

# Consultation paper – Evaluation of the Ethical Guidelines for the Government Pension Fund – Global

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# 1. Introduction

*Norway's natural resources in the form of petroleum deposits have placed us in a privileged position when compared to many other states. We have accumulated one of the world's largest government funds through revenues from the petroleum sector. This offers us more room for manoeuvre in terms of economic policy than most other countries, whilst at the same time entailing considerable management responsibility. The Government aims for the Government Pension Fund to be the best managed fund in the world, which means that we need to seek to adopt best practice within international asset management. This pertains to the formulation of the investment strategy, the execution of operational management, as well as our role as a socially responsible investor.*

*We assume, through the ethical guidelines, social responsibility attuned to our role as a financial investor. We adopt a long time horizon for our investments, and these are spread across many countries and sectors. It is of importance to the future growth of the Fund to ensure that markets are well-functioning. We contribute to this by requiring responsible conduct on the part of companies. We therefore attach weight both to good corporate governance on the part of companies, as well as to their environmental and social policies and practises. We also have a responsibility for ensuring that our investments do not contribute to companies' grossly unethical actions, omissions or products.*

*We have high ambitions for our future work in relation to the ethical guidelines for the Government Pension Fund – Global. In order to realise these ambitions, the Government has embarked on an evaluation of the ethical guidelines for the Pension Fund. Many aspects of the current ethical framework appear to work well. It is important for the evaluation process to build on well-functioning elements, whilst also identifying and implementing any necessary adjustments.*

*The Ministry of Finance has prepared, in order to ensure a constructive discussion and process that enables all stakeholders to be heard, a consultation paper that invites an open-ended and broad-based discussion, based on a thorough presentation of the work carried out thus far, together with international developments and external analyses. We hope that the consultation paper will lay the foundations for an open debate, generating a lot of feedback that the Ministry may draw on in its future work.*

## **1.1 Background, purpose and process**

Ethical guidelines for the Government Pension Fund – Global (the "GPF") were introduced in the autumn of 2004, in line with a proposal submitted by a Government-appointed committee chaired by Professor Hans Petter Graver. The Graver Committee submitted its recommendations in the NOU 2003: 22 Green Paper, *Management for the Future*. A debate concerning ethical challenges facing the Fund had already been ongoing for several years when the Committee was appointed.

Last year the Government announced, under reference to the Soria Moria Declaration, in the annual report to the Storting on the management of the Pension Fund (Report No. 24 (2006-

2007) to the Storting), that an evaluation of the ethical guidelines for the Fund would be carried out during the current term of the Storting. The Storting took note of this (Recommendation No. 228 (2006-2007) to the Storting).

The purpose of the evaluation process is threefold:

- Examine whether the guidelines have worked as intended
- Maintain the broad political support for the ethical guidelines
- Gather feedback that may help strengthening the Government Pension Fund – Global's profile as a responsible investor

In January 2008, the Ministry of Finance organised, in cooperation with Norges Bank and the Council on Ethics for the Government Pension Fund – Global, a large international conference in Oslo under the headline "Investing for the Future"<sup>1</sup>. The purpose of this conference was to bring together representatives from academic circles, financial institutions, NGOs, corporations and investors, to discuss the challenges associated with the integration of social and environmental concerns into investment decisions. At the same time, this conference marked the commencement of the evaluation process.

The Ministry has commissioned two external reports for use in the evaluation. One of these reports was prepared by Professor Simon Chesterman and The Albright Group, and concerns the work carried out by Norges Bank and the Council on Ethics pursuant to the guidelines. The second report was prepared by Professor Thore Johnsen and Professor Ole Gjøølberg. This report updates their earlier report titled "Evaluation of Ethical Management: Method, Performance and Costs" from 2003. The new report focuses, in particular, on the use of positive selection as an investment strategy. Both reports are available at the website of the Ministry of Finance<sup>2</sup>.

The Ministry of Finance will examine the reports and the statements submitted during the public hearing, and if necessary commission additional external reports during the course of autumn 2008. The findings from the evaluation will be presented to the Storting in the annual report to the Storting on the management of the Fund, in spring 2009.

The ethical guidelines for the GPFG cannot be evaluated in isolation from the general management of the Fund. The consultation paper therefore includes an introductory overview of the management of the Fund, in Sections 1.2 and 1.3 below. There follows, in Section 2 of the paper, a factual description of the current ethical guidelines, including the division of responsibilities and the measures used in the work relating to these. In Section 3 follows an assessment of the present system based on the experience gained during the period when the guidelines have been in effect, the abovementioned external reports and recent research within this area. This Section also includes a discussion of new issues resulting from changes to the investment strategy of the Fund, as well as an assessment of the use of positive selection in the investment strategy and the issue of allocating part of the Fund for special investment purposes. The ethical guidelines for the Government Pension Fund – Norway are not directly encompassed by the evaluation exercise, but are nevertheless briefly discussed in Sections 2 and 3 below.

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<sup>1</sup> <http://www.regjeringen.no/nb/dep/fin/Kampanjer/Investing-for-the-Future/Investing-for-the-Future.html?id=491345>

<sup>2</sup> <http://www.regjeringen.no/nb/dep/fin/tema/andre/Etiske-retningslinjer.html?id=446948>

Section 4 contains conclusions and a presentation of topics for discussion and issues on which the Ministry would like to receive feedback from the bodies included in the public hearing.

A thorough review of all aspects of the management of the Government Pension Fund, also in relation to ethics and active ownership, can be found, *inter alia*, in Report No. 16 (2007-2008) to the Storting.

## **1.2 On the Government Pension Fund**

*What is the Government Pension Fund?*

The Government Pension Fund is a superstructure encompassing two different fund structures; the Government Pension Fund – Global (the GPFG) and the Government Pension Fund – Norway (GPFN). The GPFG is managed by Norges Bank, and was previously named the Government Petroleum Fund (the "Petroleum Fund"). The GPFN is managed by Folketrygdfondet, a company by special statute. The Government Pension Fund does not have its own Executive Board or administrative staff.

The market value of the GPFG was NOK 2,018.6 billion as per yearend 2007. The market value of the GPFN as per the same date was NOK 117.3 billion.

*Where does the money allocated to the Government Pension Fund originate from?*

By far the main part of the capital accumulated in the GPFG originates in revenues from the petroleum sector. The nature of these revenues differs from that of other revenues on the part of the State, because they are partly offset by a reduction in the State's government petroleum wealth. It is therefore often said that the accumulation of capital in the GPFG represents a *reallocation* of oil and gas resources in the North Sea into financial wealth. The Government Pension Fund was established in 1990, but the first capital contribution to the Fund was not made until 1996.

The capital of the GPFN originates primarily from surpluses in the national insurance accounts from the introduction of the National Insurance Scheme in 1967 and until the late 1970s.

*What is the purpose of managing the petroleum revenues through a fund?*

The method for managing the petroleum wealth is motivated by a number of important considerations. Firstly, the accumulation of a fund ensures that future generations will also benefit from the value of the petroleum wealth being extracted. Since it is a finite resource that will one day be exhausted it would not be fair if only those few generations that happen to experience the extraction of oil and gas benefit from it. Furthermore, it is necessary for the State to save money in order to be able to fund the increased expenditure within, *inter alia*, social security and health care that will result from the growing proportion of older people in the population in future. The Government Pension Fund also serves other long-term interests. By facilitating the gradual phase-in of revenues from the petroleum sector, one ensures stable long-term development in the economy. The opposite – consuming all the wealth over a few generations – would have created major restructuring problems within the business sector, with a particular impact on the sector exposed to international competition. Further restructuring would have been necessary once the petroleum revenues started to decline. Such developments (so-called "Dutch Disease") would have been unwelcome.

### *The relationship between the Government Pension Fund and the Fiscal Budget*

The income of the GPFG can, somewhat simplified, be said to come from two sources: Firstly, revenues from the petroleum sector (including direct and indirect taxes, revenues from SDFI and dividends from StatoilHydro AS) that are allocated via the Fiscal Budget, and secondly the return on the investments made with the revenues from the Fund's first source of income. A third source of less importance comprises net revenues from the State's trading in StatoilHydro equities, cf. Section 3 of Act No. 123 of 21 December 2005 relating to the Government Pension Fund.

The assets of the Fund may only be allocated to transfers to the Fiscal Budget by resolution of the Storting. It is established practise to transfer as much as necessary to cover the non-oil budget deficit. The money not spent via the Fiscal Budget remains in the Fund, and contributes to fund accumulation. The so-called *fiscal rule* is a fiscal policy guideline that defines how large the transfers from the Fund to the Fiscal Budget should be over time. This rule provides guidance as to the size of the non-oil budget deficit. The fiscal rule implies that the annual transfers from the Fund shall over time represent 4 percent of the value of the Fund as per the beginning of the fiscal year. This corresponds to the estimated expected real return over time. This enables the wealth to be preserved, in order that it may also be of benefit to future generations.

The Fiscal Budget is the key policy tool as far as central government spending is concerned. The annual budget process involves the prioritisation of different objectives against each other, which is intended to ensure that central government spending is a result of the political prioritisations made and contributes to an effective use of resources.

### *How is the management of the Government Pension Fund organised?*

The Storting has, through the Act relating to the Government Pension Fund, charged the Ministry of Finance with the duty of managing the Fund. The Ministry decides on the general investment strategy of the Pension Fund, as well as its ethical guidelines, and follows up on operational management.

Operational management is the responsibility of Norges Bank and Folketrygdfondet, which are the asset managers of the GPFG and the GPFN, respectively.

More detailed rules on the management of the GPFG are laid down in Regulations No. 1725 of 22 December 2005 relating to the Management of the Government Pension Fund – Global. The Ministry of Finance has issued supplementary guidelines for the management of the Government Pension Fund – Global, and has entered into a management agreement governing the management duties with Norges Bank.

Folketrygdfondet is a company by special statute, governed by Act No. 44 of 29 June 2007. More detailed provisions on Folketrygdfondet's management of the GPFN are laid down in Regulations No. 1228 of 7 November 2007 relating to the Management of the Government Pension Fund – Norway. The Ministry of Finance has stipulated supplementary guidelines for the management of the GPFN, and has entered into a management agreement governing the management of the GPFN with Folketrygdfondet.

Both the GPFG and the GPFN are subject to ethical guidelines, as described in Section 2 below.

### **1.3 The role as investor – brief discussion on the management of the Fund**

The Government Pension Fund is one of the largest funds in the world, and its assets are growing rapidly. The Fund is large relative to the size of the Norwegian economy, and the return on the Fund will make considerable contributions to the funding of State expenditure in coming years. Focus on the management of the Fund has increased in line with the growth in its size. This underscores the importance of ensuring that the investment strategy of the Pension Fund and its ethical guidelines, have the firm backing of the Storting and the Norwegian people.

The Government has high ambitions for the management of the Government Pension Fund. The objective is for the Government Pension Fund to be the best managed fund in the world. This implies that one shall seek to adopt best practice within international asset management relating to the management of the Fund. At the same time, what constitutes a good investment strategy will depend on the characteristics of the Fund, the purpose of the investments, the owner's appetite for risk, and one's views as to how the financial markets work.

The fact that the management of the Government Pension Fund – Global is generally referred to in positive terms internationally reflects, *inter alia*, that the following main principles have been adopted:

- There is broad political support for the Fund to be managed with a view to achieving the maximum possible return, at a moderate level of risk.
- The Fund is a serious and financial investor holding small ownership stakes in virtually all listed companies of a certain size, all over the world.
- There is a clear division of responsibilities between political authorities and operational management bodies.
- The ethical guidelines are based on internationally recognised principles and standards.
- There is a high degree of transparency in relation to all key aspects of the management effort.

The Government Pension Fund is mainly invested in listed equities and investment-grade bonds. Equity investments represent ownership interests in the production of goods and services, and the value of such investments will therefore reflect, *inter alia*, expectations as to the future profits of businesses. Bond investments are investments in transferable loans that shall be redeemed by the issuer on a certain date together with a predetermined interest rate.

The Ministry of Finance has formulated a long-term investment strategy which implies that the portions to be invested in various asset classes and geographical regions can be determined on the basis of assessments of expected long-term returns and risks. The GPFG is in its entirety invested in securities abroad. The investment strategy of the Fund is reflected in a benchmark portfolio comprising broad equity and bond indices. The benchmark index for equities of the GPFG comprises almost 7,000 companies across 27 countries, whilst the benchmark index for bonds comprises more than 9,800 bonds across the currencies of 21 countries. Norges Bank's average ownership stake in these companies is about 0.8 pct. The tools used in the integration of ethical concerns are adapted to this strategy.

It follows from guidelines laid down by the Ministry of Finance that Norges Bank and Folketrygdfondet may also invest in other securities and instruments than those included in

the benchmark portfolio for the Fund. At the same time, there has been established an upper limit on the permitted tracking error in active management. By making investments in securities and instruments that fall outside the scope of the benchmark portfolio, and by changing the relative portions of securities in the portfolio from those implied by the composition of the benchmark portfolio, Norges Bank and Folketrygdfondet are exploiting their permitted tracking error for purposes of achieving an excess return. Calculations show that the return on, and volatility of, the GPFG are primarily determined by the composition of the benchmark portfolio.

