Occupational Pension Funds (IORPs) & Sustainability: What does the Prudent Person Principle say?

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ABSTRACT

The European Union encourages individuals to save in private and occupational pension funds to complement their state saving-plans. Throughout their lives, employers directly sponsor occupational retirement saving plans, so individual employees may top up their future pensions. While the European Union clearly supports the formation and cross-border participation in these financial vehicles by adopting EU regulatory framework, the EU has also decided to determine a common investment decision standard to be used in all Member States, called the Prudent Person Principle. According to this principle, the fund - the future retirement for many - shall be managed with care, the skill of an expert, prudence and due diligence. Under this principle, the pension fund’s governing body is given a broad authority to invest the pension assets in a prudent fashion in light of the particular investment plan of a fund. At the same time, the EU is also moving towards more Responsible Investment and inclusion of the ESG-principles (Environment, Social and Governance). The question we aim to answer in this paper is how these two principles co-exist and whether, due to the new Directive adopted by the occupational pension funds in 2016, all funds are obliged to make only responsible, environmentally and socially beneficial investments.

1. INTRODUCTION

Occupational pension funds [also known as “institutions for occupational retirement provision” (“IORP’)] are financial institutions that manage employers’ collective retirement schemes in order to provide benefits to employees. The occupational funds play an important role in securing a reasonable retirement plan for workers once their careers end. Currently, in the European Union there are more than 125,000 occupational pension funds, holding assets worth €2.5 trillion on behalf of 75 million Europeans, which represents 20% of the EU’s working-age population. As the large funds administered by the occupational pension funds are invested in stocks, bonds and other securities, they also have a huge impact on the business world. Investment and divestment decisions of the occupational pension funds may thus favour one sector, e.g. sustainable energy with cheap access to finances to the detriment of e.g. the fossil industry. The question, however, is whether “sustainable” investment design may be detrimental to the return on investment, and in the affirmative, whether the board of the occupational pension fund may be found liable towards the beneficiaries for the losses incurred. This question has been a subject of discussions and a few court cases. At the

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2 Will be described and analysed in section 3.
same time, all the EU Member States have adopted a new investment standard – “the prudent person principle” - applying now to all EU Member States. In this article, authors first explain the relevance of accountability standards in capital markets and their recent application across the pension fund industry. The importance of this section lies in introducing a movement that has taken place in the entire financial industry and has affected all the intermediaries, including the occupational pension funds. The analysis starts with general remarks on the international accountability standards that have been stirring the discussion about what sustainability means. This section provides the reader with the necessary background for understanding the later discourse on “Responsible Investment”. Afterwards, the authors move to analyse the prudent person principle, the origins of this principle, and its nature in three selected jurisdictions, namely Denmark, the Netherlands and the UK. Subsequently, the recent 2016 EU Directive on occupational pension funds is analysed with the focus on its introduction of the “Principles for Responsible Investment”. The article reflects on the possible liability issues arising from the prudent person principle and “responsible investment”.

2. INTERNATIONAL ACCOUNTABILITY STANDARDS ON CAPITAL MARKETS

Capital markets finance the economy. Financial institutions represent the source of capital for corporations, acquisitions as well as new ventures. Financial institutions stand at the beginning of capital distribution to any other existing or future business. Financial institutions have a unique opportunity to contribute to solving the big challenges our societies face, be it contribution to limiting the global warming to a maximum of 2 degrees Celsius, respecting human rights in business or the fight against child labour. Financial institutions stand at the very beginning of the value creation and therefore these institutions have the ability to redefine the entire value chain and focus on using their financial leverage towards a positive change. Sustainable development has been identified as a possible benefit for business and finance. Commercial banks, investment banks, pension funds as well as other financial intermediaries have realised this and many have already started to take this factor into their equation, naming it “Sustainability”, “CSR” or “ESG” in their materials and references.

International Accountability Standards (IAS) are understood as recognised principles assisting corporations with their social and environmental responsibility. Within the financial sector, there are different IAS that have been adopted. The guideline wave started in 2003,

when several banks adopted the Equator Principles. Numerous financial institutions have voluntarily undertaken to commit themselves to ensure due diligence procedures, analyse and manage the impact of their clients’ projects in accordance with the World Bank’s Environmental and Social Standards and the International Finance Corporation’s (IFC) Performance Standards. Initially, a small group of leading financial institutions created principles that would help them analyse projects for environmental and social risk in emerging markets. Currently eighty-nine financial institutions apply the Equator Principles. Beside the Equator Principles, in 2006 the IFC also adopted the IFC Sustainability Framework. Yet, probably the most known in the financial industry are the Principles for Responsible Investment that has been working with the ESG abbreviation - Environmental, Social and Governance.

2.1. THE PRINCIPLES FOR RESPONSIBLE INVESTMENT AND ESG: HOW CLOSE TO CSR?

The Principles for Responsible Investment (PRI), adopted in 2006, complement the UN Global Compact and the UN Environment Program Finance Initiative. The PRI introduced six principles in the area of ESG issues. These six principles were developed by investors and are supported by more than 1,400 signatory institutions from more than fifty countries, currently representing more than US$59 trillion of assets. The crucial argument of the PRI is that ESG factors have a material effect on the returns delivered to clients and beneficiaries.

4 Ten major international commercial banks ABN AMRO, Barclays, Citigroup, Crédit Lyonnais, Crédit Suisse, HypoVereinsbank, Rabobank and the Royal Bank of Scotland together with WestLb and Westpact adopted the Equator Principles, a charter to ensure that the projects they finance are socially responsible and respect environment. Until today additional seventy-nine financial institutions have signed up the initiative.


According to the PRI, the management of the signatory institutions, where consistent with their fiduciary responsibilities, commit themselves to:

- Incorporate ESG issues into investment analysis and decision making processes;
- Be active owners and incorporate ESG issues into their ownership policies and practices;
- Seek appropriate disclosure on ESG issues by the entities in which they invest;
- Promote acceptance and implementation of the Principles within the investment industry;
- Enhance their effectiveness in implementing the Principles;
- Report on their activities and progress towards implementing the Principles;

However, what are the ESG factors that the Principles refer to and how do they depart from the notions that we already know, such as CSR? The PRI on their website enumerate only few examples of the ESG factors. From environmental indicators it names climate change, greenhouse gases, waste and pollution, from social indicators it names slavery or child labour and from governance indicators it names issues as executive pay, board diversity or tax strategy. When breaking down the three areas, the PRI itself does not provide financial institutions with an exhaustive list of factors that they should take into consideration in order to carry out responsible investment. This approach of the UN’s drafting indicates the understanding that the ESG factors are changing. Depending on the specific financial sector, region and the development of the market itself the ESG factors may vary. Moreover, also the formulation of the factors for individual institutions is of crucial importance, given that the entire idea behind the PRI as well as the UN Global Compact emphasises the active engagement of the financial institutions with their clients, investors as well as the societies within which they operate. Thus, the PRI together with ESG represent a procedural side of understanding and determining sustainability goals that continue to develop in the light of societal change and scientific discoveries.

