DIRTY AND DANGEROUS

HOW LUXEMBOURG'S SOVEREIGN PENSION FUND IS FUELING THE CLIMATE CRISIS AND FAILING TO PROTECT HUMAN RIGHTS

astm GREENPEACE

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WHAT THE FDC DOES AND WHY WE CARE

In Luxembourg, every employee of the private sector and every self-employed person pays into the compulsory public National Pension Insurance Fund (Caisse nationale d'assurance pension CNAP). The CNAP takes these social contributions and distributes them to the entitled pensioners. What is left over goes to the 'Fonds de compensation' (FDC). The FDC manages this reserve, to be used in the future for paying pensions, by investing in various private equities, bonds and state bonds around the globe through a number of sub-funds, some of them actively managed and some passively managed.[1]

In 2020, the FDC published its first Sustainable Investor Report, which states that "[a]s an institutional asset manager, FDC is aware of its ecological, social and good governance responsibilities."[2] In addition, the FDC declared that it will revise the fund's investment approach in the course of 2022 "in order to further integrate ESG and sustainability criteria into its investment strategy."[3] At the same time, however, the FDC as well as policy makers continue to refer to the fund's mandate, that is "to ensure the long-term viability of the general pension insurance scheme"[4], to justify the continued investment in certain companies, the activities of which are contributing to climate change, are harmful to the environment and/or in violation of human rights.

This is the issue that the Luxembourgish non-governmental organisations Action Solidarité Tiers Monde (ASTM) and Greenpeace Luxembourg address in this briefing. The two NGOs commissioned Nextra Consulting, an independent business and management consulting firm with a focus on sustainability, to analyse the investments made by the FDC in 2020 and assess them in terms of their sustainability. In this briefing, sustainability is defined as in line with the objective of the Paris Agreement to limit global warming to <1,5°C by 2050 (compared to pre-industrial levels) as well as being respectful of at least the International Bill of Human Rights, referring to among others the right to freedom of expression and assembly, safe working conditions, social protection and protection from adverse effects of climate change.

The resulting report forms the basis of this briefing, which also includes the demands by the two NGOs for improving the FDC investment policy. ASTM and Greenpeace Luxembourg decided to collaborate in the elaboration of the recommendations because their causes overlap and complement each other.[5]

[1] In case of an actively managed sub-fund, an asset manager is in charge of selecting the investment portfolio, i.e. the companies and states in which the sub-fund invests. The investment securities of a passively managed fund are not chosen by a portfolio manager, but instead are automatically selected to match an index or part of the market. For example, an S&P 500 index fund is a passively managed fund that mimics the S&P 500 index.

[2] FDC Sustainable Investor Report, page 4

[3] Fonds de Compensation, 'Rapport annuel 2020', page 7

[4] FDC Sustainable Investor Report, page 6

[5] For more information on the NGOs, please visit the ASTM website or the Greenpeace website, respectively.

THE PROBLEMATIC INVESTMENTS OF THE FONDS DE COMPENSATION

According to the definition adopted by the European Union,[6] sustainable finance refers to the process of taking environmental, social and governance (ESG) considerations into account when making investment decisions in the financial sector, leading to more long-term investments in sustainable economic activities and projects. The term implies consideration for both climate change mitigation and human rights protection. In its 2020 Sustainable Investor Report, the FDC claims that "sustainability and ESG considerations are fully integrated into the investment process." However, the independent, in-depth analysis conducted by Nextra Consulting revealed that some of the companies the FDC invests in are contributing to the climate emergency (especially fossil-fuel companies) as well as to human rights violations.

