	Comments Template on EIOPA-CP-11/006 Response to Call for Advice on the review of Directive 2003/41/EC: second consultation	Deadline 02.01.2012 18:00 CET
Company name:	FairPensions	
Disclosure of comments: Public	EIOPA will make all comments available on its website, except where respondents specifically request that their comments remain confidential. *Please indicate if your comments on this CP should be treated as confidential, by deleting the word* ***Public*** *in the column to the left and by inserting the word* ***Confidential***.	Public
	The question numbers below correspond to Consultation Paper No. 06 (EIOPA-CP-11/006). **Please follow the instructions for filling in the template:** ⇨ Do **not** change the numbering in column "Question". ⇨ Please fill in your comment in the relevant row. If you have no comment on a question, keep the row empty. ⇨ There are 96 questions for respondents. Please restrict responses in the row "General comment" only to material which is not covered by these 96 questions. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific question numbers below. o If your comment refers to multiple questions, please insert your comment at the first relevant question and mention in your comment to which other questions this also applies. o If your comment refers to parts of a question, please indicate this in the comment itself. **Please send the completed template to *CP-006@eiopa.europa.eu*, in MSWord Format, (our IT tool does not allow processing of any other formats).**	

Question	Comment	
General comment	FairPensions is a UK-based charity which works to promote responsible ownership by pension funds and to ensure that pension savings are invested in the long-term best interests of beneficiaries.	

We have recently completed a major piece of work on fiduciary duty, *'Protecting our Best Interests: Rediscovering Fiduciary Obligation',* which examines the flaws in the current legal framework and makes recommendations for policymakers. The report is available at http://www.fairpensions.org.uk/fiduciaryduty, and a short briefing on its findings can be downloaded at http://www.fairpensions.org.uk/policy. Its analysis relates primarily to the UK legal regime, but it is also relevant at European level since many of the principles of UK common law are incorporated into the IORP directive – for example, the prudent person principle. There are two key points from the report's analysis which are relevant to the questions raised in this consultation:

1) **Outsourcing:** In the UK, interpretations of fiduciary duty are closely linked to the trust concept, and it is commonly assumed that fiduciary duties only apply to pension fund trustees. This is problematic in today's complex investment landscape where the majority of investment functions are outsourced, and where several parties have influence over investment decisions (for example, investment consultants, asset managers, etc). Pension fund trustees are themselves often vulnerable to their commercial agents, for example because they lack the expert knowledge to challenge their recommendations or to fully understand their activities. This confusion over where fiduciary duties lie therefore potentially creates a vacuum of accountability. We believe this issue may extend beyond trust-based systems, raising more general issues about how to ensure genuine accountability where functions are outsourced. We elaborate on this in our response to questions 80 and 82.
2) **The prudent person principle:** In a UK context, we have found that fiduciary duties tend to be interpreted narrowly as a duty to maximise return, with this in turn being interpreted as a duty to focus solely on quarterly results and ignore risks and opportunities that cannot be easily monetised. This leads to a neglect of environmental, social and governance (ESG) issues, and of macroeconomic and systemic factors, which has the potential to damage long-term investment outcomes for beneficiaries. We elaborate on this in our response to question 47. In addition, 'prudence' is interpreted by reference to the behaviour of other investors, making trustees wary of departing from market norms even if the market is behaving irrationally. This risks exacerbating herding behaviour and pro-cyclicality: we elaborate on this in our response to question 52.

