

# From Avoidance to Activism

*The Responsible Investment Frameworks of the Norwegian  
Government Pension Fund Global, the New Zealand  
Superannuation Fund and California Public Employees'  
Retirement System 2000 – 2016*

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Master's Thesis in Peace and Conflict Studies  
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UNIVERSITY OF OSLO

May 2016





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<http://www.duo.uio.no>

Original Print: Reprosentralen, University of Oslo





# Abstract

Socially responsible investing (SRI) has since the late 1990s, grown to become an important concept in the global financial industry. This growth has mainly been led by institutional investors, such as pension funds and sovereign wealth funds (SWFs) who, in the early 2000s, became aware of the necessity of behaving as real owners of companies and of adopting a long-term view of investing. As these investors started to embrace SRI, they steered the understanding of SRI away from the original ethical objects of the concept, towards the more loosely defined concepts of environmental, social, and governance (ESG) issues. This development has resulted in that it today does not exist any universal definition or understanding of what SRI actually refers and how it should be understood.

This thesis analyzes the responsible investment frameworks of the Norwegian Government Pension Fund Global (GPFG), the New Zealand Superannuation Fund (NZSF) and California Public Employees' Retirement System (CalPERS), and compares the three funds' approach to responsible investing. The comparison is done by comparing the objectives and rationales behind the responsible investment frameworks, the actors involved in the establishment and development of the frameworks, the management structures and the SRI strategies that the funds apply. The thesis also discusses what can be achieved with responsible investing by applying the GPFG as an example. By doing this, the thesis contributes to a better understanding of what responsible investing represent to these actors, how SRI is interpreted across various contexts and locations in the world, and whether responsible investors choose to exclude the same type of companies.

The thesis finds that the funds' understanding and interpretation of SRI vary based on the context and the culture in which the funds are located, the different objectives and rationales the funds are based on, and on which actors that have been involved in the establishment and the continuous development of the frameworks. Hence, the funds choose to exclude different companies in their negative screening. In their active ownership, however, the funds apply the same international standards and criteria. The thesis also finds that the GPFG can influence corporate behavior with its divestments and active ownership. The Fund's size and its reputation nationally and internationally contribute to this. In addition, the Fund's ability to change corporate behavior is strengthened by the Fund adhering to the same standards as the NZSF and CalPERS in the active ownership.





# Acknowledgements

Writing a master's thesis has been both educational and demanding. It has been an exciting process with its ups and downs. Therefore, in finishing my thesis, a few people deserve a thank you.

First, I would like to thank my supervisor Einar Lie for good help and guidance through this process. Your input and feedback have been very helpful and informative. This process would have been much more difficult without your advice.

Second, I have to thank my proofreaders, Ingrid Dybvig and Lars Foseid. I am grateful for you taking the time to help me. Your feedbacks have been very helpful.

I would also like to thank fellow classmates for being a great support, and for being good company in the reading room, common room and elsewhere through this process.

My family also deserves to be mentioned. Thank you for always being there for me and for being so supportive.

Last but not least, Kenneth. Thank you for putting up with me during this roller coaster of a process. Thank you for always being so supportive, understanding, caring and patient. This process would have been much more difficult without you.

Blindern, 12 May 2016  
Maren Diesen Kristensen



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# Abbreviations

**CalPERS** – California Public Employees' Retirement System

**ESG** – Environmental, Social and Governance

**GPIF** – Government Pension Fund Global

**KLP** – Kommunal Landspensjonskasse

**Meld. St.** – Melding til Stortinget (Government White Paper)

**NBIM** – Norges Bank Investment Management

**NZSF** – New Zealand Superannuation Fund

**NGO** – Non-Governmental Organization

**OECD** – Organization for Economic Co-operation and Development

**SAIH** – Studentenes og Akademikernes Internasjonale Hjelpfond (Norwegian Students' and Academics' International Assistance Fund)

**SRI** – Socially Responsible Investment

**St.meld.** – Stortingsmelding (Government White Paper)

**SV** – Sosialistisk Venstreparti (The Norwegian Socialist Left Party)

**SWF** – Sovereign Wealth Fund

**UK** – United Kingdom

**UN** – United Nations

**UNGC** – United Nations Global Compact

**UNPRI** – United Nations Principles for Responsible Investment

**US** – United States of America

**US SIF** – The Forum for Sustainable and Responsible Investment



# 1 Introduction

Socially responsible investing (SRI) is not a new phenomenon. Investors and institutions have invested according to non-financial criteria certainly since 1926 in the United States (US) and 1948 in the United Kingdom (UK).<sup>1</sup> During the last decades, however, with new actors starting to invest responsibly, the understanding of SRI have developed and changed.

The early investors investing according to ethical or non-financial criteria were church investors such as the Methodist Church in the UK. These investors were often reluctant to be associated with certain activities because they were seen as unethical. Hence, these investors avoided so-called “sin stocks”, usually referring to alcohol, tobacco, gambling and weapons.<sup>2</sup> Over the years, and especially with increasing globalization and many negative experiences with gross violations of ethical norms such as human rights and environmental violations in the 1990s, more investors began to see the necessity of acting as responsible investors and owners. These investors were mainly institutional investors, such as pension funds and sovereign wealth funds (SWF), who had large and diverse portfolios with investments in many parts of the world.

The institutional investors differed from the traditional ethical investors in that they were more influenced by their financial obligations to their members. Consequently, the institutional investors started to steer responsible investing away from the original ethical objective of the religious groups towards the more loosely defined environmental, social and governance (ESG) factors.<sup>3</sup> This development of new actors influencing the definition of socially responsible investing has resulted in it today not existing any universal definition or understanding of what socially responsible investing actually refers to, and how it should be understood. As a result, it is up to the different responsible investors to define themselves what kind of criteria and standards they want to subject to, and what should constitute responsible investing for them. Hence, the definition, interpretation and understanding of socially responsible investing are constantly changing and will vary between actors.

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<sup>1</sup> (Sparkes, 2001, p. 196)

<sup>2</sup> (Jamel-Fornetty, Louche, & Bourghelle, 2011, p. 87)

<sup>3</sup> (Richardson & Lee, 2015, p. 392)

Even though SRI is differently defined and understood, as well as constantly changing, institutional investors still play an important role in the development and promotion of responsible investing and behavior. The number and size of institutional investors have grown since the 1990s. With this growth, these investment vehicles have also experienced a rapid asset accumulation, which have led to their increased participation in the global financial markets.<sup>4</sup> Consequently, being large investors with diverse portfolios and a vast involvement in the financial markets, these investors have grown to become important actors.<sup>5</sup> This has left them with the potential of being influential actors that can play a significant role in the promotion of responsible investing and behavior.

Three institutional investors that have recognized this potential, developed to be influential actors through responsible investing, and are being put forward as examples for other institutional investors to follow, are the Norwegian Government Pension Fund Global (GPF), the New Zealand Superannuation Fund (NZSF) and the California Public Employees' Retirement System (CalPERS). These investment funds, which have invested according to non-financial criteria since 2004, 2003 and 2000 respectively, are all widely known for their focus on responsible investing and being responsible owners, and have been and continue to be recognized as influential actors in the development of socially responsible investing.<sup>6</sup>

The Government Pension Fund Global is the sovereign wealth fund of Norway. It was established in 1990 partly as a savings fund and partly as a buffer fund. During the late 1990s and early 2000s the Fund and its managers received massive criticism, after non-governmental organizations (NGOs) and journalists had revealed that the GPF was invested in companies that were violating international law. After years of discussions and more revelations of the Fund investing in companies that were violating international law, the Norwegian government decided in 2004 to make the Fund subject to ethical guidelines.<sup>7</sup> This was done to prevent the Norwegian people from being involved in violations of ethical norms, as well as to avoid Norway being complicit in ethical violations and from violating its

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<sup>4</sup> (Arreaza, Castilla, & Fernandez, 2009, p. 28)

<sup>5</sup> (Shemirani, 2011, p. 14)

<sup>6</sup> (Cummine, 2014, p. 172; Richardson, 2013, pp. 233-234)

<sup>7</sup> (Skredderberget, 2015, pp. 123-129)



commitments under international law through the GPFPG's investments.<sup>8</sup> The idea was that certain companies was involved in actions that was considered too unethical for the Norwegian people to place their "savings" in. Since establishing the Ethical Guidelines and starting operating after a framework for responsible and ethical investing, the GPFPG has been highly recognized for its focus on ethical investing, and is often put forward as the golden standard for other investors to follow.

