

BI Norwegian Business School
Master of Science in Political Economy

The Government Pension Fund Global

An analysis of the climate change strategy
in the period 2006 to 2012

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Abstract

This thesis in Political Economy is a case study of the Government Pension Fund Global (GPFG) and the climate change strategy in the period 2006 to 2012. Climate change is a topic of growing interest among investors, and especially universal owners, due to the financial risks it might entail across all markets. The main methodological distinction in this study is the historical approach. The objective has been to find out how climate change is on the agenda, and whether it has been a consistent strategy over the period. The GPFG is placed within a distinctive institutional design, which is given attention also in this thesis, and the three most relevant actors in this regard has been the overall manger of the Fund, The Ministry of Finance, the operational manager, Norges Banks investment Management (NBIM), and the independent Council on Ethics. It was found that climate change is an issue which has gained increased attention over the period. Among others, it is a focus area in NBIM's ownership activity and the Ministry has initiated large research projects on the financial effect of climate change. There has however been some inconsistency in how the actors communicate their climate change strategy with the owners of the GPFG, the Norwegian people.

Reference style: Chicago Manual of Style, 16th edition (Author-Date References).

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List of abbreviations

CalPERS: California Public Employee Retirement System
ESG: Environment, Social, Governance
FiOH: Future in Our Hands
GPF: Government Pension Fund Global
IIGCC: Institutional Investor Group on Climate Change
KLP: Kommunenes Lands Pensjon
NBIM: Norges Bank Investment Management
NGO: Non-Governmental Organization
NSD: Norsk samfunnsvitenskapelig datatjeneste
RI: Responsible Investments
SRI: Social Responsible Investments
UN: United Nations
UNPRI: United Nation's Principles for Responsible Investment
UNEPFI: United Nation's Environmental Programme's Finance Initiative
UNFCCC: United Nation's Framework Convention on Climate Change

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1. Introduction and problem definition

1.1. The topic – context, rationale and contribution

The research area in this master thesis in Political Economy is climate change and responsible investments (RI). A case study of the Norwegian Government Pension Fund Global's (GPFG)¹ most significant activities and strategies related to climate change in the period 2006 to 2012 will be carried out. The GPFG is a large state owned fund, entirely invested abroad and managed by the Norwegian Bank Investment Management (NBIM) which is part of the Norwegian Central Bank, Norges Bank (Ministry of Finance 2011b). The Fund had a market value of 3448 billion NOK the 17th April 2012, but the value is continuously changing (NBIM 2012a). The Fund's portfolio is broadly diversified, see §2-1(2) in the Management Mandate (see table 1). By the end of 2011 58.7 percent of the Fund was invested in equities, whereas 41 percent was invested in fixed-income and 0.3 percent in real estate (NBIM 2011a, 14). The equities, bonds, and real estate investments were spread out on 68 different countries, and the Fund owned shares in 8005 listed companies by the end of 2011 (NBIM 2011a, 38,21).

Three involved actors will be particularly relevant for this research; the above mentioned operational manager of the Fund, NBIM, and the overall manager of the Fund, the Ministry of Finance. The third actor is the independent Council on Ethics. A figure in chapter 3.1 shows the relationship between the three actors, in addition to the role of other relevant, but less central, actors. Climate change is a field of growing interest among institutional investors such as pension funds, investment banks and insurance companies. There is an increasing awareness rising about the challenge future climate change might pose for so-called universal asset owners, and thus environmental focus is becoming an integrated part of RI, both at the theoretical and practical level. Climate change has been one of NBIM's focus' areas in the corporate governance strategy for the period 2007-2010 (NBIM 2007, 89) and in NBIM's strategy for 2011-2013 (NBIM 2011f, 6). The Ministry of Finance has initiated a large research project with emphasize on climate change. Furthermore, the Ministry decided in 2008 that approximately 20 billion

¹ Commonly known as the Petroleum Fund, or "Oljefondet" in the Norwegian debate. The abbreviation SPU (Statens Pensjonsfond Utland) is also often used. In this research the Fund or the GPFG will be used. A variety of abbreviations exist in the literature, but the GPFG is the one used by the involved actors.

NOK should be allocated to an environmental program (Ministry of Finance 2008e, 16). It is interesting to note that environmental concerns, although not climate change as such, not only has been a focus in NBIMs ownership engagement and in the Ministry, but also in the work performed by the Council on Ethics. According to the Ethical Guidelines, if there is a risk that a company contributes to *severe environmental damages*, the company should be excluded from the portfolio (Ministry of Finance 2010c). However, since climate change explicitly is not a part of the Council on Ethics mandate, the analysis of this actor will be somewhat different from the two others. Focus on climate change has nevertheless been an integrated part of the strategy for the Fund as a responsible investor for some years. An interesting question is as such whether there has been consistency, or if there has been any disruptions in the climate change focus in the period 2006-2012?

Another interesting question is why it was decided to emphasize on climate change in the first place? Was it in line with the principle of *overlapping consensus*, i.e. what most Norwegians find appropriate to focus on? In 2002 the Graver Committee², led by professor Hans Petter Graver, got a mandate from the government; to design a set of ethical guidelines for the then-called Petroleum Fond (Ministry of Finance 2012b). The Graver Committee discussed the principle of overlapping consensus. The general idea is that even in a pluralistic society there are some principles which will be accepted by more or less the whole population, even though the argumentation behind might be different. The suggested ethical guidelines were supposed to be in line with “main normative characteristics that are consistent over time” (Graver Committee 2003b, chapter 2.1, third paragraph). Another plausible explanation, as to why climate changes is on the agenda, is that the actors were concerned with how climate change will affect the financial markets and the probability of securing long term return? After all the primary motivation with the Fund is to secure long term financial wealth for future generations of Norwegians (Lovdata 2010).

The three actors possess quite different tools in their work with responsible investments, this will be thoroughly discussed below, but briefly it can be said that the Ministry has the overall responsibility and authority. This has been

² Sometimes called the *Graver Commission*

delegated to the Ministry by the Parliament. The Ministry decides for instance the negative screening strategy, i.e. which companies that should never be invested in based on a product-based argumentation. This is for instance the case for companies involved in the production of tobacco, and certain kinds of weapons. The Ministry also decides if companies should be excluded from the Fund on a conduct-based argumentation. This decision is taken based on an advice from the Council on Ethics. The rationale behind is that a company can be responsible for a certain conduct that is regarded unethical. NBIM, on their side, decides which companies should be included in the portfolio, and what to focus on in the ownership engagement. Consequently, the Fund is operating with several tools that interact with climate change and environment.

A conceptualizing of the research will be necessary; this is relevant for concepts used in the introduction which might not be familiar to the reader, but also for a concept which has almost been a fuzzy word during the last decade, namely climate change. As will be carefully outlined below, the concept of climate change does not necessarily mean the same for a long-term institutional owner, which primary objective is to generate high returns, as for a scientist or an environmental organization. This research is not about climate change per se, and it will not discuss climate change to any particular extent. This research is about how a financial actor uses different responsible investment tools to consider the challenge climate change might pose for the financial return. Nevertheless, an understanding of how climate change is understood by the three different actors, and why investors consider climate change an important externality, is necessary.

It ought be mentioned that this thesis is only relevant for the 58.7 percent of the Fund that is invested in the global equity market, and not for the remaining 41 percent invested in fixed-income³. The reason is that the Ethical Guidelines, as well as the ownership engagement of NBIM, only is applicable to companies, and thus only on the equity part of the Fund. The lack of ethical principles for the fixed-income part of the Fund has been subject to major criticism, but will not be further discussed in this thesis. The real estate investments are so far quite limited (0.3 percent), but they will nevertheless be touched upon in the thesis.

³ Note that the distribution is changing, but according to the investment mandate the equity part should be around 60 percent and the fixed-income around 40 percent. When the investments in real estate increase, the fixed-income part will be decreased to around 35 percent (Lovdata 2010).

Despite the somewhat agreeable statement that the GPFG is a pioneer in RI with its ethical framework for investment and the work performed by the Council on Ethics, this might not be the case for the work with climate challenges (Alm 2010). Even being a large investor, in this case the second largest Sovereign Wealth Fund (SWF)⁴ in the world (Mercer 2012a, 52) one single actor cannot alone influence climate change, so this research aims to contribute with a conceptualizing discussion on what is being done in GPFG, and why, rather than actually measuring the outcome or the impact of what is being done. The research seeks to understand how climate change is on the agenda for the period 2006-2012. Why is this topic interesting and relevant? Climate change is a highly relevant research area, which has been on the international agenda for several decades. As will be shown in chapter 4.1, climate change is also a topic of growing interest among investors, and especially universal owners which are particularly affected by negative externalities like climate change. A proof of this topic's relevance is the fact that the Ministry of Finance in 2009 initiated a research project in which the consequences of climate change for the asset markets were discussed. The topic was also discussed at the conference "Do Investors care about the Environment" arranged by the Ministry of the Environment and BI Norwegian Business School in June 2012.

In the aftermath of the 2008 finance crisis a more responsible financial sector has also been a heated debate topic. The "Occupy Wall Street" movement is an example of ordinary peoples continued demand for a responsible finance sector. It is no longer only a matter of anti-globalization movements, many ordinary people have lost faith in the financial sector's capability of being self-regulatory and act responsibly. In this setting it is very interesting to study large and long-term institutional investor, and how it considers one of the most challenging issues today. Acting in a responsible way as an investor is of course a very broad idea, and there is no commonly accepted definition of RI. As will be shown later, definitions often include what is called ESG principles, the incorporation of **E**nvironmental, **S**ocial and **G**overnance aspects in the investment decisions (Louche 2009). Furthermore, Political Economy is an academic field which seeks to understand the interaction between economics and politics. The GPFG is placed

⁴ Sovereign Wealth Fund is a quite new term, which refers to public owned investment funds.

in such a setting by being a public owned investment fund, subject to government regulation, but still operating in the private market through their investments. As such it is also interesting to look at why and how the Fund is regulated by the Norwegian state.

Instead of focusing on the whole ethical framework, the narrower emphasis on climate change makes the research more interesting and also operational. It is also part of a less researched field. Research conducted on the Fund does unfortunately, and perhaps surprisingly, not emphasize climate change to any particular extent. On the other side, the lack of research on exactly this part of the Fund is also the reason for why the topic has been chosen in this thesis. A comprehensive discussion of how climate change is on the agenda does to my knowledge not exist. The GPFG receives quite a lot of attention in the Norwegian media debate, but the focus is quite concentrated around specific investments, rather than the overall picture.

1.2. Research question and operationalization

Based on the above outline of the research area, the developed research topic that will form basis for this research is:

How is climate change embedded in the RI agenda for the Government Pension Fund Global, and what were the major strategies in the period 2006-2012?

To operationalize the study several research questions will be used, which broadly can be divided into two bulks. The following research questions will serve to set the scene. They are definitional and conceptualizing research questions, which will be answered in chapter 3, 4 and 5:

1. What are the relevant actors, and how is the organizational structure and role-division between them?
2. What is the regulatory pattern of the GPFG, and is climate change incorporated in the legal mandate of the Fund?
3. What does climate change mean for a long-term institutional investor like GPFG?

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4. What is RI, and how can it be conceptualized for the GPFG?
 5. What are the RI instruments available for investors?
 6. What are the relevant principal-agent relationships, are there any conflicts, and if so, can they have influenced the climate change work?

The next set of research questions will form the basis for the analysis and discussion in chapter 6:

7. How is climate change on the agenda for the three different actors; NBIM, the Council on Ethics, and the Ministry of Finance?
8. What were the major happenings/strategies, and is it possible to identify a leading role among the actors?
9. Has there been consistency and continuity in the three actors' work with climate change in the period 2006-2012?
10. How are the four different instruments negative screening, positive screening, withdrawal, and corporate governance used in the work with climate change?

These research questions will together form the basis for the thesis, and will be systematically discussed in the coming chapters. Ten research questions might seem ambitious, but it should be précised that they form the basis for the whole thesis, background, literature and theory included. Moreover, some of them can be answered quite concisely. All the ten research questions are necessary in order to get an overall picture, and they do together form the basis for answering the research problem; how is climate change on the agenda for the period 2006 to 2012.

2. Methodology

This chapter presents the research design, or the methodology, adapted in this thesis. It will start by describing the research approach, which is characterized by triangulation, i.e. the use of combined methods and data (Patton 2002, 247). The research is mainly qualitative and the historical perspective will be the main approach, but some quantitative method like a simplified content analysis is used as a supporting instrument. The data sources and the data collection process will also be discussed. In the end the structure of the thesis is presented.

2.1. *The methods adapted in this research*

2.1.1. *A qualitative main approach: a case study with a historical perspective*

The main methodological distinction in this case study is the **historical perspective**. According to Della Porta (2008, 217) the use of historical approaches is especially useful in case studies, since cases are not independent from the context in which they operate. As a matter of fact this will be a qualitative case study of the GPFG with emphasize on climate change as a part of the three actors RI strategy. Case studies are interested in the complexity of a single entity, like an organization or an event, performing a detailed examination of that particular case (Bryman 2004, 48-49). The single entity in this case study is the GPFG. The GPFG is however embedded in an institutional context, in which several actors together form a distinctive institutional design. A common misunderstanding about the GPFG should be sorted out; the Fund in itself is not an independent actor. In the Norwegian media one can often see headlines claiming that “the oil fund has invested in company X”. The GPFG as such is the revenue in itself, and thus “it” cannot take investment decisions. The Fund *is* invested companies, but it *has* not invested in companies. The actors who take investment decisions are the manager and owner of the Fund. This is also emphasized in a report from Norges Bank’s Supervisory Council (2011, 13) in which it is stated that “the GPFG is not a legal entity, but the name of a given amount of the state’s assets (...)”.⁵ It could therefore be argued that each actor in the institutional context surrounding the

⁵ My translation

Fund constitutes a separate case. In this thesis there are three main actors which together form the context. It could therefore be legitimate to place this study within what Bryman (2004, 55) calls multiple-case study.

This research is not so explicitly connected to theory that it aims to accept or reject whether one specific theory can explain the empirical findings. Rather theory and literature is used and discussed together with empiricism to construct a meaningful picture together. As such the study is neither clearly deductive, nor clearly inductive. The reason for this is that the case has a distinctive character, which cannot easily be captured by a couple of theories. There is no single theoretical framework that can capture the dynamic of the institutional design related to the GPF. A thorough description of this distinctive character has been given importance, but I will argue that this does not make the study a-theoretical. Literature, theory and general concepts are presented before the specific analysis. Assumptions are however also drawn after reviewing the empirical material.

The objective with the historical perspective is to investigate whether any red thread in the strategies throughout the period 2006-2012 can be identified. According to Bartolini (1993, 132), time is an important factor in comparative social research, arguing that time should be interpreted as a dimension of variation. Contrarily, has there been any change in the guiding principles? In chapter 6 there will be a thorough analysis of how climate change has been on the agenda for the three actors. The actors' consistency, or eventually inconsistency, in their climate change approach is important. Does climate change seem to be on the agenda to the extent to which the actors claim? Is there consistency between what is actually done, and what is expressed in the actors' written material? The actors' continuity, or eventually discontinuity, is similarly important. By continuity I mean whether the actors climate change strategy has evolved and been expanded throughout the period. The historical approach will enable me to systematically analyze the actors over the given period. During the analysis it will be essential to accept the possibility of plural explanations, which is important in order to understand a phenomenon (Kratochwil 2008, 96-97). This will clearly come to expression in chapter 6.

Once the topic was narrowed down (why climate change was chosen was explained in the introduction), and the role and the importance of the different actors was clarified, a time frame had to be selected. Every study has to be limited, and this applies also for this thesis. Periodization is, according to Della Porta (2008, 220), a challenging and important step in research. It is easier to define a spatial unit that has clear borders, than a time unit with less clear borders. It is however important to choose a time frame which accounts for all the changes in the relevant variables. The periodization can moreover be both deductive and inductive. The latter refers to empirical evidence as the basis for the periodization (Della Porta 2008, 222), and is the most suited in this thesis because some particular events made it relevant to focus on the period 2006-2012.

The GPFG is a large and complex fund, with a distinctive institutional character with several actors. Therefore the timeframe could not be too long, in order to be operationalized within the space constraint and scope of a thesis. As already mentioned the chosen time frame is the period of 2006-2012, due to several reasons. The key question was whether to use the Ministry of Finance or NBIM as the reference point, in addition to identifying the key variables. In 2006 NBIM stated that they had decided on six focus areas for a corporate governance strategy for the period 2007-2010, among them climate change. As such 2006 is a natural starting point for a study of NBIM and climate change. The ethical guidelines were established in 2004, and thus before the main period of this study. The ethical guidelines do not emphasize on climate change in any particular grade, and thus it was found more natural to use NBIM's starting point as a time frame. 2006 is also the year in which the Fund was named the Government Pension Fund Global. Besides, it is also interesting to skew the timeframe towards today, both because in a field where there are constantly changes it is necessary to be updated, but also in order to include an important happening in the study; the Ministry's initiative towards a joint research project on climate change and investors. This resulted in two reports written by Mercer, published in 2011 and 2012. The most relevant is the one from 2012, since it is tailored for the GPFG. To sum up; this will be a study of the most decisive happenings and the central strategies which found place during 2006-2012, related to the GPFG and climate change. A few issues from the years before will however be touch upon when necessary. This is especially the case for the Graver Report and the subsequent establishment of the

ethical guidelines, since these set the premises for the coming years. Another issue which I will briefly refer to is the establishment of the environmental program within the then called Petroleum Fund in 2001, since it is argued that the Ministry's later on inclusion of a similar programme is a continuation of the former.

2.1.2. A quantitative approach: a simplified content analysis as a supporting method

As indicated in the title of this chapter, a simplified content analysis will be used as a supporting method. The rationale behind is explicitly connected to the historical perspective, and is thus a way to operationalize this. Since three actors' climate change strategy is studied over a six-year time period, a simplified content analysis, or a structured document analysis, might be used to systematically observe eventually changes in how the actors express the climate strategy in their written material. If for instance an actor says that they are very concerned with climate change, but only mentions it a couple of times in their central documents, then there might be inconsistency between how that actor would like to appear, and what is actually done. Content analysis has been a common method for analyzing documents and is, according to Bryman (2004, 183) an approach that quantifies content in a given document in a organized and replicable manner. According to Bryman (2004, 195-196) there are several advantages with content analysis; among others that it permits the researcher to analyze changes over time. This is relevant for this research, since the objective with the content analysis is to find out to what extent climate change is on the agenda in the central documents, but also whether there has occurred any changes. Content analysis is not used to find out *why* climate change is on the agenda, but rather if it *is* on the agenda in the written material.

Bryman (2004, 185-187) discusses how a the sample, or units of analysis, should be selected. In this case the sample is quite clear; content analysis will be carried out on the reports to the Storting and the annual reports from NBIM. It will not be systematically carried out on the Council on Ethics, since climate change not is an explicit part of their mandate. A simplified content analysis, i.e. there was not counting and coding of several variables, was therefore performed on the above mentioned documents from 2006 to 2012, in addition to the Graver Report. The

latter was included because it is regarded as an agenda-setting document, meaning that it form the basis for the whole RI framework related to the Fund. Other primary sources, like for instance NBIM's Investor Expectation document, have been left out of this methodological approach. The reason is that the aim with the content analysis is to measure to what extent climate is on the agenda by looking at the general documents, and not only by looking at the targeted documents. The simplified content analysis was performed on the word *climate*. When the number of words containing *climate* in the Graver Report resulted to be 23, it means that this included all the times *climate* appears in the text, also in combinations like for instance *climate change* or *climate questions*⁶. The extended result of the analysis can be found in appendix 1 and 2, and the general results are discussed in chapter 6. In addition to counting the frequency of the word *climate*, chapter 6 also include a more general, but still systematical analysis of NBIM's annual reports. It was for instance discussed whether there has been continuation in the amount of space dedicated to climate change in their written material.

2.2. Data sources and data collection

Sitter and Andersen (2010) divide data into three categories; the first is public, indirect and fabricated data, the second is specific indirect and the last is personal and direct data. Examples are, respectively, documents, existing studies, and interviews. This research will be conducted by using multiple data sources, and as such data from all three categories will be used. Triangulation, or the use of different types of data and methodology, makes a research sounder (Patton 2002, 247). When both interviews and document analysis is used, the researcher can test for consistency in the data by comparing the results. Interview respondents might for instance be biased, and comparing the results with analysis of documents will make the research less vulnerable (Patton 2002, 248).

It is moreover important to keep track of the difference between the primary sources, the basic documents provided by the involved actors, and secondary sources like the academic interpretation and analysis of the primary sources. This

⁶ When *climate* appeared in the references and footnotes it was not counted, whereas results from tables and figures was included. A few times the word *climate* showed up in contexts clearly not referring to climate change, such as the international climate for negotiations etcetera. These cases have been left out. Results from headings and the content list were also included.

is important because the use of primary sources entitles me the possibility to analyze the original material, whereas use of secondary source is the analysis of somebody else's interpretation of the primary sources. The distinction between primary and secondary sources goes back to the Renaissance and Luther's idea about "ad fontes", or "to the sources". When you have the original sources, you can interpret them independently, or almost independently, of what others mean, and as such create an independent opinion about the issue at stake. Thus, to create my own independent opinion primary sources are essential, but of course secondary sources will be very important data sources as well. According to Patton (2002, 293) documents like annual reports can give the researcher valuable information, and if carefully analyzed, such sources can also be used to find for instance inconsistency.

2.2.1. *Primary sources – documents*

The primary sources used in this thesis will be official reports from the Ministry of Finance, the Council on Ethics and of course NBIM. The annual Reports to the Storting from the Ministry of Finance will be analyzed from 2006 to 2011. The same applies for NBIM's Annual Reports for the same time period⁷. Furthermore NBIM's Investor Expectation Document from 2009 and the updated version from 2010, as well as the Sector Compliance Reports from 2009, 2010 and 2011 will be discussed. When it comes to the reports from the Council on Ethics they will not be assessed on a yearly basis like the material from the other two actors. The reasons are described above. The legal mandate of the management of the Fund will be an important source to find out what the premises for the actors are. The above mentioned report from the Graver Committee *NOU 2003:22 Management for the Future*⁸ will also be included, despite being from 2003. The Graver Report has an intrinsic value as an agenda-setting document. Getting access to the data has not caused major problems, all the relevant actors have the material easily available on their home pages. In the end it should be mentioned that material from the actors has been used both in Norwegian and English (there is often two versions of each document). The exact cites are almost always from the English versions. Thus, if it is not specified diversely, the citations are not translated by

⁷ The reports are in general published around Easter the subsequent year. The report about 2011 is thus published in the spring 2012. As such the reports sometimes refer to happenings in the first months of the subsequent year. In the thesis the reports are named with the content year, and not the publication year. This makes it more clear and easy for the reader to follow the argument.

⁸ In Norwegian known as "NOU 2003:22 Forvaltning for fremtiden".

me. Only the English version of the reports are listed in the bibliography (unless in those case where only a Norwegian version exists).

2.2.2. Primary sources – interviews

To get additional information apart from the documents, interviews have been conducted. A tape recorder was used in order to transcribe the interviews and turn it into a written primary source. The unit of analysis should be what the informants actually said, not what the interviewer noted herself. A case-analysis approach, in which a case is written for each person interviewed (Patton 2002, 440) was used. The interviews were semi-structured, as this was found most suited. It should be noted that I found it important to be open for the spontaneity in the conversations, in order to get as much information from the interviewees as possible. In an interviewing situation it is difficult to not be influenced by the informants, the use of tape recorder will partly cancel out the problem. One employee in NBIM's corporate governance team, and three employees in the Ministry of Finance have been interviewed (only two of them are cited in the thesis). These employees represent the Ministry and NBIM, and are therefore not named. Furthermore Dag Hessen, member in the Council on Ethics and Henrik Syse, former head of the corporate governance section in NBIM, Jeanett Bergan from KLP, and former Minister of the Environment minister Erik Solheim⁹, has been interviewed. Two environmental NGOs have also been interviewed; Bellona and the Future in Our Hands (FiOH)¹⁰. I have also attended the 2012 hearing in the Standing Committee on Finance and Economic Affairs of the Parliament (hereinafter the Committee on Finance) about the GPF, participated in several relevant conferences, and discussed the thesis with other relevant persons like professor in climate strategy Jørgen Randers. What was the rationale for selecting exactly these interviewees? First of all it was crucial to interview at least one person from each of the three actors. It was also important to speak to Syse, since he was the "founding father" of the corporate governance section in NBIM. The two NGOs were selected because they have both been active in the debate about the GPF. To get another viewpoint it was fruitful to interview another investor, and KLP was chosen since they also have extensive responsible investment strategies. Erik Solheim voiced clear opinions about the GPF and climate during

⁹ A shorter telephone interview.

¹⁰ In Norwegian: Framtiden i våre hender. The abbreviation has been made by myself.

the period in which he left the position as minister, and it was as such very interesting to speak to him.

2.2.3. Secondary sources

Several secondary sources have been used to enlighten my understanding and analysis of the primary sources. Most important is of course academic literature. Material from Mercer will also be a substantial source since they have conducted research on climate change and investors in general and about GPFG in particular. Another important source in this regard is the 53 contributions submitted to the Ministry of Finance in 2008 as a part of an evaluation of the ethical guidelines. A few things should be mentioned about the academic literature; many of the authors are also actors from the field, rather than researchers only. As Joly (2011, 195) puts it “this chapter is written from the perspective of an investment professional and RI activist. It is not a detached piece of academic research”. Part of the literature is also from international organizations, like UN bodies or various investment organizations. It has sometimes been challenging to isolate purely academic literature from more biased literature from the sector itself. Also, the purely academic literature is far less extensive. Head of Climate Change Center in HSBC bank, Robins (2012) explicitly argued that business schools, and thus academia, are lagging behind the investment sector. As a consequence investors are lacking a good theoretical fundament when it comes to responsible and/or green investments. Even though a comprehensive amount of literature has been used in this thesis, there are few peer-reviewed articles, or articles published in level two journals, in the bibliography. There is moreover also a lack of literature discussing the GPFG, as also noted by Reiche (2010, 3569) and this is also reflected in this thesis.

2.3. Structure of the thesis

The research will be divided into two main parts. Part one will be more general, reviewing literature and clarifying important issues. Chapter 3 will consist of a presentation of the three actors and the structure between them, in addition to the RI agenda of the Fund. In chapter 4 there is a conceptualizing of what climate change mean for investors and how this might necessitate a rethinking of fiduciary duties. In chapter 4 a reviewing of some literature discussing RI in general and the Fund in particular will follow. The theoretical framework in chapter 5 will include

a presentation of various RI instruments, as well as agency theory. Part two will be a more specific discussion, analyzing explicitly the GPFG. This will take place in chapter 6.

