

Strategy Council 2013

Responsible Investment and the
Norwegian Government Pension Fund Global

Executive Summary

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Executive Summary

The Strategy Council provides advice on investment strategy to the Norwegian Ministry of Finance, who represent the owners of the Norwegian Government Pension Fund Global, also known as the GPF Global or the Fund. The 2013 Strategy Council was asked to give advice on how to develop the Fund's responsible investment strategy further, increase transparency, and encourage debate on important decisions related to the management of the Fund. This document summarises our report to the Ministry of Finance. The Main Report may be downloaded from the Ministry's website.

In order to address the mandate, the Strategy Council gathered information from many sources and held a number of meetings, discussions, and interviews. The sources include the Norwegian government, the Council on Ethics, Norges Bank, portfolio managers from Norway and around the world, NGOs, consultants, researchers, environmental, social and governance (ESG) data providers, and investment professionals from comparator funds in Europe, North America, and the Pacific.

We also organised two events to help inform us further on responsible investment research and practices. First, we held a Summit on Responsible Investing at Cambridge University's Judge Business School on 31 May 2013, the purpose of which was to bring together asset owners and investment managers with experts on responsible investing in order to develop more clarity on the purposes and outcomes of such investing strategies. Second, we held a Responsible Investment Conference on 20 June 2013 in Oslo, the purpose of which was to provide an opportunity for the Strategy Council to hear the views of NGOs and other stakeholders regarding the Fund's responsible investment strategy. During this period, members of the Strategy Council also participated in a number of other conferences and meetings regarding responsible investing topics.

In developing its analysis and recommendations, the Strategy Council started with the premise that the owner of the Fund has the following key responsibilities:

- 1. To achieve the highest possible return for the Fund within acceptable risk limits:* The ultimate responsibility of the owner is to safeguard the purchasing power of the Fund for future generations through cost effective asset management at a moderate level of risk.
- 2. To understand the issues that may impact the future value of the Fund:* The purchasing power of the Fund available for future generations will depend on the total value created by the businesses owned by the Fund. The owner of the Fund therefore needs to understand significant issues (whether currently considered to be financial or nonfinancial) that may have an impact on the future value of the Fund. The priorities in the Fund's responsible investment practices should focus on initiatives expected to have material effects on the Fund's financial value.
- 3. To secure the Fund's legitimacy with the Norwegian people:* Based on assessments of overlapping consensus in the Norwegian population, it is the responsibility of the owner of the Fund to impose certain restrictions on the investment strategy followed by the Fund.

The Fund is among the largest investors in the world, holding equity and debt securities in more than 7,000 companies. The complexities of holding such a large, diversified portfolio are yet to be fully understood, especially when it comes to the effects of issues involved with responsible investing. How the Fund chooses to invest will affect its responsible investment practices. Similarly, the motivation or convictions behind the Fund's responsible investment practices could affect how the Fund can invest. Fundamental decisions regarding responsible investment practices should therefore be considered in tandem with the overall investment approach. In the future, new insights into issues involved with responsible investing may cause the Fund to consider changes to the portfolio's asset allocation. The Strategy Council recommends that any such considerations be based on research about

the expected effects on portfolio returns.

Our review of the literature and of current practice indicates a serious gap in knowledge about the impact of responsible investment activities on real portfolio value. The Council recommends that the Fund should encourage independent research that has the potential to be informative in this area. The Fund should endorse policy changes and prioritise those initiatives that seek to improve corporate transparency, ensure fair business practices, price externalities, and improve capital market quality and efficiency.

The Strategy Council recommend that the Fund is governed by principles that articulate what the Fund expects from all the companies it invests in, and that principles describe how the Fund will apply its ownership strategies. The Council believes that the Fund can achieve more powerful effects from its responsible investing practices by integrating exclusion decisions with its ownership strategies. One implication of this approach is that the resources currently devoted to responsible investment in the Council on Ethics and in Norges Bank should be integrated. Further, the responsibility for ensuring that the Fund's responsible investment principles are followed should be delegated to the Board of Norges Bank. The Report proposes mechanisms that could enhance accountability and provide incentives to counter the inherent conflicts between the financial and non-financial objectives of the mandate.

The Council recommends openness about the Fund's responsible investing objectives, principles, policies, strategies and priorities. This transparency will help to secure public trust and legitimacy in the Fund and will help create the dialogue and involvement that will lead to continuous learning and improvement.

The Strategy Council believes these recommendations will accomplish three goals. First, they will enable the Fund to stay at the forefront of responsible investment practices for large, highly diversified, long-term global investors. Second, these recommendations should strengthen the legitimacy of the Fund among the Norwegian population and stakeholders who are critical to the success of the Fund. Finally, these recommendations will guide the Fund owner and managers to pursue responsible investment practices that enhance the value of the Fund.

The main report describing these recommendations and the analysis which led to the recommendations comprises 10 chapters. The opening chapter provides an introduction to our work. This is followed by four further chapters that present our analysis. First, we survey the motives for responsible investment and the principles and practices of funds that focus on investing responsibly. Second, we summarise the research evidence that is pertinent to deciding on an approach to responsible investment. Third, we set this in the context of the Fund. Fourth, we share broad observations developed from our analysis.

Our recommendations are contained within three chapters that address key aspects of responsible investment strategy for the Fund. We cluster these aspects into three pillars that underpin our recommendations. Pillar One focuses on the objectives and strategy for the Fund's approach to investment responsibility. Pillar Two addresses the Fund's transparency and accountability. Pillar Three advocates integrating all responsible investment activities within the Fund. These three chapters underpin our recommendations for the Fund.

Our main report ends with a concluding chapter and a comprehensive list of references. This Executive Summary has two appendices: the Ministry's mandate to the Strategy Council and brief biographical details on the five Council members.