The New Zealand Superannuation Fund was established by a Labour-led government in 2001 as a saving vehicle to help pre-fund part of the future cost of New Zealand pensions.<sup>9</sup> The government saw the need to establish such a structure as the New Zealand Superannuation is a universal payment, and the number of people of eligible age was increasing making it more difficult to uphold the universal pension plan in the future.<sup>10</sup> The Fund started operating in 2003, and has since its beginning been subject to an ethical obligation stating that the Fund has to invest in a way that avoids harming New Zealand's reputation as a responsible member of the world community.<sup>11</sup> How this was to be done, was not defined in the legislation. As the procedures for how the Fund was to fulfill its ethical obligation were not explained, and the original ethical obligation of the NZSF was loosely defined, it became largely up to the fund managers to decide what responsible investing were to mean. As a result of this and lacking a clear definition of what responsible investing for the NZSF was to entail, the managers of the NZSF have developed, changed and expanded the Fund's Responsible Investment Framework over the years. Today, the Fund has an extensive Responsible Investment Framework that sets limitations on the Fund's investment portfolio and that guide the fund managers in the investment process. As a result, the NZSF is along with the GPFPG considered a world leader in responsible investing.<sup>12</sup>

California Public Employees' Retirement System was established by California State Law in 1931, and is one of the largest public pension funds in the United States.<sup>13</sup> A pension fund is an insurance pool created to protect pool members from loss of income due to retirement,

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<sup>8</sup> (Graver Committee, 2003)

<sup>9</sup> (Orr, 2012, p. 212)

<sup>10</sup> (McCulloch & Frances, 2003, pp. 2-7)

<sup>11</sup> (Ministry of Social Development and the Treasury, 2001, p. 35)

<sup>12</sup> (Cummine, 2014, p. 172)

<sup>13</sup> (California Public Employees' Retirement System, 2015e)

disability or both.<sup>14</sup> Being formed by the political environment from which it springs, CalPERS is regarded as a leader and progenitor in shareholder activism having had an organized shareholder activist campaign and engaged with companies since 1984.<sup>15</sup> A shareholder activist is a large investor such as a pension fund that attempts to use its rights as a shareholder of a publicly traded company to bring about social change and change in the company's attitude.<sup>16</sup> The shareholder activist stance, actions and behavior still characterize CalPERS, although its activism has developed and changed to include a large focus on environmental, social and governance (ESG) issues. Today, CalPERS not only promotes ESG issues in its engagement with corporations, the Fund also integrates these issues in its decision-making process.

## **1.1 Research Question, Limitations and Methods**

This thesis will analyze the responsible investment frameworks of the Norwegian Government Pension Fund Global, the New Zealand Superannuation Fund and California Public Employees' Retirement System, and compare the funds' approaches to responsible investing by analyzing the objectives and rationales behind the responsible investment frameworks, the actors involved in the establishment and development of the frameworks, the management structures and the SRI strategies that the funds apply. The thesis will also, by applying the Norwegian Government Pension Fund Global as an example, discuss what can be achieved with responsible investing.

Responsible investment frameworks are the frameworks that guide the three funds' investments, and put limitations of non-financial considerations on their investments. In other words, these frameworks act as a guide for what the funds can and cannot invest in. For the Norwegian Government Pension Fund Global, the responsible investment framework is the document known as the Ethical Guidelines. The Ethical Guidelines have been revised three times and have therefore existed in various versions, and hence had various names through its development. The current Ethical Guidelines carry the name *Guidelines for Observation and Exclusion from the Government Pension Fund Global*. The New Zealand Superannuation Fund also operates with a separate document for its investment framework. This document is

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<sup>14</sup> (Harding, 2011, p. 309)

<sup>15</sup> (Tricker, 2015, p. 132)

<sup>16</sup> (Investopedia, n.d-b)

known as the *Responsible Investment Framework*. CalPERS on the other hand, does not operate with a separate responsible investment document. The Fund's responsible investment criteria and beliefs are located in different documents making it more challenging to get an overview of the criteria in CalPERS' investment framework. The documents that have been used to get an understanding of CalPERS' responsible investment criteria is the Fund's ESG report from 2014, *Toward Sustainable Investments & Operations, CalPERS Beliefs*, the Fund's Investment Policy and the California Constitution. The criteria found in these documents have been put together and are what makes up what in this paper referred to as CalPERS' Investment Framework.

In order to analyze the funds' investment frameworks some limitations and some sub-questions were needed. The thesis limits itself in its timespan, since the three funds are all said to have started investing responsible in the year 2000 and later. Hence, the time period that are being looked at are mainly from the late 1990s until 2016, with some references to early initiatives by CalPERS since the Fund is older and has a much longer history than the GPF and the NZSF. The sub-questions that guide the analysis of the three funds' responsible investment frameworks were asked in order to get a thorough analysis of the funds and an understanding of the frameworks' origin, basic ideas, content and development since their establishment until today. These questions are:

- Why did the three funds choose to establish responsible investment frameworks?
- What obligations form the basis of the responsible investment frameworks?
- What strategies are being applied to act as a responsible investor?
- What are the non-financial criteria in the frameworks?
- How have the responsible investment frameworks developed to become the frameworks they are today?
- What are the contexts and backgrounds of the funds?

The comparison of the three funds and their approaches to responsible investing will be conducted by comparing the funds objectives and rationales behind the responsible investment frameworks, the actors involved in the establishment and development of the investment frameworks, the management structures of the funds and the SRI strategies that the funds apply. These categories are chosen because they fit well with the sub-questions asked in the analysis of the fund and their responsible investment frameworks, and because

each of these categories can highlight important differences or similarities in the funds approach to responsible investing. In addition, they are chosen as analytical categories because it is likely that the differences in these categories may have an impact on the responsible investment frameworks and the content of them.

The discussion of what can be achieved with responsible investing will apply the GPFG as an example. The primary reason why the GPFG was chosen as an example, is due to the Fund's transparency and because information about the Fund is more accessible than for the two remaining funds. The discussion of what can be achieved with responsible investing will focus on the consequences of the objective behind the SRI strategies, the reputation of the Fund and its size. This is because it is reasonable to believe that these factors have an impact on what the Fund can achieve with its responsible investments and investment strategies.

The three investment funds analyzed in this thesis are all chosen due to a shared feature of being highly respected for their focus on responsible investing. All three funds have a reputation of being ethical investors and are often put forward as best practice examples of how to combine financial goals and moral obligations. The GPFG and NZSF are frequently referred to as the examples to follow when it comes to ethical sovereign wealth funds and are the only sovereign wealth funds that are said to invest ethically.<sup>17</sup> CalPERS often tend to be characterized as an example of what an ethical pension fund should look like, and it has been named one of America's most powerful shareholder bodies and as a progenitor of public pension fund activism.<sup>18</sup> However, these three funds are not only highly regarded for their focus on responsible investments – they are also esteemed for being transparent and accountable funds with good investment policies. In fact, all three funds are ranked high in the American economist and leading analyst on sovereign wealth funds, Edwin M. Truman's scoreboard of sovereign wealth fund from 2010. While the Government Pension Fund Global is ranked as number one, CalPERS ranks as number two and the New Zealand Superannuation Fund as number three.<sup>19</sup>

Another factor that influenced the selection of the funds is the fact that these funds are located in three different contexts, in three different parts of the world. Through the

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<sup>17</sup> (Cummine, 2014, p. 175)

<sup>18</sup> (Griffiths, 2004)

<sup>19</sup> (Truman, 2010, p. 72)

comparison of three distinctive funds, each with different responsible investment frameworks, one might get a clearer understanding of what SRI might constitute in different parts of the world, if responsible investors choose to exclude the same type of companies, and whether SRI is interpreted in similar manner in different contexts and locations. Hence, the three investment funds chosen as study objects in this thesis, were chosen for the purpose of contrasting and comparing them, in order to arrive at a better understanding of what responsible investing represents to these actors, how SRI is interpreted across various contexts and locations in the world, and whether these actors exclude the same type of companies.

