Benchmark on Responsible Investment by Pension Funds in the Netherlands 2020

From boardroom governance to portfolio implementation: closing the gap

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Ranking

Ranking 2020	Change	Ranking 2019	Name of pension fund	Overall score 2020	Governance	Policy	Implementation	Accountability	Stars
1	– 0	1	Pensioenfonds ABP	4,3	4,9	3,9	4,0	4,8	★★★★
2	– 0	2	bpfBOUW	4,0	4,7	3,3	3,8	4,8	★★★
3	▲ 2	5	Pensioenfonds van de Metalektro (PME)	3,9	3,8	3,6	3,7	4,8	★★★
4	▼ 1	3	PFZW	3,6	2,1	3,3	3,9	4,4	★★
5	– 0	5	Pensioenfonds Metaal & Techniek (PMT)	3,4	3,3	2,3	3,5	4,2	★★
6	▼ 1	5	SPW	3,2	2,2	2,9	3,7	3,0	★★
7	▼ 3	4	BPL Pensioen	3,1	2,1	2,3	3,4	4,1	★★
8	– 0	8	Bpf Schilders	2,9	1,9	2,7	3,5	2,3	★
9	▲ 2	11	SBZ Pensioen	2,8	2,8	2,0	2,7	4,0	★★
10	▲ 8	18	Pensioenfonds KPN	2,8	2,1	2,7	3,0	2,9	★★
11	▲ 13	24	Bedrijfspensioenfonds voor het Bakkersbedrijf	2,6	2,9	2,3	2,4	3,2	★★
12	▼ 1	11	Algemeen Pensioenfonds Unilever Nederland 'Kring Progress'	2,5	3,0	2,9	2,4	1,8	★
13	▲ 1	14	Pensioenfonds PNO Media	2,5	2,1	2,0	2,5	3,3	★★
14	▲ 2	16	Pensioenfonds Horeca & Catering	2,5	2,3	1,8	2,4	3,5	★
15	▲ 3	18	Pensioenfonds Achmea	2,4	2,5	2,3	2,4	2,5	★
16	▲ 10	26	Pensioenfonds Detailhandel	2,4	3,0	2,7	1,8	3,5	★
17	▲ 9	26	Rabobank Pensioenfonds	2,3	1,8	1,8	2,6	2,3	★
18	▼ 1	17	Pensioenfonds DSM Nederland	2,3	1,6	1,2	2,2	4,4	★
19	▲ 11	30	Pensioenfonds Fysiotherapeuten	2,2	3,0	1,4	2,2	2,3	★
20	▼ 9	11	Pensioenfonds SNS Reaal	2,2	2,2	0,8	2,7	1,9	★
21	▼ 3	18	Pensioenfonds PostNL	2,2	2,1	2,3	2,2	2,1	★
22	▼ 14	8	Spoorwegpensioenfonds	2,1	2,1	1,5	2,1	2,9	★
23	▼ 9	14	Pensioenfonds PGB	2,1	2,8	2,2	1,9	2,1	★
24	▲ 22	46	Stichting Pensioenfonds Huisartsen	2,1	3,4	1,5	1,6	3,1	★
25	▼ 15	10	Pensioenfonds Openbaar Vervoer (SPOV)	2,1	2,1	1,5	2,0	2,9	★
26	▼ 8	18	PWRI	2,0	1,9	1,2	2,0	2,9	★
27	▼ 1	26	Pensioenfonds TNO	1,9	3,0	0,9	1,7	2,4	★
27	▼ 5	22	Bpf Koopvaardij	1,9	1,9	0,8	2,1	2,6	★
29	▼ 7	22	Pensioenfonds Architectenbureaus	1,9	1,6	1,3	2,2	1,9	★
30	▼ 4	26	Shell Pensioenfonds (SSPF)	1,9	1,7	2,1	1,9	1,7	★
31	▼ 7	24	Philips Pensioenfonds	1,8	2,3	1,6	1,8	1,6	★
32	▼ 2	30	Pensioenfonds Vervoer	1,8	2,4	1,7	1,5	1,9	★
33	▲ 5	38	Bpf Mode Interieur Tapijt & Textiel Industrie (MITT)	1,7	1,3	0,3	2,1	2,4	★
34	▲ 6	40	Pensioenfonds Wonen	1,6	1,3	1,7	1,5	2,0	★
35	▲ 12	47	Bpf voor de Meubelindustrie en Meubileringsbedrijven	1,5	2,7	1,8	1,2	0,8	★
36	▼ 6	30	Pensioenfonds APF	1,4	1,9	1,5	1,1	1,7	☆
37	▼ 7	30	ABN AMRO Pensioenfonds	1,4	1,3	2,1	1,0	2,1	☆
37	▼ 7	30	Ahold Delhaize Pensioen	1,4	3,5	0,7	0,6	2,3	☆
39	▼ 9	30	Stichting Pensioenfonds UWV	1,3	1,3	1,3	1,1	2,2	☆
40	▼ 3	37	Stichting Pensioenfonds Medisch Specialisten (SPMS)	1,3	0,8	1,2	1,2	1,9	☆
41	▼ 1	40	Bpf voor het Levensmiddelenbedrijf	1,2	0,8	1,6	1,0	2,1	☆
42	▼ 4	38	Bpf Schoonmaak	1,2	1,6	0,8	1,1	1,6	☆
43	▼ 1	42	Algemeen Pensioenfonds KLM	1,1	1,7	0,6	1,0	1,5	☆
44	▼ 2	42	Pensioenfonds Cabinepersoneel KLM	1,1	1,7	0,6	1,1	1,1	☆
45	▼ 15	30	Heineken Pensioenfonds	1,1	1,7	0,3	0,8	2,2	☆
46	▲ 3	49	Pensioenfonds ING	1,1	2,1	1,0	0,8	0,8	☆
47	▲ 3	50	Pensioenfonds Medewerker Apotheken (PMA)	0,9	1,7	0,5	0,9	0,2	☆
48	▼ 6	42	Pensioenfonds IBM Nederland (SPIN)	0,8	1,3	0,7	0,5	1,5	☆
49	▼ 4	45	Pensioenfonds Vliegend Personeel KLM	0,8	0,8	0,3	0,9	0,9	☆
50	▼ 3	47	Pensioenfonds Hoogovens	0,7	1,1	0,3	0,7	0,9	☆

* The scores are rounded to one decimal place. However, funds are only given a shared place in the ranking if they have the same score to two decimal places.

Preface

This year marks VBDO's 25th anniversary. A silver jubilee gives us a reason to look back over what has been achieved. Back in 1995, the financial sector had very little interest in responsible investment. Nowadays, institutional investors appear to have much more awareness of their societal responsibility to both minimise negative impacts and contribute to the Sustainable Development Goals (SDGs) through their investments. VBDO has helped to bring about this change.

The FNV supports VBDO's mission wholeheartedly and is proud to be a member. We call upon pension funds and asset managers to also join VBDO, so that together we can play a crucial role in working towards a more sustainable future.

We underline our commitment to VBDO's mission by taking our place on the board and therefore contributing directly to VBDO's agenda. Our focus as a union is, of course, on employment rights and human rights. In recent years, we have initiated (and sponsored) three VBDO surveys. These looked at the extent to which pension funds consider freedom of association, the living wage and forced (child) labour in their portfolios.

We are pleased to see that the 'social' part of ESG policy is gradually getting the attention that it deserves. But there is still a lot of work to be done: in supply chains all over the world there is still an abominable injustice regarding the right to collective bargaining and an income sufficient to support a family. There are also still far too many people struggling with unreasonable compulsory working hours and unsuitable working conditions.

For the 14th year in a row, VBDO presents its Benchmark on Responsible Investment by Pension Funds, of which we are a proud sponsor. The 50 largest pension funds have been assessed on their responsible investment achievements.

The questionnaire is regularly evaluated and refined to reflect market developments in the universe of responsible investment. This year, adjustments mainly relate to the topic of governance, and help VBDO to consider questions such as:

- Is there enough ESG-related expertise within the board of the fund?
- Are pension funds explicit when explaining what they expect from asset managers and are the terms in the contracts concrete and unmistakable?
- How specific is the fund's policy on engagement and on voting at shareholders' meetings? Is this policy in line with the fund's overall purpose?

Despite the fact that several pension funds improved their ESG policy over the past years, this is not a reason for self-complacency. We appeal to pension fund boards to take a critical look at their performance: is the impact on the ground actually what you intended it to be? Or is the ESG policy little more than a paper tiger?

While the assessment of this year's benchmark focuses on activities in 2019, we cannot ignore the COVID-19 pandemic. It is too early yet to have full oversight, but it is already clear that the effects of the pandemic on economies and portfolios will be enormous. The pandemic is also making people stop and think about how societies should function. There is no doubt in my mind that, as a result of this process of rethinking, people will want to take a closer look at companies to determine to what extent they really contribute to society. Board members of pension funds will, therefore, need to give this topic a considerable amount of thought.

I would like to end this preface by reiterating the point that Angelique Laskewitz made last year: it is of extreme importance that pension funds collaborate more, work to standardise monitoring instruments and encourage each other to anchor ESG in the heart of investment policy.

Tuur Elzinga
vice-chairman of FNV,
responsible for pensions

Introduction

This report provides a detailed overview of the current status and developments relating to the responsible investment practices of the 50 largest Dutch pension funds. These pension funds have a combined amount of €1.435 billion assets under management (AuM), representing 92% of the assets in the Dutch pension fund sector. The pension funds are assessed based on how they formulate, govern, implement and report on their responsible investment policy. The report covers a one-year period: the calendar year 2019. VBDO's assessment results in a ranking in order of performance.

VBDO'S PURPOSE AND ACTIVITIES

VBDO believes that a more sustainable and responsible capital market leads to a healthier and more just world.

As an independent association, we are a passionate driver, motivator and knowledge leader for responsible investment and have been helping to anchor sustainability in companies since 1995. VBDO helps organisations to make choices that look beyond financial gain alone and consider environmental, social and governance (ESG) factors.

We work towards our mission by publishing benchmarks and theme studies, organising round tables and seminars, and asking the right, critical questions at shareholders' meetings. In our benchmarking activities, we assess to what extent Dutch institutional investors take sustainability into account in their role as a responsible investor. Thanks to their shares, these types of investors own a considerable amount of the companies in which they invest, so they have both rights and responsibilities.

Through this benchmark, VBDO aims to motivate pension funds to take sustainability into account in their investment decisions. We send a thorough and detailed questionnaire to challenge the pension funds in all aspects of the responsible investment process. Answering the questionnaire requires a considerable amount of time and effort and raises awareness within the pension funds of the need to keep improving performance.

WHAT IS RESPONSIBLE INVESTMENT?

Responsible investment (RI) can be described as embedding societal issues in investment decision making. These issues are typically divided into environmental, social and governance (ESG) topics, such as climate change, biodiversity, human rights, health, diversity and anti-corruption. RI can be done in different ways, including avoiding certain issues and prioritising other issues. In their investment beliefs and policy documents, each pension fund sets out its vision on responsible investment. Ethical, financial (risk/return) and societal impact criteria all play a role here. This vision is then put into practice through a range of responsible investment instruments.

POSSIBLE INSTRUMENTS FOR RESPONSIBLE INVESTMENT

Exclusion

Investors exclude companies and countries from their investment universe for various reasons. There are legal reasons not to invest in certain sectors or countries and there can also be ethical reasons to exclude an entire sector (e.g. tobacco or weapons). Companies can be excluded if their behaviour on ESG topics does not fit with the investor's RI policy.

Engagement

Investors can start a dialogue with their investees and (as shareholders), require them to perform better on certain ESG topics. This may including asking them to reduce CO_2 emissions or uphold labour rights both within the company and within the supply chain. An engagement process can take several years, after which time the company has hopefully improved its performance or the investor can decide to sell its shares.

For more information on RI instruments and asset classes, please see the appendix.

BENCHMARK DEVELOPMENTS

Every year, the assessment criteria are reviewed to ensure relevancy, and possible adjustments are discussed with the participants of the benchmark. In addition, this

Figure 1 | **Overview scoring model, VBDO**

FINAL SCORE (between 0-5)

GOVERNANCE (16,6%)	POLICY (16,6%)	IMPLEMENTATION (50%)	ACCOUNTABILITY (16,6%)

Total score on category Implementation =
Score public equity X % of the portfolio
Score corporate bonds X % of the portfolio
Score sovereign bonds X % of the portfolio
Score real estate X % of the portfolio
Score private equity X % of the portfolio
Score alternative Investment X % of the portfolio

Figure 1 shows the scoring model. The categories are weighted differently. Governance, policy and accountability each account for 16.7%, and implementation for 50%. The weighted percentage for implementation is 50% because this theme determines the final output and quality of the responsible investment practices of a pension fund. In the governance and policy category, all questions are weighted equally. The final score for implementation is determined by multiplying the score of each asset class by the percentage of the portfolio invested in this asset class. All questions are weighted equally within asset classes.

year the questionnaire has been revised to better reflect the latest developments in responsible investment. In practice, this means that standards have been set higher. Therefore, pension funds that are performing the same as last year, will receive a lower score than previously. Due to the revision, this year's scores and star rankings are not fully comparable with last year's.

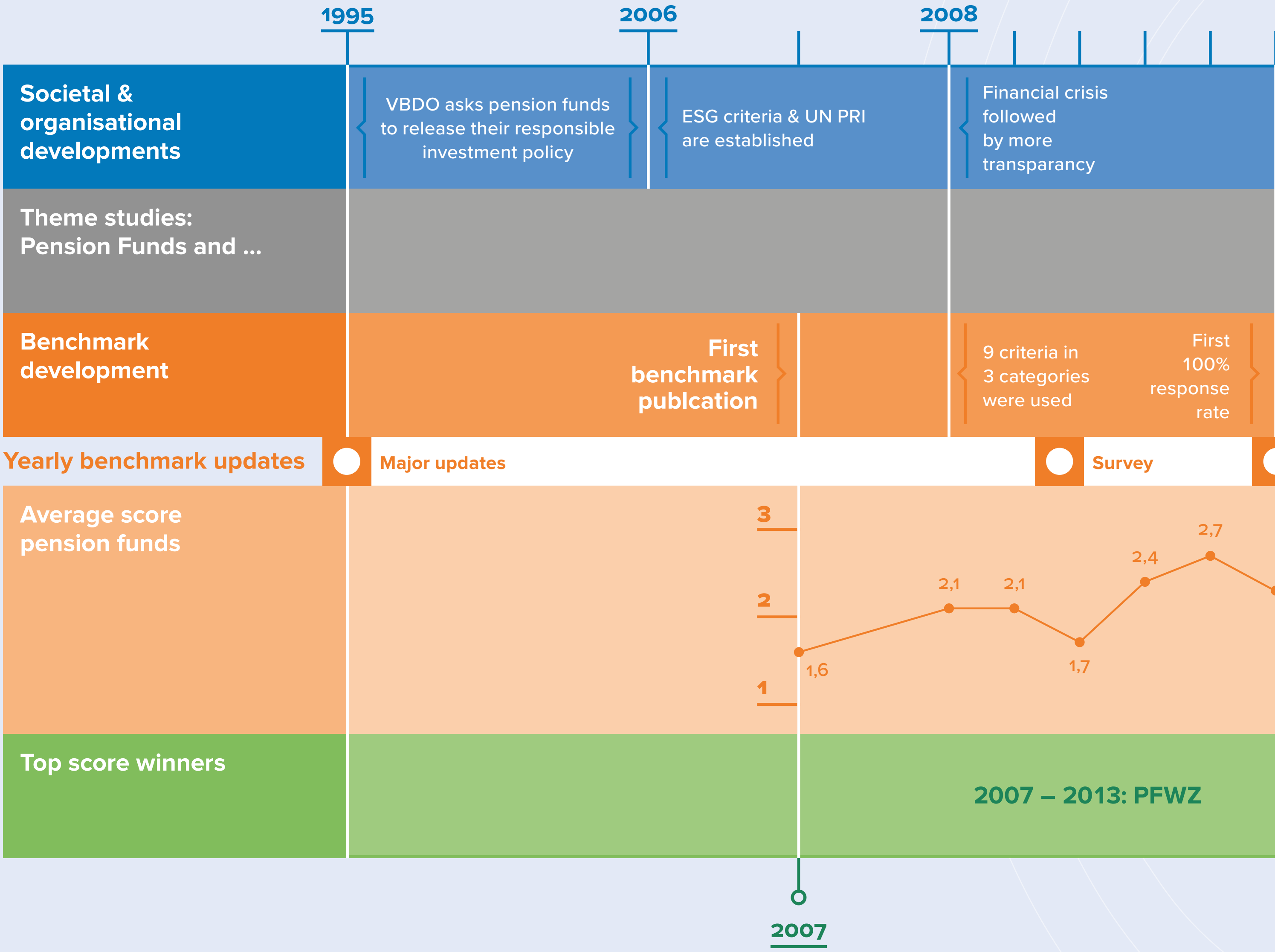
HOW TO INTERPRET THE SCORES

Pension funds are given a score between 0 and 5 in this benchmark, with 5 being most sustainable. The final score reflects how each pension fund has scored in the four categories (figure 1).

