**NB NORGES BANK**

Ministry of Finance
Box 8008 Dep
0030 OSLO

FINANSDEPARTEMENTET
SAKSNR: 08/3095 - 3
ARKIVNR:

| Your ref. | Our ref. | Oslo, |
|---|---|---|
| 08/3095 J TM | SG/AKv 08/00229 | 06.06.2008 |

**Comments on the report by The Albright Group and Simon Chesterman on the implementation of the ethical guidelines**

We refer to the Ministry's letter dated 27.05.2008 where Norges Bank and the Council on Ethics are invited to comment on the report by the Albright Group and Simon Chesterman: "Assessment of implementation of Articles 3 and 4 of the Ethical Guidelines for the Government Pension Fund - Global."

Norges Bank finds it relevant and valuable that the Ministry has provided for external evaluation of how the Bank's investment management organisation (NBIM) has implemented ownership activities in accordance with the Ethical Guidelines for the Government Pension Fund – Global. The Report has many valuable and enlightening observations. We find that the ongoing evaluation of the Guidelines provides a good opportunity to discuss how Norges Bank has interpreted its ownership mandate.

In this letter we comment on key aspects of the above-mentioned Report. Norges Bank will not comment on specific recommendations at this stage, or on the assessments of the work on exclusions. Norges Bank's general views on the Ethical Guidelines for the Government Pension Fund - Global will be presented as part of the official hearing which will follow later this year, and for which the Albright/Chesterman report will serve as a background document.

***The Guidelines' intentions***

The authors of the Albright/Chesterman report discuss whether current practices fully capture the underlying intentions behind the Ethical Guidelines. In this respect, Norges Bank would like to underline the thoroughness of the Graver report, which dealt with those issues and produced separate rationales for ethical screening and active ownership.

The Albright/Chesterman report states, for instance, that *"A central tension within the Guidelines is the question of whether they are intended simply to avoid Norwegian complicity or influence the behaviour of others"*[1]. Norges Bank notes that an intended duality is built into the Guidelines. On the one hand, the Ministry's exclusions of companies from the eligible

1 Paragraph 10.


| Postadresse | Besøksadresse | Varelevering | Telefon 22 31 60 00 | E-post / Internett | Foretaksregisteret |
|---|---|---|---|---|---|
| Postboks 1179 Sentrum | Bankplassen 2 | Revierstredet | Telefaks 22 41 31 05 | central.bank@norges-bank.no | NO 937 884 117 MVA |
| 0107 Oslo | 0151 Oslo | | | www.norges-bank.no | |

investment universe (as guided by the Council on Ethics) are intended to avoid complicity or contribution to unethical acts. On the other hand, ownership activities are intended to exercise influence in order to promote long-term financial returns for the Fund. Such ownership activity is delegated to Norges Bank.

Norges Bank's experience so far is that ownership activities can represent influence and in that way be effective. We have not experienced the kind of tension that is described in the Report. It may be that exclusions on some occasions have represented an influencing force on companies, in addition to the intended effect of avoiding complicity. This does not represent any problem for NBIM's ownership activities. We believe that the overall rationales for screening and ownership respectively are sound and can be continued.

***Principal—agent co-ordination***

The Report discusses Norges Bank and the Council as *"a single spectrum"* that must be cordially co-ordinated. While we clearly see scope for working further on the mutual information stream on approaches and priorities, we find it useful to anchor this communication in the roles of Norges Bank and the Ministry (as the party deciding exclusions as part of defining the management mandate) as agent and principal in the fund management contract, respectively.

Our experience is that companies and financial market participants are used to a separation of roles, which is useful for a number of reasons. In asset management today, it is not uncommon for the principal to request that the agent accepts certain investment constraints related for instance to weaponry, geographical presence or corporate behaviour. Such guidelines set by the principal, and sometimes acted upon via engagement, do not usually require the agent to share the views or be mandated to act upon them in coordination with the principal. This problem is thus handled in a number of ways, depending on circumstances. It is increasingly common to keep the management organisation separate from the end asset owner, as is the case with ABP/APG in the Netherlands and BTPS/Hermes in the UK, with variant models for allocation of ownership responsibilities.

