NORGES BANK
INVESTMENT MANAGEMENT

# Responsible investment

## Government Pension Fund Global

2018

No. 05

Our mission is to safeguard and build financial wealth for future generations

# How we work

## Establishing principles

We aim to contribute to well-functioning markets and good corporate governance. We recognise a set of international standards and contribute to their further development. Our expectation documents, position papers and voting guidelines make clear our priorities as a long-term investor.

## Excercising ownership

We aim to promote long-term value creation at the companies in our portfolio. We use our voting rights to support effective boards. In our dialogue with companies, we discuss the board's responsibilities and equal treatment of shareholders. We work with companies to increase the information available to investors and encourage good business practices.

## Investing sustainably

We aim to identify long-term investment opportunities and reduce our exposure to unacceptable risks. We assess how companies impact on the environment and society. We see opportunities in companies that enable more environmentally friendly economic activity. There are also companies we choose not to invest in for sustainability or ethical reasons.

## 2018 at a glance

**13**
Submissions

**5**
Academic projects

**2,256**
Companies' reporting assessed

**11,287**
Shareholder meetings voted at

**98**
Percent of shareholder meetings voted at

**50**
Integrated voting as percentage value of equity portfolio

**199**
Board level meetings

**56.7**
Environmental investments. Billion kroner

**– 8.3**
Return on environmental equity investments. Percent

**107,441**
Equity portfolio carbon emissions. Thousand tonnes $CO_2$ equivalents

**30**
New divestments

**13**
New exclusions

# Contents

3

## EXERCISING OWNERSHIP



4

## INVESTING SUSTAINABLY

# 1

# Introduction

# Long-term and responsible

**We have a single objective – the highest possible return with moderate risk. This return is dependent on value creation at the companies we invest in.**

Oslo, 7 February 2019

Yngve Slyngstad
CEO, Norges Bank Investment Management

Companies' activities have a great impact on the world around them, and the world is asking ever more of how companies conduct themselves. Over time, this could affect their profitability and the fund's return. As a long-term investor in around 9,000 companies in 70 countries, we have an interest in investors' expectations for profitability being aligned with society's broader expectations of companies. We therefore express clear expectations of the companies we invest in.

Good corporate governance promotes long-term value creation and protects our rights as an investor. It enhances transparency and breeds confidence in the markets. The board represents a company's investors and should therefore understand the environmental and social consequences of the company's operations, set its own priorities and report on the results. In 2018, we published our position on the composition and independence of company boards. We expect the board to have sufficient expertise, capacity and independence from management to discharge its duties.

The fund exists to help finance the Norwegian welfare state for future generations and must therefore have a long investment horizon. We want companies to be equipped to deal with long-term global challenges. We aim to promote good governance, increased profitability and responsible business practices. Our work on generating a long-term return is enhanced by investing in companies that act responsibly and create long-term value.

# Closer dialogue with companies

**2018 was marked by several new initiatives. We published our principled position on anti-corruption, ocean sustainability, board composition and independence, and the UN Sustainable Development Goals.**

Oslo, 7 February 2019

Carine Smith Ihenacho
Chief Corporate Governance Officer

We participated in two international initiatives, met regulators in nine markets, and responded to 13 public consultations. We voted at 11,287 shareholder meetings, held 3,256 meetings with companies, and analysed the reporting of 2,256 companies.

Corruption and marine pollution were two challenges we focused on in 2018. We expect companies to work against corruption in all its forms, with the board setting clear policies, integrating them into business operations and reporting on this work. We also expect companies that use or affect the ocean to understand the associated sustainability challenges and opportunities.

We were invited by UN Global Compact to join a new international ocean platform during the year. The Global Compact's role is to promote collaboration between the UN and business. The platform consists of companies, investors and researchers who are working together to develop principles for ocean sustainability. The principles will be launched by UN Global Compact in 2019.

The dialogue we have with companies and their boards is among the most important tools we have as an investor. We raised a number of relevant topics in 2018 on the basis of our published expectations. We engaged with companies on banks' climate disclosure, banks' financing of deforestation, tax and transparency at UK companies, marine pollution from agriculture, and the marketing of breast-milk substitutes.

As a global investor in around 9,000 companies, we must be principled and express clear expectations of all the companies in our portfolio on both profitability and responsible business practices. We follow up our expectations with voting and dialogue with companies to safeguard the fund's long-term value.


The future value of the fund is dependent on the value created by the 9000 companies in which we invest.

# Overview

**Our mission is to safeguard and build financial wealth for future generations. In delivering a long-term return, we are dependent on sustainable growth, well-functioning markets and good corporate governance.**

The objective for the management of the fund is the highest possible return with moderate risk. Responsible investment supports this objective in two ways. First, we seek to improve the long-term economic performance of our investments. Second, we seek to reduce the financial risks associated with the environmental and social practices of companies in our portfolio. We do this by considering governance and sustainability issues that could have an impact on the fund's performance over time. We integrate these issues into our work on establishing principles, our long-term ownership and our investing. This report looks at responsible management of the fund's equity and fixed-income investments. Responsible investment in real estate is covered by other publications.

**Our motivation**

The fund invests for the long term. It exists to help finance the Norwegian welfare state for future generations and must therefore have a long investment horizon. We are dependent on sustainable development for a long-term return. We have an interest in companies being able to meet the needs of the present without compromising the ability of future generations to meet their own needs. Sustainable development can make the companies in our portfolio more robust and contribute to the fund's long-term return.

The fund invests globally. It has holdings in 70 countries to spread risk and capture global growth. We benefit from free and open markets that enable global value creation and efficient allocation of resources. We trade daily in global securities markets. Well-functioning markets ensure that capital is channelled effectively from investors to companies. We have a clear interest in regulation that results in better information on markets and companies, and makes markets more stable. Markets that are less prone to shocks and facilitate sustainable growth are important for the fund's long-term return.

The fund invests widely. It has holdings in around 9,000 companies spanning every sector. However, the fund's percentage holdings in these companies are small, so we must delegate responsibility to their boards. We expect boards to set the company's strategy, oversee management and be accountable to shareholders. Good corporate governance promotes transparency and protects our rights as an investor. Good governance also breeds confidence in the markets and contributes to long-term value creation. The future value of the fund is dependent on the value created by the companies in which we invest.

Internationally agreed standards on corporate governance promote long-term value creation. We recognise a set of international principles and standards from the UN and the OECD.

**Establishing principles**

Standards provide consistency across markets and raise the bar for all companies. In Section 2 of the report, we explain how we participate in the development of international standards and use them, together with our own expectations and positions, to guide companies. Our goal is well-functioning markets and good corporate governance.

The fund is invested in 70 countries. We benefit from internationally agreed standards that apply to all companies and promote long-term value creation. We recognise a set of international principles and standards from the UN and the OECD which provide a framework for our work with companies and other stakeholders.

We contribute to the further development of standards. We participate in consultations and engage regularly with international organisations, regulators and other standard setters, industry partners and academics. We can draw on our experience as an investor in 70 national markets and our in-depth knowledge of companies in our portfolio.

Within this framework of internationally agreed standards, we set our own priorities based on our mandate and characteristics as a fund. We formulate expectations of companies, guidelines for our voting, and positions on governance issues. These public documents communicate our priorities to the wider market and ensure predictability in our long-term ownership.

We see good corporate governance as a premise for responsible business practices. Shareholders must be able to influence important board decisions. We expect boards to understand the broader environmental and social consequences of their companies' activities, take them into account when setting strategy, analyse risks and report on outcomes.

It is important in our work to understand global trends that could affect long-term creation of financial value for the fund. Economic activity in one sector can impose considerable indirect costs on other sectors and society as a whole. Understanding of how governance and sustainability impact on financial risks and returns is still evolving. We support and initiate research projects that contribute to this process. We collaborate with academic institutions to access the latest research and obtain analyses that can inform our investment strategy, risk management and ownership.

The fund has a small stake in around 9,000 companies across the globe. We manage our responsibilities and exercise our rights as an owner to promote long-term value creation at companies.

**Exercising ownership**
The fund has a small stake in around 9,000 companies across the globe. In Section 3 of the report, we explain how we manage our responsibilities and exercise our rights as an owner. Our aim is to promote long-term value creation at companies.

Voting is the most important tool we have for active ownership. Through our voting, we seek to strengthen governance, improve financial performance and promote responsible business practices. We hold boards to account for their decisions, and we consider who should sit on the board. Our voting guidelines provide a principled basis for our voting decisions, but we also take account of company-specific factors.

In our dialogue with companies, we raise governance and sustainability topics relevant to our long-term return. We prioritise our largest investments, where we know the companies best. We have a regular dialogue with these nearly 1,000 companies, which make up around two-thirds of the total value of the equity portfolio. In addition, we publish expectations and positions which are relevant to all of the companies in our portfolio, and we engage with individual companies on our strategic priorities and specific developments.

We work with companies, investors and other stakeholders to advance standards, increase the information available to investors, and promote responsible practices. This is particularly important when many companies in an industry face the same challenges. We have a particular interest in the risks and opportunities associated with climate change, water management and children's rights, and have formulated clear expectations of companies in these areas. We have also published expectations on how companies should address human rights, tax and transparency, corruption and ocean sustainability. We expect companies to integrate material risks in these areas into their business strategy, risk management and reporting. We are constantly developing our understanding of these areas and the impact they could have on the companies in the portfolio. Our work has given us a better basis for assessing companies' strategies and engaging with their boards.

Environmental, social and governance issues can have an impact on companies' performance. We work to identify, measure and manage risks and opportunities that could affect the fund's ability to generate a long-term return.

**Investing sustainably**

Responsible investment is an integral part of the fund's investment strategy. In Section 4 of the report, we explain how governance and sustainability data can inform our investment decisions. Our aim is to identify long-term investment opportunities and reduce the fund's exposure to unacceptable risks.

We encourage companies to move from words to numbers, so that we can evaluate their efforts and better understand financial risks and opportunities. To perform analyses of this kind, we need governance and sustainability data.

We support the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) set up by the G20's Financial Stability Board. We are working with companies to ensure that they are equipped for the transition to a low-carbon economy. We invest specially in climate mandates, adjust the portfolio through divestments, and consider climate issues in our investment decisions. We also analyse greenhouse gas emissions from companies in our portfolio and various climate scenarios for the fund.

We see opportunities in investing in companies with solutions that enable more environmentally friendly economic activity. These investments can have positive effects on other companies in the portfolio. These positive externalities can include reduced pollution, lower energy costs and more efficient use of resources. Companies producing such technologies may profit in turn from changes in demand and regulation. We invest in such companies through among others dedicated environment-related mandates.

Given our understanding of sustainable economic growth, there are also sectors and companies where the fund should not be invested. By not investing in such companies, we reduce the fund's exposure to unacceptable risks.

The Ministry of Finance has established ethically motivated guidelines for observation and exclusion of companies from the fund. The fund must not be invested in companies that produce certain types of weapons, base their operations on coal, or produce tobacco. The fund must also not be invested in companies that through their conduct contribute to violations of fundamental ethical norms. The Ministry of Finance has established an independent Council on Ethics to make ethical assessments of companies.

Finally, the fund itself may decide to divest from companies that impose substantial costs on other companies and society as a whole, and so are not considered long-term sustainable.

# 2

# Establishing principles

# Standards

**The fund is invested in around 9,000 companies across the globe. We benefit from international standards that promote long-term value creation, and we contribute to their development. We also publish expectations of the companies we invest in.**



Standards provide greater consistency across markets and raise the bar for all companies. Our aim is to contribute to well-functioning markets and good corporate governance. We participate in the development of standards by engaging with regulators and other standard setters.

**International standards**

We recognise a set of key international principles and standards. Our management mandate from the Ministry of Finance specifies three standards from the OECD and the UN as the framework for responsible investment management at Norges Bank. These principles and standards from the OECD and the UN are voluntary, non-statutory recommendations. They express expectations for companies' handling of environmental and social issues. We expect the companies in our portfolio to strive to observe these principles and standards.

**OECD**

The G20/OECD Principles of Corporate Governance mainly concern effective governance, such as shareholder rights, equitable treatment of shareholders, disclosure and transparency, and the responsibilities of the board. The principles form a natural starting point for our own positions and interaction with companies and other organisations.

The OECD Guidelines for Multinational Enterprises are a set of government-endorsed recommendations for companies that operate internationally. The aim is to support sustainable development through responsible business conduct, trade and investment. The voluntary nature of the guidelines means that compliance cannot be legally enforced, but there is an expectation that companies will apply the guidelines to the extent that they are applicable to their business. Companies themselves are to assess how this can best be achieved.

### UN

The UN Global Compact is a broad coalition between the UN and the business world that promotes corporate social responsibility. The initiative is based on ten general principles derived from the Universal Declaration of Human Rights, the ILO Declaration on Fundamental Principles and Rights at Work, and the Rio Declaration on Environment and Development. Among other things, the principles require companies to respect human rights, uphold the freedom of association and the right to collective bargaining, and eliminate all forms of forced labour, child labour and discrimination in the workplace. The Global Compact also encourages companies to support the UN Sustainable Development Goals. The Global Compact's principles for responsible business continue to play a key role in the management of the fund. In autumn 2018, we signed up as a Global Compact participant, enabling us to participate in its work on developing international standards that are relevant and important to the fund.

Norges Bank's Executive Board refers to two further UN standards in its own principles for responsible investment. The UN Guiding Principles on Business and Human Rights are a global standard unanimously endorsed by the UN Human Rights Council in 2011. The principles encompass three pillars outlining roles and responsibilities for states and businesses with regard to human rights: the state duty to protect human rights, the corporate responsibility to respect human rights, and access to remedy for victims of adverse impacts.

The UN Conference on Trade and Development (UNCTAD) has also published Principles on Promoting Responsible Sovereign Lending and Borrowing. These aim to prevent unsustainable debt and stress the responsibilities of both lender and borrower. The principles are advisory and are still under development.

In 2018, we published a paper in our *Asset Manager Perspective* series looking at the UN Sustainable Development Goals in an economic context and discussing the fund's relationship to sustainable development. As a long-term and global investor, the fund has an inherent interest in a sustainable development. Our goals as a responsible investment manager largely coincide with the SDGs and the transition to a more sustainable global economy. Joint solutions to global challenges such as climate change and environmental degradation will increase the resilience of our portfolio. The SDGs provide clear direction and a common framework for addressing key global challenges. National authorities are responsible for achieving the goals by 2030. How they choose to mobilise knowledge, technology and capital to realise the goals will have a significant impact on the global economy.

In 2018, we had meetings with the OECD, the UN Global Compact and the European Commission as well as standard setters in France, Germany, Japan, South Korea, Sweden, Switzerland and the UK.

**Development of international standards**
As a market participant, we contribute to the further development of standards that serve the long-term interests of the fund. We participate in consultations and engage regularly with international organisations, regulators and other standard setters in our most important markets. We can draw on experience as an investor in 70 countries and an in-depth knowledge of the companies in our portfolio.

When we meet standard setters, we are interested to learn about their strategic priorities and specific initiatives to promote well-functioning markets and good corporate governance. At the same time, we can communicate our own priorities, which in 2018 included board composition and independence, shareholders' voting rights, executive remuneration, anti-corruption and ocean sustainability. During the course of the year, we had meetings with the OECD, the UN Global Compact and the European Commission as well as standard setters in France, Germany, Japan, South Korea, Sweden, Switzerland and the UK. We were also invited by the UK Financial Reporting Council to be part of a group of 12 investors advising on corporate governance and reporting.

We support initiatives to strengthen financial markets in developing countries. For the past three years, we have supported an initiative under the African Union to develop guidelines for corporate governance in African countries. Through our support for the African Corporate Governance Network, we hope to help open up more African nations to international investment.

We responded to 13 public consultations relating to responsible investment during the year. These concerned issues that we consider important, such as differentiated voting rights, national corporate governance codes, sound voting systems, and standards for corporate disclosure. We publish all of our consultation responses on our website: www.nbim.no.

**Shares with unequal voting rights**
We are a diversified investor with holdings in around 9,000 listed companies. The protection of minority shareholder rights is necessary to safeguard and promote the fund's long-term financial interests. A company's board has a duty to act in the interests of all shareholders. 2018 saw two key developments in this area.
The first concerned listing criteria on the stock exchanges in Singapore and Hong Kong. Both exchanges decided in 2018 to introduce a new dual share class structure, with one class carrying more votes than the other. At the same time, the exchanges presented proposals intended to provide protection for minority shareholders' interests. We support measures that encourage companies to go public to raise capital and share risk. We also recognise that there is international competition for listings. In our responses to the exchanges, we reiterated our position on equal treatment of all shareholders (one share, one vote). We supported the proposal to limit differentiated voting rights to specific situations and require important decisions to continue to be based on the principle of one share, one vote. We also supported the proposal to restrict shares with special rights to key persons and make them non-transferable.

The second development concerned companies with no, or very few, voting shares listed. The right to vote is fundamental for shareholders because it gives them formal influence over the company. In 2018, index provider MSCI carried out a further public consultation on unequal voting rights and their implications for the composition of stock indices. We believe that indices that include companies with voteless shares present challenges for users requiring formal influence over the companies they invest in. MSCI proposed weighting share classes by the percentage of votes in public hands. We commended MSCI on its robust methodology, but also expressed concern about the impact on investors' portfolios and the wider market. Our calculations showed that the proposal would restrict investors' ability to diversify their portfolios and also skew the index towards more mature companies in traditional industries. We repeated our position that the principal purpose of a benchmark index is to reflect the global equity opportunity set. MSCI eventually decided not to account for unequal voting rights in the composition of its benchmark index, but to create a separate index that weights companies partly on the basis of voting rights.

### National corporate governance codes

As an investor in 70 countries, we support the development of national corporate governance codes that adapt the G20/OECD principles to the national context and promote good market practices. Most of these codes are not legally binding, but companies choosing not to comply will often need to explain why they have chosen a different approach.

The UK corporate governance code has a strong standing worldwide and is often used as a model for the development of recommendations in other countries. At the end of 2017, the UK authorities requested feedback from investors on an update of the code. We supported the emphasis on board independence as a premise for good governance. We agreed that diversity on the board is important in bringing a wide range of perspectives and experience into the decision-making process. We also backed the proposal to increase the minimum holding period for equity-based executive remuneration.

Recent years have seen Japan working on improving corporate governance and bringing its code more in line with other OECD countries, especially when it comes to the board's independence and oversight of management. Updates in 2018 mainly concerned cross-ownership and board independence. In our response, we expressed support for a higher ratio of independent board members. We also supported the recommendations on increasing diversity on the board, including through a better gender balance and more international experience.

Proposals for extensive updates of the German corporate governance code were also put forward during the year. We supported the proposal to require a majority of board members to be independent, and for this independence to be based on more stringent criteria. We also backed the recommendation that management should be rewarded with simple, transparent and long-term equity programmes. We noted clear similarities here with our own position on CEO remuneration. Finally, we supported a reduction in the term served by board members from five to three years as a step in the right direction, as well as a limit of five directorships in line with our position on time commitments.

Sweden too proposed changes to its guidelines on executive remuneration in the light of new requirements for shareholder influence in the revised EU Shareholder Rights Directive. In our response, we argued that the national code should permit simple, transparent and long-term equity-based remuneration programmes. We also supported the introduction of a limit on the number of directorships, and greater emphasis on relevant qualifications when nominating board candidates. We stressed the board's responsibility for environmental and social issues material to the company, and repeated our position that the number of votes received by each candidate in board elections should be counted and published.

Australia has clear guidelines protecting shareholder interests and contributing to a competitive market. We expressed our support for an update of the guidelines placing greater emphasis on ethical conduct and responsible business practices. We highlighted the proposal to require companies to publish their anti-corruption policies and strengthen the board's role in work against corruption. We also backed proposals to increase boards' effectiveness, partly by attaching more importance to industry knowledge and thorough evaluation of the board's skills.

### Sound voting systems

With holdings in around 9,000 companies, the fund is dependent on an effective system for voting at as many shareholder meetings as possible. The system consists of service providers that gather information about shareholder meetings and communicate them to shareholders.

The system features multiple intermediaries and often varies from market to market. The European Commission published proposals in 2018 to harmonise the voting process across the EU. In our response, we expressed support for greater harmonisation to make it easier to vote across the internal market. We stressed the importance of digital solutions to simplify and accelerate the transmission of information between companies and shareholders in different countries. We also expressed support for public share registers to make it easier for companies to identify their shareholders.

The Securities and Exchange Commission (SEC) asked market participants for input on improving the voting system at US listed companies. We responded that the SEC could improve the effectiveness of the system and strengthen shareholder rights by making a number of technical changes. First, shareholders who have issued voting instructions should receive confirmation that their votes have been cast at the shareholder meeting. Second, the time between the record date (the cut-off for voting rights) and the actual meeting should be reduced. In the US, the record date can be up to 60 days before the meeting, as opposed to just a few days in other advanced markets, which ensures more accurate representation at the shareholder meeting. Third, it may be an advantage to require all information relevant to the meeting to be provided in machine-readable form so that investors can use computer technology to analyse the situation more efficiently.

### Reporting standards

We support the development of improved standards for reporting on sustainability both nationally and internationally. As an investor, we benefit from timely corporate disclosure of high-quality data and from having access to information on sustainability.

The European Commission held a public consultation on corporate reporting in the internal market and its fitness in the light of new challenges such as sustainability and digitalisation. In our response, we stressed the importance of companies' reporting on sustainability and investors' disclosure of large holdings in companies. We also expressed our support for the commission's work on improving corporate reporting of non-financial data. This reporting should be based on materiality, i.e. whether the information could impact on the user's decisions. As an investor in the EU's internal market, we pointed out that disclosure requirements for major holdings vary from country to country. National differences within the EU bring greater operational risk and higher costs for cross-border investors.

CDP (formerly the Carbon Disclosure Project) requested input on two new questionnaires: one for financial services and one for metals and mining. We expressed our support for better sustainability reporting in these sectors. It is in investors' interest to obtain material sustainability data that are sector-specific, quantitative, consistent and in a ready-to-use format. We also believe that CDP's questions should reflect more closely the commercial implications for different financial institutions, as they are exposed to environmental risks in different ways. We also pointed out that it is important that the questionnaires do not ask for information already collected by other initiatives. We encouraged CDP to take companies' perspective into account to ensure the questions are relevant and to avoid repetitions that may create an unnecessary burden for respondents.

The London Metal Exchange (LME) is the world's leading market for metal futures. In autumn 2018, the exchange published a position paper on responsible sourcing of metals. The paper proposed requiring all metals traded on the exchange to be assessed against indicators developed by the OECD. The idea is for all metals to meet the highest standards for responsible sourcing in addition to existing chemical and physical requirements. Metals that do not satisfy these requirements could eventually be denied quotation on the LME. We supported the proposal, because we believe the OECD guidelines to be a useful framework that captures the risk of violations of human rights in the supply chain. We also backed the possible future expansion of the requirements to include environmental factors.

