

THE PROMISE OF SUSTAINABLE INVESTING

The case of the Norwegian Oil fund



By Sony Kapoor with Linda Zeilina – Re define

The promise of sustainable investing - The case of the Norwegian Oil fund

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Executive Summary

The Norwegian Oil Fund is now worth a trillion dollars and a multiple of the Norwegian economy. It is also financing an ever-increasing proportion of public spending in Norway. Its importance could not be overstated, so the attention devoted to it during and after the 2017 elections, particularly in the context of governance reform and potential changes to investment strategy, is critical. It is paramount to make sure that the sustainability dimension is factored into these discussions, given how strongly interlinked a good policy on environmental, social and governance (ESG) parameters is to generating long-term financial returns and limiting risk.

This is particularly important because, despite the fact that the Fund gets all its future income from the sale of fossil fuels, it remains heavily invested in the fossil fuel industry, a fact that confounds most finance professionals including this author. The Fund is also heavily exposed to tax havens and has been criticised for its investments in companies that are involved in tax evasion¹ and aggressive tax planning, or those that have violated human rights². This makes little financial sense and contravenes the Fund's own policies on risk management, sustainability and responsible investing, as well as its ethical guidelines.

In the mandate of the Oil Fund, the Finance Ministry states that Norges Bank must take sustainability and responsible investing into account, and that this should generate lower risk and higher return for the Fund. The Board of Norges Bank, in its strategy for NBIM, also endorsed the idea that considering sustainability will improve the financial performance of the Fund. They additionally ask NBIM to specifically take environmental risks into account and integrate these into its investment strategy.

NBIM has taken this a step further in their principles for responsible investing, asking investment managers to account for externalities. Furthermore, they have issued Expectation Documents on 1) Water Management, 2) Human Rights, 3) Children's Rights, 4) Tax and Transparency, and a particularly detailed document on 5) Climate

Change for their portfolio companies. The key facts are clear – on paper at least, the Oil Fund has a sophisticated policy on sustainability.

The problem is that very little of this rhetoric translates into action. As an example, the effect of the Expectation Document on Climate Change, the most detailed by some measures, is minimal, as there are few consequences for not complying. NBIM sets a poor example by itself not complying with the expectations set out to other institutional investors through their expectation documents. It does not, for example, perform any carbon stress tests on its portfolio, nor does it use any internal price for carbon or test the robustness of its investments when it comes to broader human and child rights, water and tax risks.

The report offers numerous examples, both from the Fund and from other sophisticated investors, on how intimately sustainability, in a broad sense, is linked to financial risks and return. The Fund, for example, cannot escape the negative externalities that some of the firms it invests in imposes on other companies in its portfolio - be it through tax evasion, climate change or violations of human rights.

A cohort of investors, who are savvier than the Oil Fund, have made far greater strides on sustainability, in almost all cases based on rigorous risk/return calculations rather than on ethical or political grounds. For example, the Swedish AP7 has divested from firms it says violate the Paris Accord and others that it says are lobbying against policy action on climate change. Meanwhile, NBIM remains invested in those very same firms.

The report lays out, in great detail, how integrating ESG factors into investment strategy can drive superior performance. Despite having all the right analysis, legal provisions, strategy and rhetoric on this basic fact, the Oil Fund falls short on action, and this could be one of the reasons why it underperforms its peer group in the returns it generates. Others have shown that a more sustainable approach can drive superior returns, something that will have a big positive impact on the welfare of Norwegians. Some policy recommendations that are presented in the report are:

- NBIM should, as an asset manager no different from Blackrock, in which it owns a 5% stake, apply its Expectation Documents on Human Rights, Children's Rights, Climate Change, Water Management and Tax and Transparency to itself, just as it expects Blackrock, as well as the many other asset managers it holds significant stakes in, to follow.
- The Ministry should, following Swiss Re, shift on ethical benchmarks instead of the FTSE All Cap Index it currently uses, which includes all manners of companies, including some who deny climate change, abuse human rights, evade taxes or pollute the water table.
- The ethical council should step back from its very restrictive line on applying the conduct criteria, which in effect leave many companies in violation of the ethical guidelines in the investment universe. Large GHG emitters such as the Oil and Gas firms and Utilities, which have failed to make the transition to renewables, should be excluded.
- The Oil Fund needs to learn from its peers, and significantly enhance its approach to managing climate risk and investing sustainably, based on rigorous risk/return considerations. Furthermore, it should join coalitions of investors teaming up to address social, environmental and governance challenges. More concretely, it should immediately join the investor coalitions that already exist on enhancing disclosures of labour policy, fighting the excessive use of antibiotics, and acting against aggressive tax planning – all examples used in this report.
- The Law Commission presented its conclusions in June 2017. If the Norwegian Parliament adopts the current recommendations to set up an independent professional board for the Fund, we insist that at least one board member have expertise in Sustainable Investing. We also think that sustainability should be incorporated as a core criterion for investment strategy into the Pension Fund Act and also the principle of Diversification taking into account the place of the Oil Fund within the whole Norwegian Economy.

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Introduction

By the time you read this report, the Oil Fund would have broken through the \$1 trillion mark, making it the first sovereign wealth fund to do so and cementing Norway's place as a country with one of the highest stocks of financial wealth, almost 300% of mainland GDP. Already, returns from the Fund finance as much as a seventh of all public spending in Norway, with this amount only set to increase in the foreseeable future. The governance of the Fund is designed in a manner that the government can only spend what the Fund earns, while the principal itself is to be shared across generations. The Fund, in this sense, belongs to all Norwegians, present and future.

Given its growing importance even without the trillion-dollar landmark, this is a particularly important moment in time to analyse how the Fund is run, how it compares to its peers and what reforms, if any, are needed. The Norwegian 2017 election is approaching, and next year will bring a renewed discussion on the organisation and mandate of the Norwegian Sovereign Wealth Fund. The Law Commission on the Act Relating to Norges Bank and the Monetary System³ has recommended significant changes to the governance of the Fund, and the Finance Ministry and Parliament are also set to discuss and debate whether to allow the Fund to invest in illiquid assets such as infrastructure, reducing exposure to fossil fuel assets, and investing in renewables and developing economies.

One of the other critical issues that will come up in the revision of the governance and mandate of the Fund, as well as in likely changes to its investment strategy, is the issue of sustainability. This is particularly important as in the past few years Norway has signed up to the Sustainable Development Goals, the Paris Accord on Tackling Climate Change and the Addis Ababa Financing for Development agenda under the aegis of the UN. All at the same time as sustainability has shot up the agenda of institutional investors. Meanwhile, NBIM has, on the recommendation of the strategy council, started issuing regular Responsible Investment reports, and added Expectation Documents on Human Rights and Tax and Transparency to existing ones

on Water, Climate Change and Children Rights because of pressure from the Parliament and civil society. In short, there has been a flurry of sustainability related activity, so now would be a good time to evaluate progress and take a reality check. Many feel that the reality has not kept up with the rhetoric on sustainability. This report seeks to hold the Oil Fund to account on its own policies and to make policy recommendations for improvement based on the best practices by its peers.

Another urgent reason to focus on sustainability is the drastic onset of global warming. Global average temperature today is already 0.88 degree Celsius above pre-industrial levels in 1880, and seventeen of the past eighteen years were the warmest on record. Business as usual will surely lead to catastrophic consequences for the world⁴. Norway has a special responsibility in helping prevent this, given that it is one of the few European countries where emissions of CO₂ are now higher than they were in 1990, even as countries such as Germany and the UK have cut down their emissions by about a quarter over the same period⁵. The Norwegian Prime Minister has said that emissions would fall to their 1990 level again by 2020, by which time Norway had originally committed to cut them by 30% compared to the 1990 benchmark. The Oil Fund, itself built on the sale of fossil fuels, needs to be at the forefront of the effort to fight climate change, an opinion shared by a majority of Norwegians. Reducing its exposure to fossil fuels, and increasing renewable investments, for example, is also a prudent way to diversify away some of the risk.

This report will show why, for a variety of reasons, sustainability should be at the core, not at the fringes, of the Oil Fund's investments and governance. This is the context for this report, which has four main chapters.

In Chapter 1, we present an analysis of the present governance structure, legal provisions and policies of the Oil Fund, in so far as they relate to responsibility and sustainability, particularly climate change. The objective in Chapter 1 is to create a clear understanding of the roles and responsibilities of various actors and their present approach to sustainability, as well as their freedom for manoeuvre and discretion if

they decided to pursue more sustainable policies, for example, by fighting climate change more aggressively.

Chapter 2 starts with a theoretical discussion on what ethical, sustainable and responsible investing mean, how they relate to each other and how they relate to the more commonly used ESG or SRI terminology. The chapter then explains why the Oil Fund needs to be an ethical investor, why sustainability is important for long-term financial return and why a trillion dollar Fund needs to behave as a responsible investor. Once the concepts have been clarified, the chapter goes into some detail as to how these apply to the Oil Fund. The many different reasons why a Fund with the universal reach, large size and long-horizon of the Fund should care about sustainability are also examined.

In Chapter 3, we look at what the present approach of the Oil Fund to sustainability and tackling climate change is. The chapter looks at what risks and opportunities that sustainability in general and climate change in particular bring to the Fund. Most of the chapter is devoted to the approaches that other investors, especially those considered to be peers by the Oil Fund, take to sustainability and what these mean for the Oil Fund.

Chapter 4 focuses on policy recommendations. This has three parts to it. The first assumes status quo in terms of the governance structure and examines what each of the actors involved in the governance of the Oil Fund should do differently within their current mandates.

The second part discusses the recommendations of the Law Commission on the Act Relating to Norges Bank. The upcoming discussion about the governance of the Oil Fund offers an opportunity to reopen the debate on the best governance structure and mandate, as well as legal basis for the Oil Fund from the perspective of sustainability.

The third part of this final chapter clarifies how a sustainable approach to investing is not political, but is instead the natural outcome of ethical and financial considerations.

The report is based not just on primary and secondary desk research, but also on background interviews with senior staff at the Norwegian Finance Ministry, at the Norges Bank Investment Management and with staff at other leading funds, such as the Swedish AP funds.

Space constraints and the weight of NBIM's own efforts on sustainability mean that the report has a disproportionate focus on sustainability in the sense of avoiding catastrophic climate change, but much of the analysis and policy recommendations apply more broadly to the more general concept of sustainability, which also includes social and governance dimensions in addition to the environment.

Chapter 1: The governance framework & sustainability

This report focuses on the current approach taken by Norway's Sovereign Wealth Fund to matters related to sustainability and climate change in particular, and responsible investment and Environmental, Social and Governance (ESG) issues in general. To understand 'who does what' and where responsibility for policies and authority for decision-making on these matters lie, it is important to discuss the multi-tiered governance model of the fund.