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38.	We are aware of the controversy over the potential application of Solvency II capital requirements to UK occupational pension schemes. This issue is somewhat outside our remit and so we do not comment on these questions, although we recognise the force of the arguments being made by UK stakeholders. We note that one objection being made to this proposal is that it would undermine the role of UK pension funds as providers of long-term investment capital. We agree that this role is important. Our work suggests that there are already problems holding pension funds back from playing this role effectively, including agency problems and misunderstandings of fiduciary duty. These are discussed elsewhere in our consultation response.	
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47.	Our work on fiduciary duty in a UK context, on which Article 18 of the IORP directive is partly based, suggests that it may be insufficient to ensure that assets are invested in the long-term interests of beneficiares. Indeed, we conclude that interpretations of the principle may actually be driving perverse outcomes. There are two inter-related problems with interpretations of the prudent person rule: 1) It is generally interpreted narrowly as a duty to maximise risk-adjusted return and to ignore non-monetisable factors. This is potentially dangerous because, as is pointed out in the OECD guidance referred to in para 20.2.8 (page 376) of the consultation paper, intangible factors such as environmental or regulatory risks can have a significant impact on long-term investment outcomes. This interpretation of the law also contributes to short-termism, since pension fund trustees believe that their fiduciary duty can only be fulfilled by frequent monitoring of their asset managers' performance against the benchmark, leading to an over-emphasis on quarterly returns. 2) 'Prudence' is interpreted by reference to the behaviour of other investors, making trustees wary of departing from market norms even if the market itself is behaving irrationally or exuberantly. This has the potential to exacerbate market volatility, which is clearly not in the best interests of savers. See also our response to Q52. These factors combined mean that, for example, a manager who refuses to invest in an asset bubble may be sacked for short-term underperformance against the benchmark, even if his strategy might be prudent in the long run. This clearly does not serve the long-term best interests of beneficiaries. In the UK context, we have recommended statutory clarification of fiduciary duties to overcome these	

	narrow interpretations. We recommend that EIOPA or the European Commission may wish to investigate whether the problems we have identified in a UK context are replicated in other Member States. There is little formal evidence on this issue, although anecdotally we believe that this may not be solely a UK problem. If it is concluded that a wider problem exists, steps to clarify Article 18, or to issue additional guidance, may be useful.	
48.	Yes, Member States should have discretion to impose limitations on investments in addition to the requirements of the IORP Directive. One reason for this is that, notwithstanding IORPs' exclusive duty of loyalty to beneficiaries, there is also a public interest in their investment activities which governments should have the right to act on.	
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50.	We comment only on the analysis of options to address the first specific call for advice, on "the material elements of Article 132(2) of Directive 2009/138/EC that should be amended or removed to adequately address the specificities of IORPs in relation to risk assessments." We strongly agree with the analysis of the negative impacts of option 3, namely that IORPs may feel that this relieves them of the obligation to monitor and manage risks in spite of their ultimate responsibility for the investment process. Indeed, it is already the case in the UK that some pension funds appear to believe that they can adequately fulfill their fiduciary responsibilities by blind delegation to an 'expert' asset manager, usually on the advice of investment consultants. Although IORPs may not need all the technical expertise to carry out asset management themselves, they certainly do need sufficient expertise to *monitor* the adequacy of risk management by those they outsource to. The absence of such expertise and active monitoring potentially creates a governance vacuum, as asset managers assume the fiduciary responsibility rests solely with the IORP. Research by Create-Research in relation to innovative investment products has found that investors who engage actively with their asset managers, wanting to "really understand what their asset managers did… when the manager took risk and why" achieved superior returns to those who were more 'hands-off'. This suggests that the quality of oversight can have a very real impact on	

	members' interests. We are concerned that the wording in option 3 - for example, the phrase "directly or through outsourced functions" – could imply that that the IORP themselves does not need to have any expertise or exercise any oversight. On this reading, it would be sufficient for IORPs to satisfy themselves that the agents they outsource are sufficiently expert to undertake risk management, rather than equipping themselves to judge and monitor the adequacy of that risk management. Blind delegation is inconsistent with the IORPs' ultimate responsibility to ensure the assets are invested prudently and in the best long-term interests of beneficiaries. On balance, we would therefore favour option 2, or a compromise wording which would enable efficient outsourcing whilst emphasising the IORP's oversight role.	
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52.	We agree that Article 28 of the Solvency II Directive, which requires supervisors to consider the potential impact of their decisions on the stability of the financial systems and to take into account the potential pro-cyclical effects of their actions, should be included in a future IORP Directive. We agree that IORPs, collectively if not individually, are still systemically relevant and that their role as institutional investors is comparable to that of insurance companies. As indicated in response to Q47, we are concerned that current interpretations of the prudent person principle potentially exacerbate pro-cyclical effects of pension funds' investment decision-making, since IORPs may feel obliged to 'follow the herd'. We appreciate that this does not concern the actions of supervisors in situations of stress, which is the focus of this consultation question. However, we do believe that it would be helpful for supervisors to consider more generally the systemic financial impact of those they regulate – liaising if necessary with other relevant domestic regulators – rather than limiting their consideration to the systemic impact of their own decisions. We also believe that it would be useful for EIOPA and the Commission to consider the potential impacts of European legislation, including Article 18 of the IORP Directive, in this regard.	