Discussing socially responsible investing and how it may be interpreted and understood in different contexts and parts of the world, is interesting because finance and the approach to finance are usually thought to be similar. However, this is not the case, and an analysis of three different institutional investors and their approach to responsible investing may contribute to highlight this fact, and show where some of the differences may be. In addition, the questions can contribute to highlight the challenges with responsible investing and the responsible investment strategies. For instance, if the avoidance strategy is based on deontological ethics and the idea that one divests in order to avoid being associated with certain companies, the strategy is useful. This is because, what industries one chooses to exclude does not really matter, since one is just concerned with protecting one selves and one's reputation. However, if every investor has goal of creating corporate change by divesting or excluding industries, it becomes a problem if investors are operating with different avoidance criteria and hence avoid different industries. Then the investors will pull in different directions, and changed corporate behavior will not be likely

## **1.2 Sources**

The societies in which the three funds are located are all open and transparent societies, which in turn have resulted in the three funds being open and transparent as well. This means that information regarding the funds' policies, investments and frameworks are made available and open to the public. These documents, such as e.g. the responsible investment frameworks, are easily accessed and available for everyone to read. This also means that, in the cases where there have been discussions about the funds in the national parliaments or similar government forums, the discussions have been made open to the public after the

conclusion of the discussions. Hence, information about the funds, their investment policies and relevant discussions and debates are easily accessible and can usually be found online.

The most important sources for information about the Government Pension Fund Global, is the different documents comprising the Ethical Guidelines. Since establishing the Ethical Guidelines, they have undergone three major revisions, meaning that four different documents have been issued (in 2004, 2010, 2015 and 2016, respectively). In addition to the Ethical Guidelines, the Norwegian Government Green Paper, *NOU 2003:22*, also known as the Graver report, constitutes one of the main sources. This document formed the basis of the original Ethical Guidelines, and outlines the main ideas behind the introduction of these non-financial criteria. Additionally, Government White Papers such as *St. Meld.* and *Meld. St.*, Parliament discussions, newspaper articles, and reports from non-governmental organizations, Norges Bank Investment Management (NBIM) and the Council on Ethics will be important literature. These sources will be informative for capturing the different actors' view of the Ethical Guidelines, as well as for arriving at an understanding of the development the Ethical Guidelines.

For the New Zealand Superannuation Fund, the Fund's founding document, which is the *New Zealand Superannuation and Retirement Income Act 2001*, annual reports published by the Fund and the Guardians of New Zealand Superannuation, the *Responsible Investment Framework*, and the information available at the Funds' webpage all constitute important literary sources. Manuscripts of speeches and documents written by members of the Guardians will also be useful literature. These sources will be helpful in understanding the rationale behind the Fund, as well as for getting a more profound understanding of the Fund's Responsible Investment Framework.

The key documents concerning the California Public Employees' Retirement System and its responsible investment framework is the California Constitution and the California Law, CalPERS' ESG report from 2014 – *Toward Sustainable Investments & Operations*, and *CalPERS Beliefs*. State Assembly Bills are also important documents, since new investment restrictions and policies are often passed through the California State Assembly. In addition, the information available from the Fund's webpage, minutes from Board meetings and Investment Committee meetings, and the annual reports are principal sources for finding

information about the Fund, as well as for understanding the development of the Fund's Investment Framework.

Apart from official government documents, newspaper articles, laws and reports, secondary literature has been important sources in this thesis. The secondary sources have had a different function than the primary sources. These books and articles have first and foremost functioned as a supplement to the primary sources when these sources have been lacking, inconclusive or proven difficult to obtain. The existing body of literature has also been useful for deriving a clearer understanding of socially responsible investments, and the developments that have been in this concept. Furthermore, these sources have been informative for understanding of how these funds have been studied in the past, and helpful in highlighting the funds, the funds' investment frameworks, and their responsible investing from different angles.

### **1.3 Existing Literature**

The thesis touches upon many different academic fields such as history, political science, law, philosophy and economics. Scholars from all these different disciplines have written extensively about socially responsible investing, ethics in investing, large institutional investment funds such as sovereign wealth funds and pension funds, and corporate social responsibility – all issues which this thesis touches upon. Having scholars from so many different academic fields researching these issues have resulted in the issues being examined from many different angles, and with the focus being on different aspects. For instance, early research on sovereign wealth funds tended to be dominated by a business perspective, often focusing on the SWFs of the Arab states, as Sven Behtendt did in his paper *When Money Talks: Arab Sovereign Wealth Funds in the Global Public Policy Discourse*.<sup>20</sup> Today, it appears to be a shift towards more scholars of law entering the field focusing on the legal mandate to invest socially responsibly and the legal aspect of SWF investments. One example of this is Benjamin J. Richardson and Angela Lee who in their article, *Social Investing Without the Legal Imprimatur: The Latent Possibilities for SWFs*, study socially responsible investing by sovereign wealth funds focusing on the contrasting experiences of three funds seemingly lacking a legal mandate to invest responsibly.<sup>21</sup> The three funds

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<sup>20</sup> (Behtendt, 2008)

<sup>21</sup> (Richardson & Lee, 2015)

studied were the Alaska Permanent Fund, the Ireland's National Pensions Reserve Fund and Australia's Future Fund.

Extensive research has been done on institutional investors focusing on pension funds. The early research had a tendency to be influenced by a business perspective, and a large body of literature examined whether institutional activism enhanced firm value by applying CalPERS as a case. As the number of sovereign wealth funds increased during the 1990s, however, the focus of the literature on institutional investors appear to have changed. Increasingly, focus was given to sovereign wealth funds. These studies have a tendency to be informed by economists and grounded in economic scenarios and objectives, and they usually concerned the investment strategies, the political and economic concerns, and the investment flows and trends. Two influential scholars researching institutional investors such as pension funds and sovereign wealth funds are the economic geographers Gordon L. Clark and Ashby H. B. Monk. As economic geographers, Clark and Monk are interested in the responsibilities and behavior of investors as regards long-term sustainable investment. Both of these scholars often apply the GPFG as a case in their research about institutional investors, and frequently discuss the Ethical Guidelines of the GPFG. Monk has also applied CalPERS as a case, as he did in his paper "*Is CalPERS a Sovereign Wealth Fund?*", discussing whether CalPERS qualifies as a SWF.

More recent literature about SWFs is informed by scholars within different academic fields, in particular law. These scholars, such as Professor Simon Chesterman and Professor Benjamin J. Richardson, tend to focus on the legal aspects of SWFs and discuss when and if such funds have legal obligations, and how these funds relate to the obligations of the nation state. Being a scholar of environmental law and sustainability, Richardson explores how law can facilitate change so the investors and corporations can embrace environmental responsibility. In his research, Richardson often applies the GPFG and NZSF as examples and compares their approach to responsible investments. In his study from 2011, *Sovereign Wealth Funds and the Quest for Sustainability: Insights From Norway and New Zealand*, Richardson compares the GPFG and NZSF and their attempts to reconcile their ethical and financial aspirations, finding that both the GPFG and NZSF resemble institutional chameleons in the conflicting expectations they face. They operate like private investment



vehicles for maximizing shareholder value, while encumbered with public responsibilities to fulfill the ethical policies of their state, Richardson argues.<sup>22</sup>

In addition to focusing on the legal aspect of SWFs, Simon Chesterman has made the ethical consequences of SWF investments a part of the agenda. In his article *The Turn to Ethics: Divestment from Multinational Corporations for Human Rights Violations – The Case of Norway’s Sovereign Wealth Fund*, Chesterman finds that the turns to ethics as a means of improving behavior of multinational corporations offers an opportunity, but also an opportunity cost. According to Chesterman, ethics can be a means of generating legal norms, through changing the reference points of the market and providing a language for the articulation of rights, yet they can also become a substitute for generating those norms.<sup>23</sup>

Another author focusing on the ethical aspects of SWF investments is Angela Cummine. In her article *Ethical Sovereign Investors: Sovereign Wealth Funds and Human Rights*, Cummine focuses on the links between government financial investment and human rights, through the prism of the New Zealand Superannuation Fund. She argues that sovereign wealth funds should be subject to a legally entrenched responsible investment obligation that governs the whole portfolio, not just limited exemptions. But such an obligation must be operationalized effectively if it is to truly endow citizen-owners with control over their government agent and their own ethical agency.<sup>24</sup>

Socially responsible investments and institutional investors have received growing attention in the literature in the recent years. Recently, there has also been increasing attention given to SWF and SRI. This growing body of literature often applies the GPF as a case, resulting in it having been extensively analyzed, especially by legal scholars. While other ethical or socially responsible funds have been applied as examples, it has not been to the same extent as the GPF. There are also few studies that compare and contrast different institutional investors and their approach to responsible investments that have been conducted, and as a result it appears to be a lack of knowledge regarding where the responsible investments of different institutional investors differs and where they are similar.

