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The Sustainability of Danish Pension Investments

Analysis of 13 Equity Portfolios of Danish Pension Funds

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1. About this report

Purpose

This report examines the sustainability profile of investment portfolios managed by Danish labour market pension funds and commercial pension funds. The analysis focuses on how listed equity, which makes up approximately 1/3 of the portfolios of Danish pension funds, is invested.

While policies, commitments and engagement of investors with the companies they invest in are important instruments to promote sustainable outcomes, these initiatives cannot stand alone. In fact, commitments and engagement tend to be less effective than perceived[1], and often these get in the way of making the harder decisions on what to invest in and divest from, which may exert a financial and reputational pressure on the investee companies[2]. This keeps members and clients of pension funds exposed to investments in companies that – in some cases – are causing harm to the ecosystems and social stability of the world that they plan to retire in.

This report therefore seeks to increase transparency into the Danish pension sector by providing a sustainability analysis of how Danish pension funds invest, and which sustainability themes they prioritise or neglect in the process. By going beyond climate commitments and the responsible investment policies of the pension funds, and looking at the actual allocations in their equity portfolios, we aim to show how differently – or similarly – the funds integrate sustainability in their investments.

It is the first time that the sustainability of Danish pension investments has been analysed so extensively, across so many providers.

Thank you for reading.

[1] See section 4.1
[2] Dordi, T. & Weber, O (2019): "The Impact of Divestment Announcements on the Share Price of Fossil Fuel Stocks" in Sustainability, Vol. 11, no. 11, p. 3122

2. Introduction

Executive Summary

Demands for sustainability in pensions are on the rise, and Danish pension funds are currently making positive steps in the right direction. However, there is notable divergence between individual pension funds, as well as across labour market pension funds and commercial pension funds. Even as clear leaders and laggards emerge from this analysis, this report lends transparency into the pension industry but also reveals an untenable burden on any pension customer – individual or company – that wants to understand the sustainability profile of their pension scheme.

Context

Since their adoption in 2015, the United Nations Sustainable Development Goals (the UN SDGs) have provided the most comprehensive and universally supported definition of sustainable development at a global scale. However, the ambitions underpinning the SDGs have lacked funding to the tune of USD 2.5tn annually since 2015. Because the financing gap has not been fully addressed, and due to the adverse impact of the Covid-19 pandemic, the need for additional financing of solutions to reach the goals has now grown to USD 4.5tn annually[3]. To close this gap, all sources of finance must be directed increasingly towards the SDGs[4], and a key element in this is to align institutional investors' portfolios with sustainable outcomes[5].

Denmark's various pension funds are by far its largest source of institutional capital, collectively managing DKK 3750bn (≅ EUR 500bn), corresponding approximately to 0.5% of all financial assets in the world[6]. Overall, the Danish pension industry invests more sustainably than the global market average, and Danish pension funds have generally led the way by co-founding or supporting coalitions that aim to strengthen investors' impact on the companies they invest in – or divest from. But a deeper analysis of the investment patterns in their equity portfolios reveal that Danish pension funds in general can do more to align their investments with sustainability objectives.

[3] OECD (2021): Closing the SDG Financing Gap in the COVID-19 era1 Scoping note for the G20 Development Working Group
[4] OECD (2018): Global Outlook on Financing for Sustainable Development 2019: Time to Face the Challenge
[5] OECD (2021): Closing the SDG Financing Gap in the COVID-19 era1 Scoping note for the G20 Development Working Group2
[6] Statista (2023): Total AUM of professionally managed assets globally was USD 112tn, or approximately 100tn EUR by end of 2021. https://www.statista.com/statistics/323928/global-assets-under-management/

Key Findings

The limitations of coalitions and commitments

Our analysis shows a noteworthy contradiction between, for example, net-zero commitments and investments into companies that continue to invest in the expansion of fossil fuel infrastructure and extraction. As such, the clients of these pension funds, whether individuals or companies, will have to look further than just policies and commitments to understand which future their pension is driving.

Finding: 9 out of 13 analysed funds have investments in companies with over 50% capital expenditure in fossil fuel infrastructure like oil and gas fields and pipelines. 8 out of 9 of these are affiliated with climate-focussed investor alliances.

Controversial investments are generally low – but problems persist

In addition to signing up to investor-led coalitions, all Danish pension funds maintain exclusion lists that help manage exposure to specific controversial themes. And while their exposure to controversial themes is generally lower than the world market and Nordic market average, some funds still invest in e.g. companies that produce controversial weapons. Furthermore, the commercial pension funds on average maintain a higher involvement in controversial activities compared to labour market pension funds.

Finding: 5 out of 13 analysed funds have investments in companies that produce controversial weapons like landmines, cluster ammunitions, chemical or biological weapons, or nuclear weapons.

A few lead the way in sustainable equity investments

The concept of 'sustainability' in investing continues to lack a clear definition, and this confusion trickles down from the professional to the individual pension saver wanting to understand how their money is invested. While there is still no global consensus on what classifies as a sustainable investment, one is emerging within the EU. Using the SFDR frameworks' Principle Adverse Impact (PAI) indicators for disclosure of sustainability in investment products, as well as the UN SDGs, this analysis finds a trend in how systematically sustainability factors seem to be embedded into investment decisions[7]. Those pension funds that perform well in one area, on average seem to also perform well in others – with notable exceptions. More specifically, the pension funds that succeed in contributing more to sustainable outcomes with their investments, also – on average – succeed in

[7] See Method & Analysis Design below for an explanation of why we have chosen to use SFDR and SDG alignment to define a framework for analysing sustainability in investments.

reducing their negative impact. While the trend is there, and leaders and laggards emerge in the field, the relative difference between many of the companies is limited.

Finding: There are clear leaders and laggards among the pension funds. All Danish pension funds in general outperform the global market average on SDG alignment.

There are clear differences between labour market pensions and commercial pensions

It is a general trend that the labour market pension funds, on average, perform better than the commercial pension funds on aligning their investments with sustainable outcomes and minimising negative impact[8], with one exception. At the same time, commercial pension funds are less exposed to controversial themes.

It is difficult to say whether Danish pension customers generally sanction commercial pension funds more on poor financial returns than they award them for the overall responsibility and sustainability profile of the investment strategies. But it seems clear that labour market funds invest differently than commercial funds.

Finding: Labour market pension funds are, on average, better at aligning their equity portfolios with sustainable outcomes while minimising harm, compared to their commercial counterparts**.**

No fund currently succeeds in being a leader across all sustainability themes

The analysis identifies a group of leaders who generally manage to perform well on positive SDG alignment, while minimising their negative impact. These three leaders are however more exposed to companies involved in human rights issues, than the average of Danish pension fund is, which goes to show that – while sustainability is often seen as a holistic practice where one theme cannot be prioritised over another – noone is yet able to properly manage all relevant environmental and social themes at the same time, across their equity portfolio.

Finding: Those pension funds that are best at investing in companies who produce products and services that address the SDGs are more exposed to companies involved in human rights issues.

