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# THE FDC'S SUSTAINABLE INVESTMENT APPROACH

A CRITICAL ANALYSIS BASED ON THE FDC'S  
SUSTAINABLE INVESTOR REPORT 2024

AUGUST 2025



**PUBLISHER**

Nextra Consulting GmbH

Methfesselstraße 16 A

20257 Hamburg

Nextra Consulting GmbH is a strategy consultancy based in Hamburg. The consulting focus is on the Green Transition - the accompaniment of companies on their way to a sustainable future. The service portfolio ranges from status quo analysis to strategy and implementation.

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08/2025

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**ON BEHALF OF:** Greenpeace Luxembourg

**IMAGE SOURCES:** iStock iStock-1340721567\_Fahroni (Cover & Table of Contents)



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## 1 INTRODUCTION

As the sovereign pension fund of Luxembourg, the Fond de compensation au régime général de pension (FDC) manages the retirement savings of current and future generations. Therefore, the FDC carries the dual responsibility to safeguard long-term financial returns while contributing to broader public interest. Public actors in capital markets are expected to lead by example, setting standards for transparency, ambition, and integrity in sustainability efforts. Moreover, given the urgency of global decarbonization and the growing recognition of finance as a lever for climate action, institutional investors like the FDC are uniquely positioned to drive the transformation of financial markets.

In 2020, the Fonds de compensation commun au régime général de pension (FDC) published its first Sustainable Investor Report, which revealed several areas for improvement regarding its sustainable investment practices.<sup>1</sup> Four years later, the FDC released its second report.<sup>2</sup> While the FDC highlights its "[...] continuous efforts in sustainable investments and [...] its commitment as a responsible investor"<sup>3</sup>, the report shows limited evidence of strategic shifts or strengthened sustainability practices. The following report will analyze the FDC's second Sustainable Investor Report for its main shortcomings and the actual progress made over the past four years since the first report.

## 2 CRITICISM BASED ON FDC'S SECOND SUSTAINABLE INVESTOR REPORT 2024

The analysis of the FDC's sustainable investment approach reveals several areas for improvement, which can be categorized into five key themes which are presented in the following sections.

### 2.1 ALIGNMENT WITH FIDUCIARY DUTIES

Fiduciary duties refer to the **legal and ethical obligations of asset managers to act solely in the best interest of their beneficiaries** whose assets they manage. In the context of the FDC, fiduciary duty means managing assets in a way that secures future retirement incomes. This includes proactively addressing long-term financial risks, such as those posed by 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. Engagement involves constructive dialogue with companies aimed at improving their environmental, social and governance (ESG) performance to mitigate associated financial risks. When it comes to fulfilling its fiduciary duties through engagement with companies, the FDC appears to leave the actual implementation largely to its asset managers. The FDC states that all its asset managers are signatories of the United Nations Principles of Responsible Investment (UN PRI).<sup>4</sup> UN PRI signatories specifically

<sup>1</sup> Unless otherwise indicated, indirect citations in the following refer to the contents of *FDC (2020)*.

<sup>2</sup> Unless otherwise indicated, indirect citations in the following refer to the contents of *FDC (2024)*.

<sup>3</sup> See: *FDC (2024)*, p. 6.

<sup>4</sup> See: *IBID*, p. 27.

commit to incorporating ESG factors into their ownership and investment practices (Principle 2). However, being a UN PRI signatory does not automatically imply clear or binding standards for engagement activities.

For its part, the FDC relies on rather vague requirements for its asset managers in this regard, stating that it "values asset managers that actively seek dialogue [...]."<sup>5</sup> Concretely, the **FDC does not provide information on any expectations or monitoring practices regarding the engagement topics addressed or the frequency of interactions.** Rather than providing specific details, the FDC illustrates engagement practices under different ESG themes in its report.<sup>6</sup> 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. Consequently, the **actual depth and quality of engagement may vary significantly and remain opaque without transparent disclosure.**

Another important aspect of fiduciary duties involves **adherence to internationally recognized frameworks and principles**, such as the United Nations Global Compact (UNGC). These normative commitments often translate into exclusion policies that aim to mitigate long-term financial risks associated with unsustainable or unethical business practices. Accordingly, the FDC emphasizes that all investments comply with several international conventions (e.g. UNGC) by excluding companies violating these ethical and legal standards. However, the **FDC explicitly rejects the broader exclusion of entire sectors** (sectoral exclusions) and

**exclusions targeting specific environmental issues** (thematic exclusions). Specifically, this means that critical sectors contributing to climate change (e.g., coal and mining) as well as other highly polluting industries are not categorically excluded from the FDC's portfolio.

