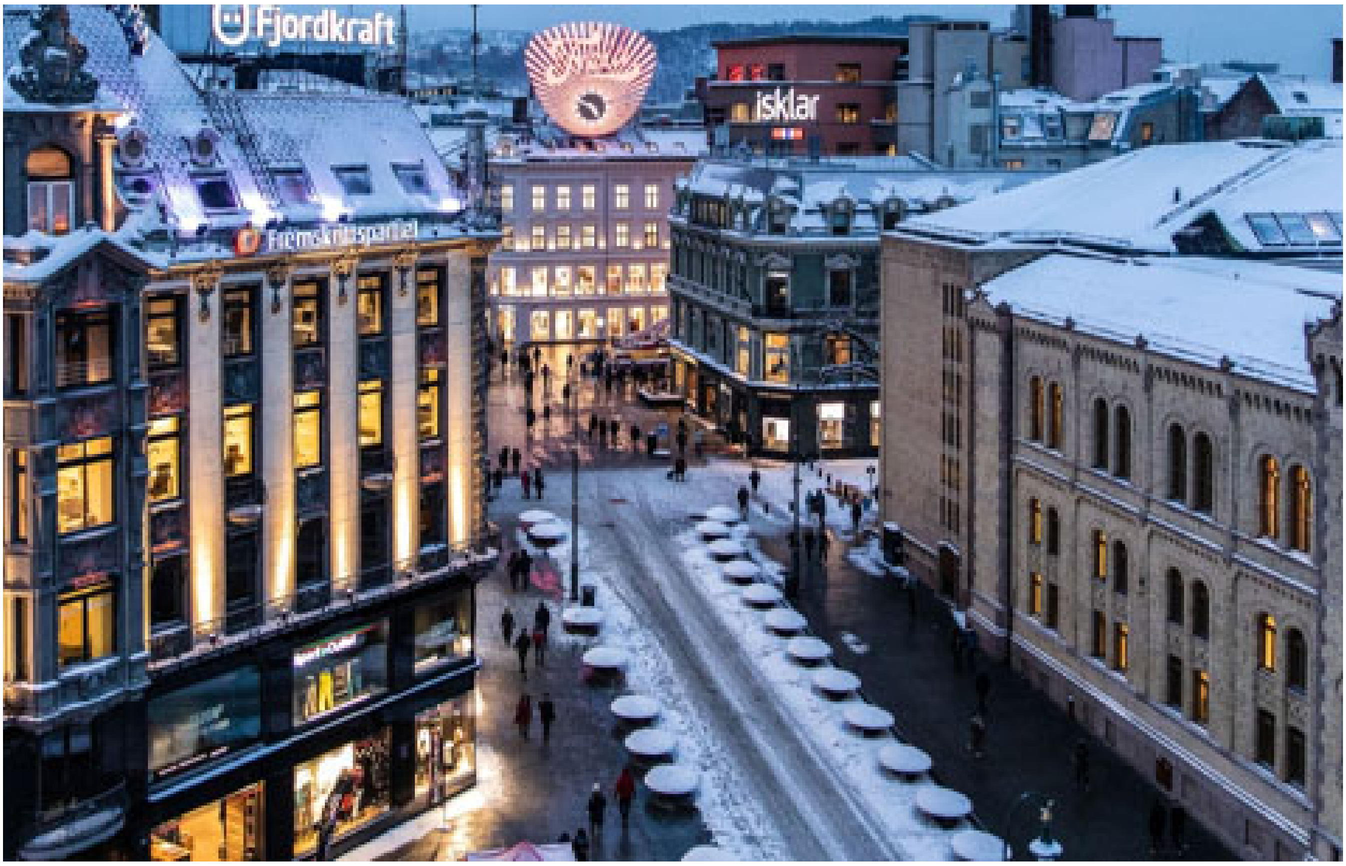
Policy and Regulation

Norway’s sovereign wealth fund exemplifies wider net zero issues

By Rachel So
January 27, 2022



As the fund adopts a net zero target for its stocks and focuses on engagement, questions remain on whether its climate risk strategy is ambitious enough

Norway's Government Pension Fund Global is the world's largest sovereign wealth fund (SWF), with $1.3tn in assets. More than 70 per cent of this is invested in equities, making the fund one of the world’s largest shareholders. But while urging oil companies in its portfolio to do more to cut emissions, as its manager did last August after criticism by some economists, the fund itself has not yet committed to net zero targets.

The GPFG is conspicuously absent from the UN-convened Net-Zero Asset Owner Alliance, though it is not unique among SWFs. While 69 investors, including pension funds and insurers with $10.4tn in assets under management have joined the alliance, Germany's KENFO is the only sovereign wealth fund among them.

Günther Thallinger, member of the board of management of Allianz SE Investments, ESG, and chair of the Net-Zero Asset Owner Alliance, says: “Most SWFs were established as savings vehicles for future generations. Their investments should be contributing to the conservation of the climate that those generations will live in.”