Improving sustainable investment practices

While the funds are all anonymised in the analyses, it is our hope that this report can help create clarity in the debate over what sustainable investing looks like in equity portfolios, and help Danish

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[8] As defined by the SFDR PAIs and SDG revenue misalignment

companies and individuals better engage with their pension provider. Controversial investments and exclusion lists often get most media focus, but the bigger question of how well the Danish pension funds actually invest in companies with sustainable solutions, is left mostly unanswered. These topics are taking up a bigger share of focus of the growing ESG teams in Denmark's pension funds, and it is our hope that analyses like this can spark the discussion of how to improve the sustainability of Danish pension investments, and move the dialogue forward in a nuanced way. The Danish pension industry might have some way to go, but it is generally performing better than the world market average on most sustainability parameters, and this is in and of itself an important vantage point for the discussion of how to move forward.

3. Method & Analysis Design

Method

The analysis draws on sustainability data across a wide range of themes, from controversial investments and fossil fuel investments, to alignment with the 17 UN Sustainable Development Goals (SDGs) and mandatory Principal Adverse Impact indicators as defined under the EU's Sustainable Finance Disclosure Regulation (SFDR). In order to provide nuance and transparency in the analysis, the sustainability themes are kept separate, and for each analysis, relevant data sources and methodological considerations are disclosed.

The analysis focuses on the correlation between membership of investor alliances and investment practices (section 4.1), controversial investments (section 4.2), the overall sustainability of investments (section 4.3), as well as select deep dives into themes surrounding the climate transition and human rights (section 4.4).

To examine how sustainably Danish pension funds invest in their equity portfolios, we have designed a method based on emerging industry practices for how to understand sustainability at portfolio level. This method takes a vantage point in the EU SFDR, article 2(17), which defines sustainable investments as investments into companies that "contribute to an environmental [or social, ed.] objective", and simultaneously "do not significantly harm any of those objectives" while following "good governance practices".

In order to examine the extent to which Danish pension investments significantly contribute to an environmental or social objective, we conduct an analysis of the investments' SDG alignment, which is becoming an established practice for measuring 'contribution'. In order to assess the negative consequences (significant harm) of the investments, we combine an analysis of misalignment towards the UN SDGs with an analysis of the funds' adverse impact according to the SFDR PAI indicators. As a result of both of these analyses, we have ranked all analysed pension funds in terms of their performance on SDG alignment, SDG misalignment, and adverse impact, to identify the leaders and laggards within this framework. The ranking method is described more in depth under the analysis, section 4.3.

In addition to this, we provide a less systematic, but issue-specific deep dive into select controversial themes, as well as climate and social issues to answer specific sustainability questions about the equity portfolios of Danish pension funds. In order to focus the analysis, we have not analysed metrics on how well the companies that Danish pension funds invest into, are governed, and as such exclude the theme of *"good governance"* from this report.

Data

The method employs three of Matter's datasets, namely SDG Fundamentals, SFDR PAIs, and Thematic ESG Flags.

SDG Fundamentals measures the alignment and misalignment of companies revenues to the UN SDGs. The data shows the percentage of a company's revenue that is aligned or misaligned towards each of the UN SDGs, as well as across all individual SDGs. It is based on a systematic, manual mapping of almost 8000 unique revenue streams to Matters SDG taxonomy, to provide a more transparent, granular, and conservative view of the extent to which company activities are aligned or misaligned with the globally most recognised framework for sustainable development. A part of the data solution analyses companies' Capital Expenditure (CAPEX) against the same SDG taxonomy, to provide a view of how companies' future business models align with the SDGs.

SFDR PAIs contains a list of mandatory and voluntary metrics by which the overall adverse impact of financial products should be reported under EU's SFDR. Matter's SFDR PAIs dataset measures portfolio PAIs utilising a wide range of data sources, from company-reported data to corporate insights from subject matter experts in the relevant field. The PAI metrics have been designed to be as closely aligned to the EU-defined indicators as possible given available data. Where this is not possible, Matter uses either a proxy metric to infer the indicator or provides partial or estimated data on the metric. This analysis only includes those mandatory PAIs that are relevant for equity analysis (16 of the 18 in total).

There are a total of 64 PAIs by which the overall adverse impact of financial products should be reported under SFDR, and the 46 additional PAIs that can be reported on a voluntary basis, but have been kept out of this analysis.

We use the PAIs in this analysis to systematically analyse the negative impact of Danish pension funds' investments.

Thematic ESG Flags is a collection of hundreds of different ESG insights into a company's conduct and its products. Matter's Thematic ESG Flags comprise 380 company and sovereign ESG insights, based on analysis from independent, global subject matter experts and revenue data.

Data from more than 40 different leading expert sources on sustainability is mapped to various ESG themes, including governance, human rights, the climate transition and more. The data is presented in a binary format as issuer-level flags. This method harnesses the power of collective intelligence, resulting in independent insights, covering more than 8,000 companies, from external expert sources that reflect best-practice expectations for companies on a given theme.

The data is used for analysis of controversial themes and other issue specific deep dives.

Analysis design

The analysis is structured into three separate sections that each provide different nuances on the equity investments of Danish pension funds. The first section examines the commitments of Danish pension funds to different investor coalitions pursuing sustainability goals through investments, and the extent to which these commitments can be seen to affect the investments in the equity portfolios.

The following two sections only examine the actual investments, and try to establish a systematic but broad overview of the state of responsibility and sustainability in the equity portfolios of Danish pension funds.

All investment analyses are based on the latest publicly available 2022 holding lists of Danish pension funds, retrieved in early March 2023. Most of these holding lists are up to date as of the end of December 2022, while one is dated from the end of October 2022. In several cases, Matter has split holding lists into several components in order to e.g. filter out bonds or other holdings that are not listed equity.

The pension funds included in the analysis are

<u>Commercial pension funds</u>

- AP Pension
- Danica Pension
- Nordea Pension
- PFA
- Sampension
- Velliv

<u>Labour market pension funds</u>

- Akademiker Pension
- Lægernes Pension

- Lærernes Pension
- P+, Pensionskassen for Akademikere
- PenSam
- PensionDanmark
- PKA

Furthermore, the following two market indices are added to provide a benchmark for the analyses.

1. Nasdaq Global Large Midcap – referred to as “the global market average”
2. Nasdaq OMX Nordic 120 – referred to as “the Nordic market average”

The global index covers 2687 of the largest publicly listed companies in the world, and provides a benchmark for comparing Danish pensions equity portfolios against a world market average. The Nordic index contains the 120 largest publicly listed companies in Denmark, Sweden, Norway and Finland.

Methodological Limitations

While some sustainability data used in the analysis is reported by companies, other data is obtained from alternative sources. This can limit the data coverage in some analyses. Fluctuation in enterprise value and variance in reporting dates create further noise.

It is also not possible to analyse all holdings made public by Danish pension funds, but on average more than 90% of the weighted publicly available holding lists of pension funds' listed equity portfolios have been analysed. Danish pension funds invest in asset classes other than the listed equities, which is often the only asset class where holdings are reported publicly. As such, bonds, alternative investments, etc., which typically make up the majority of pension funds' investments, are omitted from this analysis.

Because these limitations affect the accuracy with which we can compare the overall sustainability performance of Danish pension funds, we have anonymized the funds. The aliases given to each fund is the same across analysis section 4.2, 4.3 and 4.4., whereas section 4.1 uses alternative aliases. This is because the data shown here (commitments to investor alliances) is publicly available and as such could be used to cross reference and identify the funds in the other analyses.

4. Analysis

4.1. From Commitment to Action

How are memberships of climate investor coalitions aligned with investments in Danish pension funds?