The four categories are:
- Governance
- Policy
- Implementation
- Accountability

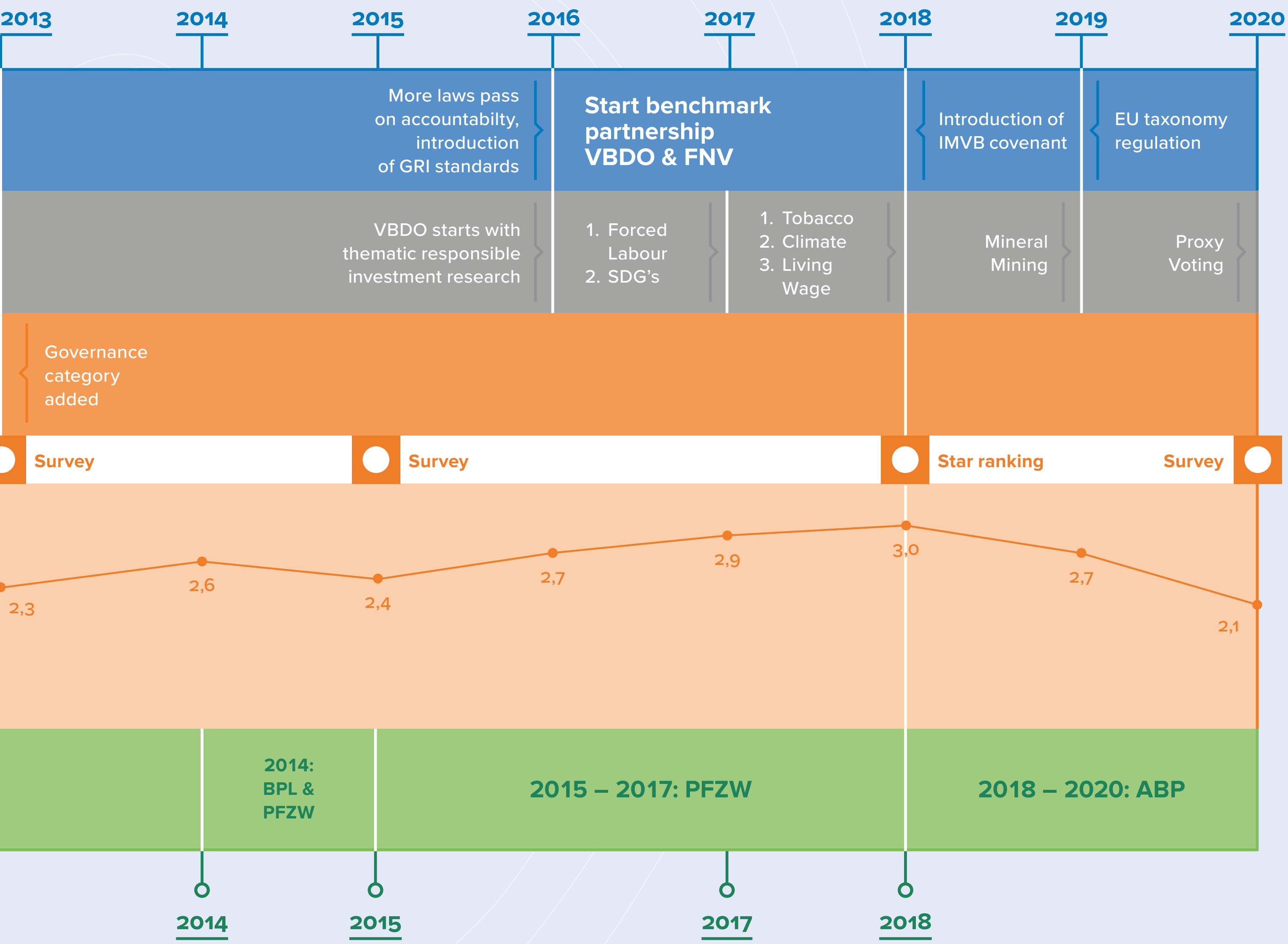
The scoring in the benchmark does not focus on individual investments (e.g. in the fossil fuel industry). Instead, the benchmark takes a more holistic approach. For an explanation and examples, see the following chapters 1. Overall performance and 2. Results per category.

VBDO's benchmarking timeline



VBDO pension fund members

ABP Pensioenfonds SNS REAAL Unilever APF Het pensioenfonds van Unilever Nederland BPL PENSIOEN samen werken voor later pme pensioenfonds


2013
2014
2015
2016
2017
2018
2019
2020
More laws pass on accountabilty, introduction of GRI standards
Start benchmark partnership VBDO & FNV
Introduction of IMVB covenant
EU taxonomy regulation
VBDO starts with thematic responsible investment research
1. Forced Labour
2. SDG's
1. Tobacco
2. Climate
3. Living Wage
Mineral Mining
Proxy Voting
Governance category added
Survey
Survey
Star ranking
Survey
2,3
2,6
2,4
2,7
2,9
3,0
2,7
2,1
2014: BPL & PFZW
2015 – 2017: PFZW
2018 – 2020: ABP
2014
2015
2017
2018

Main findings

Raising the bar unveils new challenges | Over the 14 years that we have been conducting this assessment, we have seen most pension funds gradually improve. This year, however, after raising the bar via a thorough overhaul of our survey, there has been a sharp drop in the total average score to 2.1. It is clear that pension funds need to accelerate the speed at which they are improving in order to address the challenges that the world is facing, and to meet the growing expectations of their stakeholders. While all pension funds apply responsible investment approaches on at least a basic level, performance varies greatly. Several steps could be taken by pension funds to further integrate responsible investment in their overall strategies.

- **Pension fund boards lack specific RI knowledge**

While most (70%) pension funds are advised by experts (consultants and/or asset managers), only 16% of the pension fund boards have demonstrable RI knowledge. In light of the increasing need to embed complex RI risks in investment policies, board members need to have at least a basic understanding of the different approaches and methodologies.

- **Little proof of a steady, aligned and ambitious course of action**

Although there are many standards and guidelines available, pension funds rarely make use of these when setting short, medium and long-term goals and science-based targets. Only 14% of the pension funds implement (inter)national standards and guidelines in their RI report.

- **There is a general lack of alignment between the investment portfolio and the RI policy**

Almost half (44%) of the pension funds' investment portfolios are not aligned with their RI policies. Only a few pension funds require asset managers to operate in line with the goals of the pension fund. For example, while almost 80% of the pension funds have an ESG integration policy, just over 50% of all pension funds apply it to the full public equity portfolio.

- **A large variety of RI instruments are used, but they are not consistently applied across the different asset classes**

Engagement on ESG is considerably less likely to be conducted for the real estate portfolio (36%) than the public equity portfolio (74%). Engagement with governments is not yet commonplace. Also, only 10% of the pension funds engaged companies on their strategy to ensure social-ecological resilience to the consequences of climate change.

- **It is still a major challenge to align investment portfolios with positive real-world impacts**

While a few pension funds are working to ensure that their actions result in ambitious real-world impacts, these initiatives are in the early stages. Most pension funds are still not measuring the actual impacts of their policies. For example, just a third of the pension funds review what green bonds finance and the sustainability strategy of the green bond issuer.

Recommendations

- **Ensure sufficient oversight at board level, by increasing its knowledge of RI and the diversity of the board and investment committee.**
  Formally determine the board's RI responsibilities and attribute responsibilities to (a) board member(s).

- **Develop a focused, aligned and ambitious RI policy**

This policy should have at its heart a comprehensive vision on societal developments (such as climate change, human rights, natural resource depletion and geopolitical events). It should also be aligned to intended real-world impacts, and it should cover all asset classes. To support this, pension funds should:

- Interlink RI instruments; for example funds should use voting as an escalation strategy after failed engagement.
- Integrate E&S requirements in the voting policy for routine voting items.
- Develop and implement an engagement policy for governments and real estate investments.
- Pay more attention to the greenness of the use of proceeds of green bonds.

- **Define goals and targets in line with the policy**

Goals and targets should be measured, evaluated and adjusted if necessary. Include clear, science-based targets where possible, with a multi-year roadmap for implementation.
Include RI requirements and targets in the selection, monitoring and evaluation process; ensure that all asset managers integrate these criteria in their investment analysis or index product.

- **Disclose goals and results of RI instruments per asset class;** indicate ESG and climate-related risks and report real-world impacts to and of the investment portfolio. As well as assessing climate risks to their assets, pension funds should ideally also assess the impact of their assets on the social-ecological resilience of the region or location. Doing so enables them to become part of the solution by adapting to the real-world effects of climate change.

PHOTO: ULF ERLANDSSON

1. Overall performance

This chapter gives an overview of the overall results of the benchmark study. Over the years, the benchmark has revealed a large discrepancy between the top and bottom performers. This trend continues this year, with a maximum score of 4.3 (2019: 4.6) and a minimum of 0.7 (2019: 1.1), as can be seen in the ranking on page 5. While the average score from 2015 to 2018 gradually increased, we saw a drop last year to 2.7 (2018: 3.0) due to the slight adjustment to the benchmark criteria. This year, after a thorough overhaul of our survey, there has been a sharp drop in the total average score to 2.1. While this decline can be partly accounted for by the change in the survey, it still indicates that responsible investment needs to be significantly improved in the pension fund sector.

Last year's leaders have, on the whole, retained their position in 2020. However the middle group and laggards have shown insufficient improvement, which negatively affects the overall average score. That said, over the 14 years that we have been conducting this assessment, we have seen most pension funds gradually improve. Even when adjustments have been made to our benchmark methodology and survey.

RAISING THE BAR

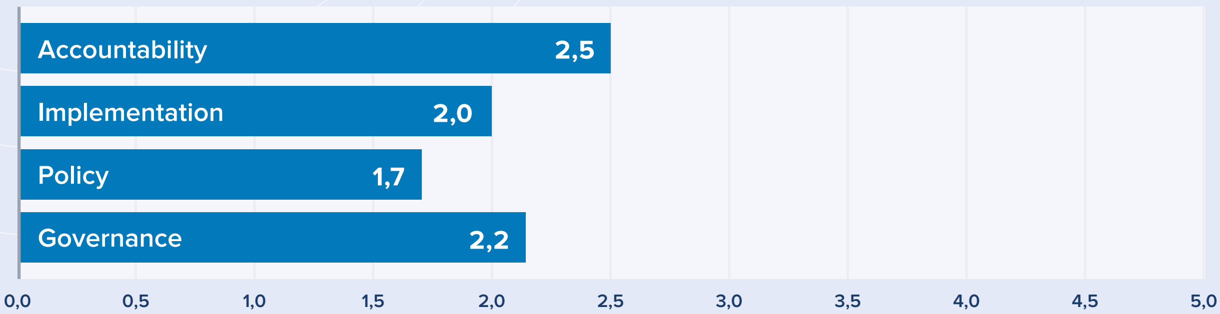
The last time that our methodology was significantly adjusted was in 2017. VBDO aims to keep our survey and methodology largely unchanged over a three year period following such an adjustment. This year, 2020, therefore marks another year in which adjustments were made to raise the bar. This time the focus was on the survey. Most significant changes have been made in the governance and policy categories. Along with the adjustments, we also require respondents to provide additional evidence around their processes and impact results in order to obtain a high rank in this benchmark. For more information about our methodology and approach, please see the appendix.

For eight years in a row, the implementation category had the lowest score of all categories. This has changed for 2020 as the policy category now has the lowest score (figure 2).

LEADERS

Although the top performers have also seen a drop in their score, they have largely maintained their leadership position. These leading pension funds have the most developed responsible investment policy and processes in place. In most cases, there is RI awareness and expertise at board-level of these pension funds, and the board closely monitors the implementation of the RI policy. They take a comprehensive ESG integration approach for the majority of investment decisions. These pension funds have shown themselves to be at the forefront of the development of responsible investment strategies, and measurement methods and frameworks.
They distinguish themselves from the middle group, by improving the way they report on RI in accordance with (inter)national standards and guidelines.
Some improvements could still be made. For example, the pension funds could further align their investment

Figure 2 | **Total average score of pension funds per category.**

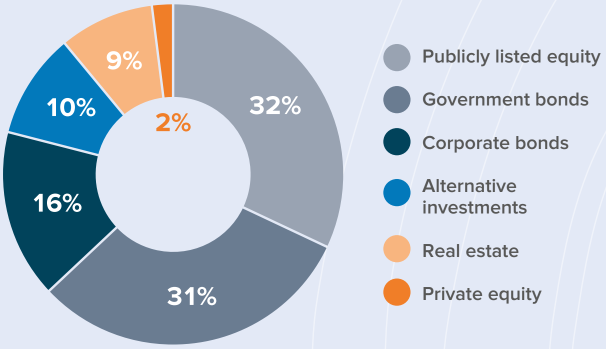


portfolio with their RI policy. They should look beyond climate change risks, by demonstrating and reporting on the negative and positive impact of their investment portfolio. In addition, leadership is not about signing more and more initiatives, but about taking an active role and focusing on the desired impacts.

MIDDLE GROUP

Some individual pension funds in the middle group have risen in the ranking, putting more pressure on the pension funds that remain in the lower ranks. Other pension funds have seen a notable decrease in their ranking. Funds in the middle group have all explained their responsible investment process, including the RI instruments they use, and to some extent the results of that process. Many mid-performers incorporate responsible investment across all asset classes on a basic level. However, more can be done to determine whether the expected result of certain RI instruments has actually been achieved. Pension funds could further improve by setting clear and measurable short and long-term goals, preferably ones aligned with the Paris Agreement. Another important improvement would be to report on climate change and ESG related risks, and on the positive and negative impact of their investment portfolio.

Figure 3 | Average asset allocation.



LAGGARDS

Pension funds in this group have been taking first steps towards defining and implementing their responsible investment policy. However, there is a lack of awareness, expertise and action on responsible investment. Average scores in this group are particularly low in the policy and implementation categories. Some of these pension funds have yet to even acknowledge the importance of a well-structured RI policy. However, encouragingly, others do recognise that they need to improve and are working to shape or strengthen their policies and processes.

MOST IMPROVED

As mentioned, competition is fierce and a small improvement in a fund's score can lead to a significant change in its ranking. Therefore, it is necessary for a fund to keep improving in order to maintain its position.
Pensioenfonds Huisartsen is the most improved pension fund compared to last year. It has demonstrated that it is in the process of considerably improving on the categories governance and accountability, which has seen it move from the bottom group to the middle one, and its position has jumped from 46th to 24th. Significant improvements have also been made by Bpf voor het Bakkersbedrijf, which has advanced for the second year in a row, this time from 24th to 11th, and Bpf Meubel, which has advanced from 47th to 35th.

BEST PERFORMING IN RELATION TO SIZE

The two largest pension funds (ABP is placed 1st, and PFZW is placed 4th in the ranking) have almost as much assets under management (AuM) as the other 48 combined (€696 billion, representing 49% of the total assets in the scope of this benchmark). For other pension funds, the differences in score are not always explained by their size. The following table shows the best three and worst two performing pension funds in each size category. Some smaller funds are clearly outperforming larger funds when it comes to responsible investment, particularly Bpf voor het Bakkersbedrijf (11th in the ranking and 39th in size), and Algemeen Pensioenfonds Unilever NL 'Kring Progress' (12th in the ranking and 37th in size). Some larger pension funds, such as ABN AMRO pension funds (6th in size) and ING Pensioenfonds (8th in size), are clearly underperforming, as they are placed 37th and 46th in the ranking, respectively.

Table 1 | Best and worst performing pension funds in groups of size.

Ranking 2020	Name of pension fund	Overall score 2020	AuM (x € 1 million)
Large pension funds (> 30 billion AuM)			
1	Pensioenfonds ABP	4,3	458.417
2	Bedrijfstakpensioenfonds voor de Bouwnijverheid (bpfBOUW)	4,0	67.504
3	Pensioenfonds van de Metalektro (PME)	3,9	55.591
37	ABN AMRO Pensioenfonds	1,4	33.755
46	Pensioenfonds ING	1,1	30.673
Medium- large pension funds (10 - 30 billion AuM)			
6	Pensioenfonds voor de Woningcorporaties (SPW)	3,2	15.023
7	BPL Pensioen	3,1	20.637
10	Pensioenfonds KPN	2,8	12.123
31	Philips Pensioenfonds	1,8	21.463
40	Stichting Pensioenfonds Medisch Specialisten (SPMS)	1,3	12.752
Medium pension funds (5 - 10 billion AuM)			
8	Bedrijfstakpensioenfonds voor het Schilders-, Afwerkings- en Glaszetbedrijf	2,9	7.988
9	SBZ Pensioen	2,8	6.468
12	Algemeen Pensioenfonds Unilever Nederland "Kring Progress"	2,5	5.385
49	Pensioenfonds Vliegend Personeel KLM	0,8	9.476
50	Pensioenfonds Hoogovens	0,7	9.403
Small pension funds (< 5 billion AuM)			
11	Bedrijfspensioenfonds voor het Bakkersbedrijf	2,6	4.613
19	Pensioenfonds Fysiotherapeuten	2,2	4.330
20	Pensioenfonds SNS Reaal	2,2	4.119
45	Heineken Pensioenfonds	1,1	3.900
47	Pensioenfonds Medewerkers Apotheken	0,9	3.657

2. Results per category

2.1 Governance | Good governance is crucial for a successfully implemented policy and relies on several factors, such as sufficient knowledge on responsible investment at board level, insight into the preferences of participants, and clear guidance from the board to asset managers when it comes to setting targets and measuring results.