There has been a gradual development in the investment strategy of the GPFG. The Fund has invested in equities since 1998. In 2000, emerging markets were included in the benchmark portfolio for equities, whilst in 2002 the benchmark portfolio for bonds was expanded through the inclusion of non-government-guaranteed bonds, i.e. corporate bonds and mortgage-backed bonds. In 2006, the investment universe was further expanded. It was decided, following the Storting's deliberation of Report No. 24 (2006-2007) to the Storting, to include the small-cap segment in the benchmark portfolio for equities, and to increase the equity portion of the benchmark portfolio from 40 pct. to 60 pct.

The Ministry presented, in Report No. 16 (2007-2008) to the Storting, plans for up to 5 pct. of the capital of the GPFG to be invested in real estate, as well as for the benchmark portfolio for equities to be expanded to include all emerging markets (as defined by the index provider, FTSE). At the same time, the Ministry proposed that the limit on ownership stakes as far as equity investments in the GPFG are concerned be increased from 5 to 10 pct. of the voting equities of listed companies, but without this affecting the role of the Fund as a financial investor. This has been unanimously supported by the Storting, cf. Recommendation No. 283 (2007-2008) to the Storting.

## **2. Description of the current ethical guidelines**

### ***2.1 Introduction and background –integration of ethical concerns into financial management: emerging trends***

Ethical guidelines for the management of capital have a history stretching all the way back to the 17<sup>th</sup> and 18<sup>th</sup> century<sup>3</sup>. The earliest examples are found amongst various religious denominations and groupings that did not, for reasons of faith, wish to invest in certain lines of business, like for example the slave trade and, later on, gambling, tobacco and alcohol. In the 1970s, ethical concerns also emerged as an investment consideration outside religious groupings, with, for example, investments in companies that profited from the Vietnam War or the apartheid regime in South Africa being deselected by certain funds and investors. There also evolved methods and principles for supporting socially and ethically motivated proposals in the shareholders' meetings of companies, as well as general guidelines for the integration of social and ethical concerns into commercial decisions. Eventually, there have also been established indices comprising companies that satisfy certain specific requirements stipulated by the index provider. There have recently been established global ethical indices, e.g. the

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<sup>3</sup> See the more detailed description in the Graver Report, p. 72 onwards

Dow Jones Sustainability Index and the FTSE4Good. There are also numerous funds that pursue specific investment strategies focused on various social or environmental criteria.

There has in recent years been an ever-increasing focus on issues relating to social responsibility and ethics in various parts of the business sector and other economic activities. The term Corporate Social Responsibility (CSR) is often used as a designation for companies' integration of social and environmental standards into their daily operations. The term SRI (Socially Responsible Investments) has been used, from the perspective of investors or managers, as a designation for investments that seek to achieve a financial return, whilst at the same time paying heed to ethical and environmental requirements. A term that is becoming more prevalent is *Responsible Investment* (RI). Responsible Investment relates to the incorporation of so-called *ESG* considerations in asset management. This refers to considerations involving *Environmental, Social and Governance* issues. These are sometimes referred to as *extra-financial* considerations. They are typically factors that may have a financial effect in the long run, whilst they cannot easily be identified through established methods of measurement, such as, for example, a company's accounts or financial reports.<sup>4</sup>

The increased focus on these issues has spawned various initiatives that operate, directly or indirectly, within areas of relevance to the integration of ESG considerations into financial management. Reference is made, *inter alia*, to initiatives under the auspices of the UN: the UNEP Finance Initiative (UNEPFI), the UN Global Compact and the Principles for Responsible Investments. Other initiatives, like for example the Global Reporting Initiative and the Enhanced Analytics Initiative, focus on issues within reporting and methods of analysis. Furthermore, a number of public and private institutional investors, like pension funds and insurance companies, both in Norway and abroad, have prepared ethical frameworks for their own investments and portfolios. ESG considerations are also discussed in cooperation fora for institutional investors, like the International Corporate Governance Network (ICGN) and the Council of Institutional Investors (CII). One may also mention the Equator Principles, as well as the Performance Standards of the World Bank's IFC (International Finance Corporation), which are applied in the context of project finance.

Terms like RI, ESG and SRI do not have a uniform and clearly defined meaning. This is a relatively new area, under continuous development. Different investors and investor circles may attribute different meanings to the terms, and make use of different techniques and mechanisms to promote the objectives they focus on<sup>5</sup>.

There are also differences between investors in terms of what objectives they focus on. Some investors may be motivated by normative considerations premised on religious or other ethical beliefs. Other investors will, in various ways, be focused on different methods for achieving financial returns and protecting their assets. On active ownership issues, like for example the right to trade freely in one's equities or to nominate company directors, the objective will often be to compensate for the asymmetric power structure characterising the relationship between the shareholders and the corporate management team. One may thereby strengthen the financial interests of the shareholders.

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<sup>4</sup> The report "Demystifying Responsible Investment Performance" (UNEPFI/Mercer 2007) defines Responsible Investment as follows: "The Integration of environmental, social and corporate governance considerations into investment management processes and ownership practices in the belief that these factors can have an impact on financial performance."

<sup>5</sup> These themes are addressed by, *inter alia*, Julie Hudson "The Social Responsibility of the Investment Profession", published by the Research Foundation of the CFA Institute, 2006



For large, well-diversified investors with a long investment horizon, the so-called Universal Owner Hypothesis may constitute an argument for promoting the integration of ESG considerations into asset management<sup>6</sup>. The hypothesis suggests that one portfolio company's externalisation of costs (which will, when taken in isolation, increase returns on that company) will, for a universal owner, have a negative effect on other companies in the portfolio, with the outcome being a negative impact on the overall return on the portfolio. A universal owner will therefore have a good reason for seeking to reduce the incidence of negative externalities (for example pollution and corruption) and to increase the incidence of positive externalities (for example those resulting from good corporate management). This may be illustrated by a simplistic example: an investor holds interests in five companies that each have a factory along the same river, and the uppermost factory pollutes the water to such an extent that it undermines the basis on which the earnings of the four other companies are premised. The uppermost factory can profit from not paying for a pollution abatement facility, i.e. from externalising the pollution cost, and will thereby generate a higher return, relatively speaking. The investor cannot see this in isolation, since the same omission represents a negative externality as far as the remaining factories are concerned, thereby undermining their earnings.

A universal owner will, in other words, be more exposed to overall developments in the markets, and it may be argued that factors like sustainability and the absence of systemic risks will be of greater importance to such an investor in the long run than to investors that hold interests in a limited number of companies and operate with a shorter time horizon<sup>7</sup>.

The integration of ESG considerations into financial management may also be founded on the belief that market functions will not always ensure a good balance between the various stakeholders in society. For example, the liability limitations implied in the limited liability company concept may, in view of the profit potential that may be opened up by the company conducting itself in a certain way, result in social or environmental considerations not necessarily being accorded sufficient weight<sup>8</sup>.

There has been much discussion of the degree to which someone who manages assets on behalf of others has the right to incorporate into his or her management efforts considerations that are not deemed to be strictly financial, as traditionally interpreted. As far as the GPF is concerned, both Norges Bank's ownership activities and the exclusion mechanism are regulated directly in the Regulations relating to the Management of the Government Pension Fund – Global<sup>9</sup>.

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<sup>6</sup> The Universal Owner Hypothesis was first presented by Robert Monks and Neil Minow, and subsequently refined by James Hawley and Andrew Williams.

<sup>7</sup> In the article "Putting the Universal Owner Hypothesis into action: Why large retirement funds should want to collectively increase overall market returns and what they can do about it", Raj Thamotheram and Helen Wildsmith state that there is, although the Universal Owner Hypothesis is new, an overlap with a general perception amongst pension fund managers that there is a correlation between the ability of a fund to meet its long-term pension liabilities and how favourably national and global economies and indices develop. The authors believe that pension funds will, irrespective of their views on the Universal Owner Hypothesis, have a legitimate interest in what effects negative externalities and other market imperfections will have on market returns as a whole.

<sup>8</sup> See for example the terms of reference stipulated by the Swedish Government for a committee appointed to examine the Swedish AP funds' guidelines on the environment and ethics, etc. (Committee Terms of Reference 2007:160)

<sup>9</sup> Jurisdictions based on a common law system, typically within the Anglo-American legal tradition, use the term Fiduciary duties to denote, *inter alia*, the manager's obligations as against its principal. It has been questioned

Commonly used techniques within socially responsible investments are:

- Exclusion of companies from a portfolio or an investment universe: This may take the form of whole industries being excluded because of a product, for example weapons, alcohol, tobacco (negative screening or filtration) or the exclusion of individual companies from the portfolio, for example because of the conduct of such companies.
- Ownership activities (engagement) involve using the rights accorded to the holders of the equities of a company to seek to influence the company to act in a manner that is deemed desirable by the investor. Active ownership will often be based on a dialogue between a company and its owners, and will in many cases be kept confidential. Hudson (2006) mentions activism/advocacy as a separate subgroup under measures premised on ownership. This is of particular relevance if an owner is, for some reason or another, prevented from engaging in a direct dialogue with the company, in which case that owner may attempt to influence the company in a more open and confrontational way.
- Positive selection means searching for investment objects that satisfy certain specific requirements or standards in relation to environmental or social factors.

## **2.2 The current ethical guidelines – GPF**

### **2.2.1 Introduction**

On 19 November 2004, the Ministry of Finance laid down ethical guidelines for the Government Pension Fund – Global. The guidelines were based on thorough work on the part of a public committee chaired by Professor Hans Petter Graver (NOU 2003: 22 Green Paper; Management for the Future). Proposed ethical guidelines were submitted to the Storting in the Revised National Budget 2004 (Report No. 2 (2003-2004) to the Storting). The proposal was unanimously approved by the Storting (Budget Recommendation No II (2003-2004) to the Storting).

The current guidelines replaced an earlier system under which companies could be excluded from the portfolio if the investment might be in conflict with Norway's obligations under international law. There was previously a designated Environment Fund, which was dissolved upon the introduction of the current ethical guidelines under reference, *inter alia*, to active ownership being considered a more suitable and comprehensive approach. (Issues relating to various forms of positive selection are discussed in more detail in Section 3.5.)

#### *Some important premises*

The Graver Report worked on the premise that the Fund is managed on behalf of others, both current and future generations of Norwegians. The term "overlapping consensus" was used to express the idea that the ethical guidelines had to be based on a set of stable principal normative features that reflected both the plurality of Norwegian society as well uncertainty

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whether the duty to act prudently and loyally in the interests of the principal, as subsumed under this concept, permits the manager to take ESG considerations into account in its management effort. This issue is examined in Freshfield Bruckhaus Deringer's paper from 2005 "A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment", published by the UNEP Financial Initiative (UNEPFI). The report concludes, in large part, that the incorporation of ESG consideration is compatible with the fiduciary duty of the manager.

as to what ethical positions future generations would adopt. This evaluation seeks to ensure continued broad support for the ethical guidelines.

The Graver Committee made a fundamental distinction between different types of ethical obligations based on the concepts of deontological ethics and consequentialist ethics<sup>10</sup>. A deontological perspective would imply that certain investments should be avoided under any circumstance. A consequentialist approach would require one to seek to influence developments in the desired direction, i.e. one would be obliged to choose the strategy that delivers the best outcome. In their current form, the guidelines reflect both these types of ethical perspectives, cf. the more detailed discussion of this below.

The Graver Committee also made it clear that the Fund is not a suitable vehicle for attending to all ethical obligations of the Norwegian people. The Committee pointed out that the Norwegian authorities have many other policy measures at their disposal, and that many of our obligations can obviously be better addressed through other measures. It was also pointed out that it would not be appropriate for the Fund to pursue a large number of different objectives. Ethical guidelines are effective if focused, and it is not possible to use the same measures to pursue different objectives that lead in different directions. The obligation to use the Fund as a policy measure is stronger where circumstances are particularly conducive to use of the Fund to meet ethical requirements. The Committee mentioned, as an example, situations in which concerns for ethics and sustainable development are aligned with the concern for long-term financial returns<sup>11</sup>.

The ethical guidelines focus on the conduct and circumstances of *companies*. This means that a company needs to be evaluated on the basis of its actions and omissions, as well as its products. An implication is, for example, that exclusion from the portfolio is not a measure that should be used on the basis of actions performed by the state in which the company is domiciled or operates.

In relation to the state of Burma, steps have been taken which will in certain cases also apply to companies that operate in the country or participate in weapons trading with Burma. See the more detailed discussion in Section 2.2.5 below.