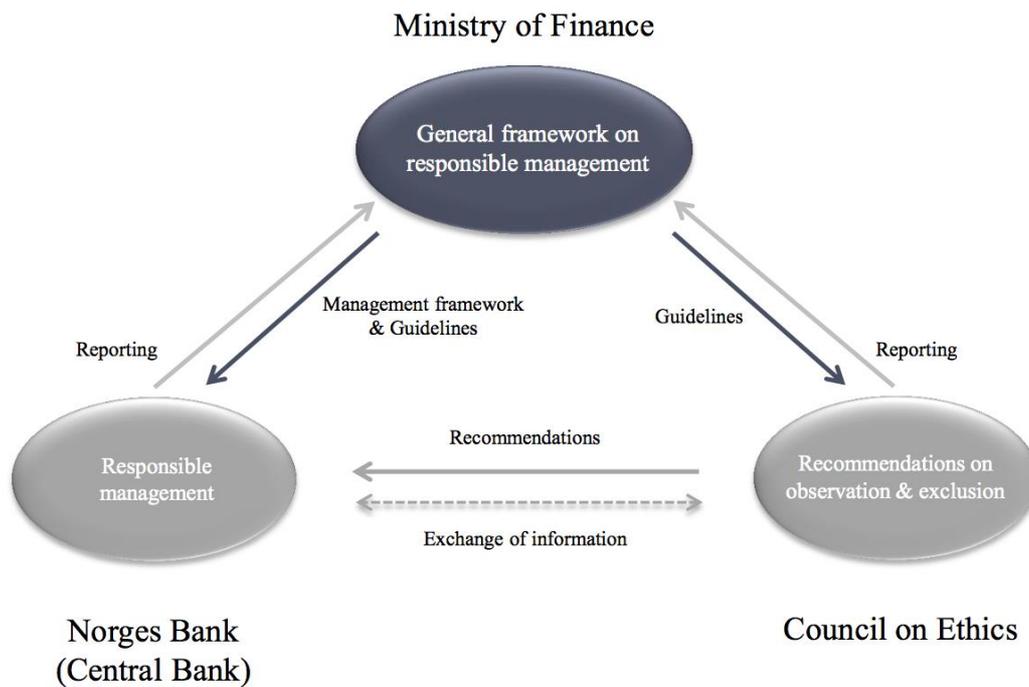
The Oil Fund is owned by the Norwegian Parliament, on behalf of Norwegian citizens. The Parliament, through the Government Pension Fund Act⁶, has asked the Ministry of Finance to manage the Fund. The original legislation, handing over the management of the Fund to the Ministry, focuses narrowly on the cash flows that constitute the inflows into the Fund, and permitted expenses the government can deduct from these. It also makes clear that the government can use no money from the Oil Fund without an act of the Parliament. The act authorises the Ministry to issue supplementary provisions to implement the act.

The Ministry, in turn, has tasked Norges Bank, the Norwegian Central Bank, to manage the Fund. The management mandate⁷, issued under the supplemental provisions, is quite detailed and very prescriptive, unlike the skeletal nature of the original act. The Ministry has also issued detailed guidelines for observation and exclusion from the Fund⁸, and these apply to the work of the Council on Ethics for the Government Pension Fund Global (the Council) and Norges Bank.

The Executive Board of Norges Bank has further delegated the management of the Fund to Norges Bank Investment Management (NBIM), a wholly owned subsidiary of Norges Bank. The Board has used the management mandate from the Ministry as a basis to issue more detailed guidelines and strategic plans for NBIM⁹. The guidelines relevant to this report include the Principles for Responsible Investment Management in Norges Bank¹⁰, the Investment Mandate for CEO of NBIM¹¹, Principles for Risk Management in NBIM¹² and the Strategy for NBIM (2017-2019)¹³.

NBIM, in turn, has turned these guidelines into a series of policy documents, the most relevant of which is its Policy on Investment as a Responsible Investor¹⁴. Drilling down one more level, NBIM has issued Expectations Documents¹⁵ on climate change, water management, human rights, children’s rights and tax and transparency.

As discussed above, the government pension fund act makes no mention of sustainability, ethics or responsible investment, and that task is delegated to the Finance Ministry. In this chapter we consider the relevant legislative measures, guidelines and policies one at a time, highlight the most critical parts and have a brief discussion on each. These will be revisited in the Chapter on Policy Recommendations.



Source: NBIM

The management mandate

In the management mandate¹⁶ the Ministry has given to Norges Bank, there are a number of sections, which are germane to sustainability and responsible investment. We highlight and discuss the most important parts.

The Ministry is very clear that the objective of the Fund is to pursue the highest possible return, which it unambiguously states depends on sustainable development in environmental terms. This is the first mention of sustainability, but the reference is clear. The Ministry also asks the Bank to integrate Responsible Investing into the management of the Fund, and states that the running of the Fund will be done at an arm's length from the Ministry. It asks the Bank to formulate measures for responsible management, such that they emphasize its long-term horizon, are based on good environmental conditions and respect internationally recognised principles and standards such as the UN Global Compact. It also asks the Bank to support research on Responsible Investing and help formulate international standards. It asks Bank to run a small 'pilot' environmental portfolio, which it normally caps at NOK 60 billion, less than 1% of the Fund's size¹⁷.

The Ministry then forbids the Bank from investing in companies excluded by the ethical guidelines, and rather inexplicably, explicitly bars it from investing in unlisted infrastructure. It keeps the Bank on a tight leash with a very prescriptive policy on index benchmarks for Norges Bank to follow on all its stock and bond investments, from which it is only allowed to deviate by 1.25%.

Having given the Bank a strong sounding mandate on sustainability and the environment, the Ministry undermines the Bank's discretion by being overtly prescriptive on allowable investments and benchmark hugging, as well as capping the environmental portfolio at an insignificant level. In essence, the Bank is not allowed to do, what the Ministry had said it should do, for example on sustainability.

The Bank is then given an advisory duty and the right to be heard on any need to change the mandate, and will be consulted by the Ministry before any changes are introduced. But in reality, the Ministry has repeatedly ignored calls from experts at Norges Bank to be allowed to invest in infrastructure assets, for more than a decade.

It also gives the Executive Board of the Bank significant authority to expand its approach to risk management including, for example, by 1) establishing principles to measure market risk 2) performing stress tests and scenario analysis and analysing extreme event risk.

Guidelines for observation and exclusion from the Fund

Parallel to the mandate, the Ministry has also issued guidelines for observation and exclusion from the Fund¹⁸, which apply both to the Council of Ethics and Norges Bank and are divided into product based criteria and conduct based criteria.

On products, the Fund is forbidden to invest in companies that 1) produce tobacco 2) manufacture certain kinds of weapons 3) generate more than 30% of revenues from thermal coal 4) or sell weapons to states under UN sanctions.

On conduct, companies may be put under observation or be excluded if there is an unacceptable risk that the company contributes to or is responsible for 1) serious or systematic human rights violations 2) serious violations of rights of individuals in war or conflict 3) severe environmental damage 4) acts or omissions that on an aggregate company level lead to unacceptable greenhouse gas emissions 5) gross corruption or 5) other particularly serious violations of fundamental ethical norms.

It further asks the Council to continuously monitor the Fund's portfolio, with the aim of identifying companies that contribute to or are responsible for production or conduct which is specified in the guidelines. The Council may investigate matters on its own initiative or at the request of the Bank.

The Ministry gives both the Council and Norges Bank the power, and indeed the obligation, to exclude certain companies from the investment universe. The criteria for exclusion, which are product based, are rather narrow and prescriptive so they leave relatively little scope for discretion. The quantitative criterion for exclusion because of the use of thermal coal is one such example.

However, there is scope for a lot more discretion, both for the Council and Norges Bank, on the matter of conduct, which affects human rights and the environment. Besides, the phrase “particularly serious violations of fundamental ethical norms” is open to interpretation and could also apply to broader social issues. The freedom of the Council of Ethics to start investigations on its own initiative gives it much additional discretion.

The strategy for NBIM

Following the mandate, the Executive Board of Norges Bank issues a strategy in which it interprets the mandate from the Ministry and translates that into how NBIM should be run¹⁹. In this, it emphasises the role of the Fund to both build (return) and safeguard (risk) wealth for future generations. It further emphasises an acceptable level of risk and the need to focus on the Fund’s unique long-term perspective, large size and limited need for liquidity as a competitive advantage.

It calls on NBIM to broaden the scope of its advice to the Ministry, including on any need for changing the mandate. It also states that it will start taking Norwegian national wealth into account, thereby situating the Fund within a Norway-wide macroeconomic framework, rather than running it as a standalone fund and instructs NBIM to develop alternative risk measures for the Fund. The Strategy envisages adding more emerging and frontier market exposure and moving further away from the benchmark portfolio of the Ministry in a bid to improve diversification and avoid weaknesses of the index.

The board also envisages that NBIM will be a global leader in responsible investing, particularly with a view to contributing to the long-term performance of the Fund, which it recognises could be significantly impacted by environmental issues.

On risk, the strategy spells out an ambitious approach which focuses on long-term risk, using scenario analysis and stress testing, as well as a whole bevy of risk metrics to understand and manage risk, including that from ESG.

Principles for Responsible Investment Management

In the principles for risk management²⁰ the Executive board of Norges Bank is very clear that it wants and *expects responsible investment to both boost long-term performance and help reduce long-term risks*. The Board unequivocally states that it will integrate environmental and social risks into overall risk analysis and *specifically also account for negative externalities from the action of companies* in its portfolios, as what matters to it as a long-term universal investor are overall portfolio risks. It will also take a sector, industry and *thematic view where relevant*.

The Board states that *both risks and opportunities from ESG considerations will be taken* into account in the investment process and in portfolio management. It also says the *Bank may divest from companies with unsustainable business practices or models*.

Expectations Documents

The expectations documents from NBIM mostly follow a standard script. They first state why the issue is important, and whether there are international guidelines from the UN or OECD relevant to the issue, whether it is water management or children's rights or climate change.

Next they call on the company to integrate the issue, including the risk and

opportunities arising from it, into their strategy and planning processes and have board level ownership. Then, these expectation documents call on the management of the firms to integrate the potential threats arising from the issue into their risk management processes. Third, NBIM asks firms to disclose strategy and report material risks and last, they expect the companies to have full transparency on how they interact on this issue with policy makers and other stakeholders.

Importantly, the expectation document on tax and transparency is not the like the others, and is somewhat weaker in it's asks, focussing just on prudent board policies and transparency on reporting.

For illustration purposes, we look at the expectation document on climate change, which is also NBIM's most detailed document.

First, the document is directed to company boards, which NBIM holds responsible for climate policy. Second, it has a long-term perspective, within which, NBIM believes that the physical effects of climate change, technological advances and policy responses will create both risks and opportunities for its portfolio companies, and hence for NBIM as the investor.

Third, NBIM acknowledges that climate change will affect all companies, but it recognises that fossil fuel firms and others in GHG intensive sectors will be especially affected, and asks for increased disclosure on GHG emissions and exposure to climate risks. Fourth, NBIM says it will use this information to check if management has an appropriate strategy for a transition to a low carbon economy.

Next, NBIM expects companies to integrate climate impacts in business strategy to inform both opportunities and risks, to stress test their business plans for various scenarios, including one where rigorous policy action successfully limits temperature rise to no more than two degrees. It expects companies with high GHG emissions to have a clear strategy for the transition and to perform sensitivity analysis on all major investments.

Last, but not the least, it expects companies to integrate material climate risk in its business framework, manage this in line with standards and best practices, report it

clearly and adopt a policy to support regulatory action on tackling climate change, and particularly, if the company is a large GHG emitter, disclose any lobbying on climate change.

Conclusion

It has become clear from the discussion in this chapter that 1) issues of sustainability, responsible investing and broader ESG matters are an important aspect, at least on paper, at all stages of the governance of the Oil Fund, with the exception of the mandate from the parliament, which is silent on these matters 2) that there is a clear recognition throughout that sustainability and ESG perspectives can both offer significant opportunities for profit and pose substantial risks 3) that these matters should be integrated completely into the investment process, even as NBIM is given the ambition to be a world leader in Responsible Investing 4) that NBIM has significant, if somewhat generic asks of the firms it invests in, on the matters it has produced expectation documents on 5) there is often a gap between the rhetoric of sustainability and the discretion available to NBIM to put that into practice and that last, but not the least 6) Norges Bank and NBIM nevertheless have significant discretion to do much more on sustainability and ESG, despite the restrictive mandate from the Ministry.