In contrast to the FDC, the **Government Pension Fund Global (GPF) of Norway** has opted for a more comprehensive exclusion approach. For instance, the GPF explicitly excludes companies involved in the manufacturing of controversial weapons, and those heavily reliant on coal (e.g. in power generation). Besides, the GPF excludes companies linked to severe environmental damage, unacceptable greenhouse gas emissions, human rights violations, and other breaches of international humanitarian laws and fundamental ethical norms.<sup>7</sup> Consequently, in contrast to the **FDC excluding only approximately 5% of companies due to environmental reasons**<sup>8</sup>, the **GPF bases more than half of its exclusion decisions on environmental concerns.**<sup>9</sup>

The limited scope of existing exclusion practices is further reflected in the fact that the **FDC does not exclude several companies linked to climate-harmful impact.** Specifically, the GPF's exclusion list encompasses 65 companies involved in the production of coal or coal-based energy and another four companies associated with unacceptable greenhouse gas emissions. Further comparison of the exclusion lists reveals that, in contrast to the GPF, **the FDC does not exclude several companies from the oil and gas industry** (e.g. Imperial Oil Ltd, Suncor Energy Inc.)<sup>10</sup> despite their well-known association with severe pollution and environmental degradation (see FIGURE 1).

<sup>5</sup> See: *FDC* (2024), p. 32.

<sup>6</sup> See: *IBID*, p. 32.

<sup>7</sup> See: *NBIM* (2025c)

<sup>8</sup> See: *FDC* (2024), p. 12 f.

<sup>9</sup> See: *NBIM* (2025a)

<sup>10</sup> See: *IBID*, p. 12 f.; *NBIM* (2025a)

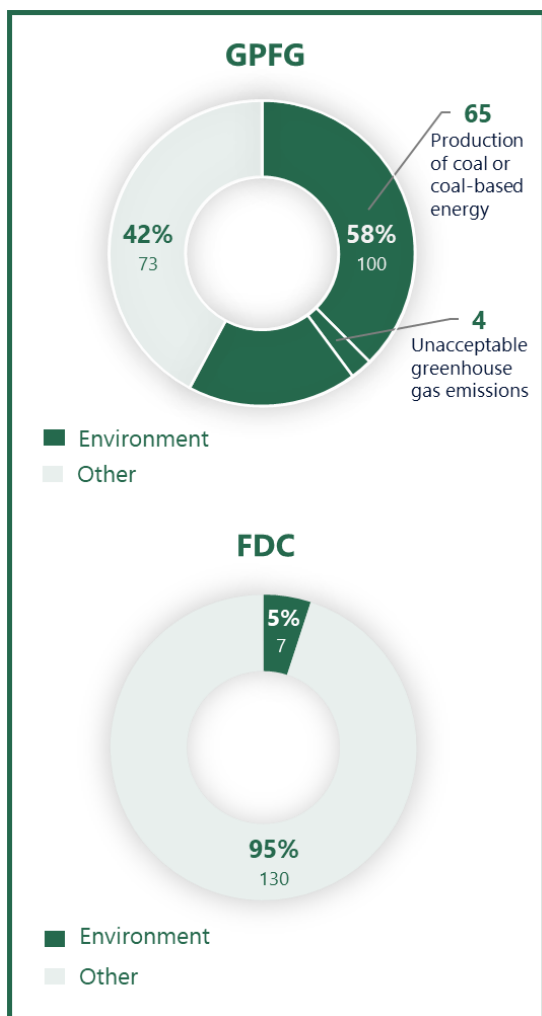


FIGURE 1: THEMATIC EXCLUSIONS: OVER HALF OF GPFG'S EXCLUSIONS ARE BASED ON ENVIRONMENTAL CRITERIA, COMPARED TO ONLY ABOUT 5% ON PART OF THE FDC.

Overall, the FDC's exclusion approach raises **concerns about its adherence to its self-imposed obligation to ensure that investments comply with the UNGC**,<sup>11</sup> particularly regarding:

#### PRINCIPLE 7:

Business should support a **precautionary approach** to environmental challenges; and

#### PRINCIPLE 8:

Undertake initiatives to **promote greater environmental responsibility**;<sup>12</sup>

The FDC justifies refraining from sectoral and thematic exclusions by arguing that such approaches would be incompatible with its legal framework and fiduciary mandate. Yet, a legal analysis examining the current social security law and the statutes governing the FDC indeed reveals that associated divestment decisions are possible without requiring legislative changes. Instead, the FDC appears to have sufficient flexibility to adapt its strategic asset allocation, as long as such adjustments align with generally accepted risk management principles.<sup>13</sup> In this context, the FDC claims that more stringent exclusion policies could jeopardize its "[...] proven track record since 2007"<sup>14</sup>, achieving an average annual return of around 5%. However, the **Government Pension Fund Global (GPFG) of Norway excludes approximately 26%<sup>15</sup> more companies while outperforming the FDC** with an average annual return of around 7.12% during the same period.<sup>16</sup> This clearly challenges the FDC's argument, demonstrating that **more ambitious exclusion policies do not necessarily compromise financial performance**.

