE, active member, Leeds.

Private equity is the umbrella term for investments in non-listed enterprises or in parts of companies that are in private ownership. The general public sometimes associates private equity with asset stripping and irresponsible behaviour. However it can also be a great creator of jobs, wealth and sustainable companies. For example, it can provide the venture capital to develop new technology in a sector such as decentralised generation systems. Generally, a private equity investment is sold only after the company has been built up over a number of years. These investments therefore suit investors such as pension funds which tend to hold investments for a longer time.

The majority of fast-growing companies working with exciting, new, sustainable technologies are too small to be listed on stock exchanges. These companies can offer highly attractive investment returns and the only practical way to invest in them is through private equity funds. One such company is Climate Energy Ltd (one of our underlying holdings), which provides energy efficiency advice across the UK (see box).

The concept of sustainable private equity is still relatively new, but we have been involved in this area for around six years. Just over £89 million of our pension fund is invested in global private equity. Our private equity portfolio is managed by Robeco-SAM, a specialist Europe-based investor which manages a spread of sustainable private equity funds for us.

Around 30 per cent of the assets we have allocated to this fund manager have been invested in specific clean technology funds that have a strong financial track record. The remaining 70 per cent is allocated to more traditional private equity that also takes into account sustainability issues.

The underlying companies in which we are investing must also have signed up to the Robeco Sustainable Private Equity programme. This helps them to build sustainability into their core business.

We require our private equity fund managers to report on their engagement with companies, and produce a comprehensive annual review. Robeco therefore undertakes an annual survey of the underlying funds in which we invest, evaluating their performance against a wide range of environmental, social and corporate governance (ESG) criteria. The most recent annual review was published in 2011 (based on 2010 data). The average ESG score was 68.5 per cent. This was up for the fourth year in a row (from 66.1 per cent in 2010), even though the ESG requirements have been getting tougher.
Powering growth for Climate Energy Ltd

Through our investment in Robeco’s Sustainable Private Equity programme and its work with Climate Change Capital, our pension fund is helping to grow companies such as Climate Energy Ltd. Climate Energy is a UK agency founded in 2005. It provides energy efficiency advice and funding solutions to local authorities, registered social landlords, homeowners and businesses. For example, the company operates an energy efficiency call centre for the Energy Saving Trust in the East of England. This provides advice to homeowners on the measures they can take to improve the energy efficiency of their homes.

As a result of Robeco’s input, the team at Climate Change Capital carried out an ESG assessment of the company’s activities. This resulted in the spidergram (next page) and, more importantly, in a number of practical improvements. These have included:

- the establishment of the Affordable Energy network, a nation-wide network of insulation installers
- a decision to place environmental communications at the forefront of business operations
- the establishment of a staff environmental committee (the Green Team)
- the establishment of a Sustainable Procurement Programme – to ensure the use of 100 per cent recycled and Forest Stewardship Council materials and that they buy from local suppliers.

Extract from press release 10 February 2012

Essex based Climate Energy number one in the region for growth, says Sunday Times Deloitte Buyout Track 100

Climate Energy, one of the UK’s leading independent energy efficiency solutions companies, has just been ranked 3rd in the latest Sunday Times Deloitte Buyout Track 100. This annual league table ranks companies by growth in profits over the last two years of available accounts. Led by managing director Andrew Holmes, the company has seen profits rise an average 155% a year over the last two years, to £6.6m in 2011.

http://www.climateenergy.org.uk
The last annual review shows that those private equity funds that have been in the programme longer seem to score better on sustainability. This suggests that the system of benchmarking, and engaging with the underlying companies, does help to improve sustainability performance.

Source: Climate Change Capital

Read more >> Responsible Investment in Sustainable Private Equity: A Case Study
Property

Almost £60 million of our pension fund is invested in UK property. Although it is only a modest part of our portfolio, property could support our wider aim to ‘green’ UK business.