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<sup>22</sup> (Richardson, 2011, p. 22)

<sup>23</sup> (Chesterman, 2008, p. 615)

<sup>24</sup> (Cummine, 2014, p. 177)

Due to the lack of such studies, this thesis wants to contribute to filling this vacuum. The thesis will contribute to the existing literature by analyzing the approach to responsible investing and the responsible investment frameworks of two funds, whose responsible investment frameworks have not been as thoroughly studied as the Ethical Guidelines of the GPFG. By studying the responsible investment frameworks of three funds, and two that have not been thoroughly studied in the past, the thesis contributes to the existing literature by highlighting the issue of responsible investing and institutional investors from a new perspective. The goal of the thesis is to provide a better insight and understanding of SRI, and how various institutional investors approach and is interpreting responsible investing.

## **1.4 Outline of the Thesis**

The thesis is divided in to six chapters. After the introduction chapter, socially responsible investing and socially responsible investment funds will be explained as two important concepts. These concepts are introduced to provide a framework and understanding of socially responsible investing in general, and to establish some background knowledge for the subsequent chapters. In chapter three, the Norwegian Government Pension Fund Global, the New Zealand Superannuation Fund and the California Public Employees' Retirement System and their responsible investment frameworks will be presented and analyzed. This chapter will provide an understanding of the various contexts the funds are situated in, the processes establishing the various responsible investment frameworks, the development and expansion of these investment frameworks, and what the responsible investment frameworks of the GPFG, NZSF and CalPERS look like today. Chapter three provides the background knowledge for chapter four, which compares the three funds by analyzing the funds' rationale behind the responsible investing, the actors involved in the development of the frameworks, the management structure, and the SRI strategies that are being employed. Chapter five will, by applying the Norwegian Government Pension Fund Global as an example, discuss what can be achieved with responsible investing. It will do so by focusing on the SRI strategies and their objectives, the reputation of the Fund and its size. Following chapter five, a conclusion will be provided. The conclusion will serve as a summary, highlighting the most important aspects and findings of the thesis.

## **2 Socially Responsible Investing – A Framework for Understanding Socially Responsible Funds**

Socially responsible investing (SRI) is the most common term in the literature of responsible investing and ethics of institutional investors and in finance. The concept is at the heart of the investment practices of the Norwegian Government Pension Fund Global, the New Zealand Superannuation Fund and the California Public Employee Retirement System, and it lays the foundation for how these funds decide what companies to invest in, what companies to stay invested in, and how to invest. The concept also acts as a means for the funds to act in the best interest of their beneficiaries.

Because the concept of socially responsible investing is so central to the understanding of the investment practices and the investment frameworks of the GPF, NZSF and CalPERS, it is necessary to explain the content of the concept and what it entails, as well as its development. This section will proceed by doing so, before explaining the two main strategies applied by investors adhering to SRI. Finally, a short explanation of socially responsible funds and their historical development will be given.

### **2.1 The History of Socially Responsible Investing**

Socially responsible investments are, in their present form, a fairly recent incarnation. However, their roots lie in a number of earlier movements emerging primarily out of the United States and the United Kingdom. Early socially responsible investing practices were initiated by church organizations that were reluctant to support or be associated with certain activities or companies. These church organizations developed a negative screening strategy, avoiding so-called “sin stocks”, usually referring to alcohol, tobacco, gambling and weapons.<sup>25</sup> The Quakers, for instance, refused to profit from weapons and slave trade when they settled in North America, and the Methodist Church in the UK avoided investing in companies involved in the gambling industry and in the production of alcohol, tobacco and weapons.<sup>26</sup>

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<sup>25</sup> (Jamel-Fornetty et al., 2011, p. 87)

<sup>26</sup> (Kiyamaz, 2012, p. 426)

Church investors, such as the Quakers and the Methodist Church, have run investment portfolios subject to certain ethical constraints for many years, notably from 1926 in the US and from 1948 in the UK. Such activities, however, attracted little attention at the time.<sup>27</sup> It was not until the late 1960s, as part of the growing opposition to the Vietnam War, that socially responsible investing started to gain public attention in the US. Beginning with students calling for universities to eliminate military contractors from their investment portfolios, the drive to divest defense industry stock quickly expanded beyond university campuses.<sup>28</sup> In the 1970s, public consciousness of SRI further increased, in the US and other parts of the world, as campaigns against the apartheid regime in South Africa led to widespread concern among investors that the funds they were invested in were used to support the existing regime.<sup>29</sup> Stocks were removed from portfolios, based mainly on ethical considerations, and a divesture movement in South Africa by US corporations emerged.<sup>30</sup> This development brought SRI into a new phase during the 1970s and 1980s, shifting from a moral and ethical logic to a more activist logic embedded into the political and protest movements of the day.<sup>31</sup>

The SRI movement has experienced a substantial growth in the United States and the rest of the world during the last two decades. Between 1995 and 2014, the number of SRI funds in the US has dramatically increased, from 55 to 925.<sup>32</sup> In Europe, the numbers rose from 159 in 1999 to 957 in 2014.<sup>33</sup> While the movement has developed and progressed, it has been accompanied by a shift in the rationale of SRI from an ethical logic to an activist logic, to focusing more specifically on financial considerations. This development towards a larger focus on financial consideration was influenced by institutional investors' entrance into the movement. As mainstream institutional investors such as pension funds and sovereign wealth funds began to embrace SRI, they steered away from the ethical stance of the religious groups, primarily because such conduct was perceived to be financially imprudent and in conflict with their fiduciary responsibility to their beneficiaries.<sup>34</sup> Instead, with increased

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<sup>27</sup> (Sparkes, 2001, p. 196)

<sup>28</sup> (Knoll, 2002, p. 684)

<sup>29</sup> (Sparkes, 2001, p. 196)

<sup>30</sup> (Blowfield & Murray, 2014, p. 228)

<sup>31</sup> (Jamel-Fornetty et al., 2011, p. 87)

<sup>32</sup> (US SIF, 2014, p. 12)

<sup>33</sup> (Vigeo, 2014, p. 7)

<sup>34</sup> (Richardson & Lee, 2015, p. 392)

attention devoted to human rights and the global environment during the 1990s, these investors started to integrate the much more loosely defined concepts of environmental, social and governance issues and practices into their decision-making. Consequently, having evolved from a church-based, single-issue activism, SRI now represents a broad constellation of interests campaigning for socially, ethically, and environmentally responsible financing.<sup>35</sup>

## **2.2 What Does Socially Responsible Investing Entail?**

Socially responsible investing is a concept that is defined in many different ways, and with different meaning attached to it. Hence, there is no clear and universal definition and understanding among investors of what it implies. As an overarching definition one can say socially responsible investing refers to making investment decisions based on both financial and ethical considerations. A common definition of SRI is to invest in a manner that takes into account the impact of investments on the natural environment and society as a whole, both today and in the future. Another often-used definition describes SRI as “an investment process in which sustainability criteria relating to a company’s social and/or environmental behavior play a decisive role in the admittance of that company’s stocks to the investment portfolio.”<sup>36</sup> The World Economic Forum defines SRI as “an investment approach that integrates long-term environmental, social, and governance (ESG) criteria into investment and ownership decision-making with the objective of generating superior risk-adjusted financial returns. These extra-financial criteria are used alongside traditional financial criteria such as cash flow and price-to-earnings ratios.”<sup>37</sup>