The 2020 assessment specifically focused on:
- Accountability & leadership of the board
- The knowledge level of the board on topics relating to RI
- Board oversight: the extent to which execution is in line with the RI policy
- Consultation with participants and stakeholders

The average score for governance is a 2.2, with a range of 0.7 to a 4.3.

Our findings show that all pension funds are involved in formulating RI objectives and that 70% are advised by experts in the field (consultants and/or fiduciary managers).

FROM AWARENESS TO EXPERTISE

As last year's benchmark results showed, all the pension funds in scope have included ESG in their investment beliefs. This entails an intensive process from formulating a comprehensive RI policy – and adhering to the commitments set out in the RI policy – through to integrating the policy in the pension funds' investment portfolio.

Increasingly, pension funds are expected to develop a vision and take a stand on how to deal with complex societal developments (such as COVID-19, the climate crisis, natural resource depletion, human rights and geopolitical events) through their investment strategies. This requires a thorough understanding of the complexity, relevance and impact of these developments and the related risks.

This is particularly challenging given that non-financial data (or rather, pre- or extra-financial data) is inherently different from the financial indicators that the financial sector is used to rely on. It is our understanding, when the pension funds' board and their advisors fully comprehend the concepts and methodologies of e.g. carbon accounting, global warming scenarios, science based targets and physical climate risk analysis, the financial and non-financial data can be used for better decision-making.

Figure 4 | **Average results per category.**

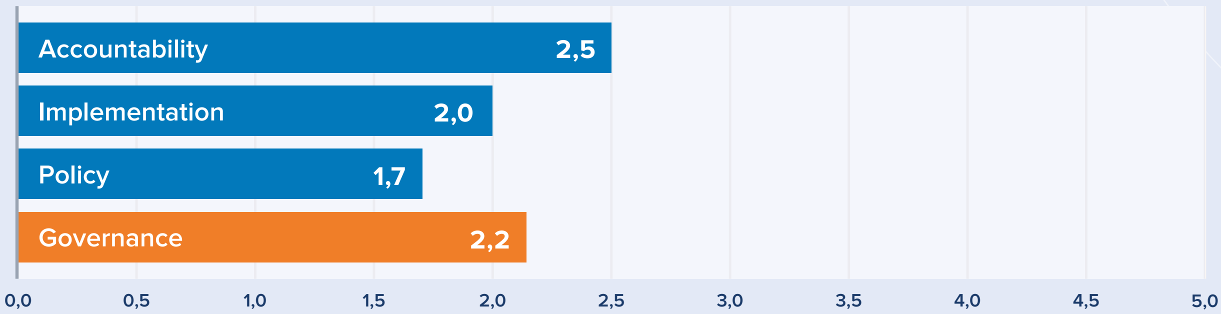
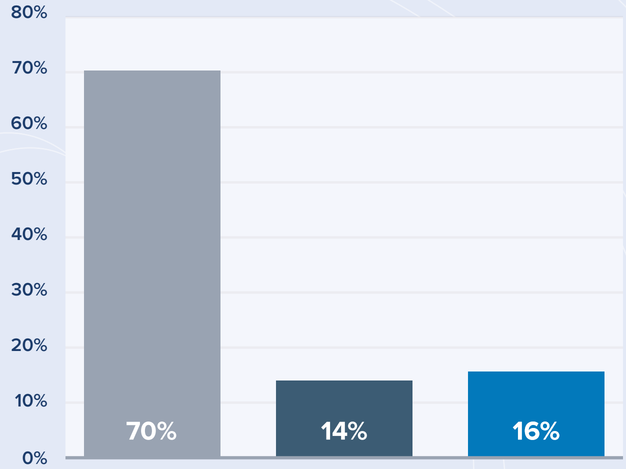


Figure 5 | **Board room accountability and leadership on RI.**

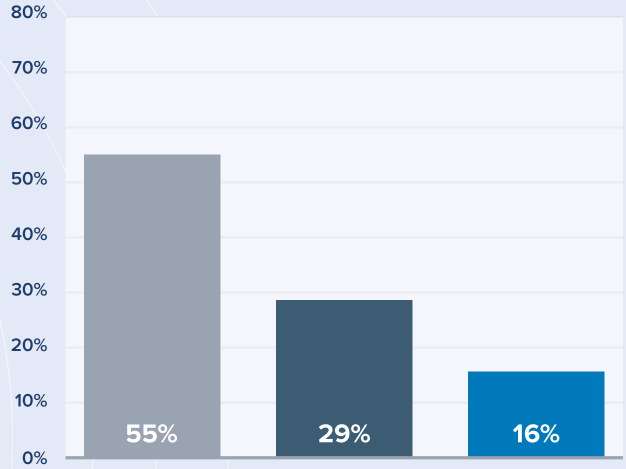


The board is in lead and/or advised by consultants/fiduciary manager on formulating RI objectives

There is a board member (with demonstrable RI knowledge) appointed to lead and implement ESG investments

There is a board member (with demonstrable RI knowledge) appointed to lead, implement, and monitor ESG investments, including an assessment/review of asset managers

Figure 6 | **Knowledge level on RI.**



The board of the pension fund does not have demonstrable RI knowledge.

The pension fund shows members of (one) of these bodies have completed RI training course either for:
- The governing body;
- The supervisory board;
- The accountability body.

The board member responsible for RI has completed an ESG training/course.

In their engagement with asset managers, the pension funds need to ensure that practitioners fully understand the complex technical aspects of relevant tools, e.g. carbon accounting for investments. Asset managers also need a good understanding of a range of complex ESG topics, such as biodiversity, pollution and ecosystems. These are specialised areas, so numerous experts may need to be brought in to support the asset manager.

With so many other responsibilities, how does the board stay in control of its RI policy? External experts and fiduciary managers are often consulted for substantive information and policy support. However, if a board member lacks suitable RI knowledge, experience or training, it is extremely difficult for them to challenge the advice they receive from outside experts, fiduciary managers, asset managers, service providers and other external parties.

While 30% of the pension funds have a board member formally responsible for the implementation of the RI policy, only 16% of the pension funds boards have demonstrable RI knowledge.

GAINING RI KNOWLEDGE

The extent to which the RI policy is successfully implemented partly depends on the level of knowledge of the board, the investment committee and the external parties they work with. Expertise in RI helps to give direction in formulating, achieving and measuring goals.

Good governance requires for decision-makers and relevant stakeholders to have equal access to RI information. For this to happen, there needs to be sufficient involvement and input from individual members of the governing body, the supervisory body, the accountability body and the executive office.

Pension funds need competent staff to incorporate ESG in a meaningful way. Therefore, the first commitment a board should make is to undertake training in order to gain a greater understanding of various ESG disciplines. The market offers a multitude of sustainable investment short courses, seminars and sustainability-related leadership programmes developed for – and often by – financial practitioners. These courses can be very helpful for acquiring ESG knowledge, if a careful consideration is made of the intended learning goals.

RECOMMENDATIONS FOR GOVERNANCE

- **Ensure sufficient countervailing power at board level, by increasing its knowledge of RI and the diversity of the board and investment committee.**
- **Keep a training register, which includes the organisation that provided the training, the type and level of the training, who was trained and at what date the training took place.**
- **Commit to an active approach when signing RI initiatives.**
- **Formally determine RI responsibilities in the board.**

2.2 Policy | This chapter covers the results of our assessment regarding the responsible investment policies of pension funds.

VBDO assesses to what extent pension funds formulate a comprehensive RI policy. Such a policy entails a clear investment framework that reflects the values of the pension fund and its stakeholders by formalising the vision, investment principles and approach to RI. Formulating a long-term vision that includes specific goals and a clear roadmap is crucial. Such goals can then be translated into measurable targets to increase the fund's RI ambitions on a yearly basis, by enabling it to keep track of progress and evaluate the improvement of the pension fund in relation to RI and the real-world impacts of the policy. Text box 1 provides an example of what could be understood by real-world impact. In addition, the policy should cover environmental, social and governance (ESG) themes, and these should be applied to all asset classes. Following this, ESG risks can be used for scenario-analysis as part of the strategic asset allocation (SAA) and asset liability modelling (ALM). Lastly, transparency on RI policy objectives and results is key, in order to make clear to participants and other stakeholders both the positive and the negative impact of the fund's practices.

The 2020 assessment of pension funds specifically focused on:

- Whether funds have a clear roadmap that includes short, medium and long-term targets
- Whether goals are measurable by real-world impact indicators
- The extent to which the UN Sustainable Development Goals (SDGs) and climate change are included in the RI policy

The average score for policy is a 1.7, with a range of 0.3 to a 3.9.

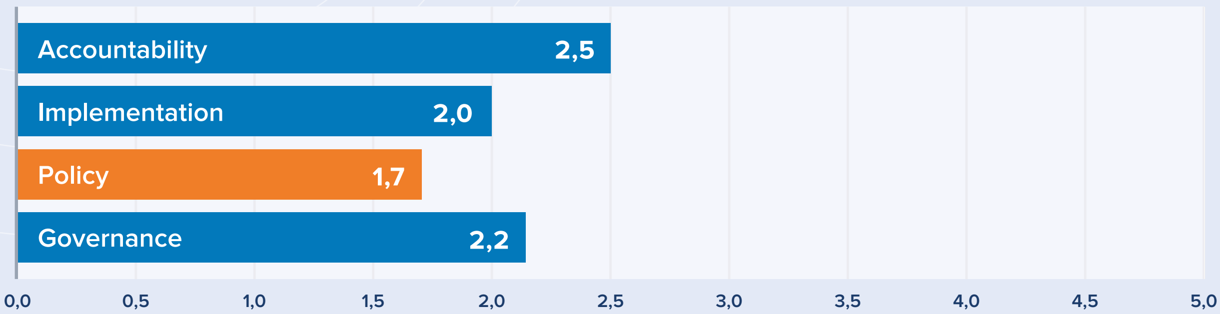
INCREASE IN SETTING GOALS

Since last year, we have seen an increase in pension funds that set RI-related goals. In 2019, 62% of the pension funds set ambitious goals and targets. Given the variation of goals and ambition between pension funds, we have adjusted our assessment and allocate points to targets that: 1) increase the ambition of RI strategies, 2) formulate a clear roadmap which includes short, medium and long-term goals, and 3) are measurable by real-world impact indicators.

According to our most recent results, most pension funds (72%) have formulated goals that demonstrably increase the ambition of their RI strategies. This shows pension funds are further developing their RI strategies. A few examples from pension fund policy documents are:

- We identified environmental and societal themes for responsible investment that we want to positively contribute to
- We contribute to positive impacts with respect to climate change, by reducing CO2 emissions in the real estate portfolio; our goal is to reduce our CO2 emissions on a yearly basis

Figure 7 | Average results per category.



- We have further developed our ESG policy by selecting SDGs; next steps are to include these in voting and engagement practices
- Our aim is to integrate sustainability in all steps of the investment process

These examples show that pension funds are increasing their ambition, but a clear strategy including a roadmap for implementation is often still missing. Only a few funds (10%) include short, medium, and long-term time-bound targets relating to the ambitious goals they have set. In addition, pension funds do not provide a roadmap to achieving the goals set out in the Paris Agreement. For several pension funds, 2020 is a transition year as many goals were set to end in 2020, and new goals and ambi-

"We encourage pension funds to align their goals with the Paris Agreement and science-based targets, and also to take planetary boundaries into account during the (re)formulation of their RI policy and implementation approach".

TEXTBOX 1 Aligning the RI policy with science-based targets:

The EU CTB and EU PAB benchmarks were created to support the 1.5°C scenario described in the Paris Agreement. To keep global warming to 1.5°C or less, the global economy needs to decrease its emissions by 7% per year for 30 years. These are absolute targets – not relative – in order to change the trend on world emissions and achieve real-world CO_2 reduction. For example, if an investor has an index portfolio and claims to represent a portion of the economy in line with the Paris Agreement, it needs to follow this decarbonisation rate. The absolute targets are a must, since the impact of a pension fund's portfolio CO_2 reduction on the real world could be misleading. One example is. "We will reduce the CO_2 footprint of our listed equity portfolio by 40% by 2027 relative to 2017." CO_2 emissions in the real economy might grow between 2017 and 2027, while the pension fund only measures at the portfolio level. As these are relative numbers, its real impact remains unknown. The research team of 2° Investing Initiative Association found that for 99% of funds, the CO_2 reduction claims are misaligned with scientific Paris-aligned frameworks.

For more information visit: https://2degrees-investing.org/wp-content/uploads/2020/02/2DII-Targets-Impact.pdf

TEXTBOX 2 How does the EU PAB benchmark work?

There are generally two mechanisms with which investors can achieve the 7% or more average per annum reduction in GHG intensity. Firstly, the fund can focus on its benchmark portfolio's constituent weights. Constituent weights describe the degree to which each individual company contributes to the computation of the overall benchmark. Benchmark operators can assign higher weights to lower GHG intensity sectors, while at the same time assigning lower weights to the sectors that contribute to climate change the most. Secondly, investors can aim to identify companies that have strategies to reduce their GHG intensity by at least 7% in the upcoming year.

For more information visit: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/192020-sustainable-finance-teg-benchmarks-handbook_en_0.pdf

Figure 8 | **Setting long-term goals.**

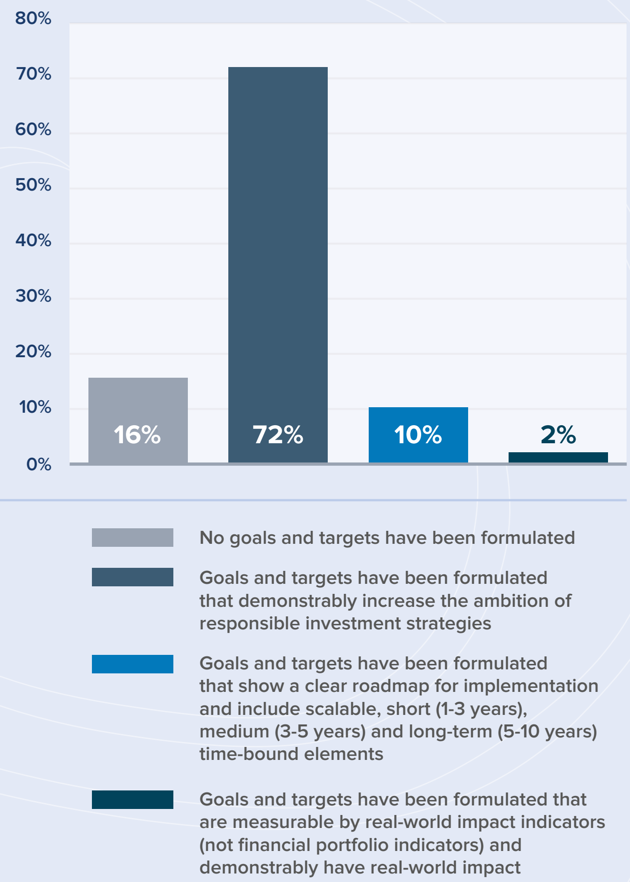
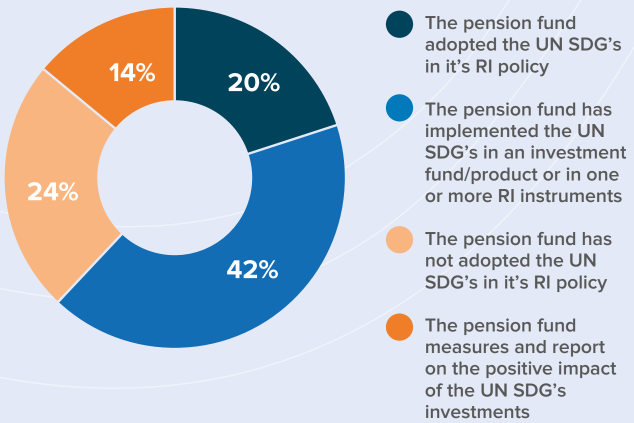


Figure 9 | **The UN-SDGs are included in the RI policy by most of the pension funds (76%).**



tions are still in the process of being developed this year. We hope to see this reflected in next year's assessment. We encourage pension funds to align their goals with the Paris Agreement and science-based targets, and also to take planetary boundaries[1] into account during the (re)formulation of their RI policy and implementation approach.

ALIGNING THE RI POLICY WITH SCIENCE-BASED TARGETS

In comparison to 2019, 2020 saw some advancements regarding standard setting and benchmarking. For example, the EU Climate Transition Benchmark (EU CTB) and EU Paris Aligned Benchmark (EU PAB) are being used by some funds. Please see textbox' 1 and 2.

RECOMMENDATIONS FOR POLICY:

- *What does the pension fund aim to achieve?*
  Develop a focused and specific RI policy, embedded in a comprehensive vision on societal developments and aligned to intended real-world impact.
- *How well is the policy being executed?*
  Link quantitative goals to meaningful performance indicators, making sure to cover all asset classes. Check whether appropriate tools are being implemented effectively to achieve goals. Goals and targets should be measured, evaluated and adjusted if necessary. Include clear, science-based targets where possible, with a clear multi-year roadmap for implementation.
- **Identify and engage with the most relevant RI initiatives and standard setting bodies.**

[1] Please refer to: www.stockholmresilience.org/research/planetary-boundaries/planetary-boundaries/about-the-research/the-nine-planetary-boundaries.html

2.3 Implementation | The scores in this category reflect how well the RI policy is being executed. VBDO analyses implementation for the various asset classes and the applicable RI instruments. The allocation of assets is the basis for determining the final score on implementation. The average score of 2.0 out of 5.0 illustrates the challenge of actually integrating ESG issues and RI goals into investment decisions.

