

# PF

Federation of the  
Dutch Pension Funds

## Service Document on Responsible Investment

DENSIOEN  
FEDERATIE

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### **Federation of the Dutch Pension Funds**

On behalf of approximately 220 Dutch pension funds, the Federation of the Dutch Pension Funds represents the interests of 5.3 million members, 3 million pensioners and 9.1 million deferred members.

The majority of the working population in the Netherlands is a member of a collective pension fund. The pension funds affiliated with the Federation of the Dutch Pension Funds collectively manage approximately 1200 billion in funds.

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Federation of the Dutch Pension Funds,  
The Hague, June 2016

# PF

## Service Document on Responsible Investment

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## 1

Introduction

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- This service document discusses how to give substance to values and standards for responsible investment in your pension fund's processes. The Code of the Dutch Pension Funds and the Pension Act provide an important regulatory framework in this area. This document suggests how to frame a view and policy for responsible investment, and implement, monitor and evaluate that policy. This policy cycle gives you an appropriate set of tools for your administrative processes relating to responsible investment.
- This document contains no judgements on which specific investments are responsible or irresponsible. You yourself as pension fund manager are responsible for identifying investments that are responsible for your fund.
- Your view on what you consider as responsible may change on the basis of developments within your fund, for example, or of changed perspective among your participants or social trends. Businesses in which you have invested directly or through an index fund may also evolve in ways that do not match your responsible investment policy.
- If you embed the responsible investment policy cycle in your administrative processes, your board will have responsible investment under control.
- Your pension fund invests the assets of your participants. Your responsibility as pension fund board member is to manage your participants' premium contributions competently in order to pay out a good pension in due course.
  - o You seek to generate optimum returns at an acceptable level of risk in the interests of your participants, and you invest the financial resources of your participants in a manner that suits them.
  - o You adopt investment strategies that are consistent with the size of your fund and the demographic composition of its population. You take account of the level of risk exposure deemed acceptable by fund participants.

- o Fund participants place their trust in you to invest competently on their behalf. They rely on you to ensure that the activities of the businesses in which the pension fund invests are bona fide.
- o You are accountable to your participants for your conduct of the investment policy.
- It follows from the above that your fund should invest responsibly.
- Views on what is 'responsible' among pension fund participants and in their social environment are not static. That is mirrored in the investment standards and regulations stipulated by law or adopted voluntarily by pension funds themselves.

## 2

## Summary of regulations

**Four requirements with which your pension fund must comply.**

The Code of the Dutch Pension Funds and the Pension Act form the starting point for the minimum requirements to be met by your pension fund in terms of responsible investment. The Code was drawn up by the pensions sector itself and came into force in 2014. It stipulates three standards for responsible investment. The Pension Act contains one relevant provision, notably on reporting requirements.

- 1 **“In determining its policy the board takes account of the fund's liabilities. The board also takes account of its responsibility towards stakeholders to ensure an optimum return at an acceptable level of risk.”**

The standard also stipulates that the ‘fiduciary duty’ of your pension fund always takes priority. At all times you must make every effort to fulfil your fund's principal commitment: to take account of pension liabilities and ensure optimum returns at acceptable risk exposure.

- 2 **“The board must ensure itself of sufficient support among stakeholders for choices made regarding responsible investment.”**

A good way to achieve that is through dialogue with the accountability body or the stakeholder body, according to the explanatory notes on this requirement in the Code. The pre-eminent consideration is that pension funds were set up by their stakeholders in order to have the complexity of pension investment dealt with professionally within a collective. Responsibility for responsible investment has thus been delegated to the pension fund by its stakeholders. Second, every pension fund represents a collective of participants with specific demands and characteristics that may be related to the industry, the enterprise, or the vocational group to which its participants belong. As pension fund board you therefore have a duty to consider not only the general values and standards appropriate to your responsible

investment policy but also the specific values and standards (relating to the industry, enterprise, or vocational group) that may be appropriate for your policy. You make sure of sufficient support among your participants for the choices you make.

**3 “The board must articulate its considerations with respect to responsible investment and ensure that these are available to stakeholders.”**

This standard in the Code is a ‘comply or explain’ provision. No requirements are stipulated as to form. If you have established or amended a responsible investment policy, you must share that with your stakeholders on your website and/or in your annual report. You may notify them of the investment principles adopted by implementing organisations in the same way. Pension providers are affiliated to ‘UNPRI’ and/or ‘UNGC’ (see *paragraph 5.1*). If, after considering the matter, your fund has decided on good grounds that it has no need to design an independent policy for responsible investment, disclosing its relevant ‘considerations’ will suffice.

**4 “Pension funds must explain in their annual report how their investment policy takes account of issues relating to the environment, climate, human rights and social relations”.**

This reporting requirement is the one and only provision in the Pension Act relating to responsible investment. It follows naturally from the previous ‘considerations’ provision. If you have established or amended a responsible investment policy, and/or have delegated its implementation to parties that have their own investment policy, you must notify your stakeholders of that fact in your annual report. If your fund has decided on good grounds not to have ‘an investment policy that takes account of environment and climate, human rights and social relations’, then disclosing that fact together with the related considerations will suffice.

## Chapter 3

### Advice for pension funds with a 'passive-indirect' investment policy

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Pension funds that exclusively invest passively<sup>1</sup> and exclusively invest indirectly (in index funds) form a special category in terms of responsible investment. These are often smaller pension funds. You must of course comply with the four statutory requirements. But how can a fund with a passive-indirect investment policy draw up a meaningful responsible investment policy?

