



# Eurosif's Response to the EC Pension Reform Green Paper

## -Towards Adequate, Sustainable and Safe Pension Systems-

Submitted on 15 November, 2010

**More info about the consultation process:**

<http://ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=839&furtherNews=yes>

### 1. Introduction

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The long term integration of environmental, social and governance (ESG) issues by pension funds into investment practices across asset classes as well as investment practices' transparency are key topics to ensure the overall success and stability of pension systems. The safety and sustainability of pension systems is a key topic that needs to be addressed successfully in order to exit the financial crisis and in the longer term, ensure a healthy balance of pension adequacy and public finances.

**Eurosif** (the European Sustainable Investment Forum) is a pan-European network and think-tank of national Sustainable Investment Forums whose mission is to **Develop Sustainability through European Financial Markets**.<sup>1</sup> Current member affiliates of Eurosif include institutional investors, financial service providers, academic institutes, research associations and NGO's. The association is a not-for-profit entity that represents assets totaling over €1 trillion through its 85 affiliate members.

Eurosif welcomes the integrated approach of the Green Paper on Pension Reform across economic, social and financial market policies in that it tackles the synergies between pensions and the overall Europe 2020 strategy for smart, sustainable and inclusive growth. In this context, **Eurosif wishes to especially address the role that the financial sector and related regulation has in increasing the sustainability and safety of pension systems across Europe.**

Pension funds serve an important function in funding the European economy, as well as in the functioning of the EU financial markets. In consequence, they play a key role in supporting employment growth, sustainability and social cohesion within the European Union. How pension funds address both short- and long-term considerations (including **financial and extra-financial objectives such as environmental, social and governance (ESG) issues**) - can boost or inhibit the sustainability and transparency of pension systems overall.

While finding the questions discussed in the Green Paper extremely relevant as potential tools for improving the European pension system architecture, Eurosif wishes to address topics from the Green Paper in which it has the most expertise and background.

In its Response, Eurosif makes several policy recommendations that might help the European Commission to strengthen the pension reform in the years ahead.

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<sup>1</sup> Please see Appendix for information on Eurosif and its activities.



## 2. Specific Comments on the Green Paper

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### ***2.1 In which way should the Institutions for Occupational Retirement Provision (IORP) Directive be amended to improve the conditions for cross-border activity? (Question 5 in the online questionnaire)***

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Following the Occupational Pensions Committee (OPC) Report<sup>2</sup> issued in 2008 and the Commission Report on the Implementation of the IORP Directive<sup>3</sup>, **Eurosif believes that a review of the Directive is needed especially on the following aspects set out in the Directive: investment rules, custodianship and cross-border activity.** As clearly stated in this Green Paper, the pension market needs to be strengthened, and to this end the IORP Directive plays the central part. Furthermore, Eurosif agrees that there needs to be a clear understanding and supervision of investment decisions, remuneration, incentive structures for service providers.

Although Article 18(1) in the IORP Directive set out a series of investment rules, aimed at investing according to the 'prudent person' rule, Eurosif believes that attention must be given as well to qualitative rules with longer-term impact. We have seen what short-termism and excessive-risk taking can create during the current financial crisis, and for this reason all financial institutions must keep a vigilant eye on the long-term impact of their actions.

The 2008 Occupational Pensions Committee Report found that *"the article 18(1) of the IORP Directive has had an impact on the regulatory framework in many Member States and that, although quantitative investment limits still play an important role, more attention is being paid now to quantitative aspects of the investment rules."* Eurosif finds that this is a strong call for the IORP Directive to be clearer on the following areas:

#### ***1. Sustainable and Responsible Investment (SRI) Policies of Pension Funds (related articles in the IORP Directive: Article 12, Article 18(1)).***

Eurosif strongly believes that the IORP Directive needs to have clearer provisions in regards to Sustainable and Responsible Investment (SRI) and should make it compulsory for pension funds to have an SRI policy and proper disclosure around it. A policy on SRI needs to show how a respective pension fund integrates environmental, social and governance (ESG) issues into their investment practices. Furthermore, such SRI policy should state how pension funds- and their investment managers- use the ESG-related information disclosed by their investee companies in the investment decision-making process.