3. The Fund and the three actors – NBIM, the Ministry of Finance and the Council on Ethics

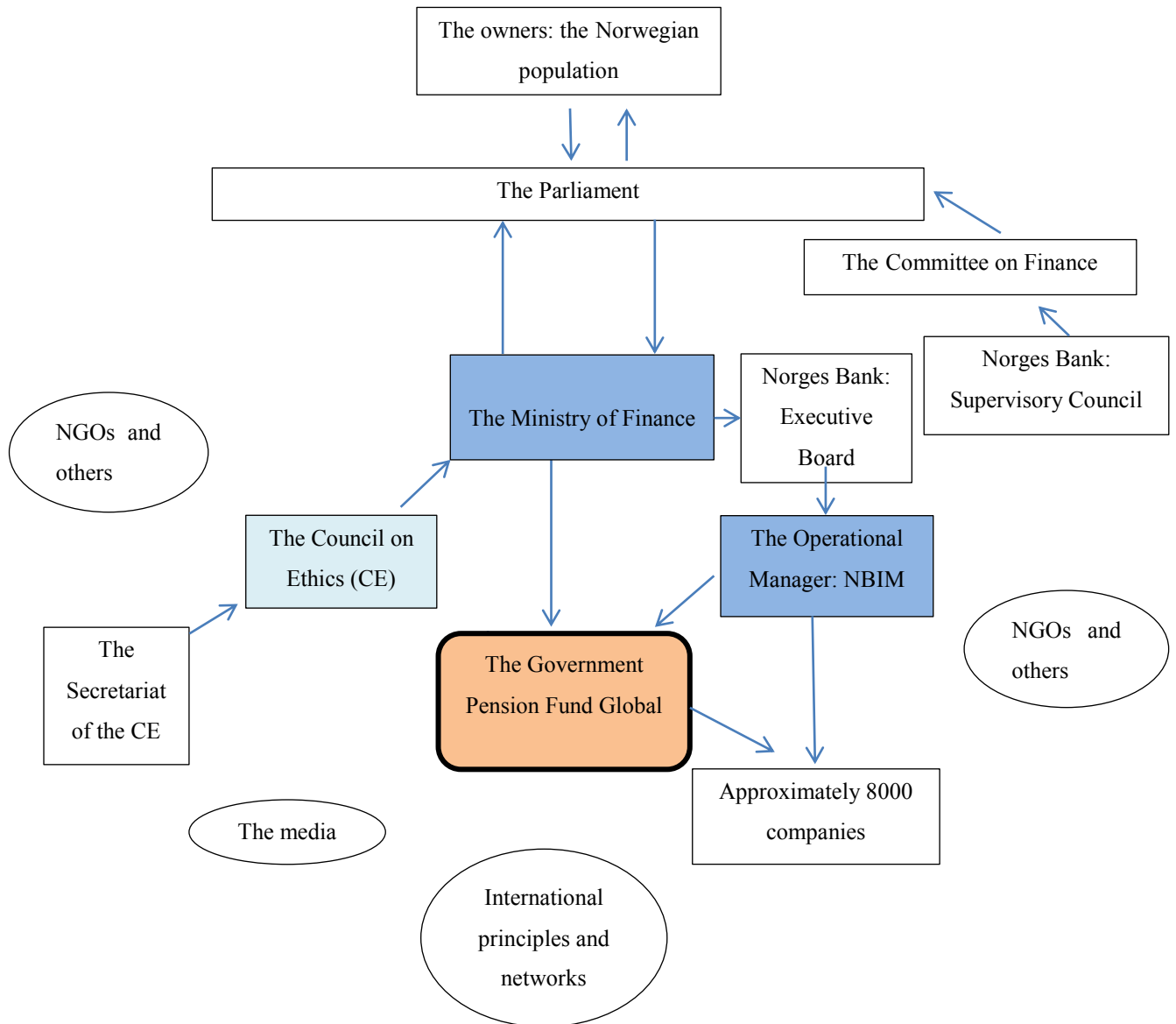
In this chapter the Fund and the responsible investment agenda will be presented. Thereafter follows a description of each of the three actors. The first two research questions presented in chapter 1.2 will be answered here, i.e. *what are the relevant actors, and how is the organizational structure and role-division between them? And what is the regulatory pattern of the GPF, and is climate change incorporated in the legal mandate of the Fund?* A presentation of the actors and the institutional distinction has an intrinsic value for the scope of this thesis, since it forms a necessary knowledge for understanding the climate change strategies. It is also important to remember that coping with climate change never can be the primary motivation for a fund like the GPF. There is also a necessary logic of consequence in the following; by presenting how climate change is *not* on the agenda in some important parts of the Fund like the laws and mandates, it becomes more clear to what extent climate change actually *is* on the agenda.

3.1. The Government Pension Fund Global

In 1990 the Fund was established with the label the Norwegian Petroleum Fund, since it was based on revenues gained through fossil resources in Norway. The first transaction took place in 1996. The objective of the establishment was to safeguard the long term financial security of the Norwegian population. In 2006 the Fund was renamed the Norwegian Government Pension Fund – Global, however the Fund is not earmarked pension expenses (Ministry of Finance 2011b). As will be shown in the analysis below, some of the informants argued that this change of name was a purely strategic act, in order to de-couple the Fund from the somewhat criticized oil production.

Figure 1 below shows the relationship between the Fund and the involved actors relevant for this research. The map is based on the research conducted in this thesis, and is my own interpretation of the various sources. The three most relevant actors are outlined in blue, and each of them will be presented in the sections below. The Council on Ethics has intentionally been given a lighter color, since this actor today has a more limited role in regard of climate change.

Figure 1: Map of the Fund and the involved actors.



The owners of the Fund are the Norwegian population. The Parliament is managing the Fund on behalf of the Norwegian population, but has delegated the management of the Fund to the Ministry of Finance, which again has delegated the operational management to Norges Bank. The Committee on Finance in the Parliament has the responsibility for the administrative procedures in the Parliament. The Ministry submits a report to the Storting¹¹ about the Fund each year. When the Parliament received the 2011 Report on the management of the Fund from the Ministry, the Committee organized a hearing. In this hearing both the Ministry of Finance, as well as the Central Bank Governor Øystein Olsen and the Director of NBIM Yngve Slyngstad participated. In addition several NGOs

¹¹ In Norwegian: Stortingsmelding

were invited. When the Committee has finished its treatment of the report, there is a hearing in the Parliament. There are usually several comments and proposals from various political parties. A few examples will be discussed in chapter 6.

The Ministry has delegated the operational management to the Norwegian Bank, which again has delegated the day-to-day responsibility to NBIM. NBIM submit both an annual report and quarterly reports to the Ministry. The Council on Ethics was established by Royal Decree in 2004, and has a separate secretariat (The Government 2012a). The circles in the figure represent relevant stakeholders, like media and NGOs, as well as international networks that NBIM and the Ministry are part of. The concrete action in each of the arrows will be discussed later in the thesis, see for instance chapter 5.

3.1.1 The responsible investment agenda and climate change

NBIM seeks to both maximize long term financial return from the Fund, and invest in accordance with the ethical standards of the Funds owner, the Norwegian people (represented by the Parliament and the Ministry). Since 2004 the Fund has been subject to a set of ethical guidelines, which were evaluated in 2008. The evaluation process resulted in new guidelines for the responsible investment activity launched 1st March 2010 (Ministry of Finance 2011b). The GPF's primary motivation is still to ensure intra-generation solidarity by securing future generations of Norwegians a stable financial situation.

The first Ethical Guidelines derived from a report written by the Graver Committee in 2003, *NOU 2003:22 Forvaltning for fremtiden*. The report was written on behalf of the Ministry and emphasized that the ethical principles were supposed to be anchored in the general ethical standards of the Fund's owner, namely the Norwegian people (Graver Committee 2003b). It is of course difficult to identify a common ethical standard that applies for everybody in Norway, but the report was concerned with overlapping consensus, i.e. that investments should be in line with what *most* Norwegians find appropriate. The Graver Committee (Graver Committee 2003b, paragraph 5.1) launched three instruments that should be used when managing the Fund:

- Exercise of ownership rights, or corporate governance.
- Negative screening/selection, i.e. not invest in certain companies.

-
- Withdrawal, i.e. the Fund divests from companies that violate the ethical standards promoted by the Fund.

These instruments will be thoroughly presented in the theory chapter, and thereafter discussed in chapter 6. The same applies to positive screening, i.e. invest in certain companies or sectors, which was not among the instruments suggested by the Graver committee. Positive screening has, on the other side, been a topic in the public debate in Norway.

3.2. The Ministry of Finance

The Ministry of Finance has the formal responsibility for the management of the Fund. Within the Ministry, the Asset Management Department has the day-to-day responsibility. They handle the general investment strategy, hereunder the responsible investment strategy and the ethical guidelines (Ministry of Finance 2012e). Since the GPFG is publicly owned it is subject to government regulation, and as also shown in figure 1, the political actors are on top of the hierarchy. There is a variety of definitions and ways to understand *regulation*. The objective of regulation can be understood as “producing outcomes that are in the interests of everyone” (Hix and Høyland 2011, 189). This is a broad and not very applicable definition, but in the GPFG case it can be understood as regulation should be in place to ensure everyone’s interest. The challenge is then both to define interest, but also everyone. In economic theory everyone would normally be understood as all agents, or all players. In the GPFG case it is not so easy to sort out. Should everyone be understood as every Norwegian citizen, and furthermore should it include every future Norwegian citizen? Or does everyone refer to all contemporary human beings? It is stated in the written material about the Fund, see for instance (Ministry of Finance 2011a, 9), that we can understand everyone as every contemporary and future Norwegian inhabitant, but it is also stated that the interest of these is dependent on sustainable development in economic, environmental and social terms, see §2-1 (1) in table 1 below. Thus there is both an inter- and intra-generational aspect when defining who the fund should operate in the interest of.

The legal mandate of the Fund is found in the Law on the Government Pension Fund of 2005¹², derived from the original law which established the Fund in 1990, in which it is stated in §2 that the Fund should be managed by the Ministry. (Lovdata 2012). The more detailed management of the Fund is regulated through several mandates and regulations. The most important is the Management Mandate for the Government Pension Fund Global¹³. For this thesis the most relevant parts of the mandate are found in table 1 on next page.

Table 1 (Lovdata 2010)

§1-1 (2)	The Bank shall seek to achieve the highest possible return after management costs measured in the currency basket of the actual benchmark index.
§1-1 (3)	The Bank shall make investment decisions independently of the Ministry.
§1-7 (1)	The Bank shall advise the Ministry on the investment strategy for the GPFG. Advice may be provided on the initiative of the Bank or on request from the Ministry
§2-1 (1)	The management of the Fund's capital shall be based on the goal of achieving the highest possible return, cf. section 1-1, second paragraph. A good return in the long term is regarded as being dependent upon sustainable development in economic, environmental and social terms, as well as well-functioning, legitimate and effective markets.
§2-1 (2)	The Bank shall have internal guidelines for integrating considerations of good corporate governance and environmental and social issues in investment activities, in line with internationally recognized principles for responsible investment. The integration of these considerations shall occur in respect of the GPFG's investment strategy and role as financial manager. In executing its management assignment, the Bank shall give priority to a long-term horizon for investments and the investments being broadly placed in the markets included in the investment universe.
§2-1 (3)	In its management of the real estate portfolio, the Bank shall in the area of environmental protection give priority to i.e. considerations of energy efficiency, water consumption and waste management.
§2-2 (1)	The Bank's primary goal in its active ownership is to safeguard GPFG's financial interests.
§2-2 (2)	Active ownership shall be based on the UN Global Compact, the OECD Guidelines on Corporate Governance and the OECD Guidelines for Multinational Enterprises. The Bank shall have internal guidelines for its exercise of ownership rights that indicate how these principles are integrated.

¹² In Norwegian: Lov om statens pensjonsfond LOV-2005-12-21-123

¹³ In Norwegian: FOR: 2010-11-08 nr 1414: Mandat for forvaltningen av Statens Pensjonsfond utland. The original source from Lovdata (2010) is in Norwegian, an unofficial English translation from the Ministry of Finance's webpage has been used for the exact citing (<http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/the-guidelines-for-the-management-of-the.html?id=434605>)

§2-2 (3)	Major amendments to the Bank's priorities in its active ownership shall be sent to the Ministry for comment before a final decision is made. The Bank's plans shall be subject to public consultation before being submitted to the Ministry.
§2-3	The Bank shall actively contribute to the development of good international standards in the area of responsible investment and active ownership.
§2-4	The Bank shall, within the frame of § 3-5, establish environmental mandates. The marked value of the environmental investments should normally be 20-30 billion NOK ¹⁴ .

What is interesting to note in regard to this research is that climate change is not explicitly mentioned in the legal mandate of the fund. However, the last sentence in § 2-1(1) "a good return in the long term is regarded as being dependent upon sustainable development in economic, environmental and social terms" makes the premises of the Fund quite clear. According to the Ministry this sentence reflects how they consider the reality in which the Fund operates (Ministry of Finance 2012d). Even though the primary motivation is the financial aspect, future return is seen as dependent of some non-financial factors. Moreover it is interesting to note that energy efficiency with regards to the real estate portfolio, and the environmental mandates are included in the mandate, cf. §2-1 (3) and §2-4. This is a clear sign of commitment. The extracted parts of the mandated will be used later in the thesis, both in chapter 5 and 6.

Why is part of the Management Mandate included in the thesis when climate change is not included in this? Again, according to a kind of inverse logic, it is important to demonstrate that climate is *not* included in the mandate and the law. The reason is that the law and the mandate are the ultimate documents, ranging over all other documents related to the Fund. Despite not being unchangeable, they are much more binding than for instance internal principles from one of the actors. When something is included in these documents, it says something about how this specific issue is valued. When climate change is not included, it means that there is nothing that obliges future actors to focus on climate change. Or, there is nothing preventing them from not focusing on climate change. One could imagine a hypothetical situation in which for instance the Progress Party (FrP)

¹⁴ Included in the Mandate in 2012. My own translation, since § 2-4 was not included in the Ministry's unofficial translation.

gets a majority in the Parliament. This party is known for openly questioning whether climate change is man-made. They have furthermore questioned the cost of the ethical guidelines (E24 2012; Tybbring-Gjedde 2012). It is a hypothetical question, but how can future commitment be ensured when there is nothing in the governing documents about climate change?

3.3. The Norwegian Bank Investment Management

The Norwegian Bank Investment Management (NBIM) is the operational manager of the Fund. The activity related to the Fund is subject to several governing documents, which are also relevant for this research. The following are the most relevant, presented in table 2 in hierarchical sequencing.

Table 2

<u>The Parliament</u> Law on the Government Pension Fund of 2005 from the Parliament
<u>The Ministry</u> Management Mandate for the Government Pension Fund Global from
<u>The Executive Board of the Central Bank</u> Central principles (the investment mandate & the principles for ownership management)
<u>NBIM</u> Guidelines from the Chief Executive Officer (the responsible investment policy)
<u>The Corporate Governance section in NBIM</u> Focus areas
<u>The Corporate Governance section in NBIM</u> Investor Expectation document on Climate Change Risk Management

The two first were presented in the previous chapter. The Executive Board of the Central Bank has issued an investment mandate to NBIM, in which it is stated, as in all other relevant documents, that the fund should maximize the highest possible return (NBIM 2011b). NBIM is furthermore an active manager, meaning that the objective is to create higher return than the index (NBIM 2010a). In the investment mandate there is furthermore a paragraph on responsible investment, in which the following is made clear (NBIM 2011b, 1):

-
- Corporate governance should be exercised to ensure the financial interests of the Fund.
 - ESG issues should be incorporated in the investment decision, in line with international principles, and taking into account long-term aspect, as well as the role as a universal owner.
 - The real estate portfolio should emphasize energy efficiency.
 - Active ownership should be based on Global Compact, and OECD's guidelines for corporate governance and multinational enterprises.

At this level, there is another governing document, the central principles for ownership management. There is nothing concrete about climate change in either of these documents from the Executive Board. In NBIM's own policy documents issued from the Chief Executive Officer, in this case the responsible investment policy document, several issues are clarified. First of all responsible investment is defined as "an investor who incorporates material ESG related risk factor considerations into fund management practices in order to improve long-term returns" (NBIM 2011c, 1). As will be shown in chapter 5.1., this definition is slightly different from most other RI definitions. Furthermore the *E* for environment in ESG factors is defined as: climate change (greenhouse gas emission), energy efficiency, biodiversity, waste management, water management, and other air and water pollution (NBIM 2011c, 1). Hence, climate change is included in NBIM's own understanding of ESG issues and as a consequence also of their understating of responsible investment.

It is furthermore stated that NBIM regards long-term return to be dependent on sustainable development in economic, environmental and social terms, which is in line with §2-1 (1) in the overall investment mandate from the Ministry. In the responsible investment policy (NBIM 2011c, 2-3) it is stated that NBIM should concentrate ownership activity to areas of particular importance for the Fund through; communication of their principles, dialogue with companies, contributing to the development of good international standards and regulation, voting at company meetings, collaboration with investors, organisations and networks, and finally by legal action. These instruments are very much in line with the principles from the Executive Board, and are more concerned with how NBIM should take action, rather than stating what areas should be of particular

importance. This is left to the governance section within NBIM, which must be considered the “lowest”, but also the most concrete, level. Here it is explicitly stated that climate change is one of six present focus areas in the ownership engagement (NBIM 2011d). According to NBIM, dialogue with companies and regulating authorities, as well as influencing other actors to take action, are the most important tools to combat climate change for an investor (NBIM 2012b).

In the annual report for 2006 NBIM launched that they had an ambition to become a leading actor in perusing of ownership rights or good corporate governance. Furthermore, environmental issues was one of two focus areas in the years to come (the other one was children's rights, despite being interesting and important, it will not be discussed in this thesis). The focus on environment was narrowed down to how companies interact with national and supranational governments in questions related to climate change. Thus, the focus was on how companies lobby, and how NBIM could encourage to more transparency and responsibility in these lobbying processes (NBIM 2006, 72-73).

Furthermore, in the 2006 report NBIM did put forward some arguments explaining why the two focus areas were chosen. First of all it was important for NBIM to focus on areas with relevance for investors. The Stern report and the possible scenario that climate change can affect the economic markets negatively in the future was one reason. Furthermore it was emphasized that the possibility of achieving good dialogues within the selected area, and of course ensuring financial return (NBIM 2006). From the beginning of 2006 climate change as a focus area has evolved. Today the focus is no longer only on lobbying, but on climate change in general. This process will be assessed in chapter 6. NBIM has developed an investor expectation document on climate change, and this document will also be discussed in chapter 6.

3.4. The Council on Ethics

As mentioned above the Council on Ethics was established by a Royal Decree in 2004, as a result of the Graver Report and a broad political unanimity about strengthening the ethical profile of the Fund. The Council on Ethics has five members and a separate secretariat (The Government 2012a). The members are

not permanent, and they have varied background. As of today professor Dag O. Hessen is the member with the most relevant background for this thesis, and therefore he has been interviewed. As showed in paragraph 3.1.1, the responsible investment work related to the Fund is expressed by several instruments. Whereas NBIM has the responsibility for the ownership engagement, the Council on Ethics has the responsibility for recommending which companies should be excluded. The Ministry has both the responsibility for the negative screening, and also whether or not to follow up the Council on Ethics recommendations for divestment. In addition to the running recommendations from the Council, they sum up their work in an annual report each year. The Council has no independent instruments, but the power to decide which companies they want to investigate further should of course not be underestimated. The Council on Ethics has no governing documents apart from the guidelines from the Ministry. Since climate change is not explicitly mentioned in these guidelines, the Council has as such no mandate to focus particularly on this. This is very important, and set the premises for their work. It also set the premises for this thesis and there will be less emphasize on the Council on Ethics in this thesis than what might have seem naturally at a first sight. In chapter 5.1 there will be a presentation of the different RI instruments, and the Council on Ethics is mainly responsible for exclusion of companies based on conduct, with regards to this thesis it is most relevant that companies can be excluded if they contribute to *severe environmental damage*. In chapter 6 the role of the Council will be discussed further, with emphasize on how this is interpreted. Is *severe environmental damage* interpreted in a restrictively manner? Or is it interpreted broadly, i.e. is climate change understood as part of *severe environmental damage*?

4. Literature and conceptualizing

In this chapter research question 3 and 4, presented in chapter 1.2, will be discussed: *what do climate change means for a long-term institutional investor like GPFG? And what is RI, and how can it be conceptualized for the GPFG?* The review of literature and definition of central concepts will consists of three parts; *first* there will be a short presentation of why climate change is a relevant issue for investors. This serves to set the scene and give some possible explanations for why the three actors have chosen to focus on climate change. *Secondly*, a review of literature discussing the concept of responsible investment will follow. This is relevant for this thesis since climate change is part of the responsible investment agenda for the Fund. Moreover, it is useful to see the GPFG within a broader picture by looking at how NBIM's and the Ministry's understanding of RI fit with the general literature. *Lastly*, there will be a short section presenting literature discussing the Fund.

It should be mentioned that this conceptualizing discussion might not be a traditional literature review, as also non-academic sources are included. These sources are often written by actors in the field, or published by various UN bodies. An interesting question is why academia shows less interest, or less innovative capacity, within this field. One gets the impression that the updated research seems to be driven from the corporate world, whereas academia seems to be somewhat lagging behind and discussing only more general aspects. A challenge with this is that much of the literature is quite a-theoretical.

4.1. Climate change and investors: from market failure to pro-activeness?

4.1.1. When externalities become internal: the universal owner nexus

Climate change per se is not the topic in this thesis, and thus there will be no independent discussion of this challenge. As a very brief background is should however be mentioned that climate change was made known as a global challenge in the early 1990's, when the UN published its first report on the issue (UNFCCC 2012)¹⁵. In the following years it was established that global temperature had to

¹⁵ United Nations Framework Convention on Climate Change

increase by no more than 2 degrees over pre-industrial level, otherwise serious climate change damages would become a reality (UNFCCC 2012). It was, however, not until the mid-2000s with the Stern Review (2006) that the economics of climate change was made really clear, and as a consequence the issue became increasingly relevant for investors. In the review it was argued that “climate change is a result of the externality associated with greenhouse-gas emissions – it entails costs that are not paid for by those who create the emissions” (Stern Review 2006, 23)¹⁶. This is at the core of the whole problem, which is also reflected in the title of this chapter; the corporate world, and index based investors, has not considered these externalities sufficiently, resulting in a great market failure. Kiernan (2007, 478) argues that failure to recognize externalities is the 21st Century’s “tragedy of the commons”.

The relevance of climate change was especially relevant for universal owners like NBIM, since they are expected to be more affected by the effects of climate change, than less differentiated funds. The reason is that climate change is expected to be costly and create harm across all markets and thus the broader the portfolio, the higher the risk. This view is present in for instance the report *Universal Ownership: Why environmental externalities matter to institutional investors* written by UN's Principles of Responsible Investments (UNPRI) and UN's Environmental Programme's Finance Initiative (UNEPFI) (UNPRI and UNEPFI 2011) in which it is argued that universal owners are especially exposed to the costs and risks posed by environmental damage. Universal owners are defined as “Universal Owners typically have diversified investments across asset classes, sectors and geographies with long time horizons” (UNPRI and UNEPFI 2011, 8). This definition fits well with NBIM, which has been defined as a universal owner also by Gjessing and Syse (2007).

One main assumption in this thesis is therefore that the universal owner nexus is the main reason for why NBIM and the Ministry focus' on climate change.

Since future climate change policies or regulation are somewhat uncertain, i.e., there is no long-term global agreements or commitment by policy makers, investors face a dual risk. According to Sullivan et al. (2011, 203) investors might

¹⁶ Part 1, chapter 2, page 23

both suffer from the direct costs of climate change, as well as the risk posted by government policy initiatives or future regulation. This might be the case for traditional investments in for instance fossil fuels, which might not be as convenient in the future if tougher regulation is imposed on the sector. It might however also be the case for investments in the renewable sector, where profitability might depend on uncertain government incentives.

In the report from UNEPFI and UNPRI (2011, 17) it was found that the global costs of environmental externalities was 6.6 trillion USD in 2008, and in line with the Stern review it is argued that mitigation is far less costly than the future damages. This was however not the first report, during the 2000s UNEPFI published several reports about this climate change, emphasizing its relevance for investors. Among them is *The materiality of climate change: How finance cope with the ticking clock* (UNEPFI 2009) in which it is argued that “responsible investors have been integrating climate change into their asset management for some time now, but *mainstream* investors still view the issue with some skepticism” (UNEPFI 2009, 8). It is furthermore argued that there it is now so much evidence of the risks and cost affiliated with climate change, that all investors should take action by include climate change as an issue in the asset management, communicate with policy makers, and collaborate with other investors (UNEPFI 2009, 8-9). One should of course be somewhat critical to these reports, but the fact that UN bodies clearly focus on the finance of climate change, and its relevance for investors, should not be underestimated either.

When it comes to collaboration and networking Tang and Dlugolecki (2005, 7) argue that the “climate change initiatives are exploding” and mention the Carbon Disclosure Project (CDP), the Institutional Investor Group on Climate Change (IIGCG) and the Investor Network on Climate Risk (INCR) as important. Neither NBIM nor the Ministry is members in the two latter. NBIM is however the main sponsor in part of CDP’s activity (NBIM 2009a), which is a non-profit initiative working for reduced green-house gas emissions (CDP 2012). Another UN body with relevance for investors is UNEPFI, UN’s Environmental Programme’s Finance Initiative, a joint initiative between UN and the finance sector (UNEPFI 2012). Among their initiatives is the “2011 Global Investor Statement on Climate Change” which has been signed by 285 investors. The statement was made in

collaboration with the UNPRI, as well as the above mentioned IIGCG and the INCR (UNEPFI 2011). NBIM has signed this statement, and furthermore one of their employees wrote about the statement and the importance of climate change in *Aftenposten* (Wright 2011). It is quite unusual that NBIM employees write chronicles, so one could argue that the fact that it was done in regards to climate change, might signify that this particular issue is of outmost importance for NBIM.

As mirrored in the title of this subchapter, there is a growing acceptance among investors about the importance of climate change, see for instance Sullivan et.al. (2005) and Ceres (2011). According to Nordhaus, climate change has a many-faced nature. He argues that climate change is a particular difficult issue since “ecologists may see it as a threat to ecosystems (...) businesses may view global warming as either an opportunity or a hazard, politicians as a great issue as long as they don’t need to mention taxes (...)” (Nordhaus 2007, 5). An interesting aspect in this regard is *how* climate change actually is conceptualized by investors. Climate change does not necessarily mean the same for universal owners as for other actors in the society like environmental NGOs, part of the media, political parties and maybe the general population in a country like Norway. The general debate about climate change is generally centered on arguments about our common future and what we can do to avoid future problems. In the investment sector discussions on climate change are more concerned with the financial risks climate change pose in the long run, and how investors can insure them self against such risks. This is of course legitimate, since investors after all are profit maximizing actors. Still, it is useful to have this in mind. To investors, focusing on climate change is often only a mean to ensure future returns. This is part of a more philosophical discussion about what the rationale for conducting good actions should be. Does good actions in se, or doing good for others, have an intrinsic value? Or is self-interest a legitimate rationale for good actions? Syse (2007) discusses the motivation behind ethics when it comes to the GPF, arguing that the ethics of the Fund can be said to have some intrinsic value. Still, the primary motivation of the Fund is, and should be according to Syse (2007), to be a traditional financial investor.

Another assumption is then that climate change is not necessarily understood in the same way for investors and the general society.

As reflected in the title of this chapter there is a link between market failures and climate change. Market failure is a situation in which markets fails to achieve a situation which is to the benefit of the whole society. One reason is the lack of considering externalities, for instance pollution and carbon emission, which traditionally has been part of negative externalities. Another market failure is related to so-called public goods, which are goods belonging to everybody and as such often over-utilized. One example is clean water or fresh air (MacKenzie 2006, 22-23). According to Joly (2008) today's financial markets does not sufficiently price the cost of externalities like climate change. Financial greed and a non-existing concern with for instance climate change and the overall long term benefit of the society also fits well into Hardin's (1968) idea about the tragedy of the commons. The whole climate change challenge can be regarded as a classical prisoner's dilemma¹⁷. In a very simplified version you can imagine two investors considering whether to include the climate change risk or not in the investment decision. In the short term it would certainly be expensive for investor A to consider this if investor B does not also do so. If on the other side both investors cooperated about the issue, it would benefit them both in the long term. In a classical prisoner's dilemma the outcome would be that neither of the investors considered the climate change risk, since they would not risk bearing the costs alone. Thus, a very clear market failure, since the opposite outcome would be better for the investors in the long term. As stated in §2-1 (2) in the Management Mandate (see table 1), the long-term perspective should be emphasized in the Fund's investments.

