The Norwegian Sovereign Wealth Fund Addresses the Interrelated Challenges of Climate Change and Sustainable Development – A Model for Regulating Other Sovereign Wealth Funds (SWF)

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ABSTRACT

The Norwegian Government Pension Fund - Global (GPFG) was set up to ensure that the country's oil wealth can benefit all generations of Norwegians. This long-term goal is to be reached in accordance with sustainable development principles, taking into account economic, social, and environmental concerns.

In 2004 the Norwegian Parliament adopted ethics guidelines for the GPFG, specifically prohibiting investments that would put the fund at risk of contributing to systematic human rights violations, serious environmental damage, and gross corruption. The GPFG recently underwent an evaluation process. The Norwegian Government has now decided to focus more on environmental, specifically climate change issues, and is considering setting aside some of the fund's assets for investments in companies developing climate friendly energy and to invest specifically in developing countries. Taking into account the long term nature of the GPFG, the government sees a need to analyze the effects that climate change will have on the financial markets. In addition, it has set out to focus on companies' impact on climate change, recognizing that if they emit large amounts of green house gases (GHGs) it will entail a cost in the future, thus bringing down the rate of return for the GPFG.

The purpose of this paper is to examine how the Norwegian government is trying to resolve the challenge of balancing financial returns with sustainable development in regulating the GPFG and the possibility of applying this model to other SWFs. Also I posit the sustainable

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development needs to be included in the newly adopted General Accepted Principles and Practices (Santiago Principles) for SWFs and I suggest a text for a new GAPP Principle 25.

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I. Introduction

Norway began exploiting its oil and gas reserves in 1971.[2] In 1990, the Norwegian Government established a sovereign wealth fund, first called the Petroleum Fund, later renamed the Government Pension Fund – Global (GPFG). The goal of the GPGF was and continues to be, to use the revenues from the oil reserves without affecting the general income flow and thereby limiting the impact of variable oil revenues on government spending.[3] This fund would also serve as an instrument for long-term financial savings, ensuring that some of the oil wealth would benefit not just the current generation, but also future generations, thereby fulfilling an important ethical obligation,[4] in line with the principle of intergenerational equity.[5] The GPFG is mandated to function as a responsible investor in fulfilling this ethical obligation, exercising good corporate governance and promoting sustainable development in economic, social and environmental terms.[6]

In terms of benefitting future generations, it is important to introduce the concept of sustainable development and place it in the context of SWFs. Balancing maximum financial returns with sustainable development is a daunting task for any profit-making entity, but particularly for the GPFG because it is a long-term fund with ethical obligations for future generations. In an effort to address this challenge, the Norwegian Parliament adopted ethical guidelines for the GPFG in 2004, specifically prohibiting investments that would put the fund at an unacceptable risk of contributing to serious or systematic human rights violations, severe

[2] Tore Eriksen, The Norwegian Petroleum Sector and the Government Pension Fund - Global (Ministry of Finance, Oslo, June 2006), http://www.regjeringen.no/upload/FIN/Statens%20pensjonsfond/The_Norwegian_Petroleum_Sector_te.pdf at 3.

[3] NOU Forvaltning for fremtiden 2003:2 at 11. Ministry of Finance, The Report from the Graver Committee (Select topics) (2003) (hereinafter Graver Report). See Eriksen, id at 7.

[4] Id.

[5] Intergenerational equity is defined as justice between generations. See Edith Brown Weiss, In Fairness to Future Generations: International Law, Common Patrimony and Intergenerational Equity 17-18 (1989).

[6] Report no. 20 to the Storting (2008-2009) On the management of the Government Pension Fund in 2008, at 5, (hereinafter Report no. 20).

environmental damage, and gross corruption,[7] essentially spelling out the requirements of sustainable development.

Recently these ethical guidelines underwent an evaluation process. The Norwegian Government has now decided to focus more on environmental and climate change issues and is considering investing some of the funds of the GPFG in companies developing climate friendly energy and to invest specifically in developing countries. Taking into account the long term nature of the GPFG, the government sees a need to analyze the effects that climate change will have on the financial markets. In addition, it has set out to focus on companies' impact on climate change, recognizing that if they emit large amounts of green house gases (GHGs) it will entail a cost in the future, thus bringing down the rate of return for the GPFG. The purpose of this paper is to examine how the Norwegian government is trying to resolve the challenge of balancing financial returns with sustainable development, including climate change, in regulating the GPFG, as well as consiedering the possibility of applying this model to other SWFs and incorporating sustainable development into the SWFs' General Accepted Principles and Practices (GAPP),[8] concluding that, based on the new reality of climate change, this urgently needs to be done.

Part II will examine the concept of sustainable development as it relates to SWFs. Part III will give an overview of the GPFG, its history and legal structure, and examine its ethical guidelines. Part IV will analyze the Norwegian government's renewed focus on sustainable development, and climate change in particular, in the management of the GPFG. Measured against the UN Principles on Responsible Investment, Part V will address whether GPFG could work as a model for other SWFs, and argue for the possibility of incorporating sustainable development into the SWFs' new General Accepted Principles and Practices (Santiago Principles) and suggest a text for an amendment to GAPP.

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[7] Norwegian Ministry of Finance, Ethical Guidelines for the Government Pension Fund (22. December, 2004) http://www.regjeringen.no/en/dep/fin/Selected-topics/Ethical-Guidelines-for-the-Government-Pension-Fund---Global-/the-ethical-guidelines.html?id=434894 (visited May 12, 2009) [hereinafter Ethical Guidelines].

[8] International Working Group of Sovereign Wealth Funds, Sovereign Wealth Funds: Generally Accepted Principles and Practices; "Santiago Principles, (October 2008), available http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf (visited May 19, 2009) [hereafter GAPP].

II. Sustainable development and SWFs

A. What is Sustainable development?

This paper uses the definition of sustainable development introduced by the 1987 Brundtland Report, Our Common Future as basis for the discussion: "Development that meets the needs of the present without compromising the needs of future generations."[9] This concept has been categorized as ambiguous at best, yet has been incorporated into legal instruments - in both hard law and soft law form - at the international, national, and local levels. The International Court of Justice in the Gabcikovo Case stated that the "need to reconcile economic development with protection of the environment is aptly expressed in the concept of sustainable development."[10] It is also explained in terms of promoting the integration of three components: economic development, social development and environmental protection - as interdependent and mutually reinforcing pillars.[11] The overarching objective of sustainable development is to protect and manage the natural resource base of economic and social development.[12]

In 1992, at the United Nations Conference on Environment and Development (UNCED) the first global conference to use the concept of sustainable development, the international community agreed to a blue print for achieving sustainable development, Agenda 21, and the Rio Declaration on Environment and Development.[13] The Rio Declaration sets out the principles necessary to achieve sustainable development. The only way to successfully achieve economic and social progress is to link it with environmental protection. This is set out in Rio Principle 4,

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[9] Brundtland Commission Report, OUR COMMON FUTURE, Report of the World Commission on Environment and Development, World Commission on Environment and Development, 1987. Published as Annex to General Assembly document A/42/427, Development and International Co-operation: Environment, August 2, 1987 8 (1987).