THE FDC'S LOVE FOR FOSSIL FUELS

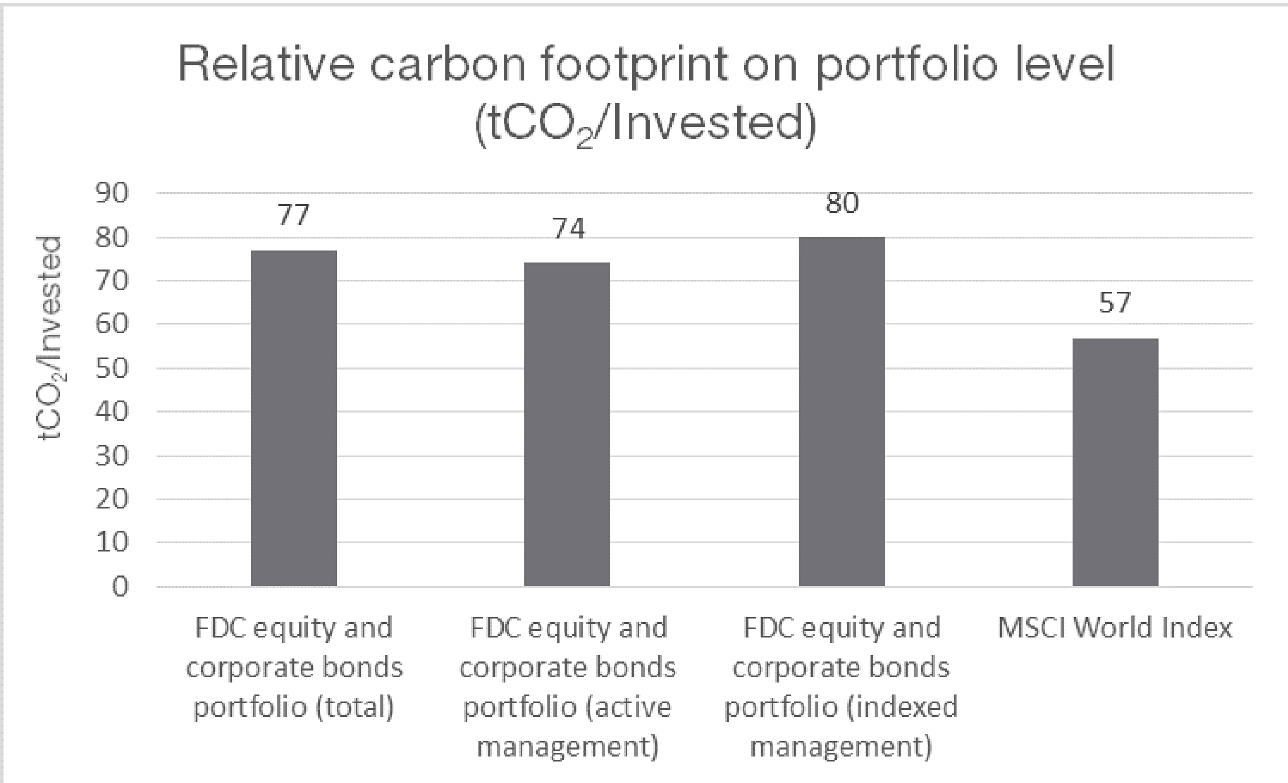
The burning of fossil fuels (like coal, oil and gas) is the primary cause of global warming and climate change.[7] Yet, the Luxembourg sovereign pension fund, a public institution of a country that ratified the Paris Agreement and the only pension fund available to employees of the private sector, continues to invest in the fossil fuel industry. The aggregated equity and corporate bond portfolio of the FDC's 2020 investments is associated with a potential temperature increase of 2.7°C by 2050, with two sub-funds even heading for a 6°C emissions pathway.[8] In addition, the portfolio's carbon budget exceeds a Paris-aligned carbon budget in the year 2028 already. This means that over the next 6 years, the companies in the FDC portfolio will emit as much carbon emissions as they would be allowed to under a Paris-compatible scenario until 2050.

The FDC's asset portfolio includes some very emission-intensive holdings, exacerbating its carbon footprint performance. The pension fund finances 1,001,741 tons of greenhouse gas emissions through its aggregated equity and corporate bond portfolio, which is equivalent to approximately 9% of Luxembourg's direct greenhouse gas emissions.[9] The relative carbon footprint performance of FDC's analysed aggregated equity and corporate bond portfolio is 35% higher than the MSCI World Index[10] - this holds true for both actively and passively managed sub-funds.

Aggravating the already significant negative impact of the FDC's investment portfolio on the environment and society is the fact that the fund is invested in companies linked to controversial and unconventional energy extraction business practices, such as arctic drilling, hydraulic fracturing (also known as fracking) and the exploration of oil sands as well as shale oil and gas. These business practices are often linked to harming ecosystems and human rights violations by threats including drinking water contamination or habitat destruction and natural resources impacts.