## Submissions

| Recipient | Topic | Submitted |
|---|---|---|
| Financial Reporting Council | Revisions to the UK Corporate Governance Code | 28.2.2018 |
| Hong Kong Exchanges and Clearing Limited | Proposal for a listing regime for companies from emerging and innovative sectors | 23.3.2018 |
| Singapore Exchange Limited | Proposed listing framework for dual class share structures | 20.4.2018 |
| Japan Exchange Group | Revision of Japan's Corporate Governance Code and establishment of guidelines for investor and company engagement | 24.4.2018 |
| European Commission | Consultation on minimum requirements in the transmission of information for the exercise of shareholder rights | 9.5.2018 |
| MSCI Inc. | Consultation on the treatment of unequal voting structures in the MSCI equity indexes | 31.5.2018 |
| European Commission | Fitness check on the EU framework for public reporting by companies | 19.7.2018 |
| Australian Securities Exchange Corporate Governance Council | Revision of the Australian Securities Exchange Corporate Governance Council's Principles and Recommendations | 24.7.2018 |
| CDP | Consultation on Financial Services and Forests: Metal & Mining questionnaires | 25.9.2018 |
| Securities and Exchange Commission | Staff roundtable on the proxy process | 5.11.2018 |
| Swedish Corporate Governance Board | Revisions to the Swedish Corporate Governance Code | 5.12.2018 |
| German Corporate Governance Board | Revisions to the German Corporate Governance Code | 17.12.2018 |
| London Metal Exchange | Position paper on responsible sourcing | 17.12.2018 |

The fund invests globally. It has holdings in 70 countries to spread risk and capture global growth.

## Membership of organisations and initiatives

| Topic | Organisation | Description |
|---|---|---|
| Corporate governance | African Corporate Governance Network (ACGN) | Network of director membership organisations in Africa |
| | Asian Corporate Governance Association (ACGA) | Membership organisation for investors and companies in Asia |
| | Council of Institutional Investors (CII) | Association of investors in the US |
| | European Corporate Governance Institute (ECGI) | Academia-practitioner research network |
| | International Corporate Governance Network (ICGN) | International association of investors |
| Sustainability | CDP Climate; CDP Forest; CDP Water | Environmental reporting initiatives |
| | Institutional Investor Group on Climate Change (IIGCC) | Investor initiative (Europe) |
| | Norsif | Norwegian sustainable investment forum |
| | One Planet Sovereign Wealth Fund Working Group | Group of Sovereign Wealth Funds |
| | Task Force on Climate-related Financial Disclosure (TCFD) | International reporting framework |
| | Principles for Responsible Investment (PRI) | International principles for investors |
| | United Nations Environment Programme Finance Initiative (UNEP FI) | Multi-stakeholder initiative for sustainable finance |
| | UN Global Compact | International business principles |
| | UN Global Compact Action Platform on Sustainable Ocean Business | Multi-stakeholder initiative for ocean sustainability |

# Expectations

**We publish expectations of companies, position papers on governance issues and guidelines for our voting. These documents communicate our priorities to the wider market and provide predictability in our long-term ownership.**

We see good corporate governance as a premise for responsible business practices. We expect boards to understand the broader environmental and social consequences of business operations and manage relevant risks and opportunities.

We believe that some global trends are particularly relevant to us as a long-term investor. Economic activity can impose substantial indirect costs on other companies and society as a whole. The inability of companies to internalise such costs is a market failure. In many cases, negative externalities are not yet priced into companies' market value. Typical examples include climate change and environmental degradation. Child labour and other forms of social exploitation violate fundamental human rights. Tax evasion and corruption have negative impacts on society and the economy.

**Expectation documents**

Since 2008, we have published expectation documents to support our ownership efforts. The purpose of these documents is to set out how we expect companies to address global challenges in their activities. Our expectations of companies largely coincide with the UN Sustainable Development Goals. Our expectations are also based on the UN Global Compact and the OECD Guidelines for Multinational Enterprises. We have issued expectation documents on children's rights (2008), climate change (2009), water management (2010), human rights (2016), tax and transparency (2017), anti-corruption (2018) and ocean sustainability (2018). Besides publishing these two new documents, we updated our expectations on climate change and water management during the year.

Climate change will impact on most sectors and markets in the longer term. Companies should plan for relevant climate scenarios and assess climate risks in their operations. Water is essential for life on earth and a key part of many production processes. Companies should use water sustainably and understand the consequences of their water consumption. The legitimacy of sectors and markets depends partly on ethically acceptable operations and products. Companies have a duty to respect human rights, including children's rights, in their operations, supply chains and other business relationships.

Corporate taxes play a key role in most countries' public finances. Companies should pay taxes where economic value is generated and report publicly on the taxes they pay in each country. Corruption hinders economic development, undermines markets and exposes companies to a significant risk of fines, blacklisting and loss of reputation. Companies should have clear anti-corruption policies, and the board should ensure that relevant actions are taken within the organisation. The ocean provides important natural resources and large open spaces for transport and new industries.

Companies should manage risks and opportunities related to ocean sustainability.

Our expectations are primarily directed at company boards. Our underlying expectation is that the board takes overall responsibility for company strategy and addresses relevant sustainability challenges. The board should integrate material risks in these areas into strategy, risk management and reporting. To analyse the risks and opportunities associated with our investments, we need high-quality information from companies. Another important premise for our work is therefore appropriate corporate disclosure in line with relevant standards for the sector.

When working on our expectation documents, we invite companies, NGOs and researchers to provide comments and discuss initiatives. We appreciate the input we receive and view it as part of our ongoing dialogue with stakeholders.

### Expectations on anti-corruption

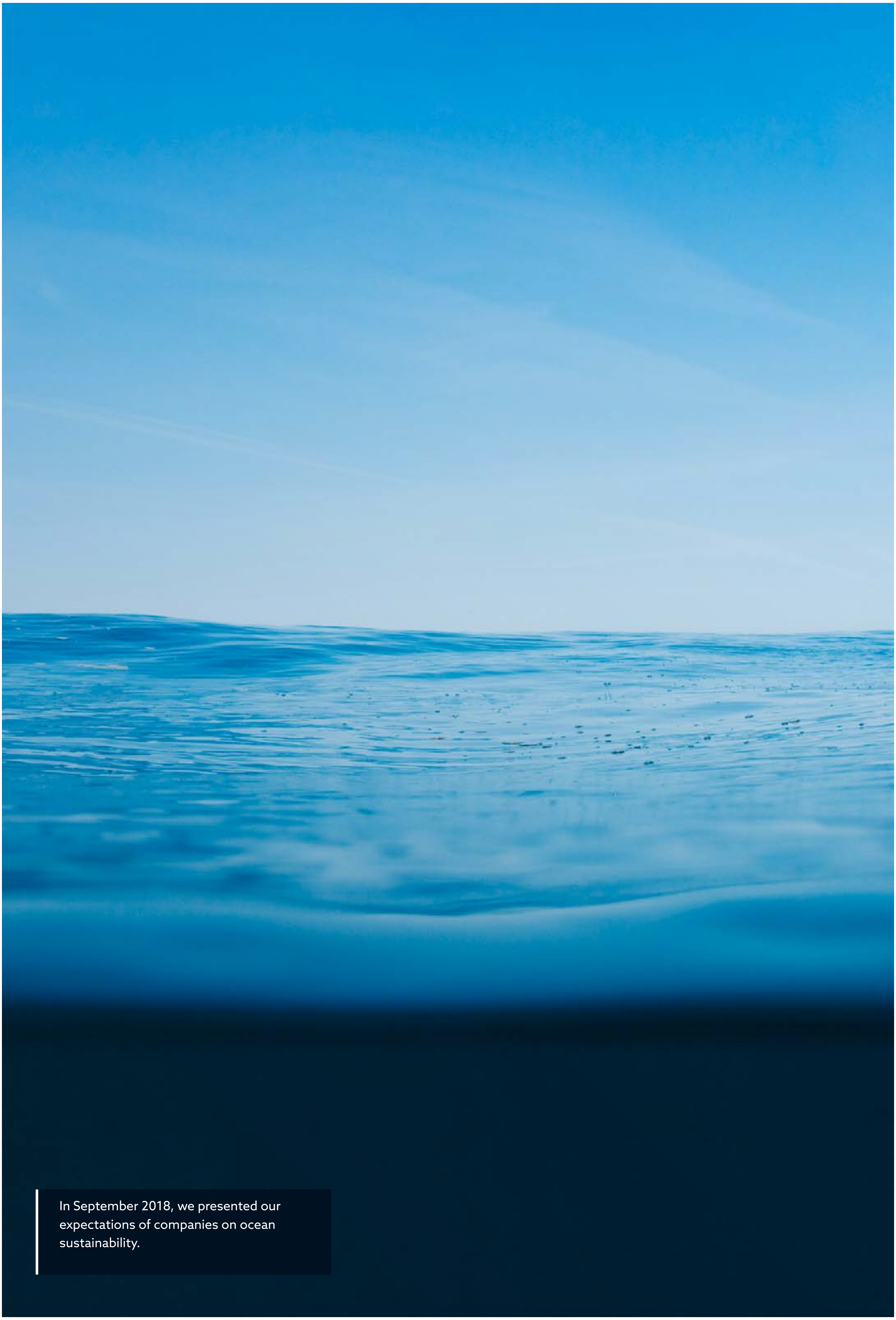
In February 2018, we published our expectations of companies on anti-corruption. Corruption at companies and their agents, or in entire markets, undermines economic efficiency, disadvantages compliant companies and is detrimental to shareholder value. As a financial investor, we expect companies to have clear policies and take effective action to prevent corruption.

Our expectations reflect international anti-corruption legislation and global anti-corruption standards. Boards should ensure that companies have clear anti-corruption policies and integrate relevant measures into strategy, risk management and reporting. Boards should ensure that measures are implemented and enforced, and that the ensuing responsibilities are assigned and communicated in the organisation. Executive management should be involved in anti-corruption work to ensure that the company is in a position to prevent corruption, and should encourage employees to comply with the anti-corruption programme. Analysis of corruption risks throughout the business are important for taking effective preventive measures in the areas where the company is most exposed to risks. Measures to prevent and detect corruption should also be monitored continuously and improved on the basis of both internal and external experience.

### Expectations on ocean sustainability

In September 2018, we published our expectations of companies on sustainable uses of the ocean. Many companies make use of the ocean and marine resources in their business operations, but some of this activity has a negative impact on the ocean. As a financial investor, we have an inherent interest in companies' using the ocean in a sustainable manner. At the same time, the ocean offers new and more sustainable business opportunities for many industries.

Our expectations are aimed both at companies with activities directly in or on the ocean, and at land-based companies that are dependent on or affect the ocean through their activities or products. The expectations cover topics such as overfishing, land-based pollution, sustainable shipping, and economic activity in areas of particular ecological or biological significance. We expect relevant companies to integrate ocean sustainability into their strategy and risk management, be transparent about their priorities and report on their performance. This means, for example, that they should understand their impact or dependence on the ocean, avoid taking fish from stocks that are overfished, and act responsibly in poorly regulated areas. The expectations form the basis


In September 2018, we presented our
expectations of companies on ocean
sustainability.

for dialogue with companies, and we have also used them to support our work on developing principles for sustainable ocean business with the UN Global Compact.

### Updated expectations

We also made some updates to existing expectation documents in 2018. We make minor adjustments regularly to ensure that the documents reflect developments in practices. In the expectations on climate change, we clarified our position on banks' role in financing coal-based industries. Many banks have now introduced restrictions or discontinued such financing. We expect those that continue to finance coal to be open about their lending policies and the assessments they perform before granting new loans. We also ask for information on other lending for activities based on fossil fuels, such as extraction, infrastructure and power stations. At the same time, we ask for information on lending for renewable energy. This gives us a basis to assess how exposed banks are to risks in the transition to a low-carbon economy, as part of the TCFD recommendations. In addition, we request disclosure of physical climate risks and express expectations for the reporting of information on assets and facilities, including location and technical data.

Our expectations on water management now set out requirements for site-specific disclosure of water consumption and water risks. Droughts, pollution and overconsumption of water are generally limited to specific geographical areas. It is therefore necessary for us to understand where a company has facilities, what the situation is in that area, and what specific steps the company is taking to address any challenges. We have also clarified that a company's organisation, culture, incentives and relations with employees and suppliers can support its work on water management.

**Position papers**

To support our ownership activities, we publish position papers that clarify our stance on selected corporate governance issues. Our point of departure is that the board is responsible for setting company strategy, monitoring management's execution of that strategy, and providing accountability to shareholders. Each year, we vote on more than 45,000 board candidates. We seek to understand what is needed for boards to be effective, and how we can contribute to better governance. In 2018, we published three position papers on the effectiveness and composition of the board. We will use these as a starting point for our voting and our dialogue with company boards.

### Industry expertise on the board

The board should collectively have a thorough understanding of the industry in which the company operates. It should have sufficient industry expertise to monitor management's implementation of corporate strategy, and it should have an effective nomination process to identify suitable candidates with industry expertise.

As a global investor, we have observed that boards place differing emphasis on industry expertise when recruiting and nominating new members. Shareholders have an interest in boards whose members thoroughly understand the industry in which the company operates. Such a board will have a better understanding of the company's business and risks, its main competitors and the trends that will shape the industry.

We therefore believe that a majority of independent board members should have fundamental industry insight, and at least two of the independent members should have worked in the industry. The board should also explain to shareholders the relevance of candidates' qualifications.

### Time commitment of board members

Board members should devote sufficient time to fulfil their responsibilities effectively. The chairperson is responsible for leading all aspects of the board's work and should devote a significant amount of time to fulfil his or her responsibilities effectively. Board members should contribute to effective discussions and decision-making by attending all meetings. The board is accountable to shareholders for the time commitment of its members.

As a global investor, we have observed that most board members are keen to contribute to a company, but some take on too many commitments and so do not have enough time to prepare or perform their duties. Shareholders have an obvious interest in boards whose members have enough time to perform the work they were elected to do. Board members should be well prepared for meetings and participate actively in discussions. This requires time and availability, which is why there will always be a limit to how many board roles one person can hold.

We therefore believe that board members at listed companies should not serve on more than five boards at one time, and that the chairperson of a leading company should generally not chair the board of another company. The company should disclose individual attendance rates and explain any absences, and the board should disclose all external board assignments, committee roles and employment, so that shareholders can assess the functioning of the board.

### Separation of chairperson and CEO

The board should exercise objective judgement and be able to make decisions independently of management.

As a global investor, we have observed that it has become less common to combine the roles of chairperson and CEO. However, there are still many large companies, especially in the US, where the board is chaired by the CEO. Minority shareholders have an interest in clear separation of the roles of board and management to ensure effective oversight and controls. This is particularly important when it comes to the recruitment, monitoring and remuneration of the CEO.

The board should therefore be chaired by an independent non-executive member, and the roles of CEO and chairman should not be held by the same individual. Where the board does decide to have a combined chairperson and CEO, it should put in place measures to mitigate any conflicts of interest and safeguard shareholder rights.

**Corporate Governance Advisory Board**
Åse Aulie Michelet, Svein Rennemo and Harald Norvik were appointed as external members of a new Corporate Governance Advisory Board for the fund in 2018. The board serves as an advisory forum for the Chief Corporate Governance Officer, who chairs the board, and is to meet six times a year.

The three bring extensive board experience from listed companies both in Norway and abroad, and will advise on corporate governance strategy, exercise of ownership rights, and principles and practices relevant to listed companies in the equity portfolio. As a long-term investor, we are particularly keen to strengthen our understanding of the board's role and working processes in order to target our ownership work more effectively.

The advisory board held five meetings in 2018 and considered matters such as the fund's stance on board composition and independence, and how we can use our voting to strengthen boards. The advisory board also discussed the fund's voting in 2018 with a particular emphasis on director elections, executive remuneration and shareholder resolutions.



Corporate Governance Advisory Board
From left: Svein Rennemo, Carine Smith Ihenacho, Harald Norvik, Åse Aulie Michelet

Since 2008, we have published our expectations of companies. We want companies to be prepared to handle long-term global challenges.

# Expectations of companies

| Markets | | The fund |
| --- | --- | --- |
| UN Global Compact established | **2000** | |
| UN Principles for Responsible Investment established | **2006** | Children's rights and climate change defined as focus areas |
| | **2007** | Company dialogue on climate risk in the US and child labour in India |
| | **2008** | Expectations on children's rights, initiative against child labour in cocoa production |
| | **2009** | Expectations on climate change |
| | **2010** | Expectations on water management |
| UN Principles for Business and Human Rights adopted | **2011** | |
| | **2014** | Publishing the fund's carbon footprint |
| UN Sustainability Goals and Paris Agreement adopted | **2015** | Executive Board principles for responsible investment management |
| | **2016** | Expectations on human rights |
| Task Force on Climate-related Financial Disclosures established | **2017** | Expectations on tax and transparency |
| UN Global Compact establishes Ocean Platform | **2018** | Expectations on anti-corruption and ocean sustainability<br>Climate scenarios for the fund |

# Research

**We are keen to develop our understanding of good corporate governance and sustainability, and how they impact on financial risks and returns. We fund research projects and collaborate with academic institutions to obtain high-quality analyses that can inform our investment strategy.**

We prioritise global trends and topics that may be particularly important for long-term financial value creation. The projects may contribute to improved market standards, access to important data, or our own responsible investment priorities.



## Academic research projects

Norges Bank's Norwegian Finance Initiative (NFI) is one channel for supporting academic research. We also initiate and fund specific research projects outside the NFI.

### Effective ownership

The fund is broadly diversified across all main sectors in 70 countries. We rely on effective ownership to safeguard the long-term value of the fund. We therefore aim to support academic inquiry into how ownership efforts can effectively support our financial objective.

With support from the NFI, the London Business School is investigating effective ownership. As part of the project, researchers are studying the extent, impact and value of ownership activities at the global asset manager Standard Life Investments.

### Shareholder approval

As a long-term minority shareholder, we are keen to ensure that all shareholders are treated equally and receive their fair share of the value a company creates. In this context, we are particularly interested in the rights of minority shareholders.

A research project supported by the fund at Boston College has found that the market reaction to equity issuances depends on whether shareholders have to give their approval. This is because management and shareholders have different interests when a company issues shares. Some markets require shareholders to approve new issues, but practices vary between markets. When shareholders have to approve new issues, the market will, on average, react positively to the news. When a company issues shares without shareholder approval, the average market reaction is negative and the announcement return is 4 percentage points lower. The closer the vote is to the issue, or the higher the required majority, the more positive the market reaction. The research also reveals that the rules on shareholder approval affect the type of offer chosen. The market appears to interpret shareholder approval as a sign that the new issue will create value for the company.

This research may be important for understanding of agency problems in capital allocation and the value of voting rights at companies. The results were published during the year in the article "Equity Issuances and Agency Costs" in the *Journal of Financial Economics*. The project was completed on schedule and within budget in October 2018.

### Climate change data

We are supporting research into the financial impacts of climate change, an area previously given little attention in finance research. The NFI invited proposals from institutions and researchers capable of facilitating academic discourse and contributing to the establishment of an international research community in this field. We supported two such research projects in 2018.

New York University Stern School of Business's Volatility Institute is conducting financial research into environmental risks under Nobel laureate Robert Engle. The project is looking at methods for measuring and modelling environmental risks, and how modern risk management techniques and hedging portfolios can be used to account for climate risks dynamically in the composition of investment portfolios. The researchers are also working on improving estimates of the long-term discount rate when investing in climate projects. In April, the Volatility Institute dedicated its annual conference entirely to finance research and market practices relating to climate risks. The fund gave a paper on its work on responsible investment and experience of divesting from coal companies. As part of the project, the institute publishes regularly updated climate risk data on its V-Lab website.

To encourage more leading finance scholars to look at climate issues, we also awarded a three-year grant to Professor Harrison Hong at Columbia University to conduct research and hold two research conferences on climate change and capital market efficiency. Together with the *Review of Financial Studies*, the project has selected 11 promising research ideas which have been discussed with peers at two conferences. The researchers are looking at how companies and markets form climate change expectations, and how this impacts on behaviour and trading decisions. Topics include asset pricing, corporate governance, profitability, risk management and the consequences of climate change for real estate markets. The findings indicate that climate change can have implications for pricing, and that many participants are trying to take account of this.

By supporting these two projects, we hope to pave the way for more research into how future physical and regulatory scenarios might affect the markets, as well as tools for addressing climate uncertainty and variations across sectors and asset classes. The projects are proceeding to plan.

### Mining industry data

We have long supported work to expand and improve non-financial data in the mining sector. Information of this kind is, for example, important for our risk-based divestments in the sector. In 2014, we commissioned an academic research project from Columbia University on the financial consequences of water-related and environmental risks in the mining sector. As part of the completion of the project, the research group published a synthesis report in 2018 looking at areas such as changes in climate cycles and the risk of dam failures, and how the environmental and social risks associated with mining projects can be integrated into valuation models through real options modelling. Columbia has also developed a modelling tool to assist mining companies and investors in assessing the financial consequences of water risks. The report and tools were presented at seminars with researchers, companies, investors and NGOs in January 2018. A number of mining companies have shown an interest in some of the models. The project was completed six months late but within budget.

# 3

# Exercising ownership

# Voting

**We voted at 11,287 shareholder meetings in 2018. Voting is one of the most important tools we have for exercising our ownership rights. We use our voting rights to safeguard the fund's assets and aim to vote at all shareholder meetings.**



The board puts a company's annual financial statements and key decisions before the general meeting to obtain shareholder approval. These decisions include director elections, executive remuneration, amendment of the articles of association, changes in share capital, mergers and anti-takeover measures. Shareholders themselves can also table resolutions. These tend to concern director elections, changes to the articles of association, and sustainability issues. When we exercise our voting rights, we aim to promote good governance, improved performance and responsible business practices.

**Voting principles**

We have drawn up voting guidelines that provide a principled basis for our voting decisions. The guidelines are anchored in the G20/OECD Principles of Corporate Governance and provide companies with the overarching rationale for our decision-making when we vote. We vote at all shareholder meetings unless there are significant practical obstacles to doing so, and we publish our voting decisions. We aim to vote in ways that further the fund's long-term interests. As a responsible investor, we emphasise long-term value creation, responsible business practices, board accountability, equal treatment of shareholders, well-functioning markets and corporate transparency.

We are open about how we vote. Our guidelines, expectation documents, position papers and public reporting lend predictability and consistency to our voting.

Our voting decisions are published the day after the shareholder meeting on our website: www.nbim.no.

**Voting process**

Given the high number of shareholder meetings, we are dependent on a reliable voting process. We strive constantly to improve this process.

**Shareholder meetings**

We aim to vote at all shareholder meetings at companies in our portfolio.

Voting procedures vary across markets and companies. Our systems and processes enable us to adapt to most situations. We voted at 97.7 percent of shareholder meetings in 2018, which is in line with previous years. When we are unable to vote at meetings, this is generally in situations where voting would lead to share blocking, thereby restricting our ability to trade, or due to other market practices that make it difficult to exercise our voting rights.

**Voting by proxy**

Most companies permit shareholders to vote at shareholder meetings without attending in person. Voting by proxy means that a shareholder appoints a representative to vote according to the shareholder's instructions. This system enables us to vote at companies all around the world.

