Norway's Sovereign Wealth Fund prepares net-zero effort amid risk

07 April 2022 | Cristina Brooks

One of the world's largest investors may become a net-zero activist shareholder, but has no plans to take the net-zero pledge itself amid rising market risks.

Norway's Government Pension Fund Global (GPFG), a sovereign wealth fund that invests the surplus revenues of the petroleum sector in its $1.4 trillion in assets, owns about 1.5% of the world's listed companies according to fund manager Norges Bank.

As part of the Ministry of Finance's annual reviews of Norges Bank's mandate, its 1 April white paper seeks to pile the pressure on invested companies to reach net-zero GHGs while the country itself aims for that target by 2050.

It envisages a change of the fund's ESG aims, replacing its environmental mandate with a broader climate-risk-oriented index. The jury is still out, however, on whether this will cause its green investment to grow or shrink as the details of the index are yet to come, according to observers.

"I think that the intention by the Ministry of Finance now is to give the fund actually a bit more room to make smarter decisions. Up until now, they have only been allowed to deviate 1.5% from the reference index, which is very little room to manoeuvre in a fast changing world," Martin Norman, global investment stewardship director of the Oslo-based advocacy group Australasian Centre for Corporate Responsibility told *Net-Zero Business Daily* by S&P Global Commodities Insights.

The ministry worried about rising market risk yet wanted Norway to lead in managing "climate and nature risks" in the context of "several types of risk" it faces.

Today's market volatility meant the fund could lose value, threatening the welfare programs it finances. "Financial markets are however volatile, and we need to be prepared for potential fund value reductions. As an ever-increasing share of the Norwegian welfare state is funded by transfers from the GPFG, we are becoming more vulnerable to fund value fluctuations," said the Minister of Finance Trygve Slagsvold Vedum in a 1 April statement.

Escalation of Russia's war in Ukraine could mean "substantial" market losses for banks. Already, the war has raised market risks through increased market volatility, lower equity valuations, and wider credit spreads the European Banking Authority noted in its 1 April risk report.

Many companies saw credit downgrades on 7 March according to data from S&P Global Commodities Insights.

In February, when Russia invaded Ukraine, the Ministry of Finance asked Norges Bank to immediately make plans to divest from Russian assets.

The white paper's recommendations now go to the Finance Committee within the Norwegian legislature, the Storting, where they could be changed before becoming law.

Net-zero stance weaker than some

The fund must pressure companies it invests in to align toward the global net-zero emissions goal within the Paris Agreement, the ministry said.

This could be done through regular reporting on companies' forward-looking decarbonization pathways using today's leading frameworks.

The fund, which has a minority stake in many companies, is not expected to engage in typical activist investing. "I wouldn't say activist because the mandate is very clearly to secure long-term income with low to moderate risk, but in a world that has to change there are all kinds of issues at hand, they need to have a clear mandate so that they can be more proactive in their approach," said Norman.

This proposed pseudo-activism shifts the burden of reaching net zero, however, away from the fund and onto its portfolio companies.

It falls short of Norway's commitment at the COP26 climate conference last year to make GPFG "the leading fund in responsible investment and the management of climate risk," said Håvard Halland, a senior economist for global policy forum OECD's Development Centre.

"It's an important step ahead as they now commit [on behalf of the fund] to working toward net-zero emissions within portfolio companies through active ownership, but the index remains largely as it is," he said.

"They don't commit to a certain emissions reduction at portfolio level: They commit to doing their best," he added.

More net-zero pressure could be brought to bear if the GPFG joined the UN initiative Net-Zero Asset Owner Alliance, which commits to net-zero emissions, an academic paper and a think tank argued last year.

But the Ministry of Finance's white paper examined Norges Bank's steering of the GPFG, and found it was "satisfactory."

The white paper highlighted the advice of an expert group on climate risk that found that nearly all volatility in the returns of the fund can be explained by benchmark index developments. Justifying the decision not to stop investing in specific industries, the ministry's expert group did not find that climate risk is systematically mispriced. The best approach to risk is diversifying and active management, it found.

In particular, the ministry emphasized the fund's aim was achieving returns and managing risk, rather than specific climate policy objectives.

Halland, who campaigns for the fund to have a net-zero emissions target, said: "This issue of the fund not being an instrument of climate policy is an argument against an emissions target at the portfolio level. My view is that none of the investors in the Net-Zero Asset Alliance are climate policy instruments."

This included insurance companies with a similar value to the fund. New Zealand had made a net-zero pledge for its sovereign wealth fund, Halland observed, adding that assets held abroad by sovereign wealth funds were a loophole for countries aiming for net-zero.

Environmental mandate gone, but not forgotten

As of 2021, the fund had a mandate to invest between $3 billion and $13 billion, or less than 1% of the fund's value, in environmental investments.

The fund's focus on climate has become broader, but the removal of the environmental mandate was mainly because it blurs the line between the ministry as specifying the mandate, and the bank finding the best ways to invest, Knut Anton Mork, professor emeritus at the Norwegian University of Science and Technology, told *Net-Zero Business Daily.*

"I think that argument is that it's a streamlining. It helps the distribution of responsibilities between the Ministry of Finance and the central bank. In any case, the environmental mandate was a very small share of total assets," added Halland.

On the other hand, without the mandate, investment in environmental projects will not be guaranteed because a shift to indexing emphasizes projects' market performance.

Mork warned that, pending finalization, this shift may mean less green investing. "Although the paper makes a big deal out of climate as an overarching principle, it is most unclear what this is supposed to mean in practice," said Mork.

However, the move to an index may be promising, as many green companies that formed part of the index used for the environmental mandate five or six years ago have now taken their place within the bank's standard reference index that is based on FTSE, said Norman.

"Today there are so many of these companies that are an increasingly big part of the main index, and with the overarching mandate and [the country] aiming for net-zero by 2050, I don't think this is a move away from any environmental investments," said Norman.

Offshore wind investment growing

More unlisted renewable companies will also become eligible for GPFG investment under the proposals.

They are now included in the pot set aside for unlisted investments, limited to $13 billion (NOK 120 billion), but the limit could be raised to $27 billion (NOK 240 billion).

Last year under the existing threshold, the GPFG invested in Ørsted's Borssele 1 & 2 offshore wind farm off the Netherlands, which was its first investment in renewable energy infrastructure.

The ministry welcoming more risky unlisted investments may be seen as continued progress for renewable energy advocates.

"It was in 2008 when [Norges Bank] asked for permission to invest in unlisted renewable infrastructure, and it took them 10 years to get that mandate," said Norman.

Posted 07 April 2022 by Cristina Brooks, Senior Journalist, Climate and Sustainability

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