- **Take a practical approach**

Policy on responsible investment must be appropriate to your pension fund. Most pension funds that invest exclusively in index funds, whether or not through an asset management organisation, will prefer to keep the implementation of its responsible investments simple. One pragmatic approach could be to have your implementing organisation or another third party compare your existing index fund portfolio with alternatives: index funds with a specific focus on sustainability or ESG (environmental, social and governance). Based on the differences then revealed, you can get a clearer perspective on what is appropriate for your fund. Another approach to setting out a policy for your fund is to take 'values' as your point of departure. Examine your implementing organisation's policy for responsible investment, and organise a few knowledge sessions for your board with an expert from the implementing organisation. The objective is to establish an appropriate view and an explicit policy for your pension fund, and then to implement that in your portfolio.

- **Make your values explicit**

Your participants and your employers have entrusted you with their contributions. You invest these assets on their behalf for an optimum return at an acceptable risk level. But your participants will not want to see their pension assets used to finance reprehensible activities. You are aware of that as a fund board member, and consistently avoid investments that are out of line with the values of the 'average' fund

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<sup>1</sup> Similarly, it is not easy for funds with a passive-indirect investment policy to implement their own specific policy, since they are committed to the benchmarks of their investment fund. Here too, the best selection of investment fund managers is an important basis for the ability to attune policy and implementation.



participant. In every pension fund there is an implicit awareness of traditional values that has evolved over time. 'Policy for responsible investment' is mainly a matter of making this awareness explicit. If you reflect on how to make the implicit values and standards of your fund explicit, then you are developing a view. If you put that into writing, you have a policy.

- **You do have some scope for policy**

If you invest exclusively or largely in index funds, you may feel you are overly dependent on these funds, especially if your pension fund is relatively small. Is it then at all useful for the board to draw up its own explicit responsible investment policy? Do you genuinely have the relevant competence? The unequivocal answer is 'yes', as the following advice makes clear.

- **Stipulate requirements for index fund managers**

If you have already drawn up policy principles for responsible investment, the first step is to ask your index fund managers, whether directly or through your service provider, whether they comply with your standards and how they can provide evidence of that. If their answers are unsatisfactory, you or your service provider can ask the index fund manager to comply with your wishes. If you are not satisfied with the response, on grounds of costs for instance, you can then reconsider your investments in this specific fund. Don't forget: there are many competing players on the index fund market. If in the process of developing your view and policy you find that your existing index funds (or some of them) do not comply with your explicitly stated principles, you can opt for a different index fund. And if cost considerations mean you are still tied to the party you want to abandon for some time, it could still be helpful to notify that party ahead of time of your reasons for wishing to divest, as a signal on behalf of your participants.

## Chapter 4

# Norms and values: self-regulation, Code of the Dutch Pension Funds, legislation

### 4.1 Responsible investment based on self-regulation

*How has responsible investment by pension funds developed historically?*

- A pension fund policy on responsible investment is based in part on fund participants' values and is modelled on standards prescribed by the fund. Pension fund policy on responsible investment is based on self-regulation.
- In 2003 an initial survey<sup>2</sup> of responsible investment policy among pension funds showed that one in four affiliated industry-wide pension funds and one in ten company pension funds had an explicit policy on responsible investment.
- In April 2007 a committee was established by pension funds, affiliated at that time to the umbrella bodies (VB, UvB and OPF) that later merged into the Federation, to produce recommendations on responsible investment policy. Its report *De gearriveerde toekomst* was issued in December 2007.<sup>3</sup> Since that date, a growing number of pension funds have drawn up and implemented responsible investment policies. In the meantime, many have communicated that policy and its implementation on their websites.
- Policy for responsible investment is now common practice among pension funds. The fourth survey<sup>4</sup> of responsible investment policy among pension funds (in 2013) showed that some 75 per cent of respondent funds had established a specific responsible investment policy, and that an additional 12 per cent were currently engaged in drawing up such a policy. Some 15 per cent of respondent funds had decided, often after internal consultation, not to adopt any specific policy on responsible investment, in many cases on grounds that most of their assets were invested through index funds.

2 'Tussen meerwaarde en moraal, de ontwikkeling van duurzaam beleggen binnen de Nederlandse Pensioenfondsen', Harry Hummels and Diederik Timmer (both: Nyenrode University), and Vereniging voor Beleggingsanalisten, 2003. [http://www.pensioenfederatie.nl/Document/Themas/Rapport\\_Tussen\\_meerwaarde\\_en\\_moraal\\_UniNyenrode.pdf](http://www.pensioenfederatie.nl/Document/Themas/Rapport_Tussen_meerwaarde_en_moraal_UniNyenrode.pdf)

3 'De gearriveerde toekomst Nederlandse pensioenfondsen en de praktijk van verantwoord beleggen', Vereniging van Bedrijfstakpensioenfondsen, Stichting voor Ondernemingspensioenfondsen, Unie van Beroepspensioenfondsen, 2007. [http://www.pensioenfederatie.nl/services/publicaties/Pages/De\\_gearriveerde\\_toekomst\\_Nederlandse\\_pensioenfondsen\\_en\\_de\\_praktijk\\_van\\_verantwoord\\_beleggen\\_17.aspx?source=/services/publicaties/servicedocumenten/pages/default.aspx](http://www.pensioenfederatie.nl/services/publicaties/Pages/De_gearriveerde_toekomst_Nederlandse_pensioenfondsen_en_de_praktijk_van_verantwoord_beleggen_17.aspx?source=/services/publicaties/servicedocumenten/pages/default.aspx)

4 'Inventarisatie beleid verantwoord beleggen', Federation of the Dutch Pension Funds, 2013. [http://www.pensioenfederatie.nl/actueel/persberichten/Pages/Steeds\\_meer\\_pensioenfondsen\\_hebben\\_beleid\\_voor\\_verantwoord\\_beleggen\\_25.aspx](http://www.pensioenfederatie.nl/actueel/persberichten/Pages/Steeds_meer_pensioenfondsen_hebben_beleid_voor_verantwoord_beleggen_25.aspx) and: [http://www.pensioenfederatie.nl/Document/Pers/Brief\\_aan\\_Klijnsma\\_Rapportage\\_verantwoord\\_beleggen.pdf](http://www.pensioenfederatie.nl/Document/Pers/Brief_aan_Klijnsma_Rapportage_verantwoord_beleggen.pdf)

- Those pension funds that had then not implement specific responsible investment policies yet were mainly (extremely) small pension funds. Together these funds represent only 1 per cent of the participants and beneficiaries that were covered by the survey. Respondent funds represented 84 per cent of all pension fund participants.

