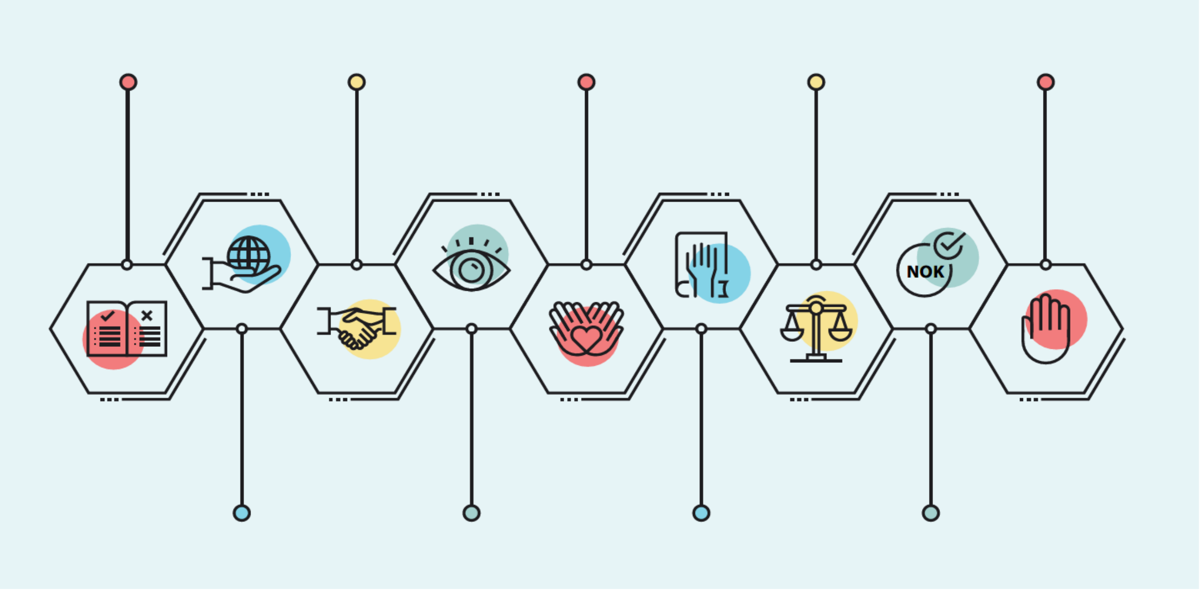
Values and Responsibility

The Ethical Framework for the Norwegian Government Pension Fund Global



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**.

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.

These changes have been more significant for the non-legally binding guidelines issued by the OECD and the UN underpinning the management of the GPFG. While international conventions bind states, guidelines assist in translating many of the topics covered by the conventions into practicable norms for companies and investors. Under its present mandate, Norges Bank's responsible investment practices take account of corporate governance, the environment and society in line with the United Nations Global Compact and the OECD's Guidelines for Multinational Enterprises. *The Committee proposes that the United Nations Guiding Principles on Business and Human Rights (UNGP) be included in the mandate as a foundational norm for the Bank's responsible investment management.* Since its adoption in 2011, the UNGP has become the prevailing international standard for what is expected of states and businesses in the area of human rights.

These guidelines provide guidance mainly on how companies and investors can behave in a responsible manner and thereby prevent the violation of ethical norms. They apply to companies' conduct but are not directly aimed to facilitate investors' exclusion of companies on the basis an unacceptable risk of serious norm violations. In our system, therefore, they are primarily relevant for Norges Bank's responsible investment management, even though they may also guide the discretionary judgement by the Council on Ethics.

Excluding companies from investment by the GPFG may have major consequences for both the companies concerned, since the reason for their exclusion is made public, and for the Fund, which misses out on investment opportunities. The threshold for exclusion of companies from the Fund should therefore remain high. In practice, the threshold has been operationalised through an assessment of the seriousness of a norm violation and the degree of connection between a company and the norm violation. A company directly responsible for a norm violation may be excluded for matters of less seriousness compared to a company contributing to a norm violation for which a third party is responsible.

