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Dutch pension funds' views on greenwashing

Introduction: Dutch pension funds' green financing efforts
The Dutch Federation of Pension Funds commends the efforts of the European Commission and the ESAs to reduce greenwashing. We recognize that greenwashing exists in the financial sector. The recent sustainable finance legislative framework helps to reduce unsubstantiated ESG claims.

Dutch pension funds manage €1,500 billion in assets and are very active in sustainable investment. The majority of Dutch pension funds have signed a sectoral agreement, together with other societal stakeholders, to implement sustainability due diligence under the OECD Guidelines in order to mitigate human rights abuses and environmental adverse impacts. Many pension funds have also implemented carbon reduction plans in line with the Paris Climate Agreement.

Meeting SFDR requirements, a majority of Dutch pension funds have classified their pension scheme as promoting ESG characteristics (Article 8). Research by the Dutch financial conduct supervisor AFM finds that 93% of Dutch pension fund participants accrue or receive a pension categorized as an Article 8 fund.

Being part of the welfare state and providing social protection, pension funds are qualitatively different from other financial institutions and investment funds. Social partners (labor unions and employee representatives) manage pension funds and determine the role of pension funds in collective agreements. Following from these collective agreements, most Dutch companies mandatorily register their employees with an industry pension fund. The mandatory character of Dutch pension funds means there is no marketing and sales in their business model and hence no financial incentive for 'misselling' ESG claims. Nevertheless, pension funds do want to and are obliged to inform their participants accurately about their investments. Moreover, most Dutch pension funds only offer one pension scheme, rendering the distinction between 'entity' and 'product' effectively irrelevant.

We stipulate that pension funds are different from other financial market participants. As not-for-profit organizations with mandatory participation and without marketing or sales, pension funds are not involved in 'misselling' ESG claims in order to obtain an unfair competitive advantage. There is simply no

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profit incentive for it. As investors positioned at the end of the investment chain, pension funds rely on external data source to assess and report on the sustainability characteristics of their investments. While it is therefore possible to spread false claims, it is also costly to verify all data. Most greenwashing risks for pension funds are thus related to the implementation of sustainable finance legislation, both internal and by external parties. This has turned out to be a rocky and unfinished process. **The Dutch Federation of Pension Funds therefore believes that the efforts to address greenwashing should prioritize correct and clear implementation of SFDR and eliminate seeking of unfair competitive advantage.**

Implementing Sustainable Finance legislation
The Taxonomy and SFDR are still being implemented and problems with ESG data availability, the implementation process and regulatory ambiguity remain. Under these conditions, Dutch pension funds find it too early to probe for evidence of violations and possible additional legislative and supervisory powers on greenwashing.

Availability of good quality ESG data remains an overall challenge. The EU Taxonomy brings much needed clarity in terms of definitions on corporate sustainability, but also requires comprehensive data on taxonomy-alignment by investee companies. Sustainability data from investee companies, required for SFDR and Taxonomy reporting, is currently patchy. The CSRD and ESAP will change that. It will bring much-needed ambitious reporting standards and will provide pension funds with the necessary data on investee companies. Yet, CSRD data is and will be lacking in the first years of SFDR and Taxonomy reporting, both in quality and in availability. Moreover, due to the role of materiality considerations under CSRD reporting – which lack portfolio-wide reporting requirements for principle adverse impacts under the SFDR – it may be expected that a degree of divergence will persist.

Moreover, some organizations - such as governments, SMEs and organizations outside the EU - will not be subject to CSRD reporting. In such cases, investments can be green, but it is not possible to support these claims with the same sustainability reporting data. It should be avoided that EU sustainable finance regulation leads to investors being more cautious of making ESG claims about organizations for which CSRD data is not available. Regulators should therefore not interpret making ESG claims about organizations not subject to EU sustainability reporting requirements as greenwashing, in order to avoid the discouragement of ESG investments in organizations not included in EU sustainability reporting regulation.

Pension funds are positioned at the end of the investment value chain and they depend on other financial service providers. The ESAs presuppose that parties at the end of the investment value chain could have a role as a spreader of misleading claims triggered by actors higher up the investment value chain. Seen in another way, a spreader is a subject to receiving such claims.