## 4.2 Responsible investment in the Code of the Dutch Pension Funds

- *What is the Code of the Dutch Pension Funds and what does it say about responsible investment?*
- The Code of the Dutch Pension Funds is designed to promote 'good pension fund governance'.<sup>5</sup> The Code was drawn up by the Federation in collaboration with the Labour Foundation and came into force in 2013. It sets out provisions for the various governance bodies functioning within a pension fund. It also addresses issues like integral risk management, remuneration, diversity, and responsible investment.
- Self-regulation for responsible investment, a practice that has grown over time within the Federation, has been given a place in the Code in the form of three standards.
- These three standards for responsible investment (and their explanatory notes) are as follows:
  - o 27 The board of trustees will lay down its considerations concerning sustainable investments and ensure these are available to stakeholders. In this regard, the board will also take account of good corporate governance.
  - *Clarification*  
*On the basis of article 135, subsection 4, of the Pensions Act, the board of trustees is responsible for ensuring the investment policy includes an explanation of how the fund takes account of the environment and climate, human rights and social relationships. In addition - within the framework of the corporate governance code - it is also appropriate for pension funds as investors to promote good corporate governance in the undertakings in which they invest.*

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<sup>5</sup> 'Code Pensioenfondsen', Federation of the Dutch Pension Funds and Labour Foundation, 2013. [http://www.pensioenfederatie.nl/actueel/persberichten/Pages/Pensioensector\\_legt\\_ambitieuze\\_doelen\\_over\\_bestuurlijk\\_functioneren\\_vast\\_in\\_Code\\_28.aspx](http://www.pensioenfederatie.nl/actueel/persberichten/Pages/Pensioensector_legt_ambitieuze_doelen_over_bestuurlijk_functioneren_vast_in_Code_28.aspx)

- o 28 In determining its policy, the board of trustees will take account of the fund's liabilities. In addition, account must also be taken of its responsibilities vis-à-vis stakeholders to ensure an optimum return at an acceptable level of risk.
- o 29 The board of trustees must ensure that the stakeholders support the choices being made regarding sustainable investment.
  - *Clarification*  
Regarding the sustainable investment policy, it is essential that support is created through dialogue with the VO or BO. Explanatory note: VO stands for verantwoordingsorgaan, the accountability body; BO stands for belanghebbendenorgaan, the stakeholders' body.
- At the request of the Federation the Code of the Dutch Pension Funds was embedded in the law on 1 July 2014 (see paragraph 4.3). The pension fund sector is the only business sector in the Netherlands with a statutory basis for corporate responsibility or responsible investment.

#### 4.3 What legislation applies to pension funds with regard to responsible investment?

In addition to self-regulation related to responsible investment there are other legal requirements for pension funds.

- **The Code of the Dutch Pension Funds is embedded into the law.**  
The Dutch government took that step at the request<sup>6</sup> of the Federation and the Labour Foundation. Its legal embedding came into effect on 1 July 2014. That means (among other things) that pension funds are legally required to comply with the above three standards for responsible investment. The legal status of the Code means that pension funds represent the only sector in the Netherlands subject to legal provisions relating to responsible investment or corporate responsibility.

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<sup>6</sup> Letter from the Federation and Labour Foundation to the state secretary for social affairs and employment (SZW) requesting legal embedding of the Code of the Dutch Pension Funds. <http://www.pensioenfederatie.nl/Document/Pensioenfederatie/Aanbiedingsbrief%20Code%20aan%20de%20staatssecretaris%20van%20SZW.pdf>

- On the same date, 1 July 2014, another provision relating to reporting came into effect in the Pension Act and the mandatory Occupational Pension Scheme (Obligatory Membership) Act: “In its annual report a pension fund must state how the fund's investment policy takes account of the environment and climate, human rights and social relations”.<sup>7</sup>
  
- **The influence of participants is legally embedded.**
  - o A pension fund with an independent board or an independent mixed board has a stakeholder body, whose job is to safeguard the influence of stakeholders on the board. The stakeholder body is subject to a specific legal provision relating to the pension fund's investment policy: it has right of approval on decisions to adopt and/or amend a strategic investment policy.<sup>8</sup> The law also stipulates that a stakeholder body may voluntarily present recommendations on issues relevant to the fund.<sup>9</sup> These may relate to matters of responsible investment. That means the board should request the advice of the stakeholder body on ‘the adoption of measures of a general nature’, on adoption of the actuarial and technical business report (ABTN), and on outsourcing contracts (as for asset management). These statutory provisions provide the stakeholder body with real powers to influence the fund's responsible investment policy, and to put forward its own ideas if need be.
  - o In pension funds with a joint Board, an inverse mixed board or a joint mixed board, there are seats on the board for stakeholder representatives, which means **stakeholders are jointly responsible** for fund policy. For that reason these pension funds have no stakeholder body. The board is then accountable for its policy and its conduct of affairs to, amongst others, the accountability body.