[6] European Commission, Overview of sustainable finance
[7] United Nations Climate Action, Key Findings - Physical Science
[8] FDC SICAV Actions EMMA Indexé and SICAV Actions EMMA Actif 1
[9] European Union, Climate action in Luxembourg: Latest state of play, 10 June 2021
[10] The MSCI World is a market cap weighted stock market index of 1,546 companies throughout the world. It is maintained by MSCI, formerly Morgan Stanley Capital International, and is used as a common benchmark for 'world' or 'global' stock funds intended to represent a broad cross-section of global markets.

> *The pension fund finances 1,001,741 tons of greenhouse gas emissions through its aggregated equity and corporate bond portfolio, which is equivalent to approximately 9% of Luxembourg's direct greenhouse gas emissions model.*



CASE STUDY 1

INVESTMENTS SUPPORTING COAL PROJECTS THREATENS ECOSYSTEMS AND LIVELIHOODS

One of the FDC's investee companies (found in one actively and one passively managed fund) is the National Thermal Power Corporation, India's largest thermal power generating company.

The company has been involved in mercury poisonings, illegal wastewater effluents, improper disposal of coal ash, and allegations of corruption in India and abroad. The company has long been associated with the construction and operation of the highly critical Rampal coal power in Bangladesh that is located just outside the largest mangrove forest in the world which, at the same time, is a UNESCO world heritage site and an important CO_2 reservoir.

Now, the ecosystem – but also the livelihood of more than two million people who depend on the forest's resources - are threatened. As a result of the destruction of the ecosystem, up to 120 million additional tons of carbon are expected to end up in the atmosphere every year. This corresponds to around ten percent of global carbon emissions from deforestation.

THE FDC'S BLIND SPOT: HUMAN RIGHTS VIOLATIONS

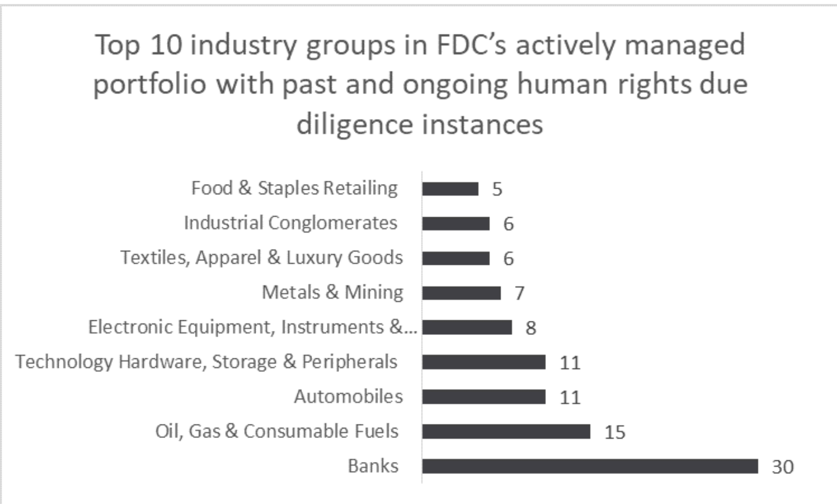
Within the FDC's actively managed equity and corporate bond portfolio, there are 282 reported instances by 196 companies of past and on-going failures to conduct human rights due diligence.[11] The financial sector is particularly at fault in this context, as 30 out of these 196 companies are banks.

The FDC is significantly exposed to high-risk sectors from a human rights perspective. 413 companies of the FDC's actively managed equity and corporate bond portfolio belong to human rights high-risk industries (agricultural products, apparel, automotive manufacturing, extractives, information and communication technology manufacturing). Among these companies, the analysis conducted by Nextra Consulting revealed 94 cases with past and on-going failures to conduct human rights due diligence.

Some of the FDC's investment activities do have a positive impact on the 17 Sustainable Development Goals (SDGs)[12], as highlighted in the Sustainable Investor Report 2020. However, the same report does not analyse or even mention any negative impact that the pension fund's investments might have in terms of the SDGs. 47% of the companies in the FDC portfolio present a negative SDG rating. The impact of the FDC's investments is particularly detrimental in terms of SDG 8 (Decent Work & Economic Growth), where 51% of the companies have a negative impact, as well as with regards to SGD 12 (Responsible Consumption and Production), where 37% of the portfolio companies impact negatively.