Reflecting on the commonalities between the ESG notion and the CSR notion that has been present since the fifties, the concepts are very

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9 The PRI association itself also adheres to the standards, but it is also incoherent. While the environmental package is compliant to ISO 14001 (certification standard), the social area works with a charity in order to narrow down the factors and within the governance, the PRI association is governed by the PRI Association Board.


similar. They both take environmental and societal factors into consideration. Human rights have been taken as a basis for both notions. The above mentioned IAS are based on environmental, labour and/or human rights, adopted by the UN, ILO, OECD as well as numerous independent States through their individual Constitutions. The main characteristic of both notions is that they are evolving and reflect the standing of our society/ies. The only difference between the two is the incorporation of governance considerations in the ESG, which presumably was affected by the OECD Corporate Governance wave. Moreover, ESG should be perceived as a merge between the UNCTAD, UNEP, UN Global Compact and PRI principles.

Looking at the ESG from a quantitative perspective, for determining ESG performance indicators effectively, it is essential to identify the appropriate key performance indicators (KPI). The European Federation on Financial Analysts Societies (EFFAS) states that KPIs for ESG should meet certain requirements: significance, measurability, comparability, reliability, usefulness and traceability. Usually, the environmental, economic and social corporate data and information are being monitored, coded, registered and aggregated into KPIs. Linking objectives of non-financial indicators with the financial goals of a corporation should contribute materially to reaching long-time sustainable performance and to the sustainability reporting itself. Thus, KPIs and ESG have always been perceived as contributing to long-time performance of an institution and thus being in the interest of the shareholders.

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13 In 1996 the OECD Ministers decided that a Business Sector Advisory Group on Corporate Governance should be established to review international corporate governance matters and develop a set of standards which should be followed by OECD countries. It has been understood that corporate activity has a direct impact on society and therefore the OECD Advisory Group on Corporate Governance has recognized that societal interests should have an impact on corporate governance and that “(...) corporate actions must be compatible with societal objectives (...)” The Principles were introduced in 1999 and since then the latest revision took place in 2015. The Principles focus on publicly traded companies, both financial and non-financial. The Principles have been intended to help policy makers evaluate and improve the legal, regulatory and institutional framework for corporate governance. See Michael Galanis Alan Dignam, ‘Governing the World: The Development of the OECD's Corporate Governance Principles' (1999) 10 European Business Law Review 396.

2.2. **LOOKING AT THE SUSTAINABILITY GOAL FROM ANOTHER PERSPECTIVE: INVESTORS’ RIGHT TO BE INFORMED**

Aside from what is considered the “right thing to do” and the fact that it could be argued that the financial institutions should be the first to adhere to ESG standards as they represent the start of the flow of capital, it is necessary to realise the relevance of ESG from another perspective. This perspective is from the side of investors and their right to information.15 This right is materialised through diverse disclosure mechanisms required by capital market regulation. Disclosure on capital markets has additional relevance, as keeping fair and honest markets16 and preventing fraud or minimising systemic risk.17 Hence, information about all market participants, including corporations and financial institutions is normally considered of the utmost relevance.

Investors consider a variety of factors when determining their investments. Annual reports, including both financial and non-financial information, have served as the traditional source of information. Yet, with the access to information online or through databases, investors are in a better position to receive greater amount of data. Often the question arises to what extent investors may effectively evaluate such data, but this is not the focus of this paper. Capital markets come with plenty of solutions to assess also non-financial information. Investment companies have developed ESG index funds which track the performance of companies with superior ESG index ratings and provide low cost, tax efficient and ESG investment.18 Investors have to simply invest in these indexes.19 Aside of the indices, there are few investors who focus only on

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16 See e.g. Michael E. Parrish, *Securities Regulation and the New Deal* (Yale University Press 1970) at 3-5; The purpose of the US Securities Act of 1933, as stated in its preamble is 'to provide full and fair disclosure of the character of securities sold in interstate commerce and foreign commerce and through the mails, and to prevent fraud in the sale thereof, and for other purposes.' Furthermore, the Senate Committee on Banking and Commerce stated that 'the purpose of this bill is to protect the investing public and honest business. The basic policy is that of informing the investor of the facts concerning securities to be offered for sale in interstate and foreign commerce and providing protection against fraud and misrepresentation.' S. REP. NO. 47, 73rd CONG., 1st Sess. 1 (1933).
18 MSCI has developed 11 ESG indices with over $56 billion in assets (December 2016); <www.msci.com/esg-index-family> accessed 16 May 2017.
sustainable investing, such as RobecoSAM or Vontobel. Furthermore, Bloomberg, Yahoo and the Financial Times also report on ESG performance. Bloomberg operates an ESG terminal which provides data on companies’ environmental, social and governance metrics. This service provides an overview of a company’s sustainability initiatives and ranks its performance within an industry. Moreover, stock exchanges also support such initiatives. Fifty-eight stock exchanges have collaborated with PRI and thus over seventy percent of listed equity markets, have made a public commitment to advance sustainability in their individual markets. Twelve stock exchanges have incorporated ESG reporting into their listing rules and fifteen provide formal guidance to issuers. It is thus obvious that this kind of information is taken into consideration by various market participants.

The efficient market theory states that share prices reflect all known information relating to a share. All new information has the potential to affect the fundamental valuation of stock price. The more complete and reliable the information available is, the more accurate the valuation of the future performance of the respective security. The attention to ESG issues might be relatively recent, yet this has already been implemented by most of the financial institutions. Even if extra-financial information may not necessarily affect the price of a company’s share during normal operations, in cases where reputational or monetarily quantifiable litigation risk exists, investment professionals pay much attention to the respective pieces of information. This is the rationale behind the companies’ disclosure requirements on extra-financial aspects, which capture additional dimensions of corporate performance that are not accounted for within financial data.