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7 Article 135 subsection 4 Pension Act and article 130 subsection 4 Occupational Pension Scheme (Obligatory Membership) Act. [http://wetten.overheid.nl/BWBR0020809/2015-11-01#Hoofdstuk6\\_Artikel135](http://wetten.overheid.nl/BWBR0020809/2015-11-01#Hoofdstuk6_Artikel135) and [http://wetten.overheid.nl/BWBR0018831/2015-01-01/1#Hoofdstuk5\\_Artikel130](http://wetten.overheid.nl/BWBR0018831/2015-01-01/1#Hoofdstuk5_Artikel130)

8 Article 115c subsection 9e Pension Act. [http://wetten.overheid.nl/BWBR0020809/Hoofdstuk5/52/Artikel115c/geldigheidsdatum\\_wijkt\\_af\\_van\\_zoekvraag/geldigheidsdatum\\_01-07-2014](http://wetten.overheid.nl/BWBR0020809/Hoofdstuk5/52/Artikel115c/geldigheidsdatum_wijkt_af_van_zoekvraag/geldigheidsdatum_01-07-2014)

9 Article 115c Pension Act. [http://wetten.overheid.nl/BWBR0020809/Hoofdstuk5/52/Artikel115c/geldigheidsdatum\\_wijkt\\_af\\_van\\_zoekvraag/geldigheidsdatum\\_01-07-2014](http://wetten.overheid.nl/BWBR0020809/Hoofdstuk5/52/Artikel115c/geldigheidsdatum_wijkt_af_van_zoekvraag/geldigheidsdatum_01-07-2014)

- Finally there is a specific prohibitive provision related to investment in the production of cluster munition, which applies to all investors, not only pension funds. Basic information on this ban can be found on the website of the Federation.<sup>10</sup> An annual update with detailed information can be found on the Federation member's area.<sup>11</sup>

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<sup>10</sup> News item on investment ban on cluster munition. [http://www.pensioenfederatie.nl/actueel/nieuws/Pages/Verbod\\_op\\_beleggen\\_in\\_clustermunitie\\_516.aspx](http://www.pensioenfederatie.nl/actueel/nieuws/Pages/Verbod_op_beleggen_in_clustermunitie_516.aspx)

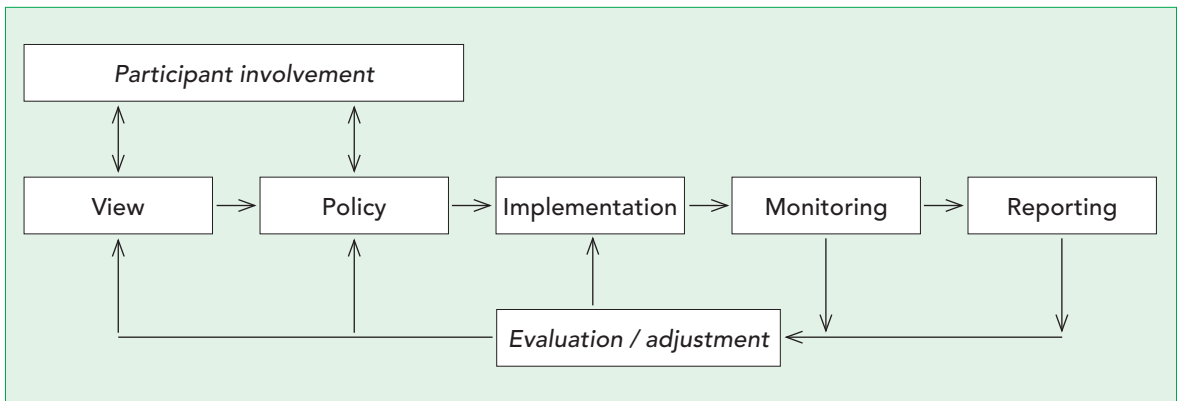
<sup>11</sup> 'Overzicht', Federation member's area, (log on), December 2015. [www.pensioenfederatie.nl/OverZicht/Pages/december2015nr35.aspx?PagePreview=true](http://www.pensioenfederatie.nl/OverZicht/Pages/december2015nr35.aspx?PagePreview=true)

## Chapter 5

## Responsible investment policy cycle

Pension funds that are planning to set up or scale up their responsible investment policy can approach this as a procedural matter, like any other key issue. The figure below gives a diagrammatic presentation of policy processes for responsible investment. All policy measures are elaborated in subsequent chapters.

### Responsible investment policy cycle



In the case of responsible investment policy, as with any policy procedure, decisions have to be taken at board level. For more information on decision making see '*Handreiking Zorgvuldige besluitvorming*' (January 2016) on the Federation member's area.<sup>12</sup>

### 5.1 View

*Why is it necessary to develop a view on responsible investment?*

- The primary focus of a pension fund is the collective interests of its participants (active participants, early leavers, and beneficiaries).
- Pension fund participants entrust their board of trustees with the mandate to invest fund assets on their behalf. The pension fund board controls the assets on behalf of the fund's participants. Pensions, by their very nature, require an investment policy based on a long-term horizon.