Property is thought to be responsible for around 50 per cent of all UK carbon dioxide emissions. The Intergovernmental Panel on Climate Change has identified buildings as offering the most significant opportunity for cost-effective reductions in emissions worldwide\(^4\).

It is important to note that improved sustainability performance in the property sector can go hand in hand with enhanced financial performance. For example, commercial buildings with energy efficiency ratings tend to command significantly higher rents, better occupancy rates and higher prices than comparable conventional buildings.

Before choosing our property investments, we assessed the environmental best practices of UK and European property funds and carried out an environmental review of the property funds in which we planned to invest.

We have a segregated property multi-manager (which means the manager selects funds of property assets rather than direct property, this means there is greater diversity in the portfolio) with 12 UK-based property funds. These include Igloo Regeneration, a sustainability and regeneration property fund which invests in disused brown-field sites. For example Igloo has helped to expand Nottingham Science Park: the park’s landmark ‘No.1’ building’ has a biomass heating system and high energy-efficiency standards. This 12-acre regeneration project won Sustainable Development of the Year in 2008.

Another of our property funds, Hermes Real Estate Investment Management, is a mainstream fund that undertakes responsible property investment, reflected in the performance of the buildings in which it invests. In the last five years, this reduced the in costs for energy and direct landfill tax for 24 properties by more than £2 million. Carbon emissions for these properties fell by 17 per cent, and water use by around 15 per cent.

Our fund-of-funds property manager, Aviva Investors, reports quarterly on current and emerging environmental issues. Its regular sustainability survey assesses how well our property funds address environmental issues that could be financially significant. This is fundamental to our obligations to manage investments for the benefit of our fund members. The financial returns from property can be affected by factors arising from climate change, such as flooding, subsidence and drought.

Our property survey suggested potential areas of improvements to each fund. This is to help encourage best practice throughout the industry. Aviva’s last sustainability survey encouraged our underlying property funds to focus on ensuring they have:

- a sustainability resource (a dedicated member of staff or a sustainability group)
- regular reporting to investors on the fund’s environmental practices
- annual data collection and reporting of specific environmental metrics
- a real estate or fund-specific sustainability policy.

In 2009, the Global Real Estate Sustainability Benchmark was developed in collaboration with investors and the University of Maastricht. It is an important development in the management of sustainability issues in property.

To increase the effectiveness of our annual survey of property funds, we are now part of this wider project. The 2011 survey had 340 respondents, and covered 21,000 properties worth a total of $928 billion. This has replaced our own survey.

We think there is further scope for property funds to promote and adopt more energy efficiency practices. As with other types of assets, we have been keen to work with other asset owners to develop this. In the last two years we have collaborated on publications such as the IIGCC Property Reporting Guide, which complemented the Property Trustee Guide.

Read more >> Unlisted real estate funds - environmental review
How green is our property?
The global property sector is responsible for around 40 percent of global greenhouse gas emissions. The buildings owned and operated by property funds account for a substantial share of these emissions.

If we, as an institutional investor, can encourage property funds to adopt best practice in green property management we can make a meaningful contribution to lessening the effects of climate change.

That is why in 2011, through our fund manager Aviva Investors, we joined more than 300 other global institutional investors in the Global Real Estate Sustainability Benchmark (GRESB). This initiative provides an environmental benchmark for property funds. It measures 50 data points of environmental and social performance which are of financial significance to investors. Example points include the use and expenditures of energy and water or the levels of tenant engagement. The initiative gives each property fund an overall score.

The 2011 GRESB survey covered more than 340 property funds. These oversee more than 21,000 commercial buildings, with a combined floor area of about 356 million square metres. It is estimated that this represents about 35 per cent of the global property market.

In 2011, 65 respondents achieved the top ‘Green Star’ status for environmental management. These included two of the funds in which we invest: the Hermes Property Fund and the Standard Life UK Shop fund.