<sup>11</sup> See: FDC (2024), p. 77.

<sup>12</sup> See: UNGC (2025)

<sup>13</sup> See: CHAMBRE DES DÉPUTÉS DU GRAND-DUCHÉ DE LUXEMBOURG (2023), p. 11, 17;

<sup>14</sup> See: FDC (2024), p. 9.

<sup>15</sup> See: NBIM (2025a)

<sup>16</sup> See: NBIM (2025b)



## 2.2 SELECTION OF ASSET MANAGERS

A central element of the FDC's investment process is the **delegation of operational portfolio management to external asset managers**. These managers are entrusted with the day-to-day decisions regarding the composition and adjustment of the fund's sub-portfolios. Given their pivotal role, it is crucial that the FDC establishes clear and ambitious guidelines to steer asset managers toward sustainable investment strategies. Without explicit expectations and robust evaluation criteria, asset managers may implement only minimal or superficial sustainability practices, undermining the FDC's commitment to responsible investing. Ensuring transparency and rigor in the asset manager selection processes is therefore essential to guarantee that sustainability considerations are deeply embedded in the FDC's overall investment approach.

While the FDC claims to incorporate sustainability criteria in its asset manager selection process, it is **not evident how sustainability considerations influence associated decision-making**. The FDC references a comprehensive questionnaire to collect data on the sustainable investment strategies of its asset managers, e.g. their exclusion policies and engagement practices.<sup>17</sup> Yet, it remains unclear how the results of this questionnaire impact the selection process, as the FDC does not specify how the responses are evaluated. Instead, the FDC's report primarily focuses on quantifying the number of assets managed with ESG integration or engagement activities, **without providing information on the depth, ambition, or actual impact of these practices**.<sup>18</sup> Thus, based on its questionnaire, the **FDC**

**cannot ensure that ambitious investment approaches are identified and selected.**

The risk of selecting asset managers with insufficient sustainable investment strategies is further reinforced by the **absence of clearly defined criteria and ambitious expectations** on part of the FDC. The FDC itself acknowledges that "the type, scope and impact of such an approach [...] are not predefined [...] and can therefore take different forms."<sup>19</sup> While some flexibility in methodological approaches is reasonable, the FDC should ensure that the chosen strategies effectively contribute to genuine management of sustainability-related risks in the portfolio. This includes providing greater transparency regarding how sustainable investment strategies are evaluated in practice.

Otherwise, this allows for a wide range of interpretations, enabling minimal or unambitious ESG approaches to qualify as sufficient. 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**. As a result, **the FDC might risk selecting asset managers who pursue merely superficial or symbolic sustainability efforts**. Despite previous criticism in this regard, there appears to be limited progress, as the lack of transparency and ambitious selection criteria continues to be an area of concern. The following section illustrates how this allows comparatively low-ambitioned sustainable investment strategies to pass the FDC's selection process, particularly regarding the integration of ESG criteria and climate-related risks.

<sup>17</sup> See: FDC (2024), p. 16 f.

<sup>18</sup> e.g. see: *IBID*, p. 29-32.

<sup>19</sup> See: *IBID*, p. 12.

## 2.3 INTEGRATION OF ESG CRITERIA AND CLIMATE-RELATED RISKS

The integration of ESG criteria and climate-related risks into investment decision-making has become a **fundamental component of responsible asset management**. For a sovereign pension fund such as the FDC, this means systematically assessing ESG factors, as well as the financial impacts of climate change when allocating capital. This enables the FDC to better align its portfolio with global sustainability goals, e.g. the transition to a low-carbon economy, while managing downside financial risks.

Instead of setting binding requirements for ESG integration and the consideration of climate-related risks, the FDC's report suggests a preference for voluntary commitments. This is particularly evident in the report's language, which adopts a **recommendatory tone** ("should," "may") **instead of formulating mandatory standards**. For instance, the FDC emphasizes that for active investments, "[...] asset managers may also apply specific carbon criteria or targets [...]" and that decarbonization strategies "[...] may be consistent with the goals of the Paris Agreement."<sup>20</sup> In practice, this vague and non-binding framing risks leading to a fragmented and inconsistent application of ESG criteria. While approximately **80%<sup>21</sup> of actively managed sub-funds claim to integrate ESG considerations, it remains unclear why full alignment is not achieved**. In addition, the FDC does not disclose the share of sub-funds that consider climate-related risks, making it **impossible to assess its actual level of climate change alignment**.