#### ***2. Transparency of Pension Funds and Information given to the members and beneficiaries ( Article 11 of the IORP Directive).***

Eurosif believes that the members and beneficiaries of pension schemes should know how pension funds engage with environmental, social and corporate governance (ESG) issues. To this end, Eurosif wishes to give ***the example currently employed in Sweden***, by which workers are being sent annual statements

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<sup>2</sup> [http://www.gcactuaries.org/documents/ceiops\\_ReportIORPdirective\\_march08.pdf](http://www.gcactuaries.org/documents/ceiops_ReportIORPdirective_march08.pdf)

<sup>3</sup> [http://ec.europa.eu/internal\\_market/pensions/docs/legislation/iorp\\_report\\_en.pdf](http://ec.europa.eu/internal_market/pensions/docs/legislation/iorp_report_en.pdf)



(in orange envelopes) showing them what they have put into their pensions and what they could receive at retirement.<sup>4</sup> The advocates of this strategy argue that this tool has a psychological effect of encouraging people to work longer in order to obtain larger benefits, so therefore Eurosif encourages the Commission to explore the possibility of implementing such good case practice all across Europe. **Such example could be applied in relation to sustainable and responsible investment practices** of pension funds in the sense that pensioners could for example, receive annually a brief report on how pension funds engage with ESG issues, thus leading to greater transparency (such reports could also be received electronically in order to reduce the negative impact on CO<sub>2</sub> emissions).

## **2.2 Does current EU legislation need reviewing to ensure consistent regulation and supervision of funded (i.e. backed by a fund of assets) pension schemes and products? If so, which elements? (Question 8 in the online questionnaire)**

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In the attempt to make regulation and supervision more consistent, the inclusion of long-term elements is critical in order to ensure the sustainability of pension funds' practices. Currently, the paragraph (24) in the IORP Directive states that:

*"The investment policy of an institution is a decisive factor for both security and affordability of occupational pensions. **The institutions should therefore draw up and, at least every three years, review a statement of investment principles.** It should be made available to the competent authorities and on request also to members and beneficiaries of each pension scheme."*

As stated in some of our public policy papers, **Eurosif strongly recommends that the EC introduce a mandatory EU-wide/ National Statement of Investment Principles (SIPs)**, which would serve as a relevant tool to improve the transparency of pension funds and more broadly, to ensure a better supervision by fund members and regulators.<sup>5</sup> To build on what is currently contained in the IORP Directive, Eurosif considers that the above provision should be reviewed in order to also refer to the principles applied to such SIPs. Thus, Eurosif believes that **pension fund SIPs should also state how ESG considerations are integrated into investment practices as well as in the overall governance of pension funds.**

The implementation of a European-wide regulation on how pension funds deal with SRI related issues is even more important as some of the EU countries have already started to make significant steps in the implementation of such regulation (either soft or hard regulation): the UK pension disclosure regulation or the implementation of the recent Stewardship Code for institutional investors, or similar regulation in Germany (the mandatory statements of SEE principles for private pension funds), Netherlands (whereby Dutch insurance companies created Code of Conduct including social responsibility) or France (the Financial Security Law setting out transparency obligations for asset managers), are a few examples.

In this context, Eurosif strongly believes that after years of measures already taken by some of the EU countries, the momentum is created for the European Commission to act at an EU wide-level in order to

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<sup>4</sup> Read more about the Orange Envelope at: <http://www.pensionresearchcouncil.org/pdf/news/42.pdf>

<sup>5</sup> Eurosif's Public Policy Paper related to SRI (2009), Eurosif's Response to the Transparency Directive (2010), all available on Eurosif's website at [www.eurosif.org](http://www.eurosif.org)



strengthen the regulation that would considerably increase transparency of investment practices of pension funds.

### ***2.3 How could European regulation or a code of good practice help Member States achieve a better balance for pension savers and pension providers between risks, security and affordability? (Question 9 in the online questionnaire)***

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Eurosif considers that the balance for pension savers and pension providers between risks, security and affordability is better achieved by keeping in mind both short-term as well as medium- and long-term considerations of investment practices, of which ESG related issues play a crucial role.