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22 More recently, the London Stock Exchange issued ESG guidelines for listed companies. It has also sent its guidelines to more than 2,700 companies listed on its UK and Italian exchanges; <www.lseg.com/esg> accessed 16 May 2017.
24 Some practitioners consider ESG data to be a distraction, see Patrick Sheehan, ESG data can be a distraction, Financial Times, March 6, 2017.
25 This has been shown by the recent stock fall of the stock value of the Volkswagen by thirty percent due to its diesel emission scandal.
26 Such disclosure obligation was recently introduced in the EU by the Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014.
To summarise, the above description shows that various soft law instruments strongly encourage institutional investors such as pension funds to take ESG-factors into account when making investment or divestment decisions. This raises the question whether under the national law, pension funds are also entitled to take such considerations into account or whether they may risk liability by doing so. Under the existing systems, understanding the concept of the “prudent person” is central if this question is to be answered.

3. **Prudent Person Principle in the United Kingdom, Denmark and the Netherlands: Protecting Occupational Pension Funds**

3.1. **Introduction of the Prudent Person and its Meaning**

The prudent person rule was historically developed in common law jurisdictions, namely England and the US, via case-law. Fiduciary duties in both countries in the nineteenth century were conservative, this was due to the legal restrictions on possible trustees’ investment as a fiduciary was perceived more as a conservator of wealth than a reproducer. However, with the evolvement of the markets and novel investment possibilities, the limiting perception of a fiduciary was altered. And the rule of the “prudent person” was clarified in the famous case of *Harvard College v. Amory* decided by the Massachusetts Supreme Judicial Court in 1830. The decision states that:

“All that can be required of a trustee to invest, is, that he shall conduct himself faithfully and exercise sound discretion. He is to observe how men of prudence, discretion, and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.”

This more “modern” form in precise statutory language was applied to pensions in both the United States and the United Kingdom, by the Employee Retirement Income Security Act of 1974 (ERISA) in the US

Section 404(a) of ERISA stipulates: (1)Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and— (A)for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan; (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with
and in the Pensions Act 1995 in the UK.\textsuperscript{31} Pension law has in the Anglo-Saxon tradition been perceived as a unique combination of trust and contract law principles.\textsuperscript{32}

Before the prudent person principle was introduced at EU level (see further below), the Member States by and large had applied different quantitative portfolio regulations in the financial sector. These quantitative regulations came in different shapes, for example imposing limits on investing in certain assets or restrictions on assets allocation. Typically, those instruments, the holding of which was limited or forbidden, were those with high price volatility and/or low liquidity and/or high credit risk, such as equities, venture capital/unquoted shares and real estate, as well as foreign assets.\textsuperscript{33}

Quantitative portfolio regulations and restrictions have been the subject of criticism on the grounds that they lead to lower returns, are inflexible when necessary to adjust and adapt investment strategies and tend to discourage competition among investors. In 1998 Davis found that in OECD states, where a prudent person rule was applied, there is a higher rate on investment in equities as compared to states with quantitative portfolio regulations and that the former had a higher rate of return during 1967-1990.\textsuperscript{34} This contributed to a policy shift also in the EU and the adoption of the prudent person principle in Directive 2003/41.
on the activities and supervision of institutions for occupational retirement provision.\textsuperscript{35}

Directive 2003/41 in its preamble stipulates that the prudent person rule represents the underlying principle for capital investment of IORPs.\textsuperscript{36} The prudent person rule is defined in Article 18 of Directive 2003/41.\textsuperscript{37} The aim of this rule is to ensure adequate diversification, thus protecting the beneficiaries - the pensioners - against insolvency of a fund, lower returns and inability of pay out the retirement and other investment risks that are inherent in investment industry. The EU prudent person rule focuses on the process and behaviour of the person doing the investment. As explained by Bevis Longstreth:

\begin{quote}
Prudent is to be found principally in the process by which investment strategies are developed, adopted, implemented, and monitored in light of the purpose for which funds are held, invested, and deployed. Prudence is demonstrated by the process through which risk is managed, rather than by the definition of specific risks that are imprudent. Under a modern paradigm, no investment is imprudent per se. The products and techniques of investment are essentially neutral. It is the way in which they are used, and how decisions as to their use are made, that should be examined to determine whether the prudence standard has been met. Even the most aggressive and
\end{quote}


\textsuperscript{36} Article 6 of Preamble, Directive 2003/41.

\textsuperscript{37} According to this article, pension funds shall invest in accordance with the following rules:

(a) the assets shall be invested in the best interests of members and beneficiaries. In the case of a potential conflict of interest, the institution, or the entity which manages its portfolio, shall ensure that the investment is made in the sole interest of members and beneficiaries;

(b) the assets shall be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole. Assets held to cover the technical provisions shall also be invested in a manner appropriate to the nature and duration of the expected future retirement benefits;

(c) the assets shall be predominantly invested on regulated markets. Investment in assets which are not admitted to trading on a regulated financial market must in any event be kept to prudent levels;

(d) investment in derivative instruments shall be possible insofar as they contribute to a reduction of investment risks or facilitate efficient portfolio management. They must be valued on a prudent basis, taking into account the underlying asset, and included in the valuation of the institution’s assets. The institution shall also avoid excessive risk exposure to a single counterparty and to other derivative operations;

(e) the assets shall be properly diversified in such a way as to avoid excessive reliance on any particular asset, issuer or group of undertakings and accumulations of risk in the portfolio as a whole. Investments in assets issued by the same issuer or by issuers belonging to the same group shall not expose the institution to excessive risk concentration;

(f) investment in the sponsoring undertaking shall be no more than 5 % of the portfolio as a whole and, when the sponsoring undertaking belongs to a group, investment in the undertakings belonging to the same group as the sponsoring undertaking shall not be more than 10 % of the portfolio. When the institution is sponsored by a number of undertakings, investment in these sponsoring undertakings shall be made prudently, taking into account the need for proper diversification.
unconventional investment should meet that standard if arrived at through a sound process, while the most conservative and traditional one may not measure up if a sound process is lacking.\textsuperscript{38}

The prudent person rule thus requires IORPs to have a robust system of internal checks and balances and a governance system in place rather than quantitative restrictions. However, some rules on cross-investing are still in place under the Directive,\textsuperscript{39} and quantitative investment principles are still allowed under certain conditions.\textsuperscript{40}

After the 2003 Directive, the Solvency II Directive (2009/138/EC) was adopted in 2009. The Solvency II aimed at the taking-up and the pursuit of the business of insurance and reinsurance within the EU. The purpose of the Directive was to provide a legal framework for insurance and reinsurance undertakings to conduct insurance business throughout the internal market, thus making it easier for insurance and reinsurance undertakings with head offices in the EU to cover risks and commitments situated therein. Similarly, to the 2003 Directive, the Solvency II also marked a transition from a rule-based approach to a risk-based approach to investing and thus introduced the prudent person principle for investments made by insurance and reinsurance undertakings on a unified legislative basis, cf. article 132 of the Directive.\textsuperscript{41}

\textsuperscript{38} Bevis Longstreth, Modern Investment Management and the Prudent Man Rule (Oxford University Press 1986), at 7.