Håvard Halland, senior economist at the OECD Development Centre, adds: “It is one of the great paradoxes of climate finance that sovereign funds are lagging behind the private financial sector with regard to climate commitments, and Norway is no exception.”

This is borne out by an International Forum of Sovereign Wealth Funds report that just 36 per cent of the SWFs it surveyed have a formal climate change strategy in place, and only 14 per cent have divested based on environmental considerations.

Not doing enough

Norway's sovereign wealth fund was created following the discovery of oil in the North Sea and designed to shield the economy from the volatility of oil revenue. The fund comprises a mix of equities, fixed income, real estate and renewable energy and invests in over 9,000 companies in 73 countries, but revenue from oil now accounts for less than half of its value.

Last year, a group of well-known economists and experts signed a letter, written by Halland and published by the Official Monetary and Financial Institutions Forum, which called not only for the GPFG to reduce its total portfolio carbon emissions towards net zero by 2050 or sooner but also to join the Net-Zero Asset Owner Alliance.

The letter pointed out that the GPFG equity portfolio carbon footprint of 107.6m tonnes of CO_2 equivalents is more than twice the amount of Norway's annual total emissions, and triple the amount excluding the country's emissions during oil and gas extraction. The letter also lamented the fund's lack of specific emissions targets and its focus on climate risk rather than impact.

Active ownership

In December, Norges Bank Investment Management, which manages GPFG’s assets, accepted an official proposal to adopt an overall long-term goal of net zero emissions from the companies in which the fund is invested, in line with international climate agreements to which Norway has acceded.

A letter from NBIM to the Ministry of Finance, signed by CEO Nicolai Tangen and central bank governor and NBIM chair Øystein Olsen, said: "As a long-term and global investor with holdings in thousands of companies, we have a financial interest in companies adapting well to the risks and opportunities presented by climate change.”

NBIM said it will prioritise active engagement as a tool for driving the companies it invests in to reach net zero, and will only use divestment as an instrument of last resort if ownership activities such as dialogue and voting prove unsuccessful: “The fund’s size gives us good access to company boards. Based on our experience from being an active owner for many years, Norges Bank believes this makes it reasonable to assume that our ownership activities have an impact.”

It added that it will step up its work with the highest-emitting companies in its portfolio, paying particular attention to companies that have not published climate plans and those with weak climate reporting.

No net zero commitment

But while NBIM has shown its commitment to mitigating climate risk, is its strategy ambitious enough? And why has the GPFG not made a net zero commitment itself?

Unpacking the dynamics between the government and the GPFG, Halland notes that the Ministry of Finance represents the government’s ownership role and constructs the benchmark index for the fund, whereas NBIM manages the fund with a limited amount of leeway to divert from the index. This means that a commitment to a net zero portfolio carbon footprint would likely need to be reflected both in the composition of the benchmark index, and in the way that the fund is managed.

NBIM can only enforce emissions objectives for portfolio companies indirectly, through engagement and stewardship. “A commitment to net zero for the fund would therefore need to come from the Ministry of Finance, as the entity responsible for constructing the benchmark index, rather than NBIM,” Halland says.

Diego López, managing director of data platform Global SWF, says any formal engagement of a sovereign wealth fund to a net zero initiative will only come once their hosting governments decide to pursue such commitments – it should be a top-down approach.

Government commitment

Unlike Norway's previous government, which opposed a more ambitious level of climate-alignment for the fund, the current government, which assumed power in autumn 2021, has taken a different approach. At 2021's COP26, prime minister Jonas Gahr Støre committed to making the GPFG the leading fund in responsible investment and management of climate risk.

Halland says: "I hope that such a [net zero] commitment might be forthcoming in the ministry's annual white paper on the fund later this spring. That said, NBIM could have recommended such an objective in their letter to the ministry, which they didn't."

Meanwhile, Thallinger says that governments should be using the financial weight of SWFs to drive climate action internationally: "It is disingenuous of governments acting domestically on climate commitments to pretend emissions linked to foreign investments of SWFs are somehow separate from the all-encompassing threat we face."

Setting an index

Halland says that a key challenge for the Norwegian fund – apart from its size – is setting emissions targets for its index. It is a problem that NBIM shares with other managers of index funds globally, and one that asset owners, asset managers and index providers urgently need to address.

"In my view, the ministry should consider revising their inclusion rules for the index," he says. "Short and long-term portfolio emissions targets for the fund could be reflected both in a more dynamic and climate-aligned composition of the benchmark index, and in the stronger climate-related engagement and stewardship that NBIM has said they are committed to."

He suggests the ministry should work with index providers to set up a net zero benchmark index for a share of the portfolio, which seeks to progressively screen companies along a trajectory consistent with a 1.5°C scenario. This would allow for the inclusion of companies in emissions-intensive sectors that are serious about reducing their climate impact.

Developing such an index for the fund, and using its financial weight to drive change in the way that indices are constructed globally, could eventually see the GPFG become the leader in responsible investment envisaged by the Norwegian prime minister at COP26.