Elroy Dimson, Idar Kreutzer, Rob Lake, Hege Sjo, Laura Starks
Oslo, Norway
11 November 2013

Appendix 1: The Strategy Council's mandate*

The purpose of the Government Pension Fund Global (GPF) is to facilitate government savings to finance rising public pension expenditures, and support long-term considerations in the spending of government petroleum revenues. The investment objective is to maximise the purchasing power of the fund capital, given a moderate level of risk. In this way, we aim to ensure that both present and future generations can benefit from our common national savings.

The objective of good financial return is closely linked to the ambition to be a responsible investor. The Fund's role as a responsible investor is expressed, for example, in the Guidelines for Observation and Exclusion of companies which do not comply with minimum ethical standards. The Council on Ethics for the GPF advises the Ministry on the observation and exclusion of companies based on these guidelines. Norges Bank manages the Fund's ownership interests and is mandated to integrate considerations of good corporate governance and environmental and social issues in investment activities in line with internationally recognised principles for responsible investment (RI), whilst bearing the purpose of the Fund in mind.

Currently, the GPF's strategy for responsible investment comprises the following elements:

- International cooperation and contribution to the development of best practices
- Environmental related investment mandates
- Research and analysis
- Exercise of ownership rights
- Observation and exclusion of companies

Both the Ministry of Finance and Norges Bank, in their respective capacities as owner and manager of the Fund, participate in international forums in which best practice RI is discussed and developed.

Purpose of the Strategy Council 2013

- The purpose of the Strategy Council is to contribute in strengthening both the legitimacy and foundation of the long-term investment strategy of the GPF. Through independent and critical reviews, the Council shall give advice on how to develop the strategy further, increase transparency and encourage debate on important decisions related to the management of the Fund.
- The Council should assess how gaps to international best practices for RI may be closed, so that the Fund actively contributes to the development of good international standards in the area of RI and active ownership.

Measures / basis for assessment

- The Council members shall prepare a public report and give a presentation of the report.
- The main focus of the report shall be on the overarching strategy for RI, building on the experience of the work so far and comparisons with other funds. The report shall not give an evaluation of Norges Bank's operational management of the GPF or the Council on Ethics' recommendations on observations and exclusions.
- The report of the Graver Committee discussed the issue of consistency between Norwegian policy in different areas and the ethical guidelines of the Fund. Experience shows that this issue is still relevant. These experiences should be part of the basis for the Strategy Council's assessment.

Priorities for the 2013 report

- The report should review and comment on the overarching objective for the GPF's RI-strategy and compare this with comparable objectives expressed by comparable funds.

* Source: www.regjeringen.no/en/dep/fin/news/news/2013/html?id=712026

- The report should discuss current best practices for RI amongst other funds and compare the findings with the GPFG's strategy for RI.
- The report should discuss the role the Fund's contributions to research, analysis and international initiatives can play in development of best practice. The development of reporting standards that encompass ESG-issues should be included in the discussion.
- The assessments in the report should cover both the fixed income and equity portfolio of the GPFG.
- The report should consider how the collective resources and expertise in the Ministry of Finance, the Council on Ethics and Norges Bank can best be utilised to strengthen the work on RI further.
- The report should assess operational risks in the current setup, and may propose measures to reduce those risks.
- The report may propose changes to strengthen the work on RI, including operational and institutional changes.

The report should be presented no later than end of October 2013.

Appendix 2: Members of the Strategy Council 2013

Elroy Dimson is Emeritus Professor of Finance at London Business School (LBS) and Professor at Cambridge Judge Business School. He has taught Endowment Asset Management at LBS, Cambridge University, and the Commonfund Institute at Yale University. He is co-author of *Triumph of the Optimists* and the *Global Investment Returns Yearbook 2013*, and of *Endowment Asset Management*. Professor Dimson was a member of the Ministry of Finance's Advisory Council on Investment Strategy 2007–09 and has chaired the Strategy Council since 2010. His PhD is from LBS.

Idar Kreutzer heads Finance Norway (FNO), a trade organisation, and is a Member of the Strategy Council for the GPFG. He worked at Storebrand from 1992 to summer 2012, the last 12 years as CEO. He holds many corporate positions in Norway, he chairs Posten Norge and the Norwegian Refugee Council, and he has served for 12 years as a Council Member of the World Business Council for Sustainable Development. Mr Kreutzer has a degree in Economics and Business Administration from the Norwegian School of Economics.

Rob Lake is an independent consultant and during this project served as Director of Responsible Investment at Principles for Responsible Investments (PRI) as well as being a Member of the Strategy Council for the GPFG. Previously he was Head of Sustainability and Governance at APG (manager of the Dutch ABP pension fund). He has broad knowledge of international responsible investment practice and participates in international symposia where responsible investment initiatives are discussed and developed. He holds degrees from Cambridge and Bradford Universities.

Hege Sjo is Senior Advisor to Hermes Investment Management; and a Member of the Strategy Council for the GPFG. She also holds a number of board positions. During 1995–2003 she worked at the Oslo Stock Exchange, latterly as Director of Finance and Marketing Director. In the period 2004–05 she was an advisor on financial communication, stock exchange listing processes and corporate governance. Ms Sjo holds a BA from Stirling University, Scotland, and a Masters in finance from the Norwegian School of Economics (NHH).

Laura Starks is the Charles E and Sarah M Seay Professor of Finance of Finance and Associate Dean for Research at the McCombs School of Business, University of Texas, Austin. She has extensive experience and has published a number of influential articles in academic journals. Her main field is within institutional investments and corporate governance. As well as being a member of the Strategy Council for the GPFG, Professor Starks is a trustee for funds offered by TIAA-CREF and also holds various other positions. She has a PhD from the University of Texas.