An overview of the evolution of norms and standards can be found in Chapter 6 and in the individual chapters in which specific issues are discussed.

1.3.4 Product-based criteria for observation and exclusion (Chapter 12)

The Committee proposes several amendments to the product-based *weapons criterion*.

The weapon criterion in the guidelines does not detail which arms are covered, but states that it applies to producers of weapons violating fundamental humanitarian principles through their normal use. The specific types of weapons concerned are listed in the Ministry of Finance's annual White Paper to the Storting on the management of the GPFG. The Committee proposes that the *list of weapons* be included in the guidelines, while simultaneously making it clear that the list is not necessarily exhaustive.

The Committee further proposes that the wording of the criterion be amended to clarify that both weapons production *and development* are meant to fall within its scope, and that the criterion covers finished weapons *and their key components* alike. This will bring the criterion's wording in line with current practice.

The Committee further proposes that *lethal autonomous weapons* be added to the list of proscribed weapons. When automation becomes so extensive that it constitutes autonomy, it is not only the use of lethal force, but the very decision to deploy the use of force that is transferred to the machines. At that point, the system itself – absent any meaningful human overview – will be in a position to select varying degrees of when, against whom and how lethal force should be applied. In the Committee's opinion, it is fundamentally problematic that the critical decisions relating to the use of force are not subject to meaningful human control. Although the future may see the emergence of technological sophistication capable of meeting the requirements of distinction under humanitarian law, *i.e.* the capacity to distinguish between military objectives and civilians, such autonomy would still be ethically problematic because of the ensuing erosion and disintegration of accountability implied under humanitarian law.

For *nuclear weapons*, the Committee proposes that the production of certain types of delivery platforms which can only be used for the delivery of nuclear weapons be encompassed by the criterion. Today, such platforms are not excluded. This applies primarily to submarines but could also relate to other platform types. Such an expansion of the criterion's scope of application would only require a change in the way it is practised, but no change in the guidelines' wording.

In the Committee's opinion, the existing *government bond exemption* is an objective and straight forward criterion. At the same time, it has had little real significance for the GPFG, as the states that it applies to have not been relevant for its investments. Today, the criterion applies to Syria and North Korea. Based on what we know today, the criterion will also in future apply to government bonds that will probably not be relevant for GPFG's investments. Nevertheless, the Committee does not advocate the provision's removal. The same applies to the criterion which limits the Fund's investment in companies that sell weapons and military materiel to states that are encompassed by the government bond exemption. The GPFG is invested broadly across large parts of the globe, and it is difficult to foresee developments several years ahead in time.

1.3.5 Conduct-based criteria for observation and exclusion (Chapter 13)

The Committee has assessed whether there is a need to amend the conduct-based criteria in light of the new challenges that have emerged in recent years. The rapid pace of technological development affords new opportunities, but can be ethically problematic if it is misused, e.g. in *surveillance technology*. The *rights of indigenous peoples* and human rights in general are under pressure in many places. The same applies to *climate change* and *biodiversity*. Developments in the area of *war and armed conflict* have also brought forth new issues that the GPFG must address.

The existing conduct-based criteria encompass human rights, individuals' rights in armed conflict, corruption, environmental damage and greenhouse gas emissions. The criteria are formulated so as to provide room for their application to new issues arising in the areas concerned. The Committee therefore considers that for most of the criteria there is no need to amend the text in light of recent developments. However, the Committee points to areas where it is important that the Council on Ethics and Norges Bank exercise discretionary judgement with due care and attention, e.g. in the handling of indigenous peoples' rights. The Committee also makes an effort to clarify the understanding of the climate change criterion.

With respect to the human rights criterion, the Committee proposes to remove the examples specified in the provision. The removal is not intended to imply any change in the way the criterion is practised, but to make clear that the criterion encompasses all types of human rights.

The Committee further proposes that the corruption criterion be expanded to cover other types of *serious economic crime*. Such cases may relate to money laundering, but also to other serious economic crimes.