\textsuperscript{39} Article 18 (1(f) Directive 2003/41.

\textsuperscript{40} See article 18, subsection 5-7.

\textsuperscript{41} According to article 132 of Solvency II, the prudent person principle is defined in the following way:

1. Member States shall ensure that insurance and reinsurance undertakings invest all their assets in accordance with the prudent person principle, as specified in paragraphs 2, 3 and 4.

2. With respect to the whole portfolio of assets, insurance and reinsurance undertakings shall only invest in assets and instruments whose risks the undertaking concerned can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of its overall solvency needs in accordance with point (a) of the second subparagraph of Article 45(1). All assets, in particular those covering the Minimum Capital Requirement and the Solvency Capital Requirement, shall be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole. In addition the localisation of those assets shall be such as to ensure their availability. Assets held to cover the technical provisions shall also be invested in a manner appropriate to the nature and duration of the insurance and reinsurance liabilities. Those assets shall be invested in the best interest of all policy holders and beneficiaries taking into account any disclosed policy objective. In the case of a conflict of interest, insurance undertakings, or the entity which manages their asset portfolio, shall ensure that the investment is made in the best interest of policy holders and beneficiaries.

3. Without prejudice to paragraph 2, with respect to assets held in respect of life insurance contracts where the investment risk is borne by the policy holders, the second, third and fourth subparagraphs of this paragraph shall apply. Where the benefits provided by a contract are directly linked to the value of units in an UCITS as defined in Directive
principle is placed in what is referred to as the 2nd pillar of the Solvency II Directive dealing with Qualitative Restrictions. The 1st pillar deals with Quantitative requirements and the 3rd pillar with Disclosure and market discipline. According to paragraph 71 in the Preamble the stipulated reason is: 'Insurance and reinsurance undertakings should have assets of sufficient quality to cover their overall financial requirements. All investments held by insurance and reinsurance undertakings should be managed in accordance with the 'prudent person' principle.'

The reason for including the reference to Solvency II in this paper, is the mixed nature of the most of the occupational pension schemes that include the saving as well as the insurance part. One part of the occupational pension scheme consists of classical saving that is combined with the savings of others while the second part is a form of a life insurance, yet these are often invested on the capital markets together. Therefore, we find both 2003 Directive and Solvency II highly relevant for our discourse. Due to the Member States’ diverse reference in their respective regulation governing the IORPs, the authors had to analyse the prudent person principle implementation through the lens of 2003 Directive in the UK and the Netherlands and through the lens of Solvency II in Denmark. This also allows us to examine the interpretation of this principle, given that in theory, the understanding of the prudent person principle should be universal across the financial industry.

Given that the general principle of Article 18 in Directive 2003/41 for IORP’s and Article 132 of Solvency II have been subject to 85/611/EEC, or to the value of assets contained in an internal fund held by the insurance undertakings, usually divided into units, the technical provisions in respect of those benefits must be represented as closely as possible by those units or, in the case where units are not established, by those assets.

Where the benefits provided by a contract are directly linked to a share index or some other reference value other than those referred to in the second subparagraph, the technical provisions in respect of those benefits must be represented as closely as possible either by the units deemed to represent the reference value or, in the case where units are not established, by assets of appropriate security and marketability which correspond as closely as possible with those on which the particular reference value is based. Where the benefits referred to in the second and third subparagraphs include a guarantee of investment performance or some other guaranteed benefit, the assets held to cover the corresponding additional technical provisions shall be subject to paragraph 4. 4. Without prejudice to paragraph 2, with respect to assets other than those covered by paragraph 3, the second to fifth subparagraphs of this paragraph shall apply. The use of derivative instruments shall be possible insofar as they contribute to a reduction of risks or facilitate efficient portfolio management. Investment and assets which are not admitted to trading on a regulated financial market shall be kept to prudent levels. Assets shall be properly diversified in such a way as to avoid excessive reliance on any particular asset, issuer or group of undertakings, or geographical area and excessive accumulation of risk in the portfolio as a whole. Investments in assets issued by the same issuer, or by issuers belonging to the same group, shall not expose the insurance undertakings to excessive risk concentration.
transposition by the Member States, in the following sections we analyse the specificities of the application of the prudent person rule in the three chosen jurisdictions to assess the character of the rule in practice.

3.2. **PRUDENT PERSON PRINCIPLE IN PRACTICE: WHAT CAN BE TAKEN INTO CONSIDERATION?**

First of all, it is necessary to re-emphasise that the prudent person rule is a behaviour-oriented principle rather than outcome-focused. Thus, the key element of the EU version of the prudent person rule is the attention on a trustee’s or fiduciary’s exercise of due diligence. This means that pension fund managers will be judged not by a retrospective assessment of whether their investment decisions were successful, but by whether they followed a reasonable process in reaching their decisions.\(^{42}\)

3.2.1. **THE UNITED KINGDOM**

In the United Kingdom, the duties and powers of IORPs derive from three sources (1) the trust document and rules of the pension scheme; (2) the general law and principles of equity applicable to trustees, which is a mixture of legislation, including the Trustees Act of 1925, and case law, and (3) the law specific to trustees of occupational pension schemes, found predominantly in the Pensions Act 1995 and Pension Schemes Act 2015.

The IORPs in the UK are bound to exercise reasonable care and to show the prudence and diligence that an ordinary man of business would in the exercise of his or her own affairs. According to the decision dating back to the 19\(^{th}\) century, the duty is to ‘… take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound.’\(^{43}\) Furthermore, in the light of the sections 33-36 of the Pension Act 1995, according to the investment principles, the trustees of a trust scheme – a pension fund – must make sure that there is prepared, maintained and from time to time revised a written statement of the principles governing decisions about investments for the purposes of the scheme. Subsection 3 of section 35

\(^{42}\) Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* (OUP, 1987), at 7. (‘Prudence is to be found principally in the process by which investment strategies are developed, adopted, implemented, and monitored in light of the purpose for which funds are held, invested, and deployed. Prudence is demonstrated by the process through which risk is managed, rather than by the definition of specific risks that are imprudent. Under a modern paradigm, no investment is imprudent per se. The products and techniques of investment are essentially neutral. It is the way in which they are used, and how decisions as to their use are made, that should be examined to determine whether the prudence standard has been met. Even the most aggressive and unconventional investment should meet that standard if arrived at thought a sound process, while the most conservative and traditional one may not measure up if a sound process is lacking.’)