For its **passive investments<sup>22</sup>, which account for nearly 50% of the portfolio<sup>23</sup>**, the FDC appears not to integrate ESG criteria, arguing this is "[...] hardly conceivable with regard to indexed management."<sup>24</sup> Concretely, the FDC contends that aligning passive investments with ESG criteria would overly restrict the investment universe and potentially jeopardize the core objective of passive management.<sup>25</sup> However, there are several established ESG indices (e.g., MSCI ACWI SRI, FTSE4Good, Dow Jones Sustainability Index) demonstrating that ESG-aligned indexing is feasible. These ESG indices exclude certain companies (e.g., fossil fuels) while maintaining diversification, thereby fulfilling the objectives of passive investment. In fact, historical performance comparisons reveal that some ESG indices have equaled or even outperformed their traditional benchmarks (see FIGURE 2).<sup>26</sup> This suggests that **ESG-indexed investing is feasible and can partially even deliver superior results compared to related traditional benchmarks**.

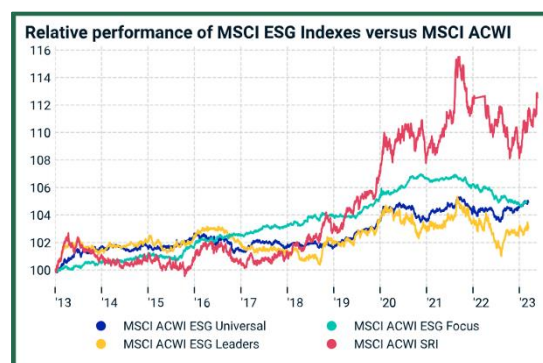


FIGURE 2: RELATIVE PERFORMANCE OF MSCI ESG INDICES VERSUS MSCI ACWI: SUSTAINABLE INDICES OUTPERFORM BENCHMARK IN HISTORICAL COMPARISON.

<sup>20</sup> See: *IBID*, p. 21.

<sup>21</sup> See: *IBID*, p. 21.

<sup>22</sup> **PASSIVE INVESTMENTS** aim to replicate the performance of a specific market index, rather than trying to outperform a benchmark.

<sup>23</sup> See: *FDC* (2024), p. 18 f.

<sup>24</sup> See: *IBID*, p. 21.

<sup>25</sup> See: *FDC* (2023), p. 6.

<sup>26</sup> See: *MSCI* (2025)



Despite the four-year gap since the first report and increasing concern about climate-related extreme weather events, the FDC has **not yet aligned its investment strategy with the Paris Agreement**. While acknowledging the importance of limiting global warming to well below 2°C by 2100, the FDC does not commit to this goal as per international agreements. The FDC highlights its equities portfolio has switched from an “above 3°C” level to a “2 to 3°C level”, while its fixed income portfolio has shifted from a “2 to 3°C” to a “1,5 to 2°C” level. However, from an aggregated perspective, the portfolio remains on a “2 to 3°C” pathway.<sup>27</sup>

Furthermore, this vague temperature range lacks precision, making it **challenging to accurately determine the portfolio’s actual pathway**. Considering that the world is currently on a 2,7°C trajectory<sup>28</sup>, it is crucial to provide an assessment of whether the FDC’s portfolio is performing better or worse in this regard. In a below 2°C scenario, acute and chronic climate-related impacts such as heatwaves, floods and sea level rise are serious but still manageable. Above 2,7°C, these effects become far more severe, widespread and increasingly irreversible. For instance, polar ice sheets may collapse, and ecosystems (e.g. coral reefs) could be lost permanently. This underscores the relevance of disclosing the portfolio’s precise climate pathway as there is a **significant difference between aligning with a 2°C versus 3°C trajectory in terms of both risk exposure and climate impact**.

Besides, the FDC discloses the “over-budget” level of its portfolio, a metric indicating how

much the portfolio’s associated emissions exceed the carbon budget compatible with a 1.5 to 2°C climate pathway. Accordingly, the FDC reports a reduction in its portfolio over-budget from 13% to 5% compared to the last report as a sign of progress.<sup>29</sup> However, a **5% over-budget still corresponds to nearly 800,000 tCO<sub>2</sub>e**, underscoring that **FDC’s investments remain misaligned with the 1.5 to 2°C climate target**. Framing this as progress might risk neglecting the fact that the portfolio is still associated with more emissions than permissible under a Paris-aligned pathway. Accordingly, **current trajectories for the aggregated equity and fixed income portfolios increasingly deviate from the 2°C-aligned pathway** as early as 2030.<sup>30</sup>

In this regard, the FDC points to the exclusion of avoided or so-called “negative” Scope 3<sup>31</sup> emissions as a methodological limitation leading to an overly negative result.<sup>32</sup> Negative emissions refer to activities that are assumed to prevent or remove greenhouse gas emissions. According to the FDC, these would include potential carbon savings from green bonds or its own forest holdings. However, there is a **broad consensus among scientific and policy frameworks** (e.g. Science Based Targets initiative (SBTi)), **that avoided or negative emissions cannot substitute for actual emission reductions**.<sup>33</sup> Accordingly, the associated effects are highly uncertain, not directly measurable and lack equivalence to real-world decarbonization. Besides, **if full Scope 3 emissions were considered** (e.g. supply-chain and product use emissions), they would likely

<sup>27</sup> See: FDC (2024), p. 66.