Going forward, situations may arise in which a violation of ethical norms cannot easily be slotted into any of the criteria. It is therefore important to retain the criterion encompassing "*Other particularly serious violations of fundamental ethical norms*."

The Committee proposes the inclusion of a new conduct-based criterion for the sale of weapons to states involved in armed conflict where there is an unacceptable risk that the weapons are used in military operations that constitute serious and systematic violation of international humanitarian law. This is additional to the existing criterion on the sale of weapons linked to the government bond exemption. In its efforts to identify which companies may be covered by this new provision, the Council on Ethics must base its assessment on a broad assemblage of information and reports stemming from authoritative institutions that show the weapons are generally being used in ways that do not comply with the rules for conduct of hostilities stipulated in international humanitarian law. The violations of international humanitarian law must be serious and reflect systemic failings over time, e.g. in target selection, precautions in attack or proportionality assessments. The threshold for exclusion under this criterion will be high.

1.3.6 Norges Bank's exercise of ownership rights and interaction between the measures (Chapter 16)

The Council on Ethics and Norges Bank's asset management unit, Norges Bank Investment Management (NBIM), are two separate institutions. They each have their own mandates provided by the

Norwegian Ministry of Finance. When assessing whether companies' activities fall within the scope of the ethical guidelines, the Council on Ethics is fully independent from the Ministry and the Bank. The Committee considers that this is an appropriate organisational model.

However, close cooperation between the Council and the Bank is important if the system is to work effectively. The measures must be seen in conjunction. Norges Bank's responsible investment management supports the work of the Council on Ethics. The positive reciprocity between the Bank's ownership efforts and the Council on Ethics' work should be allowed to function.

The Committee proposes that the requirement for coordination be expressed more clearly in the guidelines. Emphasis is placed on the fact that good coordination and information sharing are required in all phases of the work undertaken with respect to companies by the Council on Ethics and Norges Bank.

The proposal will help prevent duplication of effort. Furthermore, Norges Bank will be able to assess whether information provided by the Council on Ethics may give grounds for increased prudence, the exercise of ownership rights on individual companies or a risk-based divestment within prevailing frameworks. Correspondingly, the Council on Ethics will be able to prioritise its activities in light of what Norges Bank is working on. Both should inform the other of matters they believe the other party should look into more closely.

1.3.7 Transparency and reporting (Chapter 17)

Transparency is a fundamental premise for public confidence in the management of the GPFG. The institutions' reports to the Ministry and the general public must therefore meet certain standards. The Storting, the government, the media and the general public must have access to information about how the country's savings fund is being managed.

In the Committee's opinion, the Council on Ethics and Norges Bank do practise transparency today. At the same time, the Committee is aware that there are limits to what they can disclose. Details relating to commercial matters may be covered by a duty of confidentiality. To engage in a constructive dialogue with companies, both the Council on Ethics and Norges Bank are, furthermore, reliant on a certain degree of privacy. Within such constraints, however, the Council on Ethics and Norges Bank must constantly strive for transparency and good communication with the public.

All the Council on Ethics' assessments and sources in those cases that end in a recommendation to exclude a company or place it under observation are published at such time as Norges Bank decides. The Council on Ethics' recommendations are thorough and verifiable. The recommendations help to explain the grounds for company exclusions in a way that is unique at the international level. It is important that this practice be continued.

Norges Bank's reports on its responsible investment management have evolved substantially in recent years. Its annual publication "*Responsible investment*" is, in this context, a particularly important channel. *The Committee considers that this area is of such central importance that the Ministry should include this publication or similar disclosures as an annual reporting requirement in the Bank's management mandate.* This would give the report and areas as a whole a clearer anchoring with Norges Bank's Executive Board.

The Committee further proposes that the ethical guidelines also specify that the Bank must report annually on the progress of its efforts to exercise ownership rights in connection with the guidelines. This is largely a codification of current practice.