\(^{43}\) *Re Whiteley* (1886) 33 Ch D 347 as cited in Moore, N. *Trustees’ Duties in Relation to Money Purchase Pension Schemes in Tolley’s Trust Law International* vol. 13, no. 1 (1999).
stipulates that the investment policy must include (a) the kinds of investments to be held, (b) the balance between different kinds of investments, (c) risks, (d) the expected return on investments, (e) the realisation of investments, and (f) such other matters as may be prescribed. Section 36 further provides the rules and factors that should be taken into consideration when choosing an investment. The section 36 further stipulates that the trustee (IORP) must have regard to (a) the need for diversification of investments, insofar as they are appropriate for the circumstances of the scheme and (b) to the suitability to the scheme of investments of the description of investment (investment policy) proposed. These broad rules have however been narrowed down in the light of the UK case law.

The case of Cowan vs. Scargill\footnote{Cowan v. Scargill [1984] 2 All ER 750.} has often been cited. At the core of the case was the question of whether it was lawful for the trustees to restrict funds to investments in the UK and prohibit investments in industries competing with the coal industry. Judge Megarry VC reached the conclusion that the trustees had breached their duty of loyalty by giving preference to the interests of the union in protecting the coal industry at the expense of the interests of the pension savers (members of the Mineworker’s Pension Scheme). The court case has been cited as laying down the rule that the trustees may not take into account interests of other groups of stakeholders than the best interest of the beneficiaries, meaning the financial interest of the members.

After Cowan vs. Scargill\footnote{[1984] Pensions Law Reports 8 (Court of Session).} a Scottish case was decided in Martin v The City of Edinburgh District Council.\footnote{<https://web.archive.org/web/20140924081849/http://lawcommission.justice.gov.uk/docs/lc350_fiduciary_duties_summary.pdf> accessed 16 June 2017.} After the Labour Party had won the majority in the City of Edinburgh District Council it requested that the city disinvested all investments in or related to South Africa due to the apartheid regime at that time. Judge Lord Murray held that the council was in breach of trust in pursuing a policy of disinvesting in South Africa as it had failed to expressly consider whether this cause of action was in the best interest of the beneficiaries.

The interpretation of the above cases is debated especially as to whether they exclude any non-financial considerations on behalf of the trustees, assuming that ESG is a non-financial consideration which is debated too. In 2014, the Law Commission (England and Wales) published their report “Fiduciary Duties of Investment Intermediaries” and in their summary they state:\footnote{A.18 Trustees may take account of any financial factor which is relevant to the performance of an investment. These include risks to a company’s long-term sustainability, such as environmental, social or governance factors (often referred to as “ESG” factors). A.19 The Law Commission’s conclusion is that there is no impediment to trustees taking account of environmental,} ‘A.18 Trustees may take account of any financial factor which is relevant to the performance of an investment. These include risks to a company’s long-term sustainability, such as environmental, social or governance factors (often referred to as “ESG” factors). A.19 The Law Commission’s conclusion is that there is no impediment to trustees taking account of environmental,
social or governance factors where they are, or may be, financially material. 'The Law Commission's recommendations still await the UK Government's response. However, on the basis of the existing case law and the expressed opinion of the Law Commission, the position seems to be that ESG can be given weight in decision-making as to investments or divestments but only to the extent this is in the best interest of the beneficiaries, meaning the financial interest of the beneficiaries.

3.2.2. Denmark

In Denmark the prudent person principle came into profound discussion with the implementation of the Solvency II Directive. The prudent person principle in the Solvency II Directive has been implemented by amending the Danish Financial Business Act, Article 158, subsection 1. The wording of the article is:

'(1) In their investment of assets insurance companies shall safeguard the interests of policyholders and beneficiaries in the best possible way.'

In the preparatory work regarding the previous rule in the Financial Business Act art. 158 on how insurance companies were to invest it was – amongst other requirements - required that the board ensured a sufficient diversification and aimed towards the largest possible return on investment. This implied according to the Financial Authority that investments could be divided into 4 groups:

1) Investments already made,
2) New investments, where the board in selecting and de-selecting investments pursue the highest possible return on investments,
3) New investments, where the board consciously decides on an investment, which does not pursue the highest return on investment,
4) New investments, where the board knows that self-elected costs concerning selection and/or post-control – for example complying with environment-requirements (at least) equivalent to Danish requirements – implies, that the highest possible return on investments is not achieved.

47 Directive 2003/41 was implemented by act no. 1561 of December 19, 2007 on company pensions, making applicable the rules in Directive 2002/83/EF on life insurance to company pensions.
48 Law no. 308, 28th of March 2015.
49 Law compilation no. 182 of 18th. of February 2015 with later changes.
50 The Danish wording was: 'De midler, et forsikringsselskab eller en pensionskasse råder over, skal investeres på en benægtetmæssig og for de forsikrede tjenlig måde, således at der er betraggende sikkerhed for, at selskabet til enhver tid kan opfylde sine forpligtelser.'
51 Memorandum of the Financial Authority dated October 9, 1997 'Pensionskassers og livsforsikringsselskabelernes investeringsstrategi, herunder om etiske investeringer.'
Investments as mentioned in no. 3 and 4 were considered illegal by the Financial Authority. The Financial Authority did however not state that an investment strategy consisting of "ethical investments" is illegal but it has to pursue the highest possible return of investment.

The question on whether the above mentioned limitations on ethical investments should stay in place was debated in the Danish Parliament. The minister of economy at the time, Marianne Jelved, argued that the ROI-criteria should remain and said (translated):

"The requirement of pursuing the highest possible return on investment protects the pension-savers from the board of the pension fund to invest the capital in a way which is detrimental to the economic interests of the pension-savers."

The Danish position according to the previous rules was thus, according to the Danish Financial Authority and the minister of economy, that a pension fund was not allowed to give priority to ESG considerations in making investment decisions if the board from the outset knew that the investment would result in a smaller return on investment in the long-run.

The question is whether the new formulation in article 158, subsection is going to change this position. According to the preparatory works to the provision it is anticipated that this will not be the case.