<sup>12</sup> *Handreiking Zorgvuldige besluitvorming*, Federation of the Dutch Pension Funds, January 2016. [http://www.pensioenfederatie.nl/services/publicaties/Pages/Handreiking\\_Zorgvuldige\\_besluitvorming\\_95.aspx](http://www.pensioenfederatie.nl/services/publicaties/Pages/Handreiking_Zorgvuldige_besluitvorming_95.aspx)

- It is important for a pension fund to develop a view on investment that is suited to its participants, and to substantiate this view through its investment policy and implementation choices.
- A pension fund board bears responsibility for an optimum investment strategy and implementation processes and for ensuring itself of support for its choices on responsible investment among its stakeholders. ('Norm 29', Code of the Dutch Pension Funds).
- The investment objective of pension funds is to generate financial results and to safeguard the continuity of return on investment for the long term.
- The activities of enterprises in which pension funds invest have unintended as well as intended consequences. Intended consequences are enjoyed by the customers for their products or services: that is the enterprise's right of to exist. Unintended effects may be positive (employment, prosperity, development). But there are also negative unintended effects: environmental degradation, climate distortions, violation of human rights or social relations, for example. The costs of negative unintended effects are not charged to customers. They end up being paid for in other ways: by the company's employees, neighbourhood residents, the general public, or in their direct impact on animals, plants, and the planet.
- A view on responsible investment encompasses both the financial and real impact that investments have or may have.
- Because of these potential negative unintended effects, pension fund's investments are being watched critically by the government and social lobby groups in their role as protectors of a general or specific interest.

#### *How do you develop a view?*

- Ask yourself questions, as a pension fund board member. Talk about your issues in the board. Discuss what could be the appropriate way to consult with fund participants and on how to involve them in investment policy (for example through the stakeholder body or accountability body). Consider whether you want to acquire the expertise of external advisors in developing a view on responsible investment.



- Questions you might consider are:
  - Do any of the fund's current investments involve issues related to the environment, climate change, human rights, or social relations that have (or could have) an impact on the risk/return ratio of the investment portfolio? And if so, what should be the consequences for the investments in question?
  - What values do fund participants hold? Can any shared values be inferred from the sector/company/occupational group in which the participants are employed?
  - What constraints or focal points in investment policy could the fund use to promote to specific values, interests, and demands of a relevant group or the majority of participants?
  - Is it possible to estimate changes in risk and return on investments due to constraints or focal points in investment policy?
  - Given the nature of the sector, company or occupational group served by the fund, are there any special investment themes the pension fund could explicitly engage in?
  - Given the scale of your fund and the structure of your investment policy (active/passive, index funds, mandates) what investment targets are realistic?
- Obtain information on developing a view from pension funds that have started such a process before.
- Consider how you might use your existing expertise - in your administrative organisation, for instance - to help define your view. Organising private working sessions between board members and experts from the service provider could be good start to a process.
- Make sure you are or are becoming sufficiently aware of initiatives at home or abroad aimed at promoting responsible investment and responsible enterprise. Among leading initiatives are:
  - PRI (or UNPRI), Principles for Responsible Investment'.<sup>13</sup>  
UNPRI is an international network of large institutional investors set up at the initiative of the United Nations in 2005. UNPRI is based on six principles related to responsible investment, which have been formulated by large institutional investors in 2006. The objective of UNPRI is the integration of Environmental, Social and Corporate Governance (ESG) factors in investment policy.

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<sup>13</sup> UNPRI. <https://www.unpri.org>

Investors sign up to UNPRI on a voluntary basis. As signatories they pledge to make progress on implementing the six principles in their investment policy and to report on that progress.<sup>14</sup> Leading Dutch pension funds and pension service providers are among the signatories<sup>15</sup> to UNPRI.

- o UNGC or UN Global Compact<sup>16</sup> is a United Nations initiative targeted at the corporate sector. Its objective is to promote corporate responsibility in the areas of human rights, labour conditions, the environment and anti-corruption. UNGC has established minimum standards for companies in these four areas.
- o UNGP or UN Guiding Principles on Business and Human Rights.<sup>17</sup> These principles make up the international standard to which businesses ought to aim to adhere in the area of observing human rights.
- o OECD Guideline for multinational enterprises.<sup>18</sup>
- o Best Practices for engaged share-ownership, Eumedion.<sup>19</sup>

## 5.2 Policy

### *What are the implications of having a board view on responsible investment for investment policy?*

- A pension is intended to safeguard the prosperity and wellbeing of participants. The investment of contributions is a key resource for fulfilling that ambition. From a perspective of risk mitigation, an investment portfolio should be spread over different investment categories and geographical regions. Direct investments in corporate equities should be spread over different industries and over a range of enterprises; indirect equity holdings should be in index

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<sup>14</sup> Transparency reports are published on the UNPRI website together with a list of signatories. <http://www.unpri.org/signatories/signatories/?country=Netherlands>

<sup>15</sup> Dutch signatories of UNPRI are listed on the website. <http://www.unpri.org/signatories/signatories/?country=Netherlands>

<sup>16</sup> UN Global Compact. <https://www.unglobalcompact.org/what-is-gc/mission/principles>

<sup>17</sup> UN Guiding Principles on Business and Human Rights. <http://www.ohchr.org/EN/Pages/Home.aspx> and [http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR\\_EN.pdf](http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf)

<sup>18</sup> OECD Guidelines for Multinational Enterprises. <http://mneguidelines.oecd.org/>

<sup>19</sup> Best Practices for engaged share-ownership, Eumedion. [http://www.eumedion.nl/nl/public/kennisbank/best-practices/best\\_practices\\_betrokken-aandeelhouderschap.pdf](http://www.eumedion.nl/nl/public/kennisbank/best-practices/best_practices_betrokken-aandeelhouderschap.pdf) and <http://www.eumedion.nl/nl/nieuws/eumedion-best-practices-betrokken-aandeelhouder-schap-goed-nageleefd-en-zijn-nog-steeds-state-of-the-art->

funds with sufficient dispersal. Publicly listed shares in companies (or equity indexes) often account for 30 to 50 per cent of pension fund's assets under management. Bonds represent a similar percentage, with real estate accounting for a somewhat lower percentage.