<sup>28</sup> See: CLIMATE ACTION TRACKER (2024)

<sup>29</sup> See: FDC (2024), p. 66.

<sup>30</sup> See: IBID, p. 66.

<sup>31</sup> **SCOPE 3 EMISSIONS** refer to indirect greenhouse gas emissions that occur in a company’s value chain, including both

upstream activities like supply chain emissions and downstream activities such as product use and disposal.

<sup>32</sup> See: IBID, p. 67.

<sup>33</sup> See: SBTi (2024), p. 10 f.

**exceed the positive emissions and effects as cited by the FDC.**

Overall, the FDC reveals to be **partially more exposed to climate-related risks compared to its benchmarks**.<sup>34</sup> Based on an analysis of S&P Global Sustainable 1, the FDC reports on the exposure to climate-related physical risks<sup>35</sup>. The results indicate that the **FDC's portfolio has a higher exposure score to physical risks and resulting financial impacts** for aggregated fixed income and overall fixed income and equity portfolios. While the FDC maintains that this exposure does not pose a significant risk,<sup>36</sup> it does not offer a clear rationale or define the threshold at which such exposure would be considered material. Without this clarification, 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.

#### EXCURSE: INVESTMENT STRATEGIES OF SELECTED ASSET MANAGERS IN FOCUS

The lack of clear and ambitious guidelines in the FDC's asset manager selection and ESG integration becomes evident when examining its sub-funds. The ambition level varies significantly across sub-funds, with the following two examples illustrating particularly weak approaches. In the following, the sub-funds are analyzed with regard to their investment objective, scope of application, monitoring and transparency, performance, and sustainability performance and targets.

#### HSBC GLOBAL ASSET MANAGEMENT (UK) LIMITED (GLOBAL EQUITIES SUB-FUND)<sup>37</sup>



The sub-fund (Art. 8) **does not pursue a sustainable investment objective** but aims to outperform its benchmark (MSCI World) in terms of risk-adjusted return.



**Only 70%** of the fund's investments are **aligned with ESG criteria**, allowing the remaining 30% to be allocated without any sustainability considerations, e.g. in controversial industries. Concretely, the sub-fund invests **nearly 6% in the oil and gas sector**.



Insufficient **transparency** in the underlying calculation methodology and portfolio-based assessment of the ESG score applied **compromises the evaluation of actual sustainability performance**, particularly of negative performing individual holdings.



The sub-fund **underperforms its benchmark** in environmental indicators while demonstrating a decline in its overall ESG score compared to the previous reporting period, particularly regarding social and governance indicators.



The **GHG intensity** of the sub-fund **increased by approximately 17%** compared to the previous reporting period, indicating a significant rise in emissions.

<sup>34</sup> See: *FDC* (2024), p. 76.

<sup>35</sup> **CLIMATE-RELATED PHYSICAL RISKS** refer to the potential financial losses and disruptions caused by direct environmental impacts, such as extreme weather events (e.g. floods) or long-term shifts in climate patterns (e.g. rising sea levels).

<sup>36</sup> See: *FDC* (2024), p. 78.

<sup>37</sup> Unless otherwise indicated, indirect citations in the following refer to the contents of *HSBC GLOBAL ASSET MANAGEMENT (UK) LIMITED* (2024a) and *HSBC GLOBAL ASSET MANAGEMENT (UK) LIMITED* (2024b).

## CBRE GLOBAL INVESTMENT PARTNERS (REAL ESTATE SUB-FUND)<sup>38</sup>



The sub-fund (Art. 8) **integrates ESG aspects primarily to generate financial returns, mitigate risks, and preserve value**, rather than genuine advancing sustainability performance.



The exclusion policy is insufficiently stringent, as it **permits to invest in projects with minimal sustainability commitment**, merely requiring a rather basic sustainability policy, vague plans for future net zero carbon targets and stated Global Real Estate Sustainability Benchmark (GRESB)<sup>39</sup> participation.



Investment due diligence and monitoring are based on the **GRESB**, which primarily **evaluates data access and system implementation rather than actual sustainability outcomes**.



The sub-fund **underperforms its peer group average in several sustainability indicators**, such as building certifications, waste management, water, energy, and overall risk management.<sup>40</sup>



**Climate change adaptation and mitigation targets** are based on vague and qualitative statements **without a concrete roadmap or actionable measures** for decarbonization.