Big food companies in particular bar the way to progress for the SDG 2 (Zero Hunger) and SDG 3 (Good Health). 92% of the big food companies in which the FDC invests[13] have a negative impact on SDG 2 and 79% impact negatively on SDG 3, whereas the overall percentage of companies with a negative impact on these two SDGs are 8% and 32%, respectively.

Overall, the asset managers contracted by the FDC fail to consider human rights in their sustainability approach. While all of them state that ESG factors are integrated in the development of their respective portfolios, their understanding of sustainability is too often limited to environmental or climate aspects to the detriment of social or human rights-related considerations. Out of the 18 asset managers, only five mention human rights at all, and out of these five, only two are able to give details about the human rights policy within their sustainability approach.



[11] Human rights due diligence essentially means that a business must take all necessary, adequate, and effective measures to identify and assess their actual and potential adverse human rights impacts throughout their value chains; prevent, mitigate, or cease these impacts; track and monitor the effectiveness of the actions they have taken; and be accountable to the public. Companies must also be required to remedy harms that have occurred.

[12] The 17 SDGs are: (1) No Poverty, (2) Zero Hunger, (3) Good Health and Well-being, (4) Quality Education, (5) Gender Equality, (6) Clean Water and Sanitation, (7) Affordable and Clean Energy, (8) Decent Work and Economic Growth, (9) Industry, Innovation and Infrastructure, (10) Reduced Inequality, (11) Sustainable Cities and Communities, (12) Responsible Consumption and Production, (13) Climate Action, (14) Life Below Water, (15) Life On Land, (16) Peace, Justice, and Strong Institutions, (17) Partnerships for the Goals.

[13] Associated British Foods (ABF), Coca-Cola, Danone, General Mills, Kellogg, Mars, Mondelez International, Nestlé, PepsiCo, Unilever

CASE STUDY 2

FDC INVESTMENT IN A MINING COMPANY INVOLVED IN VIOLATIONS OF WORKERS AND UNION RIGHTS IN LATIN AMERICA

The Cerrejón mine in Colombia is one of the largest open pit coal mines in the world, employing around 10,000 workers. Until the end of 2021, the project had been a consortium equally owned by BHP, Anglo American and Glencore. The project has been systematically accused of poor stakeholder consultations and human rights violations against indigenous groups and the right to health and well-being. Already in 2001, the displacement of five indigenous communities from their traditional territories made headlines.

Later, the Colombian Constitutional Court confirmed the mine's negative impact on human rights several times and ordered the company to adopt stricter preventive measures. This included a ruling in December 2019, where the Court found that the Cerrejón company had damaged the health of residents in the region by contaminating the air, water, and vegetation, and through noise and vibration from mining as operations are carried out 24/7, using heavy machinery and explosives.

Further controversial areas are the health and safety of workers and the rights of trade unions. According to the mine workers' union, 700 workers suffer from severe health problems that are a direct result of the inadequate working conditions at the mine. The workers are forced to work 12-hour shifts and do not receive adequate medical care. Pro-union workers have reportedly been intimidated or fired and replaced by casual workers who are paid less than their permanent colleagues.

CASE STUDY 2

The example of the Cerrejón mine illustrates the limits of the FDC's current responsible investment practices. The BHP was on the FDC's exclusion list in 2018 but the FDC restarted its investments in BHP in 2019. The analysis of the FDC's equity and corporate bond portfolio revealed that investments in BHP also continued in 2020 - despite the proven human rights violations and Court rulings linked to BHP's Cerrejón mine. In addition, part of the FDC's investment in BHP is within the portfolio SICAV Actions Monde – Actif 2, which is considered “sustainable” as it obtained the LuxFlag ESG Label.

BHP is systematically linked to human rights violations caused by its activities, particularly in the mining sector in Latin America. In Brasil, the collapse of the Samarco dam in 2015 released more than 33 million cubic metres of mine tailings into the environment, taking the lives of 19 people.[14] In Ecuador, the activities of the Warintza mining project on the territory of the indigenous Shuar Arutam people has led to threats against the communities and defenders.[15] In Peru, the Anatamina mine has reportedly polluted the water in the Ancash region, threatening the water supply and the health of the local population.[16] In 2018, the global union federation IndustriALL launched a campaign against BHP stating that "the same practices exist in all of BHP's operations: a policy of outsourcing to cut labour costs and a disrespect for the fundamental rights of its workers and communities."[17]

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[14] United Nations Environment Programme, New report urges global action on mining pollution, 13 November 2017

[15] Environmental Justice Atlas, Proyecto minero Warintza de Solaris Ressource Inc., Ecuador, 27 September 2021

[16] Business & Human Rights Resource Centre, “Áncash ocupa segundo lugar en pasivos mineros y urge protección de las cabeceras de cuencas”, 24 January 2019

[17] IndustriALL Global Union, SPECIAL REPORT: BHP must #ShowRespect for workers' rights, 13 November 2019

RISKY BUSINESS: STRANDED ASSETS PUTTING OUR PENSIONS AT RISK

Investing in fossil-fuel companies is not only harmful to the environment, destroying the habitat and health of communities around the world; it also comes with considerable financial risks. Financial assets tied to fossil fuels are predicted to become “stranded assets” in the near future, i.e. assets that are no longer able to generate an economic return because of changes associated with decarbonising the economy. Companies with a non-sustainable, non-transformable core business model such as fossil fuel multinationals are facing so-called transitional risks. In short, this means that a change in consumer behaviour due to a changing regulatory framework or the development of new climate-friendly technologies will lead to a decline in value of polluting carburants, making investments in carbon-intensive assets less attractive. The latest Global Risk Report by the World Economic Forum published in January 2022 confirms the critical importance of transitional risks and highlights the fear of a disorderly and disruptive transition with late and rapid policy shift towards a low-carbon economy destabilising the financial system. Such a disorderly transition will likely affect carbon emission-intensive sectors and their supply chains the most.

The exposure of the FDC’s investment portfolio to potential stranded assets is worrisome to say the least. 45% of the energy assets in the FDC’s aggregated equity and corporate bond portfolio are fossil fuels. Moreover, most of the companies that the pension fund invests in show no concrete, measurable plan to transition to a sustainable business model. Only 23% of the FDC’s actively managed equity and corporate bond portfolio value is covered by issuers with a validated Science Based Target.[18] Further 16% of the investment value is covered by issuers that have committed to setting Science Based Targets, but have not yet done so.

Analysing the index funds reveals a similar picture with 21% of the corresponding investment value covered by companies with verified Science Based Targets and further 12% with a commitment to set Science Based Targets.[19] That leaves investee companies representing 61% of the actively managed portfolio value and 67% of the passively managed value without a strategy to become Paris aligned and avoid becoming stranded assets.

By investing in fossil fuels and other high-carbon assets, the FDC is choosing to expose itself to potentially great financial losses, thus effectively putting the pensions of retirees and future generations at risk.

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[18] The Science Based Targets Initiative guides companies in setting science-based climate targets and validates that their set targets are in line with latest climate science to meet the goals of the Paris Agreement.

[19] In this case, the worst performing sub-fund is the FDC SICAV Actions EMMA Indexé with only 1% of the corresponding investment value covered by companies with verified Science Based Targets and only 5 % with a commitment to Science Based Target.

BOTTOMLINE: A WEAK AND NON-CONSISTENT SUSTAINABLE INVESTMENT STRATEGY

Despite statements made in the Sustainable Investor Report 2020, the FDC follows no coherent, overarching sustainability approach. Instead, the responsibility is delegated to the individual asset managers. When selecting asset managers for the various sub-funds, the FDC refers to an internally developed questionnaire encouraging the consideration of sustainability criteria. However, the asset manager selection questionnaire only asks whether the asset manager follows any kind of sustainability approach and if so, what said approach looks like. The FDC does not formulate any requirements for the type, scope and impact of such an approach nor does it have a corresponding global approach for the whole fund in place. It does not impose any requirements on its asset managers to follow a systematic investment strategy in line with the 17 Sustainable Development Goals defined by the United Nations (SDGs), the United Nations Guiding Principles for Business and Human Rights or the Paris Agreement.