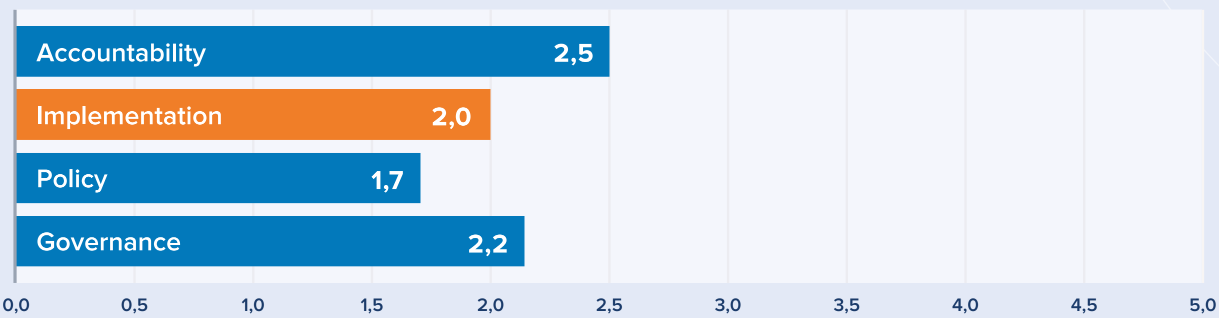
The 2020 assessment specifically focused on:
- The asset manager selection and monitoring process
- ESG integration
- Active ownership: engagement and voting

The average score for implementation is a 2.0, with a range of 0.5 to a 4.0.

Table 2 | **Responsible investment instruments and the different asset classes included in the benchmark.**

	Publicly Listed Equity	Corporate bonds	Government bonds	Real estate	Private equity	Alternatives
Exclusion	■	■	■			
ESG integration	■	■	■	■	■	■
Engagement	■	■	■	■		
Voting	■					
Impact investing	■	■	■	■	■	■

Figure 10 | **Average results per category.**

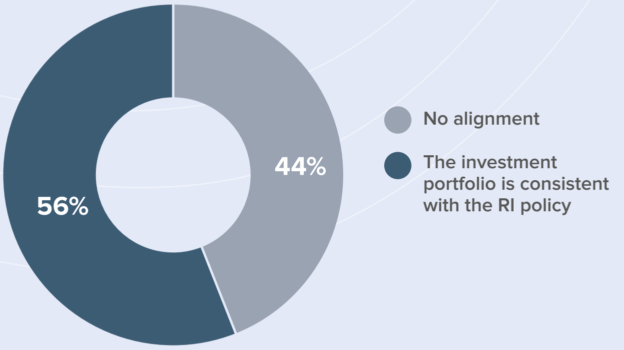


CONSISTENCY BETWEEN THE INVESTMENT PORTFOLIO AND THE RI POLICY

This year, our aim is to better reflect on the investment cycle of pension funds. By adding so-called preliminary questions, we were able to gain an overview for each asset class before diving into examining various RI instruments. The provided information gave us insight as to the distribution of asset managers per asset class and what ESG considerations pension funds take into account when selecting, monitoring and evaluating asset managers or index funds.

VBDO's view is that the asset owner (the pension fund), rather than the asset manager, should take the lead when formulating, monitoring and evaluating performance on RI objectives and goals. To make sure the RI policy is consistent with the investment portfolio, pension funds should ensure that their asset managers operate in line with the RI targets of the pension fund. In our assessment, we distinguished between several ESG requirements made to asset managers. These requirements should be part of the selection process of index funds and should be included in investment management agreements (IMAs) with (external) asset managers.

Figure 11 | **Alignment between the RI policy and investment portfolio.**



Our results show that most pension funds have at least minimum requirements in place, such as being a UN-PRI signatory. In our view, it is crucial that the asset manager has a clear policy or commitment towards responsible investing. Currently, few pension funds require asset managers to operate in line with the goals of the pension fund. Also, most funds do not require asset managers to provide insight into different ESG/SRI index funds.

44% of the pension funds' investment portfolios are not aligned with their RI policy. This means that their objectives, ESG themes and/or ESG integration strategies are not consistently executed by the appointed asset managers. There are no pension funds that can show that the real-world impact of their investment portfolio is consistent with their RI investment policy.

2.3.1 Exclusion

An exclusion policy indicates what type of investments a pension fund will not make. Exclusion can be done for various reasons, including legal grounds, reputational risks, ethical beliefs and sustainability considerations. It can be applied to companies, sectors, and countries. Exclusion is a relatively basic step to take, but it does require a vision on controversial issues. VBDO's benchmark only acknowledges exclusion criteria beyond legally binding regulations. For example, all Dutch funds are legally prohibited from investing in cluster munitions, so we do not count that as an exclusion policy.

NEW THIS YEAR

While all pension funds have defined their exclusion policy beyond legal prohibitions, every individual asset manager is not necessarily required to follow that policy. To understand the extent to which exclusion policies are applied to the pension funds' portfolios, we now require funds to provide evidence that the exclusion policy is being rigorously applied.

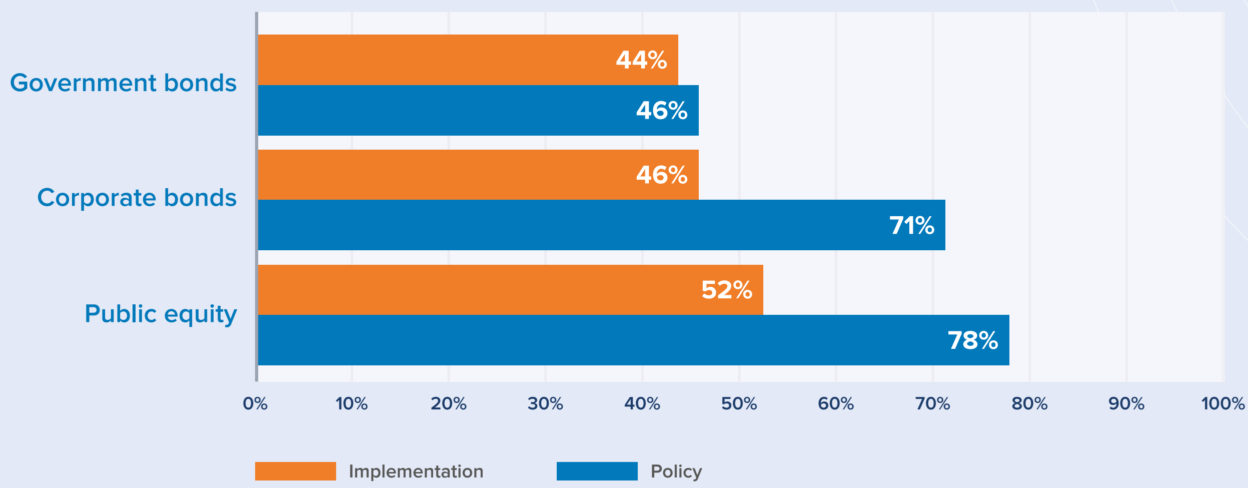
Most pension funds apply the exclusion policy to more than 75% of their portfolio. However, approximately 10% of the pension funds apply their exclusion policy to a lesser extent.

Some pension funds include certain criteria in their exclusion policy, such as tobacco, which only applies to a small proportion of the portfolio. We expect pension funds to be transparent to stakeholders about how the exclusion policy is applied and if asset managers are compliant. This is especially important given that exclusion is the preferred RI instrument used by pension funds. The most frequently given reasons for excluding companies are controversial weapons (other than legally inhibited cluster munitions) and United Nations Global Compact violations. While human rights and tobacco are also frequently mentioned, environmental or climate-related issues are rarely included.

For the government bond portfolios, exclusion criteria are mostly based on official sanction lists (e.g. those from the United Nations and European Union). Few pension funds use additional sustainability-related considerations in order to exclude countries from their investment portfolio.

Pension funds hold different approaches to exclusion, depending on their beliefs and vision. For example, while some funds might have a zero-tolerance threshold for certain activities, others might use exclusion as an escalation option for engagement with companies operating in those same activities. Both methods of exclusion can be used to influence company behaviour in line with the RI policy.

Figure 12 | ESG integration in public equity and fixed-income.



2.3.2 ESG integration

ESG integration refers to the process by which environmental, social and governance (ESG) factors are integrated into the investment decision making process. This integrative approach ensures that ESG criteria are identified and assessed in order for the fund to make an investment decision. ESG criteria can expose risks that might otherwise remain undiscovered, and can also identify investment opportunities.

NEW THIS YEAR
In this year's benchmark methodology, we have strengthened our requirements, which means it is more difficult for pension funds to obtain points. Firstly, where in previous years it was sufficient for a pension fund to require the asset manager to sign up to the UN-PRI, the bottom-line this year requires pension funds to show that they systemically and demonstrably integrate ESG criteria in either the equity, corporate bond or government bond investment process on a yearly basis. For active strategies, the fund can demonstrate that ESG criteria are integrated in the investment analysis. For passive strategies, the fund can show that the criteria are integrated in the index product.

Secondly, we believe the involvement of ESG criteria in investment decision making should not be solely limited to enhanced risk analysis. Ideally, an investment portfolio should make a positive real-world impact. Therefore, we have assessed pension funds on whether, and how, they integrate year-on-year absolute ESG criteria targets in the active or passive managed portfolio.

"We believe the involvement of ESG criteria in investment decision making should not be solely limited to enhanced risk analysis. Ideally, an investment portfolio should make a positive real-world impact".

From this year, pension funds are able to follow benchmarks developed by the European Commission that provide CO2 emissions reduction targets in line with the Paris Agreement. Various index providers have developed benchmarks that incorporate ESG factors, but the lack of transparency regarding their methodologies has affected their reliability. The EU's benchmark regulation introduces ESG disclosure rules for index providers, as well as standards for the criteria and methods used to select and weigh the underlying assets of benchmarks, and to calculate the CO2 reductions associated with the underlying assets. This will increase transparency and reduce greenwashing risks.

Because of the changes to this year's methodology, it is not surprising that no pension fund scored full points on the ESG integration questions. However, we hope that the questions will spur on front-running pension funds to enhance ESG integration in order to make real-world impacts.

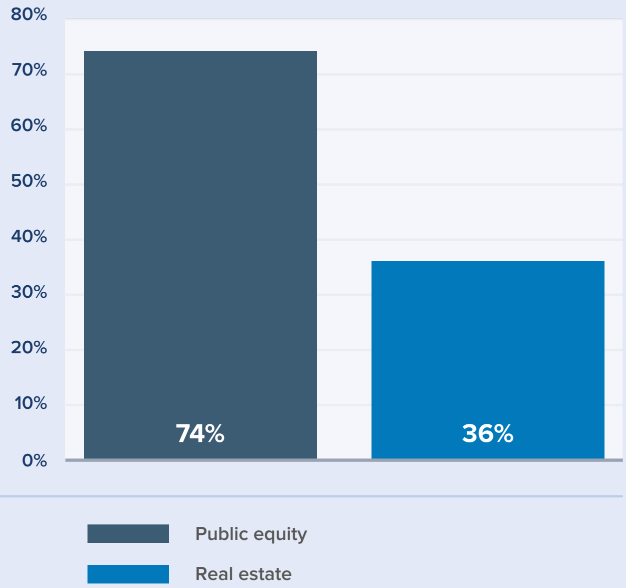
RESULTS ON ESG INTEGRATION
Pension funds often apply several investment strategies and employ multiple asset managers simultaneously. This can mean that ESG criteria are not always fully integrated in investment decision-making. While almost 80% of the pension funds have an ESG integration policy, just over 50% apply it to the full PLE portfolio. Corporate bonds provide a similar picture, although here overall implementation of ESG criteria is lagging compared to equity selection, as seen in figure 12).

ESG INTEGRATION IN GOVERNMENT BONDS
ESG integration in the emerging market bonds selection process is more often than not an integrated process. 60% of the pension funds systemically integrate ESG criteria in their bond-selection process. ESG is a value driver for credit ratings and the investment analysis is also fed into engagement with government officials.
ESG integration is often incorporated in the RI policy of pension funds. While pension funds say they require their asset managers to implement the RI policy, the results of our study show that this is not always the case.

The integration of ESG factors into developed market bonds is less frequently applied by pension funds. More than half of the pension funds (56%) do not systematically integrate ESG criteria in their bond selection process. Most of them invest in government debt in European countries, where in their view 'ESG risks are less likely to occur'. VBDO's view is that ESG factors also need considering for government debt in the developed market. In addition, according to a paper by EIOPA, there is limited knowledge regarding climate risk, and sovereign bonds are the least covered area in this instance.[2] Given the importance of sovereign bonds to pension funds' investment portfolios – comprising almost a third of their holdings – pension funds should assess if developed countries pursue policies in line with scientific climate scenarios. This means pension funds should also take fossil fuel exposure into account and determine whether their investments are enabling a just transition to a carbon-neutral landscape and aiding climate adaption.

> *"While almost 80% of the pension funds have an ESG integration policy, just over 50% apply it to the full PLE portfolio".*

Figure 13 | Difference between engagement with companies and with real estate fund managers.



ESG INTEGRATION IN REAL ESTATE

On average, pension funds have allocated 9% of their assets to real estate. In a rapidly urbanising world, real estate has great potential to accelerate sustainable development, considering its substantial use of materials and land, and also because the lives of people are centred around buildings.

All sectors, including real estate, need to significantly change in order to accomplish CO2 neutrality and a climate resilient society by 2050. With the 'Klimaatwet', the Dutch government is stimulating the development of sustainable real estate, for example by implementing a minimum energy label C requirement for office buildings as of 2023. In addition, the 'Activiteitenbesluit Wet Milieubeheer' and the Energy Efficiency Directive (EED) impose measures to improve the energy efficiency of real estate. The Bijna Energieneutrale Gebouwen (BENG) regulation specifies that from January 1, 2020, all new buildings in the Netherlands have to be near energy neutral.

Pension funds will need to take new standards and regulations into account when making investments in real estate, with a particular focus on energy use, including eliminating the need for natural gas, and incorporating green energy technologies.

Since last year, these new standards have been embedded in this VBDO benchmark. Focusing on sustainability in real estate offers investment opportunities that help society to mitigate and adapt to the effects of climate change through, for example, low-carbon real estate, green roofs and circular buildings.

In order to contribute to sustainable development, pension funds can also engage with real estate fund managers. 96% of the pension funds that participate in our survey invest in indirect real estate funds and 22% in direct real estate. While only two pension funds do not consider ESG criteria in the selection and evaluation of real estate fund managers, the overwhelming majority do. It appears that pension funds feel that it is more important to integrate ESG criteria in the yearly due diligence cycle, than to engage with fund managers directly. Engagement with real estate fund managers on all three ESG

[2] EIOPA, 'Climate Risk Assessment of the Sovereign Bond Portfolio of European Insurers', Financial Stability Report, 12-2019.

64% of the pension funds that invest in infrastructure demonstrably consider both environmental and social issues in the selection of infrastructure investments.

criteria is considerably less likely to be conducted in the real estate portfolio (36%), compared to the PLE portfolio (74%). With 9% of assets allocated to real estate on average, pension funds can play an important role in positively steering the actions of many real estate fund managers. This is especially important given that buildings account for a considerable percentage of emissions, and the social impacts of urbanisation.

ESG INTEGRATION IN INFRASTRUCTURE

Infrastructure is a key driver of economic growth and development. 44% of pension funds include infrastructure in their investment portfolio.
Investors can consider a broad range of material ESG issues that these investments might face over the assets' lifetime. Specific ESG factors can be included that are relevant for infrastructure investments, such as greenhouse gases, climate change adaptation, ecological enhancement, sustainable supply chains, and labour, health and safety standards.

Experts believe that climate change mitigation alone already needs an annual $6 trillion USD of investments. In comparison, around $3 trillion USD is currently spent on infrastructure annually.

ESG INTEGRATION IN PRIVATE EQUITY

Most pension funds invest in private equity through fund participation. More than half of the pension funds that invest in private equity integrate ESG requirements into deal documentation, such as a side letter. Given the short-term exit strategy of these funds, it makes sense to integrate ESG criteria upfront, so that fund managers are required to adhere to them in the acquisition of companies. However, pension funds could ask themselves: 'Are we doing enough?' Is there a process in place that systemically and demonstrably influences the ESG performance of the acquisition and management strategy of private equity fund managers?' Are pension funds fully utilising the breadth of RI Instruments? Currently, we do not have the answers to these questions.

One RI instrument that can be used for private equity is impact investing. In fact, private equity impact investing is for most pension funds the preferred impact investing strategy, besides investing in green bonds.

Pension funds use their investments to contribute to specific impact themes, often directly attributed to the shared occupation of the participants. Thus, Pensioenfonds Fysiotherapeuten invests in specific health care solutions that deliver 'access to medicine' and 'access to healthcare'. Both Pensioenfonds PME and Pensioenfonds PMT have an impact investing program and invest in innovative technology start-ups. An example is an investment in a fund that provides capital for Dutch innovative start-ups. The fund partners with all Dutch technical universities and an applied research institute (TNO).

