PRI Principles for Responsible Investment

POLICY BRIEFING

INSTITUTIONS FOR OCCUPATIONAL RETIREMENT PROVISION (IORP) DIRECTIVE: ESG CLAUSES

The revised Institutions for Occupational Retirement Provision (IORP II) Directive entered the Official Journal of the European Union on 14 December 2016. Member states have 24 months to transpose the Directive into national law.

The Directive requires occupational pension providers to evaluate Environmental, Social and Governance (ESG) risks and disclose information to current and prospective scheme members. This document summarises the key ESG-related clauses.

WHO IS AFFECTED?

Occupational pension funds with more than 100 members are subject to these clauses of the Directive. Member states may choose to apply the Directive to schemes with fewer than 100 members.

SUMMARY OF ESG REQUIREMENTS

In the Recital (introductory statements), the Directive emphasises the importance of good risk management, including risks associated with climate change, resource scarcity and stranded assets (recital 57, 58). The Directive describes ESG issues, as codified in the Principles for Responsible Investment, as important for investment policy and risk management of IORPs. As such, Member States should ensure that IORPs disclose the relevance and materiality of ESG factors, and how they are taken into account in their risk management system. Funds can comply by stating that such factors are not relevant, or the monitoring costs are disproportionate (Recital 41a).

The Articles of the Directive require IORPs to:

- Invest in accordance with the Prudent Person Principle. The Directive clarifies that this means acting in the best long term interests of their members as a whole, and that the Prudent Person Principle does not preclude funds from considering the impact of their investments on ESG factors (Article 19).
- Hold an effective, transparent system of governance that includes consideration of ESG factors relating to investment decisions. This system should be proportionate to the nature, scale and complexity of the IORP (Article 21).
- Establish a risk management function and procedures to identify, monitor, manage and report risks. ESG risks associated with the investment portfolio and its management are included in the list of risks that the risk management system must cover. This system should be proportionate to the nature, scale and complexity of the IORP (Article 25).

- Carry out and document their own risk assessment at least every three years, or without delay following a significant change in the risk profile. This risk assessment should include, where ESG factors are considered, an assessment of new or emerging risks including climate change, resource use, social risks and stranded assets (Article 28).
- Produce and review a Statement of Investment Policy Principles at least every three years, or immediately following significant changes to investment policy. This must be made publicly available and explain whether and how the investment policy takes into account ESG factors (Article 30).
- Inform prospective scheme members whether and how the investment approach takes ESG factors into account (Article 41).

Full text: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32016L2341

TOOLS AND GUIDANCE

PRI has a range of tools and support for asset owners looking to understand the risks and opportunities associated with ESG factors. The following publications are particularly relevant:

- Crafting an investment strategy – a process guidance for asset owners supports pension fund trustees and executives to formulate an investment strategy incorporating ESG issues.
- Investment Policy: Process & Practice – A Guide for Asset Owners provides a concise and implementable framework to support asset owners in revising their investment policy in order to incorporate long-term factors, such as ESG factors, in their investment chains.
- Aligning expectations: guidance for asset owners on manager selection, appointment and monitoring
- Case studies: Implementation of the PRI by small and resource constrained investors

For more information and additional resources, please see the Investment Practices team pages.

POLICY CONTEXT

Through our response to the European Commission's consultations on non-financial disclosure, long term and sustainable investment and the Capital Markets Union, we have demonstrated that barriers exist which prevent a fuller consideration of ESG factors by institutional investors. These issues are cross-cutting and touch on many different areas of the EU's remit. A systematic approach is needed to ensure all relevant regulation and market oversight are aligned in support of long term, sustainable investment.

PRI supported the inclusion of ESG clauses in the IORP Directive, and continues to engage with European Institutions in support of a regulatory environment consistent with the Principles. We strongly welcome the European Commission's recently announced sustainable finance expert group[1].

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[1] See commission decision of 28.10.2016 on the creation of a High-Level Expert Group on Sustainable Finance in the context of the Capital Markets Union. http://ec.europa.eu/finance/capital-markets-union/docs/20161028-decision_en.pdf