It was encouraging that there was a nine percent increase in the number of ‘Green Star’ performers in 2010. Individual key indicators of environmental performance also showed some positive results on a global level. For example, energy use decreased across the sector by 1.3 percent, and for the 65 ‘Green Star’ funds that decrease was almost 3 percent. There was also a 2.8 percent reduction in water use across the sector as a whole. These reductions tend to be driven by commercial property investment funds aiming to improve their bottom line by saving on energy and water costs.

>> Full report available online
Passively managed funds

Passive funds (also known as indexed or tracker funds) are an important part of our overall investment strategy. They offer highly diversified investments and low management costs.

The use of pooled and indexed products can be cost-effective. However, it does reduce the range of governance tools open to us. Although we have much less control in a passive fund, we are still able to exercise some measure of influence – primarily through voting and company engagement.

We direct the voting of all resolutions on environmental governance issues, such as climate change disclosure, for all the stocks held by our public equity managers. The majority of these resolutions are brought in the US market (pooled passive fund). In a pooled fund we do not own the underlying assets directly. However in our investment management agreements we insist that we are able to exercise our vote independently from other members of the pooled asset group.

We currently only request this for environmental resolutions. This amounts to 80 to 90 votes each year. You can read our voting record on our website under voting.

We have also been involved in collaborative projects in this area. We have worked with fellow investors to encourage our passive managers to sign the United Nations Principles for Responsible Investment (UNPRI) (see box). We have also contributed to the UNPRI publication Responsible Investment in Passive Management Strategies. This aims to provide examples of good practice in this area to other asset owners around the world.
Getting our passive managers to sign up to the UN Principles for Responsible Investment

In recent years we have encouraged all our fund managers and suppliers to become signatories to the UN Principles for Responsible Investment (UNPRI). By signing up to UNPRI, managers show that they are serious about responsible investment. It also helps them to work with their peers in order to match best practice in their area.

Legal & General is our biggest asset manager, with assets under management of (£371 billion). It manages passive investments. Our custodian is Northern Trust. Both companies rejected our initial invitations to sign up to UNPRI because they believed the principles for responsible investment only applied to active managers.

We disagreed. Clearly, some aspects of the principles do not apply, such as those relating to stock selection. But that does not mean that a passive manager cannot be a signatory. We joined together with several other UNPRI signatories to write directly to large passive investment providers to discuss the issues. We explained that we believe that the principles do apply to passive management because they encourage engagement, voting and disclosure.

In fact, when we considered what Legal & General already did for us, we argued that they were already largely implementing the principles in a way people would expect for a passive manager.

We were delighted that in 2010 both Legal & General and Northern Trust signed up to UNPRI and now play an energetic part in its international network.

This means that we have achieved our goal: all our fund managers and suppliers are co-signatories to UNPRI. We now have clear, shared ambitions to advance the case for responsible investment.

Read report >> Responsible investment in passive management strategies
Enhanced passive indexes

We are taking a closer look at the use of green or low-carbon indexes. From 2002 to 2007 we ran a pilot investment in this area, through our then manager State Street. The pilot demonstrated that if we considered the effects of ESG issues in our decisions, we could achieve the same financial results but cause less damage to the environment. This pilot project contributed to our decision to look for sustainable, green investments in both public and private equity.

We recognise that the technical criteria and standards behind some of today’s specialist ESG indexes have moved on considerably. We will therefore look again at what can be achieved by the use of such enhanced passive indices. It may be that we will come full circle and use them in our future investment strategy.

We recognise that there are limitations to the way we can account for ESG issues in investments that we passively manage. To make progress it is best to work with like-minded investors, so that we can bring about changes that will benefit our fund and the environment.

FTSE All-share Free Float Collaborative engagement

We are part of a group of UK institutional investors who are calling for an increase in the minimum free float requirements of the companies listed in the FTSE UK indices. These are the primary domestic indices for UK investors.