#### *The ethical obligations of, and policy measures available to, the Fund*

The ethical guidelines for the Fund are premised on the Fund having two fundamental ethical obligations. Firstly, it has an ethical obligation to ensure that the owners of the Fund, i.e. current and future generations of Norwegians, achieve *favourable long-term returns*. The ethical guidelines are based on the assumption that favourable returns in the long run are dependent on sustainable development in economic, ecological and social terms. As a large long-term investor with broad exposure to world markets, the GPF will be exposed to market or systems failure as the result of unsustainable development. This is supported by, *inter alia*, the Universal Owner Hypothesis discussed above.

Secondly, the Fund is under an ethical obligation to avoid investments that entail *an unacceptable risk that the Fund contributes to certain specified gross or serious ethical violations*, including serious or systematic human rights violations, severe environmental damage or gross corruption.

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<sup>10</sup> The Graver Report, p. 13 and p. 48 onwards

<sup>11</sup> The Graver Report, p. 21 onwards and p. 53 onwards

The exclusion mechanism is based on a presumption to the effect the Fund contributes to actions taken by companies included in the portfolio; see, *inter alia*, the Graver Report, p. 13 and p. 51. Furthermore, the company's contribution to the grossly unethical situation would have to be evaluated, cf., *inter alia*, the Graver Report, p. 35.

The ethical guidelines define two measures aimed at meeting the ethical obligations of the Fund, cf. Section 6, Subsection 2, and Section 8, Subsection 1, of the Regulations relating to the Management of the Government Pension Fund – Global. The first of these is the *exercise of ownership rights*, i.e. using the rights of the Fund as a shareholder of companies to ensure that the fundamental rights of the owners are observed, and to encourage the company to be managed in a manner that is in conformity with the interests of the shareholders. Norges Bank is responsible for exercising the ownership rights of the Fund. The main objective of the ownership activities is to protect the long-term financial return on the Fund. The financial interests of the Fund shall, according to the ethical guidelines, be strengthened through use of the Fund's ownership interests to promote sustainable development as mentioned above.

The second measure is *exclusion of companies from the portfolio*. This is effected, firstly, through the negative screening of companies that manufacture certain specific types of weapons. Secondly, it is effected through the exclusion from the portfolio of companies in which the Fund would, through its investment, run an unacceptable risk of contributing to grossly unethical conduct. This type of exclusion relates to the behaviour of companies, not to their products. The decision to exclude a company from the investment universe is made by the Ministry of Finance, at the recommendation of the Council on Ethics for the Government Pension Fund – Global. So far, 27 companies have been excluded from the Funds' investment universe.

The ethical guidelines are, as mentioned above, based on different types of perspectives on ethical obligations. The exclusion mechanism is primarily motivated by a deontological approach. The primary objective is to avoid contributing to certain specified actions/omissions, or the production of certain specified products, and not to influence companies' conduct. The ownership activities serves a consequentialist purpose – by exercising the ownership interests, Norges Bank shall protect the long-term return on the Fund through, *inter alia*, promoting sustainable development. The different ethical motivations behind the two measures have an impact on how these are applied, and to what extent they can interact; see the more detailed discussion in Section 4.

The Fund's capital is invested in listed equities and bonds, cf. the more detailed discussion of the investment strategy in Section 1.3 above. The ethical guidelines pertain to the holding of both equities and corporate bonds. Negative screening and exclusion may be effected in respect of equity and bond investments. Bonds do not convey ownership rights, and can therefore not form the basis for ownership activities. However, to the extent that the Fund holds bonds in a company in which Norges Bank engages in ownership activities on the basis of shareholdings, such efforts may have indirect implications for the bond portfolio.

It has been proposed that one should allow investments in unlisted instruments within real estate. The ethical guidelines will, as a main rule, apply to such investments as well, but will have to be adapted to the special characteristics of this type of investments. Reference is made to the more detailed discussion in Section 3.6.

*Government bonds and bonds issued by international organisations* give rise to special considerations. It is pointed out in the Graver Report, on p. 68, that Norway maintains diplomatic relations with a country despite being in disagreement with its policies in relation to, for example, human rights, with the exception of states that are subjected to international sanction regimes. Regular foreign policy channels will offer much more important opportunities for exercising influence in this respect, and commercial and other contact will in many cases afford better opportunities for exercising influence than does isolation.

A procedure has been established to enable the Ministry of Finance to prevent Norges Bank from investing in government bonds issued by specific countries, if this reflects a broad-based political preference. See the discussion on p.62 of Report No. 24 (2006-2007) to the Storting and Section 3.2 of the supplementary guidelines for the management of the Government Pension Fund – Global. The Ministry is of the view that the threshold for excluding a country's government bonds from the GPFG shall be very high. The Ministry agrees with the Graver Committee that regular foreign policy channels constitute much more important policy measures for purposes of influencing the governments of other countries in the desired direction. Such decisions must therefore reflect broad-based political agreement in line with the principle of "overlapping consensus", to prevent any uncertainty to arise as to the purpose of the investments of the Fund. Consequently, decisions to bar investment in the government bonds of certain countries should primarily apply to countries that are subject to UN sanctions, or countries that are subject to other broad-based international measures that Norway has supported.

It has been decided, against this background, that the GPFG cannot invest in government bonds issued by the state of Burma, cf. the more detailed discussion on this in Section 2.2.5 below. At present, Norway has not supported any other sanctions or similar regimes of the same scope as the sanctions against Burma.

### **2.2.2 The ownership activities (Section 3 of the guidelines)**

The ownership activities in relation to the Government Pension Fund – Global are primarily based on the UN Global Compact, the OECD Principles of Corporate Governance and the OECD Guidelines for Multinational Enterprises.

Norges Bank has adopted, in line with the ethical guidelines for the Government Pension Fund – Global, its own guidelines for the exercise of ownership rights. The guidelines imply that a number of requirements are imposed in relation to the companies in which the Fund is invested, as far as responsible business conduct and transparency are concerned. Furthermore, the principles imply that there are requirements as to the companies' form and structure of governance, as well as to their long-term sustainability, inasmuch as the companies need to take into account effects of their own activities on the environment and on society in general. The Bank notes that this area may be evolving, and writes, *inter alia*, that the principles "... may be amended over time as a result of Norges Bank's exercise of ownership rights developing as the Bank gains more knowledge and experience in the area. In addition, the Bank's guidelines will have to reflect changes in national and international regulations and guidelines. There will, correspondingly, be changes in companies' management and control systems as market requirements, guidelines and principles evolve. Norges Bank's ownership activities will therefore be a process in continuous development."

Norges Bank has committed considerable resources to establishing robust and targeted ownership activities within NBIM (the Bank's investment management department). Ten person-years were devoted to the exercise of ownership rights as per yearend 2007, as compared to six person-years in 2006. The Bank's objective for the coming three-year period is to become acknowledged as one of the world's most prominent and professional active owners.

The Bank has given priority to certain selected areas of commitment where there is a close correlation between ethics and long-term financial returns. These areas of commitment are deemed to be of relevance to investors in general, and to the Fund's portfolio in particular. The areas of commitment are also well suited for dialogue with companies and regulatory bodies, which improves the prospects for achieving results in individual cases.

Key areas of commitment in the exercise of ownership rights are:

- good corporate management, with a main emphasis on owners' rights to nominate and appoint directors, to exercise their voting rights, to trade in their equities and to exercise influence over anti-takeover mechanisms, and to receive transparent and timely information;
- children's rights and health, including the battle against child labour, with a main emphasis on the value chains of multi-national companies; and
- corporate lobbying in relation to long-term environmental problems, including climate changes.

Norges Bank states, *inter alia*, the following, in NBIM's annual report for 2007, about the focus on combating child labour and long-term climate change<sup>12</sup>:

*"The themes have been chosen because they are well aligned with NBIM's long-term perspective as an investor. They concern themes that obviously are ethically and socially important in themselves, whilst being at the same time of key importance to the future functionality, legitimacy and profitability of global markets".*

Norges Bank has drawn up a document, titled NBIM Investor Expectations on Children's Rights, to make it clear to companies what expectations the Bank, as an investor, has in this area. The document is aimed, in particular, at companies that operate in areas or sectors where there is a high risk of violating children's rights. Norges Bank had as per yearend 2007 established or continued contact with about 60 companies on issues relating to social matters, with a focus on child labour and children's rights.

Norges Bank aims to get other professional investors to focus on child labour and children's rights as well. Norges Bank will therefore, *inter alia*, encourage other investors to make use of the abovementioned document in their dialogue with companies, through the UN Principles for Responsible Investment (UNPRI).

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<sup>12</sup> For a more detailed description of the areas of commitment, see Chapter 4 of Report No. 16 (2007-2008) to the Storting 4 and Norges Bank Investment Management's (NBIM's) annual report for 2007, in particular pp. 89 onwards.

It is in the interest of Norges Bank, as a long-term investor holding a global portfolio, to promote the introduction of legislation that can reduce the risk of serious negative economic implications of climate changes. Norges Bank therefore believes that it is important whether companies work with or against government authorities when it comes to legislation that may result in significant reductions in greenhouse gas emissions. The Bank promotes, amongst relevant companies in the portfolio, with a main emphasis on the energy sectors and on energy-intensive sectors, the formation of strategies that are compatible with sustainable economic and ecologic development. Last year, Norges Bank analysed more than 100 companies in the Fund's portfolio to seek to identify the companies that are the most active when it comes to contact with government authorities on climate issues. The Bank has during 2007 approached, and held meetings with, about 20 companies, all of which make significant contributions to the emission of greenhouse gases, and have been identified as key lobbyists.

Norges Bank's dialogue has primarily been conducted with directors and senior management. Norges Bank has emphasised, in these dialogues, technological development and adaptation to the emission and tax regimes, in addition to companies' positioning in their contact with government authorities (lobbying). Norges Bank has also maintained close contact with researchers and other experts within both climate policy and lobbying. Further to this, the Bank also signals to companies its interest, as an investor, in the timely introduction of effective legislation. The signals received by NBIM from the companies show that the message is being taken seriously, and several companies have initiated follow-up contact with the Bank. A number of the companies in Norges Bank's portfolio have changed their public stance on climate regulations in 2007, many have changed the manner in which they approach national governments, and one is also observing changes in how they facilitate new technology. Norges Bank believes that it is one of the contributors to this process (NBIM's annual report, p. 96).

Norges Bank takes part in various forms of collaboration and communication with other investors, e.g. in the International Corporate Governance Network (ICGN), a worldwide network for investors and service providers within active ownership and corporate governance. Norges Bank is also a signatory to, and contributed to the formulation of, the UN initiated Principles for Responsible Investment (PRI). The international initiative labelled EITI (Extractive Industries Transparency Initiative) aims to fight corruption and increase transparency in countries that are well endowed with natural resources. Norges Bank has endorsed the statement titled "Investors' Statement on Transparency in the Extractives Sector". The initiative argues that it is in portfolio companies' own interest to operate in a business climate characterised by openness, stability and respect for the law. Norges Bank has also joined the Carbon Disclosure Project, an independent, non-profit organisation that seeks to gather and publish information concerning businesses' greenhouse gas emissions, and other information relating to businesses' handling of greenhouse gas issues.

A more detailed account of Norges Bank's ownership activities can be found in Norges Bank Investment Management's annual report for 2007, which is available on the Norges Bank website.

### **2.2.3 The exclusion of companies (Section 4 of the guidelines)**

The Council on Ethics for the Government Pension Fund – Global renders recommendations on screening and exclusion, and the Ministry of Finance decides, on the basis of this, whether

a company shall be excluded from the Fund's investment universe. At present, 27 companies have been excluded from the Fund's investment universe<sup>13</sup>.

The threshold for excluding a company from the GPFG is high. The exclusion criteria specify that it shall be a matter of *grossly* unethical conduct. This applies to companies that manufacture inhumane types of weapons, as well as companies contribute to serious or systematic human rights violations, serious violations of individuals' rights in situations of war or conflict, severe environmental damage, gross corruption and other particularly serious violations of fundamental ethical norms.

The Council on Ethics deliberates matters of its own accord or at the behest of the Ministry of Finance. The Council on Ethics has five members and maintains its own eight-person secretariat. The secretariat conducts surveillance of companies and prepares matters for the Council.

*Negative screening:*

The Revised National Budget for 2004 lists what types of weapons the Fund shall not contribute to the production of. These include weapons that are prohibited pursuant to international law, as well as cluster munitions and nuclear arms. The Council on Ethics has formed agreements with two information providers that monitor, on an ongoing basis, whether companies in the Fund's benchmark portfolio produce such weapons. In addition, the Council carries out its own searches in open sources and in databases like Jane's Information Group (one of the world's largest information sources on defence materials). When the Council deems it likely that a company produces weapons that would merit screening, the company is approached and asked to comment on the Council's assessment. If the company confirms the information invoked by the Council, the Council will render an exclusion recommendation. Companies that do not reply when approached are recommended for exclusion if the documentation in the possession of the Council shows that there is a high probability that the company produces weapons that violate the screening criteria.

This procedure offers a reasonable degree of assurance that companies producing weapons that violate the screening criteria will be excluded from the Fund. Nevertheless, it cannot be guaranteed that all companies will at all times be correctly screened through the Council's monitoring system.