As pension schemes move from single to multi-tiered systems, there is clearly a shift in risk and responsibility bearing between pension members, employers and pension funds. The general trend towards Defined Contribution (DC) schemes highlights an urgent need for transparency and clear communication by pension funds, considering the increased involvement of individuals.<sup>6</sup> Considering that the current existing disclosure regulation- mainly the IORP and the Life Directives- was designed mainly for Defined Benefit (DB) schemes,<sup>7</sup> a regulation review needs to be strongly considered in the context of defined contribution schemes in which transparency and good governance of pension funds have an increased importance.

There are two recommendations that Eurosif wishes to address in relation to strengthening the European regulation in view of better balance for pension savers and pension providers between risk, security and affordability:

1. ***The re-assessment of the IORP Directive*** in areas such as governance, risk-management, investment rules and disclosure, as detailed in the responses to questions n°5 and n°8. As stated in the Green Paper, there are still considerable barriers to cross-border activities and in ensuring a high level of transparency along the investment chain. To this end, a review of the IORP Directive is needed. Eurosif recommends that the following two areas need to be reviewed in the Directive:
  - ***Article 18 referring to Investment Rules:*** Pension Funds should be required to disclose their investment policies and especially how they integrate environmental, social and governance (ESG) issues into their investment practices. Furthermore, Pension Funds should be required to disclose their asset allocation rationale in view of reducing excessive risk taking.
  - ***Articles 19 and 20 referring to custodianship and cross-border activities:*** Eurosif welcomes any review that would improve the responsibility allocation along the investment chain especially in regards to the responsibility of custodians in order to ensure a high degree of transparency. The clarity of custodian responsibilities is particularly relevant through the role they play in asset ownership as well as investor ownership and stewardship.

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<sup>6</sup> According to the ERFP 2010 survey on Defined Contribution pensions, nearly 60 million Europeans are enrolled in DC schemes and this number is growing.

<sup>7</sup> Pension schemes where the benefits accrued are linked to earnings and the employment career (the future pension benefit is pre-defined and promised to the member). It is normally the scheme sponsor who bears the investment risk and often also the longevity risk: if assumptions about rates of return or life expectancy are not met, the sponsor must increase its contributions to pay the promised pension. These tend to be occupational schemes.



## **2. The introduction of a European-wide Code of Practice/ Statement of Investment Principles (SIPs) for Pension Funds.**

Eurosif recommends that the EC introduce a mandatory “**Statement of Investment Principles (SIPs)**” for pension funds which can be either EU-wide or national but with minimum criteria defined at an EU level. An important feature of such a Code of Practice would be that it would need to keep in mind the cross-border specificity of pension funds. Thus, to reduce the reporting burden, a pension fund that would sign a national code of practice in a country should not also be required to sign the codes of practice of all the countries in which it operates. In any case, Eurosif believes that the European Commission should be involved in setting minimum criteria for possible national codes of practice/ statement of investment principles.

### **Content of Code of Practice/ Statement of Investment Principles (SIPs):**

In these Codes of Practice/ SIPs, pension funds would state the extent (if at all) to which ESG considerations are taken into account in the selection, retention and realisation of investments, and their policy in relation to the exercise of the rights (including voting rights) attached to investments.

In addition, where institutional investors communicate that they do have an SRI policy, they should provide information on how such policies are being implemented in practice, what results have been obtained so far and what trustees’ expectations are for the future. Thus, Eurosif judges it essential that **pension funds report on how their responsible investment policy is implemented in practice** and how they monitor its effectiveness in order to prevent a gap between SRI policies and practices. Where pension funds have decided against developing a policy for the integration of environmental, social and governance (ESG) issues into investment decisions, they should also be required to report that decision and the rationale for it.