3.2.3. THE NETHERLANDS

The prudent person standard under the Dutch Pension Act 2007 (Pensioenwet) together with the Obligatory Occupational Pension Schemes Act (Wet verplichte beroepspensioenregeling) regulates the Dutch IORPs. In addition to these acts, the Foundation of Labour on request from the Ministry of Social Affairs and Employment adopted the Guidelines for Pension Fund Governance, stipulating among other principles the obligation for governing principles of IORPs.

According to the Dutch Pension Act, the prudent person rule is an open standard described in Article 135 in the following way:

1. A pension fund will conduct an investment policy in accordance with the prudent person rule, and specifically based on the following premises:
   a. The assets are invested in the interest of entitlement beneficiaries and pensionable persons; and
   b. Investments in the contributing company are limited to a maximum of 5% of the portfolio as a whole, and if the contributing company belongs to a

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52 Memorandum of the Financial Authority dated October 9, 1997 "Pensionskassers og livsforsikringsselskabernes investeringsstrategi, herunder om etiske investeringer."


54 To the knowledge of the authors, there is no case law that can confirm this position.

group, investments in the companies belonging to the same group as the contributing company are limited to a maximum of 10% of the portfolio. If a group of companies pays premiums to the pension fund, investments in these contributing companies will be made prudently, taking into account the need for appropriate diversification;

c. The investments are valued at market price.

1. Further rules to safeguard prudent investment policy will be set in or pursuant to an Order in Council.

2. The requirements set out in the first paragraph, opening lines and point b, and the rules set based on the second paragraph in regard to the diversification of assets to not apply to investments in government bonds.

As one can see, the Dutch prudent person rule is a mixture of a loyalty principle (1a), followed by quantitative limitations in the contributing company (1b). In the Explanatory Memorandum to the bill, in relation to the prudent person rule the following is stated:

The prudent-person rule has been chosen as the point of departure for the supervision of investments ... what is important in this regard is that the investments must comply with the principles of security, quality and risk diversification. In doing so, an important choice was made at the European level in favour of qualitative supervision of investments rather than quantitative restrictions on investments, which have characterised the financial supervision of pension funds in many other Member States for so many years... The interpretation of the concept of a 'prudent person' does not derogate essentially in practice from the interpretation given to the term "soundly" in Section 9b of the Pension and Savings Funds Act in past years by the Dutch Central Bank. It is expressly not the intention to give a stricter interpretation to the concept of "prudent person" than that given to the concept of "sound investment". Qualitative rules make it possible to deal better and with greater care with individual circumstances (in relation to investments) than is possible in the case of fixed quantitative criteria. The interests of members and pensioners are served much better by doing so. The other side of the coin is that supervision based on qualitative criteria is more difficult than supervision based on fixed quantitative criteria....

The Dutch Pension Act itself stipulates that more detailed rules are to be laid down by Council, which was carried out in the FTK Decree - Decree on the Financial Assessment Framework for Pension Funds (Besluit financieel toetsingskader pensioenfondsen). The FTK Decree leaves the pension funds' freedom to invest in markets, asset classes and investment instruments intact. According to Maatman, any investment restrictions

56 Actuarieel Genootschap, The Prudent-Person Rule in Relation to Investment Policy, 2010), at 8, emphasis added.
that result from the FTK Decree have prudential character, they should concern the pension fund’s balance sheet ratios and the solvency requirements formulated by the Dutch National Bank (DNB).  

Based on the above, it seems that the prudent person rule provides great flexibility to pension funds’ investment policy. However, in addition to the FTK Decree, DNB also provided a binding instruction relating to the application of the prudent person rule. As to the facts of the case, referred to as “the gold case”, the pension fund’s assets were allocated as follows: 78% government bonds, 13% commodities (gold), 8% cash investment and 1% real estate. DNB instructed the pension fund to reduce its gold allocation from 13% to 3%. The pension fund appealed DNB’s instruction in a court of law. Regarding the rationale for DNB’s instruction, the first argument of DNB was that as 55% of the 22% of the fund’s non-government bond assets were invested in gold, the pension fund was extremely dependent on the gold investment. According to the Court, this was a mere quantitative argument that fails to take into account the diversification of the assets in the pension fund’s overall portfolio. In the eyes of the Court, DNB could not successfully substantiate why a 3% gold allocation was more in line with the prudent person rule than a 13%. Secondly, DNB claimed that gold investment was risky and volatile due to the fall of gold prices in 1980s and its constant fluctuation. Yet, the Court held that this argument, given that the price of gold has been stable for the previous ten years, was not convincing. Ultimately, DNB emphasised that no other pension fund had a similar investment policy as the relevant pension fund. This argument was also rejected by the Court, as any pension fund should be free to select an asset allocation that accurately corresponds to the nature and duration of its liabilities, as long as the objective of the prudent person rule is achieved. Due to the instruction of DNB, the pension fund further claimed that it had lost €9.5m.

In the light of this case and the Explanatory Memorandum, the prudent person rule is understood in the Netherlands as a flexible principle that requires prudent aka sound investments in the name of pensioners. Pension funds should not be limited by any quantitative restrictions.

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58 Ibid.
60 Leen Preesman, ‘Court overturns Dutch regulator’s order to slash gold allocation’ Investment & Pensions Europe, 16 March 2012.
61 Ibid.
63 Ibid.
64 Leen Preesman, ‘SPVG continues battle with DNB over gold allocation’, Investment & Pensions Europe, 11 September 2013. To the knowledge of authors, the court has not ruled on the liability issue of the DNB for the financial loss of the pension fund.
According to the Court, DNB, as the prudent supervisor, has to always provide a well-reasoned tailor-made instruction in the light of the pension fund’s asset allocation and the nature and duration of its liabilities. In other words, as long as the pension funds carry out their investment decisions in the light of proper procedures and take into considerations all other requirements stipulated by law, led by the financial interest of pensioners, the DNB may not intervene.

3.3. LIABILITY ISSUES UNDER THE PRUDENT PERSON PRINCIPLE

The analysis of the understanding of the prudent person principle in all the three legal systems show that the basic approach has changed from the application of quantitative restrictions and the apprehensions that certain investments could be imprudent “per se” to a “liberalised” approach where the focus is on procedure and where no investment should be regarded as per se imprudent as long as it can be documented that the procedure surrounding the decision making was prudent.