Common to all of the above-mentioned definitions is the integrated focus on non-financial concerns. This is in consonance with Professor Christopher J. Cowton’s definition of SRI as “the exercise of ethical and social criteria in the selection and management of investment portfolios, generally consisting of company shares (stocks).”<sup>38</sup> The Forum for Sustainable and Responsible Investment, commonly referred to as US SIF, includes the same criteria in its definition, but is more influenced by financial considerations. According to US SIF socially responsible investments refers to an “investment discipline that considers

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<sup>35</sup> (Richardson & Lee, 2015, p. 392)

<sup>36</sup> (Kiymaz, 2012, p. 428)

<sup>37</sup> (World Economic Forum, 2011)

<sup>38</sup> (Sparkes & Cowton, 2004, p. 47)

environmental, social and corporate governance (ESG) criteria to generate long-term competitive financial returns and positive societal impact.”<sup>39</sup> According to this definition, an investment decision is highly motivated by financial considerations. Hence, it distinguishes socially responsible investing from the traditionally ethical investing that are primarily based on moral and ethical considerations, and which allows lower financial returns as a trade-off for meeting social and environmental goals. For many socially responsible funds, US SIF’s definition of SRI will be the most appropriate, as financial returns and motivations are crucial to the definition. Hence, the definition is consistent with the financial duty of many investment funds to maximize financial returns.

In addition to being differently defined by different actors and academics, SRI is also characterized by a lack of consensus in the terminology of the concept. There exists what Joakim Sandberg, Carmen Juravle, Ted Martin Hedesström and Ian Hamilton call a “terminological heterogeneity.”<sup>40</sup> In the literature, SRI is labeled as ethical, social, responsible, green, targeted and strategic investment or investing.<sup>41</sup> Christopher J. Cowton and Russell Sparkes emphasizes that, despite the many terms associated with the concept, socially responsible investment and ethical investment are the two most common terms used. According to Cowton and Sparkes, ethical investment and SRI are two terms with overlapping content and meaning. Ethical investment, as understood by Cowton and Sparkes, is the older term that over time has increasingly been replaced by that of socially responsible investment. Still, the authors highlight that in some cases, it can be useful to distinguish between the two terms. Ethical investment – constituting the oldest term – is usually tied to moral commitments and has closer connections to humanitarian and religious values. Socially responsible investments can be perceived as a wider term that moves away from the moral commitments, although moral commitments can still be an underlying association with the term.<sup>42</sup>

For the concept of SRI to serve its purpose in this thesis and to avoid any confusion regarding the minor differences in the terms, SRI is applied as an umbrella concept for a range of different ethically, socially and environmentally oriented investment practices that cover

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<sup>39</sup> (US SIF, n.d.)

<sup>40</sup> (Sandberg, Juravle, Hedesström, & Hamilton, 2009, pp. 520-521)

<sup>41</sup> (Sparkes & Cowton, 2004, p. 46)

<sup>42</sup> (Sparkes & Cowton, 2004)

similar classifications. Socially responsible investment, responsible investment and ethical investment will be interpreted as representing the same considerations as the main characteristic of all these terms is the integration of certain non-financial concerns in the investment process.<sup>43</sup> The terms responsible, socially responsible and ethical investing will be applied interchangeably as the investment frameworks of the three funds of interest are referred to differently and inconsistently both by the governments discussed in this paper and in the literature.

### **2.3 Socially Responsible Investment Strategies**

SRI's movement into the mainstream has been accompanied by refinements in the favored methods of SRI. Today, different types of SRI strategies exist, however two principal strategies are being used. The purpose of these two strategies is to avoid or favor investing in certain industries or companies because of the characteristics of their products or operations, or to engage with specific businesses so as to induce behavioral changes.<sup>44</sup> These methods are known as screening and corporate engagement respectively, and are being applied by the GPF, NZSF and CalPERS.

Screening is the longest established SRI strategy, and refers to the practice of including or excluding companies from a portfolio on moral, social or environmental criteria, resulting in companies being labeled ethical or socially responsible. The two most common screening strategies are positive and negative screening. Positive screening refers to the selection of investments that perform best against corporate governance, social, environmental, and ethical criteria. Negative screening, or exclusion, is the process of excluding from an investment portfolio companies that are engaging in negative or unethical business or environmental practices.<sup>45</sup> Negative screening will be the focus of the subsequent paragraphs, as it constitutes the screening strategy that is being applied by the GPF, NZSF and CalPERS.

Negative screening can be traced back to the religious investment institutions that refrained from investing in so-called "sin industries", such as the tobacco, alcohol, weapons and

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<sup>43</sup> (Sandberg et al., 2009, p. 521)

<sup>44</sup> (Richardson, 2015a, p. 233)

<sup>45</sup> (Blowfield & Murray, 2014, p. 232)

gambling. It involves excluding companies from the investment universe on the basis of the criteria relating to their products, activities, policies or performance. It is generally motivated by a desire to not support the production of certain goods or activities that contravene social and environmental values. Negative screening includes sector-based screening where entire sectors are excluded and norm-based screening where companies are excluded if they are considered to have violated international accepted norms in areas such as human rights and labor standards.<sup>46</sup> Norm-based screening is applied to eliminate specific risks to a portfolio, and for communicating with the general public and corporate members on the ethics of the organization. It is an ethical statement in itself, and may be used to guard the reputation of the investor.<sup>47</sup>

Applying screening as a strategy to protect the investor's reputation by setting clear limits on what is perceived as unacceptable behavior, renders screening a very useful tool for many investors. Notwithstanding, a lot of criticism has been raised against the consequences of using negative screening as a strategy. This is because when socially responsible investors choose not to invest in industries and companies that are perceived as the worst offenders of human rights and the environment, the SRI investors leaves the responsibility to other investors that might not have the same concerns and standards. Consequently, the corporations perceived as worst offenders might continue business as usual. Hence, when negative screening is applied, there is no guarantee that corporations will change their behavior or that alternative investors will contribute to improve corporate behavior. On the basis of this, screening can be viewed as a principled, but not as effective strategy to corporate behavioral change.

While screening is usually done pre-investment, engagement happens post-investment. Company engagement, also known as active ownership, is the process by means of which investors become involved with the business to influence its activities, behaviors, and operations. It often occurs in response to a company's approach to corporate responsibility, or to a change in its ethical and social practices. During engagement, fund and investment managers are often the actors who play the largest role.<sup>48</sup> Through their position as shareholders, the fund and investment managers attempt to raise their concerns and use their

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<sup>46</sup> (UN Principles for Responsible Investment, n.d)

<sup>47</sup> (Blowfield & Murray, 2014, p. 232)

<sup>48</sup> (Blowfield & Murray, 2014, p. 235)



position to promote their moral, ethical, environmental and social objectives. Different strategies are being used to achieve this, with the two most common being proxy voting, i.e. voting at a company's general meeting, and shareholder activism, i.e. action taken by a shareholder with the intention of improving corporate behavior.<sup>49</sup>

Engagement is a strategy that allows the investor to be more involved in the markets. The investor is actively trying to influence companies or industries, instead of avoiding and/or refraining from investing in them. The rationale behind this is that shareholders and investors can work together with the management of a corporation to change course and hence improve financial performance over time.<sup>50</sup> Thus, corporate engagement has a larger potential for harmonizing with the financial goals of the investors than negative screening does. It is, however, a strategy that is vaguer. It can therefore be applied differently, rendering a potential for falsely conducting SRI. Nevertheless, engagement is the only SRI strategy that allows the investor to directly influence the corporations through active involvement, and hence it has a higher potential of contributing to positive change than negative screening.