1.3.8 Climate considerations in the management of the GPFG (Chapter 18)

The climate crisis is the greatest challenge of our era. The issue is therefore treated separately in this report. Issues pertaining to greenhouse gas emissions are relevant for several aspects of the Fund's management. The GPFG is a financial, long-term shareholder, with investments spread out over large parts of the world. In principle, therefore, the Fund will incur more or less the same financial climate risk as the underlying markets and business sectors in which it invests. Norges Bank integrates assessments of climate risk in its management of the GPFG, within its overarching investment management framework.

Climate change is an important part of *Norges Bank's responsible investment management*. Norges

Bank expresses its expectations with respect to companies' management of climate risk in a separate expectation document and in the way it exercises its influence as a shareholder. The Bank is working to raise the standard of climate risk management and reporting across companies and markets, and the Bank supports research in the area of climate change and finance. In this way, many markets, business sectors and companies are encompassed. The Committee presumes that the Bank monitors developments in norms, research and challenges in this area, and applies appropriately adapted measures.

In addition, climate change is included in the ethical guidelines, through a specific product-based criterion for coal and a conduct-based climate criterion

The product-based coal criterion was amended as recently as 2019. The Committee has noted that the Ministry will follow up on how the absolute thresholds which were introduced at that time are working and make any adjustments that may prove appropriate. The Committee does not propose any changes to the coal criterion.

The conduct-based climate criterion requires the exercise of discretionary judgement and is more challenging to apply. Since such a large number of companies have been excluded under the coal criterion, many of the companies that would have been candidates for exclusion under the climate criterion have already been excluded from the GPFG. Although the Committee does not propose to amend the wording of the climate criterion, it does attempt to bring greater clarity to its application. This is an area undergoing rapid change. The criterion must be understood dynamically and must follow developments in norms and regulations.

Norges Bank's efforts to improve company reporting is important to enable companies to be assessed against the coal and climate criteria. The reciprocal impact of Norges Bank's responsible investment activities and the ethical guidelines is therefore particularly clear in this area. This illustrates the importance of taking a holistic approach, in which the various measures can bolster and support each other.

1.3.9 Companies operating in countries with divergent norms (Chapter 19)

The Committee has been asked to assess "*… [e]thical considerations linked to the Fund's investments in individual countries whose statutes and regulations are not in line with recognised international conventions and standards…*", and whether "*… current guidelines are adequate in connection with investments in such countries.*". The mandate also points to the fact that companies' freedom of action to comply with certain criteria, particularly the human rights criterion, may be constrained in such countries.

Current guidelines pertain to the Fund's investments in companies, not countries. However, the Committee's mandate also points towards country-specific issues. On this basis, the Committee has assessed whether it is possible to preclude or filter investment opportunities pertaining to individual countries, business sectors and/or certain types of companies in order to resolve the issues raised in the mandate. The Committee finds that such an approach would be difficult to implement.

General restrictions with respect to emerging markets or individual countries would reduce the risk of involvement that violates the ethical guidelines. Such steps would, however, cast a wide net rather than be specifically targeted. They would therefore be difficult to anchor in the GPFG's ethical framework.

Another potential approach to country-specific investment restrictions would be to filter countries based on specific rankings and indexes drawn up by authoritative international institutions. Numerous such rankings exist, but none that the Committee finds to be suitable as a starting point for rule-based investment restrictions. Considerable uncertainty attaches to the rankings and indexes, and their accuracy is variable.

When the GPFG invests in companies that operate in markets with divergent norms, various indicators and rankings based on country-specific conditions may, nevertheless, be informative to the exercise of discretionary judgement by the Council on Ethics and Norges Bank, as is the situation at present. The Committee presumes that a poor score in such rankings reflects a potentially high risk, prompting increased prudence in the follow-up of the companies concerned. Such tools may, moreover, provide information on specific issues that merit particular diligence.

Every company must be assessed against the same ethical standards. The Committee considers that the challenges in the countries concerned apply in particular to local companies and companies controlled by the government through state ownership or other means. Such companies may have limited latitude, and information about violations may be difficult to acquire. For this reason, it may be necessary to tailor the application of measures with respect to such companies on the basis of the conditions under which they operate. In such cases, assessments may concentrate more on the latitude of the companies and their willingness to mitigate the impact of the conditions under which they operate.