According to Sullivan et al. (2005, 197) most investors have not been particularly interested in climate change, arguing that "most investor intervention has tended to be reactive rather than proactive". However, they argue that this is changing, due to mainly two issues; first, climate change is increasingly regarded as a fiduciary issue which might affect long-term returns if action is not taken. Secondly, investors are increasingly concerned with how non-financial issues affect companies value and thus return (Sullivan et al. 2005, 198). More recent

¹⁷ See Shepsle (2010, 235-238) for a general introduction to the Prisoner's Dilemma.

research suggests however that there has been a change in investors attitude the last five years, and that investors now are a driving force for policy initiatives (Ambachtsheer 2012). In a report from 2006 it is also stated that investors are in fact interested in climate change, and that this also is apparent in proxy voting in the US, where the number of filings on climate change resolutions increased remarkably from early- to mid-2000s (Cogan 2006, 15-16). Seitchik (2009, 295) is moreover arguing that investors are ahead of governments in this regard, and that investors are the leading actors also in climate related research. This supports the above claim about research being mainly driven from the sector itself. The positive effect of research from the sector itself is that it might be more rooted in reality and the concrete knowledge needs investors have.

Nevertheless, there is still a large gap between the needed investments in green technology and renewables and the de-facto investments, called the clean energy investment gap by Sullivan (2011, 6). According to the World Energy Agency 500 billion USD in investments are need yearly up to 2035. In 2010 only 211 billion USD was invested in such activity. This was a 39 percent increase from 2009, and much of the growth took place in developing countries like China (Sullivan 2011, 6-7)¹⁸. There are however several challenges with investments in renewable energy, as discussed also by the Ministry (2008e, 66-68), among them the tight tie between profitability in this sector and the fossil fuel prices, as well as the sector's dependency on government incentives and regulation.

4.1.2. Obligations towards whom – rethinking fiduciary duties?

Fiduciary duties are relevant for all investors and is defined by “a relationship in which one party (the fiduciary) is bound to act for the benefit of and in the interest of another, the beneficiary” (Nagell 2011, 80). This is relevant for the GPF, since its establishment was undertaken with the objective to secure the financial wealth of future generations. Fiduciary duty is in the Norwegian case as such understood as an ethical obligation, as part of the intra-generational solidarity discussion. Nevertheless, fiduciary duty is different for the GPF since it is not earmarked the future pension of actor X and Y, like a traditional pension fund. According to Sullivan (2011, 8) the fiduciary aspect signifies that:

¹⁸ Original sources have not been double checked.

Other than in those situations where a client or beneficiary has made an explicit request in this regard, most institutional investors will only invest in areas such as low-carbon technology or clean energy if there is a compelling financial case for making such investments.

This is the classical understanding of fiduciary duties, which one could imagine might have been used as an excuse by investors to not re-allocate investments in a more green direction.

However, as Nagell (2011, 80-81) points out, fiduciary duties are no longer understood as exclusively an obligation to maximize financial returns. Several aspects have recently been included in the discussion about fiduciary duty; firstly, fiduciary duties do no longer require the optimization of single investments, but rather the whole portfolio as such. Secondly, non-financial aspect has to an increasingly extent been included in investment considerations. Thirdly, the definition of beneficiary's interest has been extended from purely financial terms. The last factor pushing the fiduciary discussion, as emphasized by Nagell (Nagell 2011) is the emergence of voluntary networks. Kiernan (2005, 212) also argues that environmental factors traditionally have been neglected by investors, since such concerns have been regarded either irrelevant or even damaging in their cost-return equation, but that this has been completely turned around over the last years. Several reasons can be identified as to why investors now are increasingly incorporating climate change in the investment decisions. Among them is the increased scientific consensus about the threat climate change pose, the physical costs of climate change, regulation of green-house gas emissions as well as other government initiatives. Lastly climate change is being increasingly accepted as a fiduciary issue (2005, 211-212). Dickinson (2005, 196) even argues that "taking climate risk into account is now becoming part of smart financial management. Failure to do so may well tantamount to an abdication of fiduciary responsibility".

According to Bellona, the change of name of the Fund from *Petroleum Fund* to *Government Pension Fund Global* was made in order to avoid excessive spending of oil revenues. It is harder to criticize the investments following international indices rather than betting on for instance green investments when the involved actors can hide behind "this is our future pensions" arguments (Bellona 2012). As such the change of name can be regarded as an attempt to re-couple the Fund to

fiduciary duties. A pension fund has different, and more concrete, obligations towards the beneficiary, than a SWF based on fossil revenues. Still, even though there was a name change, GPFG is not a traditional pension fund. KLP for instance, a pension fund for employees in Norwegian municipalities, argues that their direct fiduciary duty to their beneficiaries is what their first of all must ensure (KLP 2012).

4.3 The concept of Responsible Investments in general

A responsible way of investing is a concept that has been extensively debated in academia, but both the space constraint as well as the scope of this thesis makes it little fruitful to review all this literature. Instead a selection of literature considered most relevant, or eventually often-cited literature, will be reviewed. Based on the literature it can be argued that the responsible investment movement can broadly be divided into two general stands; the first is mainstream investment actors who encapsulate some kind of non-financial concerns into their investment decisions, or into their ownership activity. The primary motivation of these funds is often to maximize financial return, but the sub-motivation is often that financial return should be achieved in a responsible ways. There are as many variations of how this is understood and achieved as there are actors. The other category, which is less relevant for this research, is more specialized investment actors, investing only according to some kind of social or ethical criteria. This can also be called community investing or socially directed investment which, according to Sparkes (2001, 195) “accept below market returns in order to help others; this is certainly not the intention of SRI”. The GPFG clearly belongs to the first category, since the motivation is first and foremost to generate the highest possible returns. Sparkes (2001, 201) reminds us about this important distinction arguing that “some commentators on SRI seem to over-emphasize the social and environmental considerations and neglect the financial ones”. Hence, a first misunderstanding about responsible investments can be sorted out; it is *not* about charity.

The historical background for social and moral constraints in investment principles can be traced back to ancient biblical times and Jewish Law, as well as from more recent times with the anti-slave campaigns from the 19th century.

However, RI in the more present context saw its rise in the past century with important features like the anti-apartheid movements (Eccles 2011, 21-22). According to Sparkes (2006) environmental crisis, corporate scandals like the Enron case, and globalization have been major drivers the last decades (Sparkes 2006). In Europe institutional investors¹⁹ stand for 92 percent of the RI assets (Eurosif 2010, 7).

Despite being an old concept, there is a lack of agreement both in the academic literature, as well as among actors claiming to be responsible investors about what RI is, and how it should be denoted. There exists certainly what Sandberg (2009, 520-521) calls a terminological heterogeneity, and as reviewed by Sparkes and Cowton (2004, 46) terms like *green*, *strategic*, *development*, *social* and *creative* are found in the literature on responsible investments. RI is sometimes also referred to as *shareholder activism*, especially in the US (Louche 2009), but according to Sparkes (2001) this should not be confused with responsible investing. Nevertheless, the most used terms appears to be *ethical investment* and *(social) responsible investment* (Sparkes and Cowton 2004, 46). There is however a time-relevant difference, since *ethical investment* was used up to the 1990s, whereas the latter is more frequent today (Sparkes 2006, 40). Responsible investment (RI), or eventually social responsible investment (SRI), is also the term used by relevant actors like the Ministry of Finance and NBIM, and thus the selected term in this study. Moreover, there is not a clear and universal understanding among investors of what RI implies. According to the European Fund and Asset Management Association (Efama), the concept of RI cannot be understood by a single framework (Efama 2011). Sandberg et al. (2009, 521) argue that there is a heterogeneity aspect also at the definitional, strategic and practical level, in addition to the above mentioned terminological level. They argue that the diffusion of UNPRI might have contributed to a convergence or standardization of RI definitions (Sandberg et al. 2009, 522). This line of reasoning seems quite sensible, given that UNPRI has grown to become a large actor. This is also in line with another fruitful approach, outlined by Louche (2009, 55-62); the understanding of RI through new institutionalism. According to Louche (2009) RI is in a dual, and to some extent conflicting process; RI is on one

¹⁹ Institutional investors are investment managers, asset owners such as pension funds, insurance companies, and financial intermediaries (Sullivan 2011).

hand in a process of global convergence and isomorphism in which norms and laws will become more similar through the expansion of networks like UNPRI. On the other hand RI can be understood as a process of local divergence where the development will follow national specific patterns. Louche (2009, 62) points out that RI is “a concept that becomes global in its diffusion but fragmented/diverging in its practices”.

The “integration of certain non-financial concerns” is present in almost all definitions of RI (Sandberg et al. 2009, 251). This is also in line with the definition used by Sparkes (2001, 201) which emphasize RI as the combination of social concerns and financial returns. The same applies to the following definition by Louche; “SRI is defined as the constructing and managing of investment funds through the use of social, environmental and ethical considerations in addition to conventional financial criteria” (Louche 2009, 53). Furthermore, Eurosif (2010, 8) a forum for sustainable investments in Europe, points out that two issues are crucial in order for investments to be regarded responsible: a concern with long-term investment, and ESG issues as important criteria in determining long-term investment performance. This fits well with the GPF, since it is a very long-term perspective for the fund, and since there is emphasize on ESG issues within the relevant actors. It rises however an interesting question, does this mean that short-term investments are to be regarded as non-responsible? The long-term perspective is definitely of utmost importance when it comes to climate change. Kiernan (2005) argues that short-termism is as a matter of fact a great challenge, especially when it comes to climate change. Measuring results every three month is not easy combinable with the long-term aspects of the climate change challenge. This was also discussed at the conference “Do Investors care about the Environment” arranged by the Ministry of the Environment and BI Norwegian Business School in June 2012.

As mentioned in chapter 3.3. NBIM’s definition is of a responsible investor is “an investor who incorporates material ESG related risk factor considerations into fund management practices in order to improve long-term returns” (NBIM 2011c, 1). Compared to the other definitions above NBIM’s definition seems to have slightly more emphasize on the financial aspect. ESG factors are regarded as an instrument for improving return, and as such it seems like ESG has limited

intrinsic value in NBIM's definition. The Ministry does not have one explicit definition of responsible investing, but they write for instance that RI signifies to ensure a good return to safeguard future Norwegians, but also that this is dependent on sustainable development (Ministry of Finance 2010a, 4). This is very much in line with §2-1(1) in table 1, which forms the basis for the Ministry's understanding of RI. Seitchik (2009, 296) is arguing that "the exploding capital market interest in climate solutions has little to do with social investing". In this thesis however, climate change is regarded as part of the actors overall RI strategy.

4.4 Review of literature discussing the GPFG in particular

As mentioned above, the GPFG is often regarded as a pioneer in responsible investing and has thus been subject to attention from several scholars. This literature does unfortunately in general not emphasize climate change to any particular extent. As written in the introduction, the lack of research on exactly this part of the Fund is also the reason for why the topic has been chosen in this thesis. A few exceptions do nevertheless exist; Alm's (2010) book chapter discusses whether GPFG has established a "gold standard" in international climate investments, and not only in responsible investments in general. The short answer is no, since the Fund is index-based. Alm (2010, 145) argues that there is "a large gap between the Fund's ambitions and its actual climatic efforts". Another relevant article is a case study of the Fund with emphasizes on climate published by Reiche (2010) in the level-two journal *Energy*²⁰. The article gives an in depth overview of the ethical framework for the Fund, however much space is dedicated to the general aspects rather than climate change particularly. According to Reiche (2010, 3576) the importance of the Fund in regards to climate change is somewhat limited, but should nevertheless not be undervalued. Positive screening is also discussed, an instrument which Reiche (2010, 3576) argues would strengthen the general picture. Another source discussing the Fund and climate change is Hammerlin's (2008) report *Zero emissions to get full pension!*²¹, written for the environmental NGO FiOH. Despite not being a published academic source, the report gives some fruitful insight. Three suggestions to how the Fund

²⁰ *Energy* was however a level-one journal in 2010 when the article was published, see NSD (2012).

²¹ My translation, the original report is in Norwegian: Null utslipp for full pensjon!

can improve the climate related work are outlined; include positive screening, allow for climate as an independent reason for divestment, and improve the corporate governance (Hammerlin 2008).

As mentioned several times the Fund is often regarded as a pioneer in ethics, and much of the literature is concerned with discussing the importance of this role, and how it can be further improved. A somewhat different perspective is found in Clark and Monk's (2010a) article *The Norwegian Government Pension Fund: Ethics over Efficiency*. The authors seem first of all to be concerned with what they regard as too tight ties with the political leadership in Norway. It is claimed that the Fund is organized in a way that is inefficient, since the Ministry of Finance has the ultimate responsibility and since NBIM is part of the Central Bank. Clark and Monk (2010a) argue that this kind of political intervention has a financial cost. This is mainly due to the ethical guidelines, of which the authors write the following "(...) procedures that give effect to moral beliefs are valued higher than those that give effect to financial value" (Clark and Monk 2010a, 15). Similar views are also presented in Clark and Monk (2010b). Trude Myklebust, a special advisor in the Ministry of Finance, has written a responding-article published in the same journal (Myklebust 2010) in which she presents the new initiatives implemented after the evaluation process of the ethical guidelines in 2008.

As mentioned above the Ministry of Finance opened up for an evaluation process of the Ethical Guidelines in 2008, and many of the contributions will be data sources for this research. However, two evaluations were formally requested through competitive tendering. One was written by two Norwegian professors in finance, Thore Johansen and Ole Gjøølberg, and the other was prepared by professor Simon Chesterman together with the US consultancy firm the Albright Group (Ministry of Finance 2008e, 93; 2008b). Whereas the other contributions in the evaluation process have been left of in this section, these two evaluations are of more academic character, and are therefore included in this literature review. Johansen and Gjøølberg (2008) are mainly discussing the financial impact of positive screening, to which they are quite reluctant. They give several reasons for why positive screening is not advisable; the size of the Fund, reduced diversification and increased risks. The report written by the Albright Group and

Chesterman (2008) assess both the role of corporate governance in NBIM, and the work conducted by the Council on Ethics, and concludes with 27 recommendations for. The most relevant for this thesis is probably the recommendation to broaden NBIM's focus on climate by working for disclosure and also collaborate with other investors about the issue (Albright Group LLC and Chesterman 2008, 5).

Another initiative taken by the Ministry of Finance is the above mentioned research project on climate change conducted by consultancy firm Mercer, together with London School of Economics. Based on this general report Mercer submitted a tailored report for the GPFG in 2012. The general results of this joint research (Mercer 2011) and the tailored report (Mercer 2012a) will be discussed in chapter 6. To my knowledge, the Mercer report is, as of today, the most comprehensive study related to climate change performed on the GPFG. Still the Mercer report cannot be characterized as a purely traditional academic source. It is also based on a request from one of the actors, and despite being an independent work from Mercer, it was not an independent initiative from researchers.

Surprisingly few master thesis' have been written on the GPFG, however there are of course several thesis' from various academic fields, like Måntrøen's (2007) discourse analysis. NGOs are on the other side very interested in this topic, but the challenge is that these are rather normative in their publications. Recent academic sources discussing for instance climate change are lacking. There is however more academic literature from the years just after the establishment of the ethical guidelines, discussing the role of the GPFG in regards to responsible investing. This literature is, however, not very relevant for this thesis, since it is primarily discussing the role of the Council on Ethics and withdrawal. One example is Chesterman (2007).

5. Theoretical framework

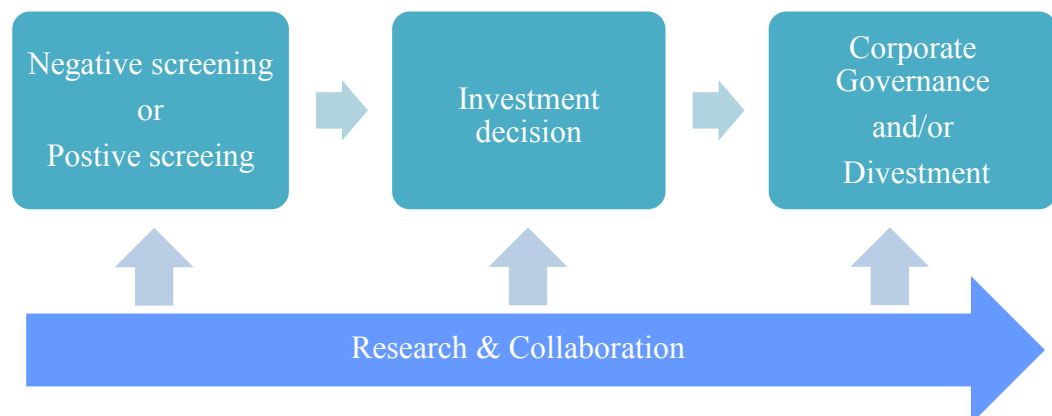
In this chapter the theoretical framework is presented. Research question 5 and 6 from chapter 1.2 will be answered; *what are the RI instruments available for investors? Moreover, what are the relevant principal-agent relationships are there any conflicts, and if so, can they have influenced the climate change work?* The chapter is divided into two parts; first a section presenting responsible investment instruments, and thereafter a principal-agent framework is constructed in 5.2. Why does this form a reasonable theoretical framework? As outlined in the methodology chapter the distinctive institutional character of the GPFG makes is little suitable for testing theories. The principal-agent theory is included since it is argued that the Fund is placed in a distinctive organisational structure, as such it is also important to figure out what the principal and agents are. In the analysis there will be a discussion of the different RI instruments used by the three actors. Therefore, it is plausible to first give some general insight about these instruments. Again, a challenge is that the literature about RI instruments is quite a-theoretical and more practically oriented, often written by actors from the field. Consequently chapter 5.1 is not presenting a theory, simply because one such theory does not exist. Rather it is a presentation of the RI in practise, using ethical theories to explain the rationale behind.

5.1 Responsible investment instruments in practice and the theoretical rationale behind

As briefly mentioned in paragraph 3.1.1 several instruments are used to ensure the responsible agenda of the GPFG. There is however a large degree of heterogeneity when it comes to exactly how investors transform responsibility strategies into actions in practice. On a very simplified timeline, as shown in figure 2, four main instruments can be included. Two of them are pre-investment tools, whereas the other two are post-investment tools. There is of course a wide range of variety within each category, and it should also be mentioned that this is my own understanding of the instruments. These instruments are what I have called *direct instruments*, since they directly affect the investment decision, strategy, the investees or other stakeholders. In addition there are some instruments which could be called *indirect instruments*, since they do not explicitly affect the

investments, the investees or other stakeholders. These instruments are as such not directly connected to the simple pre- and post- time line as illustrated in figure 2 below. Such instruments can be research and collaboration with other investors or participation in networks. These instruments can however affect the investment decision, for instance climate related research. Research might also lead to for instance changed screening criteria, and collaboration might affect corporate governance. It is furthermore interesting to discuss whether the investment decision in se also could be an instrument; after all it is the index-based portfolio that is affecting stakeholders, fiduciaries and owners. As discussed in chapter 3.3 NBIM should, according to Norges Bank's internal principles, incorporate ESG issues in the investment decision. It remains however uncertain how this eventually is done.

Figure 2



Responsible investing was part of religious institutions in its early stages, and the tool adapted was usually exclusion of certain sectors regarded unethical, mostly alcohol, tobacco and slavery (Sparkes 2006, 40). This is today commonly known as negative screening or negative selection, and refers to the exclusion of whole sectors from the investment portfolio based on what the Ministry of Finance (2009, 75) calls product-based argumentation. Hence, a fund using negative screening on tobacco will not include any company involved in tobacco production in the investment portfolio, and sometimes not even companies which are involved with tobacco through the supply-chain. Negative screening is thus a pre-investment tool and the rationale is that the product itself is unethical. According to Louche (2009, 53) negative screening is typically applied to controversial business activity. When it comes to the negative screening strategy of the GPF, there are three product-based criteria; companies involved in the production of certain types of weapons that violate humanitarian principles,

production of tobacco, or companies that sell weapons to countries excluded from the fixed-income part of the investment universe²², are not eligible for investments (Ministry of Finance 2010c). However the word screening might allude to a more comprehensive instrument. Bøhren (2011, 175) is for instance arguing that only companies found ethically acceptable will pass the screen and be eligible for investments. This seems not to be in line with the GPF, which is index-based, except for the three above mentioned sectors. Nevertheless, since climate change is not part of the negative screening for the GPF, this strategy will not be discussed further in the thesis.

In the 1990s there was a major shift towards more use of ownership engagement, also called active ownership or corporate governance. This refers to investors discussing some kind of selected issues with the companies in which they have invested. It refers also to the more formal use of shareholder rights like voting on general meetings (Sparkes 2006, 40). The concept is sometimes confused with shareholder activism, which refers to a tradition where NGOs or private persons buy shares in a company in order to have the right to participate and voice an opinion on the general meeting in that company. The objective is often to create media attention. It is mainly a tradition from the US, but not exclusively (Crane and Matten 2010, 266). In Norway this is the case for instance with Statoil. Corporate governance is thus a post-investment tool, since the communication with companies takes place after the investment. It is based on the opposite rationale than negative screening. Corporate governance is an important instrument for the GPF, especially when it comes to climate change. It will be further discussed in chapter 6.2.

Two other general tools are available for RI investors; positive selection or positive screening and divestment. Positive screening is also a pre-investment tool, with the opposite logic of negative screening; companies are selected as investees because they match some kind of selected profile, for instance being environmental friendly. This can be applied to whole sectors, or alternatively investors can look for best-in-class companies within sectors not traditionally regarded as environmental friendly (Johansen and Gjølborg 2008; Aslaksen 2003). Storebrand is one Norwegian investor applying best-in-class positive screening

²² This applies currently to Burma (Ministry of Finance 2011, 106).

(Storebrand 2012). Positive screening will be discussed in the analysis about the Ministry of Finance in chapter 6.1.

Divestment, or withdrawal, is a post-investment tool, based on what the Ministry (2009, 75) calls conduct-driven argumentation. A company can be excluded from the investment portfolio even if it is not concerned with production applicable to the negative screening. If a company contributes to the following it can be excluded (Ministry of Finance 2009, 75):

- serious or systematic human rights violations, such as, for example, murder, torture, deprivation of liberty, forced labour, the worst forms of child labour and other child exploitation
- serious violations of individuals' rights in situations of war or conflict
- severe environmental damage
- gross corruption
- other particularly serious violations of fundamental ethical norms

These are the Ministry's criteria, and not universally applicable among investors, but also other investors applying divestment often uses criteria in line with these. The most important thing to note in regard of this thesis is that climate change not is included in the divestment criteria. In chapter 6.3 there will be a discussion of how *severe environmental damage* is interpreted by the Council on Ethics.

As already mentioned it can be argued that screening, divestment and engagement are *direct instrument*. The Ministry of Finance has, however, also other tools in their overall RI strategy, which can be called *indirect instruments*, since they per se not affect the investment decision. Research and participation in international collaboration networks are such instruments. With regards to climate change it seems like research has been a very important instrument, due to the later on discussed Mercer project.

Eurosif uses another fruitful distinction of different RI tools in their 2010 analysis of European SRI. They make a distinction between core SRI, and broad SRI. Core SRI is defined as using norm-or value-based exclusion with three or more criteria, or positive screening. Broad SRI is defined as simple screening based on one criteria, engagement and integration (Eurosif 2010, 9). As mentioned above there is large degree of heterogeneity when it comes to strategic and practice in RI.

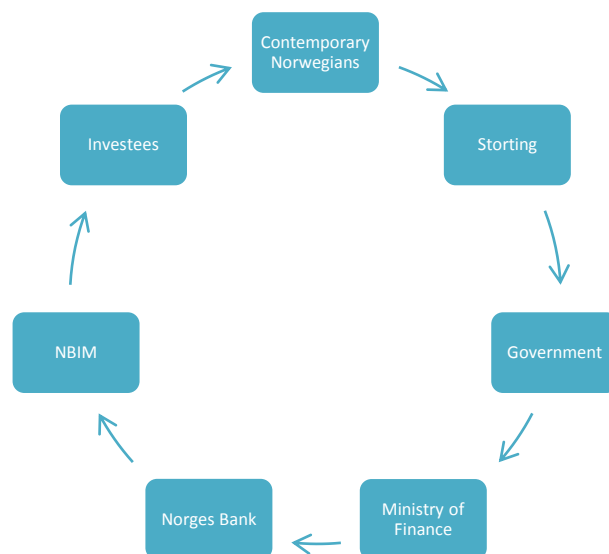
According to Eurosif (2010, 12) “some strategies are clearly favored in certain countries”. Norm-based exclusion refers to divestment from companies that violates certain principles, and is, according to Eurosif very popular in Norway and Sweden.

Different ethical schools are the background for the different instruments. Teleological reasoning, or consequentialism, is the moral background for the corporate governance strategy. Negative screening, or divestments, are on the other side more in line with deontological or non-consequentialist reasoning (Chesterman 2011, 47-48). In line with consequentialist reasoning it is the consequence or outcome of an action that should be assessed on a morality ground (Crane and Matten 2010, 97), and as such it is not unmoral to own shares in an unmoral activity, if the outcome of the ownership activity is morally acceptable. It can thus be argued that ownership engagement is a mode to achieve a moral outcome, which in the end gives a higher utility for everybody. As long as the total utility is higher than what it would have been without the activity, it does not matter how the outcome is achieved. This is also known as utilitarianism (Crane and Matten 2010, 101). When it comes to climate change this makes sense, since it is only if companies change their activity in a greener direction that the total utility, in this case less emissions, will increase. If ownership engagement in company x leads to less emissions, then it would be morally right to own shares in company x. On the other side, the outcome of the action, in this case to invest in company x, will per definition lead to emissions, since all activity does so. This is also the moral challenge about being an index-based investor; it is the aggregated sum of the indices creating climate change. Contrary, non-consequentialist reasoning is more concerned with the intrinsic value of the actions them self; a good outcome does not legitimize unmoral actions (Crane and Matten 2010, 98). Owning shares in an unmoral company is in itself unmoral, even if the outcome of eventually ownership engagement would have been a better company. This creates the rationale for the negative screening and withdrawal approaches. Positive screening might get support from both schools. It is in line with deontological reasoning, since the action is good. On the other hand it is also in line with teleological reasoning if one regard the ideal outcome to be less emissions.

