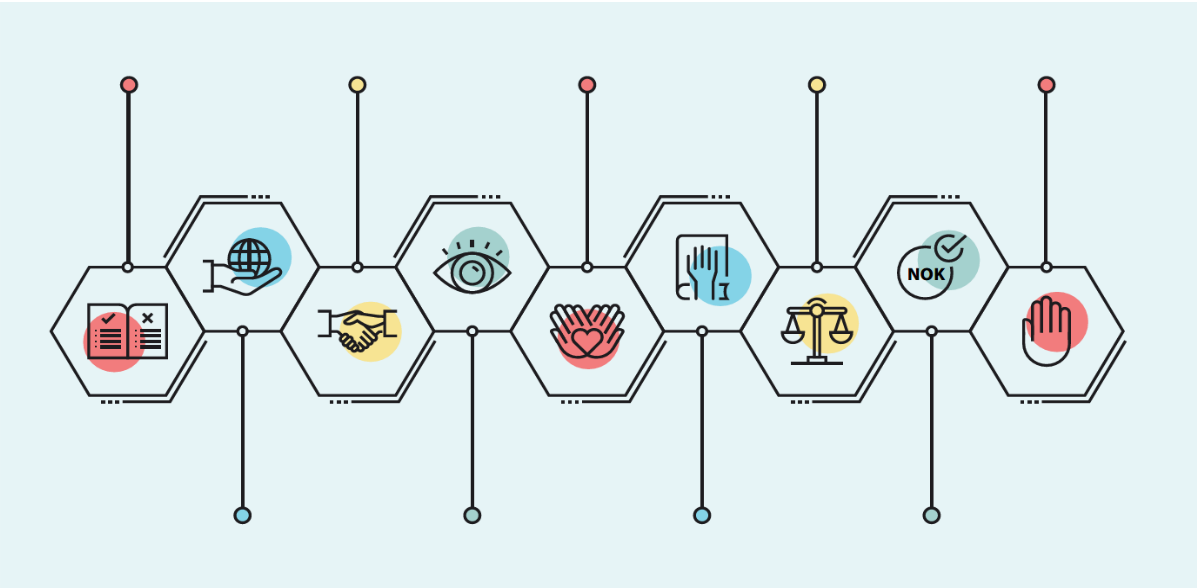
# Values and Responsibility

## The Ethical Framework for the
## Norwegian Government Pension Fund Global

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In April 2019, the Norwegian government appointed a Committee chaired by Professor Ola Mestad to review the Guidelines for Observation and Exclusion of Companies from the Norwegian Government Pension Fund Global (GPFG).

The Committee's report (NOU 2020:7) was submitted to the Ministry of Finance on 15 June, 2020.

This document contains an unofficial English translation of the report's **Chapter 1: Summary and Committee's proposals**.

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Oslo, June 2020.

This document is provided for information purposes only.

# 1 Summary and the Committee's proposals

## 1.1 Introduction

The Committee was tasked with assessing the Guidelines for Observation and Exclusion from the Government Pension Fund Global (GPFG, henceforward referred to as the ethical guidelines. The ethical guidelines were adopted in 2004 and draw on the Graver Committee's report NOU 2003: 22 *Forvaltning for fremtiden* (English: Management for the Future).

The GPFG and the thinking on responsible business practice and ethical investment have evolved considerably since the existing guidelines were introduced in 2004. The Fund has grown larger and its investments have expanded across an increased number of companies, countries and regions. Political and economic conditions worldwide have also altered. Value creation has increased, and supply chains and financial markets have become more interwoven across national borders. The ethical guidelines have been revised only partially to reflect these changes.

The Fund's background, purpose and investment strategy form the backdrop for the assessments by the Committee. The GPFG is a tool for the management of income derived from Norway's petroleum resources, wealth that belongs to both current and future generations. The savings held in the GPFG are aimed at ensuring that future generations also benefit from these petroleum resources. The statutory objective of the Fund's management is to achieve the highest possible return with an acceptable level of risk. The GPFG must be managed responsibly.