## **2.4 Socially Responsible Funds – Definition and Historical Development**

A socially responsible fund, also referred to as a responsible or ethical fund, is a fund where the choice of investments is influenced by one or more social, environmental or other ethical criteria.<sup>51</sup> These criteria are diverse in both form and content, ranging from just a few criteria to lengthy documents.<sup>52</sup> One of the first socially responsible retail funds, i.e. funds for individual investors who are not rich enough to qualify as high net worth, was established in Sweden in 1965. During the 1970s and 1980s, partly influenced by and as a reaction to the Vietnam War and the apartheid regime in South Africa, SRI funds were established in both the US and UK respectively, in 1970 and 1984.<sup>53</sup> Over the last few years, the universe of socially responsible funds has expanded considerably. This development is partly due to the SRI movement moving into mainstream as a result of opposition against political decisions,

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<sup>49</sup> (Blowfield & Murray, 2014, pp. 366-367)

<sup>50</sup> (Blowfield & Murray, 2014, p. 235)

<sup>51</sup> (EIRIS, n.d.)

<sup>52</sup> (Sparkes & Cowton, 2004, p. 49)

<sup>53</sup> (Louche, 2009, p. 54)

legislative compulsion and pressure from the people and non-governmental organizations.<sup>54</sup> It is also due to the serious violations of human rights and the environment that was seen from corporations during the 1990s, with one example being the Bhopal disaster in 1984.

It was not until the early 2000s, with the end of the equities boom and a series of major corporate failure linked to serious violations of governance practices, that the managers of pension funds became aware of the necessity of behaving as real owners of companies, and of adopting a long-term view of investing. As a result of this realization, pension funds became innovators in integrating social, environmental, and governance issues into the decision-making process.<sup>55</sup> SRI funds and their managers began moving away from simple negative screening and towards a more active approach to responsible investments through engagement. In doing so, corporations were forced to develop greater transparency in their environmental, social and corporate governance policies, and to a greater extent respond and be flexible to the needs of their stakeholders.<sup>56</sup> This development led to SRI becoming an increasingly important consideration in the global financial industry.

The incentives for institutional investors to engage in SRI and the concerns addressed in SRI portfolios vary. Although SRI seem to be predominantly a strategy for altering corporate behavior, institutional investors engage in SRI not only for non-financial returns that fulfill their own aspirations, moral obligations and values, but also for financial rewards.<sup>57</sup> This has led to a growing view among institutional investors that ESG issues can affect the performance of investment portfolios.<sup>58</sup> The idea is that investors who are to fulfill their fiduciary duty, need to consider ESG issues in the investment process. Another explanation of why institutional investors choose to invest responsibly is the “universal owner hypothesis”. This hypothesis suggests that, although a large long-term investor with a diverse investment portfolio can initially benefit from an investee company externalizing costs, the investor might ultimately experience a reduction in market and portfolio returns due to these externalities adversely affecting returns from other assets. Universal owners, such as large pension funds and sovereign wealth fund, therefore have an incentive to reduce negative

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<sup>54</sup> (Sparkes & Cowton, 2004, p. 49)

<sup>55</sup> (Blowfield & Murray, 2014, p. 228)

<sup>56</sup> (Fung, Law, & Yau, 2010, p. 146)

<sup>57</sup> (Fung et al., 2010, p. 44)

<sup>58</sup> (Fung et al., 2010, p. 136)

externalities (e.g. corruption) and increase positive externalities (e.g. good corporate governance across their investment portfolio).<sup>59</sup>

Although the focus on ESG factors had increased during the 2000s, socially responsible funds and institutional investors did not have a framework for integrating ESG factors until 2006. While the UN Global Compact (UNGC) existed, it was mainly directed at corporations. In 2005, a small group of institutional investors, under the auspices of the UN Environment Programme and the UN Global Compact, developed a set of six principles for responsible investing known as the UN Principles for Responsible Investment (UNPRI). These principles were aimed at investors and their work with ESG factors. The signatories of the UNPRI committed to integrating ESG issues into conventional investment analysis, taking ESG factors into consideration in their investment decision-making and integrating this approach throughout their organizations, with their external money managers and within the industry as a whole.<sup>60</sup> The number of signatories has increased rapidly since the establishment. Initially, there were twenty signatories – today there are 1478 signatories, belonging to three main categories: asset owners, investment managers and professional service partners.<sup>61</sup>

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<sup>59</sup> (Kerste, Rosenboom, Sikken, & Weda, 2011, p. 158)

<sup>60</sup> (UN Principles for Responsible Investment, n.d.-b)

<sup>61</sup> (UN Principles for Responsible Investment, n.d.-a)



## **3 Presenting the Three Funds and Their Responsible Investment Frameworks**

Socially responsible investing and the ideas from the SRI movement lay the foundation for the investment frameworks of the Norwegian Government Pension Fund Global, the New Zealand Superannuation Fund and California Public Employees' Retirement System. Starting to invest responsibly in the early 2000s as the SRI movement started to gain more momentum among large institutional investors, the development of the three funds' responsible investment frameworks appears to follow the development of the SRI movement. In fact, the funds have to some extent been advocates and standard setters for responsible investing among large institutional investors.

This section will analyze the responsible investment frameworks of the GPFG, NZSF and CalPERS. It will begin by analyzing the Norwegian Government Pension Fund Global, before moving on to the New Zealand Superannuation Fund and the California Public Employees' Retirement System. The analysis of the three funds will focus on their investment frameworks, the development of these frameworks, and the reasoning behind the frameworks and the responsible investing. This will provide a better understanding of the funds, their context and history, and lay the foundation and provide background knowledge for chapter four, which will analyze and compare the three funds' approaches to responsible investing by analyzing and comparing the objectives and rationales behind the responsible investment frameworks, the actors involved in the establishment and development of the frameworks, the management structures and the SRI strategies that the funds apply.

### **3.1 The Norwegian Government Pension Fund Global**

#### **3.1.1 Establishing Ethical Guidelines – The debate.**

The Norwegian Government Pension Fund Global was formally established in 1990 when the Norwegian Parliament (*Stortinget*) adopted the *Act of the Government Petroleum Fund (Lov om Statens Petroleumsfond)*. The Fund was originally known as the Petroleum Fund, but with a change in the Fund's statutory framework in 2006, it was renamed the Government Pension Fund Global.<sup>62</sup> Funded from North Sea oil and gas revenues, the Fund serves as a savings

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<sup>62</sup> (Norges Bank Investment Management, n.d.-a)

tool for future generations and a tool to prevent the sudden influx of wealth from distorting the Norwegian economy and society. In addition to these purposes, the Fund was to serve as a tool to manage the financial challenges of an ageing population, and give the government room to maneuver in fiscal policy if oil prices were to drop or the mainland economy contract.<sup>63</sup> In other words, the Fund serves partly as a savings fund, and partly as a so-called buffer fund.

Since receiving its first payment in 1996, the GPFG has developed to become one of the largest sovereign wealth funds in the world. With this development, the increasing range of the investments, and the revelations that Norwegian investments were violating Norway's international obligations, campaigns and discussions about the Norwegian responsibility and the GPFG's investment policies started to emerge. Civil society organizations, such as The Future in Our Hands (*Framtiden i Våre Hender*) and Changemaker, initiated campaigns asking for the GPFG to become governed by ethical guidelines to make sure that the GPFG's investments did not violate international environmental and human rights agreements.<sup>64</sup> The campaigns and calls for the GPFG to become subject to ethical guidelines were highly influenced by moral issues and concerns. Non-governmental organizations argued that the investments made by the GPFG were not morally justifiable when they were only governed by financial considerations. Further, they claimed that the existing practice led to the state acting passive towards the social and environmental implications of its investments, and that the state was not taking responsibility for the consequences of its investments.<sup>65</sup>

The NGOs had political support from the political party the Norwegian Socialist Left Party (*Sosialistisk Venstreparti – SV*). SV, and especially members of the party Øystein Djupedal and Kristin Halvorsen, was one of the leading proponents for establishing ethical guidelines, and based its arguments on Norway's obligations and commitment to international law. The party argued that the GPFG needed to be governed by ethical guidelines as they saw it as unacceptable that the state was investing Norwegian savings in financial activities that were in direct conflict with Norwegian environmental and foreign policy.<sup>66</sup> When the party first raised a proposal to introduce ethical guidelines for the GPFG in the Parliament in 1999, no