Green infrastructure investments can, therefore, play a vital role in enabling society to mitigate and adapt to climate change, as they can facilitate ecosystem services such as water purification and water flow, temperature regulation, biodiversity, and coastal and erosion protection. They also play a undamental role in societies by enhancing quality of life. Unfortunately, pension funds rarely take this into account.

2.3.3 Engagement

Engagement with investee companies has become a preferred strategy for pension funds to exert their influence on ESG policy and practice. The process of engagement is usually carried out by asset managers and specialised engagement service providers. Some pension funds not only outsource engagement implementation, but also engagement policy making. We believe it is crucial for pension funds to pre-define the engagement themes, norms and companies that service providers should exert their influence on. In addition, engagement policies should contain escalation strategies that go beyond exclusion. For example, voting against management could be utilised more when engaging with companies. These specific requirements were added to this year's benchmark methodology.

Pre-defining engagement themes and so on, is crucial to ensuring that the engagement service provider is engaging with companies in a manner that is aligned with the preferences of the pension fund's participants. In their RI policies, pension funds often mention environmental and societal themes to focus on in their investments. It should be clearly established that a pension fund is in control with regards to its investment portfolio and management; this also applies to RI instruments. Therefore, the minimum threshold in our assessment of engagement in the PLE portfolio, is for pension funds to pre-define ESG themes and norms for their service provider. Lastly, pension funds need to make sure the engagement scope of the service provider is in accordance with the portfolio of the pension fund.

The results of the survey show that 42% of the pension funds set pre-defined engagement themes for their engagement service providers. Another 16% also add normative engagement. Only 32% use RI instruments other than exclusion. For those that do, the most common instrument used to escalate failed engagement is voting against management. 22% of all the pension funds do not engage, or have completely outsourced the engagement policy and implementation processes.

On the whole, pension funds received fewer points on engagement this year than last. This was partly due to the adjustments to our methodology. 88% of pension funds gained at least one point for the engagement question last year; this dropped to 74% in 2020.

Peter Borgdorff, director of PFZW, comments: 'As a large institutional investor, we regularly speak with governments in whose government bonds we invest. Governments play an important role in achieving climate and social goals and we believe that a sustainable world is necessary for sufficient returns in the long term. Governments also create the preconditions within which our investments in the private sector operate. We therefore see it as our fiduciary duty to continually put this on the agenda. Engagement with governments is not yet commonplace in the investment industry. Nevertheless, the UN PRI will publish an extensive paper in October on how investors can shape engagement with governments on ESG. Pensioenfonds Zorg en Welzijn contributes to this through our executive organisation – PGGM.'

Of these pension funds it can be said 'they are in the lead' when it comes to their engagement strategy. These pension funds all evaluate their engagement approach and measure performance.

ENGAGEMENT WITH GOVERNMENTS

Why should engagement be limited to the corporate issuers of stock and credit, when government treasuries represent large parts of a pension fund's portfolio? This year's survey shows that four pension funds demonstrably exerted their influence on governments with the issuing or refinancing of the bond, or during its maturity. Evidence of the four pension funds was limited to their engagement with countries in the emerging markets. Issues relating to environmental management and punishment of same-sex marriage were amongst those discussed with governments. Engagement is most commonly carried out during the issuance of green bonds. We have only considered engagement with governments regarding traditional bond issuance, since this represents the overwhelming majority of public debt. The scores show that many pension funds can improve in this area, both in terms of creating a formal government engagement policy and when it comes to the reporting and measurement of progress.

2.3.4 Voting

Environmental and social requirements are often not explicitly communicated in the voting policies of Dutch pension funds. In last year's benchmark report, we stated that voting on environmental and social issues is often limited to the available (special) shareholder resolutions at the Annual General Meetings of companies. Given the small number of resolutions (and likewise the small number of AGMs and items to be voted on) and their geographical – Anglo-Saxon – focus, it seems that voting strategies are not being utilised to their full potential.

The results from this year's survey show that 53% of the pension funds either don't have a voting policy, or have not specified ESG requirements for routine voting decisions. In 2019, 90% of the pension funds achieved a score. From our analysis it can be gathered that many pension funds focus on governance-related issues, and neglect environmental and social topics. The change in this year's benchmark methodology should challenge pension funds to integrate ES(G) requirements in their voting policy for routine voting items.

Including explicit ES(G) requirements in the pension fund's voting policy, should also ensure the asset manager implements the policy. Please see below the voting conduct of the largest asset managers regarding Climate Action 100+ resolutions.

Figure 14 | **ESG issues in voting policy and execution thereof.**

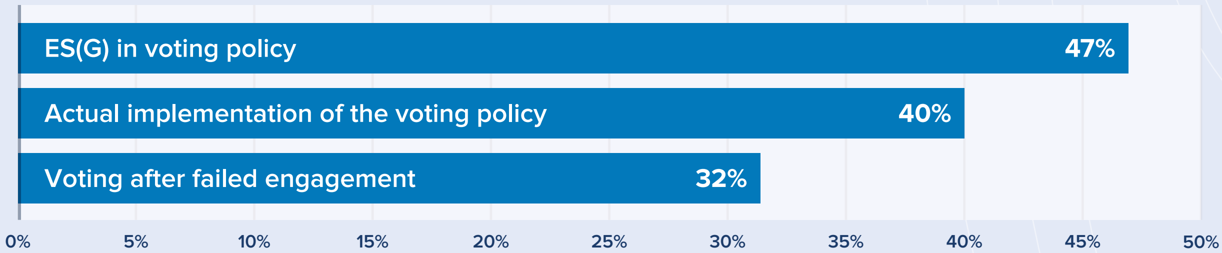
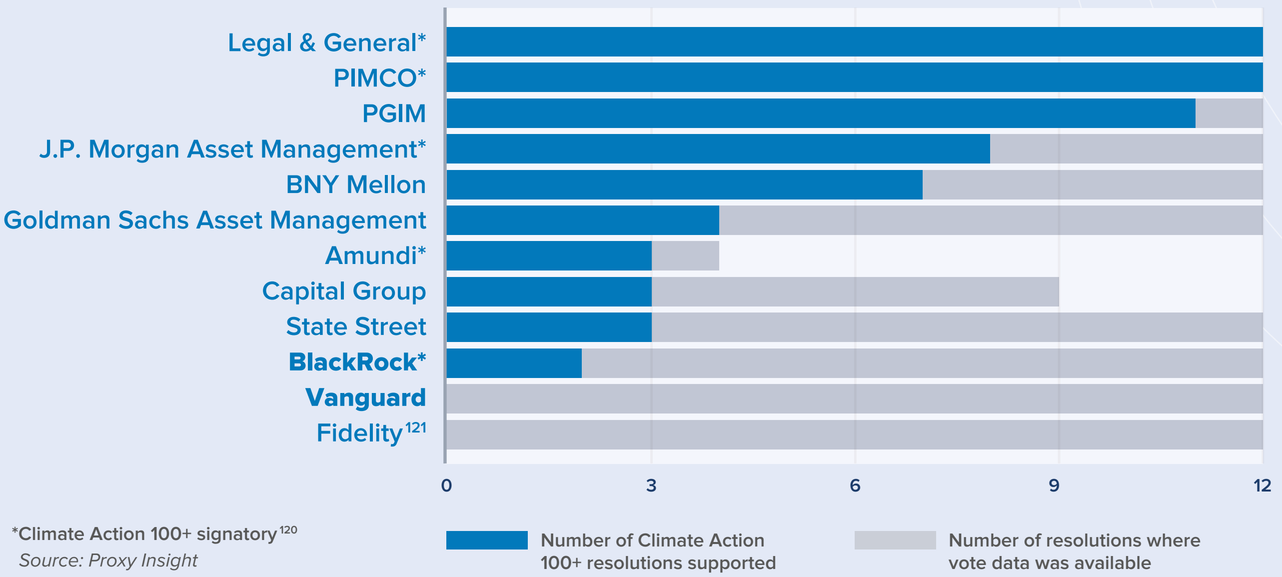


Figure 15 | **Number of Climate Action 100+ resolutions supported. Source: Majority Action – Report: Climate in the boardroom - 2020, and Proxy Insight.**



*Climate Action 100+ signatory[120]
Source: Proxy Insight


Case Study: Dutch Green Bonds

Roy Kroon and **Jacqueline van Voorthuizen** of **Pension fund PGB**

On May 21, 2019, the Netherlands became the first country with a triple-A rating to issue EUR 6 billion in 'dark green' government bonds. The bonds had a 0.5% interest rate and a term of 20 years. Demand far exceeded supply; as the bid oversubscribed 3.5 times and demand volume reached a EUR €21.2 billion. The projects financed with the loans range from bicycle parking spaces and home insulation, to the reinforcement of the Afsluitdijk and the construction of windfarms. Although ABP and PFZW made the news with investments of €171 million and €82 million respectively, PGB was by far the largest investor of all pension funds with its investment of €330 million.

Roy Kroon, *Fixed Income & Treasury Manager at PGB Pension Services (executor of PGB)* explains the choice behind the relatively large investment: 'We make the same considerations in terms of return as with credits, so with a minimum equal yield we prefer to opt for green bonds. Another factor is that these loans are expected to become more popular over time. We found them relatively well priced compared to other Dutch government bonds. Another reason was that we had to increase the interest rate hedge, so the issue came at just the right time for us.'

According to **Jacqueline van Voorthuizen**, *Portfolio Manager of Balance Sheet Management Responsible Investments at PGB*, the board of PGB believes that sustainable investing does not have to have a negative effect on returns. 'Our SRI policy is aimed at having an integrated policy for making our entire portfolio more sustainable.' Research was conducted to determine which SDG themes PGB participants were keen to prioritise. This resulted in PGB deciding to focus on the themes 3 (health), 7 (green energy), 8 (work & economic growth), 9 (industry, innovation & infrastructure) and 13 (climate). PGB is currently formulating its policy to translate these SDGs into investments. Jacqueline van Voorthuizen commented: 'If you look at the projects that are financed with these (government) green bonds, they align with practically all of the chosen SDGs.' Roy Kroon adds: 'Government bonds are at the moment quite expensive. When we bought these green bonds, they were positioned well on the curve. Now they're valued slightly higher, so they're doing what they're expected to do in terms of returns'.

2.3.5 Impact investing

Impact investments are investments made with the explicit intention of achieving a positive, measurable environmental and social impact whilst also generating a competitive financial return.

The growing impact investment market provides capital to address the world's most pressing challenges in sectors such as sustainable agriculture, renewable energy, microfinance, and affordable and accessible basic services such as housing and healthcare.

Its dual intention and commitment to track and measure investments' non-financial impacts distinguish impact investing from other approaches such as ESG integration. A key point is that any positive environmental and social impacts are intended from the outset; they're not just side-effects. Although the issuance of green, social and sustainability bonds has continued to grow, impact investment is still the RI instrument least employed by pension funds. VBDO encourages pension funds to be more active in impact investing.

Figure 16 | **Pension funds that invest >5% in green bonds.**

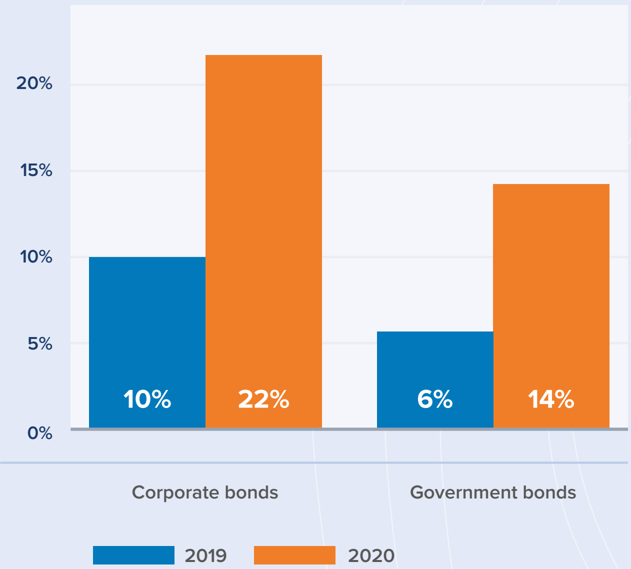
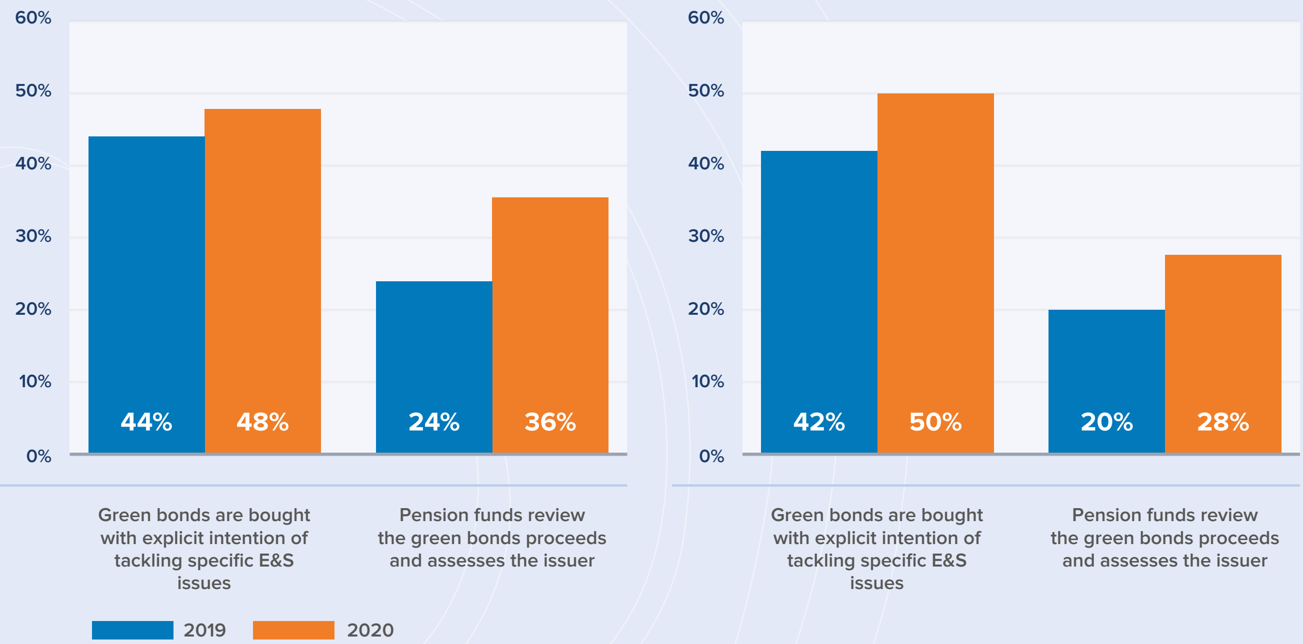


Table 3 | Recent issuance of green bonds. Source: Environmental Finance 10-2020 .

Issuer of green bonds	Example	Positive social/environmental impact	Principles/guidelines
Agency	**KfW** €1 bn green bond	Energy efficiency, renewable energy	Green bond principles
Corporate	**Volvo** €500 m green bond	Clean transportation	Green bond principles
Financial	**BNG Bank** €1 bn SBL bond	Affordable housing, green buildings	Green, Social, Sustainability Bond principles
Municipal	**Munifin** €500 m green bond	Clean transportation, energy efficiency, green buildings, pollution prevention	Green bond principles
Sovereign	**Egypt** $750 m green bond	Renewable energy, energy efficiency, green buildings	Green bond principles
Supranational	**European Investment Bank** €500 m Climate Awareness bond	Green buildings, energy efficiency, renewable energy	Climate Awareness Bond Framework

Figure 17 | Percentage of pension funds that review the ‘greenness’ of the use of proceeds.



ALLOCATION TO GREEN BONDS INCREASES

Green bonds are classified as impact investments in fixed income holdings. They are issued by companies and governmental institutions to finance specific projects that have a positive environmental or social impact (table 3).

Green bonds play an increasingly important role in financing assets needed for the low-carbon transition. They are also increasingly popular with institutional investors. Their simplicity (they have the same recourse to the issuer as traditional debt) and long investment horizons, along with the growing awareness of environmental factors in investment philosophies, and regulatory support, make listed green bonds attractive to institutional investors.

Currently, 55% of pension funds invest in green bonds, which is just a slight increase compared to last year. Green bonds that were not intentionally selected – in other words, if they just incidentally happen to be part of the portfolio – are not included in this percentage. However, we can see that the total allocations to green bonds has increased significantly over the years. Our results show that the amount of pension funds that allocate more than 5% of their investments to green bonds has more than doubled for both the corporate and the government bond portfolio in the last year.

Another important development is the increasing number of pension funds that are using stricter assessments to select and evaluate green bonds and that are demanding greater transparency. Although this is a positive development, more attention still needs to be paid to the ‘greenness’ of bonds in the selection process. This also counts for selecting green bond funds, where differences exists between these funds in their approach whether or not they evaluate the greenness of the green bonds which are part of their fund.

BE AWARE OF GREEN WASHING

It is not surprising to see an increase in the issuance of social bonds in the wake of the COVID-19 pandemic, and also a growing number of bonds aligning with the Sustainable Development Goals (SDGs). SDG bonds focus on one or several of the 17 SDGs that have been formulated by the United Nations. With the emergence of these bonds, particular attention should be paid to the purpose behind these bonds as an impact instrument. Transparency on impact indicators is needed if investors are to properly analyse the issuer’s environmental and social strategies and the financed projects.