1.3.10 Handling difficulties in accessing information (Chapter 20)

The Committee has been asked to consider how difficulties in accessing information on an individual company may result in insufficient grounds for concluding whether to exclude it or place it under observation, and how individual companies' failure to reply to queries should affect such assessments. Could a risk assessment of a business sector/industry and a region/country be sufficient in such cases?

The general rule must be that recommendations should be documented in the usual way. The Council on Ethics relies in its assessments to a large extent on responses from the companies concerned. Some companies do not respond, or they provide incomplete information. The reasons for inadequate responses may vary. The Committee takes the view that, in situations where the risk of gross violations of ethical norms is sufficiently high, lack of information from the company, particularly if the company demonstrates an unwillingness to respond to the Council on Ethics' queries, could be a factor in making the risk unacceptable.

However, the Committee considers that a more overtly risk-based approach, as referred to in the mandate, should be limited to exceptional cases, and should be based on authoritative sources. The Council on Ethics should not be able to recommend the exclusion of a group of companies, sectors, etc. It must continue to assess companies individually, in line with the guidelines. The general rule must be that recommendations must be documented in the usual way and based on specific information relating to the individual company's circumstances.

1.3.11 Financial and administrative consequences (Chapter 21)

The financial and administrative consequences of the Committee's proposals are estimated to be fairly moderate.

The financial consequences may be divided into two. One category of consequences relates to the potential impact the proposals have on the GPFG's expected return and risk, as a result of a slight potential increase in the scale of exclusions from the Fund. This will primarily apply to the proposals to amend the criterion for the sale of weapons to certain states, the proposal to change the application of the nuclear weapons criterion and the proposal to include other serious economic crimes. However, it is difficult to quantify the consequences for the Fund's future return. As demonstrated in Chapter 21, an increase in the number of exclusions from the GPFG means a reduction in the Fund's ability to spread risk, thereby also increasing the financial risk. Historically, exclusions have weakened the Fund's return.

The second category of financial consequences relates to costs or savings if the proposals cause the Council on Ethics and Norges Bank to change the way they use their resources. The Council on Ethics' secretariat currently comprises eight people. The GPFG invests in a great many companies and the subject area that the secretariat is tasked with covering is extensive. The Council on Ethics' tasks have become more wide-ranging over time, without corresponding increase in allocated resources. The Committee's proposed changes to the criteria will require some additional resources.

The Committee estimates that the Council on Ethics' secretariat should be increased by up to two full-time equivalents. This would entail an increase in the Council's budget by up to NOK 4 million, since the increase in workload may also lead to a slight increase in the need for external consulting services. This estimate reflects the fact that the resource situation is already tight.

The proposals will also require competence and a slight increase in the use of resources at Norges Bank, an estimated ½ full-time equivalent, seen in isolation. Norges Bank is a far larger organisation, with greater room to adjust staffing priorities.

Apart from this, the Committee's proposals have no material administrative consequences.

1.3.12 The Committee's proposed guidelines

The Committee's proposed updates to the Guidelines for Observation and Exclusion from the Government Pension Fund Global (GPFG) are set out below. In addition to the proposed amendments to the contents described above, the text has been edited and adjusted to make the guidelines easier to read. Content-related amendments are highlighted in *italics*.

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Guidelines for Observation and Exclusion of Companies from the Government Pension Fund Global (GPFG)

Purpose and scope

§ 1 Purpose

The purpose of the Guidelines for Observation and Exclusion from the Government Pension Fund Global (the ethical guidelines) is to prevent the Government Pension Fund Global (GPFG) from being invested in companies that cause or contribute to serious abuses of fundamental ethical norms, as set out in these guidelines' sections 3 and 4.

§ 2 Scope

These guidelines apply to the work performed by the Council on Ethics for the GPFG (the Council on Ethics) and Norges Bank (the Bank) relating to the observation and exclusion of companies from the GPFG's equity and fixed-income portfolios pursuant to the criteria set out in sections 3 and 4. Advice and decisions pursuant to the criteria set out in section 3 may also apply to companies included only in the reference index.