With the lack of clear definitions of what it means to invest sustainably and analyses like this one, it has only been possible to evaluate the responsibility of Danish pension funds based on surveys, their publicly available exclusion policies and commitments to various global investor alliances. This section reviews the extent to which membership of climate-focused investor alliances can help clients and members of pension funds understand what their money is invested in.

There are three major climate-oriented investor alliances that Danish pension funds are either members of, or support to varying degrees. These are the Paris Aligned Asset Owners (PAAO), the Net Zero Asset Owner Alliance (NZAOA), and the Climate Action 100+.

Climate Action 100+ commits its participants to engage with companies they invest in to seek assurances from boards and management that they will pursue strategies that live up to the Paris Agreement. Members of either the Paris Aligned Asset Owners (PAAO) or the Net Zero Asset Owner Alliance (NZAOA), however, commit directly to transitioning their investment portfolios to net-zero GHG emissions by 2050, taking into account the best available scientific knowledge including the findings of the Intergovernmental Panel on Climate Change (IPCC).

As such, Danish pension funds that are members of NZAOA and PAAO have committed to changing their investments away from companies that are not transitioning towards a net-zero future before 2050. A key indicator of a company's transition capability is how it invests in future business, in other words, where it directs its capital expenditure (CAPEX). This is also recognised by the Transition Pathway Initiative and the Climate Action 100+ benchmark, which use CAPEX as an indicator of progress and credibility in transition plans. Fossil fuel infrastructure typically requires high up-front investments and long depreciation cycles, committing companies to long-term operations of the assets they develop. So if a company invests in expanding fossil fuel extraction or fossil fuel infrastructure it is a strong indication that the company is not setting itself up for a transition to a net-zero future fast enough.

In Table **A** we have provided an overview of how the Danish pension funds have committed to the three investor alliances, and combined this with an analysis of whether or not the funds still own shares in companies that continue to invest in fossil fuel expansion. The specific definition we have used is whether or not the investee companies have more than 50% of their CAPEX in fossil fuels exploration, extraction, distribution or transportation. We use no minimum threshold for the share of the portfolio (allocation) that the company represents.

Table A:
Membership of Climate-focused investor alliances and investments in fossil fuel expansion

	Memberships of Climate-Focused Investor Coalitions			Equity Investments in Fossil Fuel Expansion
	Paris Aligned Asset Owners (PAAO)	Net Zero Asset Owner Alliance (NZAOA)	Climate Action 100+	Equity investments in companies with more than 50% CAPEX in fossil fuels exploration, extraction, distribution or transportation.
Fund A		Member	Participant	
Fund B	Member		Participant	
Fund C		Member		x
Fund D	Member	Member	Supporter	x
Fund E	Member			x
Fund F				x
Fund G	Member		Supporter	
Fund H	Member	Member	Supporter	x
Fund I	Member			
Fund J	Member		Participant	x
Fund K	Member	Member	Supporter	x
Fund L			Participant	x
Fund M	Member		Participant	x

As the table shows, all but one Danish pension funds are members or participants of one of these alliances, and only two are *not* members of PAAO or NZAOA. Despite the commitments of the other 11 funds to transition their investments to net-zero alignment, it is still possible to identify companies in most equity portfolios that allocate more than 50% of their investments to fossil fuels exploration, extraction, distribution or transportation. In fact, of the 11 funds that are members of PAAO or NZAOA, 7 continue to have equity investments in companies with more than 50% of their

CAPEX in fossil fuel infrastructure. Substantial investments at this scale puts into question the ability of these companies to transition to a 1.5°C aligned pathway, which is a part of the latest guidance from NZAOA to its members, to call "on consumers and suppliers of oil and gas to set Scope 1, 2, and 3 greenhouse gas emission reduction targets while aligning their operations activities, including capital expenditure, with established 1.5°C pathways"[9].

Danish pension funds still have some way to go in order to align their investments to the guidelines of the alliances they are members of. Many of the funds will however stress the importance of the work done – not by excluding certain companies from investments– but by engaging directly with the boards and management of these companies through coalitions like Climate Action 100+. That kind of work is not reflected in this report, as it only analyses how the funds invest – not how they act as active owners. In this context, it is however worth noting that the impact of active ownership on achieving substantial climate commitments through the Climate Action100+ Alliance is being called into question. Climate Action 100+ was formed in 2017, but last year the coalition revealed that less than 12% of their 166 focus companies have adequate short-term emissions reduction targets, while just 7% have stopped lobbying against climate-positive legislation. Most notably, 0% have aligned their investments with a 1.5°C future[10].

As such, active ownership has its limits and commitments are more easily visible than action. Membership of investor coalitions only tells a part of the story on how pension funds help their members and customers invest in a more sustainable future. It is necessary to also look at the hard facts about how pension portfolios are actually allocated.

[9] N AOA (2023): Net Zero Asset Owner Alliance sets expectations for oil and gas investments and calls on companies and policymakers to align with 1.5C pathways https://www.unepfi.org/industries/net-zero-asset-owner-alliance-outlines-new-guidance-for-oil-and-gas-investments-while-calling-on-companies-policymakers-and-investors-to-align-with-1-5c-pathways/

[10] Share Action (2022): Greater ambition and transparency needed to revive Climate Action 100+ initiative ahead of relaunch https://shareaction.org/news/greater-ambition-and-transparency-needed-to-revive-climate-action-100-initiative-ahead-of-relaunch

4.2. Controversial Investments

How exposed are Danish pension funds to controversial investment themes

Beyond commitments and policies, another aspect of pension funds' responsible investment strategies is their exclusion of controversial themes from their investments. Controversial investments span many themes, including controversial weapons (cluster ammunition, anti-personnel landmines, nuclear weapons, etc.) and tobacco (production and distribution). The asset management industry has been applying exclusion criteria to investable universes for more than half a century, and these have historically been motivated by ethical concerns. Today, exclusions are also seen as a way to align with international minimum standards for responsible investments, based on e.g. the UN Treaty on the Non-Proliferation of Nuclear Weapons (NPT), or the fact that the tobacco industry was excluded from membership of the UN Global Compact. Furthermore, exclusions have often attracted attention from members and clients of pension funds, as well as media and NGOs, as they are easier to measure than degrees of sustainability, and may be seen as an indication of how far the fund is willing to go in order to protect its stakeholders from negative impact, despite the potential financial consequences of staying out of segments in the market.

In table **B** we have collated an overview of how the 13 Danish pension funds perform on five of the most widely used exclusion criteria. It is important to note that the definition of each exclusion criteria may vary from pension fund to pension fund. Matter's ESG flags combine revenue thresholds with external expert observations to define each of the five themes. We may be using different revenue thresholds or definitions than the pension funds in question.