When investing in green bonds (funds), investors need to be able to spot 'green fakes'. Pension funds should consider several criteria:

Firstly, it's important to assess the issuer of the green bond and its intention, strategy and performance towards sustainability. In this analysis, pension funds (and their advisors) should be aware of the underlying criteria of ESG data and ESG ratings they might use.

Secondly, pension funds should pay attention to the greenness of the use of proceeds. In other words, the pension funds need to examine the underlying projects and judge how sustainable these actually are and what the actual impact of the bond is likely to be. Usually, this information can be found in the Green Bond Framework of the issuer. If this information is not given, or does not seem satisfactorily robust, then the investment might not make the positive social and/or environmental impact that the pension funds have been led to believe. The EU Green Bond Standard is a welcome and much needed development. It will set a standard on what is green, so there will be less cause to doubt the environmentally-friendly characteristics of future green bond issuances.

TEXTBOX 3 A bold agenda to mobilise capital towards green activities

In June 2019, the European Commission released its 'taxonomy' of green activities. This includes 67 varied economic activities across eight sectors covering climate change mitigation and adaptation. The taxonomy is an identification and disclosure tool intended to help redirect capital flows to meet targets set out in the Paris Agreement on climate change, which are included in the EU's Sustainable Finance Action Plan. The taxonomy acts as a classification system that enables investors and companies to identify environmentally-friendly economic activities.

To identify as green, or 'taxonomy-eligible', an investment needs to contribute substantially to one of six environmental objectives, without causing significant harm to any of the others.
The six objectives are:

- **climate change mitigation;**
- **climate change adaptation;**
- **sustainable use and protection of water and marine resources;**
- **transition to a circular economy, waste prevention and recycling;**
- **pollution prevention and control; and**
- **protection of healthy ecosystems.**

In addition to the taxonomy, the following reports have also been published by the European Commission Technical Expert Group on Sustainable Finance (TEG):

- **EU Green Bond Standard**
- **EU Climate Benchmarks and Benchmarks' ESG Disclosures**
- **Guidelines on the disclosure of environmental and social information**

The new EU Sustainable Finance Disclosure Regulation will also come into effect in March 2021.

On Oct 1st 2020, the EU named 50 members, and nine observers, of a new group 'Platform on Sustainable Finance', which will replace the TEG on Sustainable Finance. The group contains a mix of investors, NGOs and trade bodies, and will advise the EU on taxonomy and sustainable finance rules in the EU over the next few years.

IMPACT INVESTMENTS IN OTHER ASSET CLASSES: FROM IMPACT MEASUREMENT TO IMPACT EVALUATION AND REPORTING

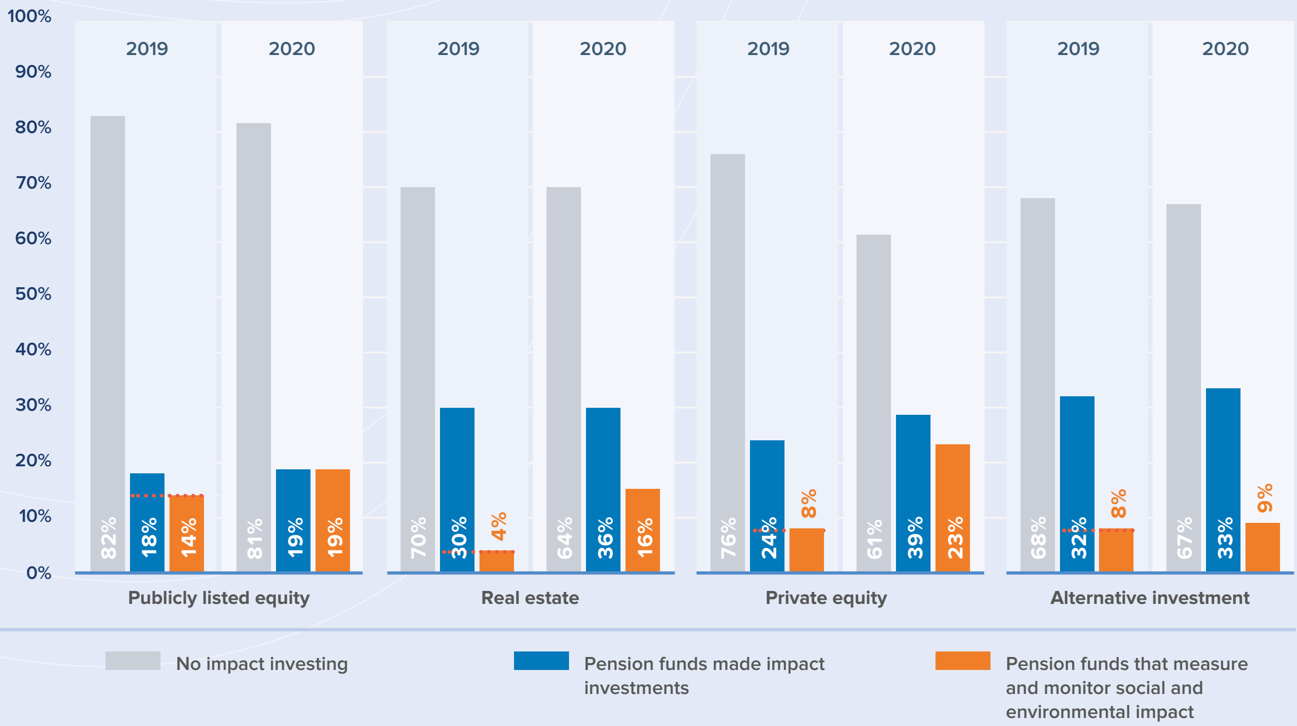
The definition of impact investments as stated on page 34 describes how the explicit intention and the commitment to track and measure investments' non-financial impacts distinguish impact investing from other RI approaches.

Connecting achieved impact (measured with an impact assessment) to expected impact (measured with an impact evaluation), is necessary in order to move from investments that intend to make an impact towards those investments that actually achieve an impact. Therefore, it is necessary to not only measure the output of impact investments, but also to formulate impact investment expectations and to re-evaluate investments. The Global Impact Investing Network (GIIN) states: "Impact measurement & management is more than counting metrics. It means considering information about risks, returns, and impact to learn, adjust, and improve investment decision-making."

RECOMMENDATIONS FOR IMPLEMENTATION:

- Include ESG integration requirements in the selection, monitoring and evaluation process; ensure that all asset managers integrate these criteria in their investment analysis or index product.
- Make full use of RI instruments for all asset classes.
  - Integrate E&S requirements in the voting policy for routine voting items.
  - Use voting as an escalation strategy after failed engagement.
  - Develop and implement an engagement policy for other counterparts, such as governments and real estate fund managers.
- Align the investment portfolio with real-world impact
  - Real-world impact indicators (e.g. in determining the greenness of the use of proceeds of green bonds).
  - Absolute target benchmarks (such as the Paris-aligned benchmarks from the European Commission).

Figure 18 | Impact investing.



2.4 Accountability | Accountability is the last category in this VBDO assessment. Concrete and transparent reporting provides stakeholders (and society as a whole) with an insight into a pension fund's strategy and results regarding responsible investment. Part of this transparency is to show how the responsible investment policy is designed. It is also important to report regularly and in a high-quality manner on strategies, goals, results and the impacts of responsible investment. Information in such reports can be the starting point for communication with and accountability to participants of the fund, while also being informative for other relevant stakeholders.

Reporting on responsible investment is no longer voluntary.[3] Since the 27th of November 2019, pension funds are required to:

- Report on the acknowledgement, measurement, monitoring and control of ESG risks
- Assess and report the potential (financial) impacts on assets from ESG risks (e.g. climate change and social risks) and changing regulations
- Report how ESG criteria are integrated in the investment policy

The average score for accountability is a 2.5, with a range of 0.2 to a 4.8.

NEW THIS YEAR

This year's assessment specifically focused on the implementation of (inter)national standards and guidelines to disclose relevant (thematic) ESG information. 14% of the pension funds were able to demonstrate that they implement standards and guidelines such as CO2 and biodiversity accounting (PCAF & PBAF) and other issue-specific standards. Disclosing in line with these frameworks assists comparability and facilitates the measurement of ESG information.

Figure 20 | Reporting on responsible investment.

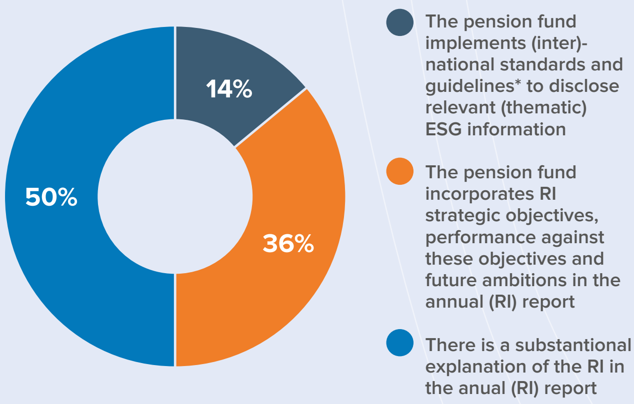
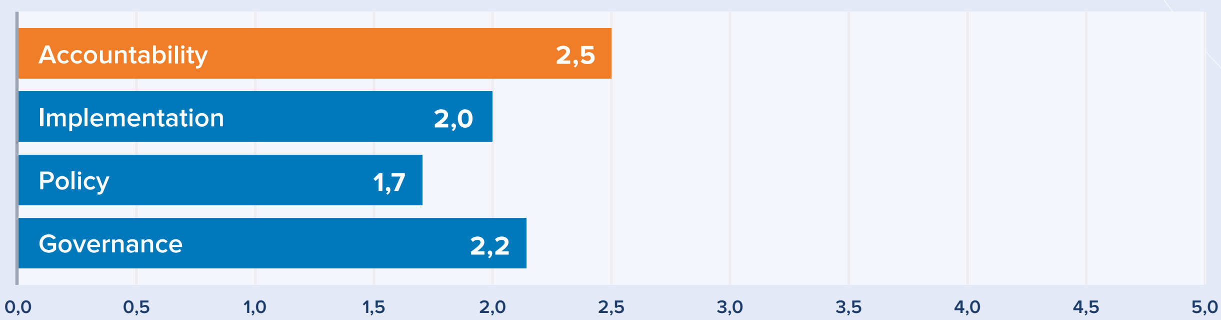


Figure 19 | Average results per category.



[3] Please refer to regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

To some extent, reporting on responsible investment is encouraged by voluntary codes, guidelines and standards. However, mandatory legislation and current (inter)national developments indicate that disclosure standards are likely to become stricter and legally-binding. Current legislation and guidelines include:

- **The Dutch Pension Act (2014) requires pension fund boards to explain how the fund's investment policy takes account of the environment and climate, human rights and social relations (Article 135(4)).**
- **The Pension Fund Code specifies that the board's considerations regarding RI should be available to stakeholders, and that the board should ensure that there is support among stakeholders for the choices made in relation to responsible investment.**
- **The European Directive IORP II requires that pension funds assess the ESG risks of their investments following a specific set of criteria, and that ESG risks acquire an equal level of attention compared to operational, liquidity or asset risks. The transposition into Dutch legislation took place in January 2019.**
- **The Pension Fund Code requires pension funds to define a responsible investment strategy and disclose it publicly.**
- **The IMVB Covenant for pension funds will make transparency increasingly important over the coming years. The objective of the agreement is for the signatory parties to prevent, mitigate and remediate the negative social and environmental consequences of investments by pension funds. The IMVB Covenant specifies that frequent and consistent reporting should be part of a good RI policy and is therefore a key requirement.**
- **The EU Sustainable Finance Taxonomy (Regulation (EU) 2020/852) for climate change mitigation and adaptation harmonises the criteria for determining if an economic activity can be considered sustainable. Institutional investors are required to disclose how and to what extent they use the criteria for environmentally sustainable economic activities to determine the environmental sustainability of their investments.**
- **The EU Disclosure of Non-Financial Reporting Directive (NFRD) requires investors to disclose certain non-financial information, including non-financial key performance indicators on environmental matters and human rights.**
- **The Task Force on Climate-related Financial Disclosures (TCFD) guidelines recommend that reporting on material climate risks is integrated into companies' ordinary financial reporting. The TCFD divides its recommendations into governance, strategy, risk management, and metrics and targets.**

With these developments in mind, pension funds should ensure that they comply with relevant environmental regulatory standards and recommendations. In addition, the RI policy and the reporting on its implementation should be easily accessible through an RI report or substantial section in the pension fund's annual report. Ideally, these reports should be verified by an external auditor.

EXPLAIN THE OUTCOME AND IMPACT OF RI INSTRUMENTS TO PARTICIPANTS

The biggest differences between pension funds are visible in the depth of their reporting; while some pension funds only explain their policy, others provide insightful overviews and concrete results. All pension funds do at least include a substantial (albeit at times general) explanation of responsible investment in their annual report or RI report on their website.

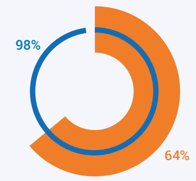
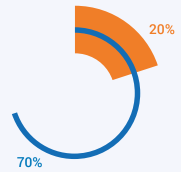
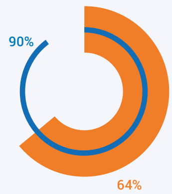
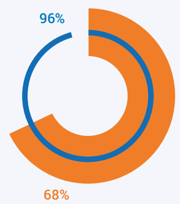
Many institutional investors, service providers and NGOs are in the process of developing guidance on disclosing the outcomes of responsible investment strategies. This guidance is likely to be beneficial for pension funds. While we see that most (68%) of the pension funds provide full disclosure on voting outcomes, this is not the case for other RI strategies. As the results show in figure 21, there is often a large discrepancy between the explanation of the methodology for implementing an RI instrument and actually reporting on the outcomes of the applied instrument. Therefore, it is also not surprising that only 14% of the pension funds that VBDO assessed implement thematic disclosure standards and guidelines. We consider proper disclosure on the outcomes and impact of RI instruments as an important next step for pension funds when it comes to accountability to relevant stakeholders.

RECOMMENDATIONS FOR ACCOUNTABILITY

- Ensure the pension fund's disclosure complies with regulatory requirements.
- Disclose the outcome and impact of RI instruments to participants.
- Make use of comparable, widely-used (inter)national standards and guidelines for (thematic) disclosure of ESG information.
- Inform participants of the content and impact of the RI policy through multiple channels (e.g. newsletters, direct e-mail and social media).

Figure 21 | Transparency on implementation.

The figure on the right gives an overview of transparency per responsible investment instrument. Almost all instruments are properly explained by most pension funds, but the level of depth to which pension funds report on outcomes leaves room for improvement.

EXCLUSION	98% of the pension funds publicly explain their exclusion policy. A total of 64% include a list of excluded companies and countries, and the reason for the exclusion.	
ESG INTEGRATION	70% of the pension funds publicly explain the methodology for ESG integration. 20% include an overview of results.	
ENGAGEMENT	90% of the pension funds publicly explain their engagement policy. A total of 64% report on concrete results.	
VOTING	A total of 96% of the pension funds publicly explain their voting policy. 68% disclose a complete and detailed voting report.	
IMPACT INVESTING	62% of the pension funds publicly report on impact investing. 12% report on the achieved impact.	

2.5 Results climate change | It is widely accepted that the effects of climate change have a considerable impact on the financial sector. This varies from financial risks to opportunities for investing in solutions. In order to reach the goals set out by the Paris Climate Agreement, and to keep the increase in global average temperature to 1.5°C or at least well below 2°C above pre-industrial levels, it is crucial that the world transitions to zero-carbon food supplies and renewable energy sources.

The financial sector can (and must) play an active role in the worldwide transition to a carbon neutral economy. If we do not keep the rise to well below 2°C, the effects could be catastrophic. For this reason, climate change is a key factor in determining the level of responsible investment of pension funds in this year's report. Since last year, we've included five questions related to climate change in our questionnaire.

BEST PERFORMING PENSION FUNDS IN TERMS OF RESPONSE TO CLIMATE CHANGE

Our five climate change questions relate to the integration of climate change in consultations, policy, modelling, active ownership and reporting. Pension funds are then given a score based on their response to these questions and ranked from highest to lowest score. The pension funds are also categorised in four categories based on their AuM size. The three pension funds that have performed best on climate change in each category are listed below.