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61.	Yes, we agree that the material elements of the requirements on insurers in respect of supervision of outsourcing should also apply to IORPs.	
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63.	Yes. We agree that governance standards should be comparable in DB and DC provision. They should also be comparable across different corporate forms of retirement provision. In the UK, there are two parallel legal and regulatory regimes governing trust-based and contract-based pension arrangements. With the advent of automatic enrolment in 2012, many employers are likely to provide workplace pensions through contract-based arrangements. Unlike trust-based pension arrangements, these providers do not have a built-in governance structure designed to protect the interests of members, and generally do not accept that they may have fiduciary duties to their policyholders, instead regarding themselves simply as a platform. Yet the basic relationship between saver and provider is the same whether trust- or contract-based: where members are bearing the investment risk they should be protected by similar governance standards regardless of the form of their retirement provision. We therefore welcome this attempt at harmonisation. However, in a UK context we remain concerned that requirements applying to contract-based providers, such as insurance companies, are insufficient to ensure members are protected. Our research (forthcoming, 2012) suggests that the absence of fiduciary-like responsibilities may lead to a governance vacuum, since neither the insurance company nor the asset managers to whom they outsource feel the responsibility to ensure that savers are looked after and that conflicts of interest are managed effectively. One possible	

	solution would be to require such providers to establish bodies charged specifically with defending policyholders' interests – mirroring boards of trustees in trust-based arrangements, or the boards of pension providers in countries such as South Africa where the trust does not exist as a legal concept. We appreciate that this falls outside the scope of this review of the IORP Directive, but do believe that this is an important issue which merits further attention. As the consultation paper notes, the OECD's best practice guidance for pension fund governance requires the existence of a policy on conflicts of interest. This is fundamental to good governance and to ensuring beneficiaries' interests are protect. We would therefore suggest that this should be an explicit requirement in the new IORP directive.	
64.	Yes.	
65.	Yes, although this should not compromise member participation. In the UK, occupational pension schemes are required to include at least one-third Member-Nominated Trustees (MNTs) on their boards. As indicated in our reponse to Q50 and Q80, we do believe it is vital that IORPs have the in-house expertise to effectively monitor their external agents and to understand the investment process. However, this should not be a bar to the participation of independent figures who can act as champions for members and help to drive accountability to ultimate beneficiaries. What matters is that the board as a whole should have the relevant expertise, rather than each individual member. We are happy with the explanatory text at para 19.3.6 in this regard.	
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68.	We strongly agree with the OECD's guidance, cited at para 20.2.8 of the consultation paper, that "prudent risk management practices should also consider intangible risk factors such as environmental, political and regulatory changes, as well as the pension fund's potential market impact through its investment decisions", and that "the risk management strategy should seek to proactively identify and explicitly balance short- and long-term considerations". In our experience, these intangible long-term risks are not always taken seriously by IORPs. This experience relates primarily to UK occupational pension schemes, but we do not believe the problem	

	is confined to the UK. Our most recent survey of UK pension schemes (available at http://www.fairpensions.org.uk/research#PF) found that, although almost all now recognise the importance of environmental, social and governance (ESG) risks in principle, this is much less frequently translated into robust risk management in practice. Similar findings have been made by more recent research by UKSIF, published in September 2011 (see http://www.uksif.org/resources/publications). Part of the problem is that many IORPs still believe that consideration of these factors does not fall within the scope of their legal duties, since the benefits of such risk management are usually not immediately monetisable (see response to Q47). In addition, research suggests that both asset managers and asset owners view it as the other's responsibility to ensure adequate integration of ESG risks: asset managers cite lack of client demand as a reason for not integrating these issues into their analysis, while asset owners assume that their asset managers will factor in all material risks, or say that it is not for them to interfere with their asset manager's strategy. We would therefore suggest that any detailed rules on risk management should include explicit reference to the need to manage environmental, social and governance risks. This would be one approach to addressing the problem of narrow interpretations of the prudent person rule. We would also suggest that implementation of an ESG risk management policy should be explicitly addressed in outsourcing agreements (see our response to Q82).	
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73.	We have comments on the proposed explanatory test in relation to other aspects of internal control, although we have no specific comment to make about the question of scope. We strongly agree that there should be an explicit reference to outsourcing as suggested in para 22.3.3. For example, it is vital that internal controls in place to manage conflicts of interest apply to the monitoring of conflicts of interest amongst external agents as well as to the IORP itself. This is a	