*Exclusion based on companies' conduct:*

Whilst screening relates to the products of companies, exclusion relates to the production methods and conduct of such companies. There exists no single overview of companies' contributions to human rights violations, environmental damage, corruption or other infringements of ethical norms. Nor do companies themselves disclose such information. The Council therefore conducts its own investigations to identify companies that may be in violation of norms.

The Council has an agreement with an information provider for the monitoring of all companies in the Fund's portfolio for purposes of uncovering possible violations of norms. The information provider conducts daily searches of, and looks systematically through, a number of information sources, and provides the Council with a monthly summary of cases

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<sup>13</sup> A list of excluded companies can be found on the Ministry of Finance's website: <http://www.regjeringen.no/nb/dep/fin/tema/andre/Etiske-retningslinjer/Selskaper-som-er-utelukket-fra-fondets-i.html?id=447122>



that may be of relevance under the Fund's ethical guidelines. Matters are also brought to the attention of the Council through requests from national and international voluntary organisations, and through research reports, media coverage or its own Internet searches. Nevertheless, it is unlikely that one will be able to identify all companies that contribute to serious violations of norms worldwide at all times.

When the Council has become aware that a specific company may become subject to exclusion, a more detailed investigation of such company is initiated. There is often a need for supplementary information beyond what can be found through publicly available sources. The secretariat of the Council on Ethics generates, and is responsible for quality assurance of, the information. Consultancy firms, research institutions and voluntary organisations are used in this work, and these are often based in the country where the company in question is accused of the violations of norms. The information gathering may involve fieldwork and assessments of companies' documentation. The Council attaches considerable weight to ensuring quality and confidentiality in this work.

A company that the Council on Ethics considers for exclusion will, in accordance with the guidelines, be requested to comment on the grounds on which the exclusion recommendation is based. The companies may also be invited to reply to specific questions. The Council on Ethics emphasises detailed description of the grounds underpinning the exclusion recommendation, and the provision of thorough documentation. Any allegations made are supported by specific source references, often from several sources. When approached, companies will also be informed of the ethical guidelines, and of the fact that the company in question is considered for exclusion pursuant to these. The Council and the secretariat of the Council have in several cases attended meetings with companies that have wished to provide additional information.

#### *Process and transparency:*

The process involved in recommending a company for exclusion consumes considerable time and resources. The continuous monitoring carried out by the Council on Ethics encompasses all companies in which the Fund is invested. In 2007, a preliminary review was conducted in respect of about 80 companies. Only a limited number of these cases will result in a recommendation to exclude a company. All exclusion recommendations of the Council on Ethics are made public. In cases where the Council on Ethics concludes that there is no basis for recommending the exclusion of a company, its assessments will normally not be made public. However, there have been cases in which the Ministry has specifically solicited the views of the Council on Ethics on a certain matter. In such cases the assessments of the Council on Ethics have been made public, cf. for example the Council on Ethics' letter concerning companies with operations in Burma, as mentioned in Section 2.2.5. If the Ministry decides to exclude a company, such decision, and the attendant recommendation from the Council on Ethics, will only be made public after Norges Bank has sold its securities in the company.

The Council on Ethics will routinely examine whether the grounds for excluding a company remain in place, and may on the basis of new information recommend to the Ministry of Finance that an exclusion decision be lifted.

#### *Financial implications of the exclusion of companies*

The exclusion of individual companies may result in a different composition of the portfolio than would otherwise have been held, and may thus also influence the expected return and

risk. Moreover, exclusion entails transaction costs associated with the sale of excluded investments and the making on new investments. Potential consequences for long-term returns and risks were discussed, *inter alia*, in Appendix 11 to the NOU 2003: 22 Green Paper (the Graver Report).

The Ministry will estimate, in connection with the evaluation of the ethical guidelines, financial implications of actual exclusions made thus far. Such computations will be published on the website for the public hearing, and analyses of the findings will be discussed together with the evaluation of the ethical guidelines in the report to the Storting next spring. However, the exclusions from the Government Pension Fund – Global have been in force for such a short period of time that it would be difficult to draw any general conclusions on the basis of such computations.

#### **2.2.4 Description of the relationship between the policy measures, including the relationship between Norges Bank and the Council on Ethics**

The policy measures – exercise of ownership rights and exclusion of companies – will in many cases have different areas of application. The rationale behind the active ownership effort is safeguarding the financial interests of the Fund, which are assumed to depend on sustainable development in economic, social and environmental terms. It is appropriate, based on this rationale, for ownership rights to be exercised with a view to influencing companies in the Fund's portfolio to adhere to principles of good corporate governance and to respect fundamental environmental and social norms. The exercise of ownership rights is relevant in relation to every company in the Fund's portfolio. The rationale behind the exclusion of a company is to prevent the Fund from contributing to what is deemed to be grossly unethical conduct. The assessment is centred on the risk of contributing to grossly unethical conduct, and has in principle no regard for the actual consequences of such exclusion. The exclusions are aimed at *grossly* unethical conduct. It follows from this that there should be a high threshold for applying this measure, and that the number of companies excluded will be fairly low relative to the total number of companies in the Fund's portfolio.

It follows from the report of the Graver Committee that the assessment as to whether the Fund runs an unacceptable risk of contributing to grossly unethical conduct will also depend on whether one exercises one's ownership rights to put an end to such conduct. If the Fund excludes a company, there will be no more scope for influencing it through the exercise of ownership rights. A possible consequence is that those harmed by the activities of the company continue to suffer poor conditions or, at worst, experience a further deterioration in conditions. These considerations suggest that companies should only be excluded as a matter of exception, and preferably after it has been examined whether active ownership may be a suitable tool.

The Ministry of Finance performs an independent assessment as to whether individual companies should be excluded. The Ministry's assessment is based on the recommendation of the Council on Ethics, but also needs to take into consideration the possibility that ownership activities may, in the relevant case, reduce the risk of contributing to grossly unethical conduct. The Ministry will therefore normally ask Norges Bank for an account of the Bank's active ownership plans in relation to the matter at hand. One alternative may be to postpone a final decision on the exclusion of a company until it has been established what results can be

achieved through ownership activities, if the scope for succeeding in such ownership activities is deemed to be sufficiently good that the risk of contributing to grossly unethical conduct is expected to be reduced to an acceptable level.<sup>14</sup>

The exercising of ownership rights to ensure that fundamental ethical norms are respected should normally form part of a chain of measures, in which the exclusion of a company is the last resort, cf. Report No. 24 (2006-2007) to the Storting. However, there will be cases in which the exercise of ownership rights is, for various reasons, not a suitable measure, or in which it must be concluded that the company does not wish any form of dialogue with, or influence from, investors. In such cases the Ministry of Finance may, at the recommendation of the Council on Ethics, exclude a company if it is involved in an activity that falls within the scope of the exclusion criteria set out in the guidelines. The final assessment as to whether a recommendation from the Council on Ethics for the exclusion of a company should be implemented, or whether one should pursue ownership activities, is made by the Ministry.

The Graver Committee pointed out, in its report, that the measures may to some extent overlap each other. The assessments of the Council on Ethics may, for example, be of use in Norges Bank's ownership activities. It will, in the same manner, be appropriate for the Council on Ethics to use Norges Bank's reporting from its ownership activities as a source of information in its activities. The system facilitates interaction between the measures, in the sense that companies may themselves wish to change their conduct if they know that there is a risk of becoming excluded from the Fund.

### **2.2.5 Issues relating to investments in Burma**

The decision to abolish the list of approved markets and currencies for the Government Pension Fund – Global was explained in Report No. 24 (2006-07) to the Storting; On the Management of the Government Pension Fund in 2006. Authority to approve what markets the Fund may invest in has now been delegated to Norges Bank, with the Bank emphasising financial considerations and applying the general requirements laid down by the Ministry as to valuation, performance measurement and the management and control of risk.

There has, at the same time, been introduced a procedure that enables the Ministry of Finance to prevent Norges Bank from investing in government bonds issued by specific countries if supported by a broad political consensus, cf. the discussion in Section 2.2.1 above. This represents a clear division of responsibilities between the Ministry and Norges Bank.

In the spring of 2007, the Ministry of Finance decided, against the background of measures adopted by the EU and other countries against Burma, to amend the guidelines for the investments of the Fund in such a way as to bar Norges Bank from investing the Pension Fund's capital in bonds issued by the state of Burma. This decision supplements the mechanism for the exclusion of equities and bonds issued by specific companies. In November 2007, Norway joined expanded international measures affecting, *inter alia*, certain types of investments in Burma. These include a prohibition against the funding of, or new acquisitions or expansions of, capital interests in listed Burmese state-owned enterprises. Furthermore, the measures include a prohibition against the funding of, or investments or participation in, listed Burmese enterprises that are engaged in the extraction of timber, metals, minerals and gemstones. The prohibitions affect in excess of Burmese 1,200

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<sup>14</sup> See Section 3.4 for a detailed assessment of the scope for interaction between the measures.

enterprises. The Government Pension Fund – Global does not have, nor shall it have in future, any holdings in any of these companies.

The Ministry of Finance requested, in view of the deteriorating situation in Burma in the autumn of 2007, the Council on Ethics and Norges Bank to place a special focus on companies engaged in activities there. The Ministry of Finance received a letter from the Council on Ethics on 11 October 2007<sup>15</sup>, in which the Council explains its assessment of the risk that the Fund may contribute to gross or systematic violations of human rights through investments in companies engaged in activities in Burma. The Council on Ethics has announced possible recommendations for the exclusion of companies that form contracts for the construction of major infrastructure projects in the country. There is every reason to believe that such construction projects will entail an unacceptable risk of future contributions to human rights violations. In 2007, Norges Bank contacted 10 companies in the portfolio of the Fund to query their activities in the country. These are companies that may run a risk of contributing to human rights violations or expose themselves to other types of risk. Norges Bank is aiming for a dialogue with these companies to ensure that it has the best available information on the situation.

The Government took this one step further in Report No. 16 (2007-200) to the Storting, inasmuch as the Fund shall also refrain from investing in companies that sell weapons and weapons technology to regimes that are included in the list of countries in whose government bonds the Government Pension Fund – Global is excluded from investing. This means that the Fund shall refrain from investing in companies that sell weapons to the Burmese regime. A preliminary review indicates that there are currently no such companies in the portfolio of the Fund. The Council on Ethics for the Fund will monitor the companies in the portfolio with a view to establishing whether the Fund may in future run the risk of holding such investments and, if applicable, render a recommendation to the Ministry of Finance for the exclusion of the relevant companies.

### **2.3 Current guidelines for the GPFN**

The Executive Board of Folketrygdfondet has laid down guidelines for the exercise of ownership rights on the part of the Government Pension Fund – Norway. The guidelines are based on the Norwegian Code of Practice for Corporate Governance and the UN Global Compact, as well as the OECD Principles of Corporate Governance and the OECD Guidelines for Multinational Enterprises.

The Government Pension Fund – Norway is primarily invested domestically. The benchmark index for the equity investments of the Fund comprises the main index of the Oslo Stock Exchange and the Nordic equity index VINX Benchmark. As per yearend 2007, the Fund held ownership stakes in a total of 48 companies listed on the Oslo Stock Exchange and 124 companies in Denmark, Finland and Sweden. Folketrygdfondet's average ownership stake in Norwegian companies is about 5 pct. Its average ownership stake in other Nordic companies is about 0.2 pct. In its management of the Government Pension Fund – Norway, Folketrygdfondet emphasises positive selection of the companies in which its capital is to be invested, and subsequently the exercise of ownership rights in the same companies. This has

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<sup>15</sup> <http://www.regjeringen.no/upload/FIN/etikk/Brev%20fra%20Etikkrådet.pdf>

to do with the fact that the investment universe is well-defined and comprised of a relatively limited number of companies.

The overarching objective of the ownership effort of Folketrygdfondet is to safeguard the financial interests of the Fund. To ensure that the Fund's portfolio will contribute, to the maximum possible extent, to promoting long-term growth, Folketrygdfondet has defined ethical principles for its investment activities, which form an integrated part of the active ownership guidelines.

In following up the ethical principles for the management of the Government Pension Fund - Norway, Folketrygdfondet attaches particular weight to examining whether the company does itself, or through entities controlled by it, produce weapons that violate fundamental humanitarian principles in their normal use. It also examines whether the company bases its business activities on actions or omissions that involve the violation of human rights, child labour, environmental damage, corruption and other violations of fundamental ethical norms.

In December 2007, the Executive Board of Folketrygdfondet adopted new ethical principles for the management of the Government Pension Fund – Norway, which are based on ethical principles that were stipulated in 2004. The guidelines are appended to this consultation paper.

The assessments made by Folketrygdfondet are based on information available in the public domain, and on information disclosed by the company itself. Through its ownership activities, Folketrygdfondet aims to increase the companies' awareness in relation to corporate governance, the environment and social considerations.