DIFFERENT TYPES OF CLIMATE RISKS

The Task Force on Climate-related Financial Disclosures (TCFD) developed guidelines for climate-related financial disclosures that can be used by companies to provide information to investors and other stakeholders. The TCFD identifies transition risks and physical risks as the two main risks driving financial impacts on companies and investors.[4]

TRANSITION RISKS

So far, most investors have placed the emphasis on transition risks and on portfolio decarbonisation. Transition risks are financial risks which could arise for pension funds from the transition to a low-carbon economy. These transition risks include the re-pricing of carbon-intensive financial assets, and the speed at which such re-pricing might occur. An abrupt transition is likely to have a substantial impact on financial stability, and also on the wider economy. For this reason, The Dutch Central Bank modelled a stress test of the potential impact of the energy transition and its related financial risks.[5] The conclusion was that pension funds should anticipate a value loss between 3% and 10% of their assets in the case of a disruptive energy transition scenario, which would impact their equity and bond portfolios. There-

Table 4 | **Best performing pension funds on climate change.**

Position (best performing)	Large pension funds (> 30 billion AuM)	Medium- large pension funds (10 – 30 billion)	Medium pension funds (5 - 10 AuM billion)	Small pension funds (< 5 billion AuM)
1.	Pensioenfonds ABP	Pensioenfonds SPW	SBZ Pensioen	Pensioenfonds Bakkers
2.	Pensioenfonds PME	BPL Pensioen	Pensioenfonds Progress	SPOV
3.	Bpf Bouw	Pensioenfonds Detailhandel & Pensioenfonds PGB	Bpf Schilders	Pensioenfonds Meubel

[4] Please refer to: www.fsb-tcfd.org/publications/final-recommendations-report
[5] DNB (2018), Overzicht financiële stabiliteit. www.dnb.nl/binaries/1706275_Klimaatverandering_NL%20WEB_def_tcm46-363851.pdf?2020100609

TEXTBOX 3 **New research on predicted climate costs**

In October 2020, CDP and UCL published a report that stated climate change costs are likely to reach \$5.4 trillion a year by 2070 and \$31 trillion a year in 2200 in a business as usual scenario. This compares with \$1.8 trillion a year in a stabilised <2°C scenario with mitigation measures in place. The report, entitled 'Costing the Earth - Climate Damage Costs and GDP', predicts the costs of climate change related economic and non-economic damage. To achieve a <2°C scenario, we need to be prepared to invest in mitigation costs. These rise sharply to \$7 trillion a year by 2050 and then decrease after that. In other words, keeping global warming to under 2°C will cost more to start with, but long-term will be considerably less expensive than not doing so.

fore, pension funds need to incorporate the potential risk of a disruptive energy transition in their risk analysis and management in order to respond to the risks, and align their investments so that they contribute to the energy transition.

PHYSICAL RISKS

In the event that the Paris Agreement is not met and global warming is not kept well below 2°C, adaptation to the physical risks of climate change will become increasingly relevant. Physical climate risks may have financial implications for organisations, such as direct damage to assets and indirect impacts from supply chain disruption. Investors will need to understand how to adapt their investment portfolios to the various types of physical climate risks, financially as well as with regards to the protection of their real assets. Ultimately, financial or asset resilience can only exist in a resilient world. That is why it is also in the long-term interests of investors to aim for real world social-ecological resilience of the areas they impact with their investments. As well as assessing climate risks to their assets, investors should ideally also assess the impact of their assets on the social-ecological resilience of the area they are invested in (directly and through their value chain). Doing so enables investors to also become part of the solution.

GENERAL FINDINGS

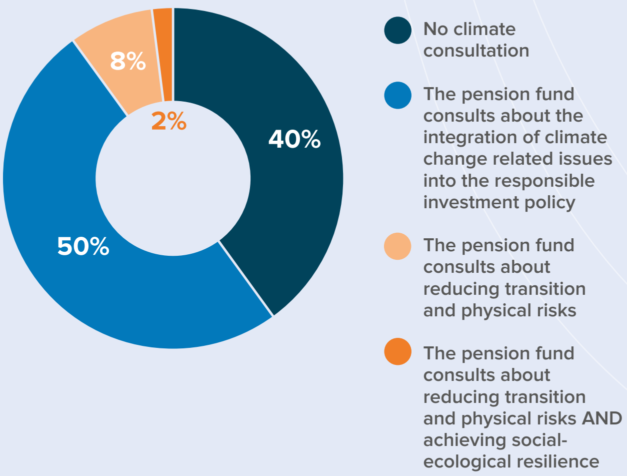
Similar to last year's benchmark, the pension funds were assessed on the following topics:

- Consultation of experts on climate change
- Level of detail of the climate change policy
- (Research on) the effect of climate risks and global warming scenarios on strategic investment decision making
- Active ownership on climate change
- Reporting on climate change

CLIMATE-RELATED CONSULTATION

Consulting participants and society in general on a regular basis on climate-related issues, contributes to a solid grounding and understanding of the issue. Beyond that, these consultations help build a robust and climate-focused RI policy. 60% (compared to 30% last year) of pension funds consult their participants or society in general on climate related issues. Several elements can make up climate change-related consultations, ranging from the integration of climate-related risks in the RI policy to

Figure 22 | Consultation with participants and society.



aligning investments with zero-emission targets and social-ecological resilience.

Figure 22 indicates approaches in climate change-related consultation and highlights the fact that only 8% of pension funds consult on detailed climate information that relates to both transition and physical risk. A next step for pension funds would be to account for the full picture of climate change risks. Consulting participants and society in general can ensure that the pension fund understands the full extent of risks associated with climate change, ranging from a just-transition to climate migration.

LEVEL OF DETAIL OF CLIMATE CHANGE POLICY

Many pension funds still need to focus on developing sound climate policies. The results of our survey show that while 20% of the pension funds do not have an explicit climate change policy yet, the majority do have one. The ones that do can be divided into two categories. The first group of pension funds, accounting for 62% of the total, include climate change in general terms, e.g. related to carbon footprint measurements. The second group of pension funds (18% of the total), include one or multiple detailed and ambitious elements in their policy, such as aligning investments with long term (2050) and short term (2025) net-zero portfolio emission targets, increasing investment in climate change mitigation, adapting to the physical (asset) risks of climate change, including criteria for achieving social-ecological resilience and/or investing in adaptation to achieve social-ecological resilience. In conclusion, where most pension funds do describe climate change comprehensively in policy documents, the overwhelming majority do not specify the actions they are taking to mitigate and adapt to climate change.

SOCIAL-ECOLOGICAL RESILIENCE DEFINED BY IPCC

"The capacity of social, economic, and environmental systems to cope with a hazardous event or trend or disturbance, responding or reorganising in ways that maintain their essential function, identity, and structure, while also maintaining the capacity for adaptation, learning, and transformation." (IPCC, 2014)

Managing climate-related financial risks is becoming increasingly important for investors, as they are recognised as being a systemic risk. New insights, metrics and investment solutions are continuously being developed to make responsible investing more accessible across all asset classes. However, these approaches do not yet always consider top-down integration of ESG and climate-related risks into asset liability modelling (ALM) and

Figure 23 | Climate change in the RI policy.

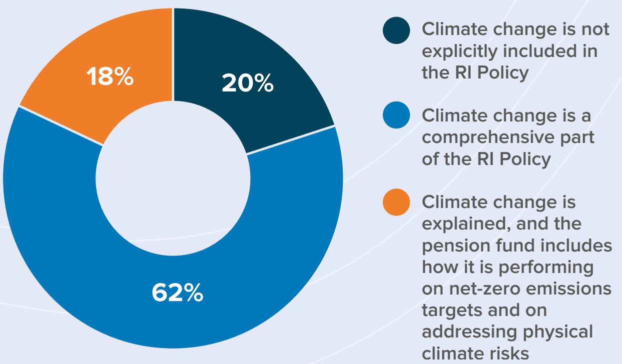
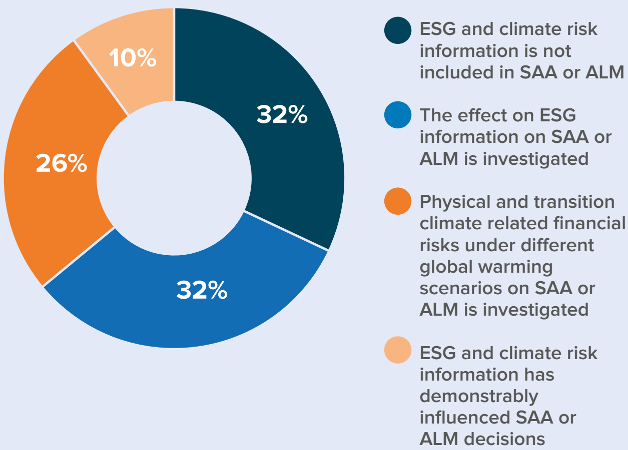


Figure 24 | Measuring the effect of ESG risks and climate scenarios on SAA and ALM.

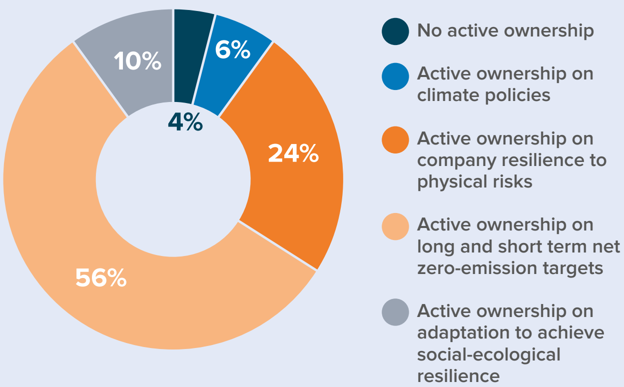


strategic asset allocation (SAA). This year, we have seen a considerable increase in the number of pension funds that research the effects of ESG and climate change risks on SAA and ALM (68% in 2020 compared to 54% in 2019). 32% of the pension funds investigate the effects of ESG information on SAA or ALM; and 10% of the pension funds demonstrate that ESG and climate risks information has influenced SAA or ALM. 26% of all pension funds analyse how 1.5°C, 2°C and 4°C global warming scenarios will affect the risk/return of their investment portfolio. It is important that pension funds increase their understanding of the risks that climate change poses to the financial system. Therefore, it is promising that more funds are now using climate risk models to determine strategic investment decisions and liability analysis.

ACTIVE OWNERSHIP

More pension funds understand that changing company climate policy and practice through active dialogue and voting is essential in reaching the goals set by the Paris Agreement. We consider two aspects within active ownership: the degree to which active ownership is practiced, and whether it specifies certain themes, i.e. climate change. In 2019, we found that 18% of all pension funds do not practice active ownership on climate change. That figure has dropped to 4% this year. Many pension funds cooperate in climate initiatives that engage with heavy CO_2-emitting companies. In addition, both Climate Action 100+ and Follow -This have put

Figure 25 | Active ownership on climate change.



Case study: Dutch Engagement Network

Henk Groot, Head of Investments of Pensioenfonds Detailhandel

When it comes to engagement, many pension funds choose to outsource to an external party. Pension funds usually do this because they themselves do not have the resources and capacity to engage with companies worldwide. However, this outsourcing means that direct influence is somewhat limited, because of the many different parties that are often represented simultaneously by these external organisations.

A few years ago, Pensioenfonds Detailhandel and Pensioenfonds Horeca en Catering decided to look into the possibility of collaborating on some engagement processes, in addition to keeping the existing processes that were already carried out by external parties on behalf of the pension funds. This led to the establishment of the Dutch Engagement Network (DEN).

Henk Groot, *Head of Investments of Pensioenfonds Detailhandel* stated: ‘With outsourcing, you normally don’t sit around the table during engagement with companies. It is true that you have influence because the external engagement party asks for input, but this does not always reflect all the choices made by the individual funds. Outsourcing is a conscious choice and we also looked for opportunities to sit at the table with a number of companies on some themes and to be able to exert direct influence ourselves. In addition to direct influence, an important additional ambition is that the pension funds acquire knowledge. Pensioenfonds Horeca en Catering is a pension fund that has mutual goals, which has led to the establishment of the Dutch Engagement Network.'

Prior to the establishment of DEN, ESG research had already been conducted together with a number of pension funds into trends and developments and how to organize ESG indicators in such a way that they can actually be implemented. The research was then further developed with the help of Finance Ideas and Achmea IM, and a business case to collaborate was drawn up. This envisaged thematic engagement, whereby investors would directly determine ESG themes and shape RI policies themselves. The business case has been further refined by Achmea IM as executor and Finance Ideas which acts as a secretariat and actively contributes to how the engagement processes can be most effective.

DEN went live at the end of 2019 and the theme of water was the first to be chosen within the programme. 'There was overlap in the chosen SDGs between us and Horeca & Catering,' Henk Groot explains. 'Water plays an important role in the supply chain for both parties. In addition, water is an important precondition for life and its availability worldwide is under pressure due to increasing demand.' An important indicator for assessing companies on the theme is the effectiveness of water management. Within the agricultural sector, for example, groundwater use and the company's water footprint are examined. In doing so, Pensioenfonds Detailhandel and Pensioenfonds Horeca en Catering are going further than merely managing risks. Amongst other things, they are examining the impact of water management on the environment around the operations of the company in question.

Although expanding DEN is not a key aim, Pensioenfonds Detailhandel and Pensioenfonds Horeca en Catering are open to collaborating with other funds. Henk Groot said: 'We have consciously opted for an informal organisation and are mainly looking for alignment with the SDGs and themes. DEN is not a commercial proposition, but a partnership. We do ask any organisation that wishes to take part to commit to active participation and the use of its own network. To prevent them from encountering the same obstacles with outsourcing engagement as described earlier, we have set a maximum of five to ten participating funds.'

TEXTBOX 5 **Net Zero Asset Owner Alliance**

The Net Zero Asset Owner Alliance (NZAOA) is a coalition of asset owners that commit to leading the way in driving sustainable economies. The Alliance announced its ambition at the UN Secretary-General's Climate Summit in New York on September 23rd, 2019.

The NZAOA works closely with existing investor climate initiatives, such as Climate 100+. The NZAOA Secretariat, consisting of UNEP FI and UNPRI staff, facilitates and coordinates asset owner activities to set ambitious sector-specific targets.

Members of the Alliance commit to transitioning their investment portfolios to net-zero GHG emissions by 2050 consistent with a maximum temperature rise of 1.5°C above pre-industrial temperatures. They also commit to taking into account the best available scientific knowledge, including the findings of the IPCC, and regularly reporting on progress, including establishing intermediate targets every five years in line with Paris Climate Agreement Article 4.9.

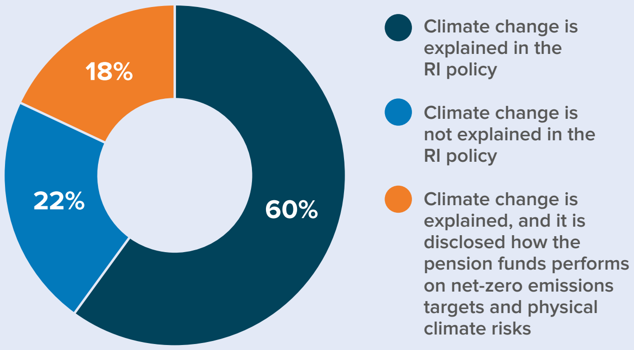
This commitment must be embedded in a holistic ESG approach, incorporating but not limited to, climate change, and must emphasize GHG emissions reduction outcomes in the real economy. Members seek to advocate for, and engage on, corporate and industry action, as well as public policies, in order to support the low-carbon transition of economic sectors in line with science and under consideration of associated social impacts. Members make their commitment with the expectation that governments will follow through on their own commitments to ensure the objectives of the Paris Agreement are met.

Official Commitment

forward climate change resolutions that pension funds demonstrably voted on in 2019. 90% of Dutch pension funds have provided VBDO with evidence that they engaged and/or voted in favour of targets that will bind companies to the Paris Agreement.

We believe it is important that pension funds not only engage on mitigating the causes of climate change, but also engage on adapting to the consequences. Only 10% of the pension funds engaged companies on their strategy to ensure social-ecological resilience to climate change. Of those that do, the primary theme was the availability of water for communities in water-stressed regions.

Figure 26 | Climate change reporting.



REPORTING ON CLIMATE CHANGE

Providing accountability on the outcomes and impact of the pension fund's climate change policy is important and most pension funds agree with this statement. Our results show that 78% of the pension funds explain climate change elements in their RI policy to their stakeholders. Yet, only 18% of all funds report on the outcomes of their climate change activities. Pension funds should improve their reporting on climate change, by showing stakeholders how they align with the goals set by the Paris Agreement, how they perform on supporting adaptation to the physical impacts of climate change and how they contribute to climate change mitigation. For guidance on proper climate adaptation disclosure, pension funds can consult a recent publication from The Institutional Investors Group on Climate Change (IIGCC).[6]

ABBREVIATIONS LIST:

UCL	University College London
CDP	Carbon Disclosure Project
USD	United States Dollar
IPCC	The Intergovernmental Panel on Climate Change
UNEP FI	The United Nations Environment Programme Finance Initiative
UN PRI	United Nations Principles for Responsible Investment

[6] For more information, please visit: www.iigcc.org/download/understanding-physical-climate-risks-and-opportunities-a-guide-for-investors/?wpdmdl=3388&refresh=5f7f31a3f2a261602171299

Appendix I - Methodology

Over the years, the benchmark has developed significantly and it has become a relevant tool to measure responsible investment by pension funds in the Netherlands. The study is impartial and its most important aim is to, together with the Dutch pension funds, enhance the sustainability performance of individual pension funds, but also sector-wide.

UNDERLYING PRESUMPTIONS

The most important underlying presumptions in this benchmark are:

I. The scope of the benchmark is determined by selecting the 50 largest Dutch pension funds derived from the figures of the Dutch Central Bank.
II. The assets that are included in this benchmark are the assets of Dutch pension funds, independent of where these are being managed.
III. The implementation of the responsible investment policy is considered to be the most important element, because here the actual impact is being made. Therefore, this receives 50% of the total score. Governance, Policy and Accountability account for the remaining 50%.
IV. The topic 'Governance' is to be considered from the viewpoint of the management of the pension fund, not from the asset manager's perspective.
V. The total score for 'Implementation' is dependent on the different scores of the asset classes (publicly listed equity; corporate bonds; government bonds; real estate; private equity and alternative investments). The weight of the asset classes in the determination of the implementation score is dependent on the asset allocation. Other assets, such as cash, interest swaps and currency overlays, are not included in this benchmark study.
VI. Within each asset class it is determined which responsible investment instruments are (reasonably) implementable. Each question receives an equal weighting.
VII. VBDO is indifferent if an investor takes an active or passive and direct or indirect investment approach and assesses what responsible investment strategies are being applied.