Chapter 2: What is Ethical, Sustainable & Responsible?

As we have seen in the first chapter (and as will become glaringly obvious in the next chapter) terminology on sustainability can be confusing. Sustainability is often used interchangeably with responsibility, ESG or SRI (socially responsible investing) in the context of investing. Sadly, there is no easy way to avoid this confusion and we will have to use these terms somewhat interchangeably.

However, from the perspective of the Oil Fund, we can try and make an academic distinction. In its report on Responsible Investing²¹, NBIM calls itself ethical, sustainable and responsible.

Ethical

Ethical in this context means subscribing to ethical norms of the owners, in this case the Norwegian population. As the strategy council to the Oil Fund puts it, *“for a fund that is run on behalf of a diverse body of underlying owners, legitimacy is an important issue. In the case of the GPF, this means that, while the Fund must adhere to its overarching financial purpose, it should also respond to the consensus views of the people of Norway²²”*. These are supposed to be represented, albeit only partially, by the Ethical Guidelines on Observation and Exclusion²³.

The guideline for NBIM not to invest in companies that make and sell tobacco, for example, offers one such perspective. It is important to remember that these are not fixed, but derive from the will of the Norwegian citizens and their values. The Fund is bound by ethics, irrespective of whether this increases or reduces returns. This is also echoed by AXA, which has also divested from all tobacco stocks. Thomas Buberl, the CEO of AXA, has talked about how *“there is no safe level of exposure to tobacco. It contributes to the early death of two out of three smokers and the World Health Organisation (WHO) estimates that 1bn people will die from smoking this century²⁴”*. Yngve Slyngstad, NBIM’s CEO, rightly says that *“NBIM can deal with any mandate politicians give it on behalf of the fund’s ultimate owners: the Norwegian people²⁵”*.

Sustainable

Sustainable is a broad concept, which implies an ability to continue indefinitely. In

this case, it refers to a company's ability to continue to operate profitably in a social, economic, environmental and governance context, for a long time to come. Social sustainability is a broad concept, but refers to a firm's ability to have the social license to operate, its adaptability to evolving social norms and its impact on society. Economic sustainability is about its fundamental business model, and if and whether the company is able to continue to generate value over the long term.

Environmental sustainability is about the firm's resilience to, for example, climate change or the shortage of clean water and its own footprint on the environment. And governance in this context is about the manner in which the company is managed, whether well or poorly. The idea of a long-term horizon is intrinsic in the concept of sustainability since countless examples abound of companies getting away with bad policies and products over the short term, eventually they get their comeuppance.

Essentially, profitability and sustainability go hand in hand over the long-term, even if there may be trade-offs in the short term, for example, when a polluting or a tax evading firm generates high profits in the near term. A recent high profile meta-study found that *"ninety per cent of studies reviewed show that cost of capital is lower for companies with higher standards of sustainability practice"*. It finds *"a remarkable correlation between diligent sustainability business practices and economic performances²⁶."*

Another points to *"a growing body of academic evidence which shows that over the long term, incorporating responsible (sustainable) investment strategies translates into outperformance²⁷."* A third study by Harvard Business School finds that *"high-sustainability companies outperformed the others in the stock market by 4.8 percentage points per annum. They also performed markedly better on accounting metrics such as return on assets²⁸."* The message is crystal clear, higher sustainability translates into better performance over the long term.

Responsible

Responsibility refers to the obligations a fund the nature and size of NBIM has to all

its stakeholders. It, for example, has an obligation towards its owners, Norwegian citizens, to represent their interests and values. It has an obligation towards the companies it owns, especially given that it is often one of the largest investors in most listed companies around the world. And it has an obligation to society at large because it operates with a social license in all the countries it invests in, as pointed out by the strategy council to the Oil Fund. This point is also echoed by Svein Flåtten, the finance spokesperson for the conservative party who says that because *“the fund is large, so is our responsibility.”* *“I think that a fund like ours always should have a responsibility to consider and discuss the consequences of investments on not only the environment and possible climate change, but also on other ethical questions²⁹.”*

As we will also see in this chapter, and broader literature, sustainability is usefully translated into environmental, social and governance filters under the rubric of ESG.

How ESG works in practice

Of these, governance is the easiest to understand, in terms of a financial impact, followed by the environment with social issues, which can be far more numerous and complex, lagging behind. This is echoed by Sustainalytics, a well-known responsible investment research firm: *“The ‘S’ [in ESG] is lagging behind.”* However, *“that’s changing, and changing quickly³⁰.”* We will discuss each of the E, S and G in turn, in terms of their importance on financial performance and to get an idea of what investors, who are on the cutting edge of sustainability, are doing.

For example, corporate governance, the G of ESG, has long been understood to affect stock performance, and there is a wealth of research showing that more diverse boards lead to better-run companies. Within this, the independence and diversity of the board, the separation of the roles of CEO and Chairman and Executive Pay, have been some of the big themes, but conceptually this is all about how well a company is run. The financial implications are best understood by looking at Fiat and Volkswagen, both firms that have been implicated in the emissions scandal, resulting in billions of dollars of expensive legal suits, irreparable reputational damage and a huge fall in share price inflicting large losses on investors.

In both cases shareholders ignored clear warnings. Both firms were ranked near the

bottom in the ESG rankings issued by MSCI. Sustainalytics and Oekom Research had also flagged ESG concerns with asset managers about Fiat. MSCI has subsequently said that investors should certainly have been aware of the risk³¹, and uses these as case studies to demonstrate how ESG factors are crucial to long-term profitability³². That is why investors rightly believe that better governance analysis helps them avoid companies that are on the brink of a costly scandal³³ and hence allows them to better manage risks.

There are several aspects to E, the environmental filter, such as water shortage, a loss of biodiversity and soil pollution but the one that has potentially the biggest financial impact is climate change. That is one of the reasons we have also treated that in the greatest detail in this report. Given the seriousness of climate change, the Church of England, together with five leading asset managers with £1.7tn in assets between them, has launched an initiative to identify companies that pose the biggest climate change risk. It ranks companies by how well their management is dealing with climate change risks, and how effective they are at achieving carbon reduction³⁴.

Blackrock, the world's largest asset manager, has said that caring about climate change is no longer just a political issue, but one central to risk/return considerations so that *“investors can no longer ignore climate risks and the impact of climate-related regulations and technological advancements on the companies in which they invest³⁵”*.

The head of Principles of Responsible Investment, which represents more than \$60 trillion of institutional investors and asset managers, has said that ESG analysis captures some of the risks faced by companies due to a number of global mega-trends, such as climate change and changing demographics, which are often not captured by financial analytics. *“They are no longer seen as political [trends, but] more investing trends³⁶.”*

Now let us turn to the S, or the social filter in ESG. Employees are often the most important resource of a business, representing its Human Capital, but most companies disclose little about how they manage their workforces. To set this right, a group of investors including Schroders, Nordea and Legal and General Investment

Management have asked for better disclosure on employee and labour policy.

Nordea has called the initiative extremely important saying that *“most investors have been looking at environmental issues, but the social angle has a direct impact on the bottom line.”* Australia’s largest pension fund echoes this saying that *“integrating workforce issues into our investment process will improve long-term value and returns for members³⁷.”* Research shows that those US companies, which have been deemed the best places to work, generated superior returns, between 2%-4% higher than peers for a sustained period³⁸.

Another example of a social issue on which investors have mobilised recently is that of the excessive use of antibiotics in food supply chains, due to fears that overuse of these drugs damages human health and hurts financial returns. The coalition, which now has the support of the WHO and 71 investors worth trillions of dollars, is pressuring large food firms such as McDonald’s and Domino’s Pizza to reduce excessive use of antibiotics in their poultry and meat supply chains. It is estimated that growing antibiotic resistance could inflict enormous misery, early deaths and cost as much as \$100 billion³⁹.

Another social issue that has come to the attention of investors is tax policy and practices. Recognising that the public mood has shifted against businesses that seek to minimise their tax bills, MSCI has heightened its focus on companies’ tax arrangements. It now lowers the ESG ratings of companies that are embroiled in legal battles over tax issues, pay effective rates of tax that are much lower than their predicted rates based on revenues, or those with opaque tax structures⁴⁰.

Echoing this, Nordea Asset Management has said that it is clear *“to companies and to the investor community in general that aggressive tax planning belongs to the past.”* It points to the risk of such practices saying that *“regulatory changes will no doubt continue to raise regulatory risk for companies who prioritise aggressive tax practices in their financial strategies. The risks related to aggressive tax practices have raised investor uncertainty⁴¹.”*

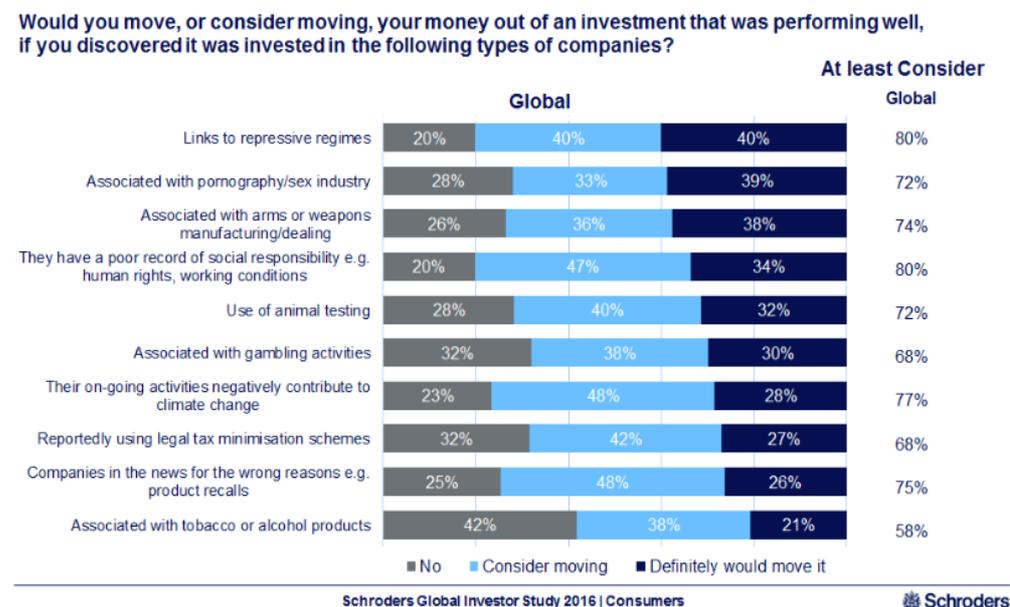
A much clearer understanding of this can be gleaned from a reading of two previous

Re-Define reports⁴² on the subject of Tax, Risk and the Oil Fund, both published in 2016.

How NBIM sees Sustainability and ESG

The Strategy Council for the Oil Fund in its 2013 report on Responsible Investment⁴³ concludes that the Ministry's mandate reflect two motivations, first its role as a universal investor and the responsibility and risks that come from that and second the idea that sustainability enhances long-term portfolio performance. It expands these into four arguments for why the Oil Fund must invest sustainably, in line with ESG.