Free float is the proportion of shares of a company that are available to investors to buy. Shares held by directors, for example, would be not be considered part of the free float. The proportion of shares held by ordinary shareholders is important for the effective governance and oversight of a company. If there is insufficient free float, shareholders can be outvoted by management on, for example, a remuneration report, or the election of a director or the Chairman.

Following a consultation in November 2011, the FTSE raised the minimum free float threshold to 25 per cent. Our group of investors is continuing a dialogue with FTSE, as we believe a high threshold of 50 per cent would secure protection for minority shareholders.
Fixed income

Our fixed-income portfolio is made up of investments in corporate bonds and index-linked gilts (such as UK government bonds). Fixed income is an important part of our investment strategy, especially in a time of volatile markets. Almost a quarter of our portfolio is invested in this asset class.

It is fair to say that investors in fixed income are far less used to considering responsible investment issues. For example, the governance arrangements or voting rights for this asset class are not as well-established as they are in the case of public equities.

However our fixed-income managers can take some steps on ESG issues. We encourage them to:

- monitor the environmental risks for their investments
- report on the ESG ratings of their bonds, where such information is available from their external ESG ratings provider
- use ‘best in class’ principles in their investment decisions.

Our segregated corporate bond manager is Royal London Asset Management (RLAM). Together we analyse the environmental performance of the companies which issue our bonds. Our manager uses specialist researchers EIRIS to analyse and assess the effectiveness of each company’s environmental management systems and other ‘green’ parameters. The chart below reflects more than two thirds of the bond issuers in our portfolio. It demonstrates that a high proportion (around 60 per cent) of these bond issuers perform strongly in reducing their environmental impact.

Figure 13: Environmental impact of bond issuers
For the last two years we have measured the environmental footprint of our UK corporate bond mandate in our annual footprinting exercise. Our manager reported that the environmental footprint for our actively managed bonds was 7.2 per cent less than the benchmark (MSCI World Developed Countries Index). The carbon footprint was 6.7 per cent less than the benchmark. 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.
We aim to give more weight to responsible investment within our fixed income strategy. We are currently working with our main fixed-interest manager, RLAM, to evaluate the environmental profiles of our bond holdings. This allows us to identify any particular areas of risk.

When we reviewed our investment strategy, we considered how we could take more account of responsible investment. As well as retaining our current corporate bond manager, we decided the best option was to allocate funds to a flexible, fixed-income ‘opportunities’ portfolio. This will enable us to invest in environmentally positive bond and fixed-interest funds as the opportunities arise – for example in funds investing in ‘green’ bonds that support environmental projects.
Next steps

We have reviewed our Active Pension Fund’s long-term asset allocation and investment strategy. As always, financial considerations are paramount, but we continue to implement our fiduciary duty to take account of financially material environmental risks and opportunities that could affect the fund’s current and future investment returns. We have also taken the opportunity to revisit and update the Active Fund’s asset allocation, corporate governance (now our responsible investment strategy) and environmental overlay.

The Environment Agency’s Pension Committee has decided to adopt a more flexible approach to the Active Fund future investment strategy and asset allocation so it can be revised responsibly and robustly in response to both the changing global economic environment and impacts of climate change.

Adjusting our asset allocation

The Active Fund has maintained a healthy funding position at it each of its triennial valuations over the last decade.

<table>
<thead>
<tr>
<th>Data as at 31 March</th>
<th>2001</th>
<th>2004</th>
<th>2007</th>
<th>2010</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of assets £m</td>
<td>937</td>
<td>983</td>
<td>1521</td>
<td>1589</td>
<td>Increasing</td>
</tr>
<tr>
<td>Value of liabilities £m</td>
<td>840</td>
<td>1050</td>
<td>1455</td>
<td>1684</td>
<td>Increasing</td>
</tr>
<tr>
<td>Funding level (%)</td>
<td>112</td>
<td>94</td>
<td>103</td>
<td>94</td>
<td>Average 100</td>
</tr>
</tbody>
</table>

As the fund’s membership has grown and the fund’s liabilities have matured, in line with best practice in pension fund management, the fund’s investments have been progressively de-risked and diversified by reducing the fund’s allocation to public equities, making higher allocations to bonds and gilts, with small allocations to property and private equity.

<table>
<thead>
<tr>
<th>Data as at 31 March</th>
<th>2001</th>
<th>2004</th>
<th>2007</th>
<th>2010</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equities</td>
<td>86</td>
<td>71</td>
<td>67</td>
<td>58</td>
<td>Decrease</td>
</tr>
<tr>
<td>Bonds</td>
<td>8</td>
<td>15</td>
<td>9</td>
<td>12</td>
<td>Increase</td>
</tr>
<tr>
<td>Gilts</td>
<td>2</td>
<td>7</td>
<td>14</td>
<td>15</td>
<td>Increase</td>
</tr>
<tr>
<td>Property</td>
<td>0</td>
<td>0</td>
<td>5</td>
<td>3</td>
<td>Increase</td>
</tr>
<tr>
<td>Private equity</td>
<td>0</td>
<td>0</td>
<td>2</td>
<td>5</td>
<td>Increase</td>
</tr>
<tr>
<td>Cash</td>
<td>4</td>
<td>7</td>
<td>3</td>
<td>7</td>
<td>Reduce</td>
</tr>
<tr>
<td>Total %</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

The next phase of ‘greening’ the Active Fund investment strategy will involve reducing risks that could significantly affect our financial position, for example taking on board the recommendations from the Mercer Climate Change SAA study (page 20). We plan to move away from investments which climate change could make increasingly financially unattractive. However, we will look to exploit investment opportunities which adapt to and reduce climate change, and to seek out investments that will boost our financial returns.
Over the next 2 years we plan to reduce public equities (63% to 50%) but within this allocation increase actively managed emerging equities from 4.5% to 10%), to reduce index linked gilts (13.5% to 5%), maintain private equity (5%), increase corporate bonds (13.5% to 28%), and increase alternative “real asset” investments (5% to 12%) via sustainable property (5%), and infra-structure (3.5%), and farmland/forestry (3.5%).

The reduction of equity risk, a continued focus on ESG analysis and sustainably themed equities, and diversification of the fund’s investments into new asset classes (infrastructure, timberland and farmland) are viewed positively in respect of reducing climate change risks to the Active Fund.

The asset allocation change will also assist us in moving towards our target that by 2015 some 25% of the fund will be invested in the ‘green’ economy an increase of 12-13% at the current level.

We regard this move as the next step in our financially and environmentally responsible investment strategy. We have decided to reduce our exposure to public equity risk, seek more fixed income, and make strategic long term investments to ‘climate friendly’ sustainable “real assets”.

We already invest in property and we now intend to look at investing globally in infra-structure, sustainably managed farmland and/or sustainably managed forestry. We want these investments to give us capital growth and be a hedge against inflation and climate change. We are looking for financial returns of >+5% real pa from these assets.

We do not intend to invest in ‘greenfield’ property developments, intensive agri-developments, tropical hardwood deforestation, or environmentally unsustainable infrastructure, all of which could accelerate climate change. If we cannot find suitable investments which meet our sustainability criteria as well as our financial criteria we will not invest.

We will continue to be a financially and environmentally responsible investor, and our current policies will apply to the new asset classes (and they will be strengthened as appropriate), with an emphasis on long term investment and stewardship.

In the area of property investment, we are particularly interested in investing in energy efficient low carbon buildings. With respect to farmland, we are interested in investing in sustainable farming ventures that demonstrate good environmental stewardship of land, soil and water resources. For timberland, we are interested in investing in sustainable forestry that encourages greater biodiversity and provides environmental services. On infrastructure this may include a range of renewable energy and public transport systems.

These new allocations will most likely be invested via managed funds or possibly in collaborative ventures with other like minded pension funds. As our fund’s liabilities stretch out well into next century we are a long term investor and so diversifying our investments makes sense in financial risk-reward terms, and in respect of adaptation to, and mitigation of, future climate change.

The Active Fund’s new investment strategy framework is designed to improve the fund’s returns and risk diversification by a more flexible approach to asset allocation.
In order to manage financial risk the following ranges are designed to limit asset allocations. In addition, a likely future "direction" of strategy is indicated from this asset allocation for the next 1-2 years – though this will be subject to annual review.

<table>
<thead>
<tr>
<th></th>
<th>Current</th>
<th>New minimum</th>
<th>New maximum</th>
<th>Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Equities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Emerging Markets</td>
<td>63.0</td>
<td>50%</td>
<td>63%</td>
<td>Decrease</td>
</tr>
<tr>
<td>Private Equity</td>
<td>5.0</td>
<td>5%</td>
<td>12%</td>
<td>Increase</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4%</td>
<td>6%</td>
<td>Maintain</td>
</tr>
<tr>
<td><strong>Real Assets:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property</td>
<td>5.0</td>
<td>3%</td>
<td>6%</td>
<td>Maintain</td>
</tr>
<tr>
<td>Timberland/farmland</td>
<td></td>
<td>0%</td>
<td>4%</td>
<td>Increase</td>
</tr>
<tr>
<td>Infrastructure</td>
<td></td>
<td>0%</td>
<td>4%</td>
<td>Increase</td>
</tr>
<tr>
<td><strong>Total Growth Assets</strong></td>
<td>73%</td>
<td>65%</td>
<td>75%</td>
<td>Increase</td>
</tr>
<tr>
<td><strong>Corporate Bonds</strong></td>
<td>13.5</td>
<td>13%</td>
<td>28%</td>
<td></td>
</tr>
<tr>
<td><strong>Index Linked gilts</strong></td>
<td>13.5</td>
<td>5%</td>
<td>20%</td>
<td>Decrease</td>
</tr>
<tr>
<td><strong>Cash</strong></td>
<td></td>
<td>0%</td>
<td>3%</td>
<td>Maintain</td>
</tr>
<tr>
<td><strong>Total Defensive Assets</strong></td>
<td>27%</td>
<td>25%</td>
<td>35%</td>
<td></td>
</tr>
<tr>
<td>Asset class</td>
<td>Current Strategy (%)</td>
<td>Current Allocation £m</td>
<td>Target 2013 (%)</td>
<td>Target 2013 £m</td>
</tr>
<tr>
<td>-----------------------------</td>
<td>----------------------</td>
<td>-----------------------</td>
<td>-----------------</td>
<td>----------------</td>
</tr>
<tr>
<td>Global Equities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Emerging Markets</td>
<td>63</td>
<td>1157</td>
<td>58</td>
<td>1075</td>
</tr>
<tr>
<td>Private Equity</td>
<td>5</td>
<td>89</td>
<td>5</td>
<td>93</td>
</tr>
<tr>
<td>Real Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property</td>
<td>5</td>
<td>60</td>
<td>9</td>
<td>167</td>
</tr>
<tr>
<td>Timberland &amp; Agriculture</td>
<td>-</td>
<td>60</td>
<td>5</td>
<td>93</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>-</td>
<td>60</td>
<td>5</td>
<td>93</td>
</tr>
<tr>
<td>Total Growth Assets</td>
<td>73</td>
<td>1306</td>
<td>72</td>
<td>1335</td>
</tr>
<tr>
<td>Corporate Bonds</td>
<td>13.5</td>
<td>263</td>
<td>20</td>
<td>371</td>
</tr>
<tr>
<td>Index-linked Gilts</td>
<td>13.5</td>
<td>253</td>
<td>8</td>
<td>148</td>
</tr>
<tr>
<td>Cash</td>
<td>-</td>
<td>32</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total Defensive Assets</td>
<td>27</td>
<td>548</td>
<td>28</td>
<td>519</td>
</tr>
</tbody>
</table>

**Monitoring our progress and updating the strategy**

We intend to improve and develop the measurement of our fund’s risk exposure, our financial performance, and our consideration of ESG issues. We will do this by:

- looking at how we select and monitor our fund managers
- the use of traditional financial and ESG benchmarks
- extending and developing our fund’s green performance benchmarking and environmental footprinting.

We will seek to increase our use of engagement to improve corporate environmental performance. We also aim to collaborate more with peers – both on engagements and in areas such as joint research on the big ESG issues. We can feed the research results into how we develop and update our strategy going forward.
## UNPRI Index

<table>
<thead>
<tr>
<th>Examples of best practice</th>
<th>Where you’ll find illustrations in this report</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>P1</strong> Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes</td>
<td></td>
</tr>
<tr>
<td>Address ESG issues in investment policy statements</td>
<td>Page 13 and throughout the report</td>
</tr>
<tr>
<td>Support the development of tools and metrics for benchmarking the integration of Responsible Investment/ESG issues</td>
<td>Pages 16,20, 28-33, 39</td>
</tr>
<tr>
<td>Assess the capabilities of external investment managers to incorporate ESG issues</td>
<td>Page 22, 30, 42, 48</td>
</tr>
<tr>
<td>Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or rating companies) to integrate ESG factors into evolving research and analysis</td>
<td>Page 22</td>
</tr>
<tr>
<td>Advocate ESG training for investment professionals</td>
<td>Page 24</td>
</tr>
<tr>
<td><strong>P2</strong> Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices</td>
<td></td>
</tr>
<tr>
<td>Develop and disclose an active ownership policy consistent with the Principles</td>
<td>Pages 39, 45</td>
</tr>
<tr>
<td>Exercise voting rights consistent with long-term ESG considerations and monitor compliance of outsourced voting service providers</td>
<td>Pages 25-27</td>
</tr>
<tr>
<td>Engage with companies on ESG issues</td>
<td>Pages 28,32-38</td>
</tr>
<tr>
<td>Participate in collaborative engagement initiatives</td>
<td>Pages 35-36,42</td>
</tr>
<tr>
<td>Ask investment managers to undertake and report on ESG-related engagement</td>
<td>Page 32-38</td>
</tr>
<tr>
<td><strong>P3</strong> Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest</td>
<td></td>
</tr>
<tr>
<td>Ask for ESG issues to be integrated within annual financial reports</td>
<td>Page 35-36, 42</td>
</tr>
<tr>
<td>Ask for information from companies regarding ESG information – where possible using standardised reporting on tools (such as the Global Reporting Initiative)</td>
<td>Page 35-36</td>
</tr>
<tr>
<td>Support shareholder initiatives and resolutions promoting ESG disclosure</td>
<td>Page 27</td>
</tr>
<tr>
<td>Disclose annual voting records, with an analysis of key votes</td>
<td>Page 25-27 (includes link on-line reporting)</td>
</tr>
</tbody>
</table>
### Principle 4: We will promote acceptance and implementation of the Principles within the investment industry

<table>
<thead>
<tr>
<th>Action</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Include Principles-related requirements in requests for proposals. Also align investment mandates, monitoring procedures, performance indicators and incentive structures.</td>
<td>13, 22</td>
</tr>
<tr>
<td>Revisit relationships with service providers when RI/ESG capabilities are inadequate.</td>
<td>22-24</td>
</tr>
<tr>
<td>Engage in dialogue, or lobby, on government policy or industry regulations related to RI/ESG issues.</td>
<td>30, 45</td>
</tr>
<tr>
<td>Communicate ESG expectations to investment service providers.</td>
<td>22-24</td>
</tr>
</tbody>
</table>

### Principle 5: We will work together to enhance our effectiveness in implementing the Principles

<table>
<thead>
<tr>
<th>Action</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning.</td>
<td>12-13, 20, 44, 45-47</td>
</tr>
<tr>
<td>Collectively address relevant emerging issues.</td>
<td>32-38, 48</td>
</tr>
<tr>
<td>Develop or support appropriate collaborative initiatives.</td>
<td>35-36, 42-44</td>
</tr>
</tbody>
</table>

### Principle 6: We will each report on our activities and progress towards implementing the Principles

<table>
<thead>
<tr>
<th>Action</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disclose what is required from service providers in relation to the Principles.</td>
<td>13, 30, 42, 45</td>
</tr>
<tr>
<td>Disclose active ownership activities (voting, engagement, and/or policy dialogue).</td>
<td>25-27 (includes link on-line reporting)</td>
</tr>
<tr>
<td>Communicate with beneficiaries about ESG issues and the Principles.</td>
<td>The purpose of this review</td>
</tr>
<tr>
<td>Report on progress and/or achievements relating to the Principles.</td>
<td>The purpose of this review</td>
</tr>
<tr>
<td>Make use of reporting to raise awareness among a broader group of stakeholders.</td>
<td>Throughout this review</td>
</tr>
</tbody>
</table>
Our awards

We were delighted that our work in integrating financially material environmental issues has been externally recognised during the last few years. Since the adoption of our new investment strategy in 2006, we have received 23 awards and citations. A full list is regularly published on our website. Our most recent awards and commendations are summarised below.

2011

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.”

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.

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.

2010

November 2010 - LGC Finance Awards 2010
Corporate Governance Award - Winner
This was the third time we had won this award (previously won in 2007 and 2005). The judges felt that we continued to set new standards in governance and were particularly impressed by our support for best practice in corporate environmental governance and for our place at the forefront of
ethical investment. The LGC Finance Awards are devoted to acknowledging and rewarding exceptional achievement in local authority pensions and investment recognising accomplishments across different markets and for the quality of their funds, service and corporate governance.

December 2010 – Funds Europe Awards 2010

European Public Sector Investor of the Year – Highly commended

This was the first time we had entered these awards and only two submissions were shortlisted. The judges felt that our approach was “remarkably professional” and we were highly commended. The judges particularly commented on the reduction we have achieved in the environmental footprint of our active equity portfolio. The award was won by Strathclyde LGPS fund.

2009

November 2009 – Investment & Pensions Europe - Environmental Social Governance (ESG) Leaders Awards 2009 – Best investor in ESG award - Winner

Our pension fund has won this EU wide award for the third year in a row for our approach to financially and environmentally responsible investment - We were named the best investor in ESG.

The judges said “The Environment Agency has long stood out as running a pension scheme that adheres to a strictly ESG-based investment strategy – rather than pay mere lip service to its principles. This is an investor that ensures ESG and SRI criteria govern every aspect of its operations and it continues to demand its investment managers engage actively on its behalf so that these principles extend way beyond its own territory. The Environment Agency has always been at the forefront of ethical pension scheme investing, and its work during 2009 will ensure it remains at the top for some time to come.”

July 2009 – Engaged Investor Trustee Awards 2009

Best Scheme Governance (Public Sector) – Highly commended

The EAPF was "highly commended" in this category which we have won in the two previous years. This award is open to all public sector funds and this year Strathclyde Pension Fund, which also has a well developed SRI policy was the winner. Engaged Investor said “It was difficult to choose between these two schemes – the EA scheme operates at a very high standard.”

Disclaimer

Please note that individual stocks and securities referenced in this document are used to illustrate responsible investment processes and procedures and should not be used as a basis for investment decisions.
Would you like to find out more about us, or about your environment?

Then call us on

03708 506 506 (Mon-Fri 8-6)

Calls to 03 numbers cost the same as calls to standard geographic numbers (i.e. numbers beginning with 01 or 02).

email

enquiries@environment-agency.gov.uk

or visit our website

www.environment-agency.gov.uk

incident hotline 0800 80 70 60 (24hrs)
floodline 0845 988 1188