We use an online platform where an external service provider brings together all necessary information about upcoming shareholder meetings. The platform includes all of the items

## Voting priciples

| G20/OECD Principle | Norges Bank Investment Management voting guidelines |
| --- | --- |
| Institutional investors, stock markets and other intermediaries | Vote in a principled and consistent manner to maximise the long-term profitability of the companies we are invested in<br>• Vote in order to support the return objective of the fund<br>• Transparency on our voting |
| Effective corporate governance framework | Encourage companies to create long-term value<br>• Accommodate market-specific practices and regulations<br>• Accommodate company-specific circumstances |
| The responsibilities of the board | Hold company boards accountable for decisions and outcomes<br>• Board composition<br>• Director commitment and board renewal<br>• Board accountability<br>• Executive remuneration |
| The rights and equitable treatment of shareholders and key ownership functions | Seek to enhance shareholder rights and work for equitable treatment of shareholders<br>• Protection of shareholder rights<br>• Equal rights within share classes<br>• Equitable treatment of shareholders<br>• Pre-emption rights |
| Disclosure and transparency | Promote timely, adequate and transparent company communication<br>• Annual report and accounts<br>• Discharge of directors and accounts<br>• Compliance with local corporate governance codes |
| The role of stakeholders in corporate governance | Promote sustainable business practices<br>• Risk management<br>• Reporting of environmental and social risk<br>• Shareholder proposals |

to be voted on, the board's position on these items, and the relevant deadlines.

### Consideration of items

The majority of our voting decisions fall within the scope of our published voting guidelines. There are, however, cases where the guidelines are less relevant due to the nature of the resolution. In these cases, we analyse the agenda items individually and vote according to the fund's long-term interests. Executive remuneration, shareholder resolutions on sustainability issues, and extraordinary meetings on mergers and acquisitions are examples of where we must often exercise our judgement.

Where our portfolio managers have an in-depth knowledge of the company, we use this information in the voting process. Voting decisions at 581 companies were made in collaboration with portfolio managers in 2018. These companies accounted for around 50 percent of the equity portfolio's market value.

Portfolio managers' company- and sector-specific knowledge provides valuable insights and improves our overall consideration of the voting items.

### Voting intentions

Shareholders can communicate their support for, or opposition to, specific resolutions by announcing publicly ahead of the meeting how they intend to vote. In 2018, we published our voting intentions at five companies. We expressed support for the board's proposed new policy for executive remuneration at The Weir Group Plc, better reporting on greenhouse gas emissions at TransCanada Corp and Kinder Morgan Inc, better reporting on water management at Imperial Oil Ltd, and the unbundling of director elections at Boliden AB. Our aim in publishing our intentions is to be even more transparent about our voting decisions and communicate our principled position to the wider market.

## Announced voting intentions in 2018

| Company | Voting position |
|---|---|
| The Weir Group Plc | Support for remuneration policy |
| Imperial Oil Ltd | Support for water-related shareholder proposal |
| TransCanada Corp | Support for shareholder proposal on climate change |
| Boliden AB | Support for unbundled board elections |
| Kinder Morgan Inc | Support for shareholder proposal on methane emissions management |

### Voting at shareholder meetings

Once we have decided how we wish to vote, we use the platform to send instructions to our agent, which then forwards them to the shareholder meeting.

**Voting in 2018**

We voted on 113,546 resolutions at 11,287 shareholder meetings in 2018. Of these resolutions, 97.8 percent were proposed by the companies and 2.2 percent by shareholders. We voted in line with the board's recommendation in 94.7 percent of cases. We voted against one or more resolutions at 27.5 percent of meetings. This was in line with our voting in 2017.

### Director elections

Director elections account for nearly half of the resolutions we vote on. The board is the interface between the company and the capital market. We expect the board to set company strategy, monitor management effectively, and act in shareholders' interests. We are therefore keen for the board to have the right composition and organise itself appropriately. We hold boards to account for their decisions, and give consideration to who should sit on the board.

We voted in line with the board's recommendation in 94.6 percent of director elections, compared with 92.6 percent in 2017 and 93.3 percent in 2016. In markets where companies publish the outcome of shareholder meetings, we observed that the board's own candidate attracted an average of 95.9 percent of the vote in 2018, which is in line with the 2017 figure of 96.0 percent.

When considering candidates, we attach importance to board independence and separation of the roles of chairperson and CEO. We will also hold members to account when the board fails to act in the interests of all shareholders.

We consider it important that the board and its committees are sufficiently independent of management and large shareholders, and have no other conflicts of interest. We require a majority of the audit committee to be independent. We have observed a gradual increase in independent board members in a number of markets, such as Japan. A lack of independence on the board or key committees led us to vote against 1013 candidates in 2018.

The chairperson plays a key role in a company. We believe that clear separation of roles and responsibilities between chairperson and CEO is necessary for board oversight of management. Combination of the role of chairperson and CEO was the most important reason for voting against director elections, leading us to vote against 595 candidates in 2018. Combined roles are particularly common in the US but decreased from 44 percent of companies in the Russell 3000 index in 2012 to 33 percent in 2018.

We also voted against candidates to hold them to account for the board's conduct. This resulted in 405 votes against director elections. For example, we voted against members of remuneration committees where there was a history of problematic executive remuneration, members of corporate governance committees where shareholders did not have the right to propose binding resolutions, and members of audit committees where the external auditor had found problems with the annual financial statements. In all of these cases, our conclusion was that the board had not acted in shareholders' interests.

In a few cases, the candidate will not receive enough votes to be elected. In 2018, 409 candidates were not elected due to a lack of support. This corresponds to 0.9 percent of all director elections and compares with 0.7 percent in 2017.

The required level of support is generally half of the votes cast, but less than 75 percent of the vote will be interpreted as a sign of shareholder dissatisfaction. Candidates received less than 75 percent of the vote in 1.9 percent of director elections in 2018, compared with 1.7 percent in 2017.

**Chart 1** Share of votes against management, by topic. Percent

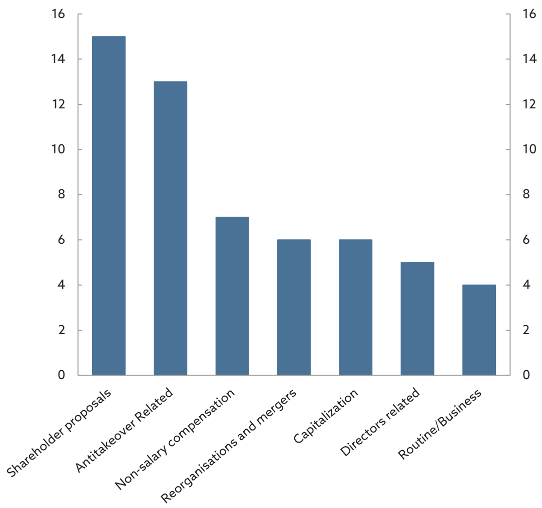
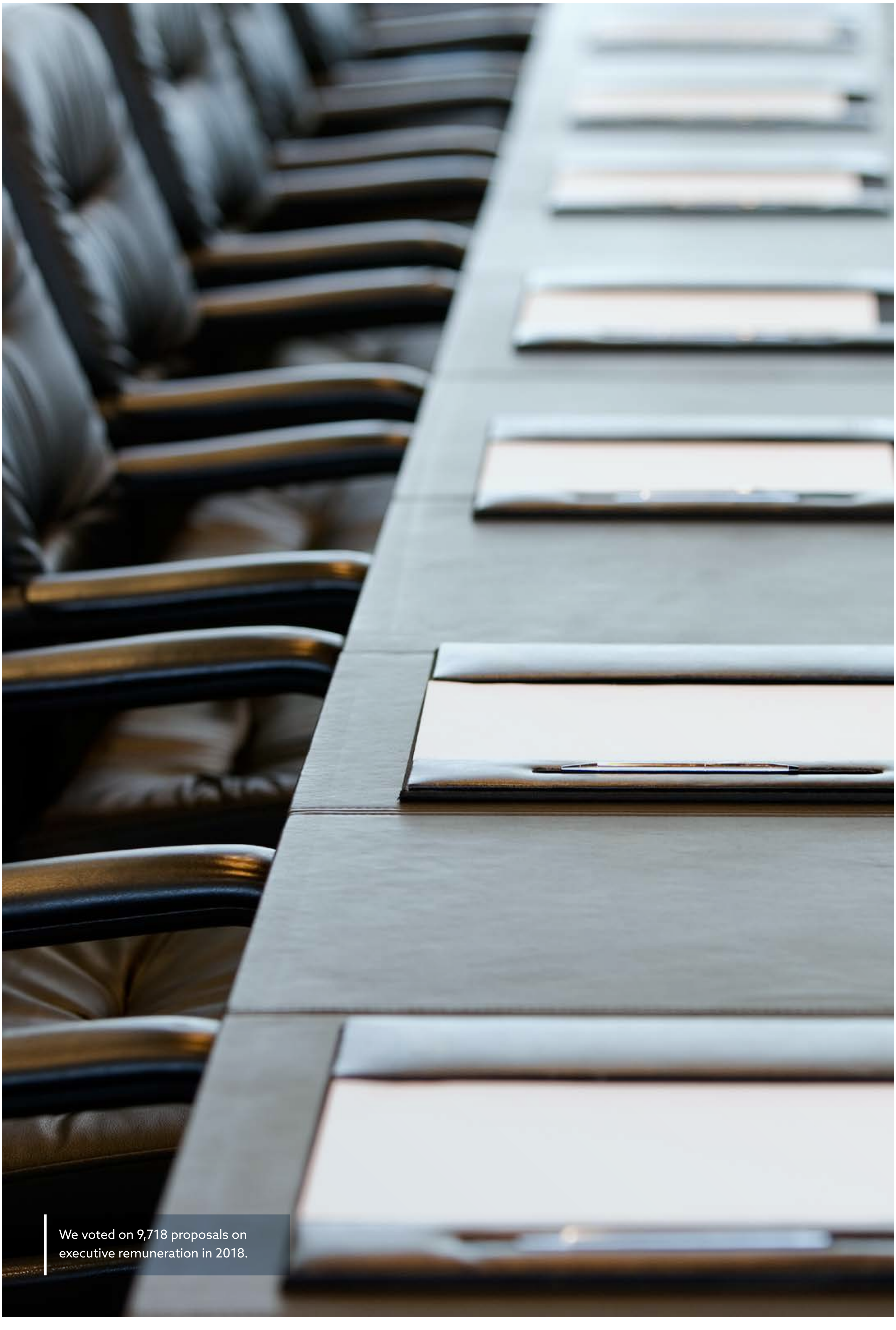



**Table 1** Voting at shareholder meetings. Per region

| Region | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| | Shareholder meetings | Voted | Percent | Shareholder meetings | Voted | Percent |
| Africa | 298 | 151 | 50,7 | 275 | 158 | 57.5 |
| Asia | 5,256 | 5,209 | 99,1 | 5,195 | 5,148 | 99.1 |
| Europe | 2,519 | 2,479 | 98,4 | 2,436 | 2,399 | 98.5 |
| Latin America | 529 | 511 | 96,6 | 541 | 526 | 97.2 |
| Middle East | 268 | 257 | 95,9 | 218 | 208 | 95.4 |
| North America | 2,281 | 2,280 | 100,0 | 2,307 | 2,305 | 99.9 |
| Oceania | 402 | 400 | 99,5 | 340 | 340 | 100.0 |
| **Total** | **11,553** | **11,287** | **97,7** | **11,312** | **11,084** | **98.0** |

**Table 2** Votes against board recommendations among the fund's top 50 holdings in 2018

| Company | Portfolio rank | Country | Resolutions voted against | Subject of resolution(s) |
|---|---|---|---|---|
| Apple Inc | 2 | United States | 1 | Proxy Access |
| Alphabet Inc | 3 | United States | 4 | Remuneration, equal treatment of sharehol-ders, enhanced reporting |
| Amazon.com Inc | 5 | United States | 1 | Combined CEO/Chairperson |
| Roche Holding Ltd | 7 | Switzerland | 1 | Shareholder rights |
| Novartis AG | 8 | Switzerland | 1 | Shareholder rights |
| Berkshire Hathaway Inc | 9 | United States | 1 | Enhanced reporting |
| Johnson & Johnson | 10 | United States | 2 | Combined CEO/Chairperson, shareholder rights |
| Facebook Inc | 11 | United States | 6 | Equal treatment of shareholders, enhanced reporting, board accountability |
| Total SA | 15 | France | 1 | Combined CEO/Chairperson |
| JPMorgan Chase & Co | 16 | United States | 5 | Combined CEO/Chairperson, shareholder rights, remuneration |
| Taiwan Semiconductor Co Ltd | 17 | Taiwan | 3 | Missing information on board election candidates |
| Exxon Mobil Corp | 19 | United States | 4 | Combined CEO/Chairperson, shareholder rights, enhanced reporting |
| Bank of America Corp | 21 | United States | 2 | Combined CEO/Chairperson |
| Pfizer Inc | 22 | United States | 4 | Combined CEO/Chairperson, shareholder rights, enhanced reporting |
| Verizon Communications Inc | 24 | United States | 5 | Combined CEO/Chairperson, shareholder rights, remuneration, enhanced reporting |
| Procter & Gamble Co | 27 | United States | 1 | Combined CEO/Chairperson |
| GlaxoSmithKline Plc | 29 | United Kingdom | 2 | Remuneration |
| Merck & Co Inc | 31 | United States | 2 | Combined CEO/Chairperson, shareholder rights |
| Intel Corp | 32 | United States | 2 | Combined CEO/Chairperson, shareholder rights |
| Chevron Corp | 33 | United States | 5 | Combined CEO/Chairperson, shareholder rights, enhanced reporting |
| AT&T Inc | 35 | United States | 4 | Combined CEO/Chairperson, enhanced reporting |
| The Home Depot Inc | 38 | United States | 5 | Combined CEO/Chairperson, shareholder rights, remuneration, enhanced reporting |
| AstraZeneca Plc | 39 | United Kingdom | 2 | Remuneration |
| Wells Fargo & Co | 42 | United States | 1 | Shareholder rights |


We voted on 9,718 proposals on
executive remuneration in 2018.

### Executive remuneration

Remuneration plays an important role in attracting talented executives and motivating them to do their best for the company. The board is responsible for recruiting the CEO and deciding on appropriate remuneration. "Say on pay" arrangements give shareholders in some countries a right or a duty to consider executive pay and express their views by voting. In some markets, such as the UK, France and Switzerland, shareholders vote on both a forward-looking remuneration plan and a retrospective remuneration report. In some of these markets, the vote on the plan is binding, but the vote on the report is normally only advisory.

We voted on 9,718 resolutions on executive remuneration in 2018. We voted against 7.2 percent of them, compared with 6.9 percent in 2017 and 2.8 percent in 2016.

We also observed growing shareholder dissatisfaction with executive remuneration. In markets where shareholders get to vote on executive pay, these resolutions attracted an average of 90.7 percent of the vote, down from 91.5 percent in 2017. This is probably because more markets, especially in Europe, have given shareholders greater opportunities to vote on executive remuneration, and because shareholders have become more critical of complex incentive structures and unpredictable maximum payouts.

Our position is that remuneration should provide an incentive for the CEO to create long-term value for the company. We support the principle that remuneration plans should be long-term and include a substantial equity component with a lengthy lock-in period. Remuneration plans should also be easy to understand and clear about how much the CEO is paid each year.

Since we published our position paper in 2017, we have been clearer about how we believe the CEO should be rewarded. We communicate this view primarily through dialogue, but it also has implications for how we vote. In 2018, we focused particularly on transparency on executive pay, long-term remuneration plans, and the pay-to-profit ratio.

In a few cases, a company's resolutions on executive remuneration fail to attract a majority. In 2018, 168 resolutions on executive pay were voted down. This corresponds to 1.7 percent of such resolutions, up from 1.2 percent in 2017.

### Shareholder resolutions

Resolutions submitted by shareholders accounted for 2.2 percent of all resolutions we voted on in 2018. Corporate governance topics accounted for 95.1 percent of these, and sustainability issues for the remaining 4.9 percent.

#### Governance resolutions

Shareholders submit resolutions on corporate governance topics to protect their rights and influence the board. These resolutions typically concern the right of shareholders to call extraordinary meetings, propose competing board candidates, or elect an independent chairperson. In many markets, these resolutions are not controversial. In the US, however, it is more usual for shareholders to submit these resolutions as a way of expressing their views on the company's direction.

We have seen a decline in the number of governance-related shareholder resolutions in the US. We voted on 398 in 2018, compared to 460 in 2017. Shareholder support for these resolutions has increased over time, with 12.8 percent gaining majority support in 2018. The fund supported 80.4 percent of these resolutions. We have also seen more companies making the changes demanded by shareholders in these resolutions, even if the resolutions are not passed. According to proxy adviser ISS, 67 percent of companies in the S&P 500 index have now introduced proxy access – the right to propose competing board candidates – compared with 50 percent in 2016. Resolutions on the introduction of annual election of all directors attracted 83.4 percent of votes on average in the US and are often passed. By way of comparison, support for an independent chairperson in the US averages just 33.2 percent, and these resolutions are rarely passed.

Our starting point is that shareholders have delegated most decision-making authority to the board. For this delegation to function effectively, boards need to demonstrate a high degree of accountability to shareholders. In addition, we view the protection of shareholder rights as necessary to safeguard the fund's long-term interests. We will support well-founded shareholder resolutions that are aligned with these principles. In 2018, we voted in favour of 65.1 percent of governance-related shareholder resolutions in the US.

We supported 44 shareholder resolutions calling for an independent chairperson, including at some of our largest holdings, such as Tesla Inc, Exxon Mobil Corp and JPMorgan Chase & Co. None received enough votes to be adopted. Our voting in favour of an independent chairperson at some companies reflects our principled position that the roles of chairperson and CEO should not be combined.

We also supported nine shareholder resolutions calling for proxy access. This is in line with our long-term support for proxy access in the US. In 2018, majorities at Netflix Inc, Hospitality Properties Trust and Old Republic International Corp voted to grant shareholders proxy access.

### Sustainability resolutions

Shareholders are increasingly raising sustainability issues with companies. One way of doing so is to put forward resolutions at shareholder meetings. These resolutions cover areas such as how companies report on environmental risks such as climate change and water management, and social risks such as human rights violations.

In 2018, we registered 123 sustainability-related shareholder resolutions, compared with 165 in 2017. Most were tabled in the US. One reason for the decline in this type of shareholder resolution is that a growing number of resolutions are withdrawn before they come to the vote. According to ISS, 2018 saw more resolutions withdrawn ahead of shareholder meetings in the US than ever before. This will often happen when a company changes its practices in line with the proposer's wishes. We are continuing to see growing support for this type of resolution. According to ISS, support for sustainability resolutions averaged 24.1 percent in 2018, compared with 19.5 percent in 2017. This continues a positive trend since 2012, when support averaged just 16.0 percent. This also indicates that the quality of the resolutions has increased, and that they are generally seen as more relevant.

However, only a small share of these resolutions win majority support: just 11 in 2018. These included environment-related resolutions at TransCanada Corp and Kinder Morgan Inc. We voted in favour of both resolutions and published our voting intentions ahead of both meetings.

Our starting point is that boards should understand the broader environmental and social consequences of business operations, set their own priorities, and report on outcomes. We will support well-founded sustainability resolutions that are aligned with our priorities. Any additional reporting requirements should be materially relevant and not place undue burdens on management. We have supported an average of one in three sustainability-related shareholder resolutions since 2010. In 2018, we voted in favour of 43.1 percent of such resolutions, up from 28.5 percent in 2017.

These included resolutions at Kinder Morgan Inc and Anadarko Petroleum Corp that asked management to report on the consequences of the two-degree global warming target for the companies' portfolios and received majority support. Our voting reflected our published expectation that companies in our portfolio should plan for different climate scenarios.

One type of resolution that stood out from previous years concerned responsible tax policies. One such resolution at Facebook Inc. won 1.4 percent of the vote. We supported the resolution in accordance with our expectations on tax and transparency.

Recent years have seen increased interest in how internet companies manage information and content. We voted in favour of resolutions at Twitter Inc, Alphabet Inc and Facebook Inc to increase transparency on how they are addressing these challenges. These resolutions won 35.6, 12.7 and 10.2 percent of the vote respectively.

Through our voting, we seek to strengthen governance, improve financial performance and promote responsible business practices.

# The fund’s voting at shareholder meetings

| | | |
|---|---|---|
| | 1998 | First equity investments |
| Public voting guidelines | 2003 | First vote at shareholder meeting: HSBC Holdings Plc, 28 March |
| Executive Board principles for corporate governance | 2004 | |
| | 2005 | All voting handled internally |
| | 2008 | Annual disclosure of voting |
| | 2009 | 5 shareholder proposals on separation of chairperson and CEO |
| | 2010 | Voting at 95% of shareholder meetings |
| Discussion note on corporate governance | 2012 | 6 shareholder proposals on proxy access |
| Advisory board on corproate governance established | 2013 | All votes published a day after the meeting |
| Global voting guidelines and positon paper on board elections in Sweden and the US | 2015 | First voting intention published |
| Position paper on CEO remuneration | 2017 | |
| Position paper on board composition and independence | 2018 | |

# Dialogue

**As a long-term investor, we engage in dialogue with companies. The aim of our dialogue is to promote good corporate governance and responsible business practices.**

In 2018, we held 3,256 meetings with 1,420 companies. The size of our investments gives us access to board members, senior management and specialists at companies in the portfolio. We are interested in understanding how companies are governed and how they manage sustainability issues. In addition, we discuss more traditional topics such as strategy, operations, risk management and capital allocation. We encourage portfolio companies to be open in their public reporting and communication.

Investor meetings are an important communication channel between companies and their shareholders. We generally meet company representatives at one of our offices. We also visit some companies, especially where we are interested in learning more about their operations. Meetings can also take place in conjunction with public events, such as investor conferences, or take the form of conference calls.

We are a large and long-term investor and communicate regularly with the boards of our largest companies. We are often one of the largest shareholders, and this dialogue is important for being a responsible investor. In 2018, the dialogue with our 50 largest holdings focused on the work of the board. We discussed how the board contributes to company strategy, the monitoring of performance and risk management, nomination processes and board composition, industry expertise on the board, the chairperson's role, executive remuneration and sustainability.

Besides direct dialogue with individual companies, we sometimes meet a larger number of companies to inform them about our expectations. In 2018, we organised a conference in Tokyo for around 300 Japanese companies where we presented our expectations for responsible business practices, reporting, board independence and executive remuneration. In France, we presented our

**Table 3** Company meetings by sector in 2018. FTSE classification

| Sector | Company meetings | Share of equity portfolio. Percent |
|---|---|---|
| Basic materials | 253 | 3.5 |
| Consumer goods | 574 | 9.5 |
| Consumer services | 223 | 5.3 |
| Financials | 893 | 15.9 |
| Health care | 262 | 7.8 |
| Industrials | 411 | 6.0 |
| Oil and gas | 114 | 4.0 |
| Technology | 205 | 9.0 |
| Tele-communications | 164 | 2.6 |
| Utilities | 157 | 2.1 |
| **Total** | **3,256** | **65.8** |

position on corporate governance to 20 members of the business federation AFEP (Association française des entreprises privées) which issues the national corporate governance code.

