



NORGES BANK

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Follow-up of recommendations on observation and exclusion of companies from the Government Pension Fund Global

We refer to the Ministry's letter of 18 December 2020 on the follow-up of the white paper *The Government Pension Fund 2020*. In view of the comments of the Standing Committee on Finance and Economic Affairs in its consideration of the white paper, the Ministry asks the Bank to present its processes and its work in following up recommendations on observation and exclusion of companies from the fund, from the recommendation being received from the Council on Ethics to any exclusion being published.

Norges Bank has held the responsibility for taking decisions on observation and exclusion since 2015. Previously, this responsibility was assigned to the Ministry. In response to this change, the Executive Board decided to create a subcommittee – the Ownership Committee – as a preparatory and advisory body for matters concerning responsible investment and decisions on observation and exclusion of companies from the fund. The Ownership Committee submits its position to the Executive Board, which then takes a decision.

Basis for the Executive Board's decisions

The positions submitted by the Ownership Committee to the Executive Board on observation and exclusion cases are based on the recommendation from the Council on Ethics, supplemented with assessments and information from Norges Bank Investment Management (NBIM). In line with the Ministry's guidelines for observation and exclusion, NBIM conducts a review of publicly available sources relevant to the case and assesses whether the exercise of ownership rights may be a more suitable measure than that recommended by the Council on Ethics. In cases where the availability of information is good and the application of the criterion is well established, NBIM will normally need between four and seven weeks to prepare this material. After being considered by the



Ownership Committee, the case is then raised at the next meeting of the Executive Board. Since meetings of the Ownership Committee and the Executive Board follow a set schedule, it may be some time before these cases are considered. The Executive Board holds around 13 meetings a year.

Decisions on observation and exclusion can have consequences for the companies in question. This places demands on the process leading to such a decision. In addition to information from the Council on Ethics, the Bank is required to consider the exercise of ownership rights as an alternative measure. The work done in the period leading up to the Executive Board's decision ensures that the Bank satisfies the requirement in the guidelines that sufficient information is available before a decision is taken.

In a small number of cases, there is a need for further investigation and clarification after receiving the recommendation from the Council on Ethics. The Bank will then initiate a dialogue with the Council on Ethics. It may also need to ask the Ministry to expand on issues before the Executive Board reaches a conclusion on a case. Since 2015, the Bank has initiated more extensive investigation or clarification in its work under two criteria: the product-based weapons criterion and the conduct-based climate criterion. This type of clarification means that the time from receipt of the recommendation from the Council on Ethics to the Executive Board's decision is longer. The Bank nevertheless considers the option of obtaining such clarification to be necessary to ensure good decisions.

Execution of decisions

When deciding on exclusion, the Executive Board sets a deadline for the sale of the fund's holdings in the company. Normally, this deadline will be between 10 and 12 weeks. The Governor is authorised by the Executive Board to grant exemptions from this deadline where warranted by liquidity or other market conditions.

We aim to execute these sell-downs in such a way that the decision can be executed and published within a reasonable period of time. On the other hand, we also aim to avoid incurring unnecessary costs for the fund. In practice, we need to make a trade-off between these two considerations. A rapid sell-down could result in lower realised selling prices after transaction costs than with more patient trading. A lower selling price is a cost to the fund. We have found this a greater challenge as the fund has grown in size. We have also found considerable variations in liquidity and market conditions for the stocks the fund has sold down. In some cases, this has presented particular challenges. Recent years have therefore seen an increase in the time it takes for the Executive Board's decision to sell down to be executed and the exclusion to be published.

The process for decisions on observation is less complex, as this will not in itself involve trading in securities. The Executive Board's decision will normally authorise the Governor to set a time for the publication of the decision. This will typically be at a suitable point not long after the Executive Board's decision. The same applies to decisions on the exercise of ownership rights and to the revocation of observation decisions.



Norges Bank altered its process for revoking exclusions in 2019. These decisions are now published without undue delay after being taken by the Executive Board. One consequence of this change is a reduction in the time between receipt of the recommendation from the Council on Ethics to revoke exclusion and publication of the decision.

Total time consumption

Since 1 January 2015, the Executive Board has considered recommendations on exclusion, observation or revocation thereof for 155 companies. The recommendations for 93 of these companies came from NBIM based on the product-based coal criterion. The remaining 62 came from the Council on Ethics, of which 41 were for exclusion, seven for observation and 14 for the revocation of previous decisions. The Executive Board has followed the recommendation of the Council on Ethics in 54 cases, opted for observation rather than exclusion in four cases, and decided on the exercise of ownership rights instead of exclusion in one case and instead of observation in three cases.

Once the Bank receives a recommendation from the Council on Ethics, NBIM begins work on its assessments, including of whether the exercise of ownership rights might be a more suitable measure. The recommendation from the Council on Ethics and NBIM's assessments are then presented to the Executive Board's Ownership Committee, which prepares a position to be put to the Executive Board. The time taken to prepare cases will depend on their complexity. In special cases, the Executive Board may need to obtain further assessments from the Council on Ethics or clarification from the Ministry of Finance.

In the cases that Norges Bank has considered, an average of 271 days have passed between the recommendation from the Council on Ethics (on exclusion, observation or revocation thereof) being received and the Executive Board's decision being published.¹ For cases with no need for additional clarification on the application of the criteria, an average of 171 days have elapsed between the Council on Ethics' recommendation and the publication of the decision. This figure breaks down into 69 days from recommendation to decision, and 103 days from decision to publication (while any necessary trading takes place²). Norges Bank believes that it is important for enough time to be allowed to consider these cases properly before taking a decision. The time from decision to publication will normally be a trade-off between the competing considerations of low costs and rapid execution of the Executive Board's decision.

The decisions and recommendations are published on an ongoing basis. There is an overview of current exclusion and observation decisions on the Bank's website, and all of the recommendations made under each criterion are presented on the Council on Ethics'

¹ The figures we present here are calendar days, not working days. When it comes to recommendations based on the conduct-based climate criterion, we have counted from the date of submission of the initial recommendation. If we count from the date of the final recommendation instead, the average for all cases during the period is 211 days. Recommendations from NBIM based on the coal criterion have been excluded. Had we included recommendations from NBIM in these calculations, the average time elapsing would have been shorter.

² In the case where the execution of trading took longest, the time from decision to publication was 446 days. This had its background in liquidity and market conditions.



website. The Bank reports on this work in various publications, including in its annual report on responsible investment.

Yours faithfully

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Enclosure



Enclosure

Chart 1: Time from Council on Ethics recommendation to publication of decision. Number of days per case. Blue portion of bar: Time from recommendation to decision. Grey portion of bar: Time from decision to publication.