Table B: Controversial Investments in Danish Pension Funds

Share of equity portfolio invested in companies flagged for controversial issues
Weighted allocation, per theme, % of equity portfolio

Pension Fund	Controversial Weapons	Tobacco	Alcohol	Gambling	TOTAL
Commercial Fund 1	0.0%	0.0%	3.1%	0.3%	3.3%
Commercial Fund 2	0.0%	0.0%	1.6%	0.7%	2.3%
Commercial Fund 3	0.0%	0.0%	1.7%	0.2%	2.0%
Commercial Fund 4	0.0%	0.3%	1.8%	0.3%	2.4%
Commercial Fund 5	<0.01%	<0.01%	1.3%	0.2%	1.5%
Commercial Fund 6	0.6%	0.0%	1.7%	0.0%	2.2%

Global market average	1.2%	0.5%	0.7%	0.3%	2.8%
Scandinavian market average	0.0%	0.0%	1.2%	1.8%	3.0%
Labour Market Fund 1	0.0%	0.0%	1.3%	0.1%	1.4%
Labour Market Fund 2	0.7%	0.0%	0.7%	0.1%	1.5%
Labour Market Fund 3	0.0%	0.0%	1.1%	0.1%	1.2%
Labour Market Fund 4	0.0%	0.0%	0.9%	0.1%	1.0%
Labour Market Fund 5	0.3%	0.0%	2.0%	0.1%	2.4%
Labour Market Fund 6	0.6%	0.0%	1.1%	0.2%	1.9%
Labour Market Fund 7	0.0%	0.0%	0.6%	0.1%	0.7%

Controversial Weapons: Companies manufacturing controversial weapons including cluster munition, anti-personnel mines, and nuclear weapons. Controversial weapons include cluster bombs, anti-personnel mines, chemical, biological, incendiary, and nuclear weapons, and other weapons which are prohibited under applicable international treaties or conventions.

Tobacco: Companies manufacturing tobacco products, as well as electronic nicotine delivery systems.

Gambling: Companies engaged in hospitality services related to gambling such as casinos, and casino hotels[11].

Alcohol: Companies with revenue-generating activities related to producing and/or serving alcoholic beverages.

Varying degrees of exposure to controversial themes

As the table shows, there is a variance in how each theme is dealt with in Danish pension investments. Exposure to tobacco is minimal, with a few exceptions, but the exposure to companies manufacturing alcohol or companies running e.g. casinos, however remains on par with or above the

[11] Note that the definition of Gambling in this screening does not include online gambling and betting services. As such, the definition is more conservative and it may be that some or all pension funds in the analysis would have a larger share of their portfolio flagged, if the definition were to be expanded.

global market average. Furthermore, several Danish pension funds are still invested in companies that produce controversial weapons – or materials used in these.

Labour market pension funds in the main seem to avoid controversial investments more often than commercial pension funds. But on the theme of controversial weapons specifically, the trend is the opposite. As indicated in the summary above, this might be the result of specific categories of controversial investments attracting more attention in commercial client dialogues which are essential for the commercial funds ability to attract new AUM. Generally speaking, it does seem to be the case, however, that commercial pension funds are less incentivised to reduce their investable universe through stringent exclusions.

Active ownership and investor coalitions, together with product-based exclusions and conventional ESG risk-rating integrations, have traditionally formed the backbone of responsible investment strategies – but are increasingly seen as minimum standards. Discussions around sustainable investment definitions are endemic of a wider realisation that ESG up to now has not been generating the positive outcomes that were hoped for.

If we are to not only assess the degree of responsibility in Danish pension fund's equity investments, but also look towards how *sustainable* they are, we need to move our focus to how the investments align with globally acknowledged frameworks for sustainability.

4.3. Overall Sustainability in Danish Pensions

New standards and tools allow for more nuance

In the absence of common standards for sustainable finance and tools to conduct deep portfolio analyses across multiple data points, the tool of choice for measuring sustainability in investments has been aggregate ESG risk ratings. These ratings combine a large number of very different variables into one (or a few) overall ratings per company, in order to measure how well the company manages the risk that different sustainability themes pose to the company's bottom line or stock performance. This approach has the advantage of generating easy-to-compare analyses on portfolio level, but runs the risk of misguiding the audience, as ESG risk ratings do not measure sustainability, but financial risk. Furthermore, ratings from different leading rating providers only correlate to a factor of approximately 0.5, meaning results vary wildly, depending on which provider you use. Gaining a thorough understanding of what is being measured is difficult, because the ESG rating providers naturally protect their rating methods as core Intellectual Property.

But as standards for sustainable finance emerge in the EU, and analysis tools like Matter's allow for more complex portfolio analyses across hundreds of sustainability themes at once, it is becoming possible to evaluate investment portfolios against publicly backed frameworks like the EU's SFDR and the UN SDGs, which requires the analysis across more individual data points.

The EU, as part of its Sustainable Finance Action Plan, has introduced the Sustainable Finance Disclosure Regulation (SFDR) to improve transparency in the market for sustainable investment products. Specifically, it aims to prevent greenwashing and increase transparency around sustainability claims made by financial market participants. While Danish pension funds do not claim that their broad equity portfolios are sustainably invested, the disclosure framework of the SFDR, combined with a metric for analysing significant contribution to a sustainability goal, provides a useful framework for comparing the overall sustainability performance across the field. This approach also allows for much more granularity in the analysis, compared to averaging ESG ratings.

Measuring degrees of sustainability in investments using three pillars

However, with great nuance comes great complexity. In this analysis we analyse how each of the 13 pension funds' equity portfolios perform on SDG Alignment, SDG Misalignment, and on each of the 16 Principle Adverse Impact (PAIs) indicators included here. To provide a conclusive summary of this analysis, we have ranked how each pension fund performs on the two different SDG metrics, as well as across all the PAIs, by grouping the PAIs into one category. We have done so by ranking each pension funds' performance on each PAI relative to the other pension funds. We then average all the individual PAI ranks into one overall PAI ranking, per pension fund, to get an indication of the degree of adverse impacts embedded in their portfolios compared to peers, across all the different themes contained in the PAIs.

This produces three overall rankings that each shows how well a pension fund performs on a given pillar (SDG alignment, misalignment or adverse impact), relative to the other pension funds.

SDG alignment: The first ranking measures SDG alignment, i.e. how large a weighted percentage of the revenue of the companies in a given portfolio is aligned with one or more of the 17 UN SDGs. The higher the rank, the more portfolio companies contribute to addressing the SDGs through their products and services.

SDG misalignment: The second ranking measures SDG misalignment, i.e. how large a weighted percentage of the revenue of the companies in a given portfolio is misaligned with one or more of the 17 UN SDGs. The higher the rank, the lower the relative harm portfolio companies do to the SDGs through their products and services.

Principle Adverse Impact: The third ranking measures overall PAI performance, i.e. how well each pension fund, on average, performs on each PAI indicator. The higher the rank, the better the pension fund manages its adverse impact across themes like CO2 emissions, Human Rights Issues, etc. See appendix I for the full list of all PAIs.

Overall ranking: Finally, we have averaged the ranking of each pension fund per pillar to produce an overall score that groups the pension funds into four quartiles.