## 2.4 REPORTING OF SUSTAINABILITY-RELATED IMPACT

Reporting on sustainability-related impact involves **disclosing how an investment portfolio contributes to environmental objectives**, such as reducing carbon emissions or supporting the UN Sustainable Development Goals (SDGs). For the FDC, transparent and accurate impact reporting is particularly important to demonstrate its beneficiaries that its investments genuinely support sustainability objectives. This requires clear methodologies, measurable indicators, and independent verification to ensure that reported impacts reflect real outcomes rather than potential or superficial claims. Without such rigor, the FDC risks overstating its positive contributions, which could undermine the credibility of its sustainable investment strategy.

Throughout the report, the FDC frequently highlights the purported positive impact generated by its investment portfolio. For instance, a graphic illustrates the number of Sustainable Development Goals (SDGs) supported per sub-fund, claiming that "[...] each goal is supported [...]".<sup>41</sup> With this illustration, the FDC may give the impression of comprehensive SDG alignment across its portfolio. 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. Instead, the FDC itself acknowledges in footnotes that an "[...] SDG might be supported while exposure is not being meaningful at a given moment."<sup>42</sup> Thus, the

<sup>38</sup> Unless otherwise indicated, indirect citations in the following refer to the contents of *CBRE GLOBAL INVESTMENT PARTNERS* (2024).

<sup>39</sup> The **GRESB** assesses the ESG performance of real estate and infrastructure assets, providing standardized data for investors to evaluate sustainability practices.

<sup>40</sup> See: *FDC* (2024), p. 25.

<sup>41</sup> See: *IBID*, p. 34.

<sup>42</sup> See: *IBID*, p. 34.



**FDC indirectly admits that the SDG contributions portrayed may not necessarily reflect the actual impact** generated by the portfolio.

In addition, sustainability-related impact is presented in a way that may appear overly positive. Specifically, the FDC's reporting on its green bond portfolio highlights metrics such as the amount of renewable energy generated or CO<sub>2</sub> emissions avoided, presenting these as direct positive outcomes of its investments.<sup>43</sup> However, the **underlying calculations are not fully transparent, and the absence of comparative data or contextualization makes it difficult for beneficiaries to assess their validity**. In practice, the reported impact metrics are likely based on unverifiable self-reports from companies or estimates by asset managers who manage respective sub-funds. **Similar practices have previously triggered consumer protection lawsuits**<sup>44</sup>, as courts have ruled that presenting claims are not logically comprehensible or constitute misleading practices. Given the lack of transparency and verification, such claims may raise questions among stakeholders and could affect the FDC's perceived trustworthiness.

#### EXCURSE: 'IMPACT' INVESTMENT STRATEGY OF IMPAX ASSET MANAGEMENT IN FOCUS<sup>45</sup>

While labelling its green bonds as "dedicated investments with positive impact"<sup>46</sup>, a closer examination raises questions about the ambition level of associated sub-funds. The following analysis of the Impax sub-fund exemplifies key areas for improvement.

**IMPACT MECHANISM:** Impact is primarily generated through primary market investments, where capital directly supports companies in implementing sustainable initiatives. In contrast, **Impax primarily invests in equities** that are already traded on the secondary market. As a result, Impax' investments **involve a transfer of ownership rather than providing new capital to support sustainable projects**.

**SCOPE OF APPLICATION:** Impax claims that at least 90% of its assets are allocated to sustainable investments with an environmental objective. However, its definition of "sustainable investment" is excessively broad, as it includes any company generating more than 20% of its revenue from environmental products or services. In practice, this means that companies with up to **80% of revenue from environmentally harmful activities can still be classified as sustainable**. Concretely, among the largest **individual holdings are major gas companies such as Air Liquide and Linde**, whose core business activities rely on fossil fuels.

**NET-IMPACT:** An examination of the Principal Adverse Impact (PAI) indicators<sup>47</sup>, as required by the Sustainable Finance Disclosure Regulation (SFDR), reveals that Impax' investments are associated with negative sustainability impacts. More precisely, **nearly one-third of the investments are allocated to companies without clear carbon emission reduction initiatives** aimed at aligning with the Paris Agreement. This suggests that **Impax might support business practices that do not fully align with sustainable transition goals**.