[10] Case Concerning the Gabcikovo-Nagymmoros Project (Hungary/ Slovakia) 1997 I.C.J. 7 and dissenting opinion of Judge Weeramantry, 25. September 1997.

[11] Johannesburg Plan of Implementation, World Summit on Sustainable Development 1 (2002). http://www.un.org/esa /sustdev/documents/WSSD_POI_PD/English/POIChapter1.htm

[12] Id.

[13] UNCED, Agenda 21, Rio Declaration, United Nations Conference on Sustainable Development, 1992, http://www.unep.org/Documents.Multilingual/Default.asp?DocumentID=78&ArticleID=1163, (visited June 19, 2009).

"In order to achieve sustainable development, environmental protection shall constitute an integral part of the development process and cannot be considered in isolation from it."[14]

Despite the international community's commitment to adopt and implement national strategies for sustainable development, there is no lack of evidence of widespread unsustainable development in the world.[15] The world's ecosystems - the basis of economic development and on which life in general depends - are worsening and poverty, though reduced dramatically in some places, such as China, is still a daunting problem.[16] The central factual premise of sustainable development, as Dernbach explains it, is that "environmental degradation undermines or limits economic development, social well-being, and security".[17] However, protecting and improving environmental quality should go hand in hand with economic development and can produce more growth together with social development, peace, and security.[18] Bearing in mind that SWFs are managing vast amounts of assets, up to two and half trillion US dollars, it is extremely important that States with SWFs are aware of the impact they have in terms of sustained economic prosperity. Therefore, it is of utmost importance that they take sustainable development into consideration in their investment decision-making.

B. Legal Status of Sustainable Development

There is still much debate about whether sustainable development is an emerging principle of customary international law or merely a policy objective of international law.[19] Several treaties mention it in their Preambles, such as the WTO,[20] giving it importance, yet recognizing that it is not a binding principle. The Framework Convention on Climate Change

[14] Id. Principle 4.
[15] John C. Dernbach, Navigating the U.S. Transition to Sustainability: Matching National Governance Challenges with Appropriate Legal Tools, 44 Tulsa Law Review 93 (2009).
[16] See id at 95.
[17] Id at 96.
[18] Id.
[19] Marie-Claire Cordonier Segger, Sustainable Development in International Law, in Sustainable Development in International and National Law, Hans Christian Bugge & Christina Voigt (eds.) 117 2008.
[20] Agreement establishing the WTO, http//www.wto.org/English/docs_e/legal_e/04-wto.pdf (visited July 16, 2009). In international law preambles are not considered binding, yet they are part of the context in which the treaty is to be interpreted. See Vienna Convention on the Law of Treaties Art. 31, 1155 UNTS 331, 8 ILM 679 (23 May 1969). See Markus Gehring, Sustainable Development in World Trade Law in Sustainable Development in International and National Law, Hans Christian Bugge & Christina Voigt (eds.) 281 (2008).

(UNFCCC)[21] includes sustainable development in its Preamble, as part of its objective, and lists it as one of its principles in Article 3, but states at the outset of this section that these principles are only to function as guidelines for the Parties to the treaty. Regardless of whether one interprets the concept of sustainable development as legally binding or not, States have an obligation to balance economic, social and environmental priorities in the development process, in the interest of future generations.[22] Depending on the treaty, the procedural and substantive obligations will differ.[23] Some States have operationalized the concept through new policies and laws, for instance, to ensure more sustainable use or management of a particular natural resource.[24]

Some of the States with SWFs belong to the category of States that have implemented sustainable development policies and laws. Others have not made it a priority. It stands to reason that if you are of the first category of States, then sustainable development is reflected in most of the State's actions, including its policy on its SWF, as is the case, for instance, in Norway and New Zealand.

International law only addresses sovereign States, in their capacity "as such," acting as sovereigns. State run businesses are not traditional subjects of international law. SWFs have different structures, some as a pool of resources run by the State and some established as separate companies, as State run enterprises. One could argue that the former version is just an extension of the State, yet several SWFs in that category go to great lengths to show that they are a separate body from the State, much like any other private or institutional investor. As part of a State, one could argue that the SWF would be obligated to take sustainable development into account in the strategic and operational side of the SWF to the extent it may have an influence in this area. For instance, if a SWF invests in a large mining company whose activities lead to gross environmental damage, that SWF would have to take the into account.

[21] UN Framework Convention on Climate Change, http://unfccc,int/essential_background/convention/background/items/2853.php.
[22] Segger, supra note 19 at 182.
[23] Id.
[24] Id.

Assuming most sovereign wealth funds are operated separa[25]tely from the State, then the more likely scenario would have the SWF abiding by the State's laws addressing sustainable development. However, if the SWF is investing abroad, then it would be in the same position as multinational companies, where the local laws of the recipient or host country apply and not those of its country of origin or home State. If the host State does not have any environmental laws or labor laws or if it has such laws, but they are not enforced, then the enterprise would not be held liable for the environmental damage its activities produced and an SWF would have not responsibility.

The move to corporate social responsibility (CSR) evolved from just such scenarios, although CSR, in terms of business ethics, has a long history.[26] Goods produced by multinational corporations in developing countries failed to reflect the environmental costs in their prices. Industrialized countries have adopted environmental laws and for the most part implemented them, but this is not always the case in developing countries leading some corporations to take advantage of that fact, lowering their standards of operation when they locate to developing countries.

In the context of the financial markets, sustainable development is often referred to as acting responsibly or taking into account environmental, social, and governance (ESG) issues. CSR has become main-stream for many corporations. Essentially, sustainable development means that the corporations, particularly multinational corporations, need to internalize their externalities in the broadest sense, both at home and abroad, thereby reflecting the environmental and social costs in their prices. This, again, infers that enterprises need to take ESG issues into account in their operations, as they would any direct financial risk, particularly because the market often does not measure and place a value on the ESG issues. In this context, climate change is considered perhaps the greatest market failure of all time.

More recently institutional investors have begun addressing ESG issues, demanding that companies disclose how they are taking ESG issues into account since these factors represent, at least indirectly, part of the enterprises' financial performance. Rather than just ethical

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26 Niklas Kreander and Ken McPhail, Some thoughts about the Ethical investment policy of Statens Pensjonsfond – Utland in Høring - evaluering av de etiske retningslinjene for Statens Pensjonsfond (Comment on the Ethics Guidelines of the GPFG) (2008).

considerations, there is a business case for considering ESG issues. Particularly, for a long-term investor, it is essential to avoid the negative economic repercussions of climate change. Climate change will entail physical, regulatory and legal risks for enterprises.[27] Physical risks, can arise from flooding of infrastructure, water scarcity, and diseases in the workforce, affecting financial performance.

By addressing climate change, the company can mitigate the financial risks of such impacts or at least take them into account. Another issue affecting the bottom line is compliance with regulations to reduce GHG emissions, pitting the initial investment cost against the effects of non-compliance, monetary and reputational. One must also the lost opportunities of not investing in energy efficiency, which can reduce costs and generate income for the company. All of these factors will influence the returns of the investment, hence becoming a much more important aspect of the SWFs decision-making process.