Criteria for observation and exclusion

§ 3 Criteria for product-based observation and exclusion of companies

(1) The GPFG shall not be invested in companies which themselves or through entities they control:

a) *develop or* produce weapons *or key components of weapons* that through their normal use violate fundamental humanitarian principles. Such weapons include biological weapons, chemical weapons, nuclear weapons, non-detectable fragments, incendiary weapons, blinding laser weapons, anti-personnel mines, cluster munitions *and lethal autonomous weapons*

b) produce tobacco *or tobacco-products*

c) sell weapons or military materiel to states that are subject to investment restrictions on government bonds as described in section 2-1(2)(c) of the Mandate for Management of the GPFG

(2) Observation or exclusion may be decided for mining companies and power producers which themselves or through entities they control:

a) derive 30 per cent or more of their income from thermal coal,

b) base 30 per cent or more of their operations on thermal coal,

c) extract more than 20 million tonnes of thermal coal per year, or

d) have the capacity to generate more than 10,000 MW of electricity from thermal coal.

§ 4 Criteria for conduct-based observation and exclusion of companies

Companies may be excluded or placed under observation if there is an unacceptable risk that the company contributes to or is responsible for:

a) serious or systematic human rights abuse

b) serious violations of the rights of individuals in situations of war or conflict

c) the sale of weapons to states engaged in armed conflicts that use the weapons in ways that constitute serious and systematic violations of the international rules of conduct of hostilities.

d) severe environmental damage

e) acts or omissions that on an aggregate company level lead to unacceptable greenhouse gas emissions

f) gross corruption or *other serious economic crime.*

g) other particularly serious violations of fundamental ethical norms.

Organisation

§ 5 The Council on Ethics' work

(1) The Council on Ethics makes recommendations to the Bank on the observation and exclusion of companies in the GPFG's portfolio, in accordance with the criteria set out in sections 3 and 4, and on the revocation of observation and exclusion decisions; see section 5(7) and section 6(6).

(2) The Council on Ethics monitors the GPFG's investments, see section 2, for the purpose of identifying companies that contribute to or are themselves responsible for the products or conducts set out in sections 3 and 4.

(3) The Council on Ethics takes up cases at its own initiative or at the request of the Bank.

The Council on Ethics shall develop and publish principles for the selection of companies for closer investigation.

(4) The Council on Ethics shall be free to gather the information it deems necessary and shall ensure that each matter is thoroughly investigated before making a recommendation regarding observation, exclusion or revocation of such decisions.

(5) A company that is being considered for observation or exclusion shall be given an opportunity to present information and opinions to the Council on Ethics at an early stage of the process. In this context, the Council on Ethics shall clarify to the company what circumstances may form the basis for observation or exclusion. If the Council on Ethics decides to recommend observation or exclusion under section 4, its draft recommendation shall be presented to the company for comments.

(6) The Council on Ethics shall describe the grounds for its recommendations to the Bank. The Bank may adopt more detailed requirements relating to the form of such recommendations.

(7) The Council on Ethics shall *have routines for* assessing whether grounds for observation or exclusion still exists. In light of new information, the Council on Ethics may recommend that the Bank revoke an observation or exclusion decision. These routines must be made public. Companies that have been excluded must be informed of these routines separately.

§ 6 Norges Bank's work

(1) Based on the advice submitted by the Council on Ethics, the Bank makes decisions on observation and exclusion in accordance with the criteria set out in sections 3 and 4, and on the revocation of observation and exclusion decisions; see section 5(7) and section 6(6). The Bank may, at its own discretion, make decisions on observation and exclusion, and on the revocation of such decisions under section 3(2).

(2) In assessments pursuant to section 3(2) importance shall also be given to forward looking assessments, including any plans the company may have that will change the level of extraction of coal or coal power capacity relating to thermal coal, reduce the income ratio or business share based on thermal coal and/or increase the income ratio or business share relating to renewable energy sources.

(3) Advice and decisions on the exclusion of companies pursuant to section 3(2) shall not encompass a company's green bonds, where these are recognised through inclusion in indexes for such bonds or verified by a recognised third party.

(4) In assessing whether a company is to be excluded under section 4, the Bank may, *inter alia*, consider factors such as the probability of future violations of norms, the severity and extent of the violations and the connection between the norm violation and the company in which the Fund is invested. The Bank may also consider the breadth of the company's operations and governance, including whether the company is doing what can be expected to reduce the risk of violations of norms within a reasonable time frame. Relevant factors in these assessments include the company's corporate governance, guidelines on the environment and social conditions, and whether the company *is implementing remedying measures* with respect to those who are or have been affected by the company's conduct.

(5) Companies may be placed under observation if it is uncertain whether grounds for exclusion exist or what developments may occur forward in time, or when expedient for other reasons. Before any decision to exclude a company or place it under observation is made pursuant to section 6(1), the Bank must consider whether the exercise of ownership rights could be an appropriate way to reduce the risk of continued norm violations or could be more expedient for other reasons. The Bank must view the different measures it has at its disposal in conjunction and apply them in a holistic manner.

(6) The Bank shall ensure that sufficient information is available before it makes a decision regarding the exercise of ownership rights, observation or exclusion, or revokes any such decision.

(7) *On the basis of new information, the Bank may ask the Council on Ethics to assess whether* the grounds for observation or exclusion continue to exist.

§ 7 Information sharing and coordination between the Bank and the Council on Ethics

(1) To facilitate good coordination between the Bank and the Council on Ethics, and the effective interaction of different measures, the Bank and the Council shall hold regular meetings.

(2) The Council on Ethics provides the Bank with information about companies it has selected for an initial assessment under these guidelines, so that the Bank may consider relevant measures. The Bank provides the Council on Ethics with a list of the companies it is working with and company information that could be relevant for the Council's assessments.

(3) The Council on Ethics may ask the Bank for information on matters concerning individual companies, including how specific companies are dealt with in the context of the exercise of ownership rights. *The Council on Ethics may ask the Bank to contact companies with which the Council is unable to establish contact for the purpose of soliciting information.* The Bank may ask the Council on Ethics to make its assessments of individual companies available to it and be given access to the Council's communications with the companies concerned.

(4) Communication with the companies shall be coordinated. The Bank may attend meetings that the Council on Ethics has with companies. The Bank exercises the GPFG's shareholder rights.

(5) The Bank and the Council on Ethics shall establish detailed procedures for the exchange of information and coordination to clarify responsibilities and promote productive communication and integration of the work of the Bank and the Council on Ethics.

§ 8 The Council on Ethics' composition and organisation

(1) The Council on Ethics consists of five members nominated by the Bank and appointed by the Ministry of Finance. The Ministry also appoints a chair and deputy chair as nominated by the Bank. The Bank's nominations shall be submitted to the Ministry no later than three months prior to the expiry of the appointment period.

(2) *The Council on Ethics performs its work independently and autonomously.* The Council on Ethics' composition must ensure that it possesses the required expertise to perform its functions as defined in these guidelines.

(3) Members of the Council on Ethics shall be appointed for a period of four years. *If a Council member steps down during their period of appointment, a new member may be appointed before the remaining portion of the period has expired.*

(4) The Ministry sets the remuneration payable to the members of the Council on Ethics and the Council on Ethics' budget.

(5) The Council on Ethics has its own secretariat, which falls administratively under the Ministry's purview. The Council on Ethics shall ensure that the secretariat has appropriate procedures and routines in place.

(6) The Council on Ethics shall prepare an annual operating plan, which shall be submitted to the Ministry. The operating plan shall describe the priorities set by the Council on Ethics for its work; see section 5.

(7) The Council on Ethics shall provide the Ministry with an annual report on its activities. This report

shall be submitted no later than three months after the end of each calendar year.

(8) The Council on Ethics shall evaluate its work regularly.