Quartile	Characteristics
1	Ranks high on generating sustainable outcomes AND minimising significant harm and adverse impact
2	Ranks high on either generating sustainable outcomes OR minimising significant harm and adverse impact – or ranks medium across all aspects
3	Ranks low on either generating sustainable outcomes OR minimising significant harm and adverse impact
4	Ranks low on generating sustainable outcomes AND minimising significant harm and adverse impact

Table C:

The Sustainability Profile of Danish Pension Funds

Performance across mandatory PAIs, SDG alignment and SDG misalignment

Weighted allocation, per theme, % of equity portfolio

	Significant contribution Rank: Highest share of revenue aligned with the UN SDGs (% revenue aligned)	Do No Significant Harm Rank: Lowest share of revenue misaligned with the UN SDGs (% revenue misaligned)	Do No Significant Harm Rank: Overall performance ran ked across all PAIs (average rank)	Rank: Overall quartile
Labour Market Fund 1	1 (28.2%)	3 (6.7%)	4 (5.9)	1
Commercial Fund 1	7 (22.5%)	4 (7.6%)	1 (3.4)	1
Labour Market Fund 2	2 (24.5%)	1 (5.1%)	9 (7.5)	1
Labour Market Fund 4	10 (21.6%)	2 (5.3%)	2 (5.4)	2
Labour Market Fund 3	3 (24.3%)	8 (10.4%)	5 (5.9)	2
Commercial Fund 6	5 (23.7)	9 (10.6%)	3 (5.8)	2
Labour Market Fund 5	6 (22.7%)	6 (10.2%)	7 (6.5)	2
Labour Market Fund 7	11 (21.2%)	7 (10.2%)	8 (7.4)	3
Commercial Fund 2	9 (21.7%)	12 (12.2%)	6 (6.4)	3
Labour Market Fund 6	12 (21.1%)	5 (8.5%)	10 (8.2)	3
Commercial Fund 3	4 (23.8%)	11 (11.6%)	13 (9.2)	4
Commercial Fund 5	7 (22.1%)	10 (11.4%)	11 (8.4)	4
Commercial Fund 4	13 (20.2%)	13 (13.5%)	12 (8.6)	4

Note: Labour Market Fund 2 & 7 both score exactly the same average rank on PAIs, and therefore share the 7th place on overall PAI rank.

The table shows how well the Danish pension funds, relative to each other, manage to invest in sustainable solutions while minimising the negative impact they have on the planet and society. By looking at the overall quartiles we group them into, a clear trend emerges. With the exception of one commercial pension fund, the labour market pension funds in general outperform the commercial pension funds on sustainable investing. As such, the other four commercial pension funds rank as low as they can in the comparison (three in 4th quartile, one in 3rd quartile), while the labour market pension fund generally all rank better. Three clear leaders emerge in the 1st quartile, who are all relatively better than the rest at increasing the significant contribution of their investments to an environmental or societal theme, while minimising their adverse impact / harm to the environment and society.

A look at the first column in Table C, which contains the revenue alignment with the SDGs, shows that the relative difference in the % alignment is relatively small, among the pension funds, while the relative difference in misalignment is substantially bigger[12]. In other words, the equity portfolios of Danish pension funds are more similar in terms of their positive contribution to sustainability topics, compared to how much they differ in terms of their negative impact. This indicates that the way sustainability is being integrated into investment decisions seems to be focusing more on avoiding harm than on generating positive sustainable outcomes.

The findings could suggest that pension funds approach the integration of sustainability quite differently in their investment strategies, with the main dividing line being between commercial and labour market funds. Furthermore, all pension funds seem to differ more in how they avoid harm in their investments, over how they ensure significant contributions to a sustainability theme. These differences are substantial, but currently not visible to members and clients of pension funds.

What explains the difference in sustainability performance?

If we look at how the Danish pension funds perform specifically on SDG alignment and misalignment, and compare this to the global market average, it is evident that Danish pension funds in general outperform the global average when it comes to increasing alignment, as well as reducing misalignment – see chart 1. However, as the Nordic market average also indicates, Scandinavian companies are historically known as producers of sustainable solutions, and as such, a relatively high exposure of Danish pension investments to Nordic equity (the traditional "home bias" found in many investment portfolios) might explain some of the overperformance compared to the world market. It does seem unlikely, though, that this explains all the differences *between* the pension funds. Rather, it could be a result of how responsibility and sustainability are operationalised and integrated, with varying degrees of consistency, into the investment strategies of the equity teams. Sustainable

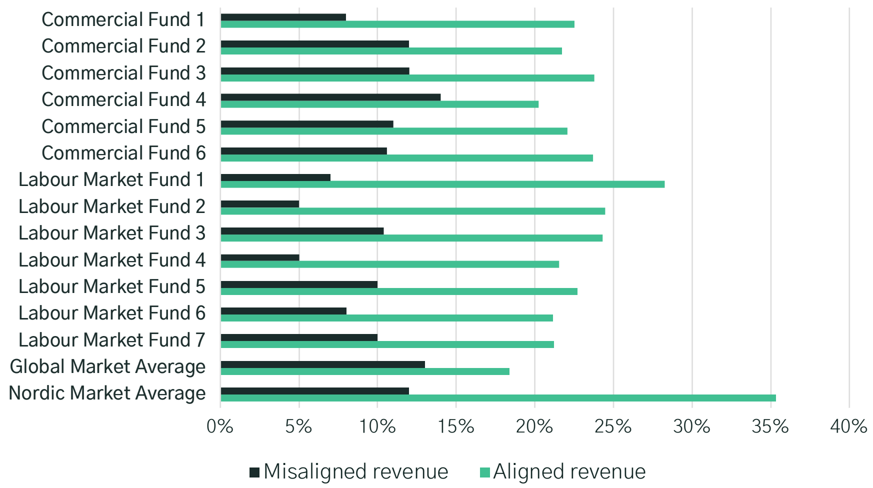
[12] The difference in alignment between the highest performer (Labour Market Fund 1 – 28.2%) and the lowest performer (Commercial Fund 4 – 20.2%) is 8%-point (28% less than the high performer). But the relative difference in misalignment, the second column in Table C, between the highest performer (Labour Market Fund 2 – 5.1%) and the lowest performer (Commercial Fund 4 – 13.5%) is 8.4% (165% more than the high performer). On adverse impact, the best performer (Commercial Fund 1) on average comes in at number 3.4 among all 13 funds on performance across all PAIs, whereas the low performer (Commercial Fund 3) on average comes in as number 9.2.

investment requires clear policies and objectives, and a systematic operationalisation and integration of these into investment decisions. Those that do this most effectively, will expose their clients or members to investments in companies that generally do more to support the advancement of a sustainable economy, compared to the global average.

Chart 1: Overall alignment and misalignment with the 17 UN SDGs

The average share of portfolio company activities which are aligned or misaligned with one or more subtarget of UN's 17 SDG's.

Weighted share of company revenue, average, (%), per fund



The above results are based on an analysis across several different metrics, and as such provides a high-level but robust picture of the sustainability of pension investments. To make the discussion more concrete, the final section will examine a number of specific sustainability themes to analyse how the different pension funds perform against each other and the market average.