Though the two Norwegian institutions may be seen as closely interrelated when observed from a distance and from outside the fund management industry, the Norwegian model is in line with a trend of separation of roles. Norges Bank will therefore recommend that the assessment of future Guidelines be based on the actual separation of roles.

***Divestment and influence***

The Report seems to assume that influence in engagement is based to a high degree on a threat of divestment.

Although this may sometimes be the case, it is Norges Bank's view – a view which seems to be shared by many market participants – that the basis for influence is more complex, and that possible divestment is not necessarily important and could on some occasions reduce influence. Commercial asset management firms, such as several of NBIM's external active equity managers, are generally perceived as potentially exercising great influence on companies, while they typically do not use divestment as a tool.

Norges Bank's assumption is that large investors' views and concerns are perceived as important for companies because they want to market their securities long-term. Companies want to be well understood and trusted in the stock market, and thus achieve the best possible valuation. Sometimes, large institutional investors may be seen as vanguards for market sentiment. NBIM aims at exercising influence, for instance by making corporate governance engagement an integral part of the interaction between NBIM and the companies' top level people.

In addition to the investment decisions, the Fund has a number of other measures in its ownership toolbox such as exercising voting rights, proposing board candidates, corporate actions such as securities transactions and issuance, top-level meetings, investor collaboration, publicity measures, etc.

Norges Bank will apply various measures according to its ownership strategies and its assessment of the specifics of the situation. Our judgement is that focusing overly on the threat of divestment may reduce the influence of our engagement, particularly over the long run.

***The role of external managers***

The Report correctly points to the key role that external managers can play in corporate governance issues. It is important to note that while NBIM has a strategy of both internal and external management mandates, exercising ownership rights and related ownership activities are centralised within NBIM. The corporate governance team votes all shares in accordance with NBIM procedures, and engages companies – held in internal and external mandates – on issues relevant to NBIM's ownership strategy. This is an appropriate solution as it enables NBIM to speak with one voice based on the consolidated holdings. This situation is fundamentally different from many other fund owners who have more limited internal resources and depend on external managers to execute ownership rights and policies. Therefore, NBIM does not need to instruct external managers about obeying certain ownership policies, as is the case with some other fund owners.

Nevertheless, the external managers can be relevant as sources of additional influence, as they may represent very significant holdings in companies on behalf of other customers and follow portfolio companies closely. NBIM has engaged corporate governance experts at external managers for policy discussions. The purpose has been to share views and experiences, to provide information about NBIM priorities, and to keep the door open for information sharing in specific cases when relevant.

***Anchoring of NBIM ownership priorities***

The Report argues that ownership priorities require a broader involvement than has been the case.

It is important to underline that ownership activities have been delegated to Norges Bank within guidelines drawn up by the Ministry. In that sense, the setup is in line with other aspects of the management mandate which prohibit ministerial involvement in specific investment decisions. Therefore, this point in the Report in part addresses the question of to what extent the Ministry wants to direct Norges Bank as the manager.

NBIM has put value on extensive communication with the public on corporate governance issues and priorities. Achieving an understanding among the general public of our approaches and our interpretation of the mandate has been considered important. Ownership aspects of the fund management have been discussed in depth in annual reports and featured articles, also before priorities were decided. NBIM has published a number of articles in the Norwegian press, given a number of presentations, given interviews to mass media including television, and engaged in dialogues with a number of NGOs. This communication has partly been in Norwegian and may not have been readily available to The Albright Group. The purpose has been to inform and involve the public far beyond compulsory disclosure. Dialogues with peer investors, external managers and service providers have also played important roles in strategy formulation. Such processes will presumably continue for strategy development purposes.