5.2. Agency theory

When discussing the GPFG, which has a distinctive institutional character with several important actors, it is interesting to find out how the authority relationship is. Agency theory refers to situations in which one actor, called the principal, delegate power to another actor, called agent. The agent acts on behalf of the principal and the delegation of power takes place because the agent has superior knowledge. Delegation is thus regarded efficient, but there is often also a cost entitled with it (Shepsle 2010, 423). There is often a conflict of interest between the principal and the agent, due to diverging preferences. Information is also a challenge, since the agent often has superior information, and the principal cannot control every aspect of the agent' work (Bøhren 2011, 29). The challenge, which is often referred to as agency problems, is the following; how can the principal trust that the agent acts according to his preferences? It is assumed that the actors act according to their own preferences, which is to maximize their own utility. Agency theory has been criticized for being based on the rational choice approach which generally denies the collaborative aspect of human nature. In Political Economy literature, see for instance Shepsle (2010) the principal is often referred to as the voters, whereas the agents are the politicians. It also often describes the politician as the principal and the bureaucrats as the agents. In corporate governance literature, among others Bøhren (2011) the principal is often the owner/investors, whereas the board or the Chief Executive Officer is the agent. In this thesis the two perspectives must be combined, since they are both relevant in the GPFG case. A multiple-level principal agency framework, which describes the logic of the Fund and the climate change challenge, can be as follows:

Figure 3

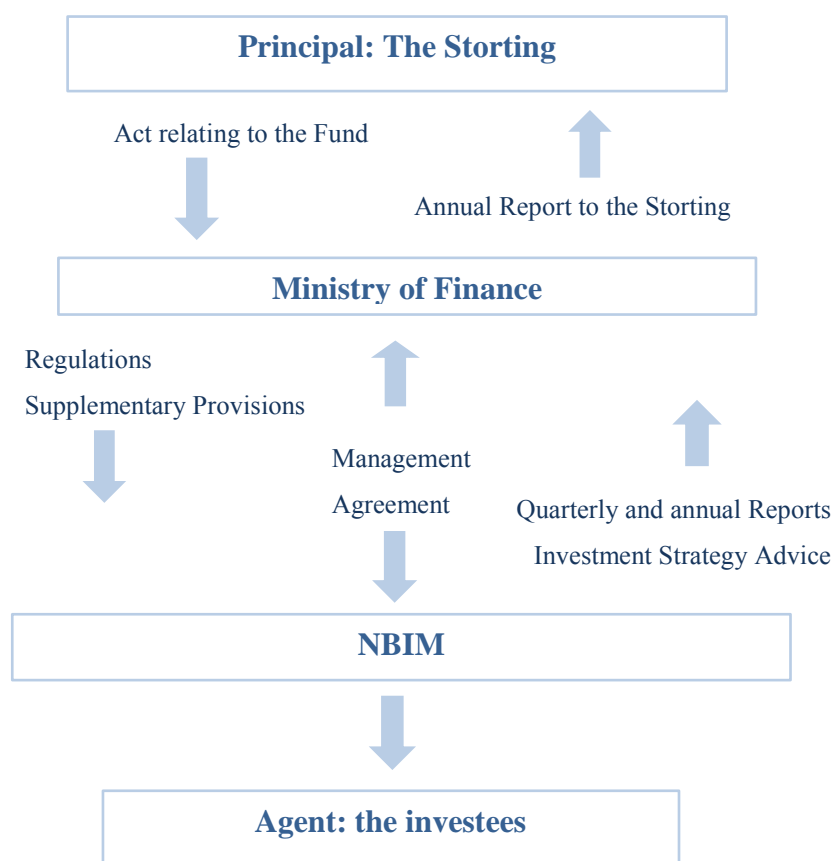


Each level either delegate to the next level, or is affected by the previous level. Several levels include both a principal and an agent role. The contemporary Norwegian voters are the principal, since they are the owner of the Fund. However, the beneficiaries of the Fund are also future generations of Norwegians, and the inter-generation solidarity aspect is one of the Fund's characteristics. The complexity of this organizational structure becomes evident when we see that there are several levels, given that the voters are not delegating directly to the operational manager NBIM. That would have been outside our democratic societal organization. Instead the Storting, which constitutes of representatives of the Norwegian people, is the acting principal. Thus, the Storting is acting as the agent on behalf of the Norwegian people, but the Storting is also delegating to the Government, and is as such also a principal. The Storting has delegated the management of the Fund the government, in line with parliamentary procedures. Within the Government the day to day management has been delegated to the Ministry of Finance. According to Bellona (2012) the Ministry has a license to invest the oil revenues on behalf of the Norwegian population. The Ministry is delegating the operational management to Norges Bank and NBIM. As showed in table 1, the Bank has independent power to take the investment decisions, see §1-1(3). NBIM is the operational manager, and is as such the ultimate agent in this regard, but NBIM has again delegated to the investees to create return. Thus, the companies in which NBIM has invested are the ultimate agents. The investees do affect the ultimate principal, the Norwegian owners, by contributing to climate change. What is also interesting to note with this remarkable long principal-agent chain, is that this institutional distinction might also lead to an institutional slowness. It is a complex structure, and changes must be approved at several levels, which is time consuming. However, this might also be a sign of quality, after all the GPFG is our common wealth.

Each of these levels has a potential conflict of interest. First of all, how can the Norwegian voters be sure that the Storting is managing the Fund according to our preferences? If one uses the Norwegian media debate as a control instrument, it seems like the voters, i.e. the principal, are not always satisfied. As already mentioned it has not been any broad media debate about climate change and the GPFG. Instead the media debate is quite concerned with specific companies. Lastly was the criticism of the investments in monitoring technology, see for

instance Dagens Næringsliv (2012a, 2012b). Furthermore one can imagine a conflict of interest between the Storting and the Government, and maybe as well within the Government. There is a broad political agreement on the general regulation of the Fund, but in chapter 6 it will be referred to cases in which there is disagreement with some political parties in the Parliament. Thereafter there might be a conflict of interest between the Ministry and NBIM, for instance about the degree of independency. Figure 4 gives a more detailed, but also simplified, presentation of the role of the three most relevant levels. These are also the most active levels, since both the Government and Norges Bank has more formal roles with overall responsibility, but in practice it is the Ministry and NBIM that manage the Fund.

Figure 4



Based on: (NBIM 2008a) and (Ministry of Finance 2009, 79)²³

Also Bøhren (2011, 175) discusses the GPF in light of agency theory and place the Norwegian people and the government as principals, whereas NBIM is assigned the role as agent. Another interesting question when it comes to the organizational structure of the GPF is the role of the Council on Ethics. It can be

²³ Part of the figure is inspired by the two sources, but the principal and agent roles have been assigned for the purpose of this thesis, and are as such my understanding of the structure.

argued that the council, due to its expertise role, is an agent. The Ministry has delegated the work with screening and assessing companies, but has maintained the power to take the final decision about divestment themselves. It seems reasonable to argue that the Council on Ethics is somewhat limited by its clear agent role. There is little reciprocity in the relationship with the Ministry, and one might imagine that the Council would have been far more proactive if it had been permitted to be so. As discussed in chapter 3 the Council on Ethics and NBIM has very different mandates, with the former having less leeway and no supervisory role. As shown in figure 4, as well as in the management mandate in table 1, NBIM should advise the Ministry about the overall investment strategy. NBIM also has a more complex role, since they act as the principal on behalf of the investees.

There is no doubt about the distinctiveness in this institutional design. As already mentioned the GPFG has been subject to attention from scholars, also due to the organizational structure with the Council on Ethics, the Ministry and NBIM. Whereas many Norwegian (for instance Storebrand and KLP) and non-Norwegian (among others the Swedish AP funds and CalPERS) institutional investors apply some kind of ethical considerations, the GPFG is, as noted by Reiche (2010, 3572) the only SWF with ethical guidelines. This is another proof of the Fund's distinctive institutional design, it is a SWF, thus it is state-owned, but still subject to comprehensive RI regulation. Most other state-owned funds are from non-democratic countries (Reiche 2010). However, according to Clark and Monk (2010a, 17) the structure around the GPFG is based on political legitimation, rather than functional efficiency.

6. The three actors climate change strategies in the period 2006-2012

By analysing annual reports, in addition to other written sources from the three actors, as well as data from the interviews, it is possible to identify how climate change is on the agenda. A few initiatives stand out as particularly relevant, and it is interesting to note that they are initiated from more than one of the actors. It seems like the Ministry and NBIM has alternately had the leading role. Research question 7 to 11, presented in chapter 1.2, will form the basis for this analysis. As emphasized in the methodology chapter, the analysis will have a historical perspective. To a large extent it is furthermore based on analysis of primary sources, with reference to the importance of “ad fontes”.

6.1. The Ministry of Finance - how is climate change on the agenda?

In this chapter the Ministry of Finance will be the main unit of analysis. The objective is to find out how climate change has been, and is, on the agenda for the period 2006-2012. As such the research questions 7 to 11 will form the basis for the discussion. To get a good starting point for the historical perspective a chronological analysis of the annual reports will be carried out. As pointed out in the methodology chapter the objective with the historical perspective is to identify consistency and continuation in the Ministry’s approach towards climate change, or contrary eventually inconsistency and discontinuation. A systematic analysis, i.e. the simplified content analysis, of the primary sources is important. Thereafter a few happenings, and/or RI instruments, will be highlighted and thoroughly discussed. To set the scene it should be briefly repeated that the Ministry’s RI instruments are the following; exclusion of companies, international collaboration and research, as well as initiating targeted investment programs. The Ministry also has the overall responsibility for the responsible investment strategy, hereunder also the corporate governance work. As such the Ministry possesses both pre-investment instruments like screening, post-investment instruments like exclusion of companies, and indirect instruments like research. As presented in chapter 3 the Ministry has the management responsibility, according to the Law.

6.1.1. How is climate change on the agenda: a historical perspective

A simplified content analysis of the annual reports to the Storting from 2006 to 2012, in addition to the report from the Graver Committee, has been performed. The Graver Committee's report was the first thorough discussion of the ethics related to the Fund, and it set the premises for the following RI strategy. It was thus a prerequisite for the coming steps. As written in the methodology chapter, performing a content analysis of the central documents can give a general idea of the extent to which climate change is on the agenda, and whether any changes have occurred. In this case there is also a tight tie between the historical perspective and the content analysis, since the latter is performed chronologically on the period of interest. Still, a content analysis alone can, on the other side, not be used to draw conclusions. This is particularly important when it is as simplified as the one performed here. The general results are presented in table 3 below²⁴.

Table 3

Report ²⁵	Frequency of the word climate
NOU 2003: 22. Forvaltning for fremtiden: Forslag til etiske retningslinjer for Statens petroleumsfond (The Graver Report from 2003 ²⁶)	23
Report No. 24 (2006-2007) to the Storting: On the Management of the Government Pension Fund in 2006	8
Report No. 16 (2007-2008) to the Storting: On the Management of the Government Pension Fund in 2007	21
Report No. 20 (2008-2009) to the Storting: On the Management of the Government Pension Fund in 2008	139
Report No. 10 (2009-2010) to the Storting: The Management of the Government Pension Fund in 2009	49
Report No. 15 (2010-2011) to the Storting: The Management of the Government Pension Fund in 2010	56
Meld. St. 17 (2011-2012) Report to the Storting (white paper): The Management of the Government Pension Fund in 2011	58

What is interesting to note is that in the annual reports about the Fund from the Ministry there has been a steady increase in the use of the word *climate*. This might signify that there has been consistency in the Ministry's climate change

²⁴ The extended result can be found in appendix 1.

²⁵ All the reports are found in the bibliography, under Ministry of Finance. The slight inconsistency in the reports naming is in line with the original sources.

²⁶ The search was conducted in the Norwegian document since the English version only is available as an internet page, and not as a searchable pdf-file. The English version might also not be complete.

strategy, since there might have been a gradually increase in the focus. An initial assumption is therefore that there has been continuity, i.e. one step as a prerequisite for the next. According to the Ministry themselves climate change has indeed become gradually higher on the agenda the last years (Ministry of Finance 2012d). As already mentioned the Ministry's most important RI initiative in the years just before the time-frame chosen in this thesis was the establishment of the ethical guidelines. These were however not particularly focused on climate change; the guidelines did not specify *how* or *if* the Ministry regarded climate change to be relevant, and eventually what measures could be taken. This might be connected to the relatively low frequency of the word *climate* in the report from the Graver Committee. As shown in table 3, *climate* was mentioned 23 times. However, the Graver Committee (2003a, 98-100) discussed a wide range of topics, among them also climate change. It is for instance discussed whether UN's Framework Convention on Climate Change could have been used to form legitimate requirements towards portfolio companies. The question was how eventually violations of the convention could be identified. The challenge with the Convention on Climate Change is that it is very general. The Committee argues that:

In the case with greenhouse gas emission an alternative could be that the Petroleum Fund could exclude companies with high emissions. It would however be difficult to define a appropriate level for this, in addition it would be irrelevant and impossible to identify violations of the convention (Graver Committee 2003a, 100).

It was therefore argued that the Convention not constitutes a fruitful foundation for negative screening or exclusion of companies. When it comes to environmental challenges, only two conventions are found specific enough by the Graver Committee (2003a, 141) to eventually be used as a rationale for negative screening. These were the Montreal Protocol on Substances that Deplete the Ozone Layer and the Stockholm Convention on Persistent Organic Pollutants. Climate was not included in the negative screening, or in the criteria for divestment. Moreover, it was left to NBIM to decide what to focus on in the corporate governance work. Therefore it can be argued that the establishment of the ethical guidelines was not a particularly important incident when it comes to climate change. It was however a decisive happening when it comes to responsible investing in general, and the guidelines of course also formed the

basis for the later work. The guidelines opened up for the use of instruments which later could, and in some cases has been, used in regards to climate change. As shown above it also remains clear that the Graver Committee as a matter of fact discussed climate change, and how to eventually include it in the suggested ethical guidelines, without finding the existent conventions satisfactory. This is a proof of the complexity of the climate change challenge; the lack of political commitment at the global level is a problem also for investors, because it is difficult to exclude companies that not violate any law. KLP (2012) argues that this is still a major challenge for investors when it comes to climate change. It is nevertheless tempting to suggest that *if* the Graver Report had pointed out climate change as *the* challenge to focus on, then today's RI strategy could have been different. However, there is no rationale for arguing that the low frequency of the word *climate* in the Graver Report equals that they not found the issue important.

In the 2006 annual report to the Storting (Ministry of Finance 2006), which is the next unit of analysis and first year in period in this thesis, the word *climate* was mentioned only 8 times, as shown in table 3. This is the lowest frequency in the sample. In the report there is a separate chapter on ethics and ownership activity, in which climate change is mentioned. There is a presentation of NBIM's corporate governance, which is very much based on NBIM's annual report. The Ministry however add in the end that;

the Ministry is supportive of Norges Bank's ownership strategy and it believes that (...) the protection of the environment are amongst the important, fundamental ethical norms that the ownership influence should contribute to safeguarding (Ministry of Finance 2006, 72).

This is the only time the Ministry was voicing their opinion about the ownership activity, otherwise they held a quite referring tone. In the report the Ministry furthermore presents the other pillar in the ethical guidelines, negative screening and divestment. Also here the Ministry held a neutral and descriptive tone, presenting facts and working methods, making no effort to for instance discuss what is meant by *severe environmental damage*, which is the most relevant conduct-based exclusion criterion in this regard. The Ministry is discussing and presenting their standpoints when it comes to for instance the use of exclusion versus the use of ownership engagement, or the importance of transparency, but in no case they come down to the specific areas. All in all it seems plausible to argue

that there is quite limited focus on climate change in the report, and this is as such in line with the findings presented in table 3. This does however not automatically mean that the Ministry was not concerned with climate change in 2006, it is just not expressed to any particular great extent in the annual report. There are however not found any other primary sources from the Ministry from 2006 which eventually could prove that they in fact were pro-active when it comes to climate change. It could therefore be argued that 2006 still was a period of consolidation of the ethical guidelines, in which the Ministry seemed satisfied with NBIM's focus on climate change in the ownership activity.

In the 2007 annual report (Ministry of Finance 2007) the word *climate* was mentioned 21 times, i.e. there was an increase from the previous year. However, also in 2007 the use of the word *climate* is almost exclusively connected to the presentation of NBIM's ownership activity. The Ministry is however more detailed in its discussion of the responsible investment policy (the whole report is also larger than the year before). It is still very much replication of what NBIM wrote in their annual report, which will be discussed in the next chapter. The Ministry repeats that they are supporting NBIM's focus areas, by using the exactly same sentence as the one cited above (Ministry of Finance 2007, 122). So far it seems to be reasonable to argue that the Ministry up to 2007 had taken few independent initiatives with respect to climate change, i.e. it is not easy to identify the Ministry's own strategy towards climate change in the first years of the chosen period. However, the Ministry clearly supported NBIM's climate change strategy. The establishment of the ethical guidelines stands out as the most important initiative up to 2007, even though it was not directly taking actions towards climate change. It can still be argued that there is consistency in the Ministry's approach towards climate change in 2006 and 2007, since the Ministry is supportive of the initiatives taken by NBIM.

In January 2008 the three actors together arranged an international conference about responsible investment, which was also the start of the evaluation of the ethical guidelines (Ministry of Finance 2007, 27). Therefore it is plausible to argue that the Ministry already in 2007 discussed the evaluation process, and that they might have discussed climate change internally. In an article in Aftenposten from November 2007 (Aale 2007) the State Secretary Roger Schjerva was

interviewed about the forthcoming evaluation process, and he emphasized the importance of climate change for an investor. The same article was also referred to on the Socialist Left Party's webpage, with the title "will use the Oil Fund as climate tool"²⁷ (Socialist Left Party 2007). This is a quite clear communication of how important then Ministry of Finance Kristin Halvorsen regarded climate change. Thus it seems reasonable that climate change was higher on the agenda in 2007 (and maybe also in 2006) than what is expressed in the annual reports to the Storting.

2008 stands out as a year with a remarkable focus on climate change in the annual report. The word *climate* was mentioned more than twice as many times as in 2011, see table 3. The Report to the Storting about the management of the Fund in 2008 (Ministry of Finance 2008e) was however somewhat different from the other years. In this year the Ministry summarized all the evaluations submitted to the Ministry as part of the evaluation of the ethical guidelines. As such one might conclude that the very high number of words containing climate in 2008 just reflects the contributors to be very concerned with climate change, and not the Ministry itself. When it comes to the contributions to the evaluation process in 2008 and their view upon climate change, the Ministry argues that this is an issue that most of the contributions are concerned about. They furthermore divide them into two groups; the first arguing for using the Fund as a tool to prevent climate change, whereas the second group is more in line with today's premises and instruments (Ministry of Finance 2008e, 104-105). Alm (2010, 137) also stresses that climate was the issue which got most attention among the evaluations. The Ministry (2008e) itself emphasizes the importance and urgency of the climate change challenge, but they also emphasize that the GPFG not should meet all the ethical obligations of the Norwegian state, hereunder climate change. Though, they point at three main reasons for why the Fund still should be used to take some initiatives; the long-term perspective, the broad diversification, and the universal owner nexus (Ministry of Finance 2008e, 105-106). This is in line with the literature presented in chapter 4.1 about the relevance of climate change for investors. It is also in line with the discussion about the motivation behind actions, the Ministry's arguments are rooted in self-interest, i.e. secure financial return.

²⁷ My translation

The use of the word *climate* in the 2008 report (Ministry of Finance 2008e) is also different in another sense. Not only the frequency of the word, but also the variety of how the word was used, was different. Whereas there was what we might call a terminological consensus, or little variation in the expressions, in both the Graver report and in the reports to the Storting in 2006 and 2007, there was much more variety in 2008. Among the 139 times *climate* was used, there was 27 different combinations including the word *climate*, with the top three being *climate change*, *climate challenge* and *climate friendly energy*. The reason is probably that the 2008 report is quite colored by the various contributions to the evaluation of the ethical guidelines.

In 2008 several interesting issues were discussed in the report, in addition to the above mentioned presentation of the contributions to the evaluations process. The most interesting is that in 2008 the Ministry opened up for including positive screening in the investment strategy, by establishing an environmental program with focus on investments in infrastructure, un-listed equities, environmental bonds as well as general eco-friendly assets and technology. The program was aimed at reaching 20 billion NOK (Ministry of Finance 2008e, 18-19). This will be further discussed in chapter 6.1.3. In 2008 the Ministry also announced that it would initiate research to assess the effects of climate change, which can be seen as a result of the evaluation process of the ethical guidelines (Ministry of Finance 2008e, 23-26). This resulted in the Mercer report, which will be discussed in chapter 6.1.2. In the report the Ministry also asks “Norges Bank to prepare more documents outlining its expectations (...) a document regarding companies’ strategy to combat climate change is regarded as particularly relevant” (Ministry of Finance 2008e, 23). This document will be discussed in 6.2.2. It can be argued that climate change was high on the agenda both among the contributions submitted to the Ministry, as well as in the Ministry’s follow-up in the report. No other ESG issue received attention to the same extent.

So far it can thus be concluded that 2008 was an important year when it comes to the Ministry’s approach toward climate change since several relevant initiatives were taken. The Ministry opened up for a broad and inclusive evaluation process in the beginning of the year, they adhered to the majority of the contributions favourable view on environmental positive screening, and they started the process

with a more in-depth analysis of climate change. So far it has been argued that 2006 and 2007 might have been characterized by consolidation of the ethical guidelines, and observation of NBIM's climate change strategy, rather than strong independent initiatives from the Ministry. It could still be argued that the Ministry is consistent in how they approach climate change, since the strategy has been gradually expanded to include new initiatives.

An interesting observation is that the Ministry (2008e) in the annual report wrote about the new environmental program in the chapter about investment strategy, and not in the chapter about responsible investment. This trend continued, since the environmental program was not part of the new ethical guidelines from 2010. Another interesting point in this regards, noted also by FiOH (2012), is that the former *ethical guidelines* are now replaced with *guidelines for NBIM's responsible management and ownership activity* and *guidelines for observation and withdrawal*, see Ministry of Finance (2012a). This signifies that the word *ethical* no longer exists in the guidelines, and that the Fund no longer has one set of guidelines, but rather one for each of the agents. It should however be noted that also the former ethical guidelines were concrete about the tasks of NBIM and the Council on Ethics respectively. The new guidelines are only concerned with corporate governance, negative screening and withdrawal/observation of companies. Climate is not mentioned in neither of these two guidelines since it is not part of the Council on Ethics mandate, and since the focus areas in the ownership activity are not specified. However, in the Ministry's pamphlet about responsible investments, both the environmental program and instruments like research is presented as part of the overall RI strategy (Ministry of Finance 2010a). There is thus a difference between the official guidelines, and how the Ministry presents the overall work with responsible investing. This is especially true for climate change, which is mentioned only in the latter. On the other side, climate change is given a great amount of attention in the pamphlet.

In the annual report to the Storting in 2009 (Ministry of Finance 2009) the word *climate* was mentioned 49 times. This is a lot less than the year before, but is however not argued that this decline represents an inconsistency in the Ministry approach to climate change. The reason is that 2008 was a particular year when it comes to the annual report, due to the high influence of the evaluations.

Contrarily, the frequency of the word in 2009 represents a continuation, since it is used more than in 2007. There is however a remarkably different use of the word in the 2009 report. As discussed above the 2006 and 2007 reports were characterized by lack of independent initiatives from the Ministry, and climate change was almost only mentioned as part of NBIM's corporate governance strategy. In 2009 the Ministry took several independent initiatives, and this comes through also in the text. Instead of only noting, and agreeing, about NBIM's focus on climate change, the Ministry in the 2009 report write about their own climate change initiatives, like the Mercer research project. In the fall 2009 the Ministry signed a contract with Mercer about the above mentioned research project on climate change (Ministry of Finance 2009, 19). This marks a very important initiative.

In the 2010 annual report to the Storting (Ministry of Finance 2010b) the word *climate* was mentioned 56 times. The development from 2009 continues also in 2010, i.e. the report is more characterized by the Ministry own climate change initiatives than in the first years. In 2010 a new word combination not used in the previous years was found; *climate breakdown*. This has a logical explanation, since climate breakdown is one of the scenarios from the Mercer report, to which the Ministry refers. The Mercer report will be discussed in 6.1.2. In the 2011 annual report (Ministry of Finance 2011a) the trend continued. Climate was mentioned almost to the same extent as in 2010.

In the written material from the Ministry of Finance it becomes clear that climate change has become gradually higher on the agenda. It makes sense to speak of a pre- and post- 2008 era when it comes to the visible climate change strategy. Before 2008 such strategy almost exclusively relied on NBIM's work with climate change. After 2008 the Ministry has taken several important and independent initiatives. This does, however, not signify that the Ministry was not concerned with climate change in 2006 and 2007, however eventually concerns were not sufficiently communicated to the public, and did not lead to concrete initiatives before 2008. As already noted, Kristin Halvorsen began to publicly voice a more pro-active climate change strategy at the end of 2007. This might at that time already have been maturing internally in the Ministry for some time. As discussed in chapter 5 the institutional complexity surrounding the Fund might

also lead to some institutional slowness. It might very well have been that the initiatives that emerged after 2008 already were planned in 2006/2007. After all, the Ministry's climate change strategy has been gradually expanding with one factor forming a prerequisite for the following.

6.1.2 Climate change on the agenda – the Mercer research

In chapter 6.1.1 a historical analysis of the Ministry of Finance was presented, and it was argued that the Ministry's climate change strategy has evolved gradually, and thus there has been a process characterized by consistency. However, the Ministry's interest in climate change was rooted in NBIM and other actors' emphasis on this issue in the early years, i.e. up to 2007. This changed in 2008 when the Ministry opened up for an evaluation process with a considerable focus on climate change. Many, maybe the majority, of the evaluations submitted as a part of this process, expressed a concern with the Ministry being too passive. In the end of 2008 the Ministry took the initiative to a research project on climate change, and in 2009 when they formally initiated the Mercer project. This happening definitely marked a change in the Ministry's role, and forms the rationale for a separate chapter about the Mercer project.

As a first step it is interesting to pose the question; why did the Ministry initiate the Mercer project? According the Ministry (2012c) itself it was naturally for a long-term investor to ask the question; which factors will affect the return from the equity markets in the future? The answer they found was that climate change can be such a factor. This is in line with the discussion about universal owners and externalities like climate change in chapter 4. One might ask why the Ministry not reached that conclusion earlier, considering that there had been discussions on investors and climate change since in the early 1990s, at least in the UK (Pfeifer and Sullivan 2008). Or alternatively, if the Ministry had considered the potential risk climate change pose earlier, which should not be unlikely, why did they not take any initiatives until 2008-2009? One possible explanation is that they relayed on NBIMs ownership activity. Another plausible explanation is that the RI work has evolved since the establishment of the ethical guidelines, and that is was just a casual reason for why climate change not was among the first issues to prioritize. In chapter 5.2 it was also argued that the complexity of the institutional design

might lead to an institutional slowness, and this might also be the case for the work with climate change in the Ministry.

Nevertheless, 2008/2009 marked a change. The Ministry (2012c) argues that it was convenient to enter into a joint collaboration with the consultancy firm Mercer, since Mercer had plans for such a project and had teamed up with other institutions with expertise had expertise knowledge about the issue. All political parties in the Parliament, except the Progress Party, were positive towards the Mercer report and welcomed such research as important and relevant (Stortinget 2012, 16). The Ministry was the first of 14 funds to sign the contract with Mercer and they claim that it probably was important for some of the other funds that the GPFG already had signed the contract, since the Norwegian fund is internationally acknowledged as an forth runner in responsible investment (Ministry of Finance 2012c). Such research collaboration regarding the economics of climate change had never taken place among investors (Ministry of Finance 2010b). A complete list of the 14 participants can be found in appendix 4, there were funds from Netherland, Sweden, UK, Singapore, USA, Canada and Australia, in addition to Norway. The research was conducted together with the Grantham Research Institute on Climate Change and the Environment at London School of Economics and Vivid Economics. The process was, according to the Ministry (2012c), characterized by several meetings. Moreover, Mercer was the leading actor, but the funds gave input on for instance methodology and the analysis. The research resulted in a report presented in London the 15th February 2011 (Ministry of Finance 2010b, 29). Most of the participants are cited in the beginning of the report, being quite generous about the importance of the project and the findings. Bruce Duguid from the Carbon Trust argues that:

The findings undermine the notion of a conflict between ‘green’ investing and acting in beneficiaries long-term financial interests. This will have profound implications for fiduciary duties and places a clear obligation to increase analysis of the consequences of climate change for portfolio management” (Mercer 2011)²⁸

This is interesting with regards to the literature presented in chapter 4.1. Half a decade ago Kiernan (2005) and Dickinson (2005) argued along the same lines

²⁸ The quote is from the preface of the report, thereby no page number exists.

when it comes to climate change and fiduciary duties. The statement above proof that fiduciary duty however has remained traditionally interpreted.