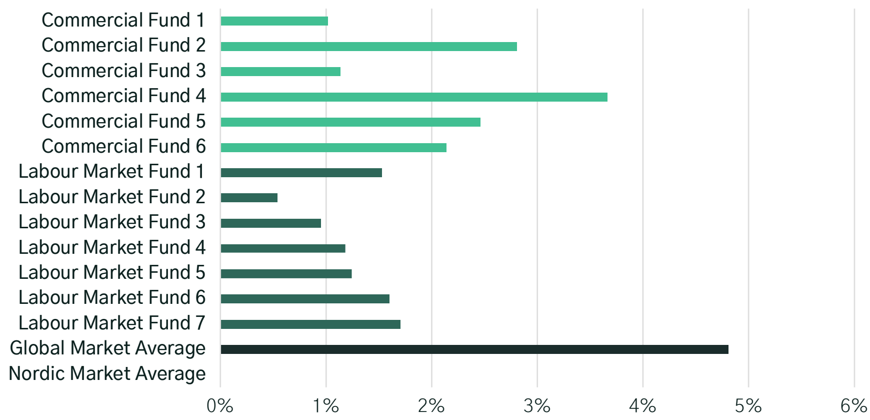
4.4. Thematic Deep Dives

Climate change

Chart 2: Blocking Climate Policy

Share of portfolio companies that lobby to block climate friendly policies

Weighted share of portfolio (%), per fund

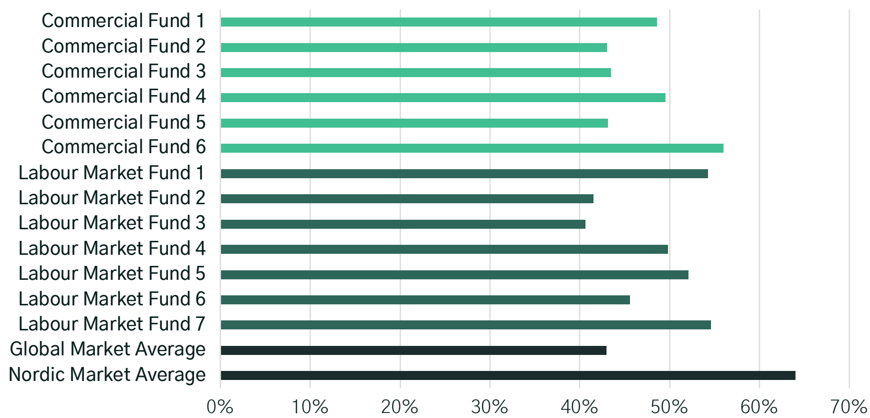


Note: Includes companies that use their influence to impede climate policy making e.g. through lobbying campaigns.

Chart 3: Net Zero & Science Based Climate Targets

Share of portfolio companies which have committed to net-zero emissions targets and/or initiatives[13].

Weighted share of portfolio (%), per fund



Note: Includes companies with near- and long-term Science Based Targets as well as Net Zero Asset Manager and Asset owner initiatives.

[13] Companies need to have set long term Science Based Targets for a 1.5 degree scenario to be considered in alignment with Net-Zero standards. See https://sciencebasedtargets.org/blog/net-zero-jargon-buster-a-guide-to-common-terms. Chart 3 measures all types of Net Zero commitments. On average, 45% of the investments across all pension funds have committed to any Net Zero and Science Based Targets - of which only very few (3.4%) have set long-term Science Based Targets for a 1.5 scenario.

Chart 4: GHG emissions scope 1+2 intensity

Scope 1+2 greenhouse gas emissions portfolio companies

Tonnes CO2 equivalent emitted annually, weighted, per fund

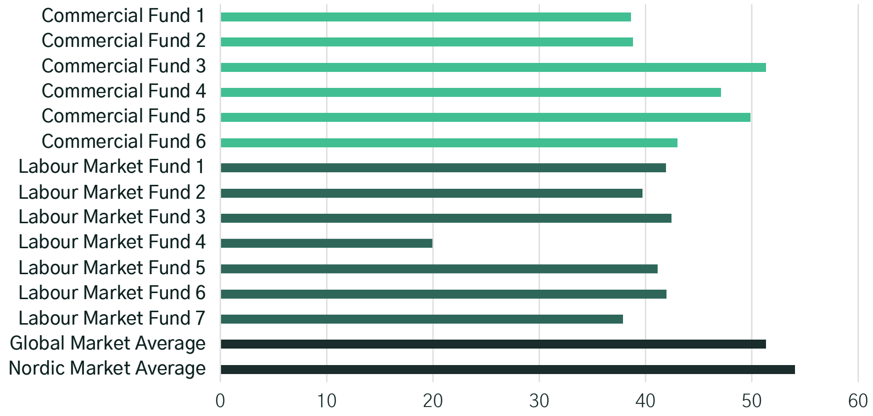
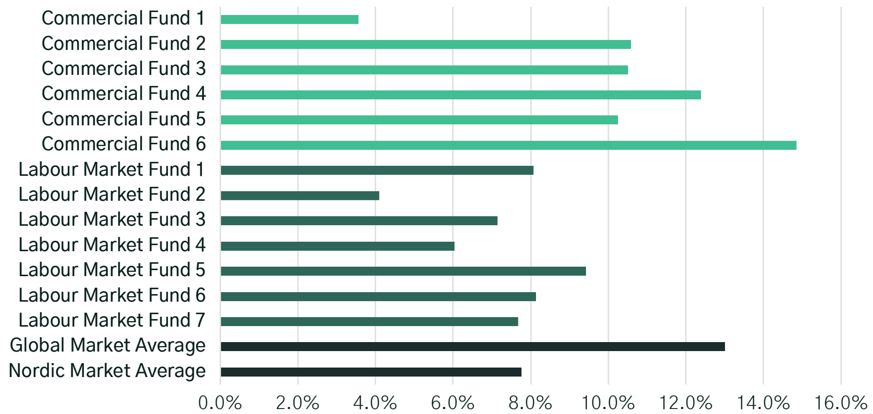


Chart 5: Fossil Fuel Activities

Share of portfolio companies generating revenue from products and/or services related to fossil fuels.

Weighted share of portfolio (%), per fund



Note: Defined as EU's SFDR (art 4) Principal Adverse Impact Indicator (PAI) 4: Coal Activities, Oil & Gas Activities, Financiers of fossil Fuels, Natural Gas or Coal Utilities.

Danish Pension funds generally perform slightly better than the world market average on the four climate-related issues we have included above, but differences between them persist. The commercial funds are generally more exposed to companies that block climate policy and in companies with fossil fuel activities. They are also, on average, more CO2 intensive in their investments.

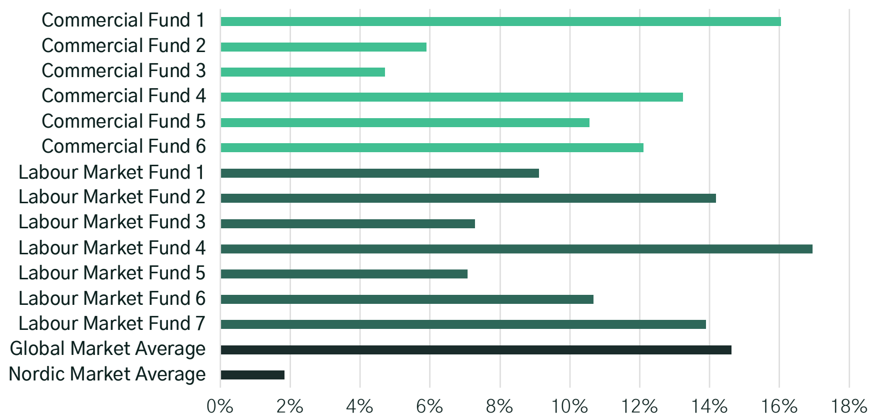
Danish pension funds' equity investments are overall just slightly better than the global market average when it comes to the percentage of companies that have committed and set goals for how to transition to a net-zero future. Again, the Scandinavian market average is better than the average of the global market and the Danish pension fund equity portfolios, and it is worth asking if Danish pension funds can do more to encourage the companies that they own shares in, to set Science Based Targets for their transition to a net-zero business model. While investors have never managed to convince, pressure or coerce a listed company to completely change its current business model (e.g. stop drilling for oil) through active ownership, they have at times been able to exert a positive influence on the long-term climate goals or disclosures of their investee companies, as the sparse evidence from Climate Action 100+ shows.