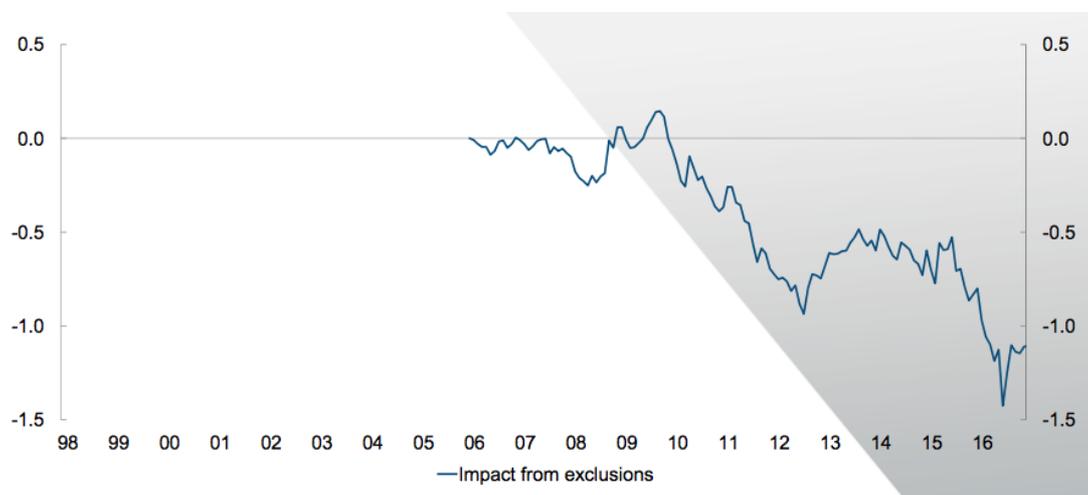
First, it says that because the Fund is owned by Norwegian citizens, it must reflect their collective values for legitimacy. As discussed, this is the motivation for the ethical guidelines, but while these partially capture what citizens don't want the Fund to do, they don't address what they want from the Fund. The graphic from Schroeders, which is not Norway-specific, captures a central idea of this argument, that citizens/investors agree that certain investments are unethical no matter what the financial costs.



Source: Schroeders⁴⁴

In a similar survey from April 2014, quoted in the newspaper Vårt Land, eight out of ten Norwegians thought it important that the Oil Fund should not make investments

harmful to the environment or people. Interestingly, 65% also thought that the Fund should contribute to development in poor countries and 72% said they would like it to contribute to clean energy.



Source: *Risk and Return, NBIM, 2016*⁴⁵

It is interesting to see that owners would be willing to see poorer returns in order to have those managing money on their behalf not violate what are seen to be some fundamental social norms, embedded in the ethical guidelines but beyond that, many citizens and capital owners would like to see their capital have a positive impact, such as save the environment or facilitate the development of poor countries. A partial reading of this means that Norwegian citizens would like the Oil Fund to have a strong emphasis on sustainability, and go beyond that.

On the basis of this argument, the Ministry is saying that NBIM sometimes needs to pursue ESG/SRI policies, even if this comes at the cost of financial return. This is illustrated in the graphic above by the loss of return from the exclusion of companies on ethical grounds mostly relating to tobacco, researchers at Henley Business School have questioned this theory that institutional investors who blacklist certain stocks “*effectively pay a price for sin aversion*”⁴⁶.

Second, the Ministry says that being a large owner with a long-horizon comes with additional obligations to society, yet another motivation to be an active and responsible owner advocating for better ESG outcomes irrespective of financial considerations. Another point within this argument is the belief that the failure to act

against socially or environmentally damaging actions, despite being a large influential owner, brings about a degree of complicity in those actions.

Third, the Ministry puts forward the universal owner argument that the Oil Fund is likely to have firms in its portfolio, which take actions that have negative externalities for other firms in the portfolio, even if they increase the profitability of that firm itself. GHG gas emissions from large fossil fuel firms such as Exxon are a perfect example of that. For normal shareholders of Exxon, particularly those with just a short-term horizon, the negative impacts of Exxon's actions on others do not matter, as long as it increases Exxon's profit. However, for the Oil Fund, the damage they can inflict on other companies in its portfolio, especially over the long horizon the Fund has, can be financially punitive.

Fourth, and based on the text of the previous chapter, the most important is the argument that having a strong ESG or sustainability focus helps the Oil Fund both improve its risk management as well as spot opportunities for superior financial performance, so it can enhance its returns in the long run. As we saw in the previous section, this school of thought has widespread support within the investor community, is also the biggest reason the Ministry and Norges Bank give for having a Responsible Investment Policy. For example, 70% of sovereign wealth funds surveyed by Invesco said they believed that ESG enhances long-term returns. Within ESG, Climate Change and Sustainability were seen to be the most important issues⁴⁷.

Two critical messages emerge from this section. First, that the strategy council for the Oil Fund, the Ministry as well as NBIM have all stated multiple motives for why the Fund should pursue ethical, responsible and sustainable policies. Second, that of these motivations, the most powerful one that emerges from the mandate, the discussions on the board of Norges Bank and NBIM's own statements is that such policies will reduce risk and enhance return over the long-term.

Conclusion

There are several key messages that emerge from this chapter. The first is that while ethics, sustainability and responsibility are sometimes used interchangeably, there also exists a clear distinction between them. Ethics, in the context of the Oil Fund, reflect the values of the Norwegian citizens, the ultimate owners of the Fund. The Fund is expected to reflect these, irrespective of whether it is profitable or not. Hence these are, in a sense, political choices. It may be that ethical guidelines, such as those the Oil Fund is expected to follow, may enhance profitability, as they have done with the sell-off of coal investments, but that is not their objective.

The second message is that sustainability has several dimensions of which the environmental, governance and social or ESG are the most important ones. Over the long-term, there is no trade-off between sustainability and maximising return while minimising risk although short-term trade-offs might exist. Given that these ESG filters, of which governance is the most mainstream followed by environmental and then social ones, can help spot both opportunities and risks, investors need to integrate sustainability and ESG factors completely into their investment processes.

Particularly for large universal investors such as the Fund, sustainability thinking can capture the negative and positive externalities that some portfolio companies may inflict on others in the portfolio, and hence improve portfolio management. The Ministry seems to clearly support the perspective that sustainability and financial performance go hand in hand in its mandate. It is unclear to what extent this is reflected in the actual investment strategy of the Fund though.

The third message is that large investors, such as the Oil Fund, need to be sustainable and ethical not just to represent citizen values or to generate superior financial returns, but also because they bear responsibility towards all stakeholders, including citizens of the countries they invest in. The larger, the more universal the investor, the bigger the burden of responsibility to shoulder and indication is that, at least on paper, the Ministry, the political establishment and NBIM understand this obligation and have strong rhetoric on Responsible Investment. However, it is not clear if their actions match their ambitions and words.

Chapter 3: Action Taken on Sustainability

The first chapter made clear that with the exception of the original parliamentary act setting up the Oil Fund, each and every level of governance, from the mandate to the Ministry has given to Norges Bank, to the Strategy from the Executive Board down to the Expectation Documents from the Corporate Governance team at NBIM, gives due deference to the issues of sustainability and responsibility, and recognises that climate change will bring about both significant opportunities as well as risks.

The second chapter built a theoretical framework for sustainability and responsibility, showed how these are understood by the Oil Fund and demonstrated that the pursuit of sustainability leads to better financial performance over the long term.

In this chapter we take a critical look at actions taken by NBIM under this rubric so far and, most importantly, look at many investors in the peer group of the Oil Fund to demonstrate how, despite the rhetoric, the Fund significantly lags its peers on sustainability.

NBIM takes a three-pronged approach to the issue of sustainability and climate change. These are standard setting, ownership and risk management. In its own words,

“Our investment management takes account of environmental, social and governance issues that could have a significant impact on the fund’s performance over time. We seek to further the long-term economic performance of our investments and reduce financial risks associated with the environmental, social and governance practices of companies we have invested in.”

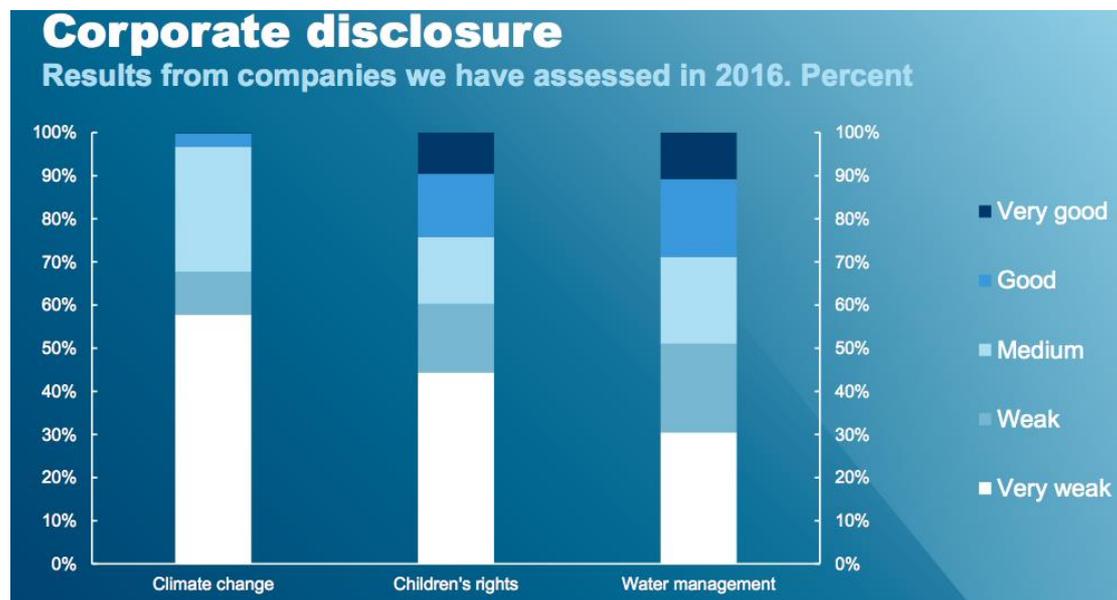
Within this, NBIM pays most attention to climate change, which was also the focus of its 2016 engagement policy. On this it says

“We consider long-term investment risk across sectors and markets. The climate challenge stands foremost as a future risk of unknown magnitude. We have enhanced our analysis of portfolio carbon emissions, funded research projects, and we removed coal companies and electricity producers with high usage of coal from the fund. In

2016, we improved our data for a range of environmental, social and governance risks⁴⁸. ”

These words support the discussion in the previous section, that the primary driver for the Oil Fund’s consideration of environmental, social and governance risks is financial, that is, to enhance returns and mitigate risks over the long term. We will use climate change as a means to demonstrate where NBIM is falling short on sustainability.

NBIM is falling short on addressing climate change



Source: NBIM Responsible Investment

In 2016 NBIM assessed 1,238 companies in eight sectors with particularly high GHGs for how well they disclose climate risk. The results from this, as seen in the graphic above, are frankly quite poor, with almost 70% of the companies assessed registered as very weak or weak in terms of disclosure of climate risks.

NBIM is long on rhetoric that there is an urgent need for companies to assess and report the effects of climate change, and have a business strategy to cope with the low carbon transition. However, despite such poor disclosures, where almost 70% of the companies assessed had very weak or weak disclosures, the issue was only raised with 12 companies in 2016, representing less than 1% of the equity portfolio. And

2016 was supposed to be the year where sustainability was a priority in corporate engagement. The action does not match the rhetoric.