C. Fiduciary (or equivalent) duty to consider ESG issues

Seeking to increase the investment community's focus on sustainable development, the UN Environment Programme Finance Initiative commissioned a report by Freshfields Bruckhaus Deringer (FBD) to address the issue of whether taking into account ESG issues in investment decisions was permissible, legally required, or hampered by law and regulations.[28] FBD did a study of the applicable laws of several States, including the EU, France, Germany, UK, US, and Japan. In common law countries, the 'fiduciary duty' - the modern prudent investor rule – has evolved through case law. The fiduciary duty obliges the person (the asset manager) who is the trustee of the trust (or fund) to use his/her discretionary power to act in the interest of the trust's beneficiaries (the asset owners) in a relationship of trust and confidence.[29] This duty is similar to

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[27] William Baue, Fiduciary Duty Redefined to Allow (and Sometimes Require) Environmental, Social and Governance Considerations, Social Funds, http://www.socialfunds.com/news/print.cgi?sfArticleId=1851, Nov. 3, 2005.
[28] Freshfields Bruckhaus Deringer, A legal framework for the intergration of environmental, social and governance issues into institutional investment 3 (2005). Commissioned by the UN Environment Program Finance Iniative (UNEPFI) [hereinafter Freshfields Report].
[29] Id. at19.

the 'duty of care' in corporations.[30] Civil law countries have much the same obligations, but they are expressed in codes and statutes.[31]

The FBD report, "A legal framework for the integration of environmental, social and governance issues into institutional investment," published in 2005, concluded that, contrary to the commonly held view, ESG considerations are indeed permissible to consider.[32] In fact, in certain circumstances, they are required to be taken into account, particularly if there is the potential for the ESG elements having a material and financial impact on the performance of the investment.[33] How to mitigate and adapt to climate change would definitely be something trustees and fiduciaries would need to consider, since the impact of climate change would likely affect their investments, entailing physical, regulatory and legal risks.[34]

D. Soft law on sustainable development

Since the concept of sustainable development became widely recognized with the Brundtland Report, most of the frameworks addressing - at the international level - are in the form of soft law.[35] The Rio Declaration is probably the most well-known.[36] Neither corporations, institutional investors, nor sovereign wealth funds are addressed in the Rio Declaration, yet the international community has adopted several non-binding standards or codes addressing businesses, such as the UN Global Compact and, more specifically on multinational corporations, the OECD Guidelines for Multinational Enterprises.[37] The Global Compact, adopted in 2000 has 6,700 participants in 130 countries.[38] It is a strategic private-public policy initiative for businesses committed to sustainable development.[39] Long-term value-creation is widely understood to include a commitment to the ten principles of the Global Compact, offering

[30] Freshfields Report, supra note 27 at 105.
[31] Id. at 7.
[32] Id.
[33] Id. at 5 and 14.
[34] Baue, supra note 26.
[35] Brundtland Commission, supra note 9.

[36] Rio Declaration, supra note 13. However, Rio Principle 2 is often referred to as the only principle of the Rio Declaration that is considered a binding principle of international law.

[37] OECD Guidelines for Multinational Enterprises (2000), available http://www.berr.gov.uk/files/file46192.pdf (visited June 19, 2009) [hereinafter OECD Guidelines].
[38] UN Global Compact http://unglobalcompact.org/AboutTheGC/ (visited July 16, 2009).
[39] Id.

a framework for development, implementation, and disclosure of sustainability principles and practices related to human rights, labor, the environment, and anti-corruption.[40] The businesses supporting the Global Compact initiative must also submit annually a Communication of Progress describing the company's efforts to implement the ten principles.[41]

These OECD Guidelines for Multinational Enterprises are voluntary recommendations addressed *by governments* to multinational enterprises. These recommendations focus on responsible business conduct consistent with applicable laws.[42] The goals stipulated in the Preface are as follows:

"to ensure that operations of these enterprises are in harmony with government policy, to strengthen the basis of mutual confidence between enterprises and the societies in which they operate, to help improve the foreign investment climate and to enhance the contribution to ***sustainable development*** made by multinational enterprises."[43]

Furthermore, the Preface states that:

"Multinational enterprises have the opportunity to implement best practice policies for ***sustainable development*** that seek to ensure ***coherence between social, economic and environmental objectives.*** The ability of multinational enterprises to promote ***sustainable development*** is greatly enhanced when trade and investment are conducted in a context of open, competitive and appropriately regulated markets."[44]

Under the OECD Guidelines, enterprises should ensure reliable and relevant information is disclosed regarding their activities, including financial and non-financial information.[45] Non-financial information is specified as including environmental and social reporting.

Focusing specifically on institutional investors, the Principles for Responsible Investment (PRI) adopted in 2006 under the aegis of the UN Global Compact and the UNEP are a set of six voluntary standards for investors aimed at incorporating ESG issues into mainstream investment decision-making and ownership practices.[46] These principles were the result of a growing

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[40] Id.
[41] UN Global Compact, supra note 37.
[42] Id. Preface.
[43] Id. (Italics used for emphasis).
[44] Id.
[45] OECD Guidelines, supra note 36 at III. Diclosure.
[46] Principles of Responsible Investment, http://www.unpri.org (visited July 17, 2009)[hereinafter PRI].

recognition by investment professionals that ESG issues can affect the performance of investment portfolios.[47] It offers a framework for investors to enable them to appropriately consider ESG issues in fulfilling their fiduciary (or equivalent) duty, thereby improving long-term returns to beneficiaries.[48] The Preamble to the PRI states as follows:

> As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society.[49]

Implementing the principles leads to a more complete understanding of several material issues which should result in increased returns and lower risk. PRI principle 3 stipulates that the investors "…will seek appropriate disclosure on ESG issues by the entities in which we invest."[50] To date 566 asset owners, investment managers, and professional service providers have signed on to the PRI principles.[51] Several SWFs are signatories to the PRI principles, among them the Norwegian GPFG and New Zealand's Superannuation Fund.[52]

The Carbon Disclosure Project (CDP), initiated in 2006, has as its goal to motivate investors, corporations, and governments to "prevent dangerous climate change" by collecting and distributing information on what actions these entities have taken to address climate change.[53] The first step is to measure the emissions, then manage and reduce them.[54] The CDP is the largest corporate GHG emissions database in the world, providing a detailed analysis of how the largest multinationals are responding to climate change.[55] The Norwegian Government has also decided to participate in the Carbon Disclosure Project.

Clearly there is a growing trend to take ESG issues and, specifically, climate change into account in corporate and institutional investment decision-making. However, standards recently

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[47] Id.
[48] Id.
[49] PRI, supra note 45 at Preamble.
[50] Id., PRI Principle 3
[51] Id.
[52] PRI Signatories, http://www.unpri.org/signatories (visited July 22, 2009).
[53] Carbon Disclosure Project, http://www.cdproject.nte/about-cdp.asp (visited July 20, 2009) [hereinafter CDP].
[54] Id.
[55] Id.

adopted for the sovereign wealth funds – the Generally Accepted Principles and Practices or Santiago Principles - do not mention sustainable development.[56] Using the Norwegian SWF to demonstrate how ESG issues can be included in SWF's investment decision-making and ownership practices, I posit that amidst the mounting international urgency to address climate change there needs to be an amendment to the Generally Accepted Principles and Practices (GAPP) for SWFs, urging the SWFs to incorporate ESG issues into their investment decision-making.