In order to safeguard shareholder value, Folketrygdfondet deems it important to follow up on the managerial salary policies of the companies. This involves, *inter alia*, evaluating whether managerial salary schemes are structured in such a manner as to actually contribute to more effective and performance-oriented corporate management. Folketrygdfondet is also sceptical about option schemes that are not performance-based, and what these imply in terms of value transfer from the shareholders to companies' management teams.

Folketrygdfondet carried out, during 2006, a survey in which the companies in the Fund's Norwegian portfolio were asked to address matters pertaining to the company's general principles and guidelines on ethical issues, its distribution of responsibility, its communication and organisation of its ethics effort, as well as senior management's attitudes concerning the environment, human rights, corruption and unethical conduct. The questionnaire was sent to a total of 41 companies, and Folketrygdfondet received responses from 32 of these. The findings are discussed in Folketrygdfondet's Ownership Report for 2007.

The survey and the assessments of Folketrygdfondet as to the ethical aspects of corporate management and practise give a generally favourable impression of the attention levels, standards and practises on the part of the companies that responded to the questionnaire. Folketrygdfondet will follow up on companies' further efforts and developments relating to the integration and handling of environmental and social matters, and will initiate additional discussions should the need arise. Folketrygdfondet will now continue to seek a dialogue with the companies that failed to respond to the questionnaire in 2006.

The guidelines for the two parts of the Government Pension Fund; the Government Pension Fund – Global and the Government Pension Fund – Norway, may in large part be said to be founded on a joint ethical platform. The measures for the integration of ethical concerns are, at the same time, somewhat different in view of the different sizes, different investment strategies and different investment universes of the Fund.

The Council on Ethics has no formal role as far as Folketrygdfondet is concerned. The Ministry of Finance has nevertheless concluded that a Nordic company held by both the Government Pension Fund – Norway and the Government Pension Fund – Global would be removed from the investment universes of both funds if the Ministry were to render a decision for the exclusion of such company.

The Ministry will examine, following the public hearing, whether there may be a need for further harmonisation of the ethical guidelines for the Government Pension Fund – Global and the Government Pension Fund – Norway.

### **3. The Ministry's assessments**

#### **3.1 Premises**

One of the main objectives of the evaluation process is to assess whether the ethical guidelines have worked as intended. To examine this, we need to refer to the obligations imposed on the Fund through the guidelines, see also the discussion in the introductory part of Section 2.2.

It is an ethical obligation to ensure a favourable return on the Fund over time. This requires the Fund to be managed professionally, with a healthy investment strategy and good risk management. Responsibility for ensuring this lies with the Ministry of Finance. The manager, Norges Bank, is responsible for practical implementation in this respect. The overarching objective of the Bank's ownership activities is precisely the safeguarding of the financial interests of the Funds.

The guidelines are based on the premise that good, long-term financial returns will depend on sustainable development in economic, environmental and social terms. This perspective shall be maintained through the active ownership effort, and will, *inter alia*, imply sharing responsibility for how the companies in which the Fund invests conduct themselves, including their degree of good corporate governance, what they produce and how they treat the environment and the people around them. See Section 3.3 for a more detailed assessment of how the ownership activities are deemed to meet this obligation.

There is also an ethical obligation to avoid investments that entail an unacceptable risk that the Fund will contribute to grossly unethical actions or omissions. By grossly unethical actions or omissions are meant the production of inhumane types of weapons, serious human rights violations, serious violations of individuals' rights in situations of war or conflict, severe environmental damage, gross corruption and other particularly serious violations of fundamental ethical norms.

The mechanism for the exclusion of companies is intended to fulfil the latter obligation. Section 3.2 contains a more detailed evaluation as to how the work of the Council on Ethics is deemed to meet said obligation.

Although the two obligations are based on different premises, and are in principle fulfilled through different mechanisms, there is also room for overlap. The potential for interaction between the exercise of ownership rights and the exclusion of companies in meeting the ethical obligations is discussed in more detail in Section 3.4.

The ethical guidelines have been in operation for close to three and a half years. This is, on the one hand, a relatively short period for purposes of examining whether the intent behind the guidelines has been served well. Ethical investments constitute, on the other hand, a field undergoing rapid development internationally. Evaluation at regular intervals is necessary to realise the ambition of being the best managed fund in the world – also within the area of Responsible Investment. There are, after such a short period of time, certain potential effects, from for example the ownership activities, which it will be difficult to measure under any circumstance. The same pertains to potential effects relating to sustainable development over time.

The Ministry is, despite certain limitations, of the view that one is in a position to analyse some development characteristics, and identify the potential for improvements in certain areas. This is discussed in more detail in Section 4 below.

### ***3.2 Assessment of efforts relating to the exclusion of companies from the portfolio pursuant to Section 4 of the guidelines***

*Attainment of objectives – have contributions to serious ethical violations been avoided thus far?*

The objective of the measures mentioned in Section 4 of the ethical guidelines is to prevent contributions to serious or systematic violations of ethical norms, as specified in more detail in Section 4 of the guidelines. This measure is, as discussed in Section 2.2, based on a deontological approach. The assessment as to the risk of contribution shall be forward looking.

The Ministry assumes, when it comes to the screening of companies on the basis of the weapons criterion, that the monitoring services used by the Council on Ethics are effective. It can be deemed likely that companies producing the relevant weapons or parts for such weapons are in fact excluded from the portfolio.

The Ministry is of the view that the companies excluded on the basis of their behaviour, are indeed covered by the exclusion criteria, i.e. that the risk of continued serious ethical violations has been and remains unacceptable. Reference is made to the thorough fact gathering, deliberations and recommendations of the Council on Ethics. However, one cannot operate on the assumption that there are no companies in the portfolio that are engaged in activities that somehow represent serious ethical violations. It will not be possible, with 7,000 companies in the portfolio, which also change their conduct over time, for the Council on Ethics to be aware of what all the companies are doing at any given time. The use of external reporters and tips from the general public will be of decisive importance in this regard.

### *The work of the Council on Ethics*

It is noted in the report from Professor Chesterman and The Albright Group that the work carried out by Norges Bank and the Council on Ethics has established Norway as a leading player when it comes to ethical issues in the global economy. Particular mention is made, in relation to the Council on Ethics, of the fact that the thorough recommendations are published. The report points out that criticism of the Council on Ethics tends to fall into three categories: Firstly, disagreement as to the merits of specific recommendations. Secondly, that the Council should have made more recommendations, on the basis of either the existing guidelines or an extension of these (the report does not take any view on potential extension of the guidelines to cover a larger number of issues). Thirdly, mention is made of an issue that has received less focus in the public debate; whether the Council on Ethics has used its resources in an efficient manner. The report formulates, on this basis, three main issues: whether the Council on Ethics has been fair, effective and efficient.

When discussing Fairness, the report focuses, in particular, on questions to do with the Council on Ethics' relationship with the companies in the portfolio. It is pointed out, *inter alia*, that the Council on Ethics needs to exercise particular caution because the actual decision to exclude a company is taken at government level and made public. The report then discusses three specific themes in respect of which there may be room for change: the Council on Ethics' method for selecting companies to investigate, the Council on Ethics' gathering of information from the companies, as well as the method by which an excluded company may seek to be readmitted into the portfolio. The report proposes, *inter alia*, that the Council on Ethics should publish how it prioritises its resources. It is further proposed that the Council should consider the establishment of a set of priorities, like for example specific sectors on which the Council will concentrate, which priorities are also made public.

The discussion of Effectiveness places a special emphasis on the degree to which the recommendations of the Council on Ethics may have an effect beyond the specific company in question. This is discussed in the sense of what demonstration effects may result from the actual publication of an exclusion ("naming and shaming"), but it is also questioned whether the Council on Ethics should prepare and publish summaries of its decisions in a manner that is suitable for providing guidance for companies on various aspects relating to compliance with the guidelines. It is stated in the report that there are indications that the recommendations of the Council on Ethics have an impact on the investments of other pension funds. The report presents, in relation to this issue, specific proposals concerning, *inter alia*, methods for the announcement of recommendations and the preparation and publication of digests.

The authors of the report believe, on the topic of Efficiency, that a greater effect can be achieved from the efforts of the Council on Ethics. An important part of the discussion on this issue concerns the scope for structuring the Council on Ethics' process towards a recommendation, if any, somewhat differently than at present. Reference is made to pages 30-32 of the report. The Ministry perceives the proposals to be intended both to increase the scope of the Council on Ethics for exercising influence within the resources at its disposal, and to make those prioritisations and efforts of the Council on Ethics that do not result in recommendations for the exclusion of companies more visible and accessible to the general public. The report specifically proposes steps that involve the introduction of a new method



for selection, as well as observation of companies and closer contact with Norges Bank in the follow-up of companies<sup>16</sup>.

The Ministry of Finance concludes, based on the report and its own observations, that the Council on Ethics has performed the duties defined by the ethical guidelines and its mandate in a proper manner. The Ministry notes that the Council on Ethics at present only has one policy measure at its disposal, i.e. to recommend the exclusion of companies. The Ministry is aware that the Council on Ethics in many cases uncovers information about companies that show those companies as having scope for improvement in relation to matters of relevance under the guidelines, although the conduct of the companies in question is not of such a nature as to qualify for exclusion. An objective of this evaluation may be to equip the Council on Ethics with some additional measures, thus enabling the information to be utilised also when there is no reason to recommend the exclusion of a particular company.

The report from The Albright Group and Professor Chesterman raises a number of interesting questions, and makes specific proposals that may further improve the work and systems of the Council on Ethics. The Ministry will pursue these issues in more detail in dialogue with the Council on Ethics. Reference is made to the discussion in Section 3.4 below when it comes to questions relating to cooperation and the exchange of information between the Council on Ethics and Norges Bank.

#### *The criteria for screening and exclusion based on companies' conduct*

There has, during the period when the guidelines have been in operation, been an ongoing public debate concerning the criteria for screening and exclusion. Different parties have highlighted various themes that certain groups or individuals believe should be included in the exclusion criteria.

An important perspective when discussing whether the criteria for exclusion from the portfolio should be expanded to include other considerations is the concept of "overlapping consensus". The ethical guidelines have to be based, as emphasised in the Graver Report, on a set of stable principal normative features. The Fund is managed on behalf of the Norwegian people, which represents various ethical perspectives, and there is uncertainty as to what ethical positions future generations will adopt. A purpose of the present evaluation is to ensure continued broad support for the ethical guidelines, which may be achieved through a broad-based consultative process and political deliberation in the Storting. Ethical consensus is of particular importance in relation to measures that are not based on concern for long-term financial returns. The Ministry would also like to point out that it is not necessarily the case that exclusion equals ethical behaviour on part of the investor. One will, when withdrawing from a company, lose the opportunity for exercising influence that is offered by ownership. The equities may be acquired by players who have very different notions as to what it means to be a good owner than those implied by our ethical guidelines (one cannot, however, disregard the possibility that the company may change its conduct in order to be readmitted into the portfolio). Another important consideration is that a system involving a large number of exclusions may potentially result in deteriorating financial returns. Consequently, there is a potential conflict between a large number of exclusions and the ethical obligation of the Fund to ensure favourable long-term financial returns.

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<sup>16</sup> See Section 111 of the report from Professor Chesterman and The Albright Group

It has in the public debate been proposed, *inter alia*, that one should exclude, through screening, investments in companies that produce, for example, tobacco, pornography and gambling. The Graver Committee also discussed other criteria for screening than screening for weapons that violate fundamental humanitarian principles in their normal use, but did not present any proposal to such effect. When the ethical guidelines were deliberated by the Storting, there was submitted a proposal to also exclude tobacco from the investments, but this did not achieve a majority backing.

The Ministry of Finance will await feedback from the bodies included in the public hearing before taking a view on whether other or more exclusion criteria should be introduced. The Ministry will, in its assessment of such feedback, continue to emphasise that one aims to have a regulatory framework that reflects, in the best possible manner, an overlapping consensus in the Norwegian people.

*Closed jurisdictions (so-called "tax havens")*

It has also been suggested that one might want to address investments in so-called "tax havens" explicitly in the ethical guidelines. Common characteristics of so-called tax havens are a low degree of transparency and disclosure, in combination with no taxes or very low tax rates. These states are also referred to, because of the secrecy they offer, as closed jurisdictions or "hideaway countries".

There is an emphasis on ensuring a high degree of risk diversification on the part of the GPFG. The Fund is therefore holding small ownership stakes in a large portion of the world's large listed companies, based on comprehensive and recognised international indices. Some of the companies that are included in these indices may have some form of affiliation with countries that have a regulatory framework permitting low or no tax, or providing a low degree of transparency and disclosure of ownership and transactions. Whether one is dealing with a so-called tax haven is determined by the laws and regulations of each individual country. The fight against so-called tax havens must therefore focus on the authorities in such countries.

The Ministry is of the view that it is important to distinguish between the Norwegian State's relations and dialogues with other states, on the one hand, and the management of the GPFG, on the other hand. The Fund invests in companies, and has relations with companies. The ethical guidelines for the GPFG concern companies, and their production and conduct. If a company operates its business in a grossly unethical manner, as defined by the ethical guidelines, for example through gross corruption, it may result in such company being excluded from the Fund.