In 2012 Mercer published a tailored report for the GPF. It is based on the analytical framework and findings from the first report, but it is applied on the GPF. This report will therefore form the basis for the discussion below. The framework consists mainly of two set of analytical tools, with the first being a set of climate change risk factors, named the TIP factors: Technology, Impacts and Policy. The second is the use of four climate change scenarios: regional divergence, delayed action, Stern action and climate breakdown. The first is the most likely scenario, in which it is assumed that different regions will have divergent responses to the climate challenge, due to lack of international agreement. Delayed action is second in likeliness, and describes a scenario characterized by measures being taking late. The Stern action is less likely, and refers to coordinated international action, in line with the Stern recommendations. The least likely scenario is however the Climate breakdown, which is a scenario in which no action is taken. Mercer (2012) thereafter assesses how sensible asset classes like listed equities, fixed income, commodities, real estate, private equity and infrastructure are towards the TIP factors. The sensitivity is measured on a four step scale, from low to very high. The four scenarios have positive, neutral or negative impact on each of the assets classes.

Global equity (a sub category of listed equities) has low sensitivity towards the TIP factors. The Stern action scenario has positive impact on this asset class, whereas the delayed action scenario has negative impact. The regional divergence and climate breakdown has neutral impact. Thus, the third less likely scenario is the only one with positive impact on this asset class, which is a huge part of the GPF. Delayed action, which is the second most likely scenario, is expected to have a negative impact on global equity. Each asset class is analyzed with the same method. Four asset classes are expected to be positively affected by three of four scenarios; sustainable listed equity, efficiency/renewables listed and un-listed equity, as well as efficiency/renewable infrastructure. All of these have however high or very high sensitivity towards the TIP factors, as well as a negative impact of the climate breakdown scenario. In addition to asset classes different regions are evaluated as to their sensitivity to the TIP factors and impact of each of the

scenarios. EU, Japan, Russia, and India/South Asia has moderate sensitivity, whereas the US and China/East Asia has high sensitivity (Mercer 2012a, 5-9). It is a comprehensive analysis and it is particularly relevant that Mercer, even though they both emphasize that the report not should be used as investment advice, and also clearly stress the uncertainty and long-term perspective, draw some general lines. Many asset classes get different results in the four different scenarios, which complicates the picture. Mercer (2012a, 52) therefore emphasizes that the recommendations depends on whether the Ministry value the likelihood of the scenarios in the same way as do Mercer. Mercer (2012a, 52-57) explicitly lists a set of key actions to consider, given that that the Ministry agrees with the likelihood of the scenarios. It would be beyond the scope of this thesis to discuss Mercer's suggestions in detail, however, some main points should be briefly touched upon. Mercer argues that if the delayed action or Stern action scenarios should become real, the Fund should re-allocate towards assets classes in new technology. As explained above, Mercer regards the delayed action and Stern Action to be respectively the second most likely, and second least likely. In the most likely scenario, regional divergence, Mercer recommends exposure towards technology, but it is regarded more risky than in the other two scenarios. Mercer furthermore argues that the Fund is best positioned to tackle the least likely scenario, the climate breakdown, and explicitly write that "in the other scenarios, which we believe to be more likely, the Fund is less optimally positioned and would benefit from considering a change in the portfolio mix that introduces a focus on climate-sensitive assets which exhibit exposure to TIP factors" (Mercer 2012a, 53). These assets are infrastructure, real estate, private-equity (priority one) and sustainable equity and energy efficiency/renewables (priority two). Bellona correspond with the suggestion from Mercer, and argues that this is very much in line with what they suggested themselves in 2008 (Bellona 2012, 2011). As already mentioned NBIM will increase the real estate investments in the coming years.

The first Mercer report gave more general advice than the above ones (Mercer 2011). It is however not easily understandable how the Ministry regards the outcome of the first Mercer report. In the 2010 annual report to the Storting they wrote that the preliminary conclusion was that the Mercer report not would necessitate changes in the investment strategy (Ministry of Finance 2010b, 31).

However, this preliminary conclusion was based on the general report, which did not give any particular advice to the GPF. It seems thus like the Ministry might have been waiting for the tailored report. In the subsequent annual report to the Storting the Ministry (2011a, 55) writes that “major uncertainty means that it is not possible, based on Mercer’s calculations, to draw concrete conclusions about the consequences for the Fund’s future returns”. Mercer also emphasize the uncertainty aspect, especially since the conclusions depends on the likeliness of each scenario. This is as such a proof of the complexity of the climate change challenge for investor. Though, the overall discussion of the tailored Mercer report has a remarkable evasive and to some extent self-defensive tone. The Ministry emphasizes the climate change focus in NBIM’s corporate governance strategy. This is important, but not related to the investments themselves, which is what Mercer discusses. Furthermore the Ministry argues that both the environmental mandates, which will be discussed in the next chapter, and the real estate investments, are in line with Mercer’s recommendations. That being said, these investments are currently each around, or below, one percent of the Fund. Mercer recommends more substantive re-allocation. However, the somewhat unclear tone in the chapter about the Mercer report (in the 2011 annual report to the Storting) makes this material difficult to analyze. It can therefore not be concluded based on this that the Ministry disagrees, or not wishes to consider Mercer’s recommendations. There might be numerous reasons why they are unclear. A plausible explanation might be that the Ministry has not yet decided whether the Mercer report should lead to major changes. According to Mercer’s own follow up report, a third of the 14 participants will allocate more of the portfolio to climate sensitive assets (Mercer 2012b). As such it seems like the Ministry is not the only Fund which is now evaluation how to cope with the Mercer results. This is yet another proof of the complexity of the issue.

In the historical analysis in chapter 6.1.1 it was argued that the Mercer report is one of the most important initiatives from the Ministry, and probably the most important since 2008 when the Ministry opened up for positive screening. The Mercer report as such represents continuation in the Ministry’s approach towards climate change, since it is part of an expanding strategy. Nevertheless, the concrete importance of the Mercer reports depends also on the following-up from

the Ministry, and so far it remains uncertain if and how the Ministry eventually will change the investment strategy.

6.1.3 Positive screening and climate change

Even though it might seem like the Ministry, and especially NBIM, see NBIM (2008b) are quite reluctant to positive screening, the Fund has in fact a history of some positive selection. This is outside the main timeframe in this thesis, but a short description serves as a useful background in order to analyze the continuity of the Ministry's climate change strategy. In 2002 the original mandate from 1997 of the then-called Petroleum Fund was changed (note that this mandate is not the same as the 2010 mandate described in section 3.2) and the following was included in §2 in the mandate: "a certain amount, decided by the Ministry of Finance, should be placed in the Environmental Portfolio" (Lovdata 2002). The environmental portfolio had been a fact already in 2001 with one billion NOK to be invested by NBIM in listed equities in certain developed countries. NBIM was supposed to make the investments in companies accomplishing environmental criteria in the FTSE index or in companies identified by the British responsible investment research agent EIRIS (Ministry of Finance 2002). The value of the Fund when the environmental portfolio was established in 2001 was approximately 304 billion NOK (Ministry of Finance 2001). The value of the environmental friendly investments was thus well below 1 percent of the total value of the Fund. Bellona criticized the Ministry and NBIM for lack of transparency, since they only published the index, and the entire list from EIRIS, and not the companies in which NBIM actually invested. In spite of that, this was changed, and Bellona argued that this happened after pressure from themselves (Bellona 2003). Another environmental NGO, the FiOH, criticized the investments themselves. Among the companies included in the Environmental Portfolio were for instance the later on excluded Rio Tinto, as well as several oil companies (FiOH 2002). The environmental portfolio was thus a very good example of how glossy reports and good reporting can make clearly non-environmental friendly companies and sectors appear more environmental friendly. This is also a challenge with today's Investor Expectations, which will be discussed in chapter 6.2.2. It is difficult to assess whether a company actually has improved or not as long as the compliance is based on self-reported material

The environmental portfolio saw its end in 2004 due to several reasons. First of all, the Ministry wanted an ethical profile of the whole portfolio, in line with the Graver Committee suggestions. The economic effects of the separate environmental portfolio had also been unclear or negative, and moreover the environmental effects were unclear (Ministry of Finance 2004). There was as such a quite short, and maybe not very successful, experience with positive selection for the Fund. After the establishment of the ethical guidelines in 2004 there was no positive screening, since Graver Committee not recommended the use of such instruments. They did not, however, explicitly argue against positive selection per se. The Graver Committee argued that best-in-class screens on the whole portfolio would limit the investment universe too much, and that eventually partly positive screening should be decided on after the evaluation of the environment portfolio was done (Graver Committee 2003b). Reiche (2010, 3575) argues that the experience with the environmental portfolio nevertheless could be useful for future initiatives in the same direction. This is also the rationale for including this in the thesis.

It might seem like there was a rupture with part of the Fund's stakeholders, owing that several Norwegian actors continued to argue in favor of positive screening. This might have been the reason for why the Ministry asked for viewpoints on positive screening when they initiated the evaluation process of the ethical guidelines in 2008 (Ministry of Finance 2008d). A total of 57 evaluations were submitted to the Ministry of Finance as a part of the evaluation process of the ethical guidelines in 2008. Among those 29 were in favor of some kind of positive screening, 6 evaluations were against such instruments, whereas 22 did not comment on positive screening. The detailed results are found in appendix 3. Among the evaluations with no comment there were many evaluations focusing on specific areas, like tobacco, fixed bounds and so on. There certainly was a majority of pro-positive screening suggestion among the evaluations, and almost all of these suggested investments in the renewable sector or similar. Even so, it should be mentioned that there was a plurality of suggestions which I have classified together as *pro-positive screening*. There was also a wide range of different actors; other ministries, NGOs, other investors, RI experts, employee's organizations and universities. Thus it was not merely radical NGOs which were in favor to the idea of positive environmental screening. The Ministry also

concludes that the evaluations in general were positive to such screening (Ministry of Finance 2008e, 18). However, one of the two evaluations requested from the Ministry, Johnsen and Gjøølberg (2008), were explicit in their criticism of positive screening, which they not regarded to be an appropriate instrument for a fund of the GPFG's size. The broadly diversification would be too reduced and thus the risks would be increased. Joly (2008) argued that that Johansen and Gjøølberg's analysis was not precise, and that positive screening in se not would lead to increased risk.

When summing up the evaluation process in the 2008 Report to the Storting, the Ministry (2008e, 23) concluded that they would establish an investment program targeted environmental friendly investments. It could therefore be argued that the Ministry adhered to the principles of overlapping consensus, by including a measure demanded by the Fund's stakeholders. The Ministry opened up for the introduction of a new RI instrument, or the re-introduction, if one considers the former environmental programme. Even though the discussion on positive screening in 2008 was an opening up for re-introducing an RI instrument, there were differences between the use of the instrument in 2001 and in 2008. It is beyond the scope of this thesis to analyze the two programmes in details, but when it comes to the Ministry's consistency it is important to note that that the new programme not was a copy of the one from 2001. This was a clear introduction of a new instrument, since earmarking or positive screening not was part of the ethical guidelines form 2004. The ministry furthermore discussed several possible options for how the program should be build up, as well as the challenges with this kind of earmarking. By for instance overweighting low carbon companies, i.e. increase the amount of these equities with respect to the benchmark index. Risk might increase in other areas. An example is banks, which have low emissions, but high risks in other areas (Ministry of Finance 2008e, 68, 73).

The new environmental programme was discussed in the 2009 annual report to the Storting. First of all it is stated that the investments should meet the standard requirements to risk and return. Thereafter the Ministry discuss possible designs, environmental bonds, environmental equity indices and active management with environmental criteria, are outlined as the most likely ones. However, after

communication with Norges Bank the conclusion is that the Ministry not distributed any particular rules for these investments. The reason seems to be that NBIM regarded such targeted regulation as inappropriate, and that the environmental programme could be managed within the existing investment universe (Ministry of Finance 2009, 41-42). However, the environmental mandates have been included in the Management Mandate, as shown in table 1 in chapter 3.2, and this clearly represents a sign of commitment from the Ministry of Finance.

According to Reiche (2010, 3574), informants in his study argued that 10 percent of the total assets could be subject to the new positive screening mechanism. It has turned out to be far less extensive. In 2010 there were ten environmental mandates, seven of them were externally managed, with a total value of approximately 25 billion NOK. Three of the mandates were within environmental technology, three were within water management and the last three within renewable or clean energy. All these investments had the same requirements to return as the rest of the portfolio (NBIM 2010b, 39). The Fund's external mandates which invest according to environmental criteria, for instance in green technology and renewables, are separate from the ownership activity and the climate change focus. It is part of the general diversification policy, in which risk and return always are considered. The renewable sector might grow fast, but also be exposed to major risks. The investments are made on the same basis as all other investments when it comes to expected returns (NBIM 2012b). It should also be remembered that 25 billion, despite being a significant amount, is well below 1 percent of the Fund's total value. According to Bellona (2012) there should be a higher percentage of green investment. They argue that a 15 percent target is achievable. The FiOH (2012) is quite explicit when they argue "we want the GPFG to use more positive screening". Former Minister of the Environment Erik Solheim is also arguing in favor of positive selection, suggesting that there should be a certain amount set aside to invest in green technology, for instance wind- and water power in China. Several possible designs exist; among them a separate portfolio, place part of the fund in Norfund, or make a whole new fund. Nevertheless, he emphasizes that it should not be based on non-profit, it should be investments giving a high return (Solheim 2012). According to Kiernan (2005, 221) it is surprising that most investors handle the climate change risk mostly by

ownership engagement, and to a little extent by what he calls the next level, namely overall investment strategies with concrete changes in the portfolio. In 2005 this was however about to change, Kiernan (2005) points at emerging environmental investment strategies among US funds like CalPERS. What is interesting to note in this regard is that in Norway went in the opposite direction in 2004, and only re-introduced such measures in 2008. According to Syse (2012) the evaluation of the first environmental program in 2004 indicated that such programs are not effective, and that this was in line with the experts at that time as well. NBIM's advice was that environmental politics should be left to the Government, since investors have other tasks.

To sum up it is argued that the re-introduction of positive screening supports the claim about continuation in the Ministry's approach towards climate change. However, there was a period with no use of such instruments, and as such there has been some inconsistency in this part of the Ministry's climate change strategy. Nevertheless, the new environmental programme is part of an expanding climate change strategy.

6.2. Analysis of NBIM – how is climate change on the agenda?

In this chapter there will be an analysis and discussion of NBIM, with the annual reports and other written material²⁹ as the departing point. The main questions to answer are in line with research question 7-11 presented in chapter 1.2. How is climate change on the agenda for NBIM in the period, and what were the major happenings? Has NBIM been consistent in their approach? This section will also look at how NBIM, more concrete, use corporate governance in the work with climate change. As with the previous chapter about the Ministry of Finance, the chapter will be characterized by the historical perspective.

6.2.1 How is climate change on the agenda: a historical perspective

As described in the methodology chapter, a small content analysis was performed for some of the written primary sources. In NBIM's case the analysis was performed in the annual reports from 2006 to 2012. It was clarified in chapter 3 that there was nothing about climate change in NBIM's mandate or in the central

²⁹ The quarterly reports have not been consulted.

principles from the Executive Board of the Central Bank. Climate change is, however, included in NBIM's understanding of ESG issues, as emphasized in the NBIM's responsible investment policy, see page chapter 3.3. When it comes to the annual reports, climate was mentioned several times. In table 4 there is an overview of the number of words containing *climate* in the annual reports³⁰.

Table 4

Report	Frequency of the word climate
NBIM's Annual Report 2006	12
NBIM's Annual Report 2007	41
NBIM's Annual Report 2008	3
NBIM's Annual Report 2009	11
NBIM's Annual Report 2010	11
NBIM's Annual Report 2011	9

The frequency of a word can say something about how high priority that particular issue is given over a given amount of time, i.e. in a historical perspective. Nevertheless, there is room for considerable dubiousness since there by no means can be sat an equal sign between how an issue is dealt with in written material, and how the same issue is dealt with in reality. Having this in mind, there seems to be some tendency in how the word *climate* is exposed in the report. As become clear from the results in table 4, *climate* is normally mentioned approximately ten times in the annual reports. This might not seem that little, but for instance the word *return* was mentioned 25 times in the 2011 report just in the summary, content list and foreword. Having this in mind, it becomes clear that climate is far from being a most-used word for NBIM. That yet not expected from an actor like NBIM, which primary obligation is to create return. What is furthermore interesting to note is that there is not an increasing trend as was found in the Ministry's reports. The picture is thus less clear, but there is a remarkable increase in the use of the word *climate* in 2007, and then again it was almost not mentioned in 2008. Probably reasons for this will be discussed below.

2005 was the starting year of the separate corporate governance section within NBIM (NBIM 2005, 24). Climate change was not yet identified as a focus area,

³⁰ All the reports are found in the bibliography.

and as a consequence it was not mentioned in the report either. There is a five-page chapter on corporate governance in the report, in which the establishment of the separate unit in NBIM is presented, as well as the foundation and principles of the ownership activity. It is clearly written that this establishment is a direct consequence of the ethical guidelines (NBIM 2005, 24). However, in a letter from Norges Bank to the Ministry in the beginning of 2003, i.e. before the Graver Committee published its report, the bank is clearly positive to the use of shareholder rights. In the then valid management mandate (not the current mandate referred to in chapter 3) it was stated that the bank not should use such instruments unless it was necessary to secure financial return. In the letter Norges Bank suggested to change this formulation (NBIM 2003). Consequently, it is not possible to claim that NBIM not would have enhanced corporate governance without the ethical guidelines. However, it remains uncertain whether the current corporate governance strategy of NBIM would have been the same if the ethical guidelines not were established.

In NBIM's 2005 annual report it is also emphasized that the objective with the corporate governance work is to ensure financial return. For a universal owner like NBIM, well-functioning markets in the future are also essential and thus factors like environment are important (NBIM 2005, 24). It is not easy to identify the direction of NBIM's ownership activity at this point in time. It remains unclear what NBIM actually planned to do. As a matter of fact NBIM got substantial criticism from Hans Petter Graver, the former head of the Graver Committee, for not fulfilling their part of the ethical obligations. As already mentioned, the ethical guidelines had two pillars, one of them left to NBIM. When it comes to climate change the Graver Committee (2003a, 157) had explicitly stated that they regarded ownership engagement as a more fruitful instrument than screening and divestment. In a chronicle in Dagens Næringsliv Graver explicitly stated that he was disappointed, and that "the bank has not yet not followed up the ethical obligation they got from the Storting and Government"³¹ (Graver 2006). It might therefore seem like the Graver Commission had intended NBIM's ownership activity to be more pro-active. As will be showed below, NBIM's ownership activity has, however, evolved, and at least some of the issues emphasized by Graver in 2006 are now in place.

³¹ My translation

The above paragraph on 2005, which is outside the main time frame in the thesis, set the scene, and serves as an exemplification of how the climate change strategy in NBIM evolved in the coming years. In NBIM's 2006 annual report, the word *climate* was mentioned 12 times. There was also an 8-page chapter on corporate governance and ethics in the main part of the annual report, in addition to a six-page feature article about the chosen priority areas for the corporate governance strategy (NBIM 2006). Both these chapters are closely-written. In the report the corporate governance strategy is repeated (cf. last paragraph, it was presented already in 2005). The following is made clear; exercise of ownership rights should be conducted with the objective of achieving financial return, it should be founded on a long-term perspective and considering the universal owner aspect. Furthermore it should be based on Global Compact and various guidelines from OECD (NBIM 2006, 40). This is also in line with §2-2 (1) and §2-2 (2) in the Management Mandate, as presented in table 1 in chapter 3.2.

The corporate governance section counted 6 man-years in 2006, and had a budget of 10 million NOK. In 2006 the work was taken one step further by identifying six focus areas for the corporate governance work, one of them being companies' lobby activity towards climate change (NBIM 2006, 41). As such 2006 therefore marks a clear continuation of the strategy commenced in 2005, since the corporate governance strategy was specified in 2006. When it comes to climate change, 2006 marks a beginning-year in NBIM. Several reasons for choosing the specific areas are outlined by NBIM (2006, 41-42). Among them was the importance of the selected areas for the long-term financial return. When it comes to climate change it has already been discussed why it is relevant for universal owners. Moreover, NBIM emphasized the probability they had to contribute to changes as a key motivation. It was also important for NBIM that they had the possibility to identify single companies to work with, and finally the probability to cooperate with other investors was emphasized. In 2006 NBIM also worked with making the corporate governance work commonly known, through participation in panels and conferences (NBIM 2006, 41-42). Voting at companies general meetings is a key instrument for NBIM in the corporate governance work. Most of the voting is by so-called proxy-voting, the use of a representative voting on behalf of NBIM. In 2006 NBIM voted on most of the companies in which they had invested (NBIM

2006, 41). In addition NBIM has direct contact with some companies. NBIM also collaborates with other investors, and write the following:

The costs will be borne by the investors conducting the activities while the results achieved will benefit all the shareholders. Owners will be able to strengthen their influence by coordinating their activities. NBIM therefore recognizes the strategic importance of participating in informal and more formalized networks (NBIM 2006, 43).

Despite not writing it directly, it becomes clear that NBIM regards corporate governance as a common good, and sees cooperation as a way to solve the prisoner's dilemma. NBIM is member of International Corporate Governance Network (ICGN), and participated in Council of Institutional Investors (CII) in the US. In 2005-2006 NBIM also contributed to the establishment of the UNPRI (NBIM 2006, 43).

In the feature article in the annual report about the Fund in 2006 the focus areas are more thoroughly presented. It is stated that NBIM "aims to become known as one of the world's most prominent and professional active shareholders over the coming four-year period" (NBIM 2006, 68). NBIM aimed at working with areas which are not part of the responsibility of the Council on Ethics. Furthermore NBIM emphasizes that it was important that NBIM is not regarded as a political actor, or a non-consistent actor (NBIM 2006, 68-69). Syse (2012) argues that this is one of the key issues in order for NBIM to be successful in its corporate governance activities. NBIM furthermore stated that climate change is a threat for a universal and long-term owner, by referring to the Stern report. According to NBIM there is a limited room for action for investors, since single companies' reduced emission not will contribute to solve the global challenge. Therefore, they argue, it is policy initiatives and regulation which will make a difference. Since several companies lobby against such regulation, especially in the US, as such they lobby against the interest of a long-term investor like NBIM. NBIM wishes to use corporate governance to contribute to a more transparent kind of lobbying, in which companies not lobby against climate regulation which would benefit NBIM as a whole (NBIM 2006, 72-73). The later Mercer research (2011; 2012) is a proof of how valid NBIM's choice was, since it is climate regulation that now is causing major uncertainty as to how the Fund should be positioned.

The 2007 annual report (NBIM 2007) is organized in the same way as the one from 2006. There was a 17-page long chapter in the main report about ethics and corporate governance, and 15-page feature articles about corporate governance and the focus areas in the end. Climate was mentioned 47 times in this report, by far the highest frequency in the sample. In 2007 there were ten man-years in the corporate governance section. Much of the content in the 2007 annual report is similar, but there is one significant difference. In the 2007 report (NBIM 2007, 42-43) there is a chapter in which NBIM's contact with companies is discussed. NBIM was in contact with 90 companies in 2007, mostly within the six focus areas for the corporate governance work. The companies were chosen based on analysis performed by or for NBIM, the general meetings or other happenings like media attention. Also the share owned by NBIM, and the size of the company is considered. When companies are identified NBIM make a plan for the dialogues, including the objective with the conversation and the timeframe. The communication is mainly with the chairman of the Central Board. According to NBIM there is in general availability from the companies, but they also write that dialogue is easier in countries with disclosure regulation and tradition for shareowner communication (NBIM 2007, 42). Between the lines we can read that the communication is not always easy. In the report NBIM shows to ten examples of how they are in communication with companies. All of them are very anonymised, and only one of them is about climate change conversations. Nevertheless, NBIM declares that this example is only one of approximately 20 dialogues about climate. Thus, this is the most precise information you can get from NBIM about company dialogue:

NBIM visited the chairman of a large power producer at its head office to discuss, among other things, developments in climate legislation. The chairman, who is also the CEO and in active contact with legislators, subsequently came to Oslo on his own initiative to continue these discussions with NBIM's management. This dialogue is continuing, and is just one of around 20 ongoing dialogues on climate legislation (NBIM 2007, 43).

This is a clear transparency challenge. During a hearing in the Committee on Finance it was pointed out by the environmental NGO Rainforest Foundation that for instance the Swedish AP funds are more transparent in their ownership activity (Løvold, Olsen and Ranum 2012). The Swedish AP funds have organized their RI work in a different way than the GPF. The four funds have one common ethical council, which also has the responsibility for the dialogue with companies. From

the 2011 annual report (Etikrådet 2011) it becomes evident that there is a higher degree of transparency. However, ongoing dialogue with companies is not always made public in Sweden either. Nevertheless, both dialogue which was fulfilled in 2011, as well as ongoing dialogue, is presented in the report. Both name of the company, sector, and country is presented. Each company is given a vote on a five step scale from *very positive development* to *no positive development*. In addition there is an in-depth presentation of the dialogue with Coldcorps, as well as anonymised presentations of ongoing dialogues (Etikrådet 2011, 14-26). The total amount of information is substantively more than what is published by NBIM. One should remember that the Swedish council embraces both the role of the Norwegian Council on Ethics and NBIM's corporate governance section. The Council on Ethics is publishing the names of companies that are under observation.

It is interesting to note that whereas NBIM had six focus areas in 2007, among them two of more social and environmentally character, namely children's rights and climate change related lobbying, NBIM had an investor expectation document only for children's rights. Thus there is a slightly excess focus on children's rights in the 2007 annual report. The focus on climate change started with a quite narrow focus on lobbying in 2007, this narrow focus was by, among others, the Albright group criticized as far too narrow in its evaluation of the ethical guidelines (Albright Group LLC and Chesterman 2008). According to Syse (2012), who was the head of the corporate governance section when the focus areas were shaped, it was intentional to focus on a relatively narrow set of issues. He furthermore argues that some of the criticism might be due to the angle that was chose when it comes to climate change. NBIM's line of reasoning was to point out where they as an investor could make a real difference, and that was found to be when companies lobby against climate regulation. Binding regulation is in the end what is needed in order to avoid climate change. For a universal and long-term owner it is especially problematic if companies work against the optimal state of affairs for the whole portfolio in the long run (Syse 2012). According to Syse (2012) the corporate governance section had support from the Chief Executive Officer and the Central Board for selecting the area. Furthermore he argues that many companies actually changed their standpoint on climate regulation during 2006 and 2007, but it is of course difficult to claim that NBIM's standpoint was

decisive. However, Syse (2012) argues that many companies listened to NBIM, and the fact that a large fund chose to emphasize this aspect might not have been irrelevant for many companies. The Albright Group and Chesterman (2008, 16-17) argue that the focus areas was chosen after a one-year process in which also external expert were included, however they also claim that the process was too internal, since general public was left out of the process. Contrarily Alm (2010, 143) argues that NBIM selected climate change as a priority area also because it was in line with what most Norwegians were very concerned about in 2006. As such it was in line with the principle of overlapping consensus. Whereas for instance Clark and Monk (2010a) argue that the rationale of the Fund is based on a political legitimacy rather than a functional one, the Albright Group and Chesterman (2008) argue that NBIM should be more concerned with anchoring its priorities among Norwegian stakeholders. The reason is that the focus areas in that way would be more robust in case of for instance political changes. This argument is in line with the discussion in chapter 3.2 about the challenge with climate change not being included in the most of the central regulations and guidelines for the Fund.