- Investment in equities entails shared ownership of enterprises and thus joint responsibility for all activities of the enterprise concerned. This applies directly to equities owned by the pension fund itself, and indirectly to investments in equity index funds.
- The larger a pension fund, the greater its potential for investing its assets directly. Smaller pension funds are more dependent on investment funds as for them the costs (including costs of expertise) of investing directly can be disproportionately high.

#### *How can you implement responsible investment?*

One approach could be to rank risk dilemmas based on three criteria: 'must', 'can' and 'want'.

- There are issues that *must* be banned from any pension fund's investment portfolio, such as investments in businesses involved in cluster munition, child labour, or violations of human rights, for example.
- In which areas *can* you make a difference as pension fund, given your fund's specific in-house expertise or experience, for example on grounds of the sector or enterprise in which your participants are employed?
- In which areas do you *want* to make a difference on grounds of the identity or target group of your pension fund, for instance healthcare, journalistic freedom, weapons industry, the environment, or animal welfare?
- A complementary direction to take, notably for large pension funds, could be to sign up to initiatives like the United Nations Sustainable Development Goals.<sup>20</sup>
- Another approach, especially for larger pension funds, could be to take into consideration the biggest risks to the global economy based on the annual Global Risks Report rankings issued by the World Economic Forum.<sup>21</sup>

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<sup>20</sup> United Nations Sustainable Development Knowledge Platform.

<https://sustainabledevelopment.un.org/>

<sup>21</sup> 'Global Risks Report 2015', World Economic Forum, 2015.

<http://reports.weforum.org/global-risks-2015>

*Does responsible investment cost money?*

*Or does it generate financial benefits?*

- Much research has been conducted into the costs as well as the financial benefits associated with constraints to investment on grounds of criteria for sustainability or social responsibility. But no unequivocal, generally accepted and valid conclusion has yet emerged.
- A simple reasoning regarding costs consists of two elements. First, from an investment perspective, every contraction of the available investment universe means a contraction of the potential for generating the optimum financial return. Second, additional costs are incurred in the potentially unrelenting research involved in examining the special considerations related to responsible investment.
- It thus seems obvious that costs are involved; assessing the degree of 'sustainability' or the quality of labour conditions requires effort and knowledge. And both have their price. However, such information is also necessary with regard to risk/return considerations. An enterprise whose operations are not sustainable or whose dealings with its employees are sub-par could – for these reasons – involve continuity risks, which is unfavourable for its projected value. Costs incurred in gaining an understanding of the degree to which an enterprise is operating sustainably or socially responsibly may also be embedded in the total costs of assessing the long term profitability of the enterprise. For pension funds, responsible investment thus also has a bearing on risk management.
- Next to the cost issue could be the potential for financial benefits. The additional knowledge the board acquires on specific long term risks associated with 'irresponsible' investment could lead to a more balanced portfolio with potentially higher return in the long term.
- The U.S.' largest pension fund CalPERS, the public service pension fund of California, has gathered a lot of relevant research on the costs and benefits of responsible investment in their 'Sustainable Investment Research Initiative Library'.<sup>22</sup>

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<sup>22</sup> *Sustainable investment Research Initiative Library*, website of California Public Employees' Retirement System (CalPERS). <https://www.calpers.ca.gov/page/investments/governance/sustainable-investing/siri-library>

- A meta-analysis by Deutsche Bank <sup>23</sup> is another good source of research data.
- A recent research project into ethical and fossil-free investment has shown its limited and variable impact.<sup>24</sup>

### 5.3 Implementation

How do you ensure that the investment portfolio suits your policy on responsible investment?

- If your pension fund has adopted or amended a responsible investment policy, you should review the mandates you have granted to external asset managers. Are they all fit for purpose, or do some or all of them need additional constraints to comply with your new responsible investment policy?
- Are the equities or index funds managed by your asset manager on your behalf still consistent with the revised mandates?
- You need not postpone a dialogue until a contract with an asset manager or index fund manager expires. Some of your new preferences or requirements could possibly be taken into account during the course of the existing contract period. And if you need bigger changes, it could help to notify your contractual party of your revised preferences and requirements in good time.
- Even if you invest exclusively in index funds you still have room for specific focal points related to your responsible investment policy. Your index fund manager is not the only player on the market. Even if there is a longstanding and good relationship between your pension fund and an index fund manager, you should be the one making the first move if you want to amend your investment policy. You can improve your negotiating position with an existing index fund manager by exploring alternatives among other market players. For compulsory industry-wide pension funds it is also important to remain alert to the (expected) impact on the benchmark when doing so.

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<sup>23</sup> *Sustainable Investing*, Deutsche Bank, 2015. [https://www.db.com/cr/en/docs/Sustainable\\_Investing\\_2012.pdf](https://www.db.com/cr/en/docs/Sustainable_Investing_2012.pdf)

<sup>24</sup> *The impact of ethical investing on returns, volatility and income*, Newton investment management, February 2016. <http://www.newton.co.uk/uk-institutional/file/the-impact-on-ethical-investing-on-returns-volatility-and-income/>