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<sup>63</sup> (Norges Bank Investment Management, 2011)

<sup>64</sup> (Bay, 2002, p. 7)

<sup>65</sup> (Bay, 2002, p. 2)

<sup>66</sup> (Djupedal, 2004)

other political party supported its suggestion. In fact, not only were the proposal of making the GPFG subject to ethical guidelines voted down, Djupedal and SV was almost ridiculed by their political opponents.<sup>67</sup>

The Ministry of Finance, the Norwegian Central Bank (*Norges Bank*) and the Parliament showed great skepticism and opposed establishing ethical guidelines for the GPFG. Their main argument was that ethical guidelines would lead to practical issues for the management, and that it would lead to less investment opportunities resulting in higher risks and lower returns on the invested capital.<sup>68</sup> This would capitulate the state's legal obligation to secure the Norwegian people a good pension, they argued. Svein Gjedrem, the Governor of the Norwegian Central Bank at the time, stated, "It would seem pointless to introduce special ethical rules for the Government Pension Fund Global." His opinion was that the GPFG should be ruled according to the standards that the state had in other areas.<sup>69</sup> Another argument that was frequently raised among the skeptics was that it would be difficult to form good investment criteria with ethical guidelines. The Bondevik administration's statement in the Revised National Budget of 2002, showing skepticism towards establishing exclusion mechanisms isolated from international law, sums up many politicians' opinion on the issue of ethical guidelines at the time:

Ethical guidelines will be very difficult to practice. It will not be possible to find clearly defined and objective criteria, and any decisions will largely be based on discretion. Such rules would easily lead to inconsistencies in relation to other government activities. No matter what kind of criteria one might choose, it will be possible to highlight unacceptable conditions affecting individual companies in the Fund's portfolio.<sup>70</sup>

The skeptics also argued that ethical guidelines would have little effect on the conditions one wanted to improve. The political journalist in *Morgenbladet*, Erling Fossen's comment

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<sup>67</sup> (Skredderberget, 2015, p. 123)

<sup>68</sup> (Bay, 2002, pp. 2,7)

<sup>69</sup> (Stavanger Aftenblad, 2001)

<sup>70</sup> (St.meld. nr. 2 (2001-2002), p. 88), Author's translation

illustrates this: “The global capitalism is uglier than any Norwegian could imagine, but it is meaningless to talk about ethical investments as a measure against it.”<sup>71</sup>

After having debated and pushed for ethical guidelines since the government opened up for investing in equities in 1997, the NGOs, the political party SV, and the individuals working for ethical restrictions on the GPFG’s investments started to gain more support in 2001 and 2002. This support came as a result of a massive media storm after The Future in Our Hands’ news service NorWatch and the newspaper *Dagbladet*, with journalist Thomas Ergo in front, had mapped out and reveal that companies in the Fund’s equity portfolio was violating ethical norms.<sup>72</sup> The ensuing media storm created a massive political pressure for establishing ethical guidelines for the GPFG, and resulted in the establishment of the Advisory Commission on International Law (*Folkerettsrådet*) that was to secure the Fund from making investments that violated Norway’s commitment to and obligations under international law, and of an exclusion mechanism in 2001. Prior to this, an Environmental Fund had been established within the GPFG that applied positive screening and that could only invest in companies that met specifically given environmental reporting and certification requirements.<sup>73</sup>

Although the government had established the Advisory Commission on International Law and an exclusion mechanism, it was still skeptical about establishing ethical guidelines and a more comprehensive investment framework based on moral considerations for the GPFG. During 2002 however, after *Dagbladet* and NorWatch had revealed even more moral problematic investments, the debate shifted.<sup>74</sup> The exclusion mechanism was strengthened, and a majority in the Parliament took initiative and pushed for the government to establish a committee that was to propose ethical guidelines for the GPFG. The government committee was established and was to be led by Professor Hans Petter Graver.<sup>75</sup> Presenting its report in 2003, the Graver Committee concluded that it was both possible and desirable to establish ethical guidelines for the GPFG. In 2004, the government presented a set of ethical guidelines, based on the recommendations of the Graver Committee. The proposed guidelines

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<sup>71</sup> (Fossen, 2002), Author’s translation

<sup>72</sup> (Hammerlin, 2007, p. 6; Skredderberget, 2015, pp. 127-128)

<sup>73</sup> (Council on Ethics, n.d.-a)

<sup>74</sup> (Skredderberget, 2015, pp. 127-128)

<sup>75</sup> (NOU 2003: 22, p. 66)



were unanimously endorsed by the Parliament, and were made effective by the Ministry of Finance from 1 December 2004.<sup>76</sup>

With the establishment of ethical guidelines for the GPF, the exclusionary mechanism from 2001 was extended, and the Advisory Commission on International Law was replaced by the Advisory Council on Ethics (*Etikkrådet*).<sup>77</sup> The governance of the Fund and the Ethical Guidelines was to be divided between three institutions: the Ministry of Finance, the Council on Ethics and the Norwegian Central Bank. The Norwegian Central Bank, represented by Norges Bank Investment Management (NBIM) was to manage the GPF on behalf of the Ministry of Finance, who is the owner of the Fund. NBIM was to make sure that the Fund's financial interests were cared for. The Council on Ethics was to monitor the Fund's portfolio in order to reveal companies violating Norway's obligations under international law. Based on this monitoring, the Council on Ethics was to issue recommendations, i.e. thorough analysis, based on ethical considerations, with recommendations of negative screening or withdrawal of a company the Fund has invested in, to the Ministry of Finance. Based on these recommendations, the Ministry of Finance was to decide upon negative screening or withdrawal of the company from the investment universe. After deciding, the Ministry of Finance was to instruct NBIM of the decision, who would then act upon it.<sup>78</sup>

### **3.1.2 The normative basis of the Ethical Guidelines.**

It was important for the Graver Committee that the Ethical Guidelines was not based on one specific ethical theory, as the Committee believed this would make it harder to achieve consensus for the Guidelines. The reasoning behind this was that there was no uniform perspective of what ethics implied. Thus, the Graver Committee recognized that they had to look for the main normative characteristics that were consistent over time in their development of ethical guidelines.<sup>79</sup> As they did not find Norwegian Law and policy fit for the purpose, the Committee rooted its proposal of ethical guidelines in international agreements and initiatives that Norway had previously given its approval to. The UN Global Compact and the OECD Guidelines for Multinational Enterprises were put forward as appropriate frameworks. These international agreements had what the Graver Committee

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<sup>76</sup> (Ministry of Finance, 2013)

<sup>77</sup> (Council on Ethics, n.d.-a)

<sup>78</sup> (Finansdepartementet, 2004)

<sup>79</sup> (Graver Committee, 2003)

called an “overlapping consensus” in the people, and it was through the basis of these international agreements and guidelines that the ethical standards of the GPFG were to be developed. It would create consensus in both the current and the future generations, the Committee argued.<sup>80</sup>

In addition to rationalizing the Ethical Guidelines in international norms and standards, the Graver Committee rationalized ethical investments on the grounds that the Fund should avoid complicity in gross or systematic breaches of ethical norms relating to human rights and the environment.

Even though the issue of complicity raises difficult questions, the Committee considers, in principle, that owning shares or bonds in a company that can be expected to commit grossly unethical actions may be regarded as complicity in these actions. The reason for this is that such investments are directly intended to achieve returns from the company, that a permanent connection is thus established between the Petroleum Fund and the company, and that the question of whether or not to invest in a company is a matter of free choice.<sup>81</sup>

As a result of this line of thought, one of two ethical obligations of the GPFG came to be to “avoiding complicity” in unethical activities. The other obligation being to ensure that the current and future generations of Norwegians achieved favorable long-term returns.