Companies' openness is also one of Norges Bank's focal areas in its ownership activities. The exercise of ownership rights in this respect must be geared towards getting companies to be open about their activities to the extent permitted under national law. Where the regulatory framework of a specific state offers a low degree of transparency and disclosure, the Ministry is of the view that other measures aimed directly at such state may be more suitable for exercising influence. This is also being done in practise, through Norway's participation in the OECD, in the Financial Action Task Force (FATF) and in other international fora that deliberate these issues, as well as through negotiations pursued with such closed jurisdictions for agreements concerning the exchange of information in tax matters.

The effort to combat tax evasion and hideaway states can only succeed through international collaboration at government level. Nevertheless, it is worth examining whether companies' disclosure of income flows and tax issues may be promoted in a more systematic manner through ownership activities. The focus of investors and companies will normally be on achieving the best possible returns within the applicable laws and regulations. It is, at the same time, in the self-interest of a long-term and universal investor like the GPFG to ensure that laws and regulations promote "healthy growth", and not growth based on someone obtaining advantages through tax evasion or by failing to disclose their financial situation to the general public. See also the discussion of real estate investments in Section 3.6.

#### *Input from the general public concerning individual companies*

The Ministry has been made aware, through suggestions from voluntary organisations and others, of individual companies that operate their business in a manner that may imply that they meet the criteria for exclusion based on their behaviour. This has particularly been the case for a period following the publication by Norges Bank of its lists of shareholdings, in connection with the annual report of NBIM. It has often turned out, on closer examination, that companies in respect of which tips have been received have already caught the attention of the Council on Ethics, and that investigations are underway. Nevertheless, it is not possible for the Council on Ethics to be fully apprised of companies' production and conduct at all times, and the Ministry therefore believes that it is very valuable to receive suggestions from civil society as to companies that may pursue ethical practises that are in violation of the guidelines. It is, at the same time, somewhat challenging, at times, to make interested parties appreciate that such suggestions cannot, in themselves, form a sufficient basis for intervention against a company. The ethical guidelines require matters to be deliberated in a thorough manner, implying, *inter alia*, that the affected company must be given an opportunity to present its version on the matter. One may also want Norges Bank to engage in a dialogue with the company, which dialogue must in that case be given time to work. Such processes take time, but a thorough deliberation of matters may lend the process credibility and impact vis-à-vis other investors as well, thus enabling our ethical guidelines to be of relevance beyond their direct effect on the Fund's own investments.

#### *Some specific issues relating to the application of the exclusion mechanism*

The concept of contribution is of key importance when assessing whether to exclude a company. In practise, this implies that the assessment of potential exclusions is of a forward-looking nature, focused on the risk of contributing to future violations of the norms. The mechanism is not intended as a form of punishment for past actions. The assessment as to whether there is an unacceptable risk of contribution comprises, in large part, an assessment of the *probability* that there will be new violations of the norms and the *seriousness* of any new violations of the norms. It was questioned, at the international conference held in January 2008, whether one could at all be said to *contribute* to an unethical action if one was engaged in a constructive dialogue that might lead to positive changes on the part of the relevant company through the exercise of ownership rights<sup>17</sup>. The Ministry wishes to raise this same question in the public hearing. One may also ask whether the ability and willingness of the company to effect change should be accorded more weight for purposes of assessing how acceptable or unacceptable a risk should be deemed to be. At the same time, the willingness to engage in constructive dialogue and/or the ability to adopt specific measures will not always be enough to bring about sufficient changes. Nevertheless, it may be argued that it is, from an

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<sup>17</sup> See Appendix; Conference Report, p. 12

ethical perspective, less problematic to be invested in a company that demonstrates clear and confidence-inspiring efforts to remedy unethical conduct than a company that is unwilling to engage in a commitment-oriented dialogue with its owners. This is already reflected in the current system, but the Ministry is of the view that there may be room for clarifying the role of this consideration in the assessment of whether the exclusion criteria are met. The Ministry assumes that this could contribute to improving the interaction between the policy measures, cf. Section 3.4 below.

### **3.3 Assessment of the ownership activities pursuant to Section 3 of the guidelines**

#### *Attainment of objectives*

The main objective of Norges Bank's ownership activities is to protect the long-term financial return on the Fund, as premised on a sustainable development perspective. The start-up of ownership activities on the part of Norges Bank has been a pioneering effort, and the initial phase was characterised by a focus on establishing an organisation, acquiring the required knowledge and developing a strategy for the exercise of ownership rights. The Executive Board determined the NBIM active ownership strategy in 2006. It is obvious, given the short period of implementation, that it is too early to draw any definite conclusions concerning the degree to which the Norges Bank ownership activities have contributed to protecting the long-term return on the Fund. This is reinforced by the challenges involved in measuring the results of ownership activities, as also pointed out in the Graver Report. It may take time to achieve improvements, and companies may opt to present changes as the result of their own initiatives, rather than efforts on the part of their owners. Norges Bank's ownership activities must therefore, for the time being, be evaluated by reference to other parameters.

The Ministry deems it appropriate to start with the assessment themes addressed in the report from Professor Chesterman and The Albright Group. The report identifies four main themes: organizational structure and resources, Norges Bank's interpretation of the ethical guidelines, the effectiveness of the ownership activities, and reporting.

As far as organisation and resources are concerned, the report takes the view that the Corporate Governance group at Norges Bank appears to have appropriate access to resources and focus from management. It is noted that it is important to have good communication between the active ownership group and external managers, in order to communicate the Bank's guidelines to external managers, thus enabling them to report any problems on the part of specific companies when needed, whilst problems within the sphere of corporate governance may, at the same time, serve as a forewarning to managers of major problems in the operations of a company, and may thereby influence investment decisions.

The report discusses whether it has been appropriate for Norges Bank to make specific prioritisations, following which there is a discussion of the actual prioritisations made. The report's answer to the first question is yes. It is noted that the principles in the guidelines of the UN Global Compact and OECD Guidelines for Multinational Enterprises have a general wording that cannot be applied directly as a matter of course. This, in combination with holdings in approximately 7,000 companies makes it impossible to operate with guidelines for any conceivable situation that may arise on the part of the companies. It is stated in the report that the accumulation of expertise within specific areas sits well with the objective of

protecting the financial interests of the Funds. A focus on specific areas protects the return on the Fund, inasmuch as the resources allocated to the ownership activities are used effectively. Although Norges Bank has chosen areas of priority, one cannot, however, disregard the fact that other themes are of relevance to the ethical guidelines. The report mentions, as an example, challenges relating to supply chains. The Bank may address this as and when any issues arise, or it may choose to cooperate more closely with other investors on various themes in order to benefit from a division of responsibilities between investors.

The selected focal areas are, according to the report, well aligned with the overarching objectives of the ownership activities, as stipulated in the ethical guidelines. The report points out that a very thorough process led up to the selection of focal areas. However, it is suggested that the process was insular, in the sense that it was not subject to public debate or consultation prior to the adoption of the principles. The report notes that it is recommended, especially when it comes to social and environmental themes, to draw on a broader set of perspectives in order to make the prioritisations viable over time, and in the face of changing political views, changes in the management team of the Fund or a shift in the general public's focus towards new themes.

The report's main conclusion, following a more detailed review of Norges Bank's prioritisations, is that the implementation is "clear, professional and appropriate".

As far as the traditional share holder rights themes are concerned, it is stated in the report that the themes selected by Norges Bank are well understood and suited for protecting investors' access to information and serving as a counterweight to the companies' management teams.

The report notes, in respect of the focal areas of child labour and climate, that these are based on a connection between sustainable markets and long-term financial performance. Negative externalities from climate changes and social effects from child labour will in the long run be detrimental to the portfolio, given Norges Bank's role as a universal investor with a long time horizon. The report points out that the current evaluation process offers a good opportunity for debating and entrenching these perspectives in the general Norwegian public, cf. what was said about the selection process above.

Norges Bank's effort aimed at the protection of children's rights is, according to the report, a path breaking one. It is noted that formulating and publishing one's expectations in a designated document<sup>18</sup> adds weight to one's position when in dialogue with the companies, as does the fact that the effort has been pursued in cooperation with other investors and nongovernmental organisations. As far as the focal area of environment and lobbying is concerned, the report finds that the strategy pursued by the Bank is somewhat narrow. It is stated that it would be advantageous to expand the strategy to include measures aimed at influencing the companies to increase their levels of disclosure when it comes to impacts and risks resulting from climate changes. Furthermore, the Bank may direct ownership activities at the companies' handling of regulatory and physical risk as the result of the climate changes, as well as involvement in investor consortias on these themes.

The report notes, as far as *effectiveness from the ownership activities* are concerned, that a number of attributes need to be in place in order to succeed in the exercise of ownership rights. It is stated that active ownership can only be said to be successful when realities on the

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<sup>18</sup> NBIM Investor Expectations on Children's Rights

ground change, not only corporate policy. Norges Bank should therefore seek to obtain confirmation that reported measures are actually implemented. It is pointed out that verification from third parties would be of considerable value, particularly in relation to child labour.

Furthermore, it is noted that Norges Bank needs to develop measures to deal with situations in which active ownership processes do not succeed. Violations will in some cases be of such a nature that they should lead to divestment. At present, Norges Bank has no clear system for concluding when an engagement process has failed, or for determining the consequences of that. The report takes the view that there should, for each active ownership process, be prepared a timetable as a basis for measuring progress. The Bank's Corporate Governance Group should also be able to make recommendations concerning portfolio changes to those responsible for investments, based on the outcomes of engagement processes. Incentive structures that prevent portfolio changes as a result of considerations related to governance concerns should be modified. The Bank has commented on the relationship with external managers in its letter of 6 June 2008, which is appended to the consultation paper.

The report notes that Norges Bank has thus far chosen, to a large extent, to act on its own when engaging in a dialogue with companies. The report takes the view that the effect of the ownership activities can be increased if Norges Bank teams up, to a larger extent, with other investors when it comes to themes that both fall within and outside the scope of their own areas of priority.

When it comes to Norges Bank's reporting on its ownership activities, the report notes that the annual report for 2007 marks a major step forward in terms of Norges Bank's openness and communication with the general public, other shareholders and investors, as well as the companies. The report recommends that reporting continues at this level to expand Norges Bank's influence on markets and market players in a direction that is aligned with the interests of Norges Bank.

The Ministry is of the view, based on the report and its own observations, that Norges Bank has done a good job in terms of initiating and implementing ownership activities that serve the overarching purpose of generating long-term financial returns, based on the premise of sustainable development in the social, ecological and economic sense. Norges Bank has developed, over a short period of time, a professional organisation with clear prioritisations. The Ministry will consider the observations made in the report, as outlined above, in more detail during the current process. The Ministry notes, as a general observation, that ownership activities can be expected to have the most impact if a number of investors or players act in concert. The Ministry believes, against this background, that it is important, in terms of the scope of Norges Bank for influencing markets and market players, that the measures and conduct of the Bank are perceived, by other investors, as being consistent with the Bank's role as a financial investor. Reference is made to Section 3.4 below as far as cooperation and communication with the Council on Ethics is concerned.

### ***3.4 Interaction between the measures***

There will, as described in Section 2.2 of this paper, be some room for interaction between active ownership and the exclusion of companies. It is important to facilitate, in the best possible manner, such interaction in cases where it is appropriate and where it is likely that

one can thus achieve better results than if the measures were applied separately. One may, for example, envisage a system involving the differentiated use of policy measures, under which the exercise of ownership rights is attempted, to the extent possible, to begin with, whilst the exclusion of a company is a last resort.

There are several indications that the current structure does not facilitate such interaction to a sufficient degree.

Responsibility for these two measures lies with different organisations, which influences the scope for information flows and communication, etc. Furthermore, the two organisations use, based on the mandates given to them, rather dissimilar approaches and working methods, which may make it difficult to achieve effective interaction between the measures.

It is noted, in the report from Professor Chesterman and The Albright Group, that there have thus far been few cases in which Norges Bank and the Council on Ethics have worked on the same cases or companies, although this must be expected to change. The Ministry holds a similar view, and refers, *inter alia*, to the practise introduced by the Ministry for normally forwarding recommendations for the exclusion of companies to the Bank for purposes of examining whether active ownership work may be a suitable approach.

A challenge posed by the present approach is that the Council on Ethics may be investigating companies in respect of which there has, for various reasons, been no opportunity for trying out active ownership, although this may be assumed to be appropriate. Neither does the Ministry's procedure for gathering advice from Norges Bank, in cases where the Council on Ethics has recommended the exclusion of a company, compensate fully for the said deficiency. It is likely that a more effective working method in certain cases would be to pursue active ownership efforts before embarking, if at all, on any procedure to consider whether to recommend the exclusion of a company. This would also pave the way, to a greater extent, for structured and credible communication with relevant companies.

There is a risk, since exclusion gets more public attention than active ownership, that exclusion, as a mechanism, is accorded more independent weight than is appropriate based on a reasonable interpretation of the intent behind the ethical guidelines.

It seems evident, at the same time, that the *threat* of exclusion may have an important role to play in catching the attention of a company, and contribute to bringing about positive changes on the part of such company. The current organisation of the system does not facilitate, to any great extent, such an effect from the exclusion mechanism. This is, *inter alia*, because Norges Bank and the Council on Ethics coordinate their contact with companies to only a rather limited extent. Neither do the mandates of the Bank and the Council encourage a particularly high degree of coordination of dialogues/contacts.

One may envisage various measures to optimise interaction between the measures. The report from Professor Chesterman and The Albright Group identifies, *inter alia*, the following issues and possibilities:

- The Ministry of Finance should continue to request an assessment from Norges Bank as to the scope for succeeding through active ownership work in cases where the Ministry has been advised by the Council on Ethics to exclude a company. One will thereby continue to draw on the overall expertise possessed by the Bank and the Council.

- The Council and the Bank should, in view of potential disagreements, seek to clarify factual and other considerations at their level, where the main expertise is located, i.e. *before* presenting the matter to the Ministry.
- One should facilitate a higher degree of information exchange between the Council on Ethics and Norges Bank, through for example regular meetings to discuss individual matters and how best to resolve these. At present, the Council on Ethics provides Norges Bank with a copy of its monthly overviews of companies that may be at risk of exclusion. The Council on Ethics has also disclosed information to Norges Bank in cases where the Council believes that ownership activities may be a more suitable measure than exclusion. Norges Bank should, to a higher degree, disclose information to the Council on Ethics that may be of use in the Council's work.
- It is important to acknowledge that, although the two bodies have different mandates, the roles played by them form part of a superstructure to do with being an owner in companies in which the Fund is invested. The Council and the Bank should, in their contact with companies, be perceived as parts of a whole. This is best achieved through coordination and communication with the other body forming an integral part of the working processes and procedures of both bodies.

The report from Professor Chesterman and The Albright Group proposes several specific measures, including the establishment of an *observation list* of companies that give cause for concern, and that could be discussed between the Council on Ethics and Norges Bank. There should be held quarterly meetings between the Council and the Bank to discuss individual cases and exchange information. Before the Council on Ethics renders a recommendation for the exclusion of a company in respect of which the Bank has initiated a dialogue or plans to do so, the Bank and the Council should seek to reach agreement on certain actions that the company might implement to avoid exclusion. The following are also proposed in the report:

- The Council on Ethics and Norges Bank should reach agreement on a process to verify whether positive changes reported by a company actually have been, or are, taking place. It will in many cases be necessary to commission independent third-party investigations for purposes of such verification. It is of particular importance to arrange for unscheduled visits to working premises, etc. One cannot rely on information from the company or its consultants only.
- Ethical guideline 4.5 should be amended such as to specifically allow for a dialogue between the Council on Ethics and a company beyond the forwarding of a draft exclusion recommendation.
- If excluded, a company should at the same time be encouraged to change its conduct such as to gain re-admittance to the investment universe. Norges Bank and the Council on Ethics must, in that context, share all relevant information concerning the conduct of the company after exclusion has taken place.

The Ministry will examine these proposals in the continued evaluation process, and discuss, in consultation with the Council on Ethics and Norges Bank, the need and scope for better facilitation of cooperation, as well as any adjustments to existing mandates.



### **3.5 Assessment of positive selection as a measure in fund management**

Positive selection is not an unambiguous term, but normally indicates that an investor searches for investment opportunities on the basis of ethical criteria. This may be effected through, for example, selecting a specific share of the most ethical companies within an industry, or by overweighting investments in industries that are aligned with the values of the investor.

Positive selection of companies as part of the investment decision was not recommended as a tool for the Fund when the Graver Committee submitted its proposal for the current ethical guidelines. The Graver Committee emphasised that the number of companies in which the Fund could have invested would have been significantly reduced. This might have impaired the ability of the Fund to spread risk. The Fund's ownership stakes in, and lending to, each company would have had to be expanded, whilst the scope for purchasing and selling freely would at the same time have been curtailed. The Committee deemed active ownership to be a better tool than positive selection for achieving positive changes within various areas. These assessments on the part of the Committee are premised on the special characteristics of the GPF, including the size and long-term investment profile of the Fund.

The Ministry of Finance has commissioned, in connection with this public hearing, an updating of an earlier study<sup>19</sup> concerning the financial implications of positive selection. The updated analysis has been performed by Professors Thore Johnsen and Ole Gjølberg. The main findings from this analysis, which is appended to the consultation paper, will be explained in the following.

The analysis discusses, by way of introduction, some key principles relating to various selection criteria, including negative and positive selection. It is argued that negative selection is much clearer and more well-defined than positive selection, and that the latter allows room for a significant element of discretion and arbitrariness. A strategy with an element of positive selection will, by way of example, be investments in so-called "best-in-class" companies or industries. A different strategy, labelled "pioneer screening", involves investing in companies within environmental technology, renewable energy and the like. The authors of the analysis point out that different forms of positive selection will tend to result in significant curtailment of the investment universe, with the investments having to be focused in large-cap companies. This will increase the risk associated with the Fund, as demonstrated by the subsequent empirical analysis. Moreover, such selection reduces the scope for the active exercise of ownership rights. The analysis notes that one runs a risk of leaving the companies with a potential for improvement to other owners – which may not necessarily be equally active when it comes to ethical issues.

The main part of the analysis examines recent empirical literature on the returns on various SRI funds, as compared to those on conventional funds. The research findings are compared to Professors Johnsen and Gjølberg's own analyses of SRI funds and indices over the period 2004 -2007. In the summary of the analysis, it is stated, *inter alia*, that

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<sup>19</sup> The earlier study was prepared by Thore Johnsen and Ole Gjølberg in connection with the work of the Graver Committee, and forms Appendix 11 to the report from the Graver Committee (NOU 2003: 22 Green Paper).

*”SRI funds and indices have throughout the period of economic expansion after 2003 registered a risk-adjusted return that is clearly inferior to that on conventional funds. The data show that this has to do with risk in particular, as a number of the SRI funds and indices have featured significantly higher risk than have conventional funds and indices. This is because the screening, and especially the more active and comprehensive positive screening, narrows the range of available investments in such a way that one is left with a heavy bias towards large-cap companies. In other words, the screening implies that the portfolio composition is biased, thus increasing unsystematic risk”.*

The authors recommend, based on the analysis, that the Government Pension Fund – Global keep to its asset management strategy of negative selection in combination with the exercise of ownership rights. They furthermore recommend that so-called ”pioneering” strategies be motivated by other considerations than those involved in managing a large pension fund. Such strategies should not be incorporated into the management of the GPFG.

The Ministry will, based on the said analysis, as well as feedback from the bodies included in the hearing, undertake a detailed examination of the issue of using positive selection for all, or parts, of the Fund. See also the discussion in Section 4.

The Ministry announced, in Report No. 16 (2007-2008) to the Storting, that financial and ethical effects of earmarking a small part of the Fund as a designated fund with a special focus on environmental investments will be specifically examined in the context of this evaluation. There has been much public interest in the scope for managing parts of the Fund in a manner different from the main part of the portfolio. There is also an international focus on the large government funds (Sovereign Wealth Funds, ”SWF”), and the role these play in the economy. The President of the World Bank, Robert Zoellick, has voiced support for measures to facilitate increased investments from, *inter alia*, government-held funds in Africa<sup>20</sup>. The IFC, which is an organisation within the World Bank system, has for several years been active within the funding of projects in Sub-Saharan Africa, and is in the process of setting up new funds to finance, *inter alia*, infrastructure projects. One of the measures pursued by the IFC is an investment platform that would also enable other investors to draw on the access, knowledge and capital of the IFC. It also allows for cooperation in the form of joint ventures between the IFC and states or government funds.

The Ministry will consider, in more detail, the scope for earmarking a small part of the Fund for specific investment purposes, within for example environmental technology or in developing countries. It may also be appropriate, in that context, to take a closer look at what other international institutional managers have done in this area.

There will, in line with the general strategy for the Fund, be a requirement for financial returns on such investments as well. The use of central government funds for other purposes than achieving financial returns will require, in the regular manner, appropriations via the Fiscal Budget, cf. the discussion of the Fund's relationship to Fiscal Budgets in Section 1.2 above.

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<sup>20</sup> Robert B. Zoellick: ”A challenge of Economic Statecraft”, 2 April 2008, published at: <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:21711307~pagePK:34370~piPK:42770~theSitePK:4607,00.html>

This issue will require thorough examination with respect to the potential amount, the investment purpose, as well as where asset management is to be effected.

The Ministry of Finance will consider various alternatives in view of the consultative submissions and any external studies. The Ministry will subsequently present the findings from the assessments when the evaluation is presented to the Storting in spring 2009.

### **3.6 Ethical considerations in relation to changes to the investment strategy**

The Ministry proposed, in Report No. 16 (2007-2008) to the Storting, changes to the investment strategy of the Fund. The plan is to invest up to 5 pct. of the capital of the GPFG in real estate, as well as to expand the benchmark portfolio for equities to include all emerging markets (as defined by the index provider FTSE at any given time). This has been unanimously supported by the Storting, cf. Recommendation No. 283 (2007-2008) to the Storting.

#### *Real estate*

The ethical guidelines for the Fund will, generally speaking, apply to investments in new asset classes like real estate as well. Real estate investments differ in several ways from the investments currently included in the portfolio. Real estate investments will primarily be effected through unlisted real estate funds and companies, and the GPFG's ownership stakes in the relevant funds and companies will often be high. Unlisted investments will normally involve high transaction costs and be illiquid, which may result in it taking a long time to divest holdings without materially affecting prices. This suggests that one should, as far as investments in unlisted real estate are concerned, place more of an emphasis on using the size of the Fund to impose requirements on the investments prior to making the investment decisions.

The Ministry has pointed out, in Report No. 16 (2007-2008) to the Storting, that the design and operation of buildings has a major impact on the environment. It is also noted that Norges Bank may have more influence on the requirements imposed on the underlying assets in the real estate portfolio than in the equity and fixed-income portfolios, due to larger ownership stakes. This suggests that the real estate management effort should be subject to special environmental considerations. This will particularly be the case within the areas of energy efficiency, water consumption and waste handling. It has been demonstrated that investments that contribute to reducing the environmental impact of buildings, by, *inter alia*, reducing waste as well as energy and water consumption, can increase financial returns by reducing operational costs and increasing rent income.

Although there has been much focus on so-called "green" real estate management internationally, real estate funds and companies that provide such management still represent a very small proportion of the market. The perspective is that the GPFG should adhere to, and contribute to the development of, best practise in the integration of environmental concerns into the management of real estate. The Ministry's investment mandate to Norges Bank when it comes to real estate investments will include a requirement that Norges Bank shall participate actively in the international effort to promote special environmental considerations. There will also be a requirement that it shall follow from Norges Bank's

internal guidelines for the management effort how environmental considerations are integrated into the investment process.

The Fund's investment universe for equity and bond investments is defined by what market places the equities are traded on, and what currency the bonds are denominated in. The investment universe is limited to regulated and recognised market places, listing on which is conditional upon, *inter alia*, minimum requirements as to transparency and reporting having been met. Market places cannot be used as a criterion for defining the scope for unlisted real estate investments. Instead, the investment universe for unlisted funds and companies will be defined on the basis of where these are established. Unlisted real estate funds and companies in which the Government Pension Fund is invested shall be established in countries that are either OECD countries, or with which Norway has formed tax treaties or other agreements that provide sufficient disclosure, or with which Norway has formed a special Tax Information Exchange Agreement ("TIEA"), based on the OECD model. In addition, the country shall not be listed as an "uncooperative jurisdiction" by the OECD. The Ministry stated, in Report 16 (2007-200) to the Storting, that this restriction on real estate investments may serve to highlight Norway's attitude in the impending negotiations concerning TIEAs with new jurisdictions.

#### *Expansion of the investment portfolio to include all emerging markets*

Investment in more emerging markets may involve issues to do with transparency and access to information about the companies, as well as the scope for monitoring the portfolio and verifying information. The Council on Ethics has, in a letter of 7 February 2008 to the Ministry of Finance, noted, *inter alia*, that inferior information disclosure may be remedied by the Council on Ethics making more use of consultants with a regional affiliation, and also more external examiners when investigating specific cases. The Ministry assumes that the expansion of the portfolio to include more emerging markets may result in more questions and suggestions relating to company conduct and violation of the norms. The Ministry operates on the assumption that the current ethical guidelines are as effective a tool in this context as it is in relation to companies in developed markets, although one must expect more resource use and higher costs associated with information gathering and the verification of information.