III. "Trust Fund" For The Future – The Norwegian Sovereign Wealth Fund

A. Background

The Norwegian Government Pension Fund – Global (GPFG) is a sovereign wealth fund (SWF). Sovereign wealth funds (SWFs) are defined as "special purpose investment funds or arrangements that are owned by the general government."[57] Most SWF's buy and hold long-term investments to provide an income substitute when another income stream runs out.[58] In this sense they are formally sovereign, yet function as private investors, as any bond or stockholder.[59] A good example is the Alaska Permanent Fund, which was specifically established by a constitutional amendment to transform some of the non-renewable oil wealth into a renewable source of wealth for future generations of Alaskans through prudent long-term investments.[60]

The purpose of setting up the Norwegian GPFG was to avoid short-term economic instability and ensure long-term consideration of the diminishing oil reserves and to set aside funds for the benefit of future generations, taking into account the steadily increasing public pension expenditures of an ageing population.[61] In giving benefits to future generations, the

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[56]GAPP, supra note 8.
[57] Id. at 10. General government is stipulated as including both central and sub-national government, i.e. states in a federal government.
[58] Andrew Lomax, Sovereign Wealth Funds: The New Wealth Of Nations, 31 Aug, 2007.
[59] Larry Catá Backer, Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investment, ExpressO (2009) http://works.bepress.com/larry_backer/9.

[60] Alaska Constitution Article IX, Section 15, Section 15. Alaska Permanent Fund. http://www.apfc.org/home/Content/fundlaw/constAndLaw.cfm Alaska Permanent Fund Corporation, Alaskan Guide, 2005. http://www.apfc.org/home/Media/reportspublications/2005_GUIDE_nocov.pdf

[61] Øystein Olsen and Arent Skjæland, *Handlingsregelen for bruk av oljeinntekter, in* HVA GJØR OLJEPENGENE MED OSS? 69 (Arne Jon Isachsen ed. 2002)

GPFG can be considered a trust fund whose purpose is to conserve the capital of the fund for future generations, while using only some of the income for present generations.[62] In effect, this purpose satisfies the principle of intergenerational equity.[63]

By sheer good fortune, these oil reserves happened to be located within Norway's continental shelf, yet, as a non-renewable resource, they are expected to constitute a diminishing part of Norway's total capital in the next fifty years.[64] As Kristin Halvorsen, the Finance Minister, stated, "the current generation does not have a right to 'burn' through the oil reserves in the course of one or two generations, but must leave some of the benefits for future generations."[65] This is ensured by limiting the GPFG's real return (surplus) that can be transferred into the national budget to four percent of the value of the GPFG, referred to as the fiscal rule, [66] hence transforming a diminishing non-renewable resource into a permanent fund, a renewable source of wealth.

The fiscal rule was adopted in 2001, specifically to avoid the "Dutch disease" that occurs when the economy gets flooded with oil money, leading to inflation and economic instability. This concept stems from the situation in the Netherlands in the 1960s when the Dutch discovered natural gas and used the surplus income in a manner that lead to unsustainable spending on social services and a weakening of the other sectors of the economy, especially export-based industry.[67] This can also be expressed in terms of avoiding the natural resource curse.[68] The "natural resource curse" has plagued many nations, especially developing countries. It describe how States - that have discovered a particular non-renewable natural resource - emerge after the resource is exhausted, usually with an economy that is in a worse situation than that of States that never had access to the resource in the first place.

B. Legal and Institutional Framework

[62] See Weiss, supra note 5.
[63] Id.
[64] Kristin Halvorsen, Minister of Finance, The Nordic Welfare Model, Kristofer Lehmkuhl Forelesning, 2008.
[65] Id.
[66] Arne Jon Isachsen, *Hva Gjør Oljepengene med Oss? In* HVA GJØR OLJEPENGENE MED OSS? 22 (Arne Jon Isachsen ed. 2002). See Eriksen, supra note 5 at 10.
[67] Id. at 20 and 56.
[68] E:\Norway's position in the debate on Sovereign Wealth Funds - regjeringen_no.mht

The GPFG was established by an act of the Norwegian Parliament, the Act of the Government Petroleum Fund,[69] in 1990, but did not receive any funds until 1996 when there was a budget surplus.[70] The Government's net cash flow from petroleum operations is transferred in its entirety to the GPFG through the state budget, whereas the fiscal guidelines stipulate that only the expected real return on the Fund – four percent of the fund, according to the fiscal rule, should be returned to the budget for general spending purposes - hence the real value of the fund itself will be protected.[71]

The Ministry of Finance is the official owner of the GPFG on behalf of the Norwegian people represented by the political authorities. However, in order to have political backing, major changes to the GPFG's investment strategy are presented to Parliament before being implemented.[72] The Ministry of Finance is responsible for managing the GPFG. [73] It determines the overall investment strategy for the GPFG, the ethics guidelines, and follows up on its operational management.[74] The operational management of the GPFG has been delegated to the Norwegian Central Bank.[75] This role, however, is not a Central Bank function and is therefore strictly separated from the Central Bank's other activities and referred to as the Norges Bank Investment Management (NBIM).[76] The GPFG is not established as a separate legal entity, but as a deposit account at the Central Bank with a management agreement between the Ministry of Finance and the Bank which is publicly disclosed.[77]

The goal for the investment strategy of the fund is to achieve maximum financial return with moderate risk to help ensure that future generations will be able to draw the maximum possible benefit from the oil wealth.[78] In order to achieve a maximum financial return and as a long-term investor, the Government sees its role as being a responsible investor, promoting good corporate governance and safeguarding environmental and social concerns.[79] This applies

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[69] Act of the Government Petroleum Fund, Act 1990-06-22, no. 36.
[70] Øystein Olsen and Yngvar Tveit, *Statens petroleumsfond – et redskap for langsiktig forvaltning av oljeformuen, in* HVA GJØR OLJEPENGENE MED OSS? 105 (Arne Jon Isachsen ed. 2002).
[71] Eriksen, supra note 2.
[72] Report no. 20, supra note 6. See Backer, supra note 58 at 34.
[73] Report no. 20 at 3. See Pension Fund Act, The Pension Fund Act, Act of 21. December 2005, no. 123 (2005).
[74] Id.
[75] Id.
[76] Eriksen, supra note 2 at 13.
[77] Id.
[78] Report no. 20, supra note 6 at 12
[79] Id.

particularly to a broadly diversified investor – often referred to as 'universal investors,' such as the Norwegian GPFG.[80]