Investors should be allowed to rely on the data they are provided with. They should not be responsible for claims triggered higher up in the investment value chain. Pension funds typically have more than a thousand companies in their portfolio and outsource investments to external asset managers. Outsourcing data collection concerning sustainability factor of these companies is necessary in order to run a pension scheme cost-effectively. While pension funds can integrate data sources into their own ESG methodologies, it is hardly feasible and very costly to verify all data obtained from data providers and investee companies.

SFDR and Taxonomy implementation is perceived as a moving target. The Dutch Federation of Pension Funds regrets the phased implementation approach of Taxonomy and SFDR requirements. SFDR level 1 regulation was implemented while level 2 regulation was still in the making. The RTSs prescribe detailed reporting templates and principle adverse impact indicators. The time gap between SFDR level 1 and 2 implementation explains why pension funds have not developed their own detailed reporting mechanisms so far.

The Taxonomy regulation has been adopted during the SFDR implementation process. In addition, there has been a stream of Q&As from the European Commission, ESAs and NCAs. Information has been communicated in pieces and several interpretations have been at odds with each other, sometimes creating further confusion.

Ambiguity in the regulatory framework needs to be addressed. In spite of the SFDR and Q&As there remain different, strongly diverging, approaches to product classification and the determination of what constitutes a "sustainable investment". The various pillars comprising the sustainable finance framework are not yet a perfect fit. Emanating from the speed of decision making and the ambition level, there are several inconsistencies and unclarities all actors involved had to work with in the implementation of reporting standards. Dutch pension funds are committed to working together with all actors involved - including the ESA's - to help eliminate the ambiguities in the legal frameworks, in order to reach the intended impact. The Platform on Sustainable Finance has provided helpful work in providing options for better alignment in recent publication.

Conclusions for greenwashing

Interpretations and preferences on what constitutes a sustainable investment, and therefore what is considered greenwashing, are inherently diverse, as they are based on diverging cultural and ethical norms. The implementation of sustainable finance legislation should introduce a certain level of comparability. Given the recent implementation of legislation, supervisors should focus on correct and clear implementation, before considering to expand legislative and supervisory powers. However, complete uniformity is not achievable and would come at the expense of comprehensibility and usability for end-users, such as pension fund participants. Instead, action on greenwashing should focus on parties seeking unfair competitive advantage. As such we draw the following conclusions.

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1. Efforts to make a positive impact on the climate transition risk greenwashing accusations. The Taxonomy and SFDR use two conceptions of accounting for ESG-factors: (i) accounting for financially material ESG risks; and (ii) making a positive impact. Consequently, there are different perspectives of what constitutes greenwashing: (i) assessing whether an investors current portfolio matches sustainability claims; and (ii) the sustainability impact of their actions. A narrow focus on the first perspective, risks brandishing impactful investment as greenwashing.

To address investors' ESG impact, the role of investors in shaping the green transition should be regarded rather than how green their investment portfolio is now. Within each industry, there are entities that are leading or lagging behind in ESG implementation (referred to as *ESG leaders* and *ESG laggards)*. As an investor, creating an investment portfolio that excludes all ESG laggards does not require a lot of work. It is an easy way to build a portfolio with a high ESG score. It is also the easiest way to avoid claims of greenwashing and public concern about the portfolio. However, it is not necessarily the most impactful investor ESG strategy.

Many pension funds believe that a company's current ESG score is not the only factor in assessing its fit with the fund's ESG profile. Instead, it is their conviction that the Taxonomy should also be used as a transition tool for companies to note their transition path. In private real estate, for example, a building is only Taxonomy-aligned when it has a level A EPC label. Investments in upgrading buildings that could never reach a level A status to a higher EPC label do not fall under the scope of the Taxonomy, while they do make a significant impact.

It is possible for investors to advance the transition by engaging with ESG laggards to make their business activities sustainable. That could avoid ESG laggards from choosing an approach of selling off their most carbon intensive activities instead. Some pension funds promote social and environmental goals by applying shareholder engagement strategies to encourage ESG laggards to make progress to become ESG leaders. Within the Sustainable Finance Framework as it stands, it is much more cumbersome and labor-intensive to invest in ESG laggards. In such instances, investment managers are required to develop and execute an engagement plan, which could eventually still lead to disinvestment if the company is non-responsive. While it takes more time and energy, society as a whole could benefit if pension fund investors are able to move ESG laggards to become ESG leaders.

In assessing greenwashing, regulators and supervisors should accept various ESG approaches. Assessing how green investment portfolios currently are and whether financial market players are doing what they say they are doing are part of that. Realizing ESG impact by taking into account engagement and contribution to the climate transition as a whole should be considered as an equally relevant approach.