In addition, NBIM has funded research on climate change and financial markets and joined other investors in calling for better disclosure of climate risks. In both cases, its contributions have been rather modest and it has been a follower rather than a leader on most investor initiatives. This belies its stated ambition and mandate to be a leader in the field of sustainability and responsible investment.

NBIM has now set up a separate climate risk framework for its portfolio. In line with this framework, and to gain a better understanding of the Fund's total climate risk, NBIM analysed greenhouse gas emissions at companies in the Fund's portfolio. It calculated the carbon footprint of its equity portfolio for the third year in a row, and that of the fixed-income corporate bond portfolio for the first time.

Sector	Equity portfolio		Benchmark index
	Share of portfolio market value. Percent ¹	Million tonnes CO ₂ equivalents	Million tonnes CO ₂ equivalents
Basic materials	5.6	11,110	14,331
Consumer goods	13.7	2,434	2,519
Consumer services	10.3	1,699	1,554
Financials	23.3	1,172	1,495
Health care	10.2	595	602
Industrials	14.1	3,069	3,715
Oil and gas	6.4	41,549	42,986
Technology	9.5	984	991
Telecommunications	3.2	3,242	3,287
Utilities	3.1	26,708	29,316

Source: NBIM Responsible Management, 2016

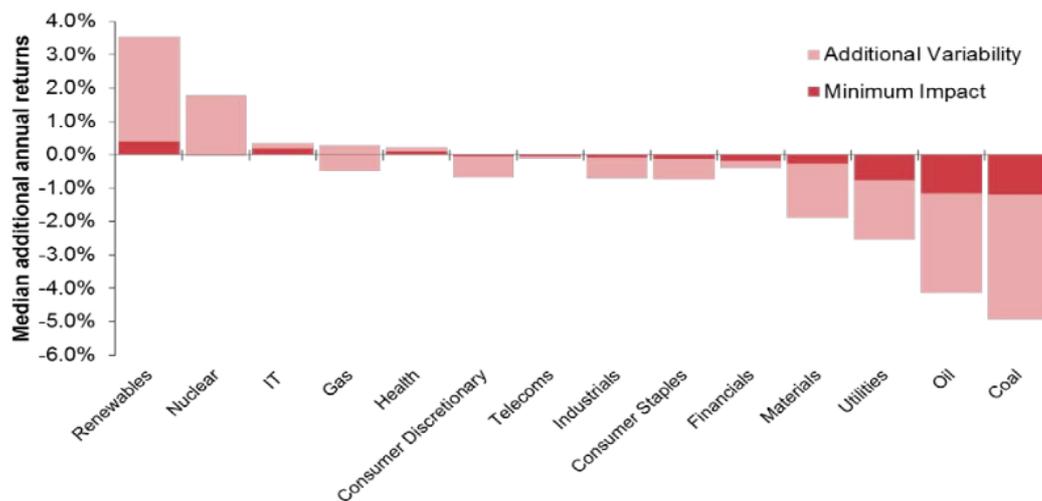
While the assessment and reporting of its portfolio-wide GHG emissions shows progress, it is problematic that oil and gas, utilities and other GHG intensive sectors continue to constitute a substantial proportion of NBIM's portfolio, with oil and gas alone accounting for 6.4%.

In further moves on sustainability, NBIM divested from 59 thermal coal companies as required by the new ethical guidelines adopted in 2016. In the past it has divested from five companies involved in oil sands production and 29 in palm oil, as these

were seen to have unsustainable business models. But while NBIM’s stake in 18 companies has been sold off on the basis of severe damage to the environment, up until now there have been no divestments based on unacceptable levels of GHG emissions.

On the positive side, looking to exploit opportunities offered by climate change and not just mitigate risks, NBIM also runs an environmental portfolio, as discussed in the mandate from the Ministry, amounting to just over NOK 60 billion. However, this constitutes less than 1% of the total portfolio of the Fund, less than a sixth of its exposure to oil and gas.

Overall, NBIM’s policies, while acknowledging significant climate risk, do little to mitigate it, leave alone try and exploit the opportunities that it may present to companies in sectors such as renewables. This is illustrated by the following graphic, prepared by Mercer for CalSTRS, one of the world’s largest pension funds.



Source: *Investing in a Time of Climate Change*⁴⁹

This clearly shows how big a risk of loss investments in the coal, oil and utilities sectors pose to the Oil Fund, and also the opportunity for higher returns from investments in renewables. This is further evidenced by the following graphic, which measures the sensitivity of various sectors to climate change through various channels such as technological progress, resource availability, physical impact of climate

change and changes to public policy.

INDUSTRY SECTOR	T 	R 	I 	P 
ENERGY	-0.25	-0.75	-0.75	-0.75
Oil	-0.50	-0.75	-0.75	-0.75
Gas	<0.25	-0.50	-0.75	<0.25
Coal	-0.50	-0.75	-0.75	-1.00
Renewable	0.50	-0.25	-0.25	1.00
Nuclear	0.50	-0.75	-0.25	0.50
UTILITIES	-0.25	-0.75	-0.50	-0.50
Electric	-0.50	-0.75	-0.50	-1.00
Gas	-0.25	-0.75	-0.25	-0.50
Multi	-0.25	-0.75	-0.50	-0.75
Water	-0.25	-0.50	-0.25	-0.75
MATERIALS	<0.25	-0.75	-0.25	-0.50
Metals and mining	<0.25	-0.75	-0.25	-0.75
INDUSTRIALS	<0.25	>-0.25	-0.50	-0.25
Transport and infrastructure	<0.25	>-0.25	-0.75	<0.25

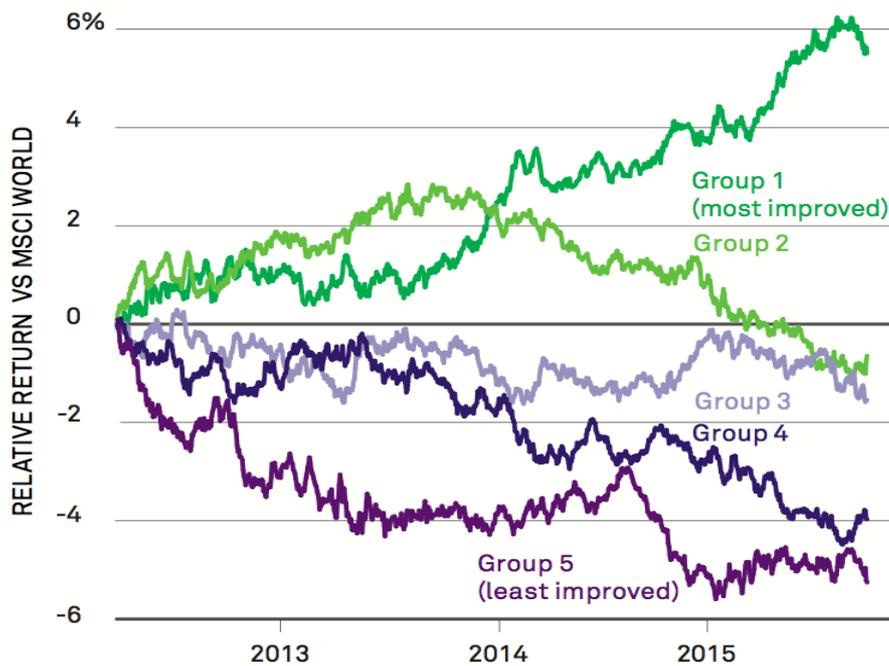
Source: *Investing in a Time of Climate Change*⁵⁰ T: Technology, R: Resource Availability, I: Physical Impact and P: Public Policy

Mercer stress tested various energy intensive sectors and also renewables to various scenarios in the evolution of climate change and the battle to mitigate it. The results look quite disturbing for NBIM, with large negative effects on sectors it has an almost 30% exposure to.

The next graphic illustrates the big difference in financial returns that can result from considerations of environmental factors. It illustrates the evolution of the share price of utilities based on their attitude towards renewable power generation. The message that utilities, which embraced renewables clearly outperformed those that did not, jumps out from the graphic.



Source: Renewables Now⁵¹



Source: Blackrock⁵²

Blackrock, the world's largest asset manager, also reinforces this point. It divided firms in an index into five quintiles depending on their approach to GHG emissions and tracked their stock performance over time. As the graph above demonstrates, firms that were most serious about reducing their GHG footprint outperformed the rest, and there was a strong correlation between performance and approach to climate change.

Commentary

This section has three important messages. The first is that on paper, NBIM has powerful rhetoric on tackling climate change as an investor. The second is that it falls massively short of this rhetoric in terms of its actions. The third is that this lack of action poses serious financial risks for the Oil Fund, by continuing exposure to risky sectors and imposing opportunity costs by foregoing sectors such as renewable energy, which would benefit from action on climate change.

In NBIM's three-pronged approach it uses the expectation document to set standards of climate change disclosure and risk management for portfolio companies, as well as funds research and co-operates with other investors. Under the second prong on ownership, NBIM assesses companies' GHG emissions and engages in corporate dialogue on climate policies. Under the third prong of risk management, NBIM measures and plans to reduce the GHG emissions of its portfolios, and sells companies, which violate ethical investment guidelines on the environment or have unsustainable business models.

While the expectation document is strong, its effect, in terms of standard setting and behaviour change is minimal, mostly because there are few consequences for companies not complying with the expectation documents. By taking up sustainability in conversations with just 12 firms, NBIM has also undermined its strong words on using corporate ownership and engagement to drive sustainability. And in reality, it has done next to nothing on mitigating the risk that climate change poses for its own portfolio. As the analysis from Mercer indicates, a substantial part of the Oil Fund's portfolio has heavy negative exposure to all manners of climate risk. At the same time, by having less than 1% of its corpus in environmentally friendly investments, NBIM is also foregoing significant opportunities for returns.

Example of Actions on Sustainability by Swedish Funds

Other funds, particularly in Sweden, have taken the issue of sustainability more seriously. For example, the Swedish government has just announced new draft rules for the AP funds, which 1) put a focus on sustainability into legislation for the first time 2) clarify the connection to Swedish environmental goals as well as to

international agreements 3) compel the funds to work together on responsible investment and develop guidelines jointly and 4) say they must work to become exemplary in the field of sustainable investment⁵³.

Meanwhile, AP3 already has guidelines to reduce its carbon footprint, increase investments in green bonds, make the buildings it invests in green and make strategic sustainable investments. It reduced its portfolio emissions by 25% by end of 2016 and is carbon neutral on a whole portfolio basis once its investments in timber are accounted for.

What is more, Sweden’s largest pension fund, the AP7, created policy precedent by selling investments in six companies, which it says violate the Paris Climate Agreement. It sold all shares that it owned in ExxonMobil, Gazprom, TransCanada Corp, Westar, Entergy and Southern Corp, and says it would no longer invest in companies that operate in breach of the Paris climate accord. In a statement on the divestment AP7 said that *"Since the last screening in December 2016, the Paris agreement to the UN Climate Convention is one of the norms we include in our analysis."*⁵⁴

Just for comparison, as the following table shows, NBIM holds significant stakes in most of these firms. It is clear that either NBIM does not consider these firms to be in violation of the Paris Climate Accord, or does not believe that this is an international standard/norm/agreement that should apply to its investment policy.