*What tools are potentially available for implementing responsible investment?*

- 'Active shareholdership' is not so much a tool, but rather a crucial point of departure for responsible investment. Your pension fund is co-owner of an enterprise (equities) and/or invests in its financing (corporate bonds), and therefore bears joint accountability for its conduct. That applies both to how the enterprise is managed and to its business activities. It is therefore important to keep in contact with the enterprises in your portfolio, in order to be able to become aware of prospective changes in good time. Be critical about what you are getting into as an investor. Look around, ask questions, seek advice from objective sources. That applies both to direct and indirect investments, thus to equities, bonds and real estate, but equally to the indexes of external parties. Active shareholdership is a key concept for responsible investment for pension funds that invest in equities directly or through a third party. An active shareholder stays aware of developments in the enterprise, has sufficient contact with the enterprise, monitors whether the enterprise is still developing.
- Enter into 'dialogue' or 'engage' with the enterprise if you hear (even rumours) about activities that do not suit the principles of your pension fund. Starting a conversation, asking questions, and making demands if the company's response is inadequate, are concrete measures through which an active shareholder implements 'engagement'.
- One approach that can be successful is to define 'SMART' objectives for engagement processes with enterprises (or index funds) that does not or no longer fulfils the pension fund's policy principles. During the lengthy stages of a dialogue, this approach provides a basic focus for taking decisions on whether or not to continue the process (or sell).
- Exercise your **voting rights** at shareholder meetings (e.g. annual general meetings) either directly or by proxy. Exercising your right to vote at shareholder meetings is the formal procedure for active shareholders to exercise their ownership rights.

- Disposing of shares when an enterprise pays no regard to the requests of the shareholder in an ‘engagement process’ is the option of last resort. Responsible shareholdership means a shareholder should spare no effort in demanding responsible behaviour from investee enterprises. While disposing of shares is a potential solution, it deprives the investor of any opportunity to exert influence. Disposal of a share that is no longer wanted does provide a strong signal to the market. The choice between having greater influence on the enterprise in question or disposing of the shares should be considered carefully on a case-by-case basis.
- ‘Exclusion’ is a step any pension fund can take in a bid to steer clear of investing in specific industries or enterprises on grounds of policy principles. But it is important to have a clear view of your reasons for whether or not to implement exclusion. You should be able to account for your decision on behalf of your participants.
- ‘Exclusion’ can apply to enterprises but also to countries: exclusion of investment in government bonds of countries that violate international standards.
- Even if your pension fund only invests in index funds you are still co-owner of enterprises and bear joint responsibility. You have no direct influence on their management. You are, however, able to select index funds that match your view of responsible investment and comply with your reporting requirements. And if your pension fund holds assets in index funds you believe to be insufficiently transparent about developments in the enterprises they include, and how the index owner imposes and influences requirements on these, you can take action. You can start a conversation to ask for the transparency you want. If this form of ‘soft engagement’ does not produce the desired result, you could consider whether another index fund is more suited to your requirements.
- ‘Positive selection’ is another way to implement your policy. It means giving a higher allocation to equities in enterprises or index funds that focus on sustainable sectors or sustainable themes.
- ‘Integration of ESG criteria’, i.e. the taking into account criteria regarding the environment, social factors and the quality of corporate governance, is intended to integrate targeted returns, risk management, and sustainability into investment decisions.
- One example of a concrete set of tools is that of PGGM.<sup>25</sup>

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<sup>25</sup> Zes instrumenten voor de uitvoering van verantwoord beleggenactiviteiten, PGGM.  
<https://www.pggm.nl/wat-doen-we/Paginas/Instrumenten.aspx>

## 5.4 Monitoring

*How do you ensure that your investment portfolio is consistent with your policy?*

- Monitoring means tracking relevant information on your investments. In the case of equities, this includes information from the enterprise itself and information from the market and the wider environment of the enterprise.
- After you have implemented your new or amended policy for responsible investment, you have to ensure that your investment portfolio remains consistent with your policy principles. Your investment portfolio will often not be static, and the enterprises in which you hold shares will also keep changing.
- It therefore makes good sense to screen every new enterprise in which you are considering to invest, in order to assess whether it meets your responsible investment criteria.
- You should also remain aware of developments in the enterprises in which you hold shares that could have an impact on your portfolio's risk/return ratio or other criteria in your responsible investment policy.
- Regular monitoring of your investment portfolio is therefore essential. You could delegate this task to your service provider.
- If monitoring indicates that elements in your portfolio are not in line with your established principles, you need to restore the order. Doing so requires 'implementation activities', and means you are returning to 'implementation' in the policy cycle.
- Some market players offer monitoring services. A few relevant initiatives are listed in this document.<sup>26</sup>

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<sup>26</sup> For example:

- *Impact Rep. and Inv. Standards (IRIS)* by the Global Impact Investing Network (GIIN). <https://iris.thegiin.org/>
- *Bridges Ventures*. <http://www.bridgesventures.com/>
- *Sonen Capital*. <http://www.sonencapital.com/>
- *Morgan Stanley*. <http://www.morganstanley.com/what-we-do/institute-for-sustainable-investing>
- *Climate Bonds Initiative*. <https://www.climatebonds.net>
- *Cambridge Investor Leaders Group*. <http://www.cisl.cam.ac.uk/business-action/sustainable-finance/investment-leaders-group/about>
- *Sustainability Accounting Standards Board (SASB)*. <http://www.sasb.org/>
- *Global Impact Investing Rating System (GIIRS)* by B-lab. <http://b-analytics.net/giirs-ratings>