	real issue in the UK, where in our experience pension fund trustees are acutely aware of their fiduciary duty to avoid conflicts of interest, but rarely monitor their asset managers in this regard. This has real potential to damage the interests of savers. Asset managers are frequently part of larger financial conglomerates with significant conflicts of interest in relation to investee companies, for example because the company is a client of their investment banking arm, or because they have an interest in acquiring business from the company's own pension fund. Moreover, asset managers generally do not regard themselves as having fiduciary duties to avoid or manage these conflicts of interest, and the regulatory rules governing management of conflicts under MiFID are less stringent. Our own research suggests that asset managers may not always have robust policies in place to ensure that conflicts of interest are resolved in the interests of clients (see http://www.fairpensions.org.uk/research#stewardship). It is therefore vital that IORPs oversee this aspect of internal control.	
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80.	We strongly agree that, although they may not have technical expertise in the detail of day-to-day asset management, IORPs must have sufficient expertise to meaningfully oversee and monitor their agents in this regard. It is difficult to see how this can be achieved in the absence of some understanding of the activity being outsourced. This has historically been a problem among UK trust-based occupational pension schemes, as identified by the Myners Report a decade ago. We also agree that IORPs must remain ultimately responsible for outsourced functions. However, care must be taken to ensure that this chain of accountability functions properly in practice. In the UK, it is clear under trust law that pension fund trustees are ultimately responsible for outsourced	

	functions. However, in practice this has sometimes led to a governance deficit, since asset managers regard themselves simply as carrying out instructions rather than having a fiduciary responsibility of their own, while pension fund trustees may not have the time or expertise to meaningfully hold their asset managers to account. It is vital that the respective responsibilities of IORPs and their external agents are clear (see also our response to Q73 and Q82). In this context, we strongly support EIOPA's suggestion (para 25.3.7) to "add a principle requiring IORPs to ensure the proper functioning of the outsourced activities through the selection process and ongoing monitoring." In addition, we believe there may be a need for clarification of the role of agents themselves, whether in the IORP Directive or elsewhere in European law. The problems associated with increasing delegation are not confined to the UK, and are highlighted by the growing popularity of fiduciary management. Even the term 'fiduciary management' illustrates the paradox of this type of delegation: IORPs cannot delegate their fiduciary responsibility to ensure that the best interests of beneficiaries are protected, yet the level of delegation implied by fiduciary management can make it difficult to see how this responsibility is discharged. In this context, clarity over the responsibilities of the fiduciary manager becomes even more important: do they also have a responsibility to effectively manage conflicts of interest, or does this responsibility rest solely with the IORP, which may not be in a position to fulfil it?	
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82.	We strongly agree that "it would be useful to provide that, in the case of outsourcing of critical or important functions or activities (such as investment management), fiduciary duties are extended to the provider of the outsourced services." Please see our report at http://www.fairpensions.org.uk/fiduciaryduty for more details of our work in this area. We note with concern that in relation to Investment Management Agreements (IMAs) used by UK pension funds, the situation may be the opposite of that envisaged by the Commission. Anecdotal evidence from lawyers suggests that asset management firms, when drawing up or negotiating IMAs, often seek to provide that they do *not* have fiduciary duties or to exclude or restrict any liability that may exist under the common law. We believe that this practice should be prevented and that pension funds should be actively encouraged to scrutinise this aspect of IMAs and to press their asset	

	managers to accept their fiduciary responsibilities. Other important factors which should be covered in outsourcing agreements with asset managers might include: - clarity about the time horizons of the pension fund and the balancing of short-term and long-term risk management - clarity about expectations regarding the management of conflicts of interest - clarity about expectations regarding voting and engagement with investee companies, including regular reporting to the IORP on voting and engagement activity - clarity about expectations regarding the management of environmental, social and governance (ESG) risks (see also our response to Q68)	
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91.	Yes, although information requirements are clearly particularly critical in DC schemes, where the member bears the investment risk. We believe that members should have access to a greater range of information on request than is currently the case. This is particularly important in DC schemes. For example, members should have the right to access: - information about how the IORP's SIPP has been implemented over the past year, rather than simply a right to access the SIPP itself (in the UK, members who raise a specific query about	

| | their investments are often directed to the SIPP which provides little relevant information);
- information on the IORP's voting and engagement policy, and on how this policy has been implemented over a given period, including how voting rights were exercised in relation to specific issues or companies;
- fuller information about costs and charges, including 'hidden' costs, for example those associated with high portfolio turnover;
- information about what assets their money is invested in.

We recognise EIOPA's concern that differing pension systems may make maximum harmonisation inappropriate, and that the principle of subsidiarity must be respected. However, we wonder whether a general provision might be possible, either within a future IORP Directive or through guidance, to the effect that IORPs must comply with any reasonable request from members for information necessary to a full understanding of their pension savings. This would guarantee members the right to access information about their money, without creating a raft of burdensome, prescriptive and potentially inappropriate disclosure requirements. This answer is also relevant to Q96. | |
| 92. | Yes. We would suggest that Key Information Documents should include a brief description of the organisation's investment policies, which should include:
- its approach to stewardship (i.e. the exercise of its ownership rights), and
- its approach to managing investment risk, including environmental, social and governance (ESG) risks.

In our experience dealing with queries from our supporters, many individuals are interested in this information and feel it is relevant to decisions about their retirement savings. In addition, this would help to embed the understanding among IORPs that these factors are not optional extras but an integral part of the prudent management of their beneficiaries' assets.

Although we understand EIOPA's clarification that the KID would not serve the same function as the SIPP, we note that UK regulations already require information about voting policies and about the approach taken to environmental and social issues to be included in pension funds' Statement of Investment Principles. A similar provision was considered at EU level although this was not ultimately | |

	adopted. We believe it is fairly important that this document should facilitate comparisons between IORPs, as it enables benchmarking of best practice and, where relevant, also enables consumers to make more informed choices in what can be a difficult and confusing field. Measures to facilitate comparison could make the documents less rather than more burdensome for IORPs to produce – for example, providing a standard template for IORPs to complete should reduce the administrative cost of compiling the document.	
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94.	Yes, we support the introduction of a personalised annual statement to be delivered to each member. We would suggest that personalised annual statements should include a brief narrative summary of the IORP's voting and engagement activity throughout the year, for the same reasons outlined in our response to Q92: i.e. 1) many members are interested in this information about what is being done with their money, and 2) it would help to ensure that IORPs take their ownership responsibilities seriously as part of their duty to beneficiaries. It is also important that information on costs in the personalised annual statement and in the KID is understandable and comprehensive. This issue was recently debated in the UK parliament; a transcript of the debate can be found at http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm111207/halltext/111207h0001.htm#11120744000003. For example, in the UK, reported information on costs (such as the Total Expense Ratio) is generally incomplete, since it does not include 'hidden' costs such as the transaction costs associated with portfolio turnover. It is important that this information is available, both to give members an accurate picture of the costs they are incurring, and to facilitate analysis of trends in IORP investment strategies. For the purposes of the personalised annual statement, the most sensible approach would likely be to factor this information into a single figure for total costs (with a breakdown available on request), rather than to provide detailed information about cost breakdowns, since most pension	

	fund members will find such information confusing and obscure. It has also been pointed out that most members find it difficult to conceptualise the implications of costs and charges due to the counter-intuitive effects of compound interest. For example, members may not realise that a 1.5% annual management charge will result in close to a 40% reduction in the ultimate value of their pension. It might be useful for personalised annual statements to provide a cumulative figure of the total losses they are likely to incur from costs and charges at current rates, rather than simply providing information about current costs.	
95.	We agree that Member States should have discretion to go beyond minimum disclosure requirements. Please see also our response to Q91.	
96.		