There is broad political support for the ethical framework for the responsible management of the GPFG.[81] Being a responsible investor is defined as ensuring that the GPFG is managed in a way that "promotes better functioning, legitimate and efficient markets and sustainable development in the broadest sense."[82] Promoting sustainable development in economic, environmental and social terms is regarded as a precondition for good financial returns over time.[83] This goal is in keeping with the United Nations' Principles for Responsible Investments (PRI) that the Ministry of Finance, as formal owner of the GPFG, has now adopted.[84] These principles, as mentioned above, emphasize that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios.[85]

Given its role as manager of the public's funds, it follows that the Government needs to take widely shared ethics values into account.[86] The goals of ensuring maximum financial returns and of taking widely shared ethics values into account will coincide in some cases, but this is not always the case.[87] For example, The Government will not invest GPFG funds in companies that are in gross breach of fundamental ethics norms, such as human rights, regardless of the effect this will have on returns.[88]

In 2006, the GPFG changed its name from the Petroleum Fund to the Government Pension Fund – Global (GPFG) by an act of Parliament, the Pension Fund Act, to reflect that it was meant to cover growing pension costs in the future, yet it does not have direct liabilities.[89] The assets are invested strictly in foreign financial instruments (bonds, equities, money market

[80] Interview with Anne Kvam, Head of Corporate Governance, Norges Bank Investment Management, July 23, 2008.
[81] Report no. 20, supra note 6 at 12.
[82] Id.
[83] Id. at 13.

[84] Report no. 20 at 12. Principles for Responsible Investment Signatories to the Principles for Responsible Investment http://www.unpri.org/signatories/ (visited June 21, 2009).
[85] PRI, supra note 45.
[86] Id.
[87] Id.
[88] Id.
[89] The Pension Fund Act, Act of 21. December 2005 no. 123. (Technically the Act established the Government Pension Fund as an umbrella entity comprised of the Government Pension Fund – Global, formerly the Petroleum Fund and the Government Pension Fund – Norway, formerly the National Insurance Scheme. This article focuses only on the Government Pension Fund – Global (GPFG).

instruments and derivatives), in forty-two developed and emerging equity markets.[90] Unlike traditional pension funds, the GPFG is not earmarked for specific liabilities, rather it is an instrument for general savings on the part of the State.[91] Because it has a very long investment horizon and is not subject to short-term liquidity requirements, the GPFG has a higher risk-bearing capacity than many comparable funds.[92] As of March 31, 2009, the market value of the GPFG was NOK 2,076 billion (US$329 billion).[93] It is the largest fund in Europe, and the fourth largest world-wide, after the SWFs in UAE-Abu Dhabi, Saudi Arabia, and China.[94] Given the present guidelines for fiscal policy, the GPFG is expected to reach a level of around 250 percent of mainland GDP in the years after 2030, before starting to gradually decline.[95]

C. Efforts in addressing sustainable development and ethics

The Environment Fund

The first attempt at positive screening by the GPFG began on January 1st, 2001, when an Environment Fund was established as a sub-portfolio of the overall GPFG for a trial period of three years.[96] NOK 1 billion was transferred to the Environment Fund on January 31, 2001 and another billion in the fall of the same year.[97] The Environment Fund was established to encourage companies to publicize information on their approach to environmental issues.[98] It was also meant to signal to the world that environmental problems were to be taken seriously, hoping to spur other investors to establish similar

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[90] Government Pension Fund, Norges Bank, http://www.norges-bank.no/templates/article_69365.aspx (visited May 19, 2009)
[91] Report no. 20 to the Storting (2008-2009) on the management of the Government Pension Fund in 2008, 5 (2009) [hereinafter Report no.20].
[92] Id.
[93] Quarterly Report Government Pension Fund – Global First quarter 2009, Norges Bank Investment Management (NBIM) 3 (31. March, 2009) http://www.norges-bank.no/upload/75046/ spu_kvartalsrapport%20q1%20gb%20internett.pdf
[94] Sovereign Wealth Fund Institute, Fund Rankings, April, 2009 http://www.swfinstitute.org/funds.php (visited July 26, 2009).
[95] Eriksen, supra note 2 at 7.
[96] History, the Ethics Council, Ministry of Finance, http://www.regjeringen.no /en/sub/Styrer-rad-utvalg/ethics_council/History.html?id=445813 (hereinafter History).
[97] Id.
[98] Ministry of Finance, Evaluation of the Environment Fund, in the Amended National Budget 2004, Report to the Storting no.2 (2003-2004) 1 (2004) http://www.regjeringen.no/nb/dep/fin/dok /regpubl/stmeld/20032004/Stmeld-nr-2-2003-2004-/4/3.html?id=403320# (visited 5/24/09) (hereinafter Evaluation - Environment Fund) [hereinafter Evaluation of the Environment Fund].

requirements for their investments, thereby strengthening the guidelines chosen by the GPFG.[99]

In 2004, at the end of the three year trial period, the Environment Fund was evaluated and the Ministry of Finance decided to dissolve the fund on the grounds that it lead to few, if any, environmental benefits and the newly established ethics guidelines encompassing the entire GPFG included environmental considerations.[100] Furthermore, economic considerations also called for dissolving the Environment Fund because the return on the investments compared to the GPFG in general were much less and the cost of running a separate sub-portfolio focusing on environmental criteria added considerable administrative and management cost.[101]

Comments from non-governmental organizations (NGOs) in conjunction with the evaluation, highlighted that the environmental criteria had not been strict enough, that all companies that the GPFG invested in should have been required to fulfill the environment reporting and certification criteria.[102] Most companies had been included in the investment universe on the assumption that they had little or no negative effect on the environment.[103] In addition, the environment reports were based on self-reporting and 'bad' companies could publish good reports, in other words they were not always reliable.[104]

In its recent evaluation of the ethics guidelines of the GPFG, the Government decided to establish a new investment program earmarked for environmental investments. These are to be "aimed at eco-friendly assets or technology that is expected to yield indisputable environmental benefits, such as climate-friendly energy, improving energy efficiency, carbon capture and storage, water technology, and the management of waste and pollution." Any infrastructure

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[99] **Id.**
[100] **History, supra note 29.**
[101] **Evaluation of the Environment Fund, supra note 97 at 8.**

[102] **Id. at 5. See also Rune Frøyland, Få lyspunkter i Miljøfondet – Bellona (Few positive aspects to the Environment Fund - Bellona) 12. March 2003, http://www.bellona.no/norwegian_import_area/energi/fossil/klima/28953 (visited 5/25/09).**

[103] **Evaluation of the Environment Fund, supra note 97 at 5.**
[104] **Id.**

investments will have to target climate-friendly energy in particular.[105] These issues are addressed further in the Part IV(B).

Ethics Guidelines

The Minister of Finance has stated that it is of great importance for the Norwegian Government to ensure that the GPFG yields favorable financial return over time for the benefit of its owners, the Norwegian people and future generations of Norwegians.[106] "At the same time", she added, "we believe that we have a responsibility towards the environment and the people that are affected by the companies in which the Fund invests worldwide. This dual responsibility and the tools with which to meet it are laid down in the ethical guidelines for the GPFG."[107]

The ethical guidelines had their rudimentary beginning with the establishment of the Advisory Commission on International Law 2001. The Ministry of Finance appointed this Commission to evaluate whether specific investments had been made in companies that were acting in conflict with Norway's obligations under international law. Already in 2002, the Commission recommended the first exclusion of a company, Singapore Technologies Engineering, from the Norwegian SWF's investment universe.[108] The Commission concluded that there was a high probability that the company manufactured landmines, which would be in

[105] Report no. 20, supra note 6.
[106] International conference "Investing for the Future. Financial Investment and Ethical Challenges" Summary report (2008) http://www.regjeringen.no/upload/FIN/Statens%20pensjonsfond /Conference%20report%20final.pdf (visited 25. May, 2009).
[107] Id.