There is a growing consensus in the financial community that taking ESG issues into consideration is consistent with the fiduciary duty of investors when it impacts profitability, and is further relevant when there is a consensus to do so by participants /members /stakeholders.<sup>8</sup> **Ownership and power imply responsibility from trustees.** ESG issues such as climate change, working conditions at suppliers’ factories, misaligned executive compensation, corruption and human rights have material impacts on stock values and investment portfolio performance. As evidence to this growing consensus, more than 800 financial institutions worldwide are now signatories to the Principles for Responsible Investment (PRI), representing over \$22 trillion.<sup>9</sup>

Similar transparency regulations have already been adopted in the United Kingdom (2000), France (2001), Germany (2001), Sweden (2001), Belgium (2004), Norway (2004), Austria (2005) and Italy (2004) and were recommended in a recent OECD consultation on Guidelines for pension fund governance.

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<sup>8</sup> UNEP FI, Freshfields, Bruckhaus, Deringer : a legal framework for the integration of environmental, social and governance issues into institutional investment, October 2005.

<sup>9</sup> The Principles for Responsible Investment (PRI), convened by UNEP FI and the UN Global Compact, was established as a framework to help investors achieve better long-term investment returns and sustainable markets through better analysis of ESG issues in investment process and the exercise of responsible ownership practices. [www.unpri.org](http://www.unpri.org)



#### ***2.4 Is there a case to modernise the current minimum information disclosure requirements for pension products (e.g. comparability, standardisation and clarity)? (Question 12 in the online questionnaire)***

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As stated in our response to Question n°9 above, Eurosif strongly considers that the current minimum information disclosure requirements for pension funds should be strengthened. Furthermore, the disclosure of how pension funds engage with ESG issues should be mandatory. As pension systems move from DB to DC schemes, more responsibility is placed on the shoulders of individuals who need to have proper access to information in order to make informed choices about the pension plans to which they adhere.

More clarity and comparability of information needs to be ensured. As shown in our response to question n°5, best-practice in Europe already gives possible solutions on the way forward regarding transparency of pension funds and their products. The 'Orange Envelope' example currently used in Sweden could easily be transposed to ensure a higher transparency of how Pension Funds operate. For example, they could report annually to their members on how they engage and integrate ESG issues into their investment decisions.

#### ***2.5 Should the EU develop a common approach for default options about participation choice and investment choice? (Question 13 in the online questionnaire)***

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As defined-contribution schemes grow in Europe and as this places greater responsibility on individuals, **Eurosif agrees that there needs to be relevant information offered to individuals in order to make informed saving decisions and to ensure proper pension scheme engagement.**

To this end, Eurosif believes that the EC should explore the possibility of developing a common approach to facilitate both participation choice by individuals and investment choice. More concretely, **we applaud the idea that the European Commission explores more deeply a European auto-enrollment system with opt-out options as currently in process of implementation in the UK, whereby employers have to automatically enroll their workers in pension schemes.** While we encourage the EC to explore the possibility of benchmarking the UK example, we wish to stress the importance of keeping in mind differences between large employers and SMEs (as shown by the Federation of Small Businesses the auto-enrollment can create an excessive administrative and financial burden for SMEs and needs to be customised to meet their needs).

While such a common approach at EU level could be the way forward on improving the pension engagement rate, Eurosif considers that the differences in the national systems need to be kept in mind. Supporting initiatives such as national pension advice services in EU countries seems to be a feasible idea as long as Member States are left with the choice of how to implement such strategies. Advisory bodies (for example in the UK, [www.pensionsadvisoryservice.org.uk](http://www.pensionsadvisoryservice.org.uk)) could offer better support both to employers that wish to enroll workers into pension schemes or to employees who can thus be more informed on the choices they can make and the implications of auto-enrollment. Eurosif believes that any decision on further steps should be based on the assessment of existing national pension systems (successes and challenges). To this end, Eurosif considers that the Dutch Pension System is worth exploring as its successful multi-tier structure could also serve as a good example (both in terms of successes and challenges, how pension funds work with the Dutch National Bank, etc).



Finally, Eurosif wishes to stress the fact that higher transparency of pension funds in their investment practices and how they integrate environmental, social and governance (ESG) issues into their investment decisions will lead to higher pension engagement rates by employees. We therefore encourage linking pension funds' transparency on their investment practices to worker pension engagement rates.