**Dialogue on strategic topics**
In our dialogue with companies, we prioritise a set of strategic topics that we follow up over a number of years. In 2018, the focus was on sustainability, board accountability and effectiveness, executive remuneration and shareholder rights.

Our long-term investment horizon and expectations for responsible business practices are a natural part of our dialogue with the board. We believe that a company's board and management should address relevant governance and sustainability challenges in their regular meetings with shareholders. We raised environmental, social or governance issues at 1,493 meetings in 2018. This corresponds to 46 percent of our meetings with companies during the year. We raised environmental issues at 33 percent of meetings, social issues at 24 percent, and governance issues at 78 percent.

In this dialogue, we inform companies about our expectations for good business practices, governance and sufficient disclosure, particularly in areas where we have published expectation



**Table 4** Company dialogue in 2018

| Category | Topic | Number of meetings | Share of equity portfolio. Percent |
|---|---|---|---|
| Environment | Climate change | 272 | 16.3 |
| | Water management | 75 | 4.9 |
| | Other environmental topics | 214 | 12.9 |
| Social issues | Human rights | 64 | 6.2 |
| | Children's rights | 27 | 2.5 |
| | Tax and transparency | 59 | 5.7 |
| | Anti-corruption | 50 | 6.2 |
| | Other social topics | 217 | 15.0 |
| Governance | Board accountability and effectiveness | 233 | 20.1 |
| | Remuneration | 196 | 19.0 |
| | Shareholder rights | 108 | 8.2 |
| | Other governance topics | 811 | 34.4 |

documents, position papers or voting guidelines. Practices often vary between the companies we engage with. We follow up areas where we believe companies can improve. We also engage with leading companies to learn from their experience.

### Sustainability

Our long-term investment horizon means that we have an interest in sustainable development. Our dialogue on sustainability is anchored in the expectations we have of companies. The most important topics raised in 2018 were banks' climate disclosure, deforestation, automotive supply chains, tax and transparency at UK companies, nutrient run-off from agriculture, the marketing of breast-milk substitutes, and the management of corruption risks.

#### Banks' climate disclosure

We use our ownership to help ensure that companies in the portfolio are equipped for the transition to a low-carbon economy. We consider it to be in the fund's interests for international climate goals to be achieved in an economically efficient manner. We want companies to give sufficient attention to climate issues and have the commercial flexibility to adjust to the transition.

In 2018, we engaged in dialogue with 24 global banks on climate-related disclosure. This followed up our dialogue with banks in 2017 on adopting the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The aim of this dialogue is to promote more relevant reporting and obtain a better understanding of how banks are applying the recommendations. We found that many banks back the recommendations. This means reporting on how they have addressed climate change in their governance work, strategy, risk management and the targets they have set themselves as a result of this. Of the 55 banks we originally contacted in 2017, 37 intended to report in accordance with the TCFD recommendations. Methods for climate scenario analysis are still evolving, and there is not yet any widely accepted standard. Twelve of the banks we contacted, including Barclays Plc, Citigroup Inc, BNP Paribas SA, Société Générale SA, Standard Chartered Plc and Banco Santander SA, participated in a pilot project with the UN Environment Programme (UNEP) during the year to define methods for scenario analysis.

#### Deforestation and financing

We continued our dialogue with Indonesian and Malaysian banks on their lending policies in 2018. We also asked them for improved reporting on deforestation risks in the light of climate change. This was a continuation of the dialogue we initiated in 2017 on the banks' policies on financing palm oil. We believe that banks that lend to palm oil producers should have policies to protect natural carbon sinks and avoid deforestation, destruction of peat bogs and exploitation of indigenous peoples and local communities. These principles promote sustainable management of tropical forests. Many leading companies have adopted a similar line. CIMB Group Holdings Bhd is one of the banks we have contacted about taking action to integrate sustainability issues into their business, including their policies and governance.

We also entered into dialogue with banks in Latin America during the year on their deforestation policies. According to Global Forest Watch, more than 60 percent of deforestation in Latin America between 2001 and 2015 was driven by the production of commodities. Our goal is to understand banks' approach to loans that contribute to deforestation. We are also encouraging banks to improve their due diligence to avoid financing deforestation. We have contacted five regional banks about these topics.

### Deforestation in Brazil

We also continued our dialogue with companies that buy and sell soya and meat in Brazil. The aim is to understand what companies are doing to manage deforestation risks, and promote internationally recognised standards for supply chain management. In this dialogue, we stress the need for better traceability of commodities in the supply chain, and the importance of ensuring that suppliers comply with buyers' policies. We are seeing various examples of measures that can make it easier to track the origins of commodities, such as satellite surveillance. Some companies have entered into partnerships with farmers or at sector level to develop joint standards. In 2018, Bunge Ltd launched a pilot project in a partnership with Banco Santander (Brasil) SA and The Nature Conservancy to offer loans to farmers in the Cerrado who commit to preserving uncleared land.

### Automotive supply chains

The transition to a low-carbon economy will also have social implications. In 2018, we engaged in dialogue with companies in the automotive sector on how they can seize opportunities and manage challenges in the transition. For example, the mining of cobalt, an essential



Deforestation in Brazil

component of lithium batteries used in electric vehicles, is associated with very poor working conditions, including the use of child labour. We contacted 14 companies to understand how they are managing the risk of human rights violations of this kind in their supply chains. We also asked them about their plans for electric cars and how they will ensure sustainable supplies of cobalt to realise these plans. Some of the companies we contacted, including Bayerische Motoren Werke AG (BMW), Daimler AG, Toyota Motor Corp and Volkswagen AG, are members of partnerships such as the Responsible Minerals Initiative, Responsible Cobalt Initiative and Drive Sustainability. BMW has also announced plans to buy cobalt directly from mining companies to reduce supply chain risks.

### Tax and transparency at UK companies

As part of the follow-up of our expectations on tax and transparency, we engaged in dialogue with a number of companies in 2018 that are required by UK law to publish a strategy setting out their approach to tax, their management of tax risks and the board's responsibility for tax matters. The strategy must be updated regularly. A review of available strategies revealed considerable variations in scope and content. The aim of the dialogue is to discuss our expectations on tax and transparency, encourage companies to develop their own strategies, and learn from good examples of such reporting. By the end of 2018, we had entered into talks with six companies on this topic, including leading players such as Anglo American Plc and BHP Billiton Plc.

### Nutrient run-off from agriculture

We initiated a dialogue with companies in 2018 on agricultural runoff. Poor management of fertiliser and organic waste can often lead to algal blooms in both fresh and salt water. This in turn can cause oxygen depletion with severe negative consequences for the affected ecosystems. We have entered into talks with six large food and meat producers to understand the extent of runoff in their value chains and how they are managing this issue. We also want to draw attention to an area where corporate disclosure is currently limited. The companies contacted include Tyson Foods Inc and General Mills Inc. Responses received to date suggest that the companies are aware of the issue and have taken steps at their own production facilities, but are not working on it systematically throughout the value chain.

### Marketing of breast-milk substitutes

In 2018, we initiated a dialogue on responsible marketing with producers of breast-milk substitutes. The aim of the dialogue was to learn more about the companies' policies for marketing these products, assessing the risks to children's rights, and monitoring this in their value chains. Our expectations on children's rights provide a basis for following up responsible marketing at portfolio companies. Breastfeeding is closely associated with child health and survival. Misleading marketing of breast-milk substitutes can pose a risk to children's fundamental rights.

We contacted ten companies to discuss this topic, including those that we consider to be leaders in many areas, such as Nestlé SA and Danone SA. To begin with, we requested information on the companies' implementation and monitoring of actions to ensure compliance with the WHO's International Code of Marketing of Breastmilk Substitutes. The responses we received revealed major differences in companies' approach to this issue. Leading companies had formulated policies for how they market their products and reported on the implementation of these policies. Some also published statistics on policy breaches, the reasons for them, and the actions taken to prevent further occurrences. In our dialogue, a number of Australian and Chinese companies explained how they have been working to comply with national standards for marketing breast-milk substitutes, such as the MAIF Agreement for manufacturers and importers of infant formulas in Australia. Other companies have chosen not to produce their own policies on marketing these products and publish little information on how they approach marketing in practice. Some companies highlighted challenges with digital marketing and pointed out that it is difficult to control how customers refer to products.

### Managing corruption risks

At the end of 2018, we initiated a dialogue with seven companies on anti-corruption disclosure. The aim was to encourage the companies to improve their reporting on how they manage corruption risks, and on the results of internal and external evaluations of their anti-corruption efforts.

After we published our expectation document on anti-corruption in February 2018, we began a dialogue with companies on the topic. Our expectation is that companies take effective action to prevent corruption. We assessed 30 companies' anti-corruption disclosure and found that some could improve their reporting. The analysis included companies with operations in sectors with a high risk of corruption, including oil and gas, mining, construction, industrial goods and services, telecommunications, financial services and pharmaceuticals.

## Board accountability and effectiveness

We believe that listed companies are best served by a clear separation of roles and responsibilities between board and management. Management takes operational business decisions and answers to the board on the company's risk management, capital allocation and implementation of long-term strategy. The board is responsible for setting company strategy, overseeing management and acting in shareholders' interests. This presupposes that shareholders can evaluate the board's work and hold it to account. For this reason, board accountability is a priority for us.

We have an ongoing dialogue with the boards of the largest companies in our portfolio and aim to meet the largest 50 at least every three years. We have had meetings at board level with 40 of these companies in the past three years, 21 of them in 2018. We also have a similar dialogue with other companies in the portfolio and had a total of 199 meetings at board level in 2018.

In this dialogue, we discuss the board's self-assessment process and what experience it has gained. We request an overview of how the board identifies good board candidates, and we discuss the board's current composition and planned changes. We want to understand whether its skills are aligned with the company's strategy and challenges. The board's independence, and its openness to members with different backgrounds, are key elements in this dialogue.

The demands on company boards have increased in recent years. Members are required to spend more time on board activities, and to have a greater understanding of the company and its sector. We therefore systematically raise the matter of the board's industry expertise and members' insight into challenges and opportunities in the sector.

Often we encounter the same individual on the boards of more than one of our companies, and it is important to us that this person is in a position to represent our interests on all of these boards. We find that companies understand our position. Some board members with numerous directorships have reduced the number of positions they hold, and some companies have introduced policies for how many directorships their members may have at other companies. Novartis AG, for example, has included in its articles of incorporation a limit of four directorships at other listed companies for its board members, with a chairpersonship counting double. The board must also approve all such positions in advance.

Electoral arrangements are also important in underlining the board's accountability to shareholders. Some 90 percent of companies in the US S&P 500 Index now require candidates to win a majority vote rather than automatically being elected in the absence of other candidates. In Sweden, 41 companies accounting for about 60 percent of the value of our holdings in the country have switched to individual director elections rather than having shareholders vote on the entire board. This unbundling enables shareholders to differentiate their voting and hold individual members to account for matters that concern them specifically rather than the board as a whole. Boliden AB introduced unbundled elections in 2018 with reference to our position paper on the topic.

We raised the composition of the board and the need for sufficient industry expertise in our dialogue with 191 companies during the year. We observed, for example, that Akzo Nobel NV and Wells Fargo & Co reported an increase in the amount of industry expertise on the board.

The board should collectively have a thorough understanding of the industry in which the company operates, and sufficient industry expertise to monitor management's implementation of corporate strategy. We therefore believe that a majority of independent board members should have fundamental industry insight, and at least two should have worked in the industry.

Companies are attaching ever more importance to explaining and justifying the composition of the board, and we are seeing greater openness about the skills of individual members.

In Sweden, we participate in the nomination process for the boards of some of our largest investments. In 2018, we decided to remain on the nomination committees of Volvo AB, Svensk Cellulosa AB (SCA), Boliden AB, Essity AB and Electrolux AB, and accepted an invitation to serve on the nomination committee at Alfa Laval AB. In this work, we concentrate on a sound nomination process rather than proposing specific candidates. Our priority is for the process to be transparent and result in the nomination of independent candidates with relevant experience and expertise, taking due account of the board's existing composition and whether candidates have sufficient time to take on a new position.

In our work on strengthening the role of the board, we have looked particularly at the role of the chairperson. A board must be able to make objective assessments of the company's operations and take decisions independently of management. We therefore consider it most appropriate for the board to be chaired by a person who is not also the CEO. In some markets, including the US and France, combining the two roles is common. We raised this issue at meetings with 67 companies in 2018. We stressed that this did not reflect a lack of confidence in the current incumbent, but called for a commitment to separate these roles the next time a CEO is recruited.

### Executive remuneration

Executive remuneration is subject to some form of shareholder approval in many advanced markets and was once again the most common topic that companies raised with us. Since we published our position paper on CEO remuneration in 2017, we have observed considerable interest in our position, which was the starting point for the discussion of executive pay with 170 companies. We have mainly discussed executive remuneration with leading companies from most sectors in the US, the UK, France, Germany and Switzerland, but we have also emphasised our position in talks with smaller companies.

In this dialogue, we attach importance to the board's future plans for executive pay. We want remuneration plans to be more straightforward and transparent, and restricted to cash and ordinary shares. Pension obligations should be limited, and other benefits should have a clear business rationale. One important part of our position is that the equity component of executive pay must be locked in for a long period of at least five and preferably ten years, even if the executive leaves the company voluntarily by resigning or retiring. This ensures that executive pay packages contribute to long-term, sustainable strategies and good succession planning at all times.

Our dialogue with The Weir Group Plc is an example of this. After extensive work on revising its remuneration plan, the company tabled a resolution at the 2018 shareholder meeting to introduce a pay structure that largely reflects our standpoint. The resolution was supported by more than 92 percent of the vote. We have also followed up cases where companies have met strong opposition from shareholders to their remuneration plans.

We acknowledge that there can be a considerable gap between our position on executive remuneration and the practices we see at companies. When assessing existing structures, we look first at whether the company provides enough information for us to understand the plan and its potential cost. We then look at the shareholding requirements for the CEO and what happens to performance-based pay on departure. We also look at the relationship between pay and performance, and how this is reflected in long-term value creation for shareholders.

Despite the gap between standard practice and our position paper, we are seeing signs of other shareholders too calling for more long-term remuneration plans where shares remain locked in after departure. The Investment Association, the trade body for investment managers in the UK, published an expectation in 2018 that the CEO is required to remain a shareholder in the company for two years post employment. Dutch investor forum Eumedion has argued for the same, and the commission behind the German corporate governance code has signalled similar changes.

### Shareholder rights

The future value of the fund is dependent on the value created by the companies we invest in, and on shareholders receiving a reasonable and proportionate share of corporate profits. We engage with companies to enhance shareholder rights and ensure equal treatment of all shareholders. We raise these topics regularly in our dialogue with companies ahead of the annual

## Selected company dialogue on strategic topics

| Category | Expectation | Company | Details | Start |
|---|---|---|---|---|
| Environment | Climate change | DBS Group Holdings Ltd | Financing of palm oil | 2017 |
| | | Banco do Brasil SA | Financing of soy, beef | 2018 |
| | | Banco Bradesco SA | Financing of soy, beef | 2018 |
| | | CJ CheilJedang Corp | Soy commodity traders | 2018 |
| | | Barclays Plc | Implementation of the TCFD recommendations | 2017 |
| | | Swedbank AB | Implementation of the TCFD recommendations | 2017 |
| | Water management | Hormel Foods Corp | Nutrient run-off | 2018 |
| | | WH Group Ltd | Nutrient run-off | 2018 |
| | | Sanderson Farms Inc | Nutrient run-off | 2018 |
| Social issues | Children's rights | China Mengniu Dairy Co Ltd | Infant formula marketing | 2018 |
| | | Abbott Laboratories | Infant formula marketing | 2018 |
| | | Bellamy's Australia Ltd | Infant formula marketing | 2018 |
| | Human rights | Peugeot SA | Responsible cobalt sourcing | 2018 |
| | | General Motors Co | Responsible cobalt sourcing | 2018 |
| | | Fiat Chrysler Automobiles NV | Responsible cobalt sourcing | 2018 |
| | Tax and transparency | Anglo American Plc | Tax policies – UK companies | 2018 |
| | | BHP Billiton Plc | Tax policies – UK companies | 2018 |
| | | BP Plc | Tax policies – UK companies | 2018 |
| | Anti-corruption | Novartis AG | Reporting in exposed sectors | 2018 |
| | | Glencore Plc | Reporting in exposed sectors | 2018 |
| | | Credit Suisse Group AG | Reporting in exposed sectors | 2018 |

| Category | Expectation | Company | Details | Start |
|---|---|---|---|---|
| Goverance | Board accountability and effectiveness | Akzo Nobel NV | Industry expertise | 2017 |
| | | Wells Fargo & Co | Industry expertise | 2017 |
| | | Total SA | Industry expertise | 2017 |
| | CEO remuneration | The Weir Group Plc | Long-term and transparent remune-ration | 2017 |
| | | Vodafone Group Plc | Long-term and transparent remune-ration | 2018 |
| | | Inmarsat Plc | Reaction to low shareholder support | 2018 |
| | Shareholder rights | Tesla Inc | Proxy access | 2018 |
| | | Raytheon Co | Right to an extraordinary shareholder meeting | 2018 |
| | | United Technologies Corp | Right to an extraordinary shareholder meeting | 2018 |

shareholder meeting, and when discussing changes to their articles of association and authorities to increase or reduce share capital. We discussed shareholder rights at 108 company meetings in 2018.

We looked during the year at shareholders' right to call extraordinary meetings. This is an important right to ensure oversight of the board and give shareholders the right to decide on fundamental strategic changes. Many companies give shareholders this right, but in our dialogue with companies such as Raytheon Co and United Technologies Corp we are looking to strengthen this right by reducing the minimum shareholding set by the company.

We also continued our dialogue on giving shareholders proxy access – the right to nominate alternative board candidates on the ordinary agenda for the shareholder meeting. After we tabled shareholder resolutions on this topic ourselves in 2012 and 2013, proxy access has been introduced on a large scale in the US in recent years. This dialogue mainly now concerns changes to a right that has already been granted, but we also raise the topic with companies that have still not introduced proxy access, such as Tesla Inc.

We want all shares to carry the same voting rights. We nevertheless see companies issuing different classes of share with different voting rights in a number of markets, including Sweden, Germany and the US. We believe that any differentiation in the treatment of shareholders has the potential to lead to conflicts of interest. An example of this is companies in France where the largest shareholder has consolidated its influence by introducing double voting rights for long-term shareholders at the expense of other shareholders. This has meant that shareholders can no longer exercise influence in proportion to the size of their investment.

**Dialogue on incidents**

In addition to these strategic topics for company dialogue in 2018, we monitored ongoing corporate governance and sustainability developments at companies in the portfolio. We consider exercising our ownership rights where we see signs of weak governance that could put the fund's assets at risk. In these cases, we may initiate dialogue with the board or management to obtain more information and express our viewpoint. We may also amend our voting, collaborate with other investors, contact regulators or take legal action.

The events to which we responded in 2018 can mainly be divided into two categories: risk incidents and corporate actions.

### Risk incidents

Risk incidents might be allegations of corruption, fraud, pollution, deforestation, health and safety violations or negative effects on local communities. We keep an eye on companies and markets using various information systems and global media monitoring to capture incidents that may be relevant for the fund. Our goal as an investor is to validate the information we have received and assess the risk before deciding on further steps to safeguard the fund's long-term interests. Examples of incidents in 2018 include allegations of corruption at Glencore Plc, Kirin Holdings Co Ltd's handling of human rights in its operations in Myanmar, and the ongoing review of Lundin Petroleum AB's alleged involvement in the conflict in Sudan. Another example is our dialogue with Danske Bank A/S where suspicions of money laundering led to the replacement of its CEO and chairman.

Other incidents may give us an opportunity to communicate on specific topics. For example, we participated in Standard Chartered Plc's consultation on its lending policies and emphasised our climate expectations. The company subsequently announced that it would no longer finance new coal-fired power production.

### Corporate actions

Corporate actions are initiated by a public company and affect the securities issued by that company. They include dividends, rights issues, stock splits, mergers and acquisitions, and spin-offs. These actions typically require approval from the board and shareholders. Our goal as a shareholder is to gain sufficient understanding of the proposed action and its likely impact on our investment, so that we can make considered voting and investment decisions. Examples of corporate actions in 2018 include Unilever NV's plan to simplify its corporate structure, the rejected takeover bid and subsequent board shake-up at Akzo Nobel NV, and governance and remuneration changes at Tesla Inc.

## Dialogue on ethical criteria

The ethical guidelines for the fund state that, before making a decision on observation or exclusion, Norges Bank's Executive Board should consider whether other measures, including the exercise of ownership rights, may be more suited to reduce the risk of continued norm violations, or whether such alternative measures may be more appropriate for other reasons. In addition to earlier decisions, the Executive Board decided in 2018 that active ownership was appropriate in one case.

### Serious violations of human rights

In April 2018, the Executive Board decided to ask Norges Bank Investment Management to raise the risk of child labour at Advanta Seeds Pty Ltd, a subsidiary of UPL Ltd, as part of our active ownership work. The decision followed a recommendation from the Council on Ethics in March 2018 to place the company under observation.

#### UPL Ltd

UPL Ltd produces artificial fertilisers, seeds and other agricultural products. The goal of our dialogue with UPL Ltd is to reduce the use of child labour at its subsidiary Advanta Seeds Pty Ltd, which produces various varieties of seed in India. We expect the company to have governance structures and good systems in place to assess the risk of child labour and take preventive action.

We initiated a dialogue with UPL Ltd on this topic in 2018. We held a first meeting with representatives of the company's management, who informed us about their work to combat child labour and planned actions to further improve this work. We wanted a better understanding of how the company monitors these actions at its subsidiaries, and how the company measures the efficacy of work to combat child labour. The company has introduced new measures to manage its supply chain. These include better monitoring of suppliers, the use of financial incentives for suppliers who can demonstrate that child labour does not occur, and consequences for suppliers that do not comply with the ban on child labour. The company is also working on various projects to raise awareness of children's rights and communicate zero tolerance of child labour to local farmers and suppliers. We will continue to monitor UPL's plans and actions, and assess its progress towards our goal of reducing child labour in the company's supply chain.

## Severe environmental damage

In October 2013, the Ministry of Finance asked Norges Bank to include oil spills and environmental conditions in the Niger Delta in our ownership work with the oil and gas companies Eni SpA and Royal Dutch Shell Plc for a period of five to ten years. The ministry also asked us to follow up on the environmental impact of the mining company AngloGold Ashanti Ltd's operations in Ghana through active ownership over a five-year period.

The goal of our dialogue with Eni SpA and Royal Dutch Shell Plc is to contribute to a reduction in the number and volume of oil spills and ensure immediate and effective remediation of spills. Oil spills due to sabotage, theft and operational failures are a concern for onshore oil production and pipelines in the Niger Delta. The spills are a main source of environmental damage in the delta. The number of spills from pipelines operated by Eni SpA continued to fall in 2018, while total volumes increased. For Royal Shell Plc's activities both the number and total volume of spills increased. Royal Shell Plc attributes this to an increase in theft and sabotage ahead of the upcoming elections in Nigeria.

In a dialogue with management at the two companies, we discussed progress on previously announced actions. These include increased surveillance of pipelines, preventive maintenance, better protection of wellheads, faster response to leaks, and improved relations with local communities. We are encouraged by the reported improvements in preventive measures and dialogue with local communities. These are a step in the right direction in reducing the risks identified by the Council on Ethics, but we will continue to monitor developments to see whether these actions lead to further

**Chart 2** Eni SpA spil statistics. Number of spills (left-hand axis) and volume of spills in thousands of tonnes (right-hand axis). Spills > 1 BBL. Data per 30 November 2018

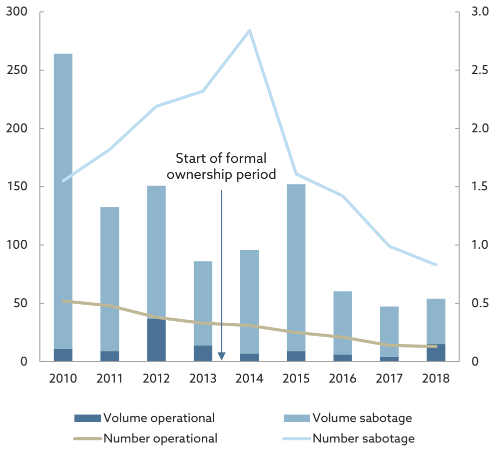
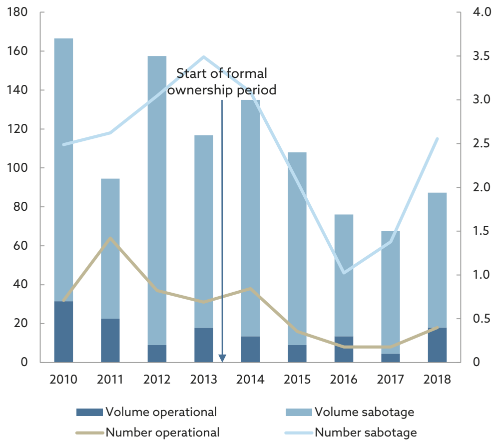



**Chart 3** Royal Dutch Shell Plc spill statistics. Number of spills (left-hand axis) and volume of spills in thousands of tonnes (right-hand axis). Spills > 100 kg



reductions in oil spills and environmental damage in the Niger Delta.

In February 2018, AngloGold Ashanti Ltd announced a plan to redevelop the Obuasi mine as a mechanised underground operation starting up in the third quarter of 2019. The plan was ratified by the Ghanaian parliament in July 2018 and has also been approved by the country's environmental protection authorities.

The original five-year period for excercising ownership in AngloGold Ashanti has elapsed. An overall assessment indicates that the company has made progress towards our goals. It remains to be seen, however, whether the reopened mine will be operated in accordance with internationally recognised standards, and whether older pollution in the area will be adequately dealt with by the company. Norges Bank's Executive Board decided in December 2018 to continue working with the company for another three years.

### Gross corruption

The Executive Board decided in May 2017 to ask Norges Bank Investment Management to raise the risk of gross corruption with Eni SpA and Saipem SpA as part of our active ownership work. This followed an initial recommendation by the Council on Ethics in December 2016 to place the companies under observation.

We held meetings with the two companies in 2018 to obtain information on their work against corruption. Our understanding from these meetings is that the companies have taken steps to prevent corruption. For example, Eni SpA has set up a dedicated anti-corruption department. The company has also revised its anti-corruption policy and had its anti-corruption programme certified in accordance with ISO 37001. Eni SpA developed a new approach and method for identifying and reducing corruption risks in 2018. According to the company, this has helped draw attention to the activities that are most exposed to corruption risks.

Training for employees on dealing with corruption risks was another focus area for Eni SpA in 2018. For the first time, the company carried out a detailed survey of all employees and identified the level of exposure to corruption risks for each individual employee. Eni SpA also provided training for its partners in a number of countries. Eni SpA developed a new self-assessment method for the efficacy of anti-corruption work in 2017, and 14 of its companies carried out these assessments in 2018.

Saipem SpA strengthened its approach to identifying corruption risks at its subsidiaries in 2018. The company's anti-corruption department is now working with management at the subsidiaries to map corruption risks. Changes have also been made to the subsidiaries' governance structure.

Saipem SpA's anti-corruption programme was certified in accordance with ISO 37001 in 2018. The certification also covers its subsidiaries. In line with the recommendations of this certification scheme, Saipem SpA has strengthened its approach to identifying corruption risks and improved its internal information management systems. At our meetings, we raised the topic of internal controls and regular evaluation of the efficacy of actions taken.

# Follow-up

**We work with companies, investors and other stakeholders to improve the information made available to the market and promote responsible business practices. This is particularly relevant where many companies in the same industry or value chain face the same challenges.**

An important part of our work is to understand global trends that could affect the fund's ability to generate a long-term return. Economic activity in one sector can impose substantial indirect costs on other sectors and society as a whole. We want to learn whether companies in high-risk sectors are equipped to manage risks and take advantage of business opportunities. Understanding of how sustainability can impact on company performance and fund returns is constantly evolving. We assess companies' reporting on strategy, policies, risk management, supply chain management and objectives. Due to companies' limited disclosure of performance indicators in these areas, these assessments will not always reflect the actual results of their work on sustainability.

Academic institutions, the media and NGOs are important sources of information. We encourage stakeholders to share information that they believe could be relevant for our investments.

In 2018, we assessed 1,700 companies' reporting on climate change, 598 companies' reporting on water management and 600 companies' reporting on children's rights. We also looked at how selected companies report on deforestation, anti-corruption, human rights, tax and ocean sustainability. The companies assessed accounted for 62 percent of the equity portfolio's market value at the end of the year.

We have been assessing companies' sustainability reporting since 2008.

Our sustainability analyses rely on satisfactory corporate disclosure. Our assessments uncover practices and trends that are useful when following up our expectations of companies. The assessments can provide information that we can use in our voting, strategic dialogue and follow-up of risk incidents. We reach out to companies with poor or limited disclosure. In this dialogue, we encourage them to improve their reporting by participating in established disclosure initiatives. In 2018, we sent letters to 35 companies on children's rights, 35 on climate change and 30 on water management. Of the companies we contacted about poor disclosure in 2017, 36 percent of those contacted about climate change have now introduced climate reporting. With 39 percent of companies contacted about water management and 18 percent contacted about children's rights we have seen improved disclosure.

We support initiatives that bring companies together to find joint solutions and standards for sustainable business conduct. These initiatives work best when numerous companies in a particular sector or value chain face the same challenges. The starting point for our expectations of companies is that boards should establish suitable strategies, control functions and reporting procedures. At the same time, many companies face practical challenges in doing so. The need for standardisation and more universal approaches is considerable. Our initiatives look at topics such as supply chain management, disclosure frameworks, and key metrics. By participating in initiatives to develop knowledge and solutions in these areas, we create a better basis for assessing individual companies' strategies and discussing them with their boards.

## Good results on sustainability disclosure. Examples from various sectors

| Childrens' righs | Climate change | Water management |
|---|---|---|
| The Coca-Cola Co | Iberdrola SA | Danone SA |
| NIKE Inc | SSE Plc | Kellogg Co |
| Stora Enso OYJ | Westpac Banking Corp | Gildan Activewear Inc |
| Marks & Spencer Group Plc | Akzo Nobel NV | Enel SpA |
| Anglo American Plc | Tokio Marine Holdings Inc | Anheuser-Busch InBev SA |



| Human rights | Tax and transparency | Anti-corruption |
|---|---|---|
| ArcelorMIttal | BHP Billiton Plc | BHP Billiton Plc |
| thyssenkrupp AG | Unilever Plc | Anglo American Plc |
| UPM-Kymnmene Oyj | Anglo American Plc | Deutsche Telekom AG |
| Stora Enso Oyj | Banco Santander SA | Novo Nordisk A/S |
| Aperam SA | HSBC Holdings Plc | Roche Holding AG |

Children are the key to future prosperity but also the most vulnerable members of society.

**Children's rights**

Children are the key to future prosperity but also the most vulnerable members of society. As a fund investing for future generations, we attach importance to companies respecting children's rights and taking action to prevent child labour.

We have been assessing how selected companies address children's rights since 2008. These are companies with activities or supply chains in high-risk sectors. In 2018, we assessed 600 companies in the automotive, retail, mining, apparel, food and beverage, commodities, basic materials, and technology hardware and equipment sectors. We also looked at selected companies in different sectors. The assessments were based on the most recently reported information from the companies.

The companies' reporting was evaluated against indicators for governance structure, policies for preventing child labour, risk assessment, strategy and implementation, supply chain management, performance reporting and dialogue with stakeholders. In 2018, we identified 39 companies with very good results and 119 with good results.

Overall, there were no major differences in companies' reporting from 2017 to 2018, but 23 percent of companies that published no significant information on children's rights in 2017 began to do so in 2018. There was also a slight increase in the number of companies publishing their own policies on child labour, having relevant action plans to prevent child labour, and having monitoring systems to avoid violations of children's rights.

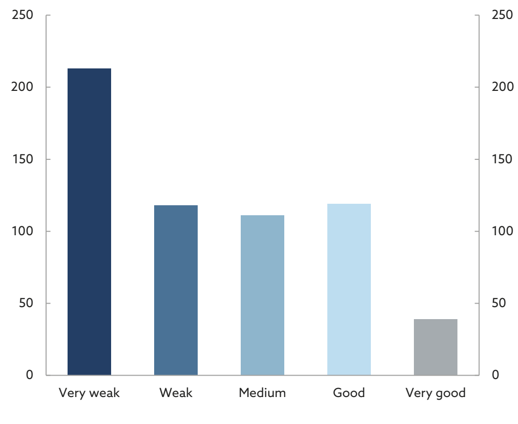
The companies assessed had relatively good results for policies and having integrated children's rights and wider social topics into their strategy. The companies generally received lower scores for having good action plans in place to combat child labour, collaboration with other stakeholders, and disclosure and metrics for child labour.

There were major variations between sectors. Technology hardware and equipment companies had the best reporting overall, along with mining companies, carmakers and garment producers. Many of these companies have global brands and value chains in areas with a high risk of child labour.

### Children's rights in global supply chains

Child labour is a challenge in the supply chain for the apparel and footwear sector, but children's rights can also be affected by the sector in other ways. Children are impacted directly and indirectly throughout the value chain, for example through working conditions for their guardians.

**Chart 4** Results for companies we assessed on children's rights in 2018. Number of companies



In 2017, we signed an agreement with UNICEF to establish a network for children's rights in the apparel and footwear sector. The aim is to help improve the management of children's rights in companies' supply chains.

Since 2017, the network has brought together a group of leading companies in the sector, including the likes of Hennes & Mauritz AB, Kering SA and VF Corp. In 2018, we organised meetings where the companies exchanged experience and discussed challenges from working on children's rights in their supply chains. Companies, suppliers and experts also attended a meeting in Bangladesh, which included a visit to factories and talks with its management and local civil society.

Learnings from the initiative were distilled into a manual that companies can use in their work. The manual is based on how children are affected in the apparel supply chain and on challenges in the current approach to children's rights, and provides recommendations and actions that the companies can assess their work against. At the most recent gathering in Geneva in November, the companies provided feedback on the manual and discussed how they can use it in their supply chains. Some expressed an interest in continuing to work with the recommendations and actions presented by the manual.

**Water management**
Companies that use water unsustainably can impose substantial costs on other companies and society as a whole, and this in turn can impact on the fund's long-term return.

We have been assessing companies exposed to water risks since 2010. In 2018, we assessed 598 companies in the chemical, consumer goods, farming and fishing, food and beverage, mining, oil and gas, pulp and paper, and power sectors. Our analyses included a large number of companies with operations in emerging markets that are exposed to water shortages. The assessments were based on the most recently reported information from the companies.

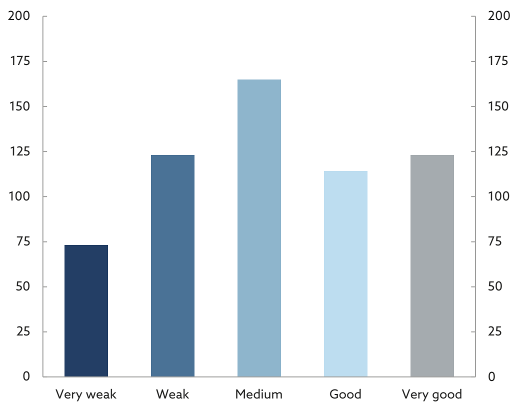
Companies' reporting was assessed against indicators for governance structure, transparency on risk management, action plans for identified risks, supply chain management, and performance reporting. As in previous years, there was considerable variation in the level of reporting. In 2018, we identified 123 companies with very good results and 114 with good results.

In general, we saw an improvement in companies' reporting on water management from 2017 to 2018. On average, companies assessed in both years improved their scores by around 8 percentage points. The greatest improvement was against the indicators for risk management and governance structure. We saw more companies publishing an assessment of water risk in their own operations and their value chains, and either the board or a board committee directly overseeing water management at the company. Around 30 percent of companies with no reporting in 2017 began to report on water management in 2018. All in all, 93 percent of companies assessed published some relevant information on water management. Supply chain management and performance reporting were the indicators where disclosure was generally weakest.

Again, there were variations between sectors. Around 80 percent of the oil and gas companies assessed had policies on water management, but only around 50 percent of companies in farming and fishing. Pul and paper was the sector with the best overall reporting.

### Water risk in agricultural value chains
Farming accounts for around 70 percent of freshwater consumption worldwide and is an important source of pollution of groundwater, rivers and lakes. Companies that are dependent on agricultural produce – primarily food and beverage producers – may be exposed to risks from overconsumption and pollution of water in their value chains. They could end up having reduced access to water, having penalties imposed by the authorities, or coming into conflict with local communities.

**Chart 5** Results for companies we assessed on water management in 2018. Number of companies

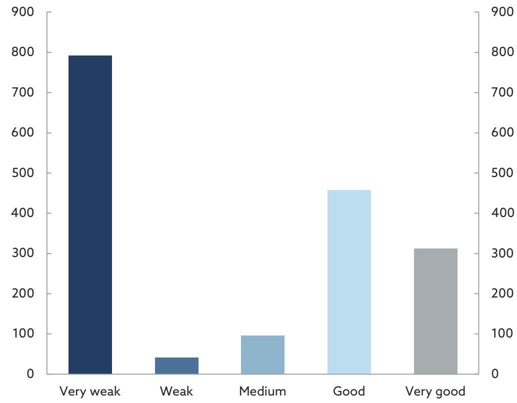


In June 2018, we organised a working meeting with CDP's water programme, inviting a number of companies and investors to discuss how companies can best manage and report on this type of risk. Large companies such as Anheuser-Busch InBev SA, the Coca-Cola Company and the Campbell Soup Co attended the meeting and discussed how investors use the information companies provide, the challenges of working with several layers of suppliers, and the potential for joint solutions where multiple players operate in the same water systems. We encourage companies to report on water consumption and pollution through CDP's water programme, and we participate in CDP's Water Advisory Council to contribute to the further development of the water questionnaire and the water programme.

**Climate change**
Climate change could affect company and portfolio returns over time. It could also open up business opportunities. We have been assessing how companies disclose on climate risks since 2010. In 2018, we assessed the reporting of 1,700 companies in 12 sectors: automotive, banks, insurance, basic materials, building materials, chemical, consumer goods, diversified industrials, utilities, oil and gas, real estate and transport. We based the assessments on company data reported to CDP and selected additional data.

Companies' reporting was assessed against indicators for corporate governance, strategy, risk management and performance reporting. There was considerable variation in the level of climate reporting across both companies and sectors. In 2018, we identified 313 companies with very good results and 458 with good results. 46 percent of companies in the selected sectors did not report data to CDP, compared with 55 percent in 2017. We also saw a slight improvement in companies' reporting on climate change in 2018. In general, we are seeing better reporting on governance and processes for risk management than on strategy and actual performance against specific metrics. Power utility companies, banks and carmakers had the best overall reporting. More than half of the companies in the building materials, oil and gas and real estate sectors had very weak reporting. For the first time, we looked at whether companies disclose information in line with the TCFD recommendations. Only 61 of the companies assessed did so – mostly in the banking and insurance sectors and a number of oil and gas and power utility companies. On the other hand, 26 percent of companies stated that they are now conducting scenario analyses. Fewer than 20 percent integrate internal carbon prices in investment decisions. We also looked for the first time at how companies in the consumer goods, food and beverage, and pulp and paper sectors report on deforestation. Our assessment was based on information submitted by companies themselves to CDP's forests programme. We also considered data from Global Canopy's Forest 500 and the Soft Commodity Risk Platform (SCRIPT). The reporting covers strategy, risk management and

**Chart 6** Results for companies we assessed on climate change in 2018. Number of companies



metrics as described in our expectation document on climate change. We found that 60 percent of companies had very weak reporting on deforestation. Reporting by pulp and paper companies is better than that of consumer goods companies. Generally speaking, European companies' reporting was better than that of companies elsewhere.

### Climate information for the financial sector

We expect the companies we invest in to consider the sensitivity of their long-term business strategy and profitability to future climate scenarios. Shortages of data, methods and tools are hampering the development of such practices.

In 2018, we took part in a pilot project led by UN Environment (UNEP) to develop methods to support investor disclosures in line with the recommendations of the TCFD. The group consists of 20 global institutional investors. Most of the group's work has involved developing analytical tools to assess portfolio risks and opportunities in different future climate scenarios. The tools look at both physical risks and transition risks and opportunities to equities, corporate bonds and real estate. We participate in working meetings and contribute insights from our own work on climate analyses. UNEP has chosen the supplier Carbon Delta to contribute to the development of models and perform various scenario analyses for the project. The project gives us an opportunity to explore different models for scenario analysis and look at issues in different asset classes, such as equities, bonds and real estate. The group will present will present a synthesis report written by the independent adviser Vivid Economics in 2019. The report will discuss project findings, methods for scenario analysis and provide selected case studies.

### The Sovereign Wealth Fund Working Group

In the longer term, climate change may impact on investors' ability to deliver returns. Sovereign wealth funds are by their very nature long-term vehicles and often diversified across numerous different investments. They are therefore exposed to financial risks from long-term climate change. Since December 2017, we have been part of a working group alongside five other sovereign wealth funds to develop a framework for integrating opportunities and managing risks in investment portfolios in the transition to a low-carbon economy. The group published its framework for managing climate risks in sovereign wealth funds the same day. The premise for the framework is that a sovereign wealth fund has a long investment horizon and should therefore take account of the long-term effects of climate change in its strategy. The funds in the working group called on portfolio companies to manage climate risks and report on the actions they are taking. The funds will integrate risks and opportunities from climate change into their investment strategies in line with their respective mandates.

The working group has continued to work on exchanging experience of how large sovereign wealth funds can manage opportunities and risks from climate change, partly through expectations of external managers, use of climate scenarios and measurement of carbon footprints. The group has also been in contact with other investors to establish broader support for the framework.

**Human rights**
We consider respect for human rights to be fundamental to good business practices and legitimate markets. We therefore encourage companies to be transparent about how they work on human rights and integrate them into business operations. We also want to know more about companies' processes, findings and actions in areas such as risk management and supply chain management. In 2018, we expanded our assessment of companies with activities in sectors with an elevated risk of adverse impacts on human rights. These include companies in the automotive, retail, mining, apparel, food and beverage, basic materials, commodities and technology hardware and equipment sectors. The assessments were based on third-party information on the content of the companies' human rights policies.

Around 60 percent of the 600 companies assessed reported that they integrated the economic impact of social issues, including human rights, into their strategic planning. For the companies that were assessed in both 2017 and 2018, this represented an increase of 6 percentage points.

We also looked at a selection of companies in the group to assess the scope and content of their public policies on human rights. We observed that around 40 percent either had no public policy or had only issued a general statement on human rights. The other companies had specific policies, but of varied scope.

### Business and human rights
The UN Guiding Principles on Business and Human Rights set out companies' responsibility to respect human rights. At the same time, there is a need for more knowledge about companies' work on human rights, and for the development of standards and reporting in this area. We want to gain a better insight into what determines whether the steps that businesses take to support human rights are effective.

In 2017, we signed an agreement with Shift, a non-profit organisation working with the UN Guiding Principles, to provide financial support for its new initiative Valuing Respect for a period of three years. Shift is looking to find more appropriate ways of evaluating companies' work on respecting human rights and preventing violations, including more accurate performance indicators. Our aim in supporting this initiative is to help ensure that companies channel resources into measures that have a positive effect on human rights and improve reporting on this area.

The initiative was launched in February 2018, and Shift has mapped existing models and tools used to evaluate companies' work on human rights. Shift organised four seminars during the year – in New York, London, Singapore and Johannesburg – where companies, investors, NGOs, trade bodies and researchers discussed challenges and new approaches to companies' work on human rights. Shift has published a research agenda with three objectives: to establish an empirical baseline for the current reality and current problems, to engage across sectors and disciplines to obtain broad input and contribute to better practices, and to identify innovative solutions with the potential to improve evaluation of the business sector's human rights performance. Summaries from the seminars are available on the project portal: www.valuingrespect.org.

### The global apparel supply chain

Good working conditions are essential for a sustainable apparel sector. However, there is no universal standard for assessing and monitoring working conditions in the apparel supply chain. Companies perform assessments of this kind as part of their own processes for supervising and auditing suppliers. This leads to extensive duplication of the same work, resulting in higher costs for the sector as a whole. This company-specific monitoring makes it hard for companies to be transparent, and prevents outsiders from comparing companies.

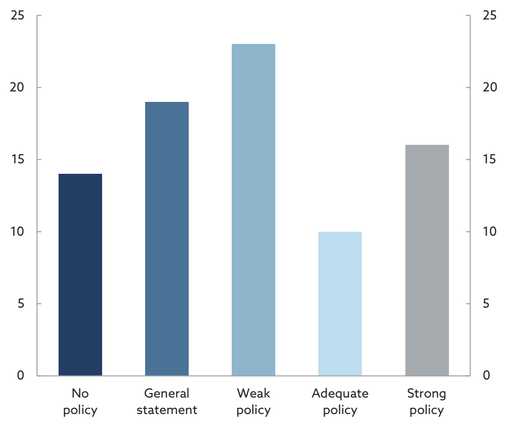
The Social & Labor Convergence Project (SLCP) believes that joint assessments and support for joint indicators may help improve working conditions in the sector. We signed up to the SLCP, an initiative of the Sustainable Apparel Coalition, in 2016. Since January 2017, we have continued our support for the project with a two-year grant to build knowledge about more sustainable business practices in the apparel sector and its supply chain.

The SLCP is industry-led and has been working since 2016 with a broad group of stakeholders to improve understanding of working conditions in the apparel supply chain through standardised processes, joint tools and the possibility of certifying companies and their supply chains. In 2018, the project finalised an agreed methodology and tool for assessing working conditions in the value chain, including children's rights, forced labour, health and safety, and pay. The benefits of a standardised tool of this kind include greater transparency and comparability, more accurate measurement and monitoring, and easier reporting. Implementation of the final tool has begun in China and Sri Lanka. The SLCP has adopted a five-year plan for rolling out the tool across more countries and sectors.

The Gap Inc., Hennes & Mauritz AB and Nike Inc. are among the companies that are actively supporting the SLCP's work.

In 2018, we provided input to the Sustainable Apparel Coalition on the development of a standard enabling apparel and footwear producers to self-assess their environmental and social efforts in the supply chain, known as the Higg Brand & Retail Module. We stressed the benefits of greater standardisation of how companies report and are evaluated in this area, and the need for good quantitative indicators to make it easier for the market to gauge progress and draw comparisons between companies.

**Chart 7** Companies with a policy on human rights.
Sub-sample of selected sectors.
Number of companies



**Tax and transparency**
Corporate taxation plays a key role in funding public services in industrialised countries and may be even more important in many developing countries. Companies for their part benefit from society's legal and financial infrastructure. By paying taxes, they help finance this infrastructure.

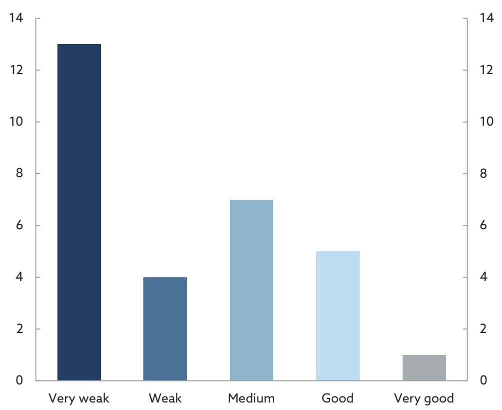
In 2018, we performed an initial analysis of 30 selected companies to understand how their boards decide their tax management policies. The analysis looked at companies that generate substantial revenues from activities outside their domestic market. We looked primarily at companies in the consumer goods and services, financial, mining, oil and gas, pharmaceutical and technology sectors. Global norms and standards for tax disclosure are evolving. Our provisional analysis therefore covered a smaller number of companies then our analyses of our other expectations.

The companies' reporting was evaluated against a number of indicators, including the company's policy for and approach to tax planning, its management of tax risks, and the board's accountability for tax matters. We based our assessment on the most recently reported information from the companies.

Our analysis revealed major differences between markets. Companies required to publish their tax strategy under UK law were more open about their tax practices than companies registered in other jurisdictions. There were also some variations between sectors, with mining and consumer goods and services generally being more transparent about tax. We also found variations in companies' reporting on governance, policies and risk management, particularly in the level of reporting. Most companies provided information on tax risks and relations with tax authorities. Some provided information on the relationship between tax and the company's more general objectives. A small number of companies explained how they work on internal pricing between related companies and activities in secrecy jurisdictions.

**Tax policies in the consumer sector**
We have launched an initiative on tax policy for companies providing consumer goods and services. The sector has been in the spotlight in recent years due to a number of tax-related controversies. Consumers are also questioning more often how much tax companies in this sector pay in different countries. The aim of the initiative is therefore to increase companies'

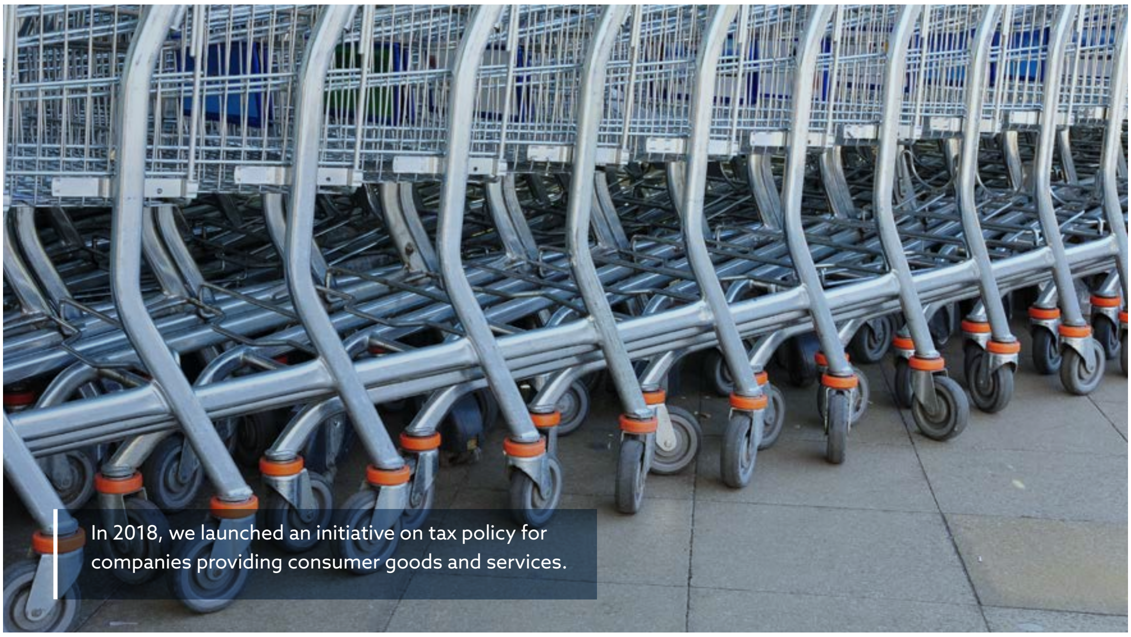
**Chart 8** Results for companies we assessed on tax and transparency in 2018. Number of companies



transparency on tax, share experience and challenges with tax policies, and encourage companies to publish the board's strategies and policies on tax.

Companies have highlighted three main challenges when it comes to tax transparency. The first has to do with public country-by-country reporting and how standardised disclosure can best be achieved across companies and sectors in the absence of regulation. Companies take different approaches to this type of disclosure. Some report tax data by country, others by region, and some not at all. The second challenge is how companies can best communicate tax data. Figures can easily be misinterpreted when taken out of context. There was therefore a strong consensus that companies must publish information explaining the numbers. The third challenge is the importance of anchoring the company's approach to tax internally. Policies for responsible tax management are not just about communicating with the outside world, but must also be part of a company's internal culture. The board and executive management can play an important role in this work. Further transparency and disclosure in these three areas will help increase understanding of how principles for responsible tax management can be observed in practice.





In 2018, we launched an initiative on tax policy for companies providing consumer goods and services.



In 2018, we surveyed corruption risks in the pharmaceutical sector.

**Anti-corruption**
Corruption at companies and their agents, or in entire markets, undermines economic efficiency. Corruption disadvantages compliant companies and can reduce investors' returns.

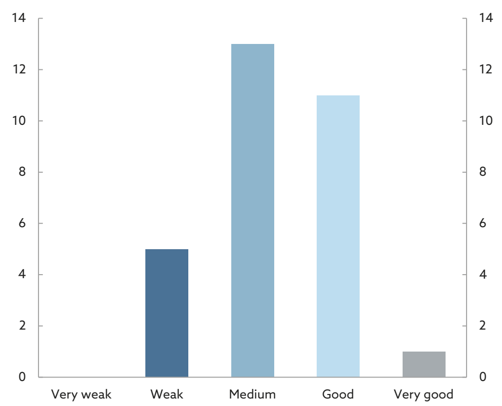
In 2018, we published expectations of companies on combating corruption. Based on these expectations, we performed a provisional analysis of 30 selected companies with operations in sectors with a high risk of corruption: construction, finance, industrial goods and services, mining, oil and gas, pharmaceuticals and telecommunications. Our findings have provided a basis for further developing our analyses.

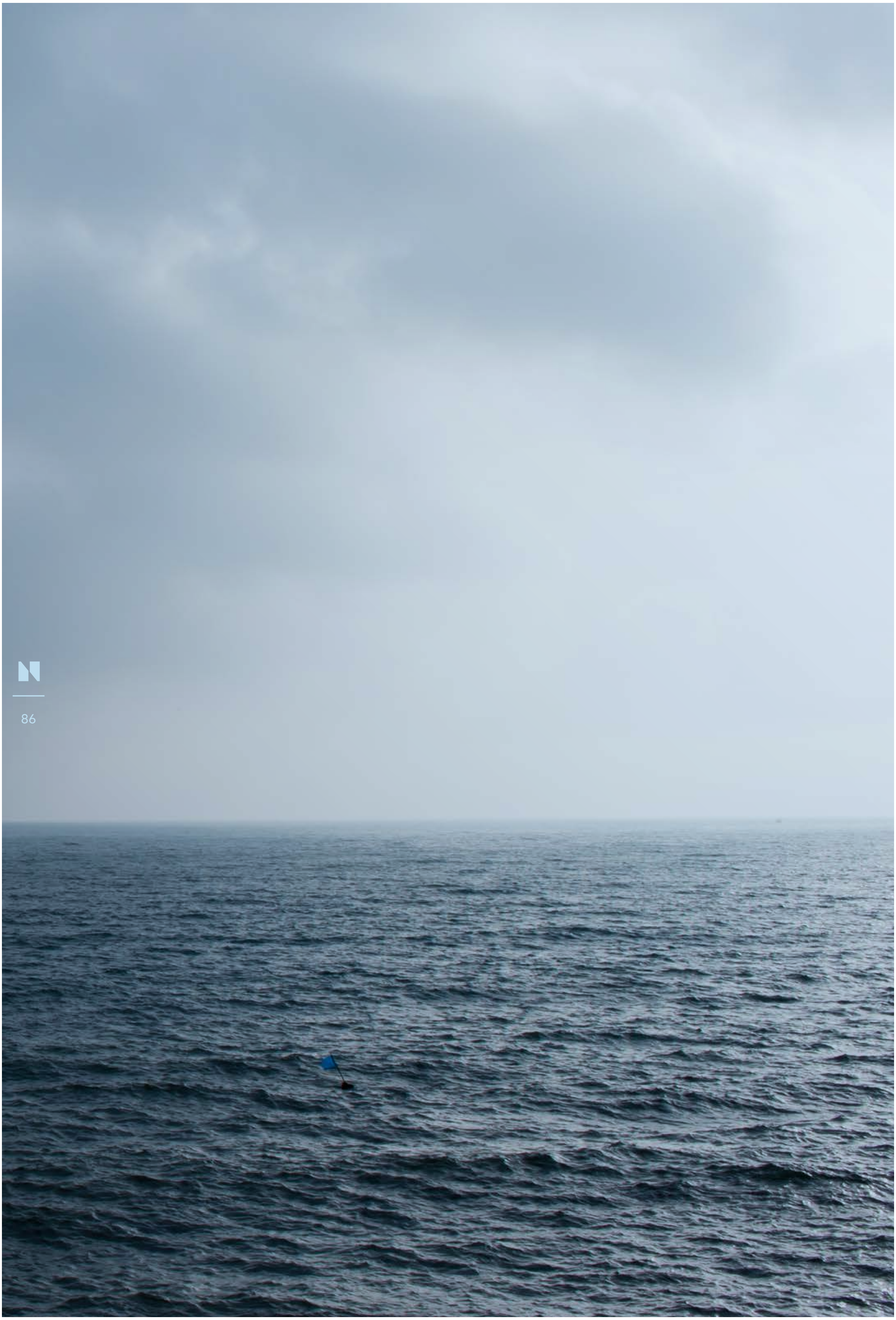
The companies' reporting was evaluated against 14 indicators covering transparency on governance structure, policies for combating corruption, risk assessment, supply chain management, reporting on corruption-related incidents, external evaluation of anti-corruption programmes, and dialogue with stakeholders. The assessments were based on the most recently reported information from the companies.

Most companies were relatively open about how their board and management address corruption risks. We also found that many companies make their anti-corruption policies and strategies public. Some reported in more detail on measures to prevent and detect corruption, such as staff training and internal whistleblowing systems. Companies provided less information on the follow-up of anti-corruption actions and the results of internal and external evaluations of the efficacy of these actions. There were also variations between sectors, with companies in the pharmaceutical and financial sectors generally being more transparent about their anti-corruption work.

**Anti-corruption in the pharmaceutical sector**
In 2018, we surveyed corruption risks in the pharmaceutical sector and raised the topic with a number of companies. Corruption is a challenge throughout the sector's value chain, from research and development through registration and authorisation to tendering, production, transport, marketing and sales. Many companies in the sector have been investigated in recent times for alleged illegalities related to corruption. In response, the companies have increasingly sought to improve their anti-corruption programmes. The aim of the initiative is therefore to promote broad dialogue in the sector on the efficacy of anti-corruption programmes, develop methods to compare programmes in the sector, and exchange experience of internal and external evaluation of these programmes. We have invited selected pharmaceutical companies to participate in further dialogue on this topic.

**Chart 9** Results for companies we assessed on anti-corruption in 2018. Number of companies





**Ocean sustainability**
How companies manage risks and opportunities related to sustainable uses of the ocean could affect our long-term return as an investor.

We published expectations on ocean sustainability in 2018. We used these to perform an assessment of which companies discuss issues relevant for ocean sustainability in their public reporting. The assessment covered the same companies assessed on water management in the chemical, consumer goods, farming and fishing, food and beverage, mining, oil and gas, paper and utilities sectors. To varying degrees, these companies base their operations on the ocean, rely on marine resources, or may have a negative impact on the ocean through pollution of water systems or the production of plastic packaging.

Only 16 percent of the companies assessed report on relevant ocean-related issues. Ocean sustainability is an area with very little standardised reporting, and we expect both disclosure and metrics to improve in the years ahead.

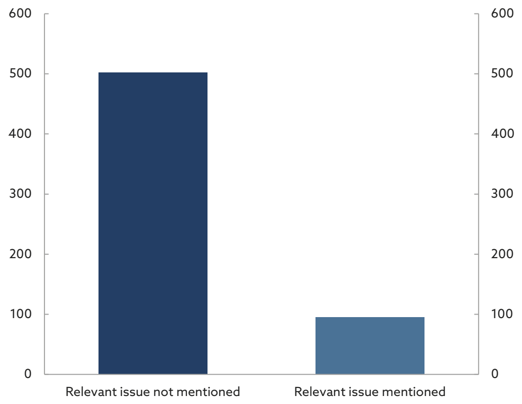
### Action Platform on Sustainable Ocean Business

In June 2018, the fund joined the UN Global Compact's new Action Platform on Sustainable Ocean Business. The aim of the platform is to develop an international framework for business leadership on the sustainable use of marine resources. Other participants include companies from sectors with activities connected with the ocean, UN institutions, NGOs and research bodies.

The platform was launched in New York on 8 June 2018, World Ocean Day, and will run until the end of 2020.

As part of the platform, we are leading a working group developing international principles for ocean sustainability. A number of meetings were arranged in New York with the whole ocean platform as part of the UN high-level week in September. Our contribution to the working group builds on our stated expectation that companies should address risks and opportunities relating to ocean sustainability and the effects they might have on companies' future development and performance.

**Chart 10** Results for companies we assessed on ocean sustainability in 2018. Number of companies



4

# Investing sustainably

# Risk assessments

**One important task in our responsible investment management is to get companies to move from words to numbers so that we can measure and evaluate their efforts and better understand risks and opportunities in our investments.**

We monitor our investments and assess sustainability issues as part of our risk management and our investment decisions. We concentrate on issues that we believe may have a material effect on the fund's financial value. For our analyses, we need both qualitative information and quantitative data on environmental, social and governance issues. We aim to identify, measure and manage all relevant risks and opportunities the fund is exposed to.

**Sustainability disclosure**
We are working on improving our understanding of potential links between sustainability on the one hand, and portfolio risk and return on the other. As an investor, we benefit from the timely disclosure of high-quality data and access to qualitative and quantitative sustainability information. Our work on sustainability draws on statistics and data for countries and sectors as well as data on specific topics such as corruption, executive remuneration, greenhouse gas emissions, deforestation and human rights.

As a result of this work, we now have increasingly comprehensive databases of sustainability data that span a number of factors at country, sector and company levels. These data are integrated into our analysis of individual companies and sectors, as well as at the portfolio level.

We closely monitor developments and seek access to information on emerging governance and sustainability issues. There is increasing interest in measuring business operations that may have a positive environmental and social impact. One example of this is green revenue – the percentage of a given company's revenue or activities that can be linked to a positive environmental impact, such as renewable energy or clean technology. Our in-house analysis is supplemented, where relevant, with analyses from external data providers. Some of this is publicly available or made available via our participation in various initiatives. We also commission research from specialists when we need more sophisticated analysis.

**Climate risk disclosure**

In 2016, we developed our own framework to increase our understanding of climate-related risks and opportunities in the fund. In addition we analyse greenhouse gas emissions from companies in the portfolio.

The portfolio's climate-related risks may be either physical risks or financial risks related to companies' transition to a low-carbon economy. These risks have different time horizons. Physical risks might be exposure to extreme weather events such as floods, droughts or heat waves. Transition risks include regulatory changes, technological innovations and evolving consumer preferences. The risks we face as an investor are not the same as the risks managed by individual companies. The price of the assets an investor buys, and the degree to which this price reflects climate risks, affects the financial risks. A broadly diversified and market-weighted portfolio will, in principle, have roughly the same financial climate risks as the underlying markets and sectors in which it is invested.

To obtain a better understanding of these risks, we have obtained analyses and participated in projects to assess and, where possible, quantify physical and transition risks at companies. In our work on assessing companies, we have focused on producers of cement, chemicals, oil and gas, power and steel, as they are exposed to particularly high climate risks.

**Climate scenarios**

Scenario analyses are useful for exploring the consequences of different actions, whether passive or active. They help us illustrate different outcomes and better understand the processes over long time periods with given levels of uncertainty. They are not predictions of the future. There is no standard method for investors' scenario analysis. Ideally, the scenarios should be based on well-founded assumptions about future greenhouse gas emissions, physical climate changes and macroeconomic conditions. The scenarios must also use reasonable assumptions for companies' future development given their sectors, regions, regulation, technological developments, installations and assets. It is essential to have a good understanding of the model's core assumptions, uncertainties in the data, and interactions between the drivers in the model.

We are working on developing a number of different methodological tools for climate scenarios that can give us a broad and deep understanding of where and how climate risk might affect individual companies and the portfolio as a whole. For example, we look at future cash flows and carbon emissions at company level, and also at how possible future regulation in the form of carbon pricing and carbon quotas might impact on different companies, sectors and regions. The aim of this work is eventually to be able to understand how climate risks could affect portfolio returns.

## Carbon footprint

We have been analysing the fund's carbon footprint since 2015. This analysis provides an insight into the level of greenhouse gas emissions from the companies we are invested in. It can also provide an insight into risks and opportunities across sectors and shed light on how changes to the fund's mandate affect its carbon footprint.

We follow the recommendations for asset managers from the TCFD when calculating the fund's carbon footprint. We start from the greenhouse gas emissions of each individual company in the equity portfolio, measured as tonnes of $CO_2$-equivalents. These emission data are supplied by analysis firm Trucost and cover companies' Scope 1 and Scope 2 emissions. Emissions within Scope 3 are not included in this analysis. At portfolio level, we calculate emissions in three ways – based on holding, revenue and market value. In all of these variants, we report emission data at sector level for the fund, the benchmark index and the FTSE Global All Cap index, which is the starting point for the benchmark index defined by the Ministry of Finance. This analysis of greenhouse gas emissions provides only a snapshot for 2018, however, and does not take account of companies' strategy, industry structure and other factors.

Reporting on greenhouse gas emissions still varies in frequency and quality. Emission data are generally published in connection with a company's annual report early the following year. When analysing emission data for 2018, the most up-to-date numbers will therefore come from companies' annual reports for 2017 published in 2018. Where a company has not published emission data for 2017, we will use data reported for 2016 or estimates. In this analysis, only 17 percent of companies disclosed data on greenhouse gas emissions directly in



**Chart 11** Data on greenhouse gas emission of companies. Number of companies

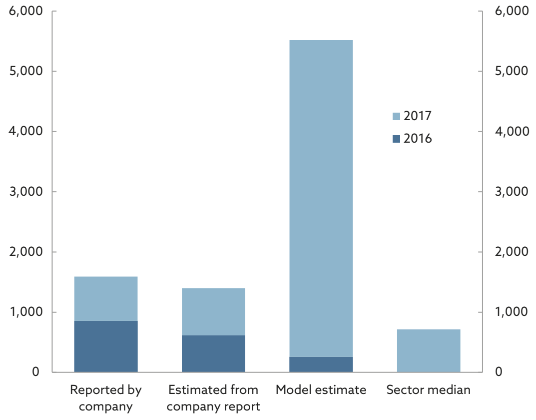
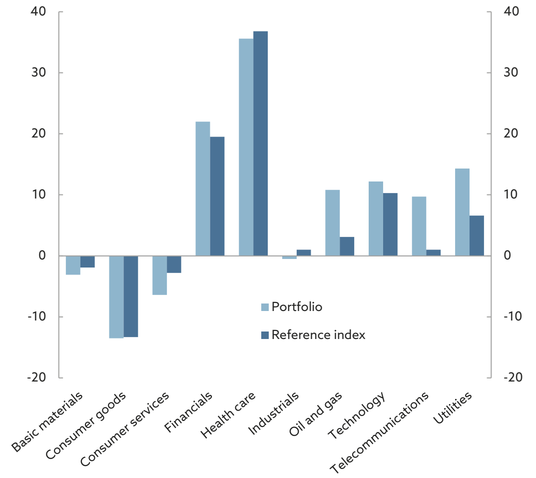



**Chart 12** Changes in contribution to carbon footprint from 2017 to 2018. Percent



their reports or via CDP. 15 percent provided relevant information permitting the calculation of emissions. For 60 percent of the companies in the portfolio, emissions have been estimated using models. This results in greater uncertainty than hard emission data. For 8 percent of companies, emissions have been estimated simply on the basis of the median for their sector. In these cases, uncertainty about actual emissions is considerable.

### Total emissions and our percentage share

Based on our percentage holdings in each company, the fund accounted for total emissions of 107 million tonnes of $CO_2$-equivalents in 2018. This is around twice the amount of Norway's total emissions in 2017 as reported by Statistics Norway. The total emissions of the companies in our portfolio increased by 6 percent from 2017 to 2018. The reason for this is an increase in companies' emissions, as can be seen from an increase of 6 percent in emissions for the reference benchmark. The emissions of the companies in the equity portfolio was about the same as in the benchmark portfolio.

These emissions are driven largely by sectors with high energy consumption, such as commodities, heavy industry, metals, oil and gas and power. Within these high-emission sectors, there are in turn a number of large companies that account for the bulk of emissions. We have also calculated what the emissions of the companies in the benchmark index's would have been without any ethical exclusions under the Ministry of Finance's guidelines for observation and exclusion. These exclusions have reduced the benchmark index's carbon emissions by 14 percent, due mainly to exclusions under the coal criterion.

When reporting our share of companies' greenhouse gas emissions, we multiply each company's emissions by our percentage holding in that company. We can then obtain a figure for the fund's share of total greenhouse gas emissions for all companies in the portfolio by adding together the results for each individual company. The emissions calculated for the FTSE Global All Cap are the total for all companies in the index excluding Norway.

### Emission intensity

Then companies in our equity portfolio emitted around 187 tonnes of $CO_2$-equivalents for every million dollars of revenue. This is referred to as equity portfolio's emission intensity.

The equity portfolio's emission intensity is three percent below that of the benchmark index. The difference can largely be put down to our investments in basic materials, industrials and utilities having a lower emission intensity than the companies in the benchmark index.

The emission intensity of both the equity portfolio and the benchmark index have increased by four and two percent respectively compared to 2017, mainly because companies' revenue increased.

We calculate companies' emission intensity by dividing the emissions of an individual company by its revenue. This enables us to compare how much different companies and sectors emit for the same amount of revenue. It is worth noting that emission intensity is affected by changes in the prices of the products companies sell. For example, an oil company's emission intensity will decrease when oil prices rise, even if the size of its emissions is constant. Similarly, a company that sells expensive cars will have a lower emission intensity than one that sells cheaper cars, even if both produce the same number of cars.

**Table 5** Scope 1 and 2 emissions by sector as at 31 December 2018

| | Equity portfolio | Reference index | FTSE All Cap |
|---|---|---|---|
| Sector | Tonnes $CO_2$ equivalents | Tonnes $CO_2$ equivalents | Tonnes $CO_2$ equivalents |
| Basic materials | 25,884,091 | 25,558,317 | 3,176,961,413 |
| Consumer goods | 4,752,213 | 4,521,544 | 456,633,469 |
| Consumer services | 8,615,816 | 6,337,238 | 857,014,193 |
| Financials | 2,160,439 | 2,011,901 | 245,109,687 |
| Health care | 1,048,314 | 974,321 | 73,882,887 |
| Industrials | 21,130,407 | 20,710,271 | 1,954,788,054 |
| Oil and gas | 19,861,028 | 19,250,688 | 1,998,709,715 |
| Technology | 1,387,691 | 1,372,780 | 125,660,711 |
| Telecommunications | 709,454 | 757,344 | 89,353,548 |
| Utilities | 21,891,067 | 25,760,999 | 4,985,354,670 |
| **Sum** | **107,440,520** | **107,255,402** | **13,963,468,347** |



**Table 6** Scope 1 and 2 emissions intensity by sector, weighted by market value of fund holdings. Equity portfolio, reference index and FTSE All Cap as at 31 Decemner 2018

| | Equity portfolio | Reference index | FTSE All Cap |
|---|---|---|---|
| Sector | Tonnes $CO_2$ equivalents per million dollars in sales revenue | Tonnes $CO_2$ equivalents per million dollars in sales revenue | Tonnes $CO_2$ equivalents per million dollars in sales revenue |
| Basic materials | 864 | 888 | 945 |
| Consumer goods | 72 | 67 | 64 |
| Consumer services | 91 | 82 | 82 |
| Financials | 40 | 36 | 36 |
| Health care | 36 | 36 | 36 |
| Industrials | 269 | 283 | 263 |
| Oil and gas | 574 | 563 | 563 |
| Technology | 44 | 43 | 43 |
| Telecommunications | 47 | 49 | 49 |
| Utilities | 1,334 | 1,439 | 2,221 |
| **Weighted total** | **187** | **193** | **231** |

To compare the sectors in our portfolio, we weight each company's emission intensity by multiplying it by the value of our investment in the company divided by the value of the fund's investment in the sector. We then add together the results in each sector. Some sectors have a higher emission intensity than others. For example, emission intensity is high in the utilities sector because the benchmark index and the fund have holdings in power companies that produce electricity from fossil fuels.

To calculate the total emission intensity of the companies in our portfolio, we weight each company's emission intensity by the value of our investment divided by the value of the entire equity portfolio. This is the metric recommended by the TCFD, because it makes it possible to compare emissions across companies, sectors and managers.

### Emissions and market value

The equity portfolio emitted 164 tonnes of $CO_2$-equivalents for every million dollars in market value. This can also be described as emissions per invested unit of money. The equivalent figure for the benchmark was four percent higher, which is to say 170 tonnes of $CO_2$-equivalents per million dollars. The difference can be explained by our investments in basic materials, and utilities having a lower emission intensity than companies in the benchmark index.

We report greenhouse gas emissions in relation to companies' market value by dividing each company's emissions by its market value. We can then compare different companies' and sectors' emissions for the same amount invested. In the same way as for emission intensity, we weight emissions by the size of our investment and add them together to compare the sectors in our portfolio.

This metric can give investors useful information for comparing the carbon footprint of equity investments across sectors and companies.

Emissions by market value are affected by a company's share price. This means that external factors unrelated to greenhouse gas emissions can result in differences between two otherwise identical companies. For example, a decline in a company's share price will increase its emissions by market value even if its actual emissions are unchanged. Nor does this metric take account of different companies having different capital structures (ratio between debt and equity).

### Emissions in the corporate bond portfolio

The bond portfolio's emission intensity is 16 percent below that of the benchmark index. This is mainly because our investments in industrial companies have a lower emission intensity than the benchmark index.

When we invest in bonds, we lend capital to companies that may have operations that release greenhouse gases. This lending does not, however, affect our percentage ownership in the company. To provide a picture of the carbon footprint of the bond portfolio, we therefore link the issuer of the bond to the parent company where the emissions actually occur. We multiply the company's emissions by the value of our lending divided by the value of all corporate bonds. We then add these figures together to produce totals for the fund and the benchmark index. The result is a measure of the carbon footprint of the bond portfolio. Finally, we disclose the bond portfolio's emission intensity, calculated in an equivalent way to that for equities. We multiply the emission intensity of each company by the value of our lending, divide this by the value of all corporate bonds, and then sum to fund level.

**Table 7** Scope 1 and 2 emissions by market capitalization, weighted by market value of fund holdings.[1]
Equity portfolio, reference index and FTSE All Cap. As at 31 December 2018

| Sector | Equity portfolio<br>Tonnes $CO_2$ equivalents per million dollars invested | Reference index<br>Tonnes $CO_2$ equivalents per million dollars invested | FTSE All Cap<br>Tonnes $CO_2$ equivalents per million dollars invested |
|---|---|---|---|
| Basic materials | 778 | 837 | 856 |
| Consumer goods | 62 | 59 | 57 |
| Consumer services | 116 | 94 | 94 |
| Financials | 14 | 14 | 14 |
| Health care | 14 | 13 | 13 |
| Industrials | 254 | 251 | 233 |
| Oil and gas | 533 | 485 | 485 |
| Technology | 17 | 17 | 17 |
| Telecommunications | 38 | 39 | 39 |
| Utilities | 1,210 | 1,394 | 1,931 |
| **Weighted total** | **164** | **170** | **197** |

[1] Does not take into account companies' different capital structure (debt-to-equity ratio)

**Table 8** Scope 1 and 2 emissions in the fixed-income corporate portfolio and reference index as at 31 December 2018

| | Tonnes $CO_2$ equivalents | Average emissions intensity weighted by market value of fund holdings. Tonnes $CO_2$ equivalents per million dollars in sales revenue |
|---|---|---|
| Fixed income corporate portfolio | 5,595,059 | 175 |
| Reference index | 6,671,156 | 210 |
| Difference | -1,076,097 | -35 |

**Sustainability assessments**
We use our databases of sustainability data to monitor and analyse the companies in our portfolio. We monitor environmental, social and governance risks in the countries, sectors and companies in which the fund is invested.

### Country analysis
In 2018, we continued to develop our understanding of sustainability risks at country and sector levels. Our analysis of these risks is based on an in-house risk framework which includes country-level data and indicators for ten key sustainability themes. This makes it easier to identify high-risk areas of the portfolio and companies that warrant further analysis.

During the year, we reviewed the data sources we use to analyse sustainability at country and sector levels. The aim is a more complete understanding of companies' risk exposure to different activities and countries, both in their own operations and in their value chain. This can provide a basis for more advanced mapping of individual companies' sustainability risk exposure.

Some markets have inherently higher sustainability risks. This is often the case in emerging markets, where regulation in areas such as pollution, child labour and corruption may not be as robust as in more advanced markets. Some of the companies in the fund's portfolio do much of their business in emerging markets. Given the inherent risk in these markets, we pay particular attention to our investments in these companies. In 2018, we assessed sustainability risks at 515 companies in emerging markets. These assessments are used internally in the management of our portfolio and as a basis for dialogue with external managers, additional risk monitoring and, in some cases, risk-based divestments.

### Sector analysis
We performed sector analyses covering 905 companies in 2018. We analyse our portfolio using our risk framework and look at environmental, social and governance issues. We then concentrate on sectors with particular exposure to specific risks. Our attention may also be drawn to particular sectors through information from our external data providers, other investors or NGOs. In addition to new sector analyses, we are working on reassessing sectors identified in the past.

Based on the results of these country and sector analyses, we may decide not to invest in selected sectors in specific countries in order to reduce the fund's exposure to unacceptable risks.

## Sector analysis

| Sectors | Number of companies assessed | Environmental, social and governance topics |
|---|---|---|
| Clothing and accessories, Footwear, Apparel retailers, Broadline retailers and Specialty retailers | 265 | Health and safety of workers, wages and benefits, labour conditions, child labour and forced labour |
| Mining (including General mining, Gold mining, Platinum & precious metals) | 89 | Water-related risk |
| Pharmaceuticals and Drug retailers | 53 | Direct or indirect involvement in opioids |
| Food products and Farming, fishing & plantations | 239 | Health and safety of workers, wages and benefits, labour conditions, child labour and forced labour |
| Agricultural commodities (palm oil and rubber) | 46 | Deforestation, sustainability certification, human rights and local communities |
| Fuel retailers | 24 | Climate change transition risk exposure |
| Marine transport | 32 | Greenhouse gas emissions and environmental pollution |
| Real Estate (REITs) | 17 | Greenhouse gas emissions, green building activities, waste management, water management, health and safety, corporate governance |
| Ocean fishing | 8 | Sustainable fishing practices |
| Conventional utilities | 51 | Greenhouse gas emissions, water stress, waste, human rights, health and safety, renewable energy exposure, coal exposure, corporate governance |
| Specialty chemicals and Commodity chemicals | 34 | Greenhouse gas emissions, water stress, waste, product quality and safety, health and safety, corporate governance |
| Consumer goods (various) | 47 | Supply chain management, greenhouse gas emissions, product quality and safety, labour issues, health and safety, community impacts, water stress, corporate governance |


In 2018, we assessed carbon
emissions at 78 steel companies

### Company analysis

We divide company analysis into two categories: material ownership reports and incident briefs.

We produced five material ownership reports in 2018. Here, we systematically analyse companies where the fund has a significant percentage holding. These reports look in more detail at business drivers and risk factors for the specific company. We use information from our databases of sustainability and governance data in addition to publicly available data reported by companies and regulators, among others, to assess how environmental, social and governance issues affect the company and how the company is addressing these issues.

We produced 34 incident briefs in 2018. We looked at incidents such as alleged corruption, fraud, environmental pollution, deforestation, health and safety violations, and impacts on local communities. We monitor companies and markets using information systems and global media to capture incidents that may be relevant to the companies we invest in. Following an initial assessment, we select companies for further analysis in an incident brief. We may follow up these briefs with more extensive company analysis, additional risk monitoring or ownership measures.

### External mandates

When investing in emerging markets, we rely mainly on external managers. We monitor environmental, social and governance risks at all of the companies in the portfolio, including those managed externally. External managers have a local presence and specialise in the markets they invest in. They have a good knowledge and understanding of these markets.

New external managers must be able to demonstrate during the selection process that they are familiar with the fund's emphasis on responsible investment and with our priorities. We require managers to take account of relevant environmental, social and governance risks in their investment activities. Established external managers must confirm and describe these activities as part of the fund's annual assessment of these managers.

## Development of the fund's environmental mandates, exclusions and divestments

| Contributing to positive externalities | Year | Avoiding negative externalities |
|---|---|---|
| From lender to owner | 1998 | |
| Environmental fund established | 2001 | Initial exclusion mechanism for investments established |
| | 2002 | Singapore Technologies Engineering excluded due to production of anti-personnel mines |
| | 2004 | Council on Ethics established and exclusion mechanism expanded |
| Investing in emerging markets | 2005 | Kerr-McGee Corp excluded due to activities in Western Sahara |
| Environmental mandate established with 20 billion kroner | 2009 | Tobacco companies excluded |
| Environmental mandate increased to 20–30 billion kroner | 2011 | |
| | 2012 | Risk-based divestment — palm oil |
| Environmental mandate increased to 30–50 billion kroner | 2014 | Risk-based divestments — oil sands and cement |
| | 2015 | Risk-based divestment — thermal coal |
| Environmental mandate increased to 30–60 billion kroner | 2016 | Coal companies excluded |

# Investments

**Our goal is to use sustainability data to identify long-term investment opportunities. We see potential in companies that contribute to more environmentally friendly economic activity.**

**Environment-related mandates**
The management mandate from the Ministry of Finance requires Norges Bank Investment Management to invest between 30 and 60 billion kroner in dedicated environment-related mandates. At the end of 2018, we had 43.3 billion kroner invested in shares in 77 companies and 13.4 billion kroner invested in green bonds under these mandates.

Equity investments under the environment-related mandates returned -8.3 percent in 2018, while the annualised return since inception in 2010 has been 4.5 percent. We have expanded the universe in recent years to include larger companies and place greater emphasis on developed markets in order to reduce volatility. The environment-related mandates have since their inception been managed both internally and externally. To reduce cost in the management of the fund, the externally managed, environment-related mandates were terminated in 2018. Today, the environment-related mandates are in their entirety internally managed.

We have built up extensive internal expertise in environmental technology. Much of our work now involves defining the universe for environmental investments. By analysing companies' activities, we can identify suppliers of goods and services with a stronger environmental profile than the wider stock market. It is worth noting that some companies in our environmental investment universe do not focus exclusively on goods and services that enable environmentally friendly economic activity. It is nevertheless important to include these companies, as they often have the capital needed to develop and apply green technologies.

We screen our environmental investments against information supplied by specialist external data providers and integrated into our sustainability databases. Our goal is to determine the extent to which our investments are exposed to selected environmental themes through their revenue or activities. We also flag any environmental, social and governance risks in companies' operations for consideration by our portfolio managers.

We invest in three main areas: low-emission energy and alternative fuels; clean energy and energy efficiency; and natural resource management. Companies must have at least 20 percent of their business in one of these areas to be included in our environment-related universe. These three categories also largely coincide with the UN Sustainable Development Goals for the environment, clean energy and resource management.

**Low-emission energy and alternative fuels**
Power generation and transport are major contributors to greenhouse gas emissions. Technological advances in these areas can significantly reduce global emissions. Companies today are increasingly developing capacity for the production of energy from renewable sources such as wind, solar, hydro, geothermal and waste.

Companies operating in the segments include Sempra Energy, SSE Plc and Enel SpA.

Renewable energy and energy storage
The commercialisation of renewable energy and energy storage is advancing rapidly. Commercialisation and increased technology convergence between renewables, electric vehicles and energy storage can be expected to bring dramatic changes in the energy mix. 2016 was a landmark year for low-emission energy



## Environmental universe — internal definitions

| Categories | Groups | Definitions |
|---|---|---|
| Companies that provide solutions to climate change and pollution | Low-emission energy and alternative fuels | Providers of energy, infrastructure and energy solutions for transport, buildings and industry |
| | Clean energy and efficiency technology | Providers of technology, equipment and services lowering emissions through clean and efficient generation and consumption of energy |
| Companies that provide solutions contributing to efficient usage of natural resources and pollution | Natural resource management | Providers of technology, equipment, infrastructure and services lowering environmental impact through clean and efficient consumption and reuse of natural resources |



**Table 9** Key figures as at 31 December 2018. Annualised data, measured in the fund's currency basket. Percent

| | Since 01.01.2010 | Last 5 years | Last 3 years | 2018 |
|---|---|---|---|---|
| Return on the environment-related equity mandates | 4.5 | 5.9 | 7.8 | -8.3 |
| Return on the FTSE Global All Cap Index | 9.2 | 7.0 | 6.7 | -7.3 |
| Return on the MSCI Global Environment Index | 7.3 | 4.5 | 7.9 | -7.2 |

**Table 10** Market value of investments in the enviroment-related mandates as at 31 December 2018. Millions of kroner

| | Values |
|---|---|
| Equities | 43,283 |
| Green bonds | 13,411 |
| **Total** | **56,694** |

and alternative fuels, as it was the first year when more capacity was built for renewable power production than for coal-based and nuclear power. This trend continued in 2018, with renewables accounting for nearly 70 percent of net installed power capacity. Companies in our mandate for low-emission energy and alternative fuels are key drivers in this energy transition.

### Clean energy and energy efficiency

Investments in solutions to climate challenges have traditionally been made mainly in energy production and concentrated on clean and renewable energy. More recently, opportunities on the demand side have begun to attract more attention. The transport sector is making progress, partly through more efficient traditional combustion engines and hybrid technologies. Major progress is also being made in electric vehicles. Despite this, the cost of producing batteries remains a challenge. Demand for energy efficiency technology for buildings has increased. Substantial reductions in energy consumption can be achieved through better insulation, lighting, heating and ventilation systems, as well as solutions that control these processes. Companies operating in these segments include Legrand SA, PTC Inc and Keyence Corp.

### Efficient mobility

Three main technologies are set to revolutionise the cost and efficiency of transportation: electric vehicles, autonomous driving and shared mobility. The combustion engine accounts for most greenhouse gas emissions from the transport sector, and around a quarter of total greenhouse gas emissions. In the next decade, progress in battery technology and costs will enable electric vehicles to replace combustion technology. Fully functional self-driving vehicles will also lead to more efficient use of the existing vehicle stock. Finally, shared mobility will increase utilisation, reduce the need to purchase cars, and aggregate transport routes for both private and commercial users. The outlook for major efficiency gains and reductions in greenhouse gas emissions has improved thanks to these three nascent technologies. Technological advances and cost savings over the past two years have brought forward the supply side for electric vehicles by as much as five years.

**Table 11** Top ten equity holdings in the low-emission energy and alternative fuel segment in the fund's environmental portfolio as at 31 December 2018

| Company | Country | FTSE Global sector | Millions of kroner | Share of portfolio Percent |
|---|---|---|---|---|
| Iberdrola SA | Spain | Utilities | 3,434 | 7.9 |
| NextEra Energy Inc | United States | Utilities | 3,283 | 7.6 |
| Sempra Energy | United States | Utilities | 3,281 | 7.6 |
| Linde Plc | United States | Basic materials | 2,421 | 5.6 |
| National Grid Plc | United Kingdom | Utilities | 1,025 | 2.4 |
| Enel SpA | Italy | Utilities | 708 | 1.6 |
| Edison International | United States | Utilities | 500 | 1.2 |
| SSE Plc | United Kingdom | Utilities | 429 | 1.0 |
| Engie SA | France | Utilities | 287 | 0.7 |
| Tokyo Gas Co Ltd | Japan | Utilities | 258 | 0.6 |



**Table 12** Top ten equity holdings in the clean energy and efficiency technology segment in the fund's environmental portfolio as at 31 December 2018

| Company | Country | FTSE Global sector | Millions of kroner | Share of portfolio Percent |
|---|---|---|---|---|
| Keyence Corp | Japan | Industrials | 1,856 | 4.3 |
| Daikin Industries Ltd | Japan | Industrials | 1,568 | 3.6 |
| Thermo Fisher Scientific Inc | United States | Health care | 1,467 | 3.4 |
| Legrand SA | France | Industrials | 1,447 | 3.3 |
| PTC Inc | United States | Technology | 1,060 | 2.4 |
| Infineon Technologies AG | Germany | Technology | 861 | 2.0 |
| Eaton Corp Plc | United States | Industrials | 748 | 1.7 |
| Shin-Etsu Chemical Co Ltd | Japan | Basic materials | 595 | 1.4 |
| Tesla Inc | United States | Consumer goods | 582 | 1.3 |
| Autodesk Inc | United States | Technology | 429 | 1.0 |

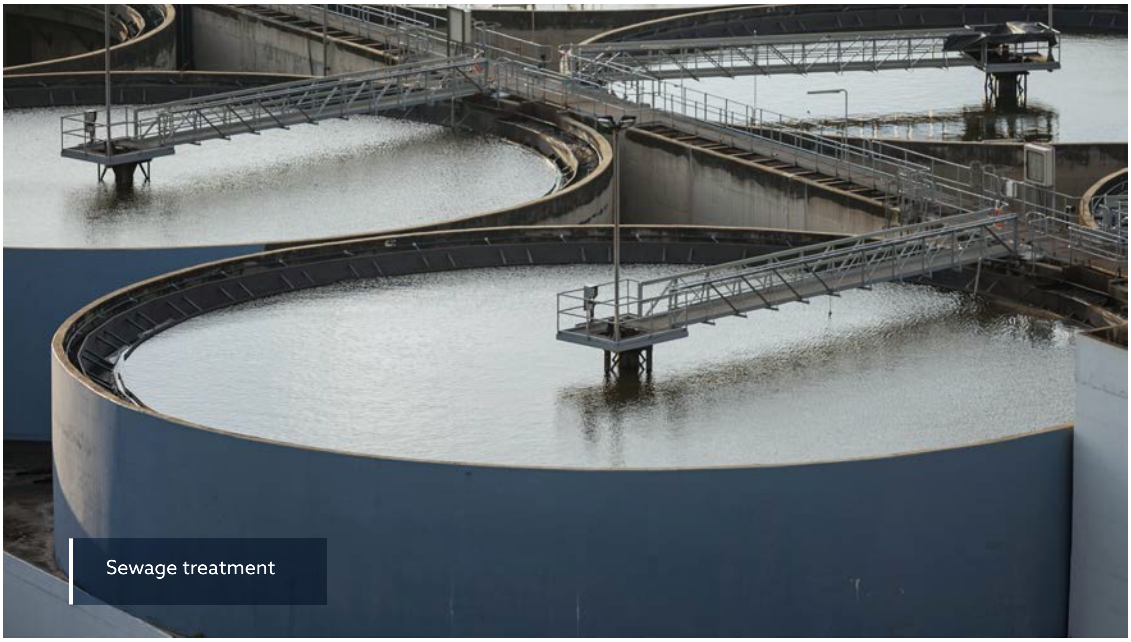
**Natural resource management**
Efficient utilisation of natural resources is important for water management, waste management, recycling, agriculture and forestry. Meeting the world's need for high-quality water in an efficient manner is a global challenge. The infrastructure to achieve this requires heavy investment, particularly as demand for water is expected to grow substantially. In areas with scarce water resources, it is important to have solutions that enable recycling of water through treatment processes and efficient pumping, measurement and control solutions. Recovering energy from waste and making good use of organic materials show how waste can be a resource. One notable example is the collection of methane gas from landfills. Efficient land management and agricultural production are also needed to ensure availability of food for a growing population while limiting negative environmental impacts.

Companies operating in these segments include DS Smith Plc, United Utilities Group Plc and AO Smith Corp.

Precision agriculture
Estimates suggest that the current food system is responsible for around a quarter of greenhouse gas emissions and consumes around 70 percent of available freshwater at a global level. Agricultural practices can also result in water pollution and soil degradation. The key to these challenges is technology, such as precision agriculture. This type of farming enables sustainable intensification of food production, helping increase efficiency by maximising yields while reducing inputs such as water and fertiliser. This is achieved with software and tools that equip farmers with real-time data and analysis for optimum decision-making in areas such as planting and irrigation. Improvements in refrigeration technology in the transportation and storage of food are also an important part of initiatives to reduce food waste.

**Table 13** Top ten equity holdings in the natural resource management segment in the fund's environmental portfolio as at 31 December 2018

| Company | Country | FTSE Global sector | Millions of kroner | Share of portfolio Percent |
|---|---|---|---|---|
| Waste Connections Inc | Canada | Industrials | 1,676 | 3.9 |
| DS Smith Plc | United Kingdom | Industrials | 1,482 | 3.4 |
| Xylem Inc/NY | United States | Industrials | 1,101 | 2.5 |
| LKQ Corp | United States | Consumer goods | 1,099 | 2.5 |
| Koninklijke DSM NV | Netherlands | Basic materials | 823 | 1.9 |
| Steel Dynamics Inc | United States | Basic materials | 625 | 1.4 |
| United Utilities Group Plc | United Kingdom | Utilities | 597 | 1.4 |
| Veolia Environnement SA | France | Utilities | 549 | 1.3 |
| Tetra Tech Inc | United States | Industrials | 547 | 1.3 |
| American Water Works Co Inc | United States | Utilities | 503 | 1.2 |


Sewage treatment

# Divestments

**There are companies in which we choose not to invest. These include companies that violate fundamental ethical norms or impose substantial costs on society through their operations. By not investing in these companies, we reduce our exposure to unacceptable risks.**

The Ministry of Finance has established ethically motivated guidelines for observation and exclusion of companies from the fund. The guidelines contain criteria for exclusion based either on the companies' products or on their conduct. The fund must not be invested in companies that produce certain types of weapons, base its operations on coal, or produce tobacco. The fund must also not be invested in companies that through their conduct contribute to violations of fundamental ethical norms. The Ministry of Finance has established an independent Council on Ethics to make ethical assessments of companies. The Council on Ethics sends its recommendations to Norges Bank's Executive Board, which then makes the final decision on exclusion, observation or active ownership.

Finally, the fund itself may divest from companies that impose substantial costs on other companies and society as a whole and so are not long-term sustainable. Examples of activities that are unsustainable are business models that do not conform to prevailing technological, regulatory or environmental trends.

**Ethical exclusions**

In 2018, Norges Bank excluded 13 companies, placed four companies under observation, and decided on active ownership for one company.

### Product-based exclusions

The fund must not invest in companies which themselves, or through entities they control, manufacture weapons that violate fundamental humanitarian principles through their normal use, or sell weapons or military materiel to certain countries. Nor may the fund invest in companies that produce tobacco. There is also a product-based coal criterion that applies to companies in two categories: mining companies

## Ethical decisions in 2018

| Category | Criterion | Number | Company |
|---|---|---|---|
| Exclusion | Thermal coal mining or coal-based power production | 2 | PacifiCorp, Tri-State Generation and Transmission Association Inc |
| | Severe environmental damage / Human rights violations | 4 | Evergreen Marine Corp Taiwan Ltd, Korea Line Corp, Precious Shipping PCL, Thoresen Thai Agencies PCL |
| | Gross corruption | 1 | JBS SA |
| | Production of specific weapon types | 4 | AECOM, BAE Systems Plc, Fluor Corp, Huntington Ingalls Industries Inc |
| | Human rights violations | 2 | Luthai Textile Co Ltd, Atal SA/Poland |
| Observation | Thermal coal mining or coal-based power production | 2 | Berkshire Hathaway Energy Co, MidAmerican Energy Co |
| | Severe environmental damage / Human rights violations | 1 | Pan Ocean Co Ltd |
| | Human rights violations | 1 | Nien Hsing Textile Co Ltd |
| Revoked | Other particularly serious violations of fundamental ethical norms | 2 | Kosmos Energy, Cairn Energy Plc |



## Total company observation and exclusions as at 31 December 2018

| Tema | Criterion | Number of companies |
|---|---|---|
| Product-based exclusions | Production of tobacco | 18 |
| | Production of specific weapon types | 19 |
| | Thermal coal mining or coal-based power production | 68 |
| Conduct-based exclusions | Human rights violations | 5 |
| | Severe environmental damage | 17 |
| | Contributions to climate change | 0 |
| | Gross corruption | 2 |
| | Other particularly serious violations of fundamental ethical norms | 3 |
| | Serious violations of the rights of individuals in situations of war or conflict | 2 |
| | Severe environmental damage / Human rights violations | 4 |
| Observation | Human rights violations | 3 |
| | Severe environmental damage | 1 |
| | Severe environmental damage / Human rights violations | 1 |
| | Gross corruption | 3 |
| | Thermal coal mining or coal-based power production | 14 |

that derive 30 percent or more of their revenue from the production of thermal coal, and power companies that derive 30 percent or more of their revenue from coal-based power production. In 2018, four companies that produce nuclear weapons and two coal companies were excluded. A total of 105 companies that produce certain types of weapon, tobacco or coal, or use coal for power production, have been excluded from the fund.

### Conduct-based exclusions

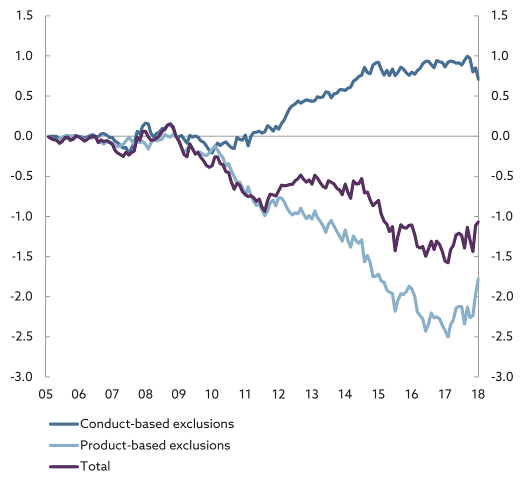
Companies may also be excluded if there is an unacceptable risk of conduct considered to constitute a particularly serious violation of ethical norms.



The Executive Board takes the final decision on the observation and exclusion of companies after receiving a recommendation from the Council on Ethics. The Executive Board bases its decisions on an assessment of the probability of future norm violations, the severity and extent of the violations, and the connection between the violation and the company the fund is invested in.

The Executive Board may also consider the breadth of the company's operations and governance, including whether the company is doing what can reasonably be expected to reduce the risk of future norm violations within a reasonable time frame. Before the Executive Board takes a decision to exclude a company, it must consider whether other measures, such as active ownership, might be more suited to reduce the risk of continued norm violations, or whether such alternative measures may be more appropriate for other reasons. In 2018, seven companies were excluded on the grounds of conduct considered to constitute particularly serious violations of ethical norms. A total of 33 companies have been excluded for unethical conduct.

**Chart 13** Return impact of equity benchmark index exclusions relative to an unadjusted index. Measured in dollars. Percentage points



### Impact on the fund's equity returns

When companies are excluded from the fund, they are also removed from the benchmark index. Product-based exclusions have reduced the cumulative return on the equity benchmark index by around 1.8 percentage points, or 0.07 percentage point annually. The exclusion of some tobacco companies and weapons manufacturers has contributed to reduced returns.

Conduct-based exclusions have increased the cumulative return on the equity benchmark index by around 0.7 percentage point, or 0.03 percentage point annually.

Since 2006, the equity benchmark index has returned 1.1 percentage points less than an unadjusted equity benchmark index. On an annualised basis, the return has been 0.04 percentage point lower.

**Table 14** Contribution to return impact of equity benchmark index exclusions by exclusion criterion as at 31 December 2018. Market value in billions of kroner. Contribution measured in dollars. Percentage points

| Criterion | Number of excluded companies from benchmark[1] | Market value in benchmark if not excluded | 2018 | 2006–2018 annualised |
|---|---|---|---|---|
| **Product-based exclusions** | **105** | **141.9** | **0.17** | **-0.07** |
| Production of specific weapon types | 19 | 63.1 | -0.07 | -0.05 |
| Production of tobacco | 18 | 47 | 0.30 | -0.02 |
| Thermal coal mining or coal-based power production | 68 | 31 | -0.06 | 0.00 |
| **Conduct-based exclusions** | **33** | **44** | **-0.03** | **0.03** |
| Human rights violations | 5 | 13 | -0.02 | -0.01 |
| Serious violations of the rights of individuals in situations of war or conflict | 2 | 0 | 0.00 | 0.00 |
| Severe environmental damage | 17 | 27 | -0.01 | 0.03 |
| Gross corruption | 2 | 1 | 0.00 | 0.00 |
| Other particularly serious violations of fundamental ethical norms | 3 | 3 | 0.00 | 0.00 |
| Severe environmental damage and human rights violations | 4 | 0 | 0.00 | 0.00 |
| **Total** | **138** | **186** | **0.14** | **-0.04** |

[1] Includes companies that are not in the benchmark universe.

**Risk-based divestments**
In 2018, we divested from 30 companies following assessments of governance and sustainability risks. Altogether, we have divested from 240 companies since 2012.

The integration of environmental, social and governance issues into our risk management may result in divestment from companies where we see elevated long-term risks. These are companies that do business in a way that we do not consider sustainable, or could have negative financial consequences. These consequences may be direct – for example, where a company has to pay fines or is excluded from markets on account of irresponsible conduct, or is outcompeted by others that manage sustainability risks more effectively. They may also be indirect, with companies' operations having negative externalities for society and undermining sustainable economic development in the longer term. We wish to reduce our exposure to such companies over time and would rather allocate capital to companies with more sustainable business models. Risk-based divestments are one way of doing so.

We carry out divestments within the overall limits for portfolio deviation from the benchmark specified in the management mandate. Where we have substantial investments in a company, dialogue may be a more suitable approach than divestment. We generally have better analytical coverage of our largest investments, and more contact with their management and board.

Our diversified portfolio requires us to take a systematic approach to risk-based divestment. Many of the topics and sectors covered by our divestment analyses are also addressed in our ongoing work on standard setting and active ownership. Recommending companies for risk-based divestment is often the last resort after other possibilities have been considered but deemed insufficient. We do not publish a list of companies from which we have divested, but we are transparent about the criteria underpinning our decisions. We also publish annual holding lists showing all of the companies in our portfolio, which makes it possible to analyse changes from one year to the next.

## Climate change
We have assessed the risk associated with greenhouse gas emissions from companies in the portfolio as part of our focus on climate change. Companies that have operations or value chains with particularly high greenhouse gas emissions may be exposed to risks in the event of regulatory changes or other market developments. This may lead to higher operating costs or reduced demand.

As part of our focus on climate change we also assess company activities that lead to deforestation, which is a significant contributor to greenhouse gas emissions.

### Coal-based power production and coal mining
Power producers' use of thermal coal as a fuel is an area with particularly high regulatory risks in some markets. More and more countries have introduced targets to reduce greenhouse gas emissions from the power sector, especially in the wake of the Paris Agreement.

Like coal-based power producers, mining companies that produce thermal coal for power production will face challenges in the transition to a low-carbon economy.

When we assess companies for divestment, we look at what share of their operations is based on coal, be it the production of thermal coal or the use of this coal in power production. This analysis has much in common with our process for assessing companies under the coal criterion in the Guidelines for Observation and Exclusion of Companies from the Government Pension Fund Global. The difference with our internal divestment criteria is that we have chosen to divest from companies where it is difficult to confirm their exposure to coal, but where we believe it to be above a certain threshold. Our analyses resulted in divestment from ten power producers and one mining company in 2018.

### Emission intensity

Our analysis of climate risk in the portfolio includes companies' emission intensity, i.e. greenhouse gas emissions in relation to revenue. Emission intensity may be a useful factor when analysing multiple companies operating in the same sector or with similar business models, because it says something about how energy-efficient their operations are, which in turn says something about the costs and risks associated with that business model. In 2018, we looked at a selection of companies in the portfolio with a substantially higher emission intensity than other companies in the same sector. Following this analysis, we chose to divest from one company.

### Palm oil

Deforestation has significant environmental and social consequences. Forests are an important part of the ecosystem and help maintain biodiversity, store carbon and produce oxygen. In some regions, deforestation is one of the main sources of greenhouse gas emissions and can also threaten human rights and indigenous rights.

There is a broad consensus that the production of palm oil is a significant contributor to tropical deforestation. We have therefore been analysing this sector since 2012, leading to divestment from a total of 32 companies between 2012 and 2017. The companies we divested from were considered to produce palm oil in a manner that is not sustainable.

When considering companies for divestment, we focus on those that operate palm oil plantations in Malaysia and Indonesia, and have palm oil production as a significant part of their business. We also look at whether companies have been certified by the Roundtable on Sustainable Palm Oil, or plan to become certified. In 2018, we assessed companies previously divested, as well as companies currently in the portfolio that have direct exposure to palm oil production. This assessment in 2018 lead to two divestment decisions.

### Rubber

The production of rubber from plantations is another known contributor to tropical deforestation in various parts of the world. In our analysis of rubber producers, we looked particularly at the share of their business for which rubber production accounts, and signs that this production is unsustainable. As a result of this analysis, we divested from one company in 2018.

## Anti-corruption

Failure to address governance risks can lead to production stoppages and fines, loss of contracts and reputational damage for companies. In 2018, we continued to assess significant governance issues in our work on risk monitoring and risk-based divestments.

As a result of our analyses in this area, we divested from nine companies with high exposure to corruption risks and signs of inadequate management of this exposure.

## Divestments in 2018

| Expectation | Theme | Criteria | 2018 |
|---|---|---|---|
| Climate Change | Palm oil production | Owns/operates plantations in Malaysia and Indonesia | |
| | | Relevant percentage of business mix allocated to palm oil production | |
| | | RSPO certification status and plans | 2 |
| | Rubber production | Owns/operates rubber plantations | |
| | | Indications of unsustainable plantation activities | 1 |
| | Coal-based power production | Relevant percentage of business mix allcoated to electricity production | |
| | | Coal at relevant percentage of fuel-mix | 10 |
| | Thermal coal mining | Owns/operates thermal coal mines | |
| | | Relevant business mix allocated to thermal coal extraction | 1 |
| | $CO_2$-intensity | Considerably higher emissions intensity than industry peers | 1 |
| Anti-corruption | Anti-corruption | Exposure to high-risk sectors and markets | |
| | | Indications of insufficient risk management related to corruption and corporate governance | 9 |
| Human Rights | Human rights | Exposure to high-risk sectors and markets | 4 |
| | | Indications of insufficient risk management related to human rights, labour rights or health, safety and environment | |
| Other | Tobacco | Activities with significant direct or indirect affiliation with tobacco production | 2 |
| Total | | | 30 |

## Divestments in previous years

| Expectatation | 2018 | 2017 and earlier[1] |
|---|---|---|
| Climate Change | 15 | 127 |
| Water Management | 0 | 46 |
| Anti-corruption | 9 | 13 |
| Human Rights | 4 | 17 |
| Other | 2 | 7 |
| Total | 30 | 210 |

[1] As of 2018, subsidiaries and financing arms of existing divestments are no longer included in the overall count. As such, the numbers in this table are lower than in previous years.



Rubber production

Examples of such signs include documented incidents relating to corruption or governance.

### Human rights
We have assessed companies' exposure to social risks in areas such as human rights, labour rights, and health and safety. In some cases, we found that companies with high inherent risk exposure had documented incidents indicating possible violations of human rights or labour rights or poor management of health and safety. The risk of companies being involved in further incidents was deemed excessive in some cases, and so we chose to divest from four companies.

### Ocean sustainability
In September 2018, we published our expectations of companies on ocean sustainability. We are working on obtaining more detailed information to put us in an even better position to understand and analyse companies' exposure to marine resources. We are keen for companies to address ocean sustainability and manage relevant risks and opportunities well. Companies that do not address these issues may be candidates for risk-based divestment.

In previous years, we have looked at sectors and topics relating to the ocean and divested from three such companies where we saw indications of inadequate management of issues related to sustainability. In 2017, we chose to divest from one company due to serious pollution of the ocean and fish deaths. In 2016, we divested from two companies in the seafood sector due to proven violations of human rights in the supply chain. The divestments were classified as relating to either water management or human rights. We will continue to analyse companies' impact on the ocean and make further divestments where their activities are not deemed sustainable.

### Other unacceptable risks
In addition to the areas covered by our expectation documents, we also monitor other factors that may expose companies in our portfolio to unacceptable risks. For example, we screen the portfolio for companies that have direct or indirect links to tobacco production. This screening has picked up two such companies, and we have therefore divested from them.

### Impact on the fund's equity returns
The purpose of our risk-based divestments is to reduce our exposure to companies with operations that may not be sustainable. In addition to reducing risk, such divestments can also have an impact on the return of the equity portfolio and the equity reference portfolio. When we carry out risk-based divestments, the companies we divest will be removed from the fund's equity reference portfolio. We can measure the impact of divestments on the fund's equity return by comparing the equity reference portfolio adjusted for risk-based divestments with an unadjusted reference portfolio. Risk-baseddivestments have since 2012 contributed positively to the cumulative return on the equity referenceportfolio by around 0.11 percentage point, or 0.01 percentage point annually.

Over time, risk-based divestments linked to climate change and human rights have contributed positively to the cumulative return on the equity reference portfolio by 0.14 and 0.03 percentage point, respectively. Risk-based divestments linked to anti-corruption and water management have reduced the cumulative return on the equity reference portfolio by 0.05 and 0.01 percentage point, respectively. There are many factors influencing market developments and affecting the share price of individual companies. In the short term, it is difficult to isolate and measure the impact that companies' approaches to corporate governance and sustainability may have on returns. At the same time, we believe that companies that integrate such issues in their strategy, risk management and reporting could over time contribute positively to the fund's return and to economic development at large.

The aim of our exclusions and divestments is to avoid having holdings in companies that are responsible for violations of ethical principles, and to reduce the fund's exposure to unacceptable risks. This is the final step in our responsible investment management, which furthers the fund's objective of managing and building financial wealth for future generations.

**Chart 14** Return impact of risk-based divestments on the reference portfolio for equities, compared to a portfolio not adjusted for risk-based divestments. Measured in dollars. Percentage points

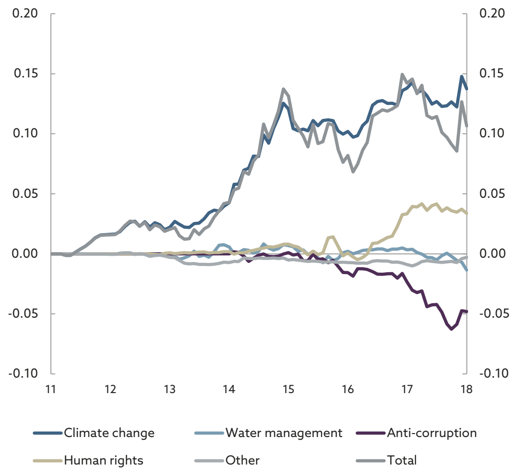



**Table 15** Contribution to return impact of equity reference portfolio risk-based divestments as at 31 December 2018. Market value in billions of kroner. Contribution measured in dollars. Percentage points

| Expectation | Number of companies divested[1] | Market value in the reference portfolio if not sold | 2018 | 2012–2018 annualised |
|---|---|---|---|---|
| Climate change | 142 | 11.9 | 0.01 | 0.01 |
| Water management | 46 | 3.9 | -0.01 | 0.00 |
| Anti-corruption | 22 | 6.6 | -0.02 | 0.00 |
| Human rights | 21 | 3.8 | 0.00 | 0.00 |
| Other | 9 | 0.7 | 0.00 | 0.00 |
| **Total** | **240** | **26.9** | **-0.01** | **0.01** |

[1] Includes companies that are not in the reference portfolio universe.

# Responsible Investment in the Management Mandate

**Chapter 1.**

### General provisions

### Section 1-3. The management objective

**1** The Bank shall seek to achieve the highest possible return after costs measured in the investment portfolio's currency basket, see section 4-2, first paragraph, and within the applicable management framework.

**2** The Fund shall not be invested in companies excluded pursuant to the provisions in the Guidelines for observation and exclusion from the GPFG.

**3** The Bank shall integrate its responsible management efforts into the management of the GPFG , cf. chapter 2. A good long-term return is considered dependent on sustainable development in economic, environmental and social terms, as well as on well-functioning, legitimate and efficient markets.

**Chapter 2.**

### Responsible management

### Section 2-1 Responsible management efforts

The Bank shall seek to establish a chain of measures as part of its responsible management activities.

### § 2-2 Responsible management principles

**1** The Bank shall establish a broad set of principles for the responsible management of the investment portfolio.

**2** In designing the principles pursuant to the first paragraph, the Bank shall emphasize the long-term horizon for the management of the investment portfolio and that the investment portfolio shall be invested widely in the markets included in the investment universe.

**3** The principles shall be based on the considerations of good corporate governance and environmental and social conditions in the investment management, in accordance with internationally recognised principles and standards such as the UN Global Compact, the OECD's Principles of Corporate Governance and the OECD's Guidelines for Multinational Enterprises.

**4** The principles and the use of measures to support them shall be published, cf. section 2-1 and section 6-2, third paragraph, letter h).

**5** In its management of the real estate portfolio, the Bank shall, within the environmental field, consider, among other matters, energy efficiency, water consumption and waste management.

### Section 2-3 Contribution to research and development relating to international standards for responsible management

**1** The Bank shall contribute to research within responsible management with the aim of developing greater knowledge of matters relevant to the investment portfolio's risk and return in the long-term.

**2** The Bank shall actively contribute to the development of relevant international standards in the area of responsible management.

### Section 2-4 Environment-related investments

The Bank shall establish environment-related mandates within the limits defined in section 3-4. The market value of the environmental-related investments shall normally be in the range of 30-60 billion kroner.

### Section 2-5 Decisions on exclusion and observation

The Bank shall make decisions on the observation or exclusion of companies, and on the revocation of such decisions, in accordance with the Guidelines for observation and exclusion from the GPFG. The Bank shall inform the Ministry about decisions on exclusion of companies and revocations of such decisions, cf. section 3-1, third paragraph.

ISSN 2387-399X
Design: Scandinavian Design Group
Photos: Hans Fredrik Asbjørnsen, Offset,
Getty Images, Shutterstock.
Paper: Galerie Art Silk 300 g / Matt 150 g
Production: 07 Media AS | Print run: 500

NORGES BANK INVESTMENT MANAGEMENT
Bankplassen 2, P.O. Box 1179 Sentrum, NO-0107 Oslo, Norway
T: +47 24 07 30 00, www.nbim.no