Company	% Stake	Value of Stake
ExxonMobil	0.82%	\$3,066 million
Entergy	1.01%	\$134 million
TransCanada	0.92%	\$359 million
Gazprom (2 affiliates)	0.42%	\$308 million
Southern Corp	0.75%	\$359 million
Westar Energy	0.00%	0

*Source: Author’s calculations*⁵⁵

NBIM has a stated policy, as we have seen in a previous chapter, of opposing any lobbying against climate change policy action so it would be interesting to see if

NBIM reacts to AP7's stated reasons for the divestment, which were that ExxonMobil, Westar, Southern Corp and Entergy had fought against introducing climate legislation in the United States. AP7 also criticised Gazprom for looking for oil in the Russian Arctic and TransCanada for building large-scale pipelines in North America. As discussed earlier, NBIM also has an ethical guideline where it should divest based on poor conduct of excessive GHG emissions, but so far this policy has not been fleshed out and no action has been taken under this yet. Another egregious case is that of Pioneer Natural Resources, which the Church of England says has failed to acknowledge climate change⁵⁶. Strangely, NBIM continues to have a 0.7% stake in it worth \$213 million.

Of all the Swedish pension funds, it is AP4 that has the most advanced policy on sustainability. AP4 believes that sustainability is key and that it is a necessity for long-term performance⁵⁷. In 2011 the board decided that AP4 had to accelerate its commitment to Socially Responsible Investment in order to increase returns and save the environment. It took firm action in 2012, when the then CEO Mats Andersson stripped out every firm with large GHG emissions and/or fossil fuel reserves from the S&P 500 stock index which made 60% of the fund's portfolio. In addition, it has committed to invest almost 10% of its \$35 billion corpus into investment funds, designed by MSCI to track low carbon benchmarks. It has also committed to decarbonise its \$15 billion equity portfolio by 2020 through drastically cutting exposure to companies such as fossil fuel firms, which have high levels of GHG emissions, while simultaneously increasing exposure to low carbon emission firms, including those working on renewable energy⁵⁸.

AP4's management say they made these decisions because they *"wanted to get better returns. There's a misconception that there's a conflict between sustainability and long-term investing. We believe it's a return enhancer"*⁵⁹.

A new paper corroborates this, finding that investors can both mitigate climate risk and enjoy potentially higher returns by investing in a decarbonised index based on a standard benchmark, such as the Standard & Poor's 500 index. Decarbonised indices have so far matched or even outperformed benchmark indices, because financial

markets still tend to under-price carbon risk⁶⁰. AP4's superior returns appear to confirm its belief that sustainability can be a driver of superior performance. Over the past 10 years, it has generated a 5.4% real rate of return, significantly higher than the 3.55% net real rate of return generated by NBIM over the same period⁶¹.

A 2015 review of over 2,000 academic studies since the 1970s found that the majority of studies show positive findings between environmental, social and governance (ESG) factors and corporate financial performance. RBC Asset Management reviewed four bodies of research on sustainable investing and concluded that socially responsible investing has not resulted in lower investment returns⁶². This also holds in emerging markets, where MSCI indices comprised of ESG-compliant companies outperform benchmark emerging market indices. For example, the MSCI EM ESG Leaders Index has been outperforming the MSCI EM benchmark consistently since the financial crisis⁶³. Another ethical index, the MSCI KLD 400 Social Index, has returned an average of 8.4% a year, versus 7.6% for the S&P 500 index since 1990⁶⁴.

Commentary

Four key messages emerge from this section. First, that a number of Swedish AP funds have taken a lead, and even set precedent on tackling climate change and incorporating sustainability into their investment processes. Second that the AP funds are expected to abide by all the international treaties Sweden has signed. Third, that NBIM risks lagging seriously behind on sustainability and fourth, that both from the superior financial performance of AP funds and evidence accumulated over time and reported in studies, as well as the performance of sustainable indices, it is clear that strong actions to tackle climate change, incorporate ESG factors and invest sustainably can be financially rewarding.

AP4's decisions to sell out of all GHG intensive companies in the S&P500 index, to invest in low carbon indices and to decarbonise its portfolio entirely are unprecedented and, according to the management, have been one of the key drivers of superior financial performance. AP3 has developed a carbon neutral portfolio, once its timber investments are included and plans a further 25% reduction in GHG emissions

from its company investments. AP7 has set new precedent by divesting from firms it says have policies incompatible with the Paris Climate Accord.

NBIM, by contrast, has done little on any of these fronts. While it has indeed reduced GHG emissions from its portfolio, these were mainly the result of selling out of coal investments as necessitated by new ethical guidelines introduced in 2016. It has no ambitious policy on decarbonisation. It has, as far as we understand, no plans to invest in low carbon indices or strip out polluters from its benchmark portfolio. It has also not divested from any firms on grounds of their business and policy being incompatible with the Paris Accord, and continues to be heavily invested in such firms as we have shown.

Last but not the least, evidence presented in the last chapter and in this section overwhelmingly points to their being no trade-off between financial performance and sustainability. Rather, most evidence points to sustainable investing both reducing portfolio risks, as well as enhancing long-term financial returns.

Examples of Actions Taken by Other Investors on Sustainability

It is not just the Swedish funds which have gone much further than NBIM, but also an increasing number of sovereign wealth funds, pension funds, asset managers, endowments and insurance firms, many of which are NBIM's peers. They are taking much bigger steps towards sustainability and tackling climate risk, driven by a host of factors, which mostly include limiting risk and increasing long-term return, but sometimes also include ethical considerations. Often, it is a mix of motives, rigorously rooted in financial analysis and research, which has led them to introduce a whole series of measures to green their portfolios. Some of these are discussed below.

Dutch Pension funds: SDG funding and investments

The Euro 189 billion Dutch pension fund PFZW, together with the Euro 387 billion ABP and the Euro 45 billion PME, have all committed to link a substantial percentage of their portfolios to meeting the UN's Sustainable Development Goals⁶⁵. ABP, for

example, seeks to double what was called its “high sustainability investments” to Euro 58 billion by 2020⁶⁶. By contrast, NBIM has no plans to go down this route, despite Norway not just being a signatory to the SDG’s but having actually played a central role in their adoption.

Yale Endowment: Climate Risk and Climate Opportunity

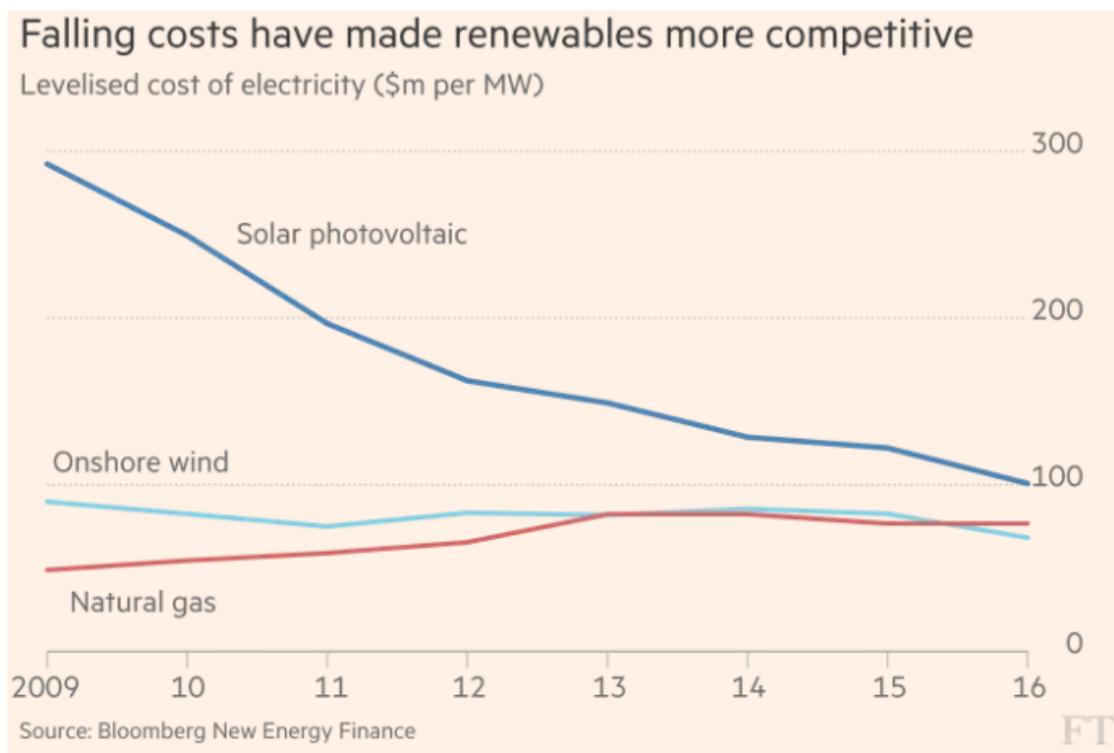
The \$25.1 billion Yale Endowment, widely considered to be the most sophisticated investor in the world, and the creator of the investment model used by most sovereign wealth funds, pension funds and endowments today, put out a very strong statement on climate change and financial risk. It has asked its fund managers not to make any new investments in greenhouse gas intensive companies. It asks managers to fully price in the externalities from GHG emissions and expects superior returns and lower risk, no matter whether governments implement policies to tackle emissions or not⁶⁷.

“Fully pricing the externalities created by greenhouse gas emissions will create opportunities for profit. Examples include companies that produce renewable energy and products that facilitate demand shifting or otherwise promote efficient use of energy. Simply put, those investments with relatively small greenhouse gas footprints will be advantaged relative to those investments with relatively large greenhouse gas footprints.”

“If countries around the world implement pricing schemes that reflect the true costs of greenhouse gas emissions and if in your investment decisions you properly account for the costs and risks of greenhouse gas emissions, Yale’s investments will be well positioned to deal with a more enlightened regulatory environment. Even in the absence of effective government policies to mitigate greenhouse gas emissions, your consideration of the costs and risks of climate change should lead you to better investment decisions⁶⁸.”

Over the past three decades, the Yale endowment has generated an annual return of 12.9%, the highest amongst all large institutional investors. It has been a pioneer in its investment philosophy, which other institutional investors have then gone on to copy.

Evidence that the Yale perspective is right is building up all around. Many think that the combination of rapid policy action and rapid technological change will mean that the energy transition would be rapid. The cost of wind turbines, for example, has dropped by a third since 2009 and that of solar panels by 80%. Countries around the world now have 1,200 climate change laws, up from just 60 two decades ago, and renewables now receive policy support in 146 countries - nearly triple the number in 2004. All of these offer the prospect of a substantial upside to those who invest in renewables⁶⁹.



Source: *Financial Times*⁷⁰

Swiss Re: Ethical Investment, Climate Risk and Stress Tests

Swiss Re, one of the world’s biggest insurance firms, has just decided to move its entire \$120 billion investment portfolio to new ethical indices. The CEO said the company had spent more than a year looking at the pros and cons of such a move, and made the decision on both ethical and financial grounds. “*It is more than doing good — it makes economic sense.*” He acknowledged that the returns from such indices

may be slightly lower than those on conventional indices, but they are also less risky to the point where the risk-adjusted returns on such ethical indices are actually better⁷¹. MSCI has found that two of its indices that excluded coal and all fossil fuels, respectively, have outperformed parent indices that included these stocks between since 2010⁷².

Researchers at Swiss Re who looked into the issue have concluded that *“taking a long-term view on responsible investing is at least as much about limiting downside risks as benefiting from upside potential”* and that investor *“motives are ... shifting from simply 'doing good' towards achieving a combination of return, risk and sustainability objectives”*⁷³.



Source: Financial Times⁷⁴

The Chairman of the Financial Stability Board Mark Carney has also warned of the significant downside risk of investor losses on investments in fossil fuel companies and others with intensive greenhouse gas emissions. He warned of such firms losing

market value to the point that it could trigger “huge investor losses⁷⁵”. The graphic above depicts how this is already starting to happen.