Human & Labour Rights

Chart 6: Human rights issues

Share of portfolio companies with one or more violations of UNGC principles or OECD Guidelines

Weighted share of portfolio (%), per fund

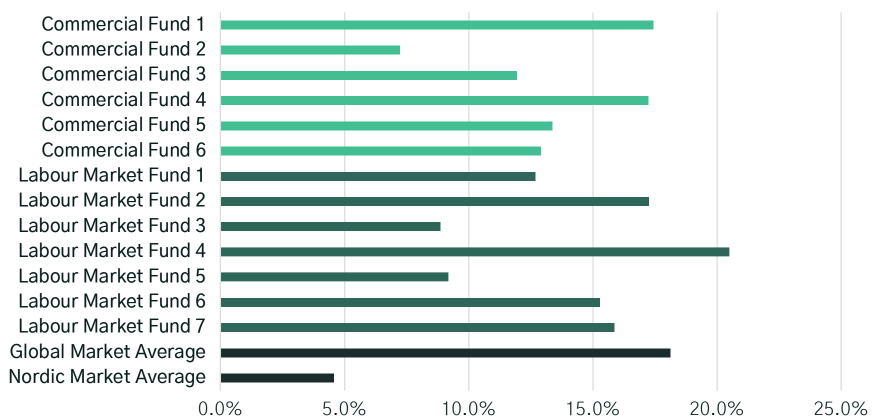


Note: Defined as EU's SFDR (art 4) Principal Adverse Impact Indicator (PAI) 10: Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises. Measured specifically as companies that have committed several human rights violations or have violated individuals' rights in situations of war or conflict, and companies that have been accused of serious allegations within the past 3 years.

Chart 7: Poor Overall Human & Labour Rights Management

Share of portfolio companies identified in one or more instances for having insufficient practices for safeguarding human and labour rights.

Weighted share of portfolio (%), per fund



Note: Poor Overall Human & Labour Rights Management may include one or more of the following: No / Poor Remedy Program, No Stakeholder Engagement on Human & Labour Rights, Involvement in Serious Allegations, No Appropriate Actions Taken to Serious Allegations, No Grievance Mechanisms, No Human Rights Due Diligence, No Training on Human Rights, No Conflict Mineral Risk Assessment, No Response to Serious Allegations and No FPIC Process

Danish pension funds generally manage to steer their equity portfolios in a more climate friendly direction than the global average, and the same overall trend continues when it comes to managing and avoiding issues related to human and labour rights. Chart 6 and 7 each show how the companies that Danish pension funds invest in *manage* human and labour rights issues, and the extent to which they are *involved* in these issues. While there is a positive trend, the overall difference from the world market average is not substantial, and indeed several Danish pension funds are more exposed to companies with problematic practices on human and labour rights than the global market average.

The extent of the issue can be further contextualised by looking at the Nordic market average, which shows that the Scandinavian economies that these funds are based in – on average – manage human and labour rights issues much better than the companies the pension funds are invested in. It is also worth asking the question of how many human and labour rights issues should be tolerated in an equity portfolio at all, in the EU, and specifically, in a portfolio targeted at normal working people's life savings? There are no definite answers to this, but it seems obvious to conclude that Danish pension funds have some way to go to ensure that the companies they invest in behave in accordance with established global principles for responsible business practices.

Finally, it is worth noting that major issues persist across the pension funds, and while Commercial Fund 1, and Labour Market Fund 1 and 2 on average perform better on sustainability, none of them perform particularly well on these issues, and indeed two of them are among the absolute laggards. This further illustrates the complexity of evaluating the overall sustainability of an investment strategy and highlights the need for clients and members of pension funds to have access to insights at a much more granular level than what is the case today when they choose how their savings get invested.

5. Trends in 2023 and beyond

Sustainability is becoming an integrated part of all tenders for corporate pension plans

Five years ago sustainability was not a theme that commercial pension funds were evaluated on when Danish companies made their decisions on where to direct the life savings of their employees. In 2018, Matter was first in Denmark to help create a sustainable investment solution with mixed risk profiles, covering both equities and bonds, and today, most commercial pension funds in Denmark offer a green or sustainability-branded alternative to their conventional investment funds. These specialised products cater to specific customer segments that are particularly concerned about sustainability. In the future, however, as EU regulation intensifies and sustainability becomes an increasingly integrated part of tenders for corporate pension plans, we should expect to see an increased focus on the sustainability of the broader, standard life-cycle offerings of the commercial pension funds.

From reducing financial risk to supporting sustainable outcomes

Sustainability, and especially themes related to climate, have been moving up on the agenda of the investment management industry over the past decade. This has coincided with an increase in negative climate related events like droughts, floods and storms, which might have contributed to increasing public interest in sustainable finance. But the first wave of sustainable finance, including in the Danish pension industry, has focused more on managing financial risk than on facilitating different outcomes in the economy. Apart from alternative investments in renewable energy infrastructure through entities like Copenhagen Infrastructure Partners, Danish pension funds have largely prioritised integrating ESG *risk* into their investment decisions. This ultimately means reducing the financial risk of e.g. environmental or social themes to their portfolio, rather than systematically investing in companies that produce the solutions to drive the economy in a more sustainable direction. As new European legislation expands the definition of what responsible and sustainable asset management looks like, to include more than just financial risks, so will the demands on pension funds. 2023 will see a continuous increase in the sophistication and extent of the regulation on sustainable finance in the EU, and solutions like Matter's analytics platform will expand to enable investors to better understand – in depth – how the companies they invest in deliver actual change. This is materially different to understanding how well companies manage to shield themselves from negative financial effects of, for example, climate change.

Sustainability in finance is expanding its definition

The themes that have traditionally been included in sustainability concerns of asset managers have often been defined by the companies supplying the ESG data: the factors that were incorporated into an ESG rating would by design be incorporated into the investment decisions of the pension fund using the rating to e.g. define an investable universe or decide an allocation. However, attention is moving away from the privatised notions of sustainability offered by rating providers, and towards publicly backed and science based notions of sustainability including the UN SDGs, SFDR PAIs and the EU Taxonomy. 2022 saw the signing of the Kunming-Montreal Global Biodiversity Framework, which sets global targets for the protection of terrestrial and marine-based ecosystems, and 126 institutional investors have already signed the Finance for Biodiversity Pledge, including three Danish pension funds[14]. While these efforts are still in their infancy, it is expected that biodiversity as a sustainable finance theme will attract significant attention in 2023 and the years to come, as the consequences of companies' activities on e.g. natural habitats or soil and water quality are better understood.

More generally, sustainable finance is constantly evolving in its definition, and as new themes are integrated into investment decisions, the financial industry will need to develop better methods and tools to monitor and communicate these efforts to the people whose money is being invested. As this report has shown, it is already today a challenge for normal pension savers to understand the sustainability profile of their investment portfolios, and the challenge keeps growing.

[14] Finance for Biodiversity: https://www.financeforbiodiversity.org/signatories/

6. Conclusion

Overall, Danish pension funds invest more sustainably than the market average, and show substantial support for investor coalitions aiming to combat climate change. A closer look at the allocations of each fund, however, shows important differences in how sustainability is operationalised in each fund.

Commitments

With one exception, all Danish pension funds have signed up to a net-zero or Paris Aligned commitment, signalling their intention to align investments with a net-zero emissions future. While this requires that no new investments be made in fossil fuel infrastructure (new wells, new pipes, etc.) most of the committed pension funds continue to invest in companies that place more than 50% of their investments into exactly this.

Investments

When analysed against the world market average, Danish pension funds' equity portfolios generally perform better on most parameters related to responsibility and sustainability. There are however significant differences across the different themes, as well as across the funds.

On controversial investments, commercial pension funds are generally more exposed to more issues compared to labour market funds, but on the theme of controversial weapons, the trend inverts.

By running a more systematic analysis on the overall sustainability profile of Danish pension funds equity portfolios, we see the same trend; namely that labour market pension funds seem to have come further in investing in companies that produce solutions to sustainability challenges. Apart from one commercial pension fund, labour market funds are on average better at investing in companies that contribute to sustainable outcomes through their products and services, while also minimising their exposure to companies that cause harm – either via their solutions or business conduct.

The picture is more muddied when diving into specific themes around climate transition and human rights: Here, labour market pension funds perform slightly better on key climate themes, but the trend is less clear on the topic of promoting labour and human rights, where some pension funds even perform worse than the market average.

As sustainable investing continues to evolve in complexity to encompass new themes and incorporate more regulation, the Danish pension funds, their clients and advisors, will need better tools for evaluating how well their investments are aligned with regulation and global commitments like the

Paris Agreement and the UN SDGs. A key theme in this ambition seems to be granularity and nuance. Important differences persists in how pension funds allocate their assets, but these are not visible to the average observer, and rarely make it into the public debate, let alone the AGMs, tender processes or advisory meetings. Here, pension fund members and clients have a chance to influence the direction of of their life savings, and which future they help finance through them. But without the necessary information about how the actual investments of their pension fund perform on sustainability, the influence of pension savers will remain limited.

It is our hope that contributions like this report will help spark the debate over which future Danes want to finance with their pensions, the role pension funds have in guiding this actively with their investment decisions, and what analyses and tools are needed to make the pension market more transparent and responsive to the needs of companies, labour unions and individuals as they engage with their providers.

7. Appendix

7.1: List of all PAIs included in the analysis

PAI 1.1–1.3: *Excluded from the analysis*[13]

PAI 1.4 Total GHG emissions: Tonnes CO_2e / mEUR EVIC[15]

PAI 2 Carbon footprint: *Excluded from the analysis* [16]

PAI 3 GHG emission intensity: Tonnes CO_2e / mEUR Revenue

PAI 4 Fossil fuel activities: Portfolio share of companies involved in Coal Activities, Oil & Gas Activities, Financiers of fossil Fuels, Natural Gas or Coal Utilities

PAI 5.1 Non-renewable energy consumption: The share of energy that portfolio companies consume from renewable energy sources compared to non-renewable energy sources, weighted against portfolio allocation.

PAI 5.2 Non-renewable energy generation: The share of energy a company generates from renewable energy sources compared to non-renewable energy sources, weighted against portfolio allocation.

PAI 6 Energy consumption intensity: The ratio of energy consumption relative to the revenue of companies per high impact climate sector. Gigawatt hours annually / mEUR Revenue

PAI 7 Biodiversity risk: Portfolio share of companies operating near or in biodiversity-sensitive areas which are negatively affected by their activities.

PAI 8 Emissions to water: Tonnes of emissions to water generated by companies, per million EUR invested, weighted against portfolio allocation. Tonnes / mEUR EVIC

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[15] Only 1.4 was included for the PAI 1 analysis. The following were excluded to avoid overweighing the analysis towards emissions data. PAI 1.1 GHG emissions scope 1; PAI 1.2 GHG emissions scope 2; and PAI 1.3 GHG emissions scope 3.
[16] PAI 2 requires information about the current value of all investments and has therefore been excluded from the analysis. The numerator of the PAI equation is however the same as with PAI 1.4, as both measure greenhouse gas emissions.

PAI 9 Hazardous waste: Tonnes of hazardous waste and radioactive waste generated by companies, per million EUR invested. Tonnes / mEUR EVIC

PAI 10 Human rights violations: Portfolio share of companies involved in violations of the UNGC principles or OECD Guidelines for Multinational Enterprises.

PAI 11 No human rights due diligence: Portfolio share of companies without policies to monitor compliance with the UNGC principles or OECD Guidelines for Multinational Enterprises or grievance/complaints handling mechanisms to address violations of the UNGC principles or OECD Guidelines for Multinational Enterprises.

PAI 12 Gender pay gap: The average unadjusted gender pay gap of companies, weighted against portfolio allocation.

PAI 13 Board diversity (gender): The average ratio of female to male board members.

PAI 14 Controversial weapons: Companies involved in the manufacture or selling of controversial weapons, including anti-personnel mines, cluster munitions, chemical weapons, biological weapons and nuclear weapons.

7.2: Key Terms & Abbreviations

- **AGM:** Annual General Meeting
- **AUM:** Assets Under Management
- **CAPEX**: Capital Expenditure
- **Climate Action 100+**: Investor group trying to affect the world's 166 most polluting companies
- **CO_2e:** CO_2-equivalent emissions all types of greenhouse gasses
- **ESG:** Environmental, Social & Governance
- **EU SFDR (SFDR):** The European Union Sustainable Finance Disclosure Regulation
- **EU SFDR PAIs (PAI):** Principle Adverse Impact. Indicators of sustainability that e.g. fund managers must disclose against under SFDR
- **EVIC:** Enterprise Value Including Cash (Market capitalisation + Issued Debt + Cash)
- **GHGH emissions:** Greenhouse Gas emissions
- **IPCC**: The Intergovernmental Panel on Climate Change
- **mEUR:** Million Euro
- **Net-zero:** net-zero emission of greenhouse gasses
- **NZAOA:** Net Zero Asset Owner Alliance
- **OECD Guidelines:** Guidelines for Multinational Enterprises on responsible business conduct in a global context.
- **OECD:** Organisation for Economic Co-operation and Development
- **PAAO:** Paris Aligned Asset Owners

- **Science Based Targets:** Target for reducing a company's emissions towards a temperature scenario, based on a scientific analysis of a company's relative carbon budget
- **Scope 1:** Greenhouse gas emitted directly from the operations of a company
- **Scope 2:** Greenhouse gas emitted indirectly from the production of electricity consumed by a company
- **Scope 3:** Greenhouse gas emitted up- and downstream in a company's value chain
- **UN SDGs (SDGs):** United Nations Sustainable Development Goals
- **UN:** The United Nations
- **UNGC Principles:** 10 fundamental responsibilities for businesses in the areas of human rights, labour, environment, and anti-corruption
- **UNGC:** United Nations Global Compact

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About Matter

Matter's mission is to make capital work for people and the planet. As a sustainability data and analytics provider for the financial industry, the company specialises in making sustainability data more accountable, granular and transparent, and offers a range of solutions for analysing investments against established sustainability frameworks. Matter creates unique datasets and collects insights from renowned expert sources, covering up to 58,000 listed companies and sovereign states on more than 700 ESG themes, including SDG alignment, greenhouse gas emissions, climate commitments, human and labour rights practices, etc. Headquartered in Copenhagen, Matter serves clients across Asia, Europe and North America, and its solutions are used to analyse and power investment strategies covering more than 700bn Euro in AUM.

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