POLICY BRIEFING | January 2017

Institutions for Occupational Retirement (IORPs) Directive – Significant Progress on Responsible Investment

An agreement has been reached on revising the EU Institutions for Occupational Retirement Directive that includes important Responsible Investment measures on environmental, social and governance factors.

The European institutions have reached an agreement on revising the IORPs Directive and the new text entered the official EU journal on 23rd December 2016. Member states now have 24 months to transpose the Directive into their national legislation. The new Directive requires occupational pension funds across Europe to take environmental, social and governance (ESG) factors into account in their investment processes and be more transparent about how they do so. This is the first time that ESG requirements for investors have been mandated in an EU Directive

Background

The European Commission released a proposal to revise the Directive in March 2014, citing the need for stronger governance requirements as a key reason for reform, particularly as more and more savers now have defined contribution pensions which means they bear investment risks themselves. The Commission proposal said that IORPs should evaluate risks relating to 'climate change, use of resources and the environment'. This requirement was deleted in the initial responses from the European Parliament and Council. ShareAction, along with numerous civil society allies, is proud to have played a crucial role in convincing policymakers to change their minds.

The June 2016 compromise text goes even further than the Commission's original draft on Responsible Investment; ESG factors are mentioned, not just environmental ones. The fact these institutions changed their minds is a hugely encouraging signal that policymakers are starting to recognise the importance of Responsible Investment issues for savers, the economy and the environment.

ShareAction coordinated a letter from 11 civil society organisations to relevant MEPs last year,[2] and another letter from 13 organisations went to representatives from each member state participating in the Council in February this year.[3] Our case was boosted by a backdrop of increasing evidence that ESG factors can be financially material and ambitious global deals on the Sustainable Development Goals (SDGs) and the Paris Climate agreement. Institutional Investors, including pension funds, have a key role to play in delivering these agreements as significant sums of investment in areas like energy efficiency and low carbon technologies are needed.

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Scope of the Directive

All occupational pension funds with more than 100 members are subject to the relevant clauses of the Directive, although member states may choose to apply the Directive to smaller schemes. According to the Directive itself, IORPs in the EU hold assets worth over €2.5 trillion[4] on behalf of 75 million Europeans,[5] if the UK is included.

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Content

The specific measures on Responsible Investment in the Directive are:

Article 19 – Investment rules

This specifies that IORPs must invest in accordance with the Prudent Person Rule, which is comparable to the concept of fiduciary duty in UK law. This Article clarifies that this principle means acting in the best long-term interests of their members and does not prohibit funds from considering the impact of their investments on ESG factors.

Article 21 - General governance requirements

IORPs must have an effective, transparent system of governance as appropriate to their nature, scale and complexity. This system must include a consideration of ESG factors related to investment assets in investment decisions.

Article 25 – Risk Management

IORPs must establish a risk management system which covers various risks, including ESG risks, relating to the investment portfolio and the management thereof. The system must include procedures to identify, monitor, manage and report risks proportionate to the nature, scale and complexity of the IORP.

Article 28 – Own risk assessment

IORPs must conduct a risk assessment at least every 3 years, or following any significant change to the risk profile. Where ESG factors are considered, the assessment must cover risks relating to climate change, use of resources and the environment, social risks and stranded asset risks. Member states can also apply this requirement in a manner they judge as proportionate to the size, nature, scale and complexity of the IORP.

Article 29 – Annual accounts and annual reports

IORPs must prepare and publicly disclose annual accounts and reports detailing their assets, liabilities and financial position and include disclosure of significant investment holdings.

Article 30 – Statement of investment policy principles

This statement must be made public, must be reviewed every three years and must include how the investment policy takes ESG factors into account.

Article 40 - Information to be given to prospective members

Prospective members, who are not automatically enrolled, in a pension scheme must be provided information on whether and how ESG factors are considered in the investment approach.

Recitals 57 & 58

These non-binding, introductory statements to the text explain the importance of IORPs improving their risk management and include risks relating to ESG factors, stranded assets, resource use and climate change. The text guides IORPs towards the UN backed PRI’s definition of ESG factors. The recitals also say that IORPs could satisfy the ESG related requirements by declaring that they do not consider ESG in their investment processes or judge the costs of monitoring to be disproportionate to the nature and complexity of their activities.

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About ShareAction

ShareAction (Fairshare Educational Foundation) is a registered charity that promotes Responsible Investment practices by pension providers and fund managers. ShareAction believes that Responsible Investment helps to safeguard investments as well as securing environmental and social benefits.

shareaction.org
info@shareaction.org
+44 (0)20 7403 7800

16 Crucifix Lane
London, United Kingdom
SE1 3JW

Contact

Rachel Haworth
Policy Officer
ShareAction
rachel.haworth@shareaction.org
+44 (0)20 7183 2351

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