[108] Petroleumfondets Folkerettsråd, Oslo 22.03.02 Notat til Finansdepartementet (Memorandum from the Petroleumfund's Advisory Commission on International Law to the Ministry of Finance), *at* http://www.regjeringen.no/nb/dep/fin/tema/statens_pensjonsfond/etiske-retningslinjer/historikk/notat-2-av-220302-om-investeringer-i-sin.html?id=413441, citing the Landmine Treaty arts. 1(1)(c) and 1(1)(b), see supra note 37.

breach of Norway's commitment under the Landmine Treaty.[109] The Government formally excluded Singapore Technologies Engineering from the GPFG's investment universe later that year.[110] The Advisory Commission was replaced by the Ethics Council in 2004.

There is broad political support for the GPFG to be managed with a view to achieving the maximum possible return, at a moderate level of risk, to enable future generations to obtain the maximum possible benefit from the wealth.[111] To better fulfill it ethics obligations for future generations, the Norwegian Parliament adopted ethics guidelines for the GPFG in 2004.[112] The guidelines are built on a proposal, based on the work of an independent commission, the Graver Commission, appointed by the Government.[113] The Graver Commission pointed at two main ethical obligations; first, the obligation to ensure financial returns so that future generations will benefit from the oil wealth contingent on sustainable development, and second, the obligation to respect fundamental rights for those who are affected by the companies in which the Fund invests. These obligations became the premises for the Ethics Guidelines:

- The Fund is an instrument for ensuring that a reasonable portion of the country's wealth benefits future generations. The financial wealth must be managed with a view to generating a sound return in the long term, which is *contingent on sustainable development* in the economic, environmental and social sense. The Fund's financial interests should be consolidated by using the Fund's ownership positions to promote *sustainable development*.

- The Fund should not make investments which constitute an *unacceptable* risk that the Fund may *contribute* to *unethical* acts or omissions, such as *violations of fundamental humanitarian principles*, serious *violations of human rights*, gross corruption or severe *environmental degradation*.[114]

Emphasizing how the long-term returns should benefit from upholding generally accepted norms of ethical behavior, the former Secretary General of the Ministry of Finance, Tore

[109] Id. Convention on the Prohibition of the Use, Stockpiling, Production and Transfer of Anti-Personnel Mines and Their Destruction, (Landmine Treaty) done at Oslo, Sept. 18, 1997 (in force Mar.1, 1999).
[110] Companies that have been excluded from the GPFG's investment universe *at* http://www.regjeringen.no/nb/dep/fin/tema/statens_pensjonsfond/etiske-retningslinjer/selskaper-som-er-utelukket-fra-fondets-i.html?id=447122 [hereinafter Listing of Excluded Companies].
[111] Report No. 20, supra note 6 at 12.
[112] Ethical Guidelines, supra note 7.
[113] Graver Commissions Report, supra note 3. See Eriksen, supra note 2.
[114] Ethical Guidelines for the Government Petroleum Fund – Issued 22 December 2005 pursuant to regulation on the Management of the Government pension Fund - Global, former regulation on the Management of the Government Petroleum Fund issued 19 November 2004. Italics added for emphasis [hereinafter Ethics Guidelines].

Eriksen, has stated that there is no contradiction between these two obligations.[115] He refers to the Commission's explanation of these norms by describing Norway as a pluralistic society where "there is no consensus on one particular uniform ethical perspective."[116] Based on this reality, the Graver Commission in its report stated that the ethical guidelines should be "based on some main normative characteristics and anchored in widely recognized standards."[117] The conventions and principles laid down by international organizations such as the UN, OECD and ILO make up such a consensus as they define what should at a minimum be required of companies regarding fundamental rights and protection of the environment, human life and health.[118]

There are three measures that can be used to fulfill the ethical obligations. They are: the exercise of ownership rights, negative screening, and exclusion of companies.[119] In order to safeguard the GPFG's financial interests, the Central Bank, through the Norges Bank Investment Management (NBIM), is mandated to exercise ownership rights for the Fund's investments based on a long-term horizon.[120] The exercise of the ownership rights shall be based on the UN's Global Compact and the OECD Guidelines for Corporate Governance and for Multinational Enterprises.[121] The Central Bank's exercise of its ownership rights in the GPFG are considered active in the sense that the bank is an active shareholder observing standards of corporate governance in the form of shareholder rights and influencing the corporations into adhering to the ethical guidelines of the fund.[122] However, it is the Ministry of Finance that decides which industries or companies are to be screened out.[123]

The Ministry of Finance makes decisions on negative screening and exclusion of companies from the investment universe based upon recommendations from the Ethics

115 Secretary General Tore Eriksen, Ministry of Finance, Norway, The Norwegian Petroleum Sector and the Government Pension Fund – Global, June 2006.
116 Id.
117 Id.
118 Graver Commission's Report, supra note 3.
119 Id.
120 Ethics Guidelines, supra note 7 at para. 2&3.
121 Id. at para. 3.1.
122 Graver Commission's Report, supra note 3.
123 Id.

Council, an entity established by royal decree in 2004.[124] If a company is involved in the production of weapons that through normal use violates fundamental humanitarian principles, it is identified through a negative screening process and then excluded from the investment universe. Companies will be excluded from the investment universe if there is an unacceptable risk of the GPFG contributing to:

> 1) serious and systematic violations of human rights, such as murder, torture, deprivation of liberty, forced labor, the worst forms of child labor, and other exploitation of children;
>
> 2) serious violations of individuals' rights in situations of war or conflict
>
> 3) severe environmental degradation
>
> 4) gross corruption
>
> 5) other particularly serious violations of fundamental ethical norms.[125]

The premises for the Ethical Guidelines clearly state that the GPFG's investment should generate a sound return, contingent on sustainable development, and not represent an unacceptable risk of complicity in grossly unethical acts, including the areas of human rights and the environment. Only states can violate human rights directly in international law, yet companies can contribute to human rights violations committed by states and the GPFG, in turn, may contribute to the companies' complicity through its ownership.[126] No evidence of contribution needs to be provided, the presence of an unacceptable *risk* is sufficient.[127] This also applies to acts or omissions in regards to the environment. Only the most serious violations of the ethical standards should provide a basis for exclusion, thus, the fact of a risk being deemed unacceptable, is linked to the seriousness of the ongoing act and the degree of probability of the act taking place in the future.[128] Past acts alone are not enough for exclusion from the GPF, yet past patterns of conduct can indicate future conduct.[129]

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[124] Id. at para. 4.2. Etikkrådets virksomhet, (Council's Activities) Ministry of Finance, http://www.regjeringen.no/nb/sub/Styrer-rad-utvalg/etikkradet/Etikkradets-virksomhet.html?id=445807 (visited May 5, 2009).
[125] Id. at para. 2.
[126] Council of Ethics - GPFG, Annual Report 2005 45 (2006).
[127] Id.
[128] Id.
[129] Id. at 46.