It shows how much the market value of European power utilities, most of which depend on fossil fuels for power generation, has shrunk in the past ten years. Within fossil fuel firms, Exxon Mobil wrote \$2 billion off the value of its U.S. natural gas fields in January 2016 and in February, it removed 3.3 billion barrels of oil from its books. Between them, oil and gas companies wrote off more than \$185 billion of the value of their fossil fuel reserves⁷⁶.

Recognising this risk, the Swiss government, in a joint project between the Ministry of Environment and the Ministry of Finance, is offering the country’s pension funds and insurers an opportunity to test their equity and corporate bond portfolios to see if they are compatible with the 2°C maximum global warming target under the international climate change agreement reached in Paris in December 2015⁷⁷.

Responding to the threat of large potential losses on their portfolios, two of the world’s largest asset managers, BlackRock and State Street Global Advisors, have announced that “*climate change was their top priority in their direct engagements with companies in which they own shares*⁷⁸”.

Also reinforcing the point is a UN Global Compact – Accenture Study on Sustainability, which surveyed 1,000 global CEO’s from 103 countries and 27 different industries. It found that 76% of them believed that embedding sustainability into core business would drive new opportunities and growth. It also found that including ESG factors in investment decisions should improve the risk-adjusted performance of any portfolio⁷⁹.

The UN Global Compact, which the Oil Fund says it abides by, has recently called on companies to set an internal price of carbon at \$100 by 2020. Already, more than 70 companies from 20 sectors representing over \$2 trillion in market capitalisation have taken on the triple challenge of setting an internal carbon price materially high enough

to affect investment decisions, calling for effective pricing policies, and reporting progress on an annual basis. Of these, more than half use a shadow price, with the rest using an internal fee or an implicit price with the average price being \$32.13 per tonne of CO₂ equivalent. Beyond corporates, nearly 40 national and 20 sub-national jurisdictions are also already participating or preparing for a carbon price⁸⁰.

Commentary

There are several important points, which emerge from this section. We focus on the main three. The first is that some of the most sophisticated investors in the world, such as the Yale Endowment, have taken a clear, financially driven stance that they will no longer invest in GHG intensive firms and instead allocate a disproportionate amount of investments to low carbon firms, which have businesses that will aid in the fight against climate change. Yale is very clear that this is not an ethical, but a financially driven decision that has no downside, but significant potential to reduce risk as well as drive up returns. Losses already in the market value of carbon intensive utilities as well as the higher than expected rate of decline in the cost of renewables, which are now the cheapest source of energy in many countries add further credence to Yale's claim. The Swiss government has introduced voluntary stress tests for its pension funds designed to show how the fund would perform in the event of a successful low carbon transition.

The second is that some other investors have taken a financially driven, but broader approach. Swiss Re, one of the world's largest insurers, for example, has shifted its entire portfolio to ethical indices after thorough and rigorous analysis that showed that this would reduce risk and increase the prospects for higher returns. Sustainability is an important, but not the only consideration in its decision. Similarly, several large Dutch pension funds have also moved in this direction through significant investments in firms, which contribute to meeting the Sustainable Development Goals. A number of indices designed on environmental or ethical grounds actually outperform regular stock indices.

A third point is that many corporates, most of which the Oil fund has invested in, are at the cutting edge of adapting their business strategy to a low carbon world. Under the auspices of the UN Global Compact, which the Oil fund claims to follow, companies with sales exceeding \$2 trillion have signed a pledge to have an internal carbon price of \$100 by 2020, with the average price they use today already more than \$30. The vast majority of CEOs surveyed under the aegis of the UN Global Compact believe that sustainability will drive new opportunities for profit and that investors incorporating ESG factors into investment strategy will enjoy better performance.

Importantly, NBIM has not moved on any of these fronts. There is no policy of not investing in high GHG emission firms, no positive discrimination for a low carbon strategy, no dedicated ESG or SDG funds, no examination of low carbon or ESG indices as an alternative to the stock indices NBIM currently uses, and no use of an internal carbon price or plan to do so. Nor is there any move by NBIM to do carbon stress tests of the kind planned by the Swiss government.

Conclusion

This chapter contains some important message for Norwegian citizens, policy makers and the Oil Fund. The first is that the Oil Fund has powerful rhetoric on sustainability. The second message is that it is failing to live up to this rhetoric and its actual actions fall far short even of what its own policy states. The third is that the Swedish AP funds, appear to be taking sustainability far more seriously and have done so while generating returns that are significantly higher than NBIM offering further proof that there is no trade-off between profitability and sustainability. Fourth, it is not just the Swedes, but a whole array of other, mostly private rather than state owned investors who have taken ESG issues and sustainability to heart and gone much further down the route of incorporating this into their investment strategy. Furthermore, many of these investors, such as the Yale Endowment fund, are far more sophisticated and financially savvy than NBIM and the fact they see no trade-off between returns and

sustainability, but rather view sustainability as a driver of superior returns should give Norwegian policy makers and the Oil Fund pause for thought.

Chapter 4: Policy Recommendations for the Oil Fund

As discussed in the previous chapters, apart from the legislation setting up the Oil Fund, which is very skeletal, all other levels of policy from the mandate from the Ministry to Norges Bank to the expectation documents on climate change for firms that NBIM invests in contain strong language on sustainability and climate change. However, it has become clear in the course of the last chapter that this language does not translate into action. In the first part of this chapter, we consider what each of the sections of the mandate, the strategic plan of the board of Norges Bank and the policy set by NBIM management, properly interpreted, would mean for sustainability.

The second part of the chapter considers what the recommendations of the law commission, suggesting that the Oil Fund be relocated away from the central bank and under a new entity NGIM, Norwegian Government Investment Management, may mean for sustainability. The Law Commission's report and the following discussion offers an opportunity to take the Oil Fund's approach to sustainability to the next level.

In the third and last part, we show how a more rigorous approach to sustainability and addressing climate change do not constitute a politicisation of the Fund.

Interpreting the current mandate on sustainability more accurately

The current mandate from the Ministry

We start with the mandate the Finance Ministry gives to Norges Bank and use a detailed discussion on climate change policy to make a broader point of how much more the Oil Fund can and should be doing on sustainability. On the surface, this mandate strongly instructs Norges Bank to take environmental sustainability into account insisting that a good long-term return depends on this. It also argues for a strong policy on the environment as part of its duty as a responsible investment. The

Ministry asks the bank to follow, amongst other international principles and standards, the UN Global Compact. It gives the Bank big leeway on risk management and a mandate for a small environmental portfolio.

But even as it gives what looks like a strong mandate on environmental policy and sustainability to the Bank, the Ministry undermines this goal. It asks the Bank to use the FTSE Global All Cap Index as the benchmark, rather than one of the many low carbon indices, which have now been established. This index has a significant proportion of high GHG emission companies, with more than 9% of the index being comprised of oil and gas, and also utility firms. The Ministry gives Norges Bank only a tiny discretion of just 1.25% of deviation from the index in any year, which means the Bank must invest in oil and gas and other high GHG sectors if it is to stay within this limit. The Ministry also forbids the Bank from investing in unlisted infrastructure, even as investing in renewable energy infrastructure remains one of the most successful means to tackle climate change.

Nevertheless, there is much more that Norges Bank could do even with this restrictive mandate. To begin with, within the UN Global Compact, it could sign up to the Business Leadership Criteria on Carbon Pricing and could commit to using an internal carbon price of \$100 by 2020. This could make a significant change to its investment strategy by driving out GHG intensive firms and overweighing low carbon firms compatible with tackling climate change. It could also ask firms it invests in to adopt an internal carbon price. In addition, it could make a case for significantly increasing its environmental investments to the Ministry, as part of its mandate to get a good long-term return.

On risk management, the Bank could put forward analysis, which treats climate risk as a systematic risk that it is and perform stress tests based on various scenarios for climate risk and policy responses including carbon prices of \$50 and \$100 by 2020. It should also analyse extreme risks both of sharp successful policy action to keep global warming within 1.5 degrees on the one hand, and of runaway global warming assuming the Paris accord fails on the other. It should modify its investment strategy

based on prudent risk management taking these stress tests and additional risk perspectives into account. Many of these ideas, for example on risk management, are also directly applicable to other social, governance and environmental issues. We had, for example, suggested that the Oil Fund stress test its portfolio to changing social norms on tax policy⁸¹.

Guidelines for observation and exclusion from the Fund

On the plus side, the ethical guidelines contain references to severe environmental damage and unacceptable levels of GHG emissions as reasons to exclude companies from the investment universe of the Fund. On the negative side, these are rather vague and so far, the Fund has excluded only a few companies on the environmental risk criteria and none for emitting unacceptable levels of GHG gases. A third possibility for excluding companies on the basis of a violation of fundamental ethical norms, which for a layman should include lobbying against climate change action, for example, has also not been used in the sustainability context.

Yes, these guidelines should be and can be strengthened to, for example, include provisions that explicitly forbid lobbying against climate change, or contain quantitative restrictions on the GHG intensity of revenue or exclude certain sectors known to be responsible for the vast majority of GHG emissions. Beyond the environment, the Council can use the provision of being able to exclude firms that violate fundamental ethical norms to look more thoroughly into the social aspects of ESG, particularly in the context of Norway's obligations under UN agreements and treaties such as the SDGs.

Both Norges Bank and the Council of Ethics do already have substantial discretion to act to make the Oil Fund more sustainable, but most of this discretion remains unused. As discussed in the last chapter, AP7 has divested from firms it says have business incompatible with the Paris Accord, as well as those which lobby against actions to tackle climate change. There is no justification, financial or ethical, as to why Norges Bank and the Council of Ethics should not follow suit. The advantage of taking this route is that such firms are automatically excluded from the benchmark

portfolio, so they do not count in the narrow tracking error set by the Ministry. Global warming has already inflicted so much environmental damage that the Council of Ethics could also include this within its interpretation of severe environmental damage.

Like with the Swedish AP's, there is a strong case to be made that the fact that the international treaties signed by Norway, should automatically apply to the Oil Fund, should be spelt out in the mandate from the Ministry.

The Strategy for NBIM and Principles for Responsible Investment Management

The strategy laid out by the board of the Norges Bank for NBIM again, on paper, has a substantial focus on sustainability. For example, it talks of taking only acceptable levels of risk and the importance of being a responsible investor. It speaks of broadening NBIM's advisory work, including advice that takes national wealth into account and of designing alternative measures of risk as well as makes changes to the reference portfolio to improve diversification. It expands upon the mandate's request for scenario analysis and risk analysis of extreme events and the need to manage all relevant risks in the portfolio, including environmental risks. Last but not least, it says NBIM will seek to be a global leader in responsible investing.

The strategy could have an even stronger focus on sustainability, perhaps explicitly asking NBIM to measure, report and manage climate and environmental risk. It could also explicitly ask for carbon stress tests, for example. On responsible investing, the strategy could be to ask NBIM to be at the cutting edge of international efforts on sustainability such as setting up an internal carbon price, and not making investments incompatible with the Paris Accord. But even without this, NBIM has a lot of room for discretion to be more sustainable. Again, we use climate change as an example to make a broader point.

First, NBIM should use the policy focus and discretion provided to it by the strategy document to 1) define climate risk as an unacceptable risk so it can take steps to

mitigate it 2) perform carbon stress tests on its portfolio and test out extreme climate scenarios to manage such risks 3) rigorously measure and report climate and other environmental risks such as water risk and 4) exclude oil and gas, but include renewables in its reference portfolio to improve diversification.