§ 9 Meetings with the Ministry of Finance

(1) The Ministry, the Bank and the Council on Ethics shall meet at least once a year. The report on responsible investment management included in the annual report to the Norwegian parliament (Storting) on the management of the GPFG shall be based in part on the information exchanged at such meetings.

(2) The Ministry and the Council on Ethics shall meet at least once a year. The following matters shall be discussed at these meetings:

a) activities in the preceding year

b) other matters reported by the Ministry and the Council on Ethics for further consideration.

Public disclosure

§ 10 Publication

(1) The Bank shall publish its decisions pursuant to these guidelines. Such public disclosure shall be in accordance with section 6-1(5) of the Mandate for Management of the GPFG. When the Bank publishes its decisions, the Council on Ethics shall publish its recommendations. When the Bank makes decisions in accordance with section 6(1)(2) at its own discretion *or decides to implement a measure other than that recommended by the Council on Ethics, the Bank shall explain its decision*.

(2) The Bank shall keep a publicly available list of companies that have been excluded from the GPFG or have been placed under observation pursuant to these guidelines. *Each year, the Bank shall publish details of the progress made in cases involving the exercise of ownership rights under these guidelines.*

Other provisions

§ 11 Amendability

The Ministry may issue additions or make amendments to these guidelines.

§ 12 Entry into force

These guidelines enter into force on *ddmmyy*. From that same date, the Guidelines for Observation and Exclusion from the Government Pension Fund Global (GPFG) adopted on 1 January 2015 are rescinded.

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1.3.13 How the report is subdivided

The report is divided into two parts.

Part I is descriptive and covers chapters 3–10. The Committee's assessments and proposals follow in Part II, which covers chapters 11–21. The assessments in Part II build, *inter alia*, on the facts and analyses set out in Part I.

Before Part I, the Committee's mandate, composition and activities are described in Chapter 2.

Part I

The GPFG's background, important development trends since its establishment in 1996 and the assessments underpinning the present investment strategy are set out in *Chapter 3*. This forms the starting point for an assessment of the Fund's ethical framework. *Chapter 4* presents the historical development of the GPFG's ethical guidelines since they were established in 2004 up to the present day. *Chapter 5* discusses the Council on Ethics and Norges Bank's application of the guidelines and the Bank's responsible investment management.

A key aspect of the Committee's mandate has been to assess the guidelines in light of the evolution in ethical norms that has taken place in recent years. This is described in more detail in *Chapter 6*. *Chapter 7* contains a description of the impact the various measures permitted in the guidelines may have. This is based partly on what the research literature provides on the matter. *Chapter 8* examines the efforts undertaken in this area by other institutions and investment funds.

The Committee has, moreover, been asked to assess how investments in countries with divergent norms should be handled. *Chapter 9* provides a list of various rankings and indexes that assess both countries and companies according to predefined indicators, such as those for human rights, corruption, etc. A summary of the external input received by the Committee is provided in *Chapter 10*.

Part II

The Committee discusses some overarching issues with regard to responsible investment and the ethical guidelines in *Chapter 11*. This includes the ethical obligations that should apply to the GPFG and how to facilitate a so-called overlapping consensus to underpin them. The chapter also examines what the evolution in norms and standards seen in recent years entails for the GPFG's ethical framework and forms the starting point for subsequent chapters.

The ensuing chapters address in more detail the various parts of the Committee's mandate. The ethical guidelines' product-based criteria are discussed in *Chapter 12*, the conduct-based criteria are discussed in *Chapter 13*, while decisions to observe or exclude companies under the ethical guidelines are discussed in *Chapter 14* and *Chapter 15*, respectively. *Chapter 16* addresses the exercise of ownership rights and the interaction between the measures available in the framework. Reporting and transparency are important for the GPFG and are discussed in *Chapter 17*. Climate-related issues as a factor in investment management are discussed separately in *Chapter 18*. Issues relating to investments in countries "*whose statutes and regulations violate internationally recognised conventions and standards*" and how to deal with poor access to information are discussed in *Chapter 19* and *Chapter 20*, respectively. Finally, the financial and administrative consequences of the Committee's proposals are presented in *Chapter 21*.

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