Even though the Graver Committee stressed that the Ethical Guidelines was not to be based on any specific ethical theory, and stressed that the important investments to avoid were those where the Fund risked being complicit in violations of ethical norms, one can recognize ideas from both teleological and deontological ethics in the Ethical Guidelines and the Fund’s mandate.<sup>82</sup> Teleological ethics, such as utilitarianism, emphasize the importance of consequences; deontological ethics, such as Kant’s categorical imperative, hold that one should do the right thing not in order to achieve a goal but simply because it is right.<sup>83</sup> Hence, these two approaches primarily influences the choices of the GPFG.

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<sup>80</sup> (Graver Committee, 2003)

<sup>81</sup> (Graver Committee, 2003)

<sup>82</sup> (Graver Committee, 2003)

<sup>83</sup> (Chesterman, 2011, p. 47)

Deontological ethics dictate that certain investments must be avoided under any circumstances, and states that an investment will be unethical if the investor actively supports a company's production or behavior even if the support is not necessary for the unethical behavior to take place.<sup>84</sup> This line of thought is reflected in the exclusion mechanism and the recommendations of the Council on Ethics, where the focus is to avoid doing the wrong thing by being complicit in ethically problematic businesses, rather than trying to achieve desirable behavior. Hence, when the Graver Committee stated that the GPFG should avoid the investments that imply a risk of complicity in grossly unethical actions, their ideas were in line with deontological ethics.<sup>85</sup>

From a teleological perspective on the other hand, it is not likely that a financial investor could be an accomplice in a breach of ethical norms. Instead, teleological ethics leads to the avoidance of investments that have less favorable consequences and the promotion of investments that have more favorable consequences.<sup>86</sup> This line of thought can be found in the Fund's active ownership strategy. Active ownership serves as a tool to secure the Fund's future returns by promoting socially responsible investments and sustainable development. In other words, it is applied to influence businesses to change their behavior in direction the GPFG desires in order for the Fund to increase its long-term financial returns. If the companies do not change their behavior, and start acting according to the standards that the GPFG adhere to, the Fund might divest.

### **3.1.3 The Ethical Guidelines from 2004 to 2016.**

The Ethical Guidelines adopted in 2004 had two main elements. The first was that the Fund was an instrument for ensuring that a reasonable portion of Norway's petroleum wealth benefited future generations. This represented an ethical obligation for present generations to manage the Fund in a way that generated a sound return. The second was that the Fund was not to make investments that constituted an unacceptable risk in which the Fund might contribute to unethical acts or omissions, such as violations of fundamental humanitarian

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<sup>84</sup> (Graver Committee, 2003)

<sup>85</sup> (Graver Committee, 2003)

<sup>86</sup> (Graver Committee, 2003)

principles, violations of human rights, gross corruption or severe environmental damages.<sup>87</sup>

The work with the Ethical Guidelines was to be carried out by three mechanisms: exercise of ownership rights, negative screening and withdrawal.<sup>88</sup> Exercise of ownership rights meant to promote long-term financial returns based on the UN Global Compact and the OECD Guidelines for Multinational Enterprises and was to be carried out by NBIM. The overall goal with the active ownership and exercising ownership rights was to secure the Fund's financial goals. Negative screening was adopted to prevent companies that produced weapons whose normal use were in violation of fundamental humanitarian principles, either themselves or thought entities under their control from being included in the investment universe. These weapons were chemical weapons, biological weapons, anti-personnel mines, non-detectable fragments, incendiary weapons, blinding laser weapons, cluster munitions and nuclear weapons.<sup>89</sup> The last mechanism, withdrawal, signified withdrawal from the investment universe of companies where there was an unacceptable risk of contributing to gross or systematic human rights violations, such as murder, torture, deprivation of liberty, forced labor and the worst forms of child labor, serious violations of the rights of individuals in situations of war or conflict, severe environmental damage, gross corruption or other particularly serious violations of fundamental ethical norms.<sup>90</sup> In sum, the screening mechanism applied to companies that produced certain products, and was adopted to keep the Fund from investing in these companies. The withdrawal or exclusion mechanism applied to companies' production methods and conduct, and was to prevent that the Fund's investments contributed to unacceptable conditions through discretionary assessments and thorough analysis of individual companies. Active ownership was adopted to secure the Fund's financial goals.

In 2006, the government suggested to revise the management mandate of the GPF, concerning the role of NBIM. The government wanted to include a mechanism whereby the Ministry of Finance could prevent NBIM from investing in government bonds issued by certain countries.<sup>91</sup> This was implemented, and in 2007 the government decided to amend the

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<sup>87</sup> (Finansdepartementet, 2004)

<sup>88</sup> (NOU 2003: 22, p. 23)

<sup>89</sup> (Regjeringen Bondevik II, 2004)

<sup>90</sup> (Finansdepartementet, 2004)

<sup>91</sup> (St.meld. nr. 24 (2006–2007), p. 62)

managing mandate of the Fund and prohibit NBIM from investing the Fund's capital in bonds issued by Myanmar.<sup>92</sup> This happened against the background of measures adopted by the EU and other countries against Myanmar due to the political and human rights situation in the country. In addition to suggest a revision of the GPFG's management mandate, the Ministry of Finance announced that there would be an assessment of the Ethical Guidelines. The assessment was to make sure that the Ethical Guidelines was functioning as intended.<sup>93</sup> As a contribution to the assessment process, members of the Parliament Hans Olav Syversen, Bjørg Tørresdal and Ingebrigt S. Sørfohn, proposed in 2007 that the government should exclude companies that produce tobacco from the GPFG's investment universe.<sup>94</sup> This suggestion was further discussed and then implemented in the revised Guidelines. In 2008, the government expanded the screening criteria further. As a result, the GPFG was no longer allowed to invest in companies that sold or produced weapons and weapon technology to regimes that were on the list of those government bonds the Fund was prohibited from investing in.<sup>95</sup> At the time, Myanmar was the only country on the list.

Although some changes to the Ethical Guidelines had already been made, the evaluation of the Guidelines was presented in 2009. This evaluation was a major review of the legal mandate and the practices of the Council on Ethics, and was conducted by the Ministry of Finance. In the assessment, a separate report written by the Albright Group and Professor Simon Chesterman assessing the implementation of the article 3 (ownership) and article 4 (screening and withdrawal) of the Ethical Guidelines was included, as well as a report by Professors Ole Gjølberg and Thore Johnsen discussing whether positive screening would be a useful tool for the GPFG to adopt. The main conclusions of the evaluation were that the Ethical Guidelines was based on a solid foundation, and had proven to be reasonably robust. Many important aspects with the Ethical Guidelines were to be continued, but in light of international developments and the experience gained with ethical guidelines, the Ministry of Finance proposed some changes and adjustments to the existing goals and instruments.<sup>96</sup> Among these was a recommendation of more engagement with companies, and to establish a

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<sup>92</sup> (Ministry of Finance, 2008, p. 29)

<sup>93</sup> (St.meld. nr. 24 (2006–2007), p. 75)

<sup>94</sup> (Syversen, Tørresdal, & Sørfohn, 2007)

<sup>95</sup> (St.meld. nr. 20 (2008–2009), p. 85)

<sup>96</sup> (St.meld. nr. 20 (2008–2009), p. 89)

watch list of companies as a new instrument.<sup>97</sup> These changes led to new Guidelines called *Guidelines for Observation and Exclusion of Companies in the GPF*, issued in March 2010.<sup>98</sup>

The revised Guidelines were more comprehensive than its predecessor. The exclusion mechanism was continued, and remained, as in the 2004 Guidelines, divided between exclusion based on products and exclusion based on conduct. The criteria for conduct-based exclusion of companies remained more or less unchanged, except with one important amendment. In the 2004 Guidelines, the conduct-based criteria concerned both acts and omissions, while the 2010 Guidelines only concerns acts. The criteria for product-based exclusion of companies were expanded and new products qualified for exclusion. In addition to not investing in companies which themselves or through entities they controlled produced weapons that violated fundamental humanitarian principles through their normal use, the Fund was not to invest in companies which themselves or through entities they controlled produced tobacco, or sold weapons or military materiel to states that were subject to investment restrictions on government bonds as described in the management mandate for the Fund.<sup>99</sup> In addition to these changes an observation mechanism was included. Observation was to be chosen if there was doubt whether the conditions for exