The FDC's sustainable Investment Approach[1] - Summary

A Critical Analysis based on the *FDC's Sustainable Investor Report 2024*

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1. Introduction

As Luxembourg's sovereign pension fund, the Fonds de compensation (FDC) manages the retirement savings of current and future generations with a dual responsibility: ensuring long-term financial returns and contributing to the public interest. Given the urgency for decarbonization and the growing recognition of finance as a lever for climate action, the FDC is expected to lead by example in sustainable finance.

In 2020, the FDC published its first Sustainable Investor Report, which revealed several areas for improvement regarding its sustainable investment practices. Published in January 2025, its second report reaffirms a commitment to responsible investment but shows limited evidence of strategic shifts or strengthened sustainability practices. The following summary will focus on the main findings of Nextra's analysis of the FDC's *Sustainable Investor Report 2024*, examining both its main shortcomings and the actual progress made since the first report in 2020.

2. Criticism based on FDC's *Sustainable Investor Report 2024*

Greenpeace Luxembourg commissioned Nextra Consulting GmbH with the analysis of the *FDC's Sustainable Investor Report 2024*. This analysis reveals several areas for improvement which can be categorized into five key themes.

2.1. Alignment with Fiduciary Duties

As the sovereign pension fund of Luxembourg, the FDC has a fiduciary duty to act in the best interests of its beneficiaries, which includes addressing long-term financial risks such as climate change and unsustainable business practices that could undermine the financial stability of the fund. An important aspect of fiduciary duty is engagement with investee companies, which involves constructive dialogue with companies aimed at improving their ESG performance to mitigate associated financial risks. The FDC delegates engagement responsibilities to external asset managers but sets only vague expectations, offering little transparency and oversight regarding monitoring of the asset managers engagement practices.

While the FDC commits to responsible investment principles and adheres to international frameworks, which promote a precautionary approach and environmental responsibility, it continues to invest in companies contributing to climate change as well as other highly polluting industries linked to severe climate-harmful impacts. This raises critical questions about whether the FDC adequately oversees or evaluates the effectiveness of its asset managers' engagement efforts, beyond passive involvement in collaborative initiatives such as the UN PRI (UN Principles of Responsible Investment).

The FDC explicitly rejects the broader exclusion of entire sectors and exclusions targeting specific environmental issues (such as climate change), claiming that more stringent exclusion policies could jeopardize its track record of achieving an average annual return of around 5%. This means that critical sectors contributing to climate change as well as other highly polluting industries are not categorically excluded from the FDC's portfolio. This approach stands in contrast to more ambitious strategies adopted by other pension funds, such as the Norwegian Pension Fund GPFG, which excludes 100 companies for

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[1] The complete analysis can be consulted here (add link)

environmental reasons (of which 69 for climate-related reasons), while achieving stronger average annual financial returns than the FDC. This clearly challenges the FDC's argument, demonstrating that more ambitious policies do not necessarily compromise financial performance.

Legal analysis reveals that the FDC has the flexibility to implement stricter exclusion policies without requiring legislative changes.

2.2 Selection of Asset Managers

A central element of the FDC's investment process is the delegation of day-to-day portfolio management to external asset managers. Despite their critical role, the FDC has not set clear and ambitious sustainability guidelines which undermines the FDC's commitment to responsible investment, allowing asset managers to adopt low-ambitioned or symbolic environmental, social and governance (ESG) strategies.

The FDC claims to assess sustainability through a questionnaire during asset manager selection, however, the lack of defined evaluation criteria makes it difficult to ensure meaningful ESG integration. Concretely, the current lack of transparency raises concerns about how effectively climate-related risks and opportunities, such as companies' alignment with decarbonization pathways, are considered in investment decisions.

Despite past criticism, there has been limited improvement on this issue. The lack of transparency and ambitious selection criteria for asset managers continue to be an area of concern. Without ambitious standards and accountability, the FDC risks continuing to support unsustainable investments that contradict its own stated principles. The FDC should ensure that the chosen sustainable investment strategies effectively contribute to genuine management of sustainability-related risks in the portfolio.

2.3. Integration of ESG criteria and climate-related Risks

Integrating ESG criteria and climate-related risks is a core responsibility for an institutional investor like the FDC. However, despite the four-year gap since the first report and increasing evidence of the impact of climate related weather events, the FDC has not yet aligned its investment strategy with the Paris agreement: Despite acknowledging the importance of the 2°C climate goal, the FDC has not committed to it. Its aggregated portfolio follows a 2-3°C pathway with growing misalignment by 2030. The FDC reports a reduction in its portfolio over-budget from 13% to 5% compared to the last report as a sign of progress. However, a 5% over-budget still corresponds to nearly 800,000 tCO_2e, underscoring that FDC's investments remain misaligned with the 1.5 to 2°C climate target. Framing this as progress obscures the fact that the portfolio still contributes to a future climate scenario where impacts become increasingly severe, widespread and irreversible.

