

24 November 2015

Re: Improving transparency and management of environmental, social and governance risks in the revision to the Institutions for Occupational Retirement Provision Directive (IORPs)

Dear MEP,

We the undersigned are writing in relation to the proposed revisions to the IORPs Directive (2014/0091 (COD)). We are concerned that the revised Directive will fail to address some of the key reasons given by the Commission for its review, namely:

- *'higher governance standards reflecting best practices at national level following the economic and financial crisis are needed to protect scheme members and beneficiaries'*¹
- *'to strengthen the capacity of IORPs to invest in assets with a long term economic profile and support the financing of sustainable growth in the real economy'*²

IORPs in the EU hold assets worth €2.5 trillion on behalf of 75 million Europeans³. As such their good governance and risk management is extremely important for the health of the EU economy and for the financial security in retirement of millions of citizens, particularly the increasing numbers with unguaranteed, 'defined contribution' pensions who bear investment risks themselves. Recent events in the EU automotive sector, for example, have highlighted the exposure of EU citizens individual pension savings invested in quoted companies to real financial loss, where there is insufficient disclosure of environmental and governance risks.

It is disappointing that the draft text from the ECON committee removed the Commission's proposal that IORP's 'risk evaluation should include new or emerging risks, such as risks related to climate change, resource use or the environment'(Article 29). We are calling on the European Parliament to vote for a strengthened text, mandating consideration of not only environmental but also social and governance factors by IORPs and better transparency of their investment policies and practices. The European Parliament has an opportunity to take a leadership role in seeking to protect pensioners financial futures through promoting a culture of responsible investment.

There is growing recognition from investors and policymakers worldwide that environmental social and governance (ESG) factors can be financially material, particularly for long-term investors like pension funds, so failure to properly consider them puts beneficiaries' money at risk. For example, investors with assets under management of \$59 trillion are now signatories to the UN-led Principles for Responsible Investment (PRI)⁴ and, therefore, committed considering ESG issues in their investment decisions and engagements with investee companies.

¹ European Commission, 'Proposal for a Directive on the activities and supervision of institutions for occupational retirement provision, 2014/0091 (COD)', paragraph 1

² Ibid., paragraph 1

³ Hayes, B., 'Working Document on the proposal for the Directive of the European Parliament and of the Council on the activities and supervision of institutions for occupational retirement provision (recast)', Committee on Economic and Monetary Affairs, European Parliament'

⁴ <http://www.unpri.org/news/pri-fact-sheet/>

To take the example of environmental risk, it is predicted that global warming of 6 °C could lead to losses of \$13.8 trillion against the world's current \$143 trillion stock of manageable assets; more than the entire market capitalisation of the London Stock Exchange.⁵ Furthermore, agreement by policymakers to limit global warming to the levels widely agreed as safe by scientists would require 80% of known fossil fuel reserves to remain in the ground and become 'stranded assets'.⁶ The stranded assets problem is highlighted as an urgent risk area by the World Bank⁷ and the Bank of England⁸, and the Financial Stability Board has also just recommend to the G20 the creation of a disclosure task force on climate related risk.⁹ As fossil fuel reserves are an estimated 5% of total EU pension fund assets this is a serious risk for IORPs and their members and beneficiaries.¹⁰

'Social' factors include workforce productivity, human and labour rights, land grabbing and impacts on communities. 'Governance' issues include corruption, tax evasion and avoidance, executive remuneration and board competence and independence. Institutional investors' attention to ESG issues at investee companies is thus extremely important for our economy, communities and environment as well as investment returns.

Although investors' recognition of this and integration into their investment processes¹¹ is improving, research into the largest IORPs in the UK¹² and Netherlands¹³ found that many are failing to properly take these factors into account. There is good reason to believe that the situation is worse amongst smaller funds who 'find it more difficult to fully consider ESG issues due to lack of time, resources and in some cases understanding' according to one study.¹⁴

Furthermore, there is confusion amongst IORPs as to whether the 'prudent person principle', encompassing the 'duty to invest in beneficiaries' best interests', (Article 20.1 in this text) permits them to consider ESG factors. Several studies by the PRI¹⁵, and the UK's Law Commission¹⁶ have found that investors and their legal advisors often interpret these duties, called fiduciary duties in some jurisdictions, as a duty to maximise short-term financial returns and exclude consideration of long-term and ESG factors. As such MEPs must use the opportunity presented by the revision of this Directive to clarify the law in this regard.