The abovementioned underlying presumptions are based on VBDO's consultation with the pension funds participating in this study. This consultation is based upon an annual physical meeting with a selection of participating pension funds. Key in this meeting are the quantified survey results.

THE BENCHMARK

The VBDO Benchmark 'Responsible Investment by Pension Funds in the Netherlands 2020' compares the responsible investment performance of the 50 largest pension funds in the Netherlands based on data of 2019. VBDO assesses responsible investment through detailed profiles of each pension fund.

Table 5 | Responsible investment instruments and the different asset classes included in the benchmark.

	Publicly Listed Equity	Corporate bonds	Government bonds	Real estate	Private equity	Alternatives
Exclusion	■	■	■			
ESG integration	■	■	■	■	■	■
Engagement	■	■	■	■		
Voting	■					
Impact investing	■	■	■	■	■	■

This year, the methodology has been thoroughly revised to better reflect the developments in responsible investment. While in all categories changes have been made, the most revisions have been made in the governance and policy categories. We have adjusted the governance category from questions that require board room awareness of RI, to board room accountability, expertise and oversight. For policy, this year we assessed to what extent the pension funds' investment portfolio is aligned with the RI policy, if their long-term targets include a clear roadmap for implementation and if pension funds implement the Sustainable Development Goals. For the implementation category, the questions on voting and engagement changed to better assess if the pension fund is in the lead. Also, a question regarding government bond engagement was added. In the category accountability, we have added a question whether pension funds report in line with (inter)national standards and guidelines. Lastly, the questions on climate change that were added to the survey last year, but were scored separately, have been integrated in this year's benchmark. Due to the revision scores and star rankings are not one on one comparable to the previous year.

VBDO BENCHMARK PROCESS

The benchmark is set up to stimulate pension funds to inform themselves about their current status of responsible investment and to challenge them to take next steps. The research process consists of several phases (figure 1).

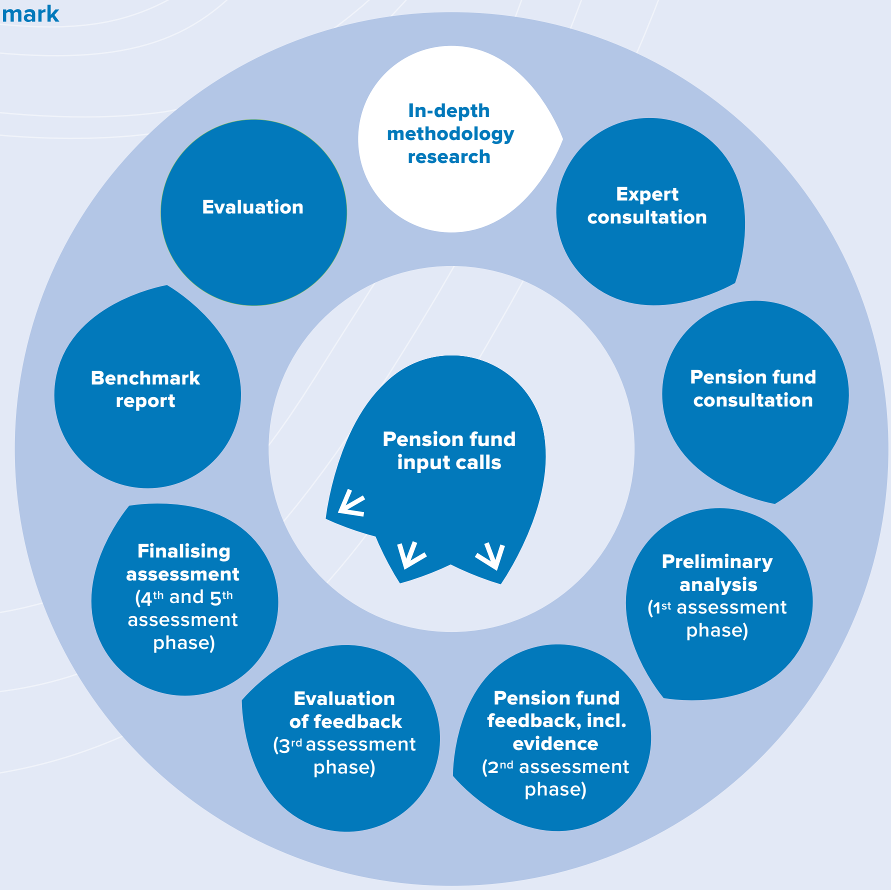
SETUP

The questionnaire is composed of four themes:

I. **Governance** | The first theme regards the governance of pension funds on responsible investment, including board room awareness and expertise of RI, board room accountability and oversight, and the consulting of participants and relevant stakeholders.

II. **Policy** | This theme focuses on the responsible investment policy in place. Its applicability to the entire portfolio, its depth, and its quality are surveyed.

Figure 27 | Benchmark process.



III. **Implementation** | The implementation of the responsible investment policy applies to six different asset classes. Table 5 shows the asset classes with the corresponding responsible investment strategies that are covered in the study. VBDO believes that the asset owners should take responsibility for the investments made on their behalf. Therefore, all implementation questions include the whole investment chain from pension fund to asset manager or fund of a fund manager. They are directed towards the state of implemented strategies in 2019.

IV. **Accountability** | This section discusses transparency about responsible investment policies, strategies, results and reports.

SCORING MODEL

The categories are weighted differently. Governance, policy, and accountability each account for 16.7%, and implementation for 50% which makes a 100% in total. The weighted percentage for implementation is 50% because this category determines the final output and quality of the responsible investment practices of a pension fund. In the governance and policy category, all questions are weighted equally. The final score for implementation is determined by multiplying the score of each asset class by the percentage of the portfolio invested in this asset class. All question are weighted equally within asset classes. In the accountability category, 5 sub categories are distinguished: the publication of the responsible investment policy, list of investments, transparency on implementation, actively informing and verification of the responsible investment report. Figure 4.3 gives an overview of the scoring model.

Figure 28 | **Overview scoring model, VBDO.**

FINAL SCORE (between 0-5)

GOVERNANCE (16,6%)	POLICY (16,6%)	IMPLEMENTATION (50%)	ACCOUNTABILITY (16,6%)

Total score on category Implementation =
Score public equity X % of the portfolio
Score corporate bonds X % of the portfolio
Score sovereign bonds X % of the portfolio
Score real estate X % of the portfolio
Score private equity X % of the portfolio

This figure shows the scoring model. The categories are weighted differently. Governance, policy and accountability each account for 16.7%, and implementation for 50%. The weighted percentage for implementation is 50% because this theme determines the final output and quality of the responsible investment practices of a pension fund. In the governance and policy category, all questions are weighted equally. The final score for implementation is determined by multiplying the score of each asset class by the percentage of the portfolio invested in this asset class. All questions are weighted equally within asset classes.

Star ranking

This is the third year VBDO uses the star ranking based on a 0 - 5 star range instead of only a 1-50 ranking in numbers. The star ranking is based on the total score and on the scores of the individual categories of the pension fund; governance, policy, implementation and accountability. These minimum standards might be expanded in the future. The following scores and minimum standards determine the number of stars awarded:

★★★★★

5 STARS

A score of at least 4.5 on all categories
(governance, policy, implementation, accountability)

★★★★

4 STARS

A total score of at least 4.0
A score of at least 3.5 on all categories
(governance, policy, implementation, accountability)

★★★

3 STARS

A total score of 3.5 up to and including 3.9
A score of at least 2.5 on all categories
(governance, policy, implementation, accountability)

★★

2 STARS

A total score of 2.5 up to and including 3.4
A score of at least 2.0 on all categories
(governance, policy, implementation, accountability)

★

1 STAR

A total score of 1.5 up to and including 2.4

☆

0 STARS

A total score below 1.5

Appendix II - Responsible investment strategies and asset classes

Responsible investment strategies

Based on reviews of implementation practices by investors worldwide and its own vision on responsible investment, VBDO has identified a range of responsible investment instruments that are applicable to one or more asset classes:

- **Exclusion**

Certain products, processes or behaviour of some companies and governments, are at such odds with international agreements and treaties that they should be excluded from the investment portfolio. Merely taking general issues such as human rights violations into consideration offers insufficient means of judgment for the exclusion of specific companies. It is important to specify these issues and use well defined Environment, Social and Governance (ESG) criteria or international guidelines, in order to exclude companies and governments. Concerning the exclusion of government bonds, pension funds can exclude countries based on official sanction lists of, for example, the EU and UN or based on other criteria. In January 2013 the legal ban of investments in cluster munitions came into force in the Netherlands. In the opinion of VBDO responsible investment should be a practice that goes beyond merely following legal obligation. Therefore, the pension funds can only receive points for exclusion criteria that go further than merely excluding on the basis of cluster munition.

- **ESG integration**

Even when the excluded companies are left out, large differences in terms of corporate responsibility sometimes remain between companies in which institutional investors invest. Where one company may only abide by the current environmental and social laws of the country in which it operates, the other may pursue high social and environmental standards in every country in which it is active. Institutional investors should consider this in developing their investment policy and should give preference to companies that perform well in relation to corporate responsibility.
VBDO defines ESG integration as the process by which ESG criteria are incorporated into the investment process. This involves more than screening the portfolios against exclusion criteria, but does not mean that an investor merely selects the best-in-class companies. ESG integration can go one step further by identifying and weighing ESG criteria, which may have a significant impact on the risk return profile of a portfolio. Therefore, VBDO distinguishes between investors making ESG information available to the portfolio manager on the one hand and investors systematically incorporating ESG criteria into each investment decision on the other hand. The latter is rated higher because this truly meets the idea behind ESG integration. An example of ESG integration is positive selection, this is defined as choosing the best performing organisation out of a group of corresponding organisations (sector, industry, class) with the use of ESG criteria. In this case, ESG criteria do not guide the investment decision process, but form the basis for selecting companies that perform above average on ESG issues. Integration of ESG criteria in the investment selection can be applied to all of the selected asset classes in this research. Regarding publicly listed equity and bonds, the assessment in this benchmark takes into account both the extent and the volume of ESG integration.

- **Engagement**

Pension funds can actively exert influence on companies in which investments are made by entering into dialogue with them. If the policy and behaviour of a company are at odds with the responsible investment policy, pension funds should to some extent use their influence to alter the conduct of companies in which investments are made. Institutional investors that have formulated an engagement policy, actively seek dialogue with companies outside the shareholder meeting. In order to obtain optimal engagement results, it is essential to evaluate and monitor the engagement activities and take further steps based on the outcome of the engagement activities. Engagement can be used to publicly listed equity as well as corporate bonds and real estate funds.

- **Voting**

Institutional investors can actively exert influence on companies in which they invest by voting during shareholder meetings. Many institutional investors vote at shareholder meetings, but their voting policy is limited to subjects regarding corporate governance. This might push companies towards a better sustainability policy, but that is in itself not enough. A clearly defined voting policy is required, one that explicitly emphasizes social and environmental issues. By pro-actively introducing or supporting resolutions about sustainable development and corporate social responsibility, companies can be pushed towards improvement and corrective action. Voting is examined only at the asset class publicly listed equity.

- **Impact investing**

Impact investing implies active investments that are made in companies or projects, which lead in terms of sustainability or clearly offer added value for sustainable development. Examples are investments in sustainable energy sources, innovative clean technology, affordable medicine against tropical diseases, microcredit and sustainable forestry. Impact investing might look like positive selection, because it may be using the same positive ESG criteria and can be done by investing in specially constructed funds, but it is not a best in class approach. Rather, investors choose a specific theme or development and search for companies or projects that contribute to this development and thus create added value for society in a way that can hardly be compared with mainstream industry or solutions. VBDO values the measurement and evaluation of the actual environmental and social impact of the investments. The instrument is applicable to all asset classes.

Asset Classes

- **Publicly listed equity**

The public equities market consists of the publicly traded stocks of large corporations. The risks and opportunities connected to ESG issues are important for the analysis and adjustments of an equity portfolio. Both exclusion and selection of companies within the portfolio, as well as voting and engagement gives the investor many ways to integrate ESG issues into its investment decisions. Emerging markets deserve special attention from investors, since these are increasingly reported as interesting opportunities because of their economic growth. Due to the growing demographic and resource challenges, and the potential dangers for the environment, a more sustainable approach to economic development is crucial for emerging markets. In many sectors economic development shows that these countries are already responding to the abovementioned challenges (think of, for example, the leading role in solar power of China). Nevertheless, extracting the relevant ESG data on emerging market companies can require a large amount of research. It is also possible to take ESG criteria into account with passive investments, by following a sustainable index or by using an engagement overlay.

- **Corporate (including covered) bonds**

For corporate bonds responsible investment activities can be similar as for equities, however corporate bonds do not have voting rights and bring a fixed return. This reduces the financial risk, but also offers fewer opportunities to take advantage of high returns and to influence the policies of a company. Because bondholders lack the voting power shareholders have, most ESG integration activity has been in equities. But with growing client demand, bond managers are working to integrate ESG factors in fixed-income portfolios.

- **Government / sovereign bonds**

Like corporate bonds, government bonds (together often referred to as fixed-income) are generally regarded as one of the safer, more conservative investment opportunities. They are issued to fund public services, goods or infrastructure. The first association about responsible investment and this asset class may often be exclusion of countries with dictatorial regimes, because of their human rights violations. This is a clear example of the results of an ESG risk analysis. ESG rating agencies increasingly offer products to screen bonds portfolios on corporate governance regulatory practices, environmental policies, respect for human rights and international agreements. Investors can also seek those government bonds that support the creation of public goods, such as needed infrastructural improvements, support for schools, or the development of sustainable energy sources and purchase government debt targeted to a specific activity.

- **Real estate**

Real estate investments encompass a wide range of products, including home ownership for individuals, direct investments in rental properties and office and commercial space for institutional investors, publicly traded equities of real estate investment trusts, and fixed-income securities based on home-loans or other mortgages. This assessment is limited to direct investments in buildings and indirect investments via real estate funds. Investors could screen their portfolio by developing ESG criteria for the construction of new buildings, their locations and the maintenance of existing buildings, machines and other facilities within buildings, such as environmental efficiency, sustainable construction and materials and fair labour practices. For real estate (investment) that is managed externally, the selection of fund managers based on experience with and the implementation of ESG is an important tool. Additionally, the managers of real estate funds can be engaged to improve their social and environmental performance.

- **Private equity**

With regard to private equity, an institutional investor can stimulate innovative and sustainable companies because it can directly influence management, encourage entrepreneurs to focus on developing business with high-impact social and/or environmental missions. This can be done especially in regions and communities that are underserved, and promote creation of local business and jobs. With this in mind, integrating the responsible investment policies in the selection process can be an important tool for institutional investors.

- **Alternative investments**

Depending on the asset allocation and definitions of an investor, alternative investments can include many kinds of assets, while at the same time experiences with and strategies for responsible investments are in their infancy. Also because the investments are a small part of total investments, this research limits this asset class to hedge funds, infrastructure, commodities, mortgages and impact investments. Information provided on other asset classes will not be taken into account. The following opportunities were derived from literature:

I. Although hedge funds are often handled as a separate asset class, the underlying assets are generally publicly listed securities (stocks and bonds) and their derivative products. Thus, investors could consider an ESG analysis of underlying assets and theoretically use the same tool for ESG management as for public equity and fixed income. Likewise, integrating the responsible investment policies in the selection process can be an important tool.

II. Infrastructure is widely considered to have a positive social impact. Infrastructure investors should take into account a broad range of material ESG issues that these investments might face over the assets' lifetime. Examples of ESG issues could involve; biodiversity impact, labour-, health and safety standards, resource scarcity and degradation, extreme weather events and supply chain sustainability. It is therefore relevant to monitor how ESG is integrated in infrastructure investments.

III. Regarding commodities, investors could direct capital to commodities with better ESG profiles and consider the source (region) of the commodity. As there are few ways to foster positive ESG changes, investors may advocate change on a broader level within commodities exchanges. Also integrating the responsible investment policies in the selection process of commodity investments or asset managers can be an important tool for this category.

50
Pension funds

50
Questions
of which 5 are climate related

100%
response rate

35
average documents provided by each pension fund

92%
of the total Dutch pension funds' assets are represented (€1.435 billion)

4 Score categories

Participants receive a score per category and a total, weighed score between 0 - 5

Governance
16,6%
Are the funds' board and stakeholders actively involved in ensuring responsible investment?

Policy
16,6%
In what way does a funds' investment policy take people and the environment into account?

Implementation
50%
To what extent does policy translate into practice?

Accountability
16,6%
How transparent is a fund on it's policy and implementation to outsiders?

Researched asset classes

- Publicly listed equity
- Corporate bonds
- Alternatives
- Government bonds
- Private equity
- Real estate

We focus on the use of these responsible investment instruments

- Exclusion
- ESG integration
- Engagement
- Voting
- Impact investing

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