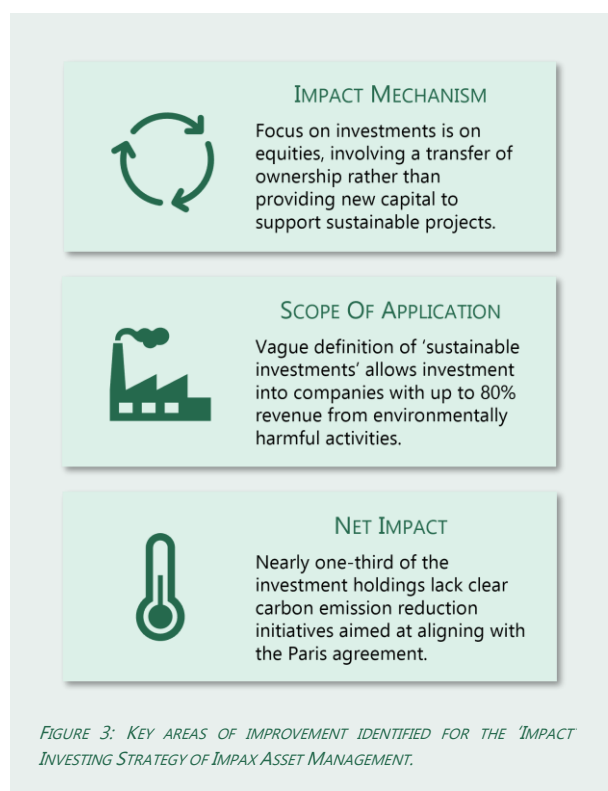
<sup>43</sup> See: *IBID* (2024), p. 63.

<sup>44</sup> e.g. see: *VERBRAUCHERZENTRALE BADEN-WÜRTTEMBERG* (2023a); *VERBRAUCHERZENTRALE BADEN-WÜRTTEMBERG* (2023b)

<sup>45</sup> Unless otherwise indicated, indirect citations in the following refer to the contents of *IMPAX ASSET MANAGEMENT* (2024).

<sup>46</sup> See: *Fdc* (2024), p. 40.

<sup>47</sup> Under the SFDR, financial products are required to disclose **PAI INDICATORS**, which reflect on the negative sustainability effects of investments, such as carbon emissions.



Similar patterns can be observed throughout the reporting on the results of the climate analysis conducted, where **selected indicators are highlighted while more material aspects remain unaddressed**. One example is the FDC's emphasis on the energy revenue exposure of its aggregated equity and corporate bond portfolio. The report notes that only around 5% of investments are allocated to companies with any form of energy-related revenues, while the share of fossil fuel energy revenues is lower than the benchmark.<sup>48</sup> This framing appears to signal low climate risk and a degree of alignment with climate goals. However, the difference in fossil fuel exposure compared to the benchmark is marginal (approx. 0,1%). Furthermore, this analysis focuses

on the 5% share of companies with energy revenues, while **the climate impact associated with energy consumption across all sectors in the rest of the portfolio remains unaddressed**. Particularly companies in energy-intensive industries (e.g. manufacturing, transport, or technology) may have significant indirect Scope 2<sup>49</sup> emissions if powered by fossil-based energy. Since this share is not reflected in the analysis, it may lead to an **incomplete picture of the portfolio's overall exposure to climate-related risks and its full emissions footprint from energy use**.

Another 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 is less exposed to carbon-intensive companies"<sup>50</sup>, 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 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. Rather, by **focusing solely on marginal improvements in revenue-based metrics**, the report risks overstating the climate performance of the portfolio and may contribute to a misleading impression.

<sup>48</sup> FDC (2024), p. 69.

<sup>49</sup> **SCOPE 2 EMISSIONS** refer to indirect greenhouse gas emissions from the generation of purchased electricity, heating or cooling consumed by a company.

<sup>50</sup> See: FDC (2024), p. 53.

## 2.5 LUXFLAG LABELLING

LuxFLAG is a **well-known sustainability certification that awards labels to investment products meeting certain ESG criteria**. However, sustainability certifications such as LuxFLAG may vary considerably in their rigor and scope. In other words, obtaining a sustainability certification does not necessarily equate to a comprehensive or robust sustainability performance. Reflecting on the specific certification criteria and inherent limitations of the LuxFLAG label is therefore essential for a meaningful assessment of the actual sustainability credentials of the labelled investments.

The FDC openly acknowledges that the investment approaches employed by its asset managers vary significantly. To demonstrate its sustainability ambitions, the FDC refers to the LuxFLAG label as an “overarching criterion”<sup>51</sup>. However, the FDC’s claim of **sustainability credibility through LuxFLAG labels may be overly optimistic**, as the requirements to obtain such labels are relatively low and not necessarily ensure robust ESG integration. Concretely, the eligibility criteria for receiving the LuxFLAG ESG label do require, among others, to:

### I. CONDUCT AN ESG SCREENING FOR 100% OF THE SELECTED PORTFOLIO INCLUDING UNDERLYING ASSETS THROUGH A “LOOK-THROUGH APPROACH”

Associated requirements appear rather broadly defined and allow for significant interpretation. For instance, the requirement to conduct ESG screening<sup>52</sup> for the entire portfolio can be fulfilled using an external provider, a proprietary methodology, or a combination of both.<sup>53</sup> In practice, this means that asset managers can meet the LuxFLAG requirements by applying minimal or inconsistent ESG screening methods, such as using superficial checks or only a few selected criteria. As illustrated in the previous excursion, this can result in sub-funds to include companies associated with environmental degradation or weak social practices.