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2. Legal definitions of greenwashing should be leading. This Call for Evidence presents a wide array of features and dimensions defining greenwashing and greenwashing risks. We note a difference in public and regulatory discourse on greenwashing. Public concern regarding the sustainable investment policy of Dutch pension funds often focusses on the justification for investing in a certain company. By contrast, EU sustainable finance regulations focus on business activities within companies. Supervision of greenwashing should fit the definitions used in the sustainable finance regulations, notably the SFDR and Taxonomy.

3. Regulation and supervisory powers to address greenwashing are already in place. National Competent Authorities are currently equipped with supervisory tools to oversee the implementation the SFDR, based both on the SFDR itself as well as provisions on factual and balanced communication set in the Dutch pension law. In the Netherlands, the aforementioned research conducted by the NCA (AFM) drew preliminary conclusions about the state of SFDR implementation by the pension sector.

The full framework, including the RTSs, is only in force since 1 January 2023. This means that this year it will be possible to properly take stock of the SFDR implementation by financial market participants. The Dutch Federation of Pension Funds recognizes that not all market participants will get everything right immediately and is working with members to incorporate the feedback from the supervisor. The AFM has various enforcement tools available for market participants and may consequently follow-up with individual pension funds. At this time there is no need for additional European regulatory intervention.

4. Greenwashing can be unintentional. Due to the fact that the current framework in place - in particular the SFDR - is not sufficiently clear, greenwashing may be unintended. Some crucial definitions are still missing, e.g. on ‘ESG-characteristics’ and ‘sustainable investments’. We observe that financial market participants use very different interpretations. That means similar ESG approaches or the exact same portfolio could be categorized differently. By giving clarity about existing rules, many of the current problems will disappear over time.

Misconceptions of ESG scores may also emanate from differences in interpretations. Various views on how environmental and social aspects relate exist as there are different views of acceptable thresholds of and trade-offs between sustainability objectives. Challenges based on different viewpoints on ESG and sustainability should be distinguished from intentional greenwashing.

5. Underselling or overselling ESG characteristics, there is a difference. Within the context of uncertainties around SFDR classifications and the reporting requirements that follow from them, we see that smaller Dutch pension funds have generally been reluctant to classify their fund (entity) and pension scheme (product) as promoting ecological or social aspects. Most still aim to promote ESG-aspects in their investment policy. We could argue that some of these funds

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are in effect *green-bleaching* their investment portfolio, underselling on their ESG-characteristics. In the case of characterizations of Taxonomy-alignment, the Dutch supervisor AFM explicitly recommends green-bleaching in cases where reliable data is not available.

There are examples of pension funds with an Article 6 pension product that nevertheless have a responsible investment policy in place. Similarly, there are examples of pension funds with an Article 8 product that opt out on publishing a PAI statement on an entity level under Article 4, on the basis of the lack of resources. We would argue that such apparent incongruencies are different from greenwashing practices where financial market participants classify their entity and/or product as greener than they are. Implementing a sustainable investment policy is a demanding process. Sustainability reporting requirements should not lead to discouraging organizations from taking steps towards incorporating ESG elements.

6. Differences in standards for government issued green bonds persist. The diversity in government-initiated green bond frameworks makes it hard for governments to quantify their impact, opening the door for multiple approaches to substantiate impact statements. This way, traditional bonds could be categorized Article 8 or 9. Investors can be tricked by an overflow of framework scores. The Polish Green Bond Framework in 2016 provides an example. The Polish government claimed that these green bonds would not provide funding for the national coal industry, but investors were skeptical about the possible the bonds' benefits for the coal industry.

With regard to the securitization market, proposed regulations could increase the risk of "adverse green selection of assets " and thus incentivize the funding of 'brown' assets. The recent draft EU Green Bond Standard proposes that true sale securitizations, in which the proceeds from non-green securitized assets are used for Taxonomy-aligned purposes, can be classified as green bonds. In such case, even a portfolio consisting of oil, gas and coal companies without any commitments to the transition to a low-carbon economy could be considered 'green', depending on how the proceeds of transactions are deployed.

We recognize that it is difficult to originate sufficient volume and granularity of green assets to structure a transaction with 100% of the portfolio consisting of green assets. However, this greenwashing risk could be prevented by requiring performance indicators for the underlying portfolio or including a minimum share of green assets in the underlying portfolio.