Second, it should sign up to the UN Global Compact's commitment to have an internal carbon price of \$100 by 2020 and exclude investments incompatible with the Paris accord.

Last, but not the least, it should, as instructed by the Norges Bank board, think of managing the Fund not as a standalone fund as it does now, but a fund that exists within the context of Norwegian national wealth, a disproportionate amount of which is derived from the sale of fossil fuels. Such a consideration, which makes far more economic sense, would lead it to sell out of fossil fuels and decarbonise its portfolio purely for the purpose of risk diversification. Even then, the residual exposure of the Norwegian economy to fossil fuels is so large that the Fund would need to significantly expand investments in industries such as renewables, which are negatively correlated to fossil fuels, in order to meet its mandate of maximising returns for moderate risk⁸². It should make such considerations public and use them to persuade the Finance Ministry to make suitable modifications to its mandate to execute this prudent strategy.

The Principles for Responsible Investment Management call on NBIM to use its responsible management mandate, which includes sustainability to reduce risks and seek to increase return. They also specifically ask NBIM to take into account the externalities that companies in its portfolio impose on other companies in the portfolio, while making investment decisions. Last but not least, they ask NBIM to account for environmental risks and opportunities in its investment decisions on companies, and allow it to use such considerations to overweight or underweight whole sectors or industries.

These offer a substantial amount of room for action, most of which NBIM has failed to use thus far. There has been no effort to use an environmental or sustainability analytical lens to make investment decisions, contrary to what the principles say. There has been no attempt to measure or account for externalities imposed, for example, by GHG emissions and adjust investment decisions accordingly. Nor have these considerations been used to underweight GHG intensive sectors such as oil and gas, or overweight sectors such as renewable energy. In short, NBIM has a lot of discretion and also obligation to take further action on sustainability under the principles for responsible investment management laid out by its own management.

The Expectation Documents on Climate Change and other issues

NBIM's expectation documents are full of sensible suggestions on how companies should approach the challenges and opportunities associated with climate change, water management, human rights and children rights. The document on tax and transparency is weaker. Here we use the example of the climate change document to make a broader point, that NBIM should apply the policies and ideas embedded in these documents to itself.

On climate change, NBIM first expects the company board to be responsible, ensuring that climate change policy is driven by the top management and is a strategic imperative rather than an afterthought. Second, it rightly says that there are multiple aspects to it, such as policy and technological changes, that it creates both risks and opportunities and that it is disproportionately important for firms with high GHG emissions. Third, it asks for full disclosure, which it says it will use to determine if the company has a long-term business strategy for a transition to a low carbon economy.

Furthermore, it asks companies to incorporate both the physical and policy aspects of climate change in risk management, in investment planning, in sensitivity analysis and scenario planning. This should include a scenario, which considers a successful implementation of policies to limit the likelihood of global warming within 2 degrees. It also asks companies to formulate guidelines on how they engage with policymakers on climate change.

There is a lot to unpack here, but we will resort to a simple mental trick instead. In the first week of August 2017, NBIM’s holdings are worth \$984 billion, of which \$132 billion are equity holdings across 1,804 financial sector firms which include, banks, asset managers, insurance firms, reinsurers and financial firms of every hue and colour. Together, they constitute a full 13.4% of the Fund, its largest sector holding. A sample of these firms is presented in the table below. The Fund, as discussed above, expects all of these firms to follow its expectations documents on climate change and other issues and thus measure, report and manage their climate risk and other risks, conduct stress tests and scenario analysis, and report on policies with regard to engagement with policymakers. Some of the financial firms the Fund owns substantial stakes in, such as Swiss Re and Blackrock, have already been mentioned in this report.

NBIM too is an asset manager which, like Blackrock, the world’s largest asset manager, seeks to maximise financial returns for prudent risk, subject to the constraints imposed by asset owners. In the case of Blackrock, these are institutional investors such as pension funds and pension holders, and in the case of NBIM this is the Norwegian Parliament on behalf of Norwegian citizens. If NBIM expects the Expectation document on Climate Change to be followed by the likes of Blackrock, which manages more than \$5.7 trillion for several hundred clients⁸³, then surely it can and should apply the document to itself, given that it manages less than \$1 trillion, for just a single client in a much simpler arrangement.

Name	Amount (USD)	% Ownership
Aberdeen Asset Management	75 million	1.80%
Aviva	493 million	2.02%
Blackrock	3.2 billion	5.18%
Credit Suisse	1.48 billion	4.93%
HSBC	2.9 billion	1.82%
JP Morgan	2.7 billion	0.82%
Schroeders	90 million	1.04%
Swiss Re	291 million	0.85%
UBS	1.97 billion	3.26%
Zurich	901 million	2.17%

Source: NBIM⁸⁴

Thus NBIM should

- Ensure board level buy in of its climate change strategy.
- Recognise that there are both risks and opportunities and act to minimise risk and maximise opportunity.
- Recognize the different aspects of climate change such as policy risk, physical risk and technological change.
- Pay special attention to GHG intensive companies in its portfolio.
- Develop a long-term business strategy for a transition to low-carbon economy.
- Incorporate all aspects of climate risk in its investment planning and execution.
- Consider and report the sensitivity of profitability to future regulatory and physical climate scenarios with one such scenario considering the successful implementation of the Paris accord.
- Adopt the best standards in climate change risk management.
- Clearly disclose the climate risks it faces and steps undertaken to overcome it.
- And have a clear policy of engaging with policymakers on climate change.

In short, if NBIM takes the next logical step and applies the climate change expectation document it expects all financial firms, including asset managers, it invests in to follow, then the positive outcome for sustainability would be nothing short of radical.

New mandate for Norwegian Government Investment Management

In June 2017, the Norwegian Law Commission on the Act relating to Norges Bank and the Monetary System set out its final report⁸⁵. This has a number of interesting parts relevant to the theme of this report, sustainability.

The Commission has proposed the establishment of a separate statutory entity, separate from Norges Bank, to manage the Fund. It further says that the board of the entity should have specialised competence in finance and investment management and perhaps even have international expertise.

Our suggestion here is that if a new professional board is indeed appointed to oversee the oil fund, it should be ensured that at least one member has deep expertise on sustainable investing.

Next, the amendments proposed to the Pension Fund act by the commission will be examined. We agree with most of the amendments suggested, with one caveat and in addition, propose two amendments of our own.

The Commission has proposed the strengthening the formulation of objectives in the Government Pension Fund Act concerning the Fund's role as a source for financing the welfare state across generations. *"This is achieved by an investment management strategy that seeks to attain the highest possible return at an acceptable risk while promoting responsible investment."*

We recommend adding ***"and sustainability"*** to the end of this amendment.

The Commission has also proposed enshrining in law a provision to the effect that the Fund shall invest outside Norway and in foreign currency in a draft new Section 6 of the Act on the Government Pension Fund.

To this, we recommend adding

"The Fund must invest in a manner that maximises its diversification by taking into account the whole Norwegian economy."

This will ensure that the excessive dependence of the Norwegian economy on oil and gas is accounted for in a rigorous manner when designing the best investment strategy for the Fund to maximise long-term return for moderate risk.

Rebutting the myth of a Political Use of the Fund for Environment

The message that calls for the Oil Fund to sell out of fossil fuels or to invest in renewables, or to strengthen its sustainability policies are somehow “political”, is a constant refrain from the Finance Ministry. It even manages to make its way, indirectly, into the Commission’s report in the form of

The Commission would also caution against using the Fund as an instrument of foreign policy, business policy, regional policy or environmental policy.

The truth is that it is the Fund’s present investment strategy of continuing to invest more than 6% of its equity portfolio in oil and gas, and not having a more ambitious strategy on climate risk and climate opportunity, which is politically motivated, driven perhaps by powerful oil and gas interests that permeate the Norwegian establishment.

That could explain how the debate, launched by us in the 2013 political cycle of getting the government to consider selling out of all fossil fuel investments on pure risk – return considerations, was narrowed it down to considering selling out of just coal - that too only on ethical grounds.

As the discussion in previous chapters has shown, sustainability is driven purely by considerations of risk and return, and hence not political. The ethical guidelines are political, but driven by the need for legitimacy of the Oil Fund with its ultimate owners, the Norwegian citizens. The kind of measures which are understood to be political in this context, refer to measures where politicians make ad hoc investment decisions, which are embedded neither in considerations of risk or return nor embedded in the ethical framework. That does not happen in Norway.

As this report has repeatedly demonstrated, the case for sustainable investing is rigorous and is one that has been taken up by both private and public investors that are considered to be more savvy than NBIM and who have, despite taking strong measures on sustainability, generated returns far superior to what NBIM has managed. On most measures, the case for NBIM becoming a champion in sustainable investing is crystal clear. Below, it is briefly discussed why this is so.

First, as discussed, a Fund owned by Norwegian citizens must reflect their values. That is why the Fund does not invest in tobacco or in firms which make certain kinds of weapons or use child labour. Surveys have repeatedly shown that Norwegian citizens overwhelmingly want the Oil Fund to make a bigger contribution to the environment. This means both reducing its GHG exposure drastically, and making positive sustainability themed investments that help mitigate climate risk.

Second, as the Strategy Council of the Fund and the Norges Bank have acknowledged, a large universal investor such as the Oil Fund has complicity in the actions of firms it invests in. That is a good reason for the Fund to divest from firms that inflict significant environmental damage, including through contributions to global warming. As one of the highest per capita contributors to GHG emissions, and as the only European country, which has completely failed to meet its GHG reduction commitments, we have even more complicity than most. A good reason then to also invest in businesses, which will contribute to helping tackle climate change and overcome environmental destruction.

Third, as discussed by the Strategy Council as well as the board of Norges Bank, as a long-term universal investor, the Oil Fund cannot escape the negative externalities that some of the firms it invests in, impose on the other firms in its portfolio. This is especially true of GHG emissions and is another reason for the Fund to shun GHG intensive firms and buy those, which have positive externalities for the rest of its portfolio instead.

Fourth, the Norwegian economy as a whole is excessively dependent on oil and gas and ancillary industries. All future revenue for the Oil Fund also comes from the sale of oil and gas. As we have demonstrated convincingly elsewhere⁸⁶ together with others⁸⁷, this means that a sound risk management and diversification strategy, based on pure financial considerations, dictate that the Oil Fund must divest all of its oil and gas holdings immediately, drastically reduce its exposure to utilities and other GHG intensive industries and invest heavily in renewables and other industries negatively correlated to fossil fuels.

Fifth, as the analysis in this report has repeatedly shown, and as other investors, the Finance Ministry and the NBIM have said on numerous occasions, sustainability and a low carbon investment strategy can help reduce risk for the Oil Fund. This would entail selling out of fossil fuels and decarbonising the portfolio.

Sixth, as examples in this report have shown and both the Ministry and Norges Bank have acknowledged, climate change also brings opportunities, particularly for firms that enable the transition. This means that a sustainable investment strategy can also produce higher financial return, in line with the Oil Fund's goal of maximising return for moderate levels of risk.

In short, the ethical, diversification, risk mitigation and profit maximisation case for the sustainable investing by the Fund is overwhelming, and there are no grounds to dismiss calls for sustainability or divestment from oil and gas as “political”. As demonstrated, what is “political” and makes little financial sense is continuing the status quo where a lot of lip service is paid to sustainability and tackling climate change, but no real action has been undertaken to deliver such outcomes. The double standards and complicity should not continue.

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