## **4. Conclusions and issues for examination**

### ***4.1 Continuation of important elements of the current system***

The ethical guidelines for the Government Pension Fund - Global have been in operation for just over three and a half years. As short a time span as this does not enable unequivocal conclusions to be drawn. Nevertheless, the Ministry finds clear indications that it can already now be said that the ethical guidelines have, generally speaking, worked well. However, the assumption of social and environmental responsibility on the part of a financial investor still needs to be evolved over time. Thus far, the framework for such responsibility is self-imposed, and in large part reflected in non-binding international regulatory frameworks. The Government Pension Fund - Global has been at the forefront in the introduction of ethical rules that govern its entire financial wealth, and not only parts of it. The Fund is also a leading player when it comes to openness in its asset management and its implementation of the ethical guidelines. By way of example, all exclusions of companies and the relevant

recommendations from the Council on Ethics are published, and Norges Bank has recently disclosed information as to how it has cast its votes, down to the level of individual cases<sup>21</sup>.

There have, during the brief period of operation of the guidelines, been established two fully operational organisations – the Council on Ethics for the Government Pension Fund - Global and a designated active ownership group within Norges Bank Investment Management – which are well underway with their work, and which have delivered a number of visible results.

The Ministry notes, furthermore, that the Government Pension Fund - Global enjoys a generally good reputation, and that there is considerable interest in the ethical guidelines from many parties, domestically and abroad. We are aware that other international investors pay attention to our decisions in implementing the ethical guidelines. The summary in the report from Professor Chesterman and The Albright Group states, *inter alia*, that:

*“Our review concludes that the general framework established by the Guidelines remains sensible and workable. The scope of the Guidelines remains broad enough and flexible enough to allow for Norway to incorporate its values into investment decisions. The Guidelines have been implemented in a professional and conscientious manner by both NBIM and the Council. Implementation has proceeded in a step-by-step manner that is appropriate for such a novel structure”.*

The ethical guidelines are tailored to the size, structure and investment strategy of the Fund. The main purpose of the Government Pension Fund is to work as an instrument for government savings on behalf of the Norwegian people and future generations of Norwegians, to meet future needs and sustain long-term perspectives as mentioned in Section 1.3 above. There is broad political agreement that the Fund shall be managed with a view to achieving the maximum possible return, given moderate risk. The Ministry would like to point out, in this context, that it is important, as a matter of principle, to distinguish between issues to do with the ethical *management* of the financial wealth being accumulated, and issues that are in actual fact to do with the *spending* of petroleum revenues. The division of functions between the Fiscal Budget and the management of the Government Pension Fund suggests that the Government Pension Fund should not be used for funding objectives that are not accorded priority in the Fiscal Budget. The Ministry holds the view that this must remain a basic premise.

The Ministry believes, furthermore, that there is reason to retain the basic objectives of the ethical guidelines; the ethical obligation to ensure that the owners of the Fund achieve a favourable long-term return, as well as avoiding contributions to gross violations of ethical norms. The Ministry will proceed on the assumption that there is a relationship between favourable returns in the long run and sustainable development in the social, economic and ecological sense.

It is, correspondingly, important to keep in mind that the Government Pension Fund is not a suitable vehicle for attending to all of our ethical obligations as a state. The State has many other political and financial policy measures at its disposal, which measures will in many cases be more suitable for attending to such obligations than would imposing restrictions on the investment strategy of the Fund. The Fund has the most scope for success, in the sense of

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<sup>21</sup> In 2007, Norges Bank cast votes in a total of 38,862 cases, covering 4,202 shareholders' meetings, corresponding to 89 pct. of the meetings held with companies included in the Fund's portfolio.

exerting a positive influence on individual companies, industries, regulations and other investors, if the focal areas and tools are in conformity with the role of the Fund – that of a financial investor. It must be taken into consideration, in view of this, that it is not the purpose of the Fund to serve as an international aid policy or foreign policy instrument.

It may also be noted, in this context, that Norway has to a large extent avoided the negative attention received by other large government funds through the so-called Sovereign Wealth Funds debate. The Ministry assumes that an important contributory factor in this regard is the clear division of responsibilities between the formal owner of the Fund (the Ministry of Finance) and the operational manager (Norges Bank), with the investments serving a well-defined financial objective and the portfolio being very comprehensively diversified and financially motivated (not strategic ownership).

The Ministry of Finance is of the view that one should, in order to preserve ethical guidelines that appear to be working well in themselves and within the general framework for the management of the Fund, retain the following elements and principles:

- The principle of overlapping consensus
- Openness concerning the management of the Fund and the ethical guidelines
- High quality in the background work serving as a basis for making decisions
- The role as a serious financial investor
- The division of functions between the Fiscal Budget and the Fund
- The ethical guidelines shall be based on internationally recognised standards and principles, and have to be tailored to the Fund's investment strategy
- It is not the purpose of the Fund to serve as a tool for international aid policy, for trade and industry policy or for foreign policy.

## **4.2 Development of the ethical guidelines**

Developments within this area are very swift, and there is an ever-growing focus on what is often labelled non-financial factors, both amongst investors and in the business sector as a whole. The Ministry stated, in Report No. 16 (2007-2008) to the Storting, that the evaluation process aims at generating feedback that can strengthen the ethical profile of the Fund.

It is stated in the summary of the report from Professor Chesterman and The Albright Group that:

*“The Ethical Guidelines arise in part from a desire for the Fund to serve as a “model” for investors. In the nearly five years since the Graver Commission completed its work, institutional investors have become more expert in this field. The implementation of the Guidelines could benefit from greater collaboration with peer investors and other groups such as third party service providers”.*

The Ministry has, in view of the external inputs already gathered and appended to this consultation paper and the Ministry's own assessments, formulated the following main themes for discussion:

### The ownership activities:

The Ministry is of the view that Norges Bank's efforts and prioritisations of focal areas are in conformity with the objective of protecting financial returns, and with the sustainability

assumption underpinning such objective. Can we achieve even more leverage in the ownership activities, for example based on the recommendations in the report from Professor Chesterman and The Albright Group, as outlined in Section 3.3 above? These include, *inter alia*, methods for verifying information provided by companies and the establishment of systems for determining when an active ownership process should be terminated because it cannot be expected to yield the desired outcome or is too time-consuming.

The exclusion mechanism:

Are the criteria for exclusion as they should be? The Ministry of Finance will await feedback from the bodies included in the public hearing before deciding whether to introduce other or more exclusion criteria. The Ministry will, when addressing this issue, emphasise that it is an objective to have a regulatory framework that reflects, in the best possible manner, an overlapping consensus in the Norwegian people.

Should the Council on Ethics be equipped with more policy measures? The structure of the present system does not allow for anything in between exclusion and no sanction whatsoever. The Ministry assumes that a number of the report's proposals may be suitable for purposes of placing more tools at the disposal of the Council on Ethics. Should one facilitate, to a greater extent, dialogue between the Council on Ethics and the companies? Would it be a positive development to make focal areas public, for example by giving the general public more knowledge of the work undertaken by the Council on Ethics?

Both the number of countries and the number of companies in which the Fund is invested will be increasing. Such developments will, in combination with the Fund's high degree of openness about its investments, possibly increase the amount of information and the number of assertions that the Fund is holding investments that are not in conformity with the ethical guidelines. The Ministry assumes that this can be dealt with through the measures stipulated by the guidelines. The Ministry would welcome the views of the bodies taking part in the public hearing when it comes to what special challenges may arise in relation to the application of the ethical guidelines to new countries and companies.

Should changes be made to the interaction between the measures?

The Ministry of Finance is of the view that it is highly important for the measures to be used as effectively as possible, and for the potential for interaction between them to be utilised to the maximum possible degree. It is obvious, given how the mandates of the Council on Ethics and Norges Bank, respectively, are formulated at present, that this potential cannot always be fully exploited. Would it be of interest to facilitate a broader range of policy measures? Would, for example, the establishment of an observation list to be discussed between Norges Bank and the Council on Ethics make the work more effective? This may potentially result in a reduction in the number of companies that it becomes necessary to exclude, whilst it may at the same time also highlight companies that avoid the spotlight at present because they do not quite reach the threshold for exclusion. A separate issue is whether such an observation list should be made public. Professor Chesterman and The Albright Group have proposed not to, out of concern for the companies.

There have been relatively few cases thus far in which the Bank and the Council have been examining the same company or industry. There is reason to believe that this will happen more frequently in future, not least as the result of the Ministry often choosing to present an

exclusion recommendation to Norges Bank for purposes of enquiring whether ownership activities may reduce the risk of contributing to continued grossly unethical conduct. The Bank and the Council have different mandates, and they will, as the result of that, often operate with different time horizons in their assessments. One cannot, against this background, exclude the possibility that the Bank may believe that continued ownership activities may produce a good effect in the longer run, whilst the Council may be of the view that the prerequisites for exclusion are nevertheless in place. In such a case it will be up to the Ministry to decide whether to continue the ownership activities or to exclude the company in question. Such an assessment may be difficult for a number of reasons. Firstly, there may be real differences between the Bank's and the Council's interpretation of the facts of the case. In such a situation there is little scope for the Ministry to gather independent information with the required level of detail. Secondly, any disagreement may reflect differences in the mandates of the Bank and the Council on the grounds, *inter alia*, that the exclusion mechanism primarily reflects a deontological perspective, whilst the Bank's mandate is premised on a consequentialist perspective. The Ministry would welcome feedback in relation to this theme.

Might there be a need for making changes to the mandates of the Council on Ethics and Norges Bank, respectively, for better facilitating interaction between the policy measures? The Ministry assumes that this merits closer examination, and will in this context be evaluating, *inter alia*, the proposals set out in the report from Professor Chesterman and The Albright Group, as discussed in Section 3.

Organisation of the work: should structural amendments or adjustments be made to the procedural rules?

The policy measures available under the ethical guidelines are handled by two separate and independent bodies. This distinguishes the Government Pension Fund – Global from other funds and investors. There may be both advantages and disadvantages associated with such a structure and such a division of responsibilities.

Professor Chesterman and The Albright Group recommend, in their report, that such division of responsibilities be retained, whilst at the same time proposing changes that may contribute to more interaction than at present. The report states, *inter alia*, the following in relation to the division of responsibilities:

*“The independence of the organizations makes sense. The Council’s mandate is to provide independent advice on when there is “an unacceptable risk of the Fund contributing to“ violations of specific norms based on its assessment of risk at a specific moment. NBIM’s mandate is to exercise ownership rights with a view to the Fund’s long-term returns, and it is expected to engage regardless of whether there is a prospect of a violation under Article 4. It has, in short, a mandate to work with many companies in a variety of ways, on issues that may or may not fall within the Council’s mandate.”*

The Ministry of Finance takes the view that the mechanism for the exclusion of companies has a role to play beyond the avoidance of contributions to grossly unethical conduct, although in the form of serving as a threat that may move an active ownership process forward. This is also of relevance in assessing the attainment of objectives, as well as whether the current division of responsibilities is appropriate.



The Ministry of Finance will, in view of the report from Professor Chesterman and The Albright Group, as well as feedback from the bodies included in the public hearing, examine whether one should make structural changes that influence the division of responsibilities between the Council on Ethics and Norges Bank. One may also contemplate amendments to the guidelines when it comes to communication, exchange of information and coordinated deliberation of cases between the Bank and the Council.

### The issue of positive selection

The issue of using positive selection as a tool for the Government Pension Fund - Global has been raised by many parties over the period since the introduction of the ethical guidelines. Positive selection is, as described in Section 3.5, an ambiguous term that encompasses a fairly broad range of strategies.

The Ministry of Finance is of the view that the existing measures – active ownership and the exclusion of companies – are well tailored to the size and investment strategy of the Fund. The arguments invoked against using positive selection for the Fund when the Graver Committee undertook its examination in 2003 still remain valid. The updated analysis performed by Professors Johnsen and Gjølborg has resulted in a clear recommendation that the present structure should be upheld. Can one raise arguments in support of using such a measure in the context of the Fund that can outweigh the arguments against doing so?

### The issue of earmarking funds for special investments

The Ministry of Finance aims for the Fund to be managed in conformity with best practise internationally, in terms of investment strategy, risk management as well as social responsibility.

The Ministry has noted an increasing focus on the scope for earmarked investments amongst investors that may be compared to the Government Pension Fund - Global, principally for a minor part of the wealth under management.

There must also for any such investments – as for the remainder of the asset management effort – be an obligation to ensure financial returns over time. Consequently, it is, *inter alia*, a prerequisite that the investments have a clearly commercial profile, thus serving to fulfil the responsibility one has for generating returns on behalf of the owners of the Fund.

Potential strategies for earmarking parts of the Fund's investments will be examined by the Ministry, based, if appropriate, on external evaluations. The Ministry would welcome the views of the bodies taking part in the public hearing when it comes to whether it is at all appropriate to move in the direction of reserving part of the Fund for management under a special mandate. The Ministry would also welcome feedback from these bodies as to what types of investments, if any, might be examined in more detail for such purposes.

## **5. Overview of appendices**

Ethical guidelines for the Government Pension Fund – Global  
Ethical guidelines for the Government Pension Fund – Norway  
Report from Professor Simon Chesterman and The Albright Group  
Report from Professors Ole Gjølborg and Thore Johnsen  
Summary report from the conference “Investing for the Future”  
Letter of 6 June 2008 from Norges Bank