So far it has been argued that 2005, in which the corporate governance strategy was formulated, sat the premises for the further specification of this strategy and the inclusion of climate in 2006. In the same way the Graver Committee's report from 2003 and the ethical guidelines from 2004 formed the rationale for NBIM's change from a passive owner, to an active owner with concrete focus areas. Each year is as such a premise for the next year. There is continuation in how NBIM approach the issue. This has also been expressed in the written material. There is consistency in the amount of pages dedicated to ownership activity as well as climate change, the layout is similar (with closely-written pages), and an increase in the use of the word *climate*, in line with this issue becoming gradually more important from 2006. In 2008 there seems however to be a discontinuity in how NBIM express their climate change strategy. In the 2008 annual report *climate* was mentioned only 3 times (NBIM 2008). This should, in line with the critical discussion about the limitations of content analysis, not be emphasized too much. However, there is a remarkable difference from the previous years, especially from 2007.

There are also other indicators stressing the discontinuity in the written material in 2008. The annual reports from NBIM includes a special thematic part each year, or feature articles. In 2007 this part of the report was partly dedicated to social and environmental issues, whereas the thematic part in 2008 was about risk in the equity markets and traditional corporate governance issues like shareholder voting. This difference might of course account for some of the decrease in the mentioning of *climate* in 2008. Nevertheless, there was a remarkable difference also in the main part of the report between 2007 and 2008. As already mentioned, in 2007 there was a 17-page long chapter on ethics and corporate governance with concrete examples on how the work had proceeded. It was almost without exception closely written pages. In 2008 there was an 8-page chapter about the same, with considerably more air and figures on most of the pages. Within this chapter there was only a short two-page section on climate change, stressing a continued focus on lobbying and climate regulation. NBIM voted on 80 environmental issues in 42 companies in 2008, mostly related to concrete suggestions to reduce CO₂ emissions. In addition NBIM continued the more detailed contact with 10 companies within the energy sector in the US (NBIM 2008a, 54). However, in 2007 NBIM had contact with more than 20 European and American companies about climate related risks, and there is not written anything about whether, and eventually why, they only continued the contact with ten companies in the US in 2008.

As already underlined, analysis of the annual reports might not say anything about how a concrete issue, in this case climate change, was on the agenda, or how high on the priority list it was. Annual reports can serve as simple window-showing, and the frequency of a word, or the space dedicated to an issue is not necessary a good measure of what was done. Nevertheless, this is the unit of analysis publicly available, and a remarkable difference is noted. Whether it was due to some kind of more occasional organizational gap in the corporate governance section, or whether it reflects an actual change in prioritizing, is difficult to assess. One reason might be that there was a change in staff members at the end of 2007. Henrik Syse, a well-known Norwegian philosopher, was headhunted to NBIM in 2005. The Graver Committee had suggested a work-sharing between NBIM and the Council on Ethics, where NBIM should be responsible for one of the responsible investments pillars, namely the ownership activity. NBIM had until

this been a passive owner. Syse, with outspoken opinions about ethics, was asked to form the corporate governance section within NBIM. The section had five staff members in the beginning, and was later expanded to approximately eight before Syse left NBIM at the end of 2007. Today the section has approximately ten staff members (Syse 2012). According to the Albright Group and Chesterman (2008, 12) one of these employees worked with climate change, a division they argue seemed suitable. Since there was such a remarkable difference in the frequency of the word *climate* between 2007 and 2008, and also a general difference in how the climate strategy is expressed, there is tempting to suggest that this might have been connected to the fact that Syse left the position as head of the corporate governance section. This does not mean that the new leader, Anne Kvam, was not as interested as Syse in climate change, it can simply mean that there was what we might call an organizational gap in between.

Another plausible explanation is that NBIM was more transparent in 2007. The shorter and more general presentations in the latest reports might be symptom of NBIM being less willing to share information with the public. It might also be that it does not reflect any change within the corporate governance section, but rather a change in the power relations within NBIM. Maybe Syse was better at promoting corporate governance within NBIM and thus gained more space dedicated to these issues in the annual report than his successor. This assumption is supported by the fact that there also was a change in the top management of NBIM in this period. Yngve Slyngstad was the new Chief Executive Officers as of 1st January 2008. It might also be that there was a change in the importance given to wordy presentations of a strategy. It might also be that the corporate governance strategy and the climate change issue had been so thoroughly presented in 2006 and 2007, that it was regarded unnecessary to repeat it in 2008. To sum up; it is not easy to conclude with one answer as to why this difference between 2006-2007 and 2008 was found.

One could argue that the focus on climate change in NBIM's ownership activity has evolved from focusing on a narrow area, to become broader, i.e. emphasizing more aspects of climate change. This might have been a process in line with the evolvement of the corporate governance section during the same period. One could also argue that NBIM answered to the criticism from the evaluation process

in 2008 by widening the focus area. The Albright Group and Chesterman (2008, 19) explicitly wrote that the focus seemed narrow. This line of reasoning could be turned the other way around, by arguing that it is not usual for an ownership engagement to start with companies lobby activity, rather the contrary. Multiple investors which NBIM can be compared with, and which they collaborate with, does not talk about lobbying. The reason is that lobbying is a sensitive area which can easily be regarded too political. It was controversial when NBIM launched lobbying in 2007, especially since there was a discussion in the US at that time about whether SWF were used as political tools (NBIM 2012b).

In 2009 there was again an increase in the frequency of the word *climate* in the annual report, but it was still very far from the 2007 level. There was a ten-page chapter on corporate governance in the main part of the 2009 report, but the feature articles were dedicated to other aspects. The pages are less closely-written than in 2006-2007, and as such more in line with the 2008 report. However, 2009 serve as a good example of why it is challenging to assess NBIM purely looking at the annual reports. The reason is that even though there was not a very large focus on corporate governance and climate change in the annual report in 2009, a side-path appeared this year. In august 2009 NBIM published its *Investor Expectations on Climate Change* document (NBIM 2009b). This document represent on one side a continuation in NBIM's corporate governance work, since such document already existed with regards to children's rights. On the other side it represent a new moment in the climate change strategy, and also a new way to communicate with the general public.

Up to 2009 climate change was only commented on in the annual reports, and as such it is a side-path to move the focus into other documents. The expectation document clearly represented a shift in the focus on climate change since there was no longer only a focus on lobbying. The work was also made far more concrete with this document, which is followed by a *Sector Compliance Report* each year. The challenge is however that by moving the focus on climate change from the annual report to more targeted documents, these areas might be less visible for the general public. The reason is that the annual reports are summarized in the reports to the Storting, and it is also my impression that they are read by several actors. Contrarily, other written material might suffer from less

attention. There will however be a separate analysis of these documents in the next subchapter.

In 2010 *climate* was mentioned with the same frequency as in 2009 in the annual report. Also in this report there was a chapter on corporate governance in the main part, this year it was six pages long. In 2010 there was also published a new version of the document describing the NBIM's expectations when it comes to climate change. In 2010 NBIM also launched their new real estate investments (NBIM 2010b). In this regard it is interesting to note that these should give importance to, cf., §2-1(3) from the management mandate (see table I, chapter 3.1) "energy efficiency, water consumption and waste management". In theory, i.e. in the written management mandate, the real estate investments are as such a new factor which contributes to enhance the overall climate change strategy. This was also noted by Alm (2010). Despite not being part of NBIM's outspoken climate change strategy, which is related to ownership engagement, the real-estate investments could be said to contribute to further enhance NBIM's overall work with climate change. However, the energy efficiency aspect is not mentioned in NBIM's 2010 annual report. Instead they write that they will focus on "investments in well-developed markets and traditional property types, such as offices and retail premises" (NBIM 2010b, 24). The real-estate investment were however very new in 2010.

In 2011 *climate* was mentioned nine times, so almost the same as the two previous years. The chapter about corporate governance was only three pages long (NBIM 2011a, 46-47). Again, there is less content on each page than what was the case in 2006-2007. The feature article in 2011 was about the real estate investments. The energy-efficiency aspect does not seem to be prioritized in NBIM's real estate investments so far (in London and Paris). However NBIM (2011a, 65) write that "when assessing prospective investments (...) environmental issues will also be addressed as set out in the regulations governing the fund". It is therefore reasonable to argue that real estate investments in the future might add a factor to the overall climate change strategy, but at this point in time the issue has not yet been prioritized by NBIM. As mentioned in the introduction the investments are also so far limited (0.3 percent), and thus it is not possible to analyze the real

estate investments from a climate change perspective yet. This might be an interesting topic for future research.

The amount of space dedicated to corporate governance and climate change in the annual reports reach the lowest level in 2011. There has been a continuing trend from 2008 and onwards. The 2006-2007 reports had more text, less air and figures, as well as less irrelevant photos than the reports from 2008-2011. This trend is so clear that it is tempting to argue that there has been a commercializing of the reports. If this is the case, and if it eventually has been done deliberately is not easy to say.

When it comes to the extent to which climate change seems to be on the agenda, it might be plausible to argue that it is an issue of growing interest and attention. It has turned out to be one of six focus areas in the ownership activity, there is an employee dedicated and responsible for the issue, and expectation documents and compliance reports have been developed. As such there has been continuity in NBIM's climate change strategy, which has gradually evolved. There has however been some inconsistency in how climate change specifically, and corporate governance generally, has been expressed in the annual reports. It is not legitimate to argue that NBIM's interest and effort related to these issues has decreased. The possible explanations discussed above seem more likely. Still, this consists of a communication challenge for NBIM, since it seems like they actually are more concerned with these issue than what is communicated through their most important information channel, namely the annual reports.

However, it remains uncertain whether the increased interest in climate change also is followed up at the top management level in NBIM and Norges Bank. The fade-out of climate change, responsible investing and corporate governance issues in the annual reports might signify that these issues have been totally delegated to the governance section. The fact that climate change not is included in any of the guidelines at higher levels seems to support this line of reasoning. Another interesting observation is that nor the Governor of Norges Bank Øystein Olsen, nor the Director of NBIM Yngve Slyngstad, mentioned responsible investing, corporate governance or climate change in their presentation of the Fund in 2011 at the hearing in the Committee on Finance in the Parliament the 17th of April

2012. It is not reasonable to expect these issues to be the *main* unit of attention in such a presentation, but it seems somewhat strange that it was not at least mentioned. Ethical challenges, climate change, environmental issues like investments in the rain forest, the use of corporate governance versus withdrawal - these were however all issues at stake in the subsequent question round. Several members in the Committee on Finance, from parties like Venstre, the Christian Democratic Party (KrF) and the Socialist Left Party (SV) were all quite concerned with these issues.

6.2.2. Corporate governance and climate change - NBIM's Investor Expectations document and the Sector Compliance Reports

Today there is a broad general agreement in Parliament about the active ownership strategy of NBIM. This has not always been the case. In 1999 the first Bondevik Government suggested that NBIM should use its shareholder rights to vote in a way that would benefit environment and human rights. This suggestion was not approved in the Parliament (Ministry of Finance 2004). It seems as such quite clear that there has been a remarkable development. This section will look closer at corporate governance and climate change.

In 2009 NBIM launched their first investor expectation document on climate change. According to the Ministry of Finance (2012d) NBIM's investor expectations are interesting, and show how minority owners can explicitly formulate expectations. Besides, the Ministry argues that NBIM has managed to operationalize something difficult, which might be valuable for other investors (Ministry of Finance 2012d). NBIM had already issued such a document on one of the other focus areas, namely children's rights, and the outline is more or less the same. It remains uncertain why NBIM decided to make an expectation document for one of the focus areas in 2007, but only in 2009 for the other one. Several possible reasons could however be discussed. It might be that NBIM's newly established corporate governance team regarded children's rights to be more urgent or important than climate change. Nothing has been found that support this assumption. It might also be that the corporate governance team, due to for instance limited resources, simply had to pick one focus area first. Yet it seems a bit awkward that it took two years to make the other expectation document. Though, this could be in line with the assumption about a possible

institutional slowness due to the complex structure surrounding the Fund. It was also shown in table 1 in chapter 3.2 that according to §2-2 (3) NBIM has to consult the Ministry before they make “major amendments to the Bank’s priorities in its active ownership” (Lovdata 2010). As mentioned in chapter 6.1.1, the Ministry invited NBIM to prepare an expectation document on climate change in the annual report to the Storting for 2008 (Ministry of Finance 2008e, 23). It might have been internal communication between the bank and the Ministry, which might have delayed the process, but also embedded the final outcome in both institutions. However, the Ministry’s request for an expectation document is a proof of their role as principal with regards to NBIM. In §2-2 (3) it is further stated that there should be a public consultation before NBIM send eventual proposals to the Ministry (Lovdata 2010). Indeed it was opened up for commenting NBIM’s first version of the expectation document (NBIM 2009c). Unfortunately is neither the first version of the document, or the comments, publicly available. Consequently it is difficult to assess whether NBIM eventually changed the document after receiving the comments.

Another possible explanation as to why NBIM not had an expectation document on climate change in the period of 2006-2009, is that a single event urged NBIM to concretize the expectations on children’s rights first. In 2006 the Council on Ethics recommended divestment from the biochemical company Monsanto due to severe risk that continued ownership would contribute to what is labelled “the worst forms of child labour” (Council on Ethics 2006a, 16). The Councils conclusion was quite clear, however, the Ministry decided to not divest, and instead try to influence Monsanto though pursuing active ownership (Ministry of Finance 2008a). Therefore it seems reasonable to argue that Monsanto was the first real possibility for NBIM to show that corporate governance might be more efficient than divestment, and that since this case was related to child labour, and not climate change, they chose to focus on this first. If the first real case had been related to climate change, the situation might have been the other way around. I would therefore argue that there is no reason to believe that NBIM intentionally regarded either one of the focus areas less important. It is however interesting that NBIM themselves has admitted that children’s’ rights is the focus area which has led to the most clear results (Slyngstad 2012). Rather than a confession of the importance of either of the focus areas, this statement should be regarded as an

acknowledgement of how complicated climate change is as a focus area in corporate governance work. In addition to unclear reporting routines and political risk related to uncertain policy initiatives, it is a challenge that there is today no global climate change law. This is opposed to for instance conventions on labour standards or children's rights, which might be the reason why it is easier to see results in the corporate governance work with children's rights.

The investor expectation document was slightly updated in December 2010. I will mostly consider the updated version (NBIM 2010c) in this section. Some comparison with the original document will be done, in order to assess NBIM's consistency. The document is at the core of how NBIM regard climate change, and many of the issues discussed in chapter 4 are addressed here. It can be called *the* governing document when it comes to climate change. Still, we should not forget that this document is placed quite low on the hieratical list of documents presented in table 2. As problematized in chapter 3, since climate change is not included in the overall mandates, there is nothing preventing NBIM or the Ministry from changing their minds in the future.

Like most of the written material from NBIM, at least after 2007, the document is quite short and concise. NBIM (2010c, 3) writes that having expectations towards companies is a priority for investors because "there is overwhelming scientific evidence that climate change threatens long-term financial returns". NBIM has as such a very concrete understanding of the link between climate change and future return. This impression was also confirmed by both Syse (2012) and by NBIM themselves (NBIM 2012b). An initial assumption was that NBIM incorporated climate change in the focus area due to political will. Nothing has been found to support this hypothesis.

The expectations are divided in four main categories; A) strategy for optimized investment in climate change risk mitigation, B) specific action to implement climate change strategy, C) effective and efficient governance for risk management, and D) transparency and disclosure. Within each category NBIM offers concrete questions and expectations to companies. Under A) companies are for instance asked to identify the material threats and opportunities from by climate change in itself, but also from regulation concerning climate change. The

same also applies to companies' investment in major projects where future profit can be affected by the above mentioned. Under A) companies are also asked whether it has environmental policies, and if so, whether they are frequently updated (NBIM 2010c, 5). The expectations under B) address specific action that NBIM recommends companies to take. NBIM encourages company boards to reflect over several issues, for instance about concrete actions to mitigate climate change risk, both in direct operations, but also in the supply chain. One concrete example is whether the company has introduced or increased the use of more environmental-friendly raw material. NBIM also asks whether companies contribute to research (NBIM 2010c, 6).

Under C) NBIM addresses good corporate governance as a key element for companies in order to implement the expectations. NBIM asks company boards to consider whether there is a clear responsibility structure in the company, whether reporting and monitoring on climate change exists, and finally whether the board explicitly integrates climate change in the company's risk management (NBIM 2010c, 6). The last category D) is concerned with transparency and disclosure. This is important since NBIM uses this information to assess the companies. NBIM consider companies CO₂ emissions in tonnes, and the production or revenue per tonnes of emission. NBIM's initial focus on lobbying has not been left out either, NBIM still expects companies to reflect around how they interact with regulating authorities, and what the position on climate related legislation is (NBIM 2010c, 7).

NBIM's investor expectation document is quite concrete and NBIM is to some extent clear about what they expect companies to do. I would say this gives NBIM a quite pro-active role. Nevertheless, NBIM is still using quite general formulations like "companies should be" or "key questions for boards to consider". The updated expectation document is longer and more detailed than the first document from 2009. As such it seems reasonable to suggest that the work with climate change has evolved and matured over the last years. This is part of the consistent process in which NBIM is gradually expanding its climate change strategy. The list of what company boards are recommended/expected to focus on is long, and as pointed out by Syse (2012) it might be harder to see results when one has a broad focus area. There is also a terminological difference which makes

it unsure whether NBIM is clearer about what they actually expect from portfolio companies now. In the 2009 version of the document NBIM always used the formulation “NBIM expect companies to...” instead of the vaguer emphasize on what company boards might focus on in the 2010 version. This is a quite significant difference. At a fist glance it might seem like NBIM has taken a step backward by being less explicit in the new document. However there might be good reasons for using broader formulations. Climate change is after all a very complex challenge, both for NBIM and the investees, and as such more openly formulated expectations might be better suited to encounter the climate change challenge.

NBIM has followed up the expectation document with an annual *Sector Compliance Report*. According to the Ministry of Finance (2012d) the compliance reports contribute to further concretization of NBIM’s climate change strategy. The report is based on public information, and companies are assessed as either compliant or non-compliant. Companies that do not have sufficient disclosure routines are evaluated to be non-compliant. According to NBIM (2010d, 5) “companies must have addressed the relevant indicator in their publicly available material” in order to be regarded compliant. Even though NBIM has not included all its investees in the sample, the expectations are meant to reach all the approximately 8000 companies in which it has invested (NBIM 2012b). Results from the compliance survey, alongside information from other sources, can be used to identify companies that may be inclined to change management and disclosure practices following a constructive dialogue with a large shareholder (NBIM 2012b). The compliance level was low in 2009, and NBIM wrote the following in the report “(...) the absolute compliance level are still low given the high and sustained level of shareholder concern on these specific issues” (NBIM 2009d, 2). Between the lines it could be understood that NBIM has had a considerable effort with regards to climate change, and that they are disappointed about the results. This is also a proof of how challenging this issue is. The compliance level was low also in 2010, and NBIM (2010d, 3) explicitly write “we found little to suggest an overall improvement between this report and the first assessment in 2009”. A low compliance level with regards to investor expectations on climate change seems to be nothing new. In a study from 2006 performed by Insight Investment it was found that the European electricity sector

not met their investor expectations towards climate change. It is also argued that the same applied of other sectors, and the challenge was especially poor disclosure (Sullivan and Kozak 2006).

In the 2009 report there were 476 companies from six energy-intensive sectors included in the sample, which were evaluated on basis of nine indicators (NBIM 2009d, 2-3). In 2010 NBIM assessed 452 of the same companies as in 2009, in addition to 47 new companies (NBIM 2010d, 5). In 2011 they assessed 453 companies (NBIM 2011e, 3). The indicators on which NBIM assessed the companies on in 2009 and 2010 are the following (NBIM 2009d, 2010d);

- Integration of climate change impacts into strategic business planning
- Action plans for sector specific risks and opportunities
- Continuous risk assessment
- Participation in sector relevant research
- Mitigation of climate change risk in supply chain
- Disclosure of climate change performance
- Disclosure of reduction plans and quantified targets
- Disclosure of policy position in regard to regulation
- Transparent and functioning governance structure for climate change policies/ programmes

In 2011 the indicators were slightly changed, probably in line with the updated investor expectation document. They are however quite similar, but for instance *disclosure of climate change performance* has been replaced with *disclosure of current greenhouse gas emission*, which arguably can be regarded as an even more concrete measurement indicator.

In 2009 there was, as already mentioned, a low level of compliance. Only the power generation sector scores around 50 percent on most of the indicators. The transport sector, on the other side, scores around 10 to 20 percent on most of the indicators (NBIM 2009d, 5). In 2010 the picture was quite similar. There were still substantial differences between the sectors. The power generation sector is still the most compliant, whereas the transport sectors score low (NBIM 2010d, 6). The level of compliance on each of the indicators in 2010 is then compared to the compliance level in 2009. There is a separate analysis for each sector. In the transport sector, where the compliance level is in general very low, there was

however a small increase in compliance from 2009 to 2010 on six of nine indicators. In the power generation sector the overall level was higher, but there was a small decrease in the 2010 compliance level in six of nine indicators (NBIM 2010d, 7, 12). In 2011 the overall compliance level was considerably higher than in 2009 and 2010, but there are big differences both between different sectors, as well as between the different indicators. The score of the sectors are in line with the previous years, i.e. power generation is most compliant and transport least compliant. On average all sectors score lowest on the most concrete indicators like disclosure of current emissions and plans to reduce these, as well as lobby activity. In 2011 real estate was also included as a separate sector (NBIM 2011e, 6). The overall compliance level in this sector was high (NBIM 2011e, 13). This is interesting, given that real estate both is a recommended asset class by Mercer, and also that energy efficiency should be stressed in NBIM's real estate investments.

The compliance has in general been low in the three years NBIM has surveyed companies. What does this mean? Does it mean that NBIM is not successful with regards to meet their own expectations? On a general basis this assumption seems to be far too simple. Evidence from for instance CalPERS back in the 1980s and 1990s support the fact that ownership engagement can be an efficient instrument. Smith (1996) found that 71 percent of 51 companies addressed by CalPERS changed attitude after CalPERS intervention. However, the example from CalPERS might not be transferable to NBIM's work with climate change, which is less visibly connected to short-term return than the issues dealt with by CalPERS some decades ago. Several factors make NBIM's work challenging. During the conference "Does Investors care about the Environment" arranged by the Ministry of the Environment and BI Norwegian Business School in June 2012 it was emphasized by several actors from different sectors, among others professor in climate strategy Jørgen Randers, former head of Storebrand Idar Kreuser, director of NBIM Yngve Slyngstad and environmental minister Bård Vegard Solhjell, that lack of standardized reporting regimes makes it very challenging for investors to evaluate how companies assess climate change risk. This is a challenge also for NBIM. Moreover it is a methodological challenge with NBIM's compliance reports; they are based on what companies publish them self. Since NBIM not perform any independent analysis or data collection, and the

information to a large extent is based on companies self-reporting, there is not necessarily a link between a high score and actually adhering to the expectations. The energy sector for instance (power generation and oil & gas) scored higher than other sectors in 2009 (NBIM 2009d, 5), but as Bellona (2012) points out; this does not necessarily mean that this sector is compliant with NBIM's expectations. It might simply mean that they are better at reporting what they do.

According to NBIM (2012b) their expectations are regarded controversial and challenging among some companies, especially in Asia and in family-owned companies in which there is no culture for dialogue with owners. Time and patience are highlighted as essential when it comes to communication with companies about climate change. It could be argued that NBIM is little successful in accomplishing the desired results with regard to their expectations. However it could also be argued that the low compliance level is a sign of quality, since it necessarily signifies that NBIM sets high standards. According to Bellona (2012) the data published in NBIM's sector compliance report are too aggregated and thus there is almost nothing to learn from it. Of course NBIM cannot say who they are in dialogue with, since such information might be sensitive and lead to change in the stock exchange values. Nevertheless, Bellona (2012) argues that there could exist a compromise with for instance more detailed, but still anonymised information for sub-sectors. That would have been in line with what for instance the AP funds are publishing. In 2006 the Ministry wrote that when a process towards an individual company was brought to an end, they assumed that NBIM would make both its efforts and the outcome public in a suitable manner (Ministry of Finance 2006, 81). This has not been the outcome, cf. the discussion above. As such, NBIM is less transparent than what might have been expected.

Even though the investor expectation document could have been even more clearly spelled out, NBIM deserves approval for explicitly formulating some expectations. The challenge is how they follow it up, and to what extent they have any sanction options toward companies not adhering to the expectations. Even though there is a growing acceptance of the materiality of climate change for investors, Sandberg et al. (2009, 522) refers to an investigation of ESG factors in which it was found that the **G** - governance aspect - is by far the one given most attention by investors. This might seem disappointing with respect to climate

change, but as Syse (2012) argues, traditional governance issues are closely linked to the results an owner can achieve when it comes to social and environmental issues. The owner must for instance receive board documents in due time and in a comprehensible language. Otherwise it is very difficult to try to influence the company.

Divergent views about NBIM's corporate governance strategy and climate changes exist. Hessen (2012) and Solheim (2012) are among those being skeptical, raising the question about the extent to which corporate governance has the potential to contributing to change. The environmental NGO Bellona is placed somewhere in the middle, in favor of influencing companies by having shares rather than only selecting high achievers or "clean companies". Simultaneously they argue that there are two main challenges for NBIM; first of all, that they are working with more than 8000 companies. Secondly, that NBIM always must consider that in the stock market the value of the equities is sensitive to every action they perform (Bellona 2012).

6.3. Analysis of the Council on Ethics

One of the initial hypotheses was that *the* most important actor would be the Council on Ethics. This assumption was probably colored by the attention given to the Council on Ethics in the Norwegian media debate, as well as in academic literature. However, it turned out that the Council on Ethics has a quite limited role, and they have no explicit mandate on climate change. Consequently, the analysis of the Council on Ethics is less extensive than the analysis of the other two actors. Since climate change is not a specific part of the Council mandates, there has not been conducted any content analysis on *climate* in the reports, and the reports have not been subject to systematically analysis as in the case with NBIM's annual reports. The lack of a mandate which includes climate change is of course also governing for the Council's written material. Climate change is rarely mentioned in the reports.

According to Syse (2012) there is a tendency in Norway, among the NGOs and in the media debate, that exclusion of companies is regarded more ethically correct than for instance ownership activity. In Alm's (2007) assessment of the media

debate it was also found that the media is very concerned with divestment. It is beyond the scope of this thesis to discuss the morality or the successfulness of the various instruments. The discussion below is as such not an attempt to argue in favor of climate change based exclusions. It is simply a discussion of the Council's interpretation of their mandate. Moreover, it is not a criticism of the important work the Council does when it comes to local environmental damage. This is certainly an important aspect, but outside the topic of this thesis.

As discussed in chapter 3.4, climate change is not a focus area of the Council on Ethics, or more precisely, it is not explicit part of the mandate from the Ministry. This is supported by Dag Hessen as well, a member of the Council. He argues that climate change should be part of the overall investment strategy of the Fund, and that the Council's narrow mandate results in a very passive strategy (Hessen 2012). Passive in this regard can be connected to the deontological rationale, which is more concerned with not contributing to immorality. Excluding a company certainly makes the Fund less responsible for the conduct, but as noted by Nagell (2011) exclusion of a company does not equal that the Fund no longer has responsibility. The complicity is only sold to another investor.