As mentioned above, the FDC Sustainable Investor Report 2020 does not analyse or even mention any negative impact that the pension fund's investments might have in terms of the SDGs. The Nextra analysis shows that there is a negative impact from 47% of the investee companies, both in terms of human rights and environmental repercussions.

In addition, neither the FDC Sustainable Investor Report 2020, nor the assets managers' policies mention the practice of human rights due diligence to assess the human rights performance of investee companies. In this context, it is worth noting that Luxembourg's National Action Plan 2020-2022 on Business and Human Rights foresees the implementation of pilot projects on due diligence in companies with majority state ownership.

When addressing its investment policy, the FDC often refers to its exclusion list to demonstrate its commitment to sustainability. The list in question excludes companies that violate international standards as set out in the ten principles of the United Nations Global Compact. While commendable in principle, this affects very few companies compared to the total investment universe of the pension fund. Only 126 companies are excluded from the FDC investment universe (as of 30 October 2020) while its aggregated equity and corporate bond portfolio covers holdings from approximately 5,700 companies. The criteria defining the exclusion list are not transparent and have proven to be insufficient as several companies in the FDC's actively managed equity and corporate bond portfolio have committed verified violations against the principles of the United Nations Global Compact.

Another argument often brought forward by the FDC to defend its sustainability approach is the fact that 75% of FDC's actively managed transferable securities hold a LuxFLAG label. The Luxembourg Finance Labelling Agency (LuxFLAG) awards ESG labels to investment products that (according to the agency) incorporate ESG criteria throughout the entire investment process. Even though requirements for sustainability labels in the EU are increasing, labelled investments cannot guarantee that investment activities do not have any negative impacts on environment and society.

Though the FDC has taken first steps toward measuring and implementing sustainability in its investment approach, its efforts pale in comparison with other pension funds such as the EU's biggest pension fund ABP, Danish pension provider ATP, and many others[20] that have divested completely from fossil energies. Its most decisive move toward integrating sustainability in its portfolio is the implementation of weak exclusion criteria. To address climate risks in its investment process, the FDC merely "encourages" its asset managers to "periodically measure and report the carbon footprint" of the portfolio(s) they manage.[21] The fund has not formulated any further quantifiable sustainability targets to achieve nor Key Performance Indicators to measure progress. This unambitious approach cannot be concealed by publishing a Sustainable Investor Report or highlighting the share of ESG labelled funds (that do not necessarily rule out negative impacts by the FDC' investment activities). The Luxembourg pension fund must formulate, implement and oversee a comprehensive, ambitious and assessable sustainable investment that is respectful of the planet and its inhabitants.

[20] Divestment Database

[21] FDC Sustainable Investor Report 2020, page 27

ASTM AND GREENPEACE LUXEMBOURG: OUR DEMANDS

Over the coming months, the FDC will review its investment strategy for the period 2023-2028, representing a unique opportunity to significantly improve its sustainability performance. ASTM and Greenpeace Luxembourg propose concrete steps in terms of governance, investment strategy, divestment and government action to advance Luxembourg's sovereign pension fund on its path to becoming aligned with the Paris Agreement and respectful of human rights.

DEMANDS TOWARDS THE FDC

For the FDC to be sustainable, its overall investment policy needs to be revised: the implementation of one global, coherent and ambitious investment strategy for the fund as a whole as well as for individual asset managers and their mandated sub-funds (both actively and passively managed) is critical in this regard. Fund managers need to be supervised and supported in implementing the FDC's sustainable investment strategy, exclusion list, ESG criteria, and reporting standards.

The FDC's existing ESG criteria must become more ambitious. Strict criteria and a transparent methodology must be put in place, including meaningful climate protection and human rights due diligence requirements for fund managers and investee companies. Furthermore, the fund should start introducing targets to reduce biodiversity risks.[22]

A clear signal in favour of sustainability would and should be the divestment from all companies that are unable to transition to a Paris compatible business model. In terms of fossil fuel divestment, the FDC should be guided by the Global Coal Exit List[23] and the Global Oil and Gas Exit List[24]. Investing in companies with particularly contentious operations such as arctic drilling, fracking, oil shale extraction, etc. must cease immediately. Also, a sustainable portfolio cannot include investments in companies active in the field of nuclear energy. Of course, the FDC must also divest from companies whose activities have repeatedly been found in violation of human rights.

All investments ought to be aligned with the objective of the Paris Agreement of limiting global warming to 1,5°C; climate-related financial risk should be disclosed. The fund's policies and any outsourcing contracts with external fund managers should further accommodate the OECD Guidelines for multinational enterprises and institutional investors as well as the UN Guiding Principles on Business and Human rights. Regular reporting in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), the Task Force on Nature-related Financial Disclosures (TNFD) and the UN Guiding Principles Reporting Framework[25] should be implemented.

To ensure compliance with ESG criteria, the FDC must establish a clearly defined, continual and publicly available engagement policy with regards to investee companies. It must determine how to address human rights risks as well as climate-related financial risks and the negative impacts of its investment activities, and instruct its asset managers on how to do so in turn.

In terms of governance, the FDC needs to become more inclusive. The development of the revised investment policy should involve all relevant stakeholders - not only delegates from the government, the employers federation and trade unions, but also from civil society organisations; the resulting guidelines and objectives should be enshrined in the directive of the FDC's board of directors. The FDC must proactively seek input from relevant stakeholders as part of its efforts to meaningfully as-

[22] "Biodiversity underpins all economic activities through the provision of a range of ecosystem services, and it is experiencing dangerous and unprecedented declines due to the current model of economic development. The world's ecosystems have declined in size and condition by 47% globally compared to estimated baselines, and the continued degradation of ecosystem services represents an annual loss of at least US$479 billion per year. With recent estimates stating that more than half of the world's total Gross Domestic Product is moderately or highly dependent on ecosystem services, these declines in biodiversity are a signal that action needs to be taken to strengthen the global economy's resilience." UN Environment Programme, UNEP Finance Initiative and Global Canopy 2020. Beyond 'Business as Usual': Biodiversity targets and finance. Managing biodiversity risks across business sectors. UNEP-WCMC, Cambridge, UK

[23] Global Coal Exit List 2021

[24] Urgewald, Die Global Oil and Gas Exit List

[25] The UN Guiding Principles Reporting Framework is a comprehensive guidance for companies and institutions to report on how they respect human rights. Further information is available here.

sess the sustainability performance of investee companies. If necessary, external experts should be consulted on matters regarding investment impact on climate, biodiversity and human rights, and their assignment ought to be communicated in a public manner.

"The FDC must determine how to address human rights risks as well as climate-related financial risks and the negative impacts of its investment activities, and instruct its asset managers on how to do so in turn."

DEMANDS TOWARDS POLICY MAKERS

In addition, ASTM and Greenpeace Luxembourg call upon the members of the government and parliament to assume their responsibility for a sustainable sovereign pension fund. The FDC's mandate, defined by the law of 6 May 2004 on the administration of the assets of the general pension scheme, needs to be clarified. To avoid any contestation on this point, It should explicitly include the incorporation of sustainability criteria in its investments.

The legislator should amend the legal framework to establish clear investment criteria for the FDC that are in line with the International Bill of Human Rights, the United Nations Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises, international conventions ratified by Luxembourg (including the Paris Agreement and the Convention on Biological Diversity), as well as any other international treaties that have been or will be ratified by the Grand Duchy. Such a law should include provision regarding the exclusion of investments in specific companies or sectors, including but not limited to the nuclear sector.

In the context of the review of the current legislation, the legislator should consider the establishment of an ethics committee to assess the sustainability of the FDC's investment activities and make recommendations. The committee should be composed of experts from various sectors of Luxembourg society, chosen for their knowledge, competence and commitment to sustainable development. In order to be transparent and accountable to its beneficiaries, all these processes should be communicated and made available to the public.

Referring to the law of 6 May 2004, the FDC insists on the tenets of profitability and diversification in its mission statement to the detriment of its actual duty of guaranteeing the safe lifestyle and wellbeing of current and prospective retirees. Its mandate must include the implementation of a truly sustainable investment strategy if it is to safeguard our future.

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