As has been shown in section two, various soft law instruments encourage the pursuance of ESG goals by pension funds. This raises the question how far the board can go in the pursuance of such goals under the prudent person rule without incurring liability towards members for not having sought the most financially beneficial investments. The prudent person principle is a flexible concept leaving room for different interpretations in different national legal systems. This also means that there are different approaches to the extent to which ESG can be taken into account in different legal systems, within the limits of national implementation. In English law, such considerations seem to have been allowed for as long as the financial interests of the beneficiaries have also been taken into account. It is unclear whether under English law, it is only possible to give priority to ESG if this at the same time is considered to be the most financially beneficial investment to make, and to what extent this should be evaluated in the short or in the long term. In Dutch law, the focus has been on avoiding quantitative restrictions. The issue of ESG friendly investments seems not to have been directly addressed. In Danish law, in contrast, it has been quite clear that pension funds prior to the implementation of the Solvency II Directive have been required to seek the highest possible return for their members. It has only been possible to make ESG investments to the extent that such investments were at the same time the most financially beneficial investments. This would seem to imply that pension fund members could be able to hold board members liable for losses suffered by the members for investments that do not give the highest possible return, but are - for instance - ESG friendly for purely idealistic reasons. As explained, the introduction of the prudent person principle in the Solvency II Directive does not seem to change this.

65 Chance, 'Prudent pension investments: Court nullifies Dutch Central Bank instruction', Clifford Chance Client Briefing, April 2012.
However, in order to succeed with a liability claim several requirements must be met. Firstly, the plaintiff must be able to prove that he or she has suffered a loss and that the loss has been caused by the investment decision. In other words, the member of the pension funds must be able to show that the value of his or her pension has decreased due to the investment. Obviously, it may be extremely difficult for the member of the pension fund to lift the burden of proof in this regard.

Secondly, the plaintiff must prove that there is a basis of liability for the claim. In most legal systems, board members are subject to ordinary fault based liability. For board members in financial institutions the duties are specified in more detail than for other board members. On this basis it has been discussed whether board members in the financial sector (in banks in particular), are subject to a professional liability standard, meaning a stricter liability standard than “the reasonable man” (bonus pater) standard. At first sight, the prudent person principle might seem to support this view. However, as explained above, the main function of the prudent person principle has been to shift the focus from quantitative restrictions to procedure. Consequently, it cannot be assumed that the introduction of the prudent person principle in itself has introduced a stricter liability. In contrast, it could be argued that the turning away from quantitative restrictions to a procedural approach implies a much more complicated liability assessment as no investments can be regarded imprudent per se. Also, the fact that an investment is ESG friendly and thus may not in the short run be the most financially beneficial but may well be so in the long run, could be argued. Consequently, the task of arguing that there is a basis of liability for making an ESG investment rather than a more financially beneficial investment may be a demanding one for the pension fund member. However, with regard to pension funds the liability issue may be complicated further by that fact that members of the pension funds to some extent have the right to vote and exercise influence on the investment decisions. This raises the question to what extent such votes may influence the liability assessment. Under Danish law, it is the board that is responsible for making the investment decisions. Votes by members may be taken into consideration but the board is not obliged to follow such votes. Rather, the board is obliged to make “prudent” investment decisions. This means that even if a majority of members of the pension fund has been in favour of pursuing an ESG-friendly investment, the board still has the right to pursue non-ESG objectives, provided the board – in contrast to the members – believes that these investments will give the best return to the pension fund members.

For Danish law, see FIL §§ 70-71.

See Pensionsmarkedstædets rapport om etiske investinger, 2007, p. 8 with reference to two administrative decisions handed down by the Danish Financial Supervisory body (Finanstilsynet).

In 2014, the European Commission proposed a revision of Directive 2003/41/EC in order to improve the governance, risk management, transparency and information disclosure of IORPs. This endeavour was materialised in December 2016, when the Directive 2016/2341/EU was adopted and published in the Official Journal of the European Union.\(^{68}\)

There are several reasons why a new Directive has been adopted. First of all, the financial crisis has emphasised the need for sound governance of financial institutions. Second, the pensioner-to-employee ratio has increased, which calls for more retirement savings and for strong and reliable retirement savings. Due to the aging of the EU’s population and the increasing investment in these pension institutions across the EU, accumulation of capital in these vehicles by private individuals is unstoppable.\(^{69}\) Third, pension funds represent a strong player on the market, supporting a functioning capital market across the EU and thus greater support for cross-border activity has been necessary.\(^{70}\) According to the European Council, Directive 2016/2341 improves the soundness of the IORPs, information disclosure to the members, enhances the cross-border investment and portfolio transfers and beneficiaries and also encourages responsible investment.\(^{71}\) Member States have until 13 January 2019 to transpose the new Directive.

4.1. **The 2016 Directive and Responsible Investments**

Given the specific focus of this paper, we do not analyse in detail all the changes that the new Directive brings. In the following sections we focus only on the Directive’s new embracement of responsible investment and the possible consequences thereof.

We have analysed the notion of responsible investment in the light of the Principles for Responsible Investment (PRI), adopted in 2006, in the section 2.1. The same understanding has been adopted by Directive 2016/2341 when referring to the UN PRI (Article 58 Preamble).

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\(^{69}\) Currently, there are around four people of working age for every person aged over 65 years. By 2060, there will be only two people working for every retired one. This means an increased pressure on pension systems. On the other hand, presently the IORPs across the Europe hold assets worth €2.5 trillion on behalf of around 75 million Europeans, which represents 20% of the EU’s working-age population. It is highly presumable that this representation will only rise in the future.


\(^{71}\) Ibid at 2 and 3.
2003/41 did not mention responsible investment, ESG or CSR. At the time of the adoption of the Directive, these topics were far away from investment industry. However, the new 2016 Directive has adopted the PRI as the standard.

Article 58 of the Preamble to the 2016/2341 Directive stipulates that:

‘Environmental, social and governance factors, as referred to in the United Nations-supported Principles for Responsible Investment, are important for the investment policy and risk management systems of IORPs. Member States should require IORPs to explicitly disclose where such factors are considered in investment decisions and how they form part of their risk management system. The relevance and materiality of environmental, social and governance factors to a scheme’s investments and how such factors are taken into account should be part of the information provided by an IORP under this Directive. This does not preclude an IORP from satisfying the requirement by stating in such information that environmental, social and governance factors are not considered in its investment policy or that the costs of a system to monitor the relevance and materiality of such factors and how they are taken into account are disproportionate to the size, nature, scale and complexity of its activities.’

The investment policy represents a decisive aspect for investment execution and the IORPs should at least every three years review their investment principles, while being available to their members, beneficiaries and competent authorities (Paragraph 60 of Preamble). The investment policy plays an incremental role for a management of the IORP as it serves as a guideline for investments decisions. At the same time, the management decides under the prudent person principle that remains the key investment rule for IORPs. In comparison to the 2003/41 Directive, the 2016/2341 Directive, in most parts is identical. Only one new provision has been introduced that is directly connected to the PRI and ESG. According to Article 19(1)(b) the IORPs, ‘…within the prudent person rule, Member States shall allow IORPs to take into account the potential long-term impact of investment decisions on environmental, social and governance factors.’

Thus, reading the Article 19 (1)(b) in the light of the Preamble to Directive 2016/2341, from 2019 all IORPs across the EU should be allowed to take into consideration the ESG and PRI when making an investment. The only obligation is for the pension fund to disclose such consideration in its investment principles (Article 30) and towards prospective members (Article 41). Yet, the Directive is clear that all Member States shall provide for the IORPs to take the ESG into account when investing.

In addition to the clear reference to ESG in the investment policy and prospectuses, Directive 2016/2341 introduced an obligation for the

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72 Emphasis added.
73 Emphasis added.
IORPs own governance system. According to Article 21, the IORPs’ sound and prudent management, besides including adequate and transparent organisational structure, shall include considerations for ESG factors related to investment assets in investment decisions, and shall be subject to regular internal review. Furthermore, also the risk management, both internal and outsourced, take the ESG into review together with an assessment of new or emerging risks, including risks related to climate change (Article 25(2) and 28(2)).

Ultimately, Directive 2016/2341 obviously made a step forward in considering the ESG and loudly stipulates the pension funds’ right to consider the ESG and PRI in their investment policy. It has been stated that it is the strongest and clearest requirement on such issues yet seen in an EU text.74

4.2. LIABILITY ISSUES UNDER THE NEW DIRECTIVE

While the 2016/2341 Directive apparently “nudges” towards ESG and PRI, the specific wording of the Member States’ transposition is only to be seen. It could be argued that pension funds should be forerunners in pursuing ESG goals and it is plausible that some Member States will want to go a step further in nudging and will require the IORPs to simply take the ESG into account within their investment policy (due to the minimum harmonisation directive). However, based on the wording of Directive 2016/2341 itself, there is no plausibility for liability in case of non-pursuance of ESG in a concrete investment decision. The only obligation for the pension funds with regard to ESG is to take ESG factors into account in their system of governance, while not being obliged to take ESG as a “factor” itself when investing. The natural question to raise is what the difference between the two is. What is the difference between taking ESG into consideration within a corporate governance of an IORP vis-à-vis the investment decision? For the moment, the answer is unclear.

The ESG represents a set of value standards while the PRI represents a procedural tool. The PRI should transpose the ESG into every investment decision. The character of the ESG and PRI also lies in their unfolding and active character. The first step of a pension fund is to define what it understands as specific ESG factors, depending on the fund’s own activity and nature of investment. Secondly, once the ESG factors are determined, the pension fund has to identify the KPIs together with the formula for their measurability, comparability and traceability. In practice these are coded as indicators into an investment algorithm in

74 Catherine Howart, ShareAction Chief Executive stated that “[t]his is a landmark movement for responsible investment in Europe. European policymakers are to be applauded for their bold action is not only recognizing the clear financial risks posed by ESG factors, but also for mandating European pension funds to act on them.” <https://shareaction.org/press-release/iorps-ii-ground-breaking-esg-risk-protection-measures-afforded-to-european-pension-savers-the-uk-must-allow-savers-the-same-says-shareaction/> accessed 8 July 2017.
order to better estimate the investment’s performance. Thus, while the pension fund within its prudent management has the obligation to include consideration of ESG into its investment performance estimate and to its internal review (Article 21), it does not have the obligation to invest accordingly, meaning ESG-friendly. From a technical perspective, within its investment algorithm, it will consider ESG friendly factors as not positive indicators, thus modelling its investment on ESG non-friendly factors, identifying those as more economically beneficial. In other words, the pension funds have to do the analysis and adopt the ESG KPIs, yet according to Directive 2016/2341 they do not have an obligation to invest based on the outcome. It must be presumed that membership votes in favour of an ESG-friendly investment policy will not change this. Such a vote may be taken as advice but the responsibility to make the prudent investments still rests on the board.

It could be considered whether those pension funds that directly stipulate their adherence to ESG-friendly policy in their investment statement could have an obligation to live up to this policy, given the contractual character of the relationship between the members, beneficiaries and the fund. It is a difficult question, open for future endeavours, to what extent such policy could be considered to be “self-binding” on the pension fund’s management so that members and beneficiaries would be able to base a liability claim on it. Directive 2016/2341 does not state the binding character of the investment policy; therefore the national law would have to be assessed to reflect on the legal character of an investment policy.\footnote{In the Danish national legal system there is case law to the effect that internal guidelines may have an impact when determining liability questions, see U 2009.1835 H.}

5. CONCLUSIONS

Pension schemes all over the world do not only provide a financial safe haven for a retired workforce, but also represent substantial investors on capital markets. Pension funds’ savings are used to support economic growth and to finance the corporate sectors.

The IORP Directive from 2003 introducing the prudent person principle aimed at developing a pan-European pension market, with prudential investment supervision across the entire Europe while providing the opportunity for cross-border pension activities. The Directive was later followed up by the Solvency II Directive building also on the prudent person principle. The effect of this principle is a turn away from rule-based quantitative restrictions to a risk-based and procedurally oriented focus. At the same time numerous soft law instruments encourage ESG-friendly regulation. Under the 2003 Directive, the IORPs across the EU were obliged to adhere to the prudent person principle, while keeping open the substantive factors that should be considered. Now, the 2016 Directive suggests also the substantive factors, namely the
ESG. Yet, keeping the mandatory or non-mandatory nature of the ESG values for the Member States to decide. Even though, under the prudent person principle the approach towards investments has been liberalised, the “best interest” of beneficiaries remains the key principle for all the pension funds. Thus ultimately, it is to be seen whether the ESG-friendly investments will be over time considered as in the “best interest” of beneficiaries”. In other words, whether these will render the highest returns. From the liability perspective, the management of IORPs is left with a reasonable margin of appreciation. As long as they prudently assess the existing information, all that is stipulated as significant in their investment policy, they should be considered prudent. It will be difficult for fund members and/or beneficiaries to succeed with any liability claims as long as the management has acted diligently and procedurally correctly.