⁵ Economist Intelligence Unit, 'The cost of inaction: Recognising the value at risk from climate change', 2015, <http://www.economistinsights.com/sites/default/files/The%20cost%20of%20inaction.pdf>

⁶ Carbon Tracker Initiative, <http://www.carbontracker.org/wp-content/uploads/2014/05/New-Brochure-4-CTI-web.pdf>

⁷ Speech by World Bank Group President Jim Yong Kim Press Conference at the World Economic Forum Davos, Switzerland, 23/01/2014, <http://www.worldbank.org/en/news/speech/2014/01/23/world-bank-group-president-jim-yong-kim-remarks-at-davos-press-conference>

⁸ Letter from Bank of England Governor to Chair of Environmental Audit Committee of UK Parliament, 30/10/2014, <http://www.parliament.uk/documents/commons-committees/environmental-audit/Letter-from-Mark-Carney-on-Stranded-Assets.pdf>

⁹ <http://www.financialstabilityboard.org/2015/11/fsb-proposes-creation-of-disclosure-task-force-on-climate-related-risks-2/> 10/11/2015

¹⁰ Weyzig et al., 'The Price of Doing Too Little Too Late: The impact of the carbon bubble on the EU financial system', A report prepared for the Greens/EFA Group of the European Parliament, 2014

¹¹ Eurosif, European SRI Study 2014, 2014, <http://www.eurosif.org/wp-content/uploads/2014/09/Eurosif-SRI-Study-20142.pdf>

¹² Livesey, B., and Toy, L., 'Entrusted with our Future: A Survey of the Responsible Investment Performance of UK Pension Funds', ShareAction, 2014

¹³ Duiker, J., Fijt, E., de Kruif, D., 'Benchmark RI by Pension Funds in the Netherlands 2014', VBDO, 2014, <http://www.vbdo.nl/files/report/VBDOBenchmarkResponsibleInvestment2014.pdf>

¹⁴ UK Sustainable Investment and Finance Association, 'Attitudes to Ownership 2014', 2014

¹⁵ The most recent being Principles for Responsible Investment, 'Responsible Investment and Fiduciary duty', 2015, <http://www.unpri.org/wp-content/uploads/3.Responsibleinvestmentandfiduciaryduty.pdf>

¹⁶ Law Commission, 'Fiduciary Duties of Investment Intermediaries', 2014, http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc350_fiduciary_duties.pdf

We urge you to vote in favour of the following amendments, or compromise amendments which reflect the content thereof:

- **Amendment 399 or 400** to Recital 41 on risk assessment, (where the Commission's requirement to include risks relating to 'climate change, resource use and the environment' has been deleted) which specify that environmental, social and governance risks should be included in the risk assessment.
- **Amendment 527, 528 or 530** – amending Article 20 on the Investment Rules to make it clear that investing in members' 'best interests' and the Prudent Person Principle are compatible with considering ESG issues and long-term consequences of investment decisions.
- **Amendment 548** – which amends Article 22 on the general governance requirements to require inclusion of ESG factors in investment decisions and involvement of relevant stakeholders
- **Amendment 589, 590 or 591** – amending Article 26 on the risk management system and function to include environmental, or environmental, social and governance factors in the list of risks to be assessed
- **Amendment 602 and 603**– to Article 29 on the risk evaluation for pensions reinserting the Commission's requirement for this to include consideration of risks relating to the environment, resource use and climate change, and strengthen this to include social, governance and stranded asset risks.
- **Amendment 614** – to Article 31 on the annual accounts and annual report, requiring these to be made public
- **Amendment 616 or 617** – to Article 32 on the statement of investment policy principles (SIPP) requiring this to contain more detail and be made public. SIPPs should be important tools used by occupational pension funds to closely think about their investment strategy and investment process, but quality of these documents is often poor.

Yours sincerely,



2 Degrees Investing



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