At the Council on Ethics homepage (The Government 2012b) there is a list of frequently asked questions, among others "why does not the Council recommend that more money is invested in green companies?"³². The answer is that it is beyond the Council's mandate to recommend in which companies and sectors the Fund should be invested. According to Nilsen (2010, 114)³³ the Council on Ethics' Secretariat (2007) claimed the following about the issue; "it is beyond the mandate of the Council on Ethics to have an opinion on climate-political issues in general. The Council's assessment will always be linked to single firms". Nilsen (2010, 114) holds that the Council has no official authority to support this argumentation, i.e. she argues that it is not included in the Council mandate that they should not focus on climate-political issues. The Council is clearly a subordinated actor with little leeway. Whereas NBIM, or Norges Banks, has a supervisory role included in their mandate (see §1-7 (1) in table 1) the Council is given a narrower task. It can be said that the principal, in this case the Ministry,

³² My translation

³³ Council on Ethics Secretariat (2007), cited in Nilsen (2010,114). The original source is a letter to Nilsen, which has not been consulted in this regard.

has given the two agents different leeway, with the Council being given a far less flexible mandate. It seems like there is an institutional skewness, but one should remember that the two actors not are comparable.

The Council on Ethics' mandate is to recommend the exclusion of companies that violates the Ministry's criteria of company conduct. According to both the former ethical guidelines, and the new guidelines for observation and withdrawal (see page 55), a company can be excluded from the portfolio if it contributes to *severe environmental damage* (Ministry of Finance 2009, 75). That is a quite diffuse and broad concept, but it could also have been an advantage for the Council to have some definitional freedom. It has been argued that the Council has a quite narrow mandate with little leeway, but since the criteria in the mandate from the Ministry are general, the Council has in fact the power to define how a criterion should be interpreted. This should not be underestimated. As presented in chapter 5.1, the other criteria are also quite general. However it could be argued that *severe environmental damage* is among the criteria with most definitional leeway, being more flexible than for instance *worst forms of child labour*.

In their 2006 annual report the Council had a conceptualizing discussion of how *severe environmental damage* should be interpreted. This was related to the recommendation to exclude Freeport MacMoRan Copper & Gold Inc. from the portfolio due to the above mentioned (Council on Ethics 2006b, 38-42). In 2006 *climate* change was mentioned only once in the annual report, during this discussion. The outcome of this conceptualising discussion was a narrowing, or specification, of how the Council interpreted *severe environmental damage*. The criteria they argued for are; huge damage with irreversible and long-term consequences, huge negative impact on humans life and health, a violation of national and international laws and norms, the company has not acted to prevented the damage and has not acted to repair the damage, and the probability that the practice will continue (Council on Ethics 2006b, 42). These criteria form the basis for the assessment of companies in 2007 (Council on Ethics 2007), as well as in 2008 (Council on Ethics 2008) and 2009 (Council on Ethics 2009, 38). Climate change, or greenhouse gas emission, is not explicitly part of how the Council has interpreted severe environmental damage. As shown in chapter 3.3 NBIM includes climate change in their understanding of *environment*. Storebrand,

another pioneer in responsible investing, has interpreted the exclusion criterion somewhat different. Storebrand excludes companies which contribute to severe *climate- and environmental damage*. This formulation might make it easier for Storebrand to exclude companies with very high emission levels. They explicitly state that³⁴:

Storebrand, within the most climate-intensive industries, should only invest in the most climate-friendly companies. The criterion is among others based on the Climate Convention with the following Kyoto Protocol, the UN Convention on Biological Diversity, the Stockholm Convention on persistent organic pollutants (POPs), the Convention on Nuclear Safety and the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal (Storebrand 2011, 2).

Storebrand has thus interpreted the possibility to use the Climate Convention as a criterion for exclusion diversely than what did the Graver Committee in their report. As it was discussed in chapter 6.1.1 the Graver Committee did not find the Climate Convention precise enough. KLP uses the same formulation as the GPFG, i.e. severe environmental damage, and they do also without exception follow all exclusions made by the Ministry. KLP (2012) states that there currently is not any internationally climate change regulation that entitles investors to exclude companies based on greenhouse gas emission, i.e. argumentation in line with the Graver Committee.

According to an analysis by Trucost, submitted as part of Greenpeace's evaluation of the ethical guidelines in 2008, it would be beneficiary to replace the risk that the Fund contributes to *severe environmental damage* with the risk that the Fund contributes to *greenhouse gas emissions and climate change* (van Ast 2008, 15). In addition it was argued from Bodø Graduate School of Business that exclusions based on conduct should include climate, i.e. severe environmental damage should be interpreted as to include contribution to climate change (Lindberg and Nilsen 2008). The FiOH (2012) also argues that climate should be included in the exclusion strategy. The same applies to Hammerlin (2008, 12-13, 17) who also stressed that the Council's understanding of severe environmental damage is a result of interpretation. An inclusion of climate in this understanding would consequently not necessitate a change in the existing guidelines. Also Solheim (2012) is in favor of including climate change as part of the exclusion criteria.

³⁴ My translation

According to World Economic Forum (2011) climate change was one of the biggest risks in 2011, with both high impacts and high likelihood. The literature presented in chapter 4.1 also clearly emphasized the relevance of climate change for universal owners. It is also stated in the Fund's management mandate's §2-1(1), see table 1, chapter 3.2, that future return is dependent upon sustainable development in environmental terms. It seems as such debatable that the Council on Ethics has interpreted severe environmental damage restrictively, rather than inclusively, i.e. the Council has applied a narrow understanding mostly connected to locale environmental damage where the causality between action x and outcome y is clear and visible. A broader and more inclusively understanding would also be applicable on climate change. It seems as such that the Council has given very much importance to the Graver Committee's discussion, and tentative conclusion, about the challenges with including climate change as rationale for exclusion. However, the Graver Committee discussed a wide range of issues and it is almost ten year old. When it comes to for instance tobacco, the Graver Committee (2003a, 151) did not come to a joint recommendation about whether it should be excluded from the portfolio or not. This has been included in the guidelines later on though, and has therefore made a demonstration of the non-static nature of such guidelines. Bellona (2012) argues furthermore that there is no explicit international convention that support the decision to exclude tobacco producers, and as such the decision is political. It could therefore have been possible to also exclude companies based on a political climate change rationale (Bellona 2012). It seems like it would have been legitimate for the Council to eventually interpret the possibility of including climate change in the understanding of severe environmental damage diversely than what did the Graver Committee. Hessen (2012) on the other hand points out that even though climate change is not explicitly part of how severe environmental damage is understood, the companies examined often are what we could call "worst case companies" when it comes to contribution to climate change. The existing understanding severe environmental damage is often more than enough to initiate an investigation of these companies, since they often are involved in local environmental damage which is more easily identified than for instance CO2 emissions.

In 2010 the Council had forecasted that they would initiate more research on some environmental areas, in relation to the revised ethical guidelines (Council on Ethics 2010, 21-22). This is further elaborated in their 2011 annual report (Council on Ethics 2011, 16-23), and some areas are emphasized as important for further research. The Council had already initiated research on the following issues; especially polluting oil production, mining activity with especially high waste challenges, illegal and other especially damaging felling, illegal and other damaging fishery, very damaging dams, and protected areas. The most relevant in this regard is probably the first category, since the others seems to be more related to local environmental damage, which is in line with what the Council has done earlier. What is interesting to note is that the Council has initiated a research on companies involved in oil sand, in order to find out about eventually negative consequences with regards to for instance water use and indigenous populations. NBIM has invested in 30 companies engaged in such activity (Council on Ethics 2011, 16). The Council did however not mention high CO2 emissions as an area of further research when it comes to oil sand, something that could have been possible, given the extensive debate about the issue, with regards to for instance Statoil's project in Canada. Climate change is furthermore not mentioned in the 2011 report, even though part of the report is dedicated to extensive discussion of environmental issue. The emphasis is still on local environmental damage and the Council preserves the Graver Committees rather restrictively understanding of the issue. Having this in mind, and considering the secretariats response to Nilsen (2010, 114), it might seem like the Council interprets their mandate narrowly. Nilsen (2010) is correct in arguing that there is no visible rationale for this narrow interpretation. Nevertheless, it might be beneficial if also the Council was given leeway to come with advice on the investment strategy, given that the Council holds different knowledge than Norges Bank.

7. Concluding remarks about the climate change strategy during the period 2006-2012

The rationale for this thesis topic has been my fascination for the growing interest for climate change among investors. Being the second largest SWF in the world it is very interesting and relevant to investigate how the GPFG manages the climate change challenge. The aim of the research has thus been to discuss how climate change is, and has been, on the agenda of the Ministry of Finance, NBIM and the Council on Ethics in the period between 2006 and 2012. Within the respective period the analysis had a historical perspective that aimed to discuss the consistency and continuity, or eventually inconsistency and discontinuity, in the actors' climate change strategy. The most relevant findings will be discussed and summarized below.

When it comes to the actors' mandate, which constitutes the underlying premises for the actors, the first interesting finding was that climate change was not embedded in the law or the official management mandate of the Fund. Climate change is consequently not anchored in the top governing documents. It is however stated that financial return, which is the Fund's primary motivation, is dependent on sustainable development also in environmental terms. This is the rationale behind the focus on climate change, and in line with the universal owner nexus discussed in chapter 4; everything is internal for a broadly diversified owner. Since climate change is expected to create cost across all markets, universal owners will be highly affected, since they per definition own a share of every market. To answer the *why* question it seems like both NBIM and the Ministry have a clear understanding about the direct link between climate change and future return. Climate change is also part of NBIM's understanding of ESG issues, as well as focus area in their corporate governance work. The Ministry has not explicitly included climate change in any definition, but it is stated in their responsible investment presentation that this issue is important and prioritized. Climate change is not part of the Council on Ethics mandate, which is quite narrow, and it is not explicitly part of their interpretation of severe environmental damage. This does not mean that the Council not regards the issue to be important.

The premises for the climate change strategy thus seem to be; two of three actors have climate change included in some sort of definition, as a focus area, or explicitly state that they regard it important, but climate change is not anchored in the top governing documents like the management mandate. It remains uncertain how this should be interpreted. When the original documents were published, climate change might not have been as urgent as it is today. However, the documents, especially the management mandate, have been updated several times. As such it could have been possible to include climate change at a later stage. However, it might be that the Ministry, which is issuing/drawing the documents, regarded climate change to be an issue better dealt with in other written material. Nevertheless, both the environmental mandates, and the energy efficiency aspect of the real estate investments, are included in the management mandate. In this thesis it is argued that these are either part of the overall climate change strategy, or has the potential to be part of it in the future. The Ministry thus seems willing to include climate change related issues in the mandate. When the overall climate change strategy is not mentioned, it might be because it is difficult to identify *the climate change strategy*. Rather it makes sense to speak of *the climate change strategies*, since the three actors have different strategies. The question is whether an eventual inclusion in the top governing documents is essential for the attention given to that particular issue. According to the findings in this thesis it does not seem to be the case. However, an inclusion of climate change in the management mandate might have been a sign of commitment, as well as stating an example.

As highlighted both above and in chapter 6 there are several important strategies when it comes to climate change and the GPFG. This is also why it, methodologically wise, makes sense to speak of the GPFG as a case placed within a distinctive institutional design, whereby the different actors each constitutes a case, i.e. a multiple case study. In chapter 5 there was a short presentation of different types of responsible investment instruments. Pre-investment instruments are only partly applied on climate change in the GPFG case. Negative screening is not used, but positive screening is used to some extent since 20-30 billion NOK is set aside to environmental mandates. This is well below one percent of the Fund's total value and might as well also be regarded as part of the Fund's regular diversification strategy. However, the environmental mandates are included in the management mandate as of 2012, and this is a sign of commitment. Among the

post-investment instruments it is undoubtedly corporate governance which is applied most clearly on climate change. NBIM has had a corporate governance team since 2005, which today consists of ten employees. NBIM uses both formal shareholder rights like voting, as well as in-depth dialogue with some selected companies, to address the climate change risk. The other post-investment instrument, exclusion of companies, might be used if there is a risk that the company contributes to severe environmental damage. Climate change is not explicitly understood as part of this criterion. In addition climate change is part of what was called indirect instruments, and in this regard climate change research is the most important. The investment decision in se, i.e. the portfolio composition, is not used as a climate change instrument, so far.

The Ministry could be called the leading actor in the years just prior to 2006, by introducing a crucial premise for the later work with climate change, namely the ethical guidelines. These suggested a two-pillar system, with NBIM being responsible for corporate governance, and the Ministry and an independent council being responsible for negative screening and exclusion of companies. When NBIM in 2005 decided to establish a corporate governance section within the bank, it was as a direct consequence of the obligation to implement their part of the ethical guidelines. However, since the ethical guidelines did not mention climate change, it cannot be said that these alone marked a significant incident. Nevertheless, they formed the basis for the latter strategies, and as such it can be argued that the ethical guidelines were decisive as a prerequisite. However, the agenda-setting role of the Graver Committee has not been exclusively positive when it comes to climate change. The reason is that the Graver Committee regarded climate change as difficult to incorporate in the screening and exclusion criteria. This argumentation has governed much of the later work, especially within the Council on Ethics, and as a consequence climate change is not directly part of product- or conduct-based exclusions from the portfolio.

Climate change has been the topic of increased attention in the Ministry's annual reports over the period, especially from 2008 and onward. After the establishment of the ethical guidelines few initiatives were taken from the Ministry with respect to climate change. In the analysis in chapter 6 it was argued that the Ministry presumably relied on what was done by two agents (NBIM and the Council on

Ethics) in the period 2006-2008. Climate change was not a big topic in the Ministry's annual reports, and when it was discussed it was in general only with respect to NBIM's ownership activity. Meanwhile NBIM were quite proactive with regards to climate change. Within the newly established corporate governance section it was in 2006 decided to select climate change as one of two focus areas. The focus on climate change was in the first years further narrowed down by NBIM. The emphasis was on how companies lobbied with regulating authorities with regard to climate change. This focus was criticized as too narrow by several actors in the later evaluation of the ethical guidelines. However, it could contrarily be argued that this initial focus was quite courageous and targeted, since after all clear government regulation is exactly what is lacking in the climate change challenge. This was also made clear in the Mercer research, published half a decade later. The recommendations to the Fund depend on exactly how climate change will be addressed by global authorities. NBIM had, however, no expectation document for climate change in the first years. To focus on climate change was NBIM's decision, but it was supported by the Ministry. NBIM incorporated climate changes in line with what they believed most Norwegians found important (Alm 2010). Furthermore, the Ministry's establishment of the ethical guidelines was the premise for NBIM's further work. As such it could be said that one actors' first step was necessary for a second actors' next step. However, as it was clarified in chapter 6.2.1., NBIM had also before the establishment of the ethical guidelines started to argue in favor of using shareholder rights. As such it is not possible to claim that there is only causality between the ethical guidelines and NBIM's corporate governance strategy, but it seems plausible to argue that the former influenced the design of the latter.

In the years 2006-2007 it apparently seems like NBIM was the most proactive actor when it comes to climate change. It was selected as focus area, and it was extensively discussed in the annual reports. The Council on Ethics spent these years to interpret and conceptualize *severe environmental damage*. The outcome was a quite restrictive definition, in line with the Graver Committee's understanding of the issue. Climate change was not included in the interpretation, due to lack of clear international conventions, and the emphasis was laid on local environmental damage. The Council on Ethics thus chose to interpret their mandate narrower than what would have been necessary, given that other actors,

like Storebrand, has interpreted severe environmental damage inclusively, i.e. as to include climate change. Even though the Ministry appeared quite passive in 2006-2007, it was argued in chapter 6.1.1 that the Ministry most likely discussed climate change internally in 2007, and maybe as early as in 2006. In the end of 2007 former Minister of Finance Kristin Halvorsen officially expressed that climate change should become a crucial issue in the years to come. And as a matter of fact there was a change from late 2007 and onwards. In the beginning of 2008 the Ministry of Finance launched an evaluation process of the ethical guidelines.

2008 marked a change in several ways. In 2008 the Ministry opened up for a broad and inclusive evaluation of the ethical guidelines, and as already mentioned the Ministry started to openly argue for a stronger emphasis on climate change. From 2008 and onward the Ministry initiates several independent measures when it comes to climate change. This was also expressed in the written material, climate change was a topic which gained increased space in the Ministry's annual reports to the Storting. The 2008 report stands out as the one with a remarkable focus on climate change. This was probably caused by the interest in this issue, as well as other social and environmental issues, among the numerous evaluations submitted to the Ministry. As a consequence of the evaluations process the Ministry initiated a large research project with focus on the financial effects of climate change for asset managers, which resulted in the above discussed Mercer reports. Moreover, the Ministry decided to re-introduce the use of some positive screening by establishing an environmental programme. After dialogue between Norges Bank and the Ministry it turned out that the environmental programme could be handled within the existing investment strategy. It furthermore seems like the result was a less regulated programme than the Ministry initially had outlined, but the Ministry expressed their satisfaction with NBIM's environmental mandates. It could however be argued that these mandates only were part of NBIM's regular diversification strategy. However, in 2012 the environmental programme was included in the management mandate, in §2-4, see table 1, chapter 3.2. This is a clear sign of commitment towards these investments. Several actors argue that the 20-30 billion target seems unambitious.

2008-2009 were as such years in which the Ministry became more visible, and marked a continuation of the establishment of the ethical guidelines. The Ministry has as such been a consistent actor, even though 2006-2007 were years in which it is difficult to identify their strategy. In 2009 the Ministry signed the contract with Mercer about the large research project on the financial risks of climate change. In the 2010 annual report to the Storting the Ministry discussed the finding in the first Mercer report, which was about climate change and asset managers in general. In the subsequent report to the Storting the Ministry discussed the tailored Mercer report, which analyzed only the GPFG.

From 2008 and onward there was noted a change in NBIM's annual reports, which had apparently less focus on corporate governance and climate change. Several possible reasons were discussed in chapter 6.2.1; among others that it might have been an organizational gap caused by change in leadership in 2008. In 2006-2007 the annual reports included long parts about corporate governance and climate change. Whatever the reason behind, the consequence is that NBIM seems to have a communication challenge towards the owners, the Norwegian people. The reason is that there seems to be inconsistency between the amount dedicated to these issues in the different annual reports, which is NBIM's primary communication channel, and what is actually conducted. Whereas the climate change strategy has been expanded, and the corporate governance team has increased, this does not sufficiently come to expression in the annual reports. Even though 2008 was the year in which climate change had the lowest frequency, it turned out that the tendency from 2008 continued. There has been less focus on corporate governance and climate change in the reports each year. In the 2011 annual report there was only a short 3-page about these issues. Compared to more than 30 closely-written pages in 2007, it seems to be a remarkable difference. NBIM's annual reports are dedicated also to present new issues, in 2011 the feature article is therefore about real estate investments. As discussed above the real estate investment does in theory, i.e. in the management mandate (see §2-1(3) in table 1), strengthen the overall climate change strategy of the Fund. However, the energy efficiency aspect has not yet been prioritized by NBIM, and the real estate investments are so far limited. And thus it is not yet possible to analyze whether they also in practice will add an element to the climate change strategy. In 2007 corporate governance and climate change were

still new issues for the bank. It seems legitimate that more space is dedicated to new issues, however it is problematic for NBIM when important issues are not prioritized in the annual reports. In 2009 NBIM launched their *Investor Expectation Document* on climate change, with subsequent *Sector Compliance Reports*. It seems like NBIM from 2009 and onward has moved the emphasis on climate change from the annual reports to more targeted documents. This might be part of a strategy to clearly place this responsibility within the corporate governance section.

During 2009-2012 NBIM's climate change strategy seems nevertheless to be enhanced, however the compliance level among the surveyed companies remains low as to NBIM's expectations. As it was argued in chapter 6.2 this might also be a sign of quality, since it means that NBIM has high expectations toward companies. However, it might be legitimate to argue that NBIM should consider to further developing their strategy, in order to better achieve their high expectations. This could be done by strengthen the governance section. After all a governance section counting approximately ten staff members seems to be little, when the Fund is invested in more than 8000 listed companies. Secondly, NBIM should consider dedicating more space to corporate governance and climate change in the annual reports, in line with the 2006-2007 reports, since climate change is a main focus area. In this way NBIM could better communicate their strategy with owners and other stakeholders.

As already mentioned the Ministry enhanced their climate change strategy from 2008 and onward. Contrarily to what is the case of NBIM, climate change has been a topic of growing attention in the Ministry's annual reports to the Storting. In this way there has been consistency between the Ministry's increased focus, and what is expressed through their reports. The 2010 and 2011 annual reports to the Storting dedicate quite some attention to the Mercer reports. The last Mercer report is tailored for the GPF, and is as such very interesting. Mercer's finding confirms the complexity of the climate change challenge for asset managers. The recommendations to the Fund depend on the likeliness of four different scenarios. The scenarios differ for instance in how climate change will be regulated by authorities in the future. Thus, there is no single answer as to how the GPF should incorporate climate change risk. However, Mercer argues that in the two

most likely scenarios, according to Mercer, the Fund should significantly re-allocate towards climate-sensitive assets. It remains uncertain how the Ministry will respond to the Mercer report. In both the annual report to the Storting in 2010 and 2011 the Ministry discusses the findings with an ambiguous tone. The material is therefore not easily analyzable and conclusions should be drawn carefully. However, it can be argued that the Ministry is taking the Mercer results seriously, but that they need time to evaluate if and how eventually changes in the investment portfolio should be taken. It is challenging for a fund of the GPF's size to re-allocate, especially since many of the markets suggested by Mercer are relatively small.

As a concluding remark it is argued that; climate change has been a topic of increased attention over the period 2006-2012. It has gradually become higher on the agenda of both the Ministry and NBIM, and there has as such been continuity in how these two actors have approached climate change. The two actors have however approached climate change in different forms, or by the use of different measures. The Council on Ethics has no clear mandate on climate change. The Council has interpreted *severe environmental damage* in a consistent matter throughout the period, this interpretation has however been restrictive and has not included climate change. The Ministry had few independent initiatives before 2008, and has as such enhanced their climate change strategy most in the last four years. This has especially been done by the use of research, but also through the re-introduction of positive screening. There has been consistency between the Ministry increased focus on climate change, and what has been expressed in their written material. NBIM were on the other side quite pro-active already in 2006-2007, by selecting climate change as one of two focus areas in their corporate governance strategy. In 2009 NBIM published the Investor Expectation Document on climate change, and the subsequent sector compliance reports. It has thus been a gradually expanding climate change focus in NBIM. However, there has been some inconsistency in how NBIM expresses their climate change strategy through their annual reports, and what has actually been done. Whereas the climate change strategy seems enhanced, in the annual reports it has been a decreasing focus on this issue. It is therefore argued that NBIM has a communication challenge towards their owners when it comes to climate change.

For future research it will be interesting to follow up on whether the compliance level with regard to NBIM's expectations increases, if there will be significant changes in the overall investment strategy as a result of Mercer's research (and eventually future research), if energy efficiency will be prioritized in the coming real estate investments, if the environmental mandates will be a gradually increased, whether the Council on Ethics will interpret their mandate as to include climate change and whether the Council on Ethics in the future also will be allowed to give more general advice.

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Appendix:

Appendix 1

Content analysis of words containing <i>climate</i> in the Ministry of Finance's Annual Reports	
<p>NOU 2003: 22. Forvaltning for fremtiden: Forslag til etiske retningslinjer for Statens petroleumsfond (The Graver Report NOU 2003³⁵)</p> <p>Total words containing climate: 23 climate change 9 climate emission 9 climate affect 1 climate convention 3 climate questions 1</p>	<p>Report No. 24 (2006-2007) to the Storting: On the Management of the Government Pension Fund in 2006:</p> <p>Total words containing climate: 8 Climate change 5 Climate-related problem 1 Climate problem 2</p>
<p>Report No. 16 (2007-2008) to the Storting: On the Management of the Government Pension Fund in 2007:</p> <p>Total words containing climate: 21 Climate change 7 Climate issue 2 Climate panel 1 Climate-related legislation 4 Climate regulation 1 Climate measure 2 Climate proposal 1 Climate quota system 1 Climate solution 1 Climate risk 1</p>	<p>Report No. 20 (2008-2009) to the Storting: On the Management of the Government Pension Fund in 2008:</p> <p>Total words containing climate: 139 Climate change 55 Climate system 1 Climate effects 1 Climate requirements 1 Climate negotiators 2 Climate field 1 Climate friendly energy 15 Climate legislation 1 Climate change regulation 1 Climate 8 Climate change panel 3 Climate challenge 20 Climate development 1 Climate technology 2 Climate exposure 1 Climate agreement 4 Climate policy 7 Climate treaty 3 Climate related measures 2 Climate profile 1 Climate lobbying 1 Climate strategies 1 Climate issue 2 Climate offenders 1 Climate profile 1 Climate fund 2 Climate work 1</p>
<p>Report No. 10 (2009–2010) to the Storting: The Management of the Government Pension Fund in 2009:</p> <p>Total words containing climate: 49 Climate change 37 Climate threat 1 Climate impact 1 Climate effects 1 Climate negotiators 1 Climate challenge 2 Climate agreement 1 Climate policy 1 Climate work 1 Climate strategies 1 Climate scenarios 1 Climate risk 1</p>	<p>Report No. 15 (2010–2011) to the Storting: The Management of the Government Pension Fund in 2010:</p> <p>Total words containing climate: 56 Climate change 34 Climate breakdown 7 Climate emission 1 Climate 3 Climate issues 1 Climate policy 1 Climate scenarios 3 Climate risk 5 Climate friendly technology 1</p>
<p>Meld. St. 17 (2011-2012) Report to the Storting (white paper): The Management of the Government Pension Fund in 2011:</p> <p>Total words containing climate: 58 Climate change 33 Climate targets 1 Climate breakdown 3 Climate 1 Climate issues 1 Climate risk 10 Climate policy 2 Climate area 1 Climate related investments 2 Climate challenge 1 Climate friendly technology 2 Climate friendly infrastructure 1</p>	

³⁵ NB search in Norwegian, the terms are translated by myself.