The Norwegian Ministry of Finance manages the GPFG on behalf of the Norwegian people.[1] Norges Bank undertakes the Fund's operational management on the basis of a mandate issued by the Ministry. All important decisions relating to the Fund's investment strategy are endorsed by the Norwegian parliament (Storting).[2] An independent Council on Ethics provides recommendations for observation or exclusion from the Fund of individual companies , subject to guidelines provided by the Ministry of Finance. The Ministry reports annually to the Storting on the Fund's management.

In the view of the Committee, the close proximity to the Fund's management on the part of democratically elected bodies, both in the determination of its investment strategy and the follow-up of its investment management is important for the legitimacy of the GPFG. In periods that are challenging for its investment management, this is probably even more imperative. Correspondingly, a considerable degree of transparency in the management of the Fund is crucial for retaining confidence. The Committee considers that the ethical aspects of the management of the Fund have been largely successful, and that continued reliance on the main principles that have hitherto characterised it is important.

The GPFG is currently among the world's largest sovereign wealth funds. It is a financial investor, with small shareholdings in more than 9,000 companies in over 70 countries. Many of these companies have operations in countries additional to those where they are listed. Moreover, the Fund is a lender to more than 1,100 bond issuers in more than 25 different currencies. Thus, the GPFG is invested in large parts of the world's economy. Its return over time will therefore reflect changes in the global economy.

The Committee presumes that the Fund will continue to be a financial investor, with investments distributed over major parts of the world and with the objective of achieving the highest possible return with an acceptable level of risk. The Fund will be managed responsibly and will promote the safeguarding of human rights, the environment and society in line with recognised international standards. In the Committee's opinion, this requires certain amendments to the Fund's Guidelines for

[1] See section 3 of the Government Pension Fund Act.

[2] This is a natural function of the Norwegian system of government. The Storting's right to issue instructions with respect to the GPFG also derives from Article 19 of the Norwegian Constitution.

observation and Exclusion from the Government Pension Fund Global and certain adjustments to its practices. In the context of these proposals for change, the Committee also suggests that these guidelines be edited in order to enhance the structure and improve their readability.

The GPFG gives rise to two primary ethical obligations: *to achieve* a good return for future generations and, at the same time, *to avoid* being invested in companies that contribute to grossly unethical conditions.

A comprehensive framework is a necessary precondition for the fulfilment of these ethical obligations. Yet, a comprehensive framework will not resolve all issues. Norms will continue to evolve, and new challenges will emerge going forward. Good results will therefore require the Council on Ethics and Norges Bank to monitor developments on an ongoing basis and apply sound judgement and wisdom to their decision-making within the overall framework.

The GPFG's background, purpose and investment strategy are discussed in further detail in Chapter 3.

## 1.2 Mandate and framework for the Committee's deliberations

The starting point for the Committee has been the ethical guidelines adopted on the basis of the Graver Committee's report, and the extensive practice that has developed over the past 15 years. Along the way, the guidelines and Fund's management mandate have also been amended to accommodate relevant trends in the period since 2004.

Although the term "*ethical guidelines*" was formally left in 2010, the substance of the guidelines was nevertheless retained (in other provisions). The mechanism for exclusion of companies was included in the Guidelines for Observation and Exclusion from the Government Pension Fund Global. The provisions relating to ownership exercise were included primarily in the Mandate for Management of the GPFG, but also form part of the Guidelines for Observation and Exclusion.

The Committee has been asked to "… *review the contents of the existing ethical criteria in the guidelines and assess whether these should be amended.*". At the same time, the Committee is to assess *"[w]hether and when the exercise of ownership rights is better suited than observation or exclusion* ...". In this connection, the Committee shall assess the "… *effect of the various measures and the extent to which these cause changes in company conduct, thereby reducing the risk of future guideline violations*."