To date, the Ministry of Finance, based upon recommendations from the Ethics Council, has screened out investments in over twenty companies on the basis of their production of certain kinds of weapons, such as central parts of nuclear weapons, and involvement in the production of cluster munitions and landmines.[130] In order to avoid an unacceptable risk of the Fund contributing to serious or systematic human rights violations and severe environmental damage, ten companies have been excluded from GPFG.[131]

No companies have been withdrawn from the investment universe of the GPFG due to their lack of action to mitigate climate change. However, Norges Bank has entered into a dialogue with companies lobbying against such action and used its voting rights as a stock holder on climate change resolutions introduced by groups of stock holders at the general assembly of several companies.[132]

IV. GPFG's Renewed focus on sustainable development and climate change

Following a broad and elaborate evaluation process of the ethical guidelines to the GPFG, the Norwegian Government has decided to focus more on sustainable development in the broadest sense, especially the environment and climate change issues.[133] As a long-term, responsible investor, the goal is to avoid negative repercussions of climate change on the global portfolios managed by NBIM which would interfere with long-term financial returns on the GPFG's investments.[134] With that in mind, the Government has decided to analyze the effects that climate change will have on the financial markets. Furthermore, the Government will take a more active and cohesive perspective on ESG issues, and they are to be integrated to a greater extent as relevant factors in all aspects of the management of the Fund.[135]

A. Environmental investment program

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130 Report no. 20, supra note 6 at 89.
131 Id.
132 Anne Kvam, supra note 79.
133 Report no. 20, supra note 6.
134 Id.
135 NORWAY – Official site in the United States, "Thriving Norway Provides an Economics Lesson" writes the New York Times", May 14, 2009. http://www.norway.org/misc/print.aspx?article={dd5d0cef-e39f-4ba9-afee-8a75b7f6a854}, visited July 7, 2009.

In the context of investment policy and strategy, the Government is studying ways of including climate change as a factor in investment decisions. In addition, the Government has decided to establish an environmental program aimed at climate-friendly energy, improving energy efficiency, carbon capture and storage, water technology and management of waste and pollution. This would earmark funds from the GPFG, using NOK 20 billion (US $3 billion) over a five year period.[136] The Government is considering using positive screening as a tool, using indexes available for such purposes.[137] In addition, the Government is considering a program to promote sustainable growth in emerging markets.[138]

B. Amending the ethical guidelines

The ethical guidelines will be amended to add new measures aimed at exclusion of companies. The exclusion mechanism will be further developed, first by excluding tobacco producing companies from the investment universe.[139] The Government is also going to clarify which issues should be given priority when making decisions on exclusion, including the impact of the exclusion.[140] The content of the criteria for exclusion are to be made more available for companies and others.[141]

Even now, when climate change has become a top priority, one can question whether it is possible and necessary to exclude industries refusing to address climate change from the investment universe. Given the GPFG's framework, these industries do not constitute viable long-term investments and create lasting serious environmental damage. However, under the current ethics guidelines, the exclusion of companies based on gross environmental damage has only occurred in less than ten cases.[142] At this time, the Government seems to be opting to address climate change through the exercise of ownership rights as described below.[143]

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[136] **Report no. 20, supra note 6. See also Innstilling fra finanskomiteen om forvaltning av Statens pensjonsfond i 2008, Innst. S. nr. 277 (2008-2009), Innstilling til Stortinget fra finanskomiteen (herinafter Innst. S. nr. 277).**
[137] **Phone interview with Valborg Lie, Ministry of Finance, Asset Management Department, July 9, 2009.**
[138] **Innst. S. nr. 277, supra note 142.**
[139] **Report no. 20 supra note 6 at 23.**
[140] **Id.**
[141] **Id.**
[142] **Listing of Excluded Companies, supra note 109. See also http://www.etikkradet.no.**
[143] **See text accompanying note 144.**

The Government is also considering a watch-list, of companies in an ethical gray-zone, to be watched more closely. The establishment of a procedure to readmit a previously excluded company is also planned.[144]

In order to strengthen of the active ownership effort, NBIM has been asked to formulate more documents outlining their expectations of companies where the GPFG invests.[145] One document pertains to environmental issues concerning the companies' strategies on climate change. Another will be related to corporate governance, concerning transparency and reporting on payment flows in companies. Clear expectations in this area may help counteract the use of closed jurisdictions (so-called tax havens) to conceal unlawful acts.[146]

NBIM recently published a draft of its Investor Expectations on Climate Change Management.[147] This follows the format used for the expectations set out for corporations in relations to children's rights.[148] The focus of the expectations on climate change management is on both mitigation and adaptation.[149] NBIM states why climate change is an issue for investors:

> The global portfolios that are managed by NBIM are exposed to the risk of adverse economic effects of climate change. Reports such as the Stern Review[150] issued by the UK government and those issued by the Intergovernmental Panel on Climate Change1 highlight that the economic impact will be critical on a global scale if the current anthropogenic release of greenhouse gases continues in line with «business as usual» scenarios.[151]

The expectations address four areas; direct operations, products and services, supply chain, and transparency.[152] Under direct operations, companies are to measure their GHGs and set clear targets. In addition, they are to analyze the commercial effects of regulatory responses,

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[144] Id.
[145] Id.
[146] Id.
[147] NBIM Investor Expectations: Climate Change Management, http://www.norges-bank.no/template/article__74441.aspx [hereinafter NBIM Investor Expectations on Climate Change].
[148] NBIM Investor Expectations on Children's Rights (2007), http://www.norges-bank.no/upload/nbim/cg/expectations%20childrens%20rights.pdf
[149] NBIM Investor Expectations on Climate Change, supra note 146
[150] Stern Report stated that it would cost 1% of global GDP if we start addressing climate change now, versus up to 20% of global GDP is we continue business as usual.
[151] IPCC Report 2007. The IPCC is a scientific intergovernmental body set up by the World Meteorological Organization (WMO) and by the United Nations Environment Programme (UNEP). Quoted from NBIM Investor Expectations on Climate Change, supra note 146.
[152] NBIM Investor Expectations on Climate Change, supra note 146.

and the physical and social impacts of climate change. Furthermore, NBIM expects companies to identify and consider implementing best available processes and practices to mitigate climate change.[153]

Finally, an important focus of the results of the Government's evaluation process was to strive for a better interaction between the active ownership side of the GPFG, administered by the NBIM and the exclusion mechanism, administered by the Ethics Council.[154] Any assessment of whether a company is to be excluded needs to consider whether other mechanisms would be better suited, thereby achieving the GPFG's main goal as a responsible investor.[155]

V. The Sustainable Pathway

A. GPFG as a Model for other SWFs

The GPFG has been referred to as the "gold standard for SWFs" by the President of the European Commission.[156] The Norwegian SWF is also listed among the most transparent of the SWFs, with a rating of ten, the highest possible on the Lindaburg-Maduell Transparency Index.[157] This rating is based on several factors, among them, the fund providing its history including reason for its creation, origins of wealth, and government ownership structure, the fund providing up-to-date independently audited annual reports, ownership percentages of company holdings, and guidelines in reference to ethical standards, investment policies, and enforcement of guidelines.[158]

Measured against the UN Principles on Responsible Investment and considering its most recent revisions, the GPFG is a workable model for other SWFs. Now that it has brought environment and climate change to the fore, it is more likely to take ESG issues into account in a broader fashion than before. The exclusion mechanism is a long, time-consuming process which

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[153] Id.
[154] Report no. 20, supra note 6 at 23.
[155] Id.
[156] On Sovereign Wealth funds Statement by Jose Manuel Barrosso, President of the European Commission, Oslo, Norway, February 25, 2008, http://ec.europa.eu/commission.../pdf/statement_20080225_02_en.pdf.

[157] The Sovereign Wealth Fund Institute, Linaburg-Maduell Transparency Index, http://www.swfinstitute.org/research/transparencyindex.php. (visited July 22, 2009).
[158] Id.

may not be necessary if a SWF takes ESG issues into account in its investment decision-making. However, as with all voluntary approaches, they will only be as good as the reliability of the self-reporting mechanisms. Having an exclusion mechanism available can indeed be very effective. The best approach is to address ESG issues from all sides, in addition to having investors and companies integrating ESG issues into their decision-making process. States should be encouraged (or assisted) to adopt practical legislation addressing ESG issues.

The New Zealand Superannuation Fund is also a suitable model for other SWFs. It uses the negative screening process for certain weapons, but does not exclude companies, except as a last resort.[159]

B. Amending the Generally Accepted Principles and Policies (GAPP)

The Generally Accepted Principles and Policies (GAPP) were adopted under the aegis of the IMF in 2008. They are soft law principles meant to set out certain standards and best practices for SWFs.[160] These standards give recipient or host states assurances that the SWFs are legitimate entities with the intent to invest funds in the same way private investment funds or institutional investors do in foreign countries, emphasizing that they do not have strategic or political interests.[161]

According to GAPP, states that have interests other than economic or financial ones must specify what those are. [162] The idea is to demonstrate that the purpose of the SWF is not to project state power.[163] SWF management "should be consistent with what is generally accepted as *sound* asset management principles,"[164] Recognizing the changes that have recently taken place, including the Freshfields Report, mentioned above, this confirms that ESG considerations are legally permissible, and may be required.[165]

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[159] New Zealand Superannuation Fund, http://www.nzsuperfund.co.nz/ (visited July 16, 2009).
[160] GAPP, supra note 8.
[161] Backer, supra 58 at 134.
[162] GAPP, supra note 8 at Principle19, and Sub-Principle 19.1.
[163] Backer, supra note 73.
[164] Santiago Principles, supra note 8, at GAPP 19.2 Sub-Principle
[165] Freshfields Report, supra note 27.

When exercising its ownership rights, the SWF should do so "in a manner that is consistent with its investment policy and protects the financial value of its investment."[166] Taking climate change into consideration would definitely need to be part of the equation in order to protect the long-term value of the investment.

There is a long-running debate on SWFs' impact on the financial markets and the importance of transparency to make sure they do not have strategic or other "ulterior" motives, such as buying up defense and media companies or companies producing sensitive technology.[167] The Santiago Principles are an effort to relieve the tension. However, there is great difference between buying a defense company and taking ESG considerations into account in investment decisions. All States have signed on to sustainable development through countless declarations and some treaties, yet many lag behind in fulfilling their obligations, be it they considered legal or just political. Taking ESG issues into consideration on a company level is just another approach to reach the same goal of sustainable development. Increasingly, companies that take ESG issues into account are in a win-win situation. If it were not the case, CSR would be dead as a concept. Furthermore, investors have begun to see the light, signing on to the UN's Principles on Responsible Investment. In the context of climate change considering ESG issues is a given. Since the investment industry, SWFs in particular, has such a huge impact on the financial markets, taking into account the impact of climate change will likely be the answer to a low carbon economy. If they do not get it "right" any number of post-Kyoto treaties will likely have very little effect.

I posit that the next step for the Santiago Principles is to add a new principle to the GAPP, namely, that the investments must be made taking into account sustainable development with a special focus on climate change. It can also be expressed as being a responsible investor or as integrating environment, social, and governance (ESG) issues into investment decision-making and ownership practices in order to better maximize financial returns. This follows from the Principles of Responsible Investment (PRI). As climate change is already having significant

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[166] Santiago principles, supra note 8, GAPP Principle 21. On this point, see also Paul Rose, Sovereigns as Shareholders, 87 N.C. L. REV. 83 (2008) (arguing that this approach works best in states with strong regulatory traditions and institutions).

[167] See Rose, supra note 165 at 87.

impact – most likely constituting the biggest environmental risk for corporations[168] – the Santiago Principles must reflect the new situation making it a living and relevant document.[169] Climate change will have serious economic consequences on the financial markets. Using PRI standards will promote the SWF to consider climate change issues as part of protecting its investments and even maximizing the return on their investments.

A possible text for Principle 25 of GAPP would be the following:

> SWF should act as responsible investors and their investment decision-making and ownership practices should take environment, social, and governance (ESG) issues into account, with a particular focus on climate change.

VI. CONCLUSION

The Albright Group and Simon Chesterman, who were hired by the Norwegian Ministry of Finance to evaluate the ethical guidelines of the GPFG, stated that "The work done by NBIM and the [Ethical] Council has established Norway as a leader on ethical issues in the global economy, in particular through NBIM's work on child labor and the Council's practice of publishing thorough opinions."[170] Given that the Government has decided to focus even more on environmental issues, particularly climate change, bodes well for the Norwegian SWF to be an even better model of a responsible investor.

I have examined the Norwegian SWF and argued for the importance of SWFs taking ESG issues into account in their decision-making and ownership activities as these issues are becoming even more important in the context of climate change. I have posited that sustainable development needs to be included in the Santiago Principles and I have a suggested text for a new GAPP Principle 25.

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[168] New Zealand Superannuation Fund, Responsible Investment in Practice Report, June 2009, http//www.nzsuperfund.co.nz/index.asp?pageID=2145855970 (visited July 14, 2009).

[169] See International Working Group Sovereign Wealth Funds, Statement made by Director General Martin Skancke at Roundtable on the Santiago Principles for Sovereign Wealth Funds, Press Release No. 08/12, October 11, 2008, http//www.iwg-swf.org/pr/swfpr0812.htm (visited July 14, 2009) (referring to "living and relevant document").

[170] Albright Group and Simon Chesterman, Assessment of Implementation of Articles 3 and 4 of the Ethical Guidelines for the Government Pension Fund – Global, May 21, 2008, http://www.responsible-investor.com/images/uploads/resources/research/21214492869 Albright_Group_Ethical_Guidelines.pdf. (visited May 15, 2008).