Appendix 2

Content analysis of words containing <i>climate</i> in NBIM's Annual Report	
NBIM Annual Report 2006 Total words containing climate: 12 Climate change 10 Climate initiatives 1 Climate problems 1	NBIM Annual Report 2007 Total words containing climate 41 Climate change 19 Climate problem 1 Climate system 1 Climate legislation 8 Climate issues 5 Climate measures 2 Climate factor 1 Climate proposal 1 Climate solutions 1 Climate debate 1 Climate policy 1
NBIM Annual Report 2008 Total words containing climate 3 Climate change 2 Climate 1	NBIM Annual Report 2009 Total words containing climate 11 Climate change 11
NBIM Annual Report 2010 Total words containing climate 11 Climate change 8 Climate change risk 1 Climate change risk management 2	NBIM Annual Report 2011 Total words containing climate 9 Climate 2 Climate change 3 Climate change risk 4

Appendix 3

Overview of evaluations submitted to the Ministry of Finance	
Pro positive screening: 29	Amnesty, Asa Kasher, Attac, Bellona, Atle Midttun BI, Carlos Joly, Changemaker, the Norwegian Church, Teologiske Menighetsfakultet, ForUM, Framtiden i våre hender, Greenpeace, Handelshøgskolen Bodø, Kirkens Nødhjelp, LO, Miljøverndepartementet, Niklas Kreander, Norfund, Norsk senter for menneskerettigheter, Redd Barna, SAM Sustainable Asset Management, SIGLA as, Storebrand, United Nations Global Compact Office, Universitetet i Oslo (SUM), Utenriksdepartementet, WWF-Norge, YS
Against positive screening: 6	Martin E. Sandbu, HSH, Norges Bank, KLP, NHO, Sparebankforeningen
No comment on positive screening: 22	American Chamber of Commerce in Norway, Den Norske Burmakomit�, Council of Ethics, Finansn�rings hovdorgansasjon, Folketrygdfondet, FORUT, Government Pension Fund Thailand, Helsedirektoratet, Kreftforeningen, Kristian Alm BI, LHL, Norges Astma- og Allergiforbund, Forskningsr�det, Norsk Tamilske Forum, Norske Pensjonskassers Forening og De selvstendige kommunale pensjonskasser, Publish What You Pay Norway, Regnskogfondet, Riksrevisjonen, Robert A. G. Monks, Robert C. Pozen, SLUG, The Elfenworks Center for the Study of Fiduciary Capitalism, Tobakksfritt

Source: (Ministry of Finance 2008c)

Appendix 4

Participants in the Mercer project (Mercer 2011)

International Finance Corporation (IFC)	Norwegian Government Pension Fund, Norway Första AP-fonden (AP1), Sweden
Government of Singapore Investment Corporation (GIC), Singapore	Environment Agency Pension Scheme, United Kingdom
Carbon Trust, United Kingdom	Ontario Municipal Employees Retirement System (OMERS), Canada
California Public Employees' Retirement System (CalPERS), USA	AustralianSuper fund, Australia VicSuper Pty Ltd., Australia
Maryland State Retirement Agency, USA	British Columbia Investment Management Corporation (bcIMC), Canada
All Pensions Group (APG), Netherlands	PGGM Investments, Netherlands
California State Teachers' Retirement System (CalSTRS), USA	

Preliminary Thesis Report

Climate changes and social responsible investment - a discussion of the Norwegian Pension Fund Global's investment strategy

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Programme:
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Summary

This preliminary thesis report summarizes the most important ideas that will be further elaborated in my final thesis in Political Economy. The topic of the thesis is Social Responsible Investment (SRI) related to climate changes, and a case study of the Norwegian Pensions Fund Global will be carried out.

1. Introduction

1.1. The topic - and why it is this interesting for a MSc thesis in Political Economy

This preliminary thesis report will give an outline of the first chapters in my final master thesis in Political Economy. The research area is Social Responsible Investments (SRI) and climate changes and environmental concerns. A case study of the Norwegian Government Pension Fund Global (GPFG)¹ and its investment strategy related to climate changes will be carried out. Climate changes were one of Norwegian Bank Investment Management (NBIM), the Fund's manager, focus areas in the corporate governance strategy in the period 2007-2010 (NBIM 2007, 89). In addition approximately 20 billion NOK of the Fund was set aside in 2008 in an environmental program (Ministry of Finance 2008, 16). Focus on environment and climate changes has been part of GPFG's strategy as a responsible investor for some years, and thus it will be convenient to use a historical approach in part of the analysis. Is there consistency or has there been any disruptions in the focus on climate changes?

Another major interesting question is why NBIM chose to emphasis climate changes as a part of the strategic focus area; was it a result of a political will or pressure from the owner, the Ministry of Finance? Is it in line with the principles of overlapping consensus, i.e. does most Norwegians find it appropriate to focus on climate? Does Norway wish to use the Fund as "a best in class" investor to show off on the international scene? Did NBIM chose to focus on climate changes due to international regulation or participation in network organizations like UN's Principles for Responsible Investment (UNPRI)? Or was it due to a concern with how climate changes will affect the financial markets and the probability of securing long term return? After all GPFG's primary motivation is, as stated by both the manager NBIM and the owner Ministry of Finance, to secure long term financial wealth for future generations of Norwegians.

¹ Commonly known as the Petroleum Fund, hereafter called the Fund or the abbreviation GPFG will be used.

It is furthermore interesting to note that environment not only has been a focus in the corporate governance strategy, and in the above mentioned environmental fund, but also in the work performed by the Council of Ethics when it comes to negative screening of investments and divestments. According to the Ethical Guidelines, if there is risk that a company contribute to severe environmental damages, the Fund should divest from that company (Ministry of Finance 2010). Thus, the Fund is operating with several tools that interact with climate changes and environment.

Despite the somewhat agreeable statement that the GPFG is a pioneer in SRI with its ethical framework for investment and the work performed by the Council of Ethics, this is might not be the case for the work with climate challenges (Alm 2010). This research seeks to understand why, and how, the use of ownership rights, screening and divestment can influence GPFG role as an important actor in climate governance. Why is this topic interesting and relevant? Climate change and environmental concerns are highly relevant research areas, which have been on the international agenda for several decades, and recently discussed in the Cape Town meetings in 2011. In the aftermath of the 2008 finance crisis a more responsible financial sector has also been a heated debate topic. The "Occupy Wall Street" movement is a proof of the continued demand for a responsible finance sector. It is no longer only a matter of anti-globalization movements, many ordinary people have lost faith in the financial sector's capability of being self-regulatory and act responsible. In this setting it is very interesting to study big institutional investors like GPFG. Acting in a social responsible way as an investor is of course a very broad idea, and there is no commonly accepted definition of SRI. Definitions often include what is called ESG principles, the incorporation of **E**nvironmental, **S**ocial and **G**overnance aspects in the investment decisions (Louche 2009)².

Instead of focusing on the whole ethical framework, the narrower emphasize on climate/environment makes the research more interesting, as well as part of a less researched field. To my knowledge there is not much research done on GPFG and climate changes. Despite being a big investor, and one of the largest Sovereign

² This paragraph has earlier been submitted as a part of a term paper in GRA 5915

Wealth Fund (SWF³) in the world (Shemirani 2011, 39), one single actor cannot alone influence climate changes, so this research aim to contribute with a conceptualizing discussion on what is being done in GPFG, and why, rather than actually measuring the outcome.

Political Economy is an academic field which seeks to understand the boundary between the economics and politics. The GPFG is placed in such a setting by being a public owned investment fund, subject to government regulation, but still operating in the private market through their investments. As such it is also interesting to look at why and how the Fund is regulated by the Norwegian state, but also how it interact with other supranational regulating authorities.

1.2 Research design and structure of the preliminary thesis report

As mentioned above, this report will give some insight to the first part of the final thesis. A preliminary problem definition and some precise research questions will be presented in the next chapter. This will form the basis for the thesis, but might be subject to some minor changes. Thereafter a chapter discussing methodology and data will follow. A short background chapter will also be provided. This will help to conceptualize important issues. Lastly a chapter reviewing some relevant literature and sketching the theoretical framework will also be presented. All the chapters are short drafts and will be rewritten in the final thesis, but they still provide some key ideas. The main part of the thesis will of course be to answer the research questions by analyzing the collected data, but no draft of the analysis will be presented in this report.

2. Problem definition

Based on the above short outline of the research area, the developed research topic that will form basis for this research is:

³ Sovereign Wealth Fund is a quite new term, which refers to public owned investment Funds.

Why and how is climate change/(environmental concerns) on the SRI agenda for the Government Pension Fund Global, and has it been successful?

To operationalize the study the following six research question will be used:

- How is climate change on the agenda for the three different actors; NBIM, the Council of Ethics, and the Ministry of Finance?
- How are the four different instruments negative screening, positive screening, withdrawal, and corporate governance used in the work with climate changes?
- Has there been consistency in NBIM's work with climate changes in the corporate governance strategy in the period 2007-2010?
- Why did NBIM incorporate climate changes in their focus area for corporate governance?
- How important are soft-law actors like UNPRI for the work performed by GPFPG?
- To what extend has the GPFPG been successful as an important climate change actor?

The analysis will consist of four main sections, which together aim to answer the research problem:

- Section one: discussion of the three actors (NBIM, the Council of Ethics, and the Ministry of Finance) and the SRI instruments adopted. The focus will of course be on the work relative for climate/environment, which is only a small part of what for instance the Council of Ethics is concerned with. A few cases might be given more attention, most likely how the Fund placed itself as a climate investor with for instance the divestment from the mining company Rio Tinto. The first two research questions will be discussed in section one.
- Section two: NBIM and the corporate governance strategy. In this section the third research question will be discussed. NBIM and active ownership is part of the actors/instruments that will be discussed in section one, but a separate and more in-depth section is nevertheless dedicated to NBIM.

Furthermore it will be discussed how the work with climate has evolved from a quite narrow focus (see below), why water was included in the strategy, and lastly, the new focus on green real-estate projects.

- Section three: regulation and the rationale for choosing climate. In this section regulation of GPFG will be discussed. The emphasize will firstly be on regulation from the Norwegian state, and secondly, regulation understood as participation in international network organizations/guidelines like UNPRI. The aim is to answer research question four and five in this section.
- Section four: overall discussion of the findings and assessment of the Fund's work with climate changes. Whether the Fund can be regarded as an substantial and successful actor with its climate change work will be critically discussed.

Based on the introduction to the topic, and the above research problem and research questions, several hypothesis or assumptions will be derived. At the time of writing the following hypothesis has been derived:

Hypothesis 1: GPFG has the potential to become an important actor in climate change governance, but at the time of writing it is not expected that the Fund can be regarded as successful in the work with climate, as in the overall work with ethical investments.

3. Methodology and data

3.1. The methods adapted in this research

This research project will be a case study of the GPFG with emphasize on SRI and climate changes. The research carried out will be of qualitative nature and thus analysis of documents and interviews will be the main sources of data.

Slightly different methodological approaches will be used in the four different sections. Section one will consist of a comparative analysis of the work with climate changes done by the three actors NBIM, the Council of Ethics, and the Ministry of Finance. The emphasize will be on how negative screening, positive screening, withdrawal, and corporate governance is used to ensure that investments not contribute to increased climate changes. A historical approach will be adopted in the section looking at how climate change has evolved as a focus area in NBIM's corporate governance strategy. Is it possible to identify any red line in the documents throughout the whole period, or has there been any changes in the guiding principles? The governance section in NBIM has for instance been through a change in leadership in the actual period. Has this had any implications for the focus on climate changes?

3.2. Dependent and Independent variables

Identifying the independent and dependent variables is not as straightforward in qualitative research. At the time of writing I understand the dependent variable as the research problem, and the independent variables used to answer the research problem are the research questions. Nevertheless, a more precise definition of the variables will be outlined in the final thesis.

3.3. Data sources and data collection

This research will be conducted by using multiple data sources. Triangulation, using different types of data and methodology, makes a research sounder. When both interviews and document analysis is used, the researcher can test for consistency in the data by comparing the results. Interview respondents might for instance be biased, and comparing the results with analysis of documents will make the research less vulnerable (Patton 2002, 248). It is important to keep track of the difference between the primary sources, the basic documents provided by the involved actors, and secondary sources like the academic interpretation and analysis of the primary sources. This is important because the use of primary sources entitles the me the possibility to analyze the raw material, whereas use of secondary source is the analysis of somebody else's interpretation of primary sources. Thus, to create my own independent opinion primary sources are essential, but of course secondary sources will be very important data sources as well.

3.3.1. Primary sources – documents

The data used in this research will be primary sources like official reports from the Ministry of Finance, the Ethical Council and of course NBIM. The above mentioned Graver Report, in Norwegian known as “NOU2003:22 Forvaltning for fremtiden” is one example. Annual reports and strategy reports are other examples. International guidelines and consensus documents that are relevant for GPFG are yet other examples. Getting access to the data should not cause major problems, the Ministry of Finance and NBIM have both emphasized the importance of openness. Nevertheless, the data collection has not yet started, and it remains to see how easy available different material will be.

3.3.2. Primary sources – interviews

To get additional information interviews will be conducted. A tape recorder will be used in order to transcribe the interviews and turn it into a written primary source. The unit of analysis should be what the informants actually said, not what the interviewer noted herself. This will thus be a case-analysis approach, in which a case is written for each person interviewed. Contrarily, with a cross-case approach answers from different respondents are grouped together according to themes, and thereafter compared. However, the usefulness of each approach depends on the form of the interviews, and it might turn out that cross-case analysis of some of the interviews conducted is more fruitful (for instance among respondents from NBIM) (Patton 2002, 440). At the time of writing nor the interview guide, nor the interview approach, has been decided. However, semi-structure interviews might be the best suited. In an interviewing situation it is difficult to not be influenced by the informants, the use of tape recorder will partly cancel out the problem. Nevertheless, even when recording the interview there remains a certain risk of being influenced by the informant, it will be essential to be conscious about this challenge, as well as being well-prepared.

Hopefully it will be possible to interview actors from the Council of Ethics, the Ministry of Finance and NBIM. In addition it would be fruitful to interview independent experts. List of planned interview objects (is still to be confirmed since they are not yet contacted).

NBIM:

Anne Kvam

Ola Petter Gjessing

Christopher Wright

The Ministry of Finance:

Trude Myklebust

The Council of Ethics:

Eli Lund: Head of Secretariat, Council of Ethics

One member of the Council

Independent actors/experts:

Henrik Syse: PRIO

Atle Midttun: BI

Øyvind Bøhren: BI

Jørgen Randers: BI

Danyel Reiche: American University of Beirut

Carlos Joly

NGO's?

Among the informants in this category it should be some of those participating in the evaluation process of the ethical guidelines from 2008, like Carlos Joly. It is furthermore important to distinguish different types of informants. Some of the potential informants might be used more for exchange of views, recommendations or discussion, rather than being primary sources them self.

3.3.3. Secondary sources

Several secondary sources will be used to enlighten my understanding and analysis of the primary sources. Most important is of course academic literature. In addition media might be consulted, some journalists have been writing a lot about GPFG. Material from Mercer will also be a substantial source since they have conducted research on climate changes and investors in general and about GPFG in particular. Nevertheless, the most important source in this regard is the 53 contributions submitted to the Ministry of Finance in 2008 as a part of the evaluation of the ethical guidelines.

3.4 The way forward

The first priority now will be to start the data collection. A huge amount of primary sources must be obtained and organized. Similarly, informants must be contacted. This is quite urgent, as some informants might have a very busy schedule. There is also a lot of preparation to be done before any interviews can be conducted, and most likely I will have to develop a few different interview guides. Hopefully all the data will be collected by March 2012. During the same period I will also focus on the theoretical framework, which is the weakest part of this preliminary thesis report.

4. Background

4.1. Short about the Norwegian Government Pension Fund Global and SRI

The Fund was established in 1990 and was labeled the Norwegian Petroleum Fund, since it was established due to the revenues gained through fossil resources that Norway had experienced for some decades. The objective with the establishment was to safeguard the long term financial security of the Norwegian population. In 2006 the Fund was renamed the Norwegian Government Pension Fund – Global (Ministry of Finance 2011). The Fund is managed by Norwegian Bank Investment Management (NBIM), and is one the world's biggest Sovereign Wealth Funds. The Fund has a market value of approximately 3077 billion NOK (the value is continuously changing), has invested in 69 countries, and owned on average 1% of the listed equities in 2010 (NBIM 2010).

Since 2004 GPFG has been subscript to ethical guidelines, which were evaluated in 2008. As mentioned above the contributions submitted to the Ministry of Finance as a part of this evaluation process will be one data source in the analysis. The Fund seeks to both maximize long term financial return, and invest in accordance with the ethical standards of the Funds owner, the Norwegian people (Ministry of Finance 2011). Thus GPFG's primary motivation is to ensure intra-generation solidarity by securing future generations of Norwegians a stable financial situation. The intra-generation versus inter-generation solidarity is an interesting aspect which also will be touched upon in the thesis.

The Ethical Guidelines derived from a report written by the Graver Committee in 2003. The Graver Committee (2003) emphasized that the ethical principles are supposed to be anchored in the general ethical standards of the Fund's owner, namely the Norwegian people. It is of course difficult to identify a common ethical standard that applies for everybody in Norway, but the Graver report is concerned with overlapping consensus, i.e. investments should be in line with what most Norwegians find appropriate. The notion of overlapping consensus will be discussed thoroughly when answering the question about why NBIM chose to focus on climate change in the corporate governance strategy.

The Graver Committee (2003, paragraph 5.1) launched three instruments that should be used when managing the Fund:

- Exercise of ownership rights, or corporate governance.
- Negative screening, i.e. not invest in certain companies.
- Withdrawal, i.e. the Fund divests from companies that violate the ethical standards promoted by the Fund.

Positive screening was not among the mechanisms suggested by the Graver committee, but it has been a topic in the public debate in Norway. Furthermore several of the contributions submitted to the evaluation of the Ethical Guidelines in 2008 emphasized positive screening as an alternative, among others the environmental organization Bellona (2008) and the expert Carlos Joly (2008). However, also contributions which did not recommend positive screening should be mentioned, like professor in finance Thore Johansen and professor in economics Ole Gjøølberg (Johansen and Gjøølberg 2008). Also the manager, NBIM (2008, 7) was reluctant when it comes to positive selection. The Ministry of Finance decided however that a certain amount (approximately 20 billion NOK in 2008) was to be invested in accordance with some positive selection, in an environmental program (Ministry of Finance 2008, 16). The establishment of this environmental program will of course be critically discussed in the thesis.

4.2. Norwegian Bank Investment Management and the corporate governance strategy: climate changes

In the annual report for 2006 NBIM launched that they had an ambition to become a leading actor in perusing of ownership rights or good corporate governance. Furthermore, environment was one of two focus areas in the years to come (the other one was children's rights, despite being interesting and important, it will not be discussed in this thesis). Nevertheless, the focus on environment was narrow: how companies interact with national and supranational governments in questions related to environment and climate changes. Thus, how companies lobby, and how NBIM could encourage to more transparency and responsibility (NBIM 2006, 72-73). The focus on lobbying was criticized as being too narrow by, among others, the Albright Group (2008, 19) which submitted one of the most comprehensive evaluations of the ethical guidelines in 2008.

Furthermore, in the 2006 report NBIM puts forward some arguments explaining why the two focus areas were chosen. First of all it was important for NBIM to focus on areas with relevance for investors. The Stern report and the possible scenario that climate changes can affect the economic markets negatively in the future is one reason. Furthermore it was emphasized that the possibility of achieving good dialogues within the selected area, and of course ensuring financial return (NBIM 2006). NBIM's argumentation, its own understanding of itself as an climate investor, and how active ownership is used, will of course be important in section three where the reasons for choosing climate will be analyzed. In this section it will also be important to look at how the focus on climate has evolved over the period, for instance why focus on water was included in the strategy in 2009 (NBIM 2009). Among others, Gjessing and Syse's (2007) article about universal ownership will be used in this section.

4.3. Social Responsible Investment – global regulation and principles

At the national level, GPFG is subscript to a very comprehensive SRI regulation. SRI regulation at the global level tends to be in the soft-law corner, with voluntary principles and networking, rather than binding laws. One example is the United Nations' Principles of Responsible Investments (UN PRI), launched in 2006. This is a partnership network among UN and global investors, designed to increase investors' interest in ESG issues. The principles have been signed by 900

signatories from 49 different countries (UN 2011). UNPRI are regarded as an important feature in global SRI work. Efama, the association for the European investment management industry, awards much of the success to the collaborative nature of the process resulting in the principles (Efama 2011). Both NBIM and the Ministry of Finance have signed UNPRI (UNPRI 2012). The more recent “2011 Global Investor Statement on Climate Change” which has been signed by 285 investors is another example with a more narrow focus area (UNEP FI 2011). This statement is very relevant and will of course be used in the analysis. NBIM has signed this statement (Wright 2011). Another important network organization is International Forum of Sovereign Wealth Funds⁴ which in 2008 agreed on the Santiago Principles, an investment framework for SWF (IWG 2008).

5. Literature review and theoretical framework

5.1 Review of literature

In the final thesis the literature review will cover mainly two types of literature; firstly the main academic studies concerning SRI in relation to climate changes will be critically discussed. Literature discussing the challenges facing institutional SRI investors in general will also be consulted. Examples are Tessa Hebb's (2012) *The Next Generation of Responsible Investing*, and *Responsible Investments in Times of Turmoil* by Vandekerckhove et.al. (2011). Secondly, literature discussing GPGF in particular as a responsible investor will be assessed. As mentioned above GPGF is often regarded as a “best in class” investor and has thus been subject to attention from several scholars. Some serious academic literature discussing the fund as a responsible investor exists. Unfortunately does this literature in general not emphasize climate changes particularly. On the other side, the lack of research on exactly this part of the Fund is also the reason for why it has been chosen in this thesis. A few exceptions does nevertheless exist; my supervisor Dr. Kristian Alm is the author of a book chapter in Veggeled's (2010) book about *Innovative Regulatory Approaches*. In the chapter Alm (2010) discusses whether GPGF is a pioneer also in international climate investments. The short answer is no. Another very relevant article is

⁴ Previously International Working Group of Sovereign Wealth Funds (IWG)

written by Danyel Reiche (2010), this is a case study of GPFG with emphasize on climate. According to Reiche (2010, 3576) the importance of the Fund as an climate actor is somewhat limited, but should not be underestimated.

5.3 Theoretical framework

At the time of writing the plan is to use three theoretical frameworks to support the analysis in my final thesis. The first concept it is important to discuss, and which of course will be an important framework, is the notion of Social Responsible Investments. The second theoretical framework will discuss regulation theory. The last theoretical approach that will be useful is agency theory with emphasize on corporate governance theory.

5.3.1 The concept of Social Responsible Investments

There is a lack of agreement in the literature when it comes to definition of SRI, and as reviewed by Sparkes and Cowton (2004, 46) terms like *green*, *strategic*, *development*, *social* and *creative* are found in the literature on responsible investments. SRI is sometimes also referred to as shareholder activism, especially in the US (Louche 2009). Nevertheless, the most used terms appears to be ethical investment and social responsible investment (Sparkes and Cowton 2004, 46). Moreover, there is no clear and universal understanding among investors of what SRI implies, and the concept cannot be understood by a single framework (Efama 2011). According to Eurosif (2010, 8), a forum for sustainable investments in Europe, two issues are crucial in order for investments to be regarded responsible:

1. A concern with long-term investment;
2. Environmental, Social and Governance (ESG) issues as important criteria in determining long-term investment performance.

The following definition by Céline Louche, a well-known researcher in the field, might be applied in the thesis: “SRI is defined as the constructing and managing of investment funds through the use of social, environmental and ethical considerations in addition to conventional financial criteria” (Louche 2009, 53). Most SRI Funds, also GPFG, gives financial return the highest priority (NOU 2003). The definition of SRI implies a dual concern for investors, which is also in line with how GPFG is understood. This duality will of course be further discussed in the thesis.

Another fruitful approach is outlined by Louche (2009, 55-62); the understanding of SRI through new institutionalism, thus SRI in a process of global convergence and isomorphism in which norms and laws will become more similar. UNPRI, the "2011 Global Investor Statement on Climate Change", and the Santiago principles will all contribute to global convergence. Contrarily SRI can be understood as a process of local divergence where the development will follow national specific patterns. The development and regulation of SRI is following both paths, Louche (2009, 62) points out that SRI is "a concept that becomes global in its diffusion but fragmented/diverging in its practices".

5.3.2 Regulation theory

Regulation theory will be applied in the thesis since some of the research questions are concerned with regulation. As for the concept of SRI, there is a variety of definitions and ways to understand *regulation*. The objective of regulation can be understood as "producing outcomes that are in the interests of everyone" (Hix and Høyland 2011, 189), thus the notion of overlapping consensus will be relevant to discuss also when it comes to regulation. Positive versus normative theories of regulation will have different understanding of how and why the government should intervene in order to obtain pareto improvements (Hix and Høyland 2011, 189). According to Baldwin, Scott and Hood⁵ (1998, cited in in Jordana and Levi Fleur 2004, 3) three main issues are often included in defining regulation;

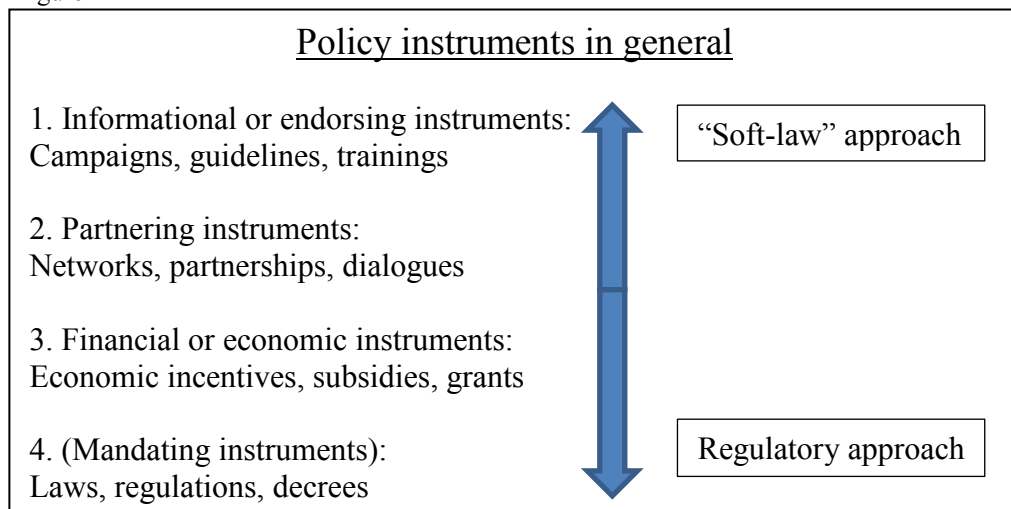
- target rules,
- all state intervention in the economy,
- mechanisms of social control.

The GPFG can be said to be subscript to regulation in all three categories. Even though NBIM is an independent manager of the Fund, the state does clearly regulate several aspects of the activity, for instance through the ethical guidelines, which must be understood as targeted rules. The last aspect of regulation includes a quite broad understanding of regulation, encapsulating also the evolution of social norms, voluntary agreements and international consensus driven regulation

⁵ Unfortunately I could not get hold of Baldwin, Scott and Hood in due time.

without strong enforcing mechanisms. It can be referred to as regulation as a multi-level governance process. Regulation of GPFG which can be included in the third category might be both the participation in voluntary agreements like UNPRI and the Santiago Principles, but also the above mentioned concept of overlapping consensus. Adapting such a broad understanding of regulation will of course makes it easier to see many of the process which has shaped GPFG as a regulatory pattern. When it comes to the regulatory authorities, several dimensions can be identified. Figure 1 (Berger et al. 2007, 11) illustrates the dynamics of the regulatory approaches that can be adapted by authorities.

Figure 1



Policy instruments within category one and two can be understood as part of Baldwin, Scott and Hood’s (1998, cited in Jordana and Levi Fleur 2004, 3) third definition of regulation as a mean of social control. Again, one interesting question is; to what extent has such soft-law approaches shaped the Fund, and especially NBIMs' decision to focus on climate? The two last categories are more in the traditional hard-law regulation pattern. Financial and economic instruments are a way of re-introducing market incentives in regulation. One example of policy instruments in the third category is the Dutch case where return from investments in green environmental friendly projects has been exempted from income taxes since 1995 (OECD 2007).

5.3.3 Agency theory and corporate governance theory

In addition to regulation theory it will be fruitful to use some agency theory and theories of corporate governance. At the time of writing this section has not yet been elaborated.

6. Conclusion

This Preliminary Thesis Report has presented the topic that will be discussed in my final MSc thesis in Political Economy. A draft of the introduction, problem definition, methodology and partly some theory/literature chapters have been outlined. The research problem that I aim to look further into is why and how climate changes/environmental concerns are on the agenda for GPFG, and to what extent the Fund has been a successful actor in this regard. Several research question that will help operationalize the research has been presented, and will be answered in four main sections in the final thesis. The preliminary hypothesis is that GPFG not can be regarded as successful in the work with climate changes as in the overall work with ethical investments.

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