While deliberately inviting the public to understand and debate NBIM's interpretation and operationalisation of the guidelines, we have sought to avoid a politicised decision-making process since such a process would threaten to limit the Fund's ownership influence and would not be in line with the premise that ownership should be based on a high degree of consensus. Additionally, a politicised profile could impact NBIM's ability to perform its overall professional fund management duty.

We do believe that delegation of the implementation of ownership activities to Norges Bank, within ethical guidelines and based on international norms, serves as a basis for analytical thoroughness and time consistency in priorities and procedures. All major decisions have been anchored with Norges Bank's management and the Executive Board. The Ministry has been kept informed along the way as part of periodic Fund reviews.

***Focus versus opportunism***

The Report raises the relevant question of how strictly Norges Bank should prioritise its ownership activities and to what degree our activities should opportunistically pursue cases that come to our attention. It states that *"The decision to select priorities cannot, of course, be used to justify inaction on other issues that implicate the Guidelines."2*

We find that strict prioritisation is crucial to fulfilling the task. The aim of utilising ownership positions to promote sustainable development and thus support the financial interest of the Fund is a very broad purpose. The equity portfolio consists of more than 7,000 listed groups of companies, each usually consisting of a number of divisions, product lines, geographical operations, legal entities and supply chains. Clear priorities make it more likely that our ownership efforts will succeed at fulfilling the high ambitions reflected in the Guidelines. A balanced prioritisation also contributes to making NBIM's ownership activities understandable, predictable and consistent over time. This implies less focus on lower-priority issues.

Today, NBIM collaborates with other investors in order to effectively and efficiently share the work. We aim to support other investors and non-investor organisations in work that we regard as important for the Fund, but to which we cannot give full priority ourselves. For instance, NBIM surveys and supports other investors' efforts on anti-corruption through The Investors' Statement on Transparency in the Extractive Sectors (linked to EITI). In our voting, we support a number of proposals put forward by other investors.

NBIM's focus areas have been selected with an eye to effective approaches that have not been exhausted by peer investors. This aspect was relevant when choosing themes such as child labour and corporate interaction with regulators of greenhouse gases. NBIM is working to rally peers in support of its initiatives.

***Prospects of engagement when exclusion is being considered***

The Ministry has established a routine of asking Norges Bank about the prospects of

2 Paragraph 35.

engagement with companies that the Council has recommended for exclusion. If NBIM has commenced or planned engagement in such cases, the Bank will communicate on the relevance of engagement *based on Norges Bank's mandate* and not on the judgements and facts presented by the Council and rooted in *its* mandate. The Report describes situations when Norges Bank and the Council do not give the same advice as "*disagreements*" and "*disputes*", and warns against letting them "*percolate to the Ministry*".[3]

Norges Bank and the Council do not necessarily disagree, even if the Council recommends divestment of a company that NBIM would consider engaging should it remain in the portfolio. The reason for this is, as mentioned above, that NBIM and the Council assess the situation for different purposes. Norges Bank does not regard this as particularly problematic. We expect that in some situations the existence of NBIM's engagement can be a factor in the assessment of the risk of complicity, and that this assessment can either be made by the Ministry in its final decision-making or be mandated to the Council as part of its recommendation-making processes.

***Co-ordination between NBIM and the Council on Ethics***

Most of the activities of the Council and NBIM do not relate to the same companies or issues, as stated in the Report. The authors presume, however, that this overlap will increase, a presumption that forms the basis for some of the Report's recommendations. We believe that the company overlap in future is likely to be limited and manageable. This is not only because of the much broader scope of ownership activities company-wise, but also because of evolving differences in approach.

Norges Bank does not wish to comment on the many detailed suggestions in the Report regarding operations and co-ordination between NBIM and the Council on Ethics. In general, we underline the importance of robust procedures which in our view are best achieved through policy co-ordination by the Ministry of Finance and formalised and verifiable communication.

Yours sincerely

Svein Gjedrem

Anne Kvam

---

3 Paragraphs 117 and 118.