The Committee has, on this basis, primarily assessed the ethical guidelines, and has not examined the requirements for responsible investment management included in Norges Bank's Mandate for Management of the GPFG in as much detail. The Committee's task has, inter alia, been to assess whether certain criteria should be taken out of the ethical guidelines or new ones added. At present, the guidelines include product-based criteria that cover the production of certain weapons, and of tobacco and coal, as well as conduct-based criteria that cover human rights, individuals' rights in armed conflict, corruption, environmental damage and greenhouse gas emissions. Some of these criteria are linked in spirit to existing international standards (*e.g.* with respect to human rights abuses), while others are not (*e.g.* with respect to serious environmental damage). The criteria reflect fundamental international and Norwegian ethical norms. One particular challenge relates to how to deal with investments in countries whose statutes and ethical norms diverge from the norms underpinning these criteria.

The ethical guidelines allow for Norges Bank to choose to exercise ownership rights rather than follow the Council on Ethics' advice to exclude a company or place it under observation. The objective of the exercise of ownership rights in such cases, is to influence the company to change its conduct and thereby sufficiently reduce the risk of infringing the guidelines.

As part of its ordinary investment management activities, Norges Bank exercises its influence as a shareholder on a far larger number of companies. Norges Bank's responsible management of the GPFG includes contributing to companies respecting human rights and protecting the environment. The Bank does this both through direct dialogue with companies and through contact with standard-setters and regulatory authorities. The Bank also publishes expectation documents on a variety of topics.

Consequently, there is a substantial degree of convergence between the criteria in the ethical guidelines and the issues that Norges Bank will address as an integrated part of its responsible investment management. Norges Bank's responsible investment management practices hence contribute to raising levels of compliance with respect to the criteria for observation or exclusion against which the Council on Ethics assesses GPFG companies. In principle, the Bank thereby contributes to a gradual reduction in the number of companies that warrant exclusion.

Norges Bank's investment management mandate and the GPFG's ethical guidelines must be viewed in conjunction. The Committee therefore also proposes certain changes to Norges Bank's mandate pertaining to responsible investment management. At the same time, the Committee has attached importance to the fact that the long-term objective of the ethical guidelines differs from the objective of exercising ownership rights as part of the Bank's responsible investment activities. The objective of the latter is to achieve the highest possible financial return; reducing the risk of ethical norm violations is not a goal in itself. That is how it must be. There must be a singular goal by which Norges Bank can be measured. However, diverging objectives are not necessarily at odds. In the Bank's investment mandate, the Ministry of Finance has expressed an expectation that, in the long term, a good return "… *is considered to depend on sustainable economic, environmental and social development.*"[3] This mandate also states that responsible investment shall form an integral part of the management of the investment portfolio.

Norges Bank's responsible investment management practices and the ethical guidelines are both cornerstones of the GPFG's underlying framework, and both are necessary for the Fund's legitimacy with the population. The Council on Ethics and Norges Bank have separate mandates with different objectives, but they both work towards the same *overarching* goal, which is to manage the Fund as well as possible on behalf of contemporary and future generations.

The Committee's mandate is presented in full in Chapter 2.

## 1.3 The Committee's assessments and proposals

### 1.3.1 Two ethical obligations

As pointed out above, the GPFG is a tool for managing the income derived from Norway's petroleum resources so that future generations may also benefit from them. One ethical obligation relates to what the Fund is intended to achieve. Managing the Fund with the aim of securing lasting value creation for current and future generations is in itself an ethical obligation. The fundamental design of the Fund's investment strategy is therefore to achieve a high rate of return on its investments, while not taking too great a risk. Section 2 of the Government Pension Fund Act defines this obligation thus: "*The objective of the Government Pension Fund Global's investments shall be to achieve the highest possible return at an acceptable risk.*"

A second ethical obligation relates to what the GPFG shall avoid. Some businesses and operations are of such a nature that the Fund, for ethical reasons, should not invest in them. The purpose of the ethical guidelines is to prevent the GPFG from being invested in companies that contribute to or are themselves responsible for grossly unethical conditions. Such conditions may be associated with the manufacture of certain *products*, such as tobacco and certain types of weapons, or they may be due to serious breaches of ethical norms, such as serious human rights violations, severe environmental damage or unacceptable greenhouse gas emissions, resulting from companies' *conduct*. The ethical guidelines are discussed in more detail in Chapters 12 and 13.