Overall, the FDC reveals to be partially more exposed to climate-related risks compared to its benchmarks. An analysis indicates that the FDC's portfolio has a higher exposure score to physical risks and resulting financial impacts. It remains uncertain whether the heightened exposure could indicate increased vulnerability to climate-related events, potentially resulting in greater financial losses compared to the benchmark.

Instead of setting binding requirements for ESG integration and the consideration of climate-related risks in investment decisions, the FDC suggests a preference for voluntary commitments. This lack of enforceable standards has led to inconsistent application of ESG criteria. While approximately 80% of actively managed sub-funds claim ESG integration, it remains unclear why full alignment with the Paris Agreement is not achieved.

For its passive investments, which account for nearly 50% of the portfolio, the FDC appears not to integrate ESG criteria, arguing that this is “hardly conceivable with regard to indexed management”. However, several ESG indices (e.g., MSCI ACWI SRI, Dow Jones Sustainability Index) show that ESG integration is compatible with passive investing and may even match or outperform results based on traditional benchmarks.

2.4. Reporting of sustainability-related Impacts

Transparent and credible sustainability impact reporting is essential for sovereign pension funds like the FDC to demonstrate that their investments support sustainability objectives. This requires clear methodologies, measurable indicators, and independent verification.

However, the FDC’s reporting practices risk drawing an overly positive impression on the negative and positive sustainability impact generated.

One example is the FDC’s presentation of its portfolio carbon footprint. The FDC report concludes that the aggregated portfolios contribute less to climate change and are less exposed to carbon-intensive companies, based on their slightly lower weighted average carbon intensity (WACI) compared to the benchmark. However, the WACI is a relative, intensity-based metric that measures emissions per unit of revenue. In other words, a company with high emissions can still reveal a low WACI if its revenues are sufficiently large. This means that the reported reduction in carbon intensity does not necessarily reflect a reduction in the portfolio's climate impact.

Throughout the report, the FDC frequently highlights the positive impacts the fund has generated. However, the FDC does not explain how these positive impacts are measured or verified, raising significant concerns about the accuracy and credibility of these claims.

Specifically, the FDC’s reporting on its green bond portfolio highlights metrics such as renewable energy generated or CO_2 emissions avoided, presenting these as direct positive outcomes of its investments. However, the underlying calculations are not fully transparent. In practice, the reported impact metrics are likely based on unverifiable self-reports from companies or estimated by asset managers.

Thus, the FDC indirectly exposes itself to “green-washing” allegations. This approach mirrors similar practices that have previously triggered consumer protection lawsuits, where courts ruled that associated claims were either not logically comprehensible or constitute misleading practices.

2.5. LuxFLAG Labelling

LuxFLAG is a well-known ESG sustainability certification, however its standards may vary considerably in their rigor and scope and do not necessarily reflect comprehensive or robust sustainability performance. While the FDC highlights LuxFLAG certification to demonstrate its sustainability ambitions, this may give an overly optimistic impression of its actual ESG integration.

LuxFLAG’s exclusion policy is notably weak. It does not explicitly exclude fossil fuel companies and allows up to 25% of total assets to be invested without sustainability criteria. Even in environmental investments, up to 80% of a company’s turnover may fall outside sustainability considerations.

Finally, LuxFLAG claims to monitor ongoing compliance but offers little transparency on how it verifies ESG standards, raising concerns about the label’s credibility.

Thus, while the FDC proudly highlights the increase of LuxFLAG-labelled actively managed assets from 72% to 100% compared to the first report, this does not necessarily reflect a genuine improvement in sustainability ambitions. Rather, it may give consumers an overly positive impression of the fund's actual sustainability quality.

3. Further Action

To effectively address key shortcomings in the FDC’s investment approach, the following five recommendations are proposed:

1. **Alignment with fiduciary duties:** Application of consistent exclusions for critical sectors (such as fossil fuels), increased transparency, and binding engagement guidelines for asset managers to improve the FDC’s weak engagement practices.

2. **Selection of asset managers:** Introduction of clear and ambitious sustainability criteria for asset manager selection to prevent the risk of weak sustainability performance.

3. **Integration of ESG criteria and climate-related risks:** Establishment of ambitious and mandatory standards with robust monitoring and evaluation processes to ensure alignment with the Paris Agreement and reduce risk exposure to unsustainable investments across the FDC’s portfolio.

4. **Reporting of sustainability-related impact:** Enhancement of transparency and verifiability of sustainability metrics to ensure the credibility of sustainability claims.

5. **LuxFLAG Labelling:** Adoption of stricter sustainability standards for asset manager selection and investment strategies, focusing only on genuinely sustainable practices.