## 5.5 Reporting and communication

- Reporting on responsible investment is the main channel for communication with stakeholders. First, the facts recorded in the report are the basis for communication with and accountability to pension fund participants. Second, the annual report is the source of information for other interested shareholders, such as the government and social organisations.
- Starting with their annual report over 2014, pension funds are legally required to report 'in what manner they take account of the environment, climate, human rights and social relations' in their investment policy, as referred to above in paragraph 2.
- Your board is free in choosing how to take action on this requirement. Some large pension funds choose to publish a separate annual report on responsible investment, giving detailed records of their conduct and through explanatory notes.<sup>27</sup> Most smaller pension funds deem it sufficient to include a paragraph on responsible investment in their annual report.
- Of course the annual reports of other pension funds could be a helpful source of information when drafting your report. Alternatively, you could use the (non-mandatory) reporting guidelines of the Global Reporting Initiative,<sup>28</sup> which include the Dutch '*Richtlijnen voor duurzaamheidsverslaggeving*',<sup>29</sup> or the Sustainability Accounting Standards Board.<sup>30</sup> KPMG provides a convenient overview in '*De Pensioenwereld in 2016*',<sup>31</sup> with a list of items to consider when accounting for responsible investment in annual reports.
- You are free to choose your own chapter heading or title for a paragraph in the annual report as these relate to the focus of your fund's policy. Some pension funds use the term 'responsible' investment, while others prefer 'socially responsible' investment or 'sustainable' investment.
- Your annual report will often be consulted by only a limited number of your participants. If you wish to reach a larger audience with your responsible investment policy and its results, you will have to turn to other communication channels, as shown in a specific example.<sup>32</sup>

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<sup>27</sup> See for example:

- ABP, <https://www.abp.nl/images/verslag-verantwoord-beleggen.pdf>
- PFZW, [https://www.pfzw.nl/Documents/Over-ons/jaarberichten-en-jaarverslagen/Verantwoord-beleggen-jaarverslag\\_2014.pdf](https://www.pfzw.nl/Documents/Over-ons/jaarberichten-en-jaarverslagen/Verantwoord-beleggen-jaarverslag_2014.pdf)

<sup>28</sup> <https://www.globalreporting.org/Pages/default.aspx>

<sup>29</sup> <https://www.globalreporting.org/resource/library/Dutch-G3-Reporting-Guidelines.pdf>

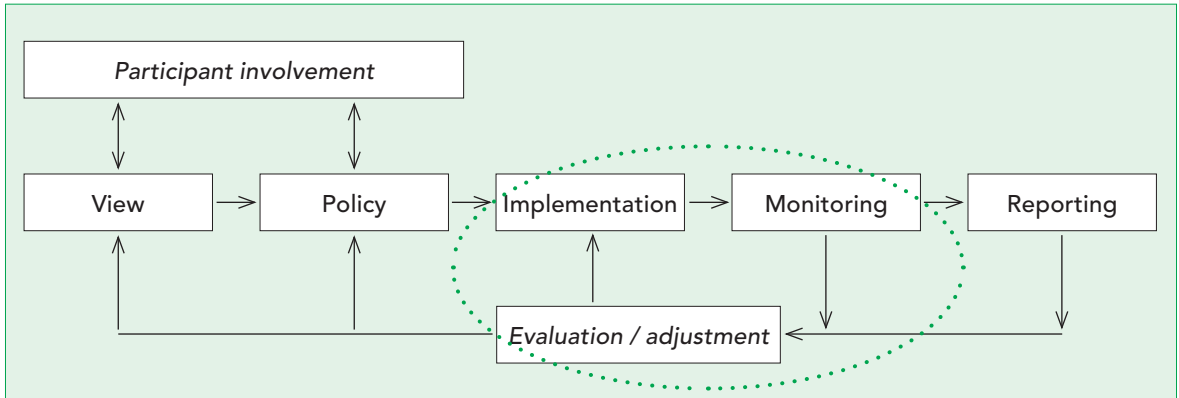
<sup>30</sup> <http://www.sasb.org/>

<sup>31</sup> <http://www.kpmg.com/NL/nl/IssuesAndInsights/ArticlesPublications/Documents/PDF/Insurance-en-Pensions/Hoofdstukken-PW-2016/De-pensioenwereld-in-2016-Hoofdstuk-14.pdf>

<sup>32</sup> Brochure *duurzaam beleggen*, PGGM, <https://www.pfzw.nl/Documents/Over-ons/verantwoord-beleggen/Korte-brochure-duurzaam-beleggen.pdf>

## 5.6 Evaluation

### Responsible investment policy cycle: evaluation



- ‘Evaluation’ is the collection and interpretation of information on your investments, mainly for the purpose of determining whether the return on investment meets your goals and matches your responsible investment policy, and secondly as a means to assess alternative solutions.
- If evaluation reveals that a development in one of your investments has rendered it inconsistent with your responsible investment policy, you could take action to intervene, as referred to in paragraph 3.3.
- Within the policy cycle, it is important to pay regular attention to the relationship between monitoring and implementation. Your investment portfolio is not static; nor are the enterprises of which your pension fund is shareholder/co-owner. If enterprises develop activities that are inconsistent with your responsible investment policy, it is your responsibility to take action and do something about it. Monitoring could therefore lead to new implementation activity.
- Despite all monitoring efforts, you might overlook relevant signals concerning an enterprise in your portfolio, or be alerted to an issue of concern by a social organisation.
- If the relevant issue is indeed out of line with your policy, being alerted to that by a third party is a good thing. You are then able to take action, for example entering into dialogue with the enterprise in question, and step up your monitoring to get a better grip on such developments in the future.

- Another possibility is that the issue is not out of line with your policy, and that the the social organisation that alerted you holds different values. In such circumstances, it is important to explain and clearly communicate the motivation behind your policy principles and why they are appropriate to your pension fund.
- Your view on what you deem to be responsible or irresponsible for your investment policy may, however, evolve under the influence of a new social appreciation of risk/return estimates and sustainability among your participants, yourself, and those with whom you are in dialogue.
- It therefore deserves recommendation to review your responsible investment policy periodically. Reality shows that larger pension funds that have been implementing responsible investment policy for several years (see the historical sketch in paragraph 2.1) scrutinise and explore their policy every couple of years.
- How your fund conducts periodic reviews may depend on the size of your fund and the simplicity or complexity of your investment policy.

# PF

Service Document  
on Responsible  
Investment

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