### II. COMPLY WITH THE LUXFLAG’S EXCLUSION POLICY

A detailed review of the exclusion policy reveals that LuxFLAG does not explicitly exclude certain problematic sectors such as fossil fuel industries. Instead, LuxFLAG recommends considering further engagement with investee companies or developing appropriate exclusion mechanisms.<sup>54</sup> Thus, the FDC’s sub-funds may continue to invest in controversial industries despite holding a LuxFLAG label.

<sup>51</sup> See: *IBID*, p. 3.

<sup>52</sup> **ESG SCREENING** refers to evaluating investments based on ESG criteria to assess their sustainability practices and risks.

<sup>53</sup> See: *LuxFLAG* (2024a)

<sup>54</sup> See: *LuxFLAG* (2024b)



### III. DESCRIBE ITS RESPONSIBLE INVESTMENT STRATEGIES INCORPORATED INTO INVESTMENT PROCESSES AND DECISIONS

LuxFLAG reserves the right to individually assess whether the labeled product continues to comply with the label eligibility criteria. Although LuxFLAG indicates that this assessment may include a review of the investment policy, investment sampling, and analysis, there is a lack of transparency regarding the specific extended assessment criteria that may be applied.<sup>55</sup> This approach raises concerns about the consistency and robustness of the compliance verification process, leading to uncertainty regarding the sustainability credentials of labeled products.

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, the application of the LuxFLAG label **may give consumers an overly positive impression of the fund's actual sustainability quality**.

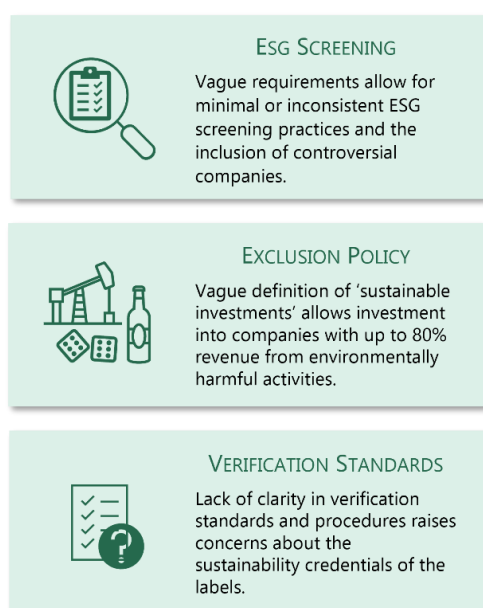


FIGURE 4: Key areas of improvement identified for the eligibility criteria of LuxFLAG's ESG label.

<sup>55</sup> See: LuxFLAG (2024a)

### 3 FURTHER ACTION

The preceding analysis revealed several areas for improvement within the FDC's investment approach. To effectively address these, we propose the following five recommendations:

**FIRSTLY**, the FDC's limited structured and transparent engagement practices, and the lack of exclusion of critical companies may challenge its commitment to the UN PRI and UNGC principles. To address these shortcomings, the FDC should establish clear and binding engagement guidelines, consistently apply sectoral and thematic exclusions (e.g. for carbon-intensive industries and companies), and enhance transparency in this regard.

**SECONDLY**, the FDC's vague sustainability standards in the asset manager selection process may result in the portfolio being managed without genuine consideration of sustainability and climate-related aspects. To mitigate this risk, the FDC should establish clear and ambitious sustainability criteria for asset manager selection to ensure compliance and performance accordingly.

**THIRDLY**, the FDC revealed a relatively low ambition in integrating ESG criteria for both active and passive asset management. Besides, the portfolio is not yet aligned with the Paris Agreement, with current trajectories partially deviating from climate targets. To strengthen its approach, the FDC should establish mandatory standards while implementing robust monitoring and evaluation processes to ensure consistent alignment and reduction of risk exposure across its portfolio.

**FOURTH**, the FDC's tendency to present an overly positive portrayal of its sustainability and climate performance raises concerns about the authenticity of its impact claims,

potentially exposing it to legal disputes, financial liabilities, and reputational damage. To address these risks, the FDC should enhance transparency and verifiability of sustainability metrics to ensure credibility in sustainability claims.

**FIFTH**, the FDC's reliance on LuxFLAG labels to demonstrate sustainability efforts may not fully reflect the robustness of its sustainability approach, as these labels are based on relatively broad and flexible criteria. To enhance credibility, the FDC should consider adopting stricter sustainability standards for asset manager selection and investment strategies, ensuring that only genuinely sustainable practices are recognized and promoted.

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