***2.6 Should the policy coordination framework at EU level be strengthened? If so, which elements need strengthening in order to improve the design and implementation of pension policy through an integrated approach? Would the creation of a platform for monitoring all aspects of pension policy in an integrated manner be part of the way forward? (Question 14 in the online questionnaire)***

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Sustainable pension systems have important macroeconomic benefits as pensioners are growing sources of stable and regular consumption. Considering the new possible challenges raised by the trend towards defined contribution (DC) schemes (risk-sharing, greater responsibility for individuals, the need for higher transparency) and the national differences in implementing European minimum harmonization legislation for pension funds, Eurosif welcomes the ideas of the EC looking into the setting up pension policy coordination at an EU level.

To this end, the way pension funds are governed and their investment practices is crucial for proper pension system management at an EU Level. The integration of environmental, social and governance (ESG) issues into investment policies ensures that, besides the financial impact, pension funds take into consideration the long-term impact of their actions. While we agree that the European Commission should play an active role in coordinating broad pension systems issues (i.e. regulation on social security and for occupation pension funds, surveillance, mutual learning, etc.), **we consider that at the same time, the EC has to better regulate the transparency of pension funds and how they integrate ESG issues into their investment practices.**

Pensioners have an increasingly important role in the European economy as consumers while pension funds play a crucial role in the financial market. Thus, the sustainable development of the pension market needs to take into consideration the long term impact of pension funds' investment practices.

Furthermore, in light of the EC's Europe 2020 Strategy and its priority to ensure *sustainable* European growth through a greener and more competitive economy, the integration of ESG issues into investment practices buttresses the 2020 Strategy while forming a critical part for the EU to 'practice what it preaches'. As shown in some of our answers in this Response, there are an array of possible tools available to increase pension fund transparency and better integrate ESG factors into investment practices which, if explored, will strongly support the EU's wider economic and social objectives.



## **APPENDIX**

### **About Eurosif**

EUROSIF, the European Sustainable Investment Forum, is the pan-European network whose mission is to develop sustainability through European financial markets. Eurosif works as a partnership of the national Sustainable Investment Forums (SIFs) within the EU and with the support and involvement of Member Affiliates. Recognised as the premier European forum for sustainable investment, Eurosif's Member Affiliates are drawn from leading pension funds, asset managers, NGO's, trade unions, academic institutes and research providers, together representing assets totaling over €1 trillion. Eurosif's work includes a focus across asset classes - equity and fixed income markets, microfinance, renewable energy, property, private equity and hedge funds - all centred around the industry trends and future legislation affecting this space. The key benefits that Eurosif affiliate members receive include EU interfacing, SRI information and European wide initiatives that integrate Environmental, Social and Governance (ESG) issues into the financial services sector.

**For the full list of Eurosif Member Affiliates, please see [www.eurosif.org](http://www.eurosif.org)**

Eurosif has two main roles: (1) to provide an international forum that allows members and member affiliates to work together on issues pertaining to Sustainable & Responsible Investment (SRI, see below for definition of SRI and its market size in Europe) and Corporate Governance in the EU financial services sector, and (2) to collect input from members and member affiliates and then communicate their ideas and initiatives to European policy makers, including the European Commission as well as the European Parliament. Therefore, this note is mainly driven from and by the interest and expertise of our membership.

### **Sustainable and Responsible Investment Definition**

Eurosif continues to use the term "SRI" as the most readily acknowledged expression for this field and defines SRI as follows:

*Sustainable and Responsible Investing (SRI) is a generic term covering any type of investment process that combines investors' financial objectives with their concerns about Environmental, Social and Governance (ESG) issues.*

### **Market Size**

Eurosif recently published the latest Sustainable and Responsible Investment (SRI) figures and trends in its "European SRI Study 2010". This unique study highlights the scale of European SRI as well as European and National trends across nineteen countries. Based on a survey of asset managers and self-managed asset owners, we found that total SRI assets under management (AuMs) have reached €5 trillion as of December 31, 2009, corresponding to a remarkable growth given the financial crisis over the past two years since the study was last published.