*These two ethical obligations should, in the Committee's opinion, continue to underpin the way the GPFG is managed. They balance the aspects that it is reasonable to assume the people of Norway wish the Fund to take into account.*

[3] Section 1-3(3) of the Mandate for the Management of the Government Pension Fund Global (GPFG).

### 1.3.2 Measures should continue to be exclusion, observation and exercise of ownership rights

The ethical obligation to prevent the GPFG from being invested in companies that contribute to or are themselves responsible for grossly unethical conditions is upheld through exclusion, observation or the exercise of ownership rights under the prevailing ethical guidelines.

As previously mentioned, companies are *excluded* with reference to both product- and conduct-based criteria. *Observation* may be employed if it is uncertain whether grounds for exclusion exist.

Norges Bank determines whether companies should be excluded or placed under observation pursuant to the conduct criteria on the basis of the Council on Ethics' recommendations. Prior to making the decision whether to exclude a company or place it under observation, Norges Bank must consider whether the *exercise of ownership rights* could be a suitable way of reducing the risk of continued norm violations. In such cases, Norges Bank assesses whether the exercise of ownership rights could influence the company to change its conduct and thereby sufficiently reduce the risk of future norm violations. In such cases, exercise of ownership rights will target the risk of norm violation that the Council on Ethics describes in its recommendation.

*The Committee considers that the measures should continue to be exclusion, observation and the exercise of ownership rights. In light of the evolution of norms and other developments in recent years, the Committee proposes that the criteria for observation and exclusion be amended in some areas, see below for further details.*

Thus, the purpose of the guidelines is to seek to prevent the GPFG from being invested in companies that contribute to gross violations of ethical norms. The Committee considers it important to uphold this objective. This also applies when Norges Bank chooses exercise of ownership rights rather than exclusion or observation. In such cases, the Bank will attempt to influence the company so that it no longer contributes to the gross violations in question. Furthermore, there is reason to believe that the Council on Ethics' work with respect to exclusion and observation also influences companies, occasioning that they – to a greater or lesser extent – operate in keeping with expectations for responsible business conduct. In this respect, it is nevertheless important to differentiate between the fundamental purpose of the measure and any additional effects it may also contribute to.

*The Committee proposes to include in the guidelines a clause specifying their purpose. The objective is to prevent the GPFG from being invested in companies that cause or contribute to serious violations of ethical norms. This corresponds to the clause that was included in the ethical guidelines from 2004 until 2010 and that has subsequently underpinned the way in which the guidelines have been practised*.

### 1.3.3 Overlapping consensus and fundamental norms

From the initial debate on the Graver Committee's report, there has been a consistent emphasis on the need for the ethical guidelines to build on fundamental ethical norms that enjoy broad support in the population. Guidelines whose ethical foundations rest on international conventions covering the environment as well as human rights and labour rights assist in this endeavour. The Committee has been asked to consider "*the extent to which what is referred to as Norwegian and international consensus has evolved with respect to the minimum ethical standards that companies should be held to*".

The Committee considers that an ethical framework rooted in international conventions, standards and guidelines provides a good foundation for national and international consensus. A direct link to conventions, etc., is nevertheless not appropriate for all the criteria in the guidelines. Certain criteria are linked to existing international instruments, while others are not. In some cases, such instruments provide guidance ( *e.g.* with respect to labour rights violations), while in other cases no correspondingly detailed norms exist ( *e.g.* with respect to loss of biodiversity). The criteria reflect fundamental international and Norwegian ethical values.

The conventions that the guidelines rested on 15 years ago also apply today. Some of them have been further refined, while new ones have also been adopted. In particular, developments in the area of climate change have been substantial. International climate negotiations are ongoing and international agreements to limit greenhouse gas emissions have come into effect. With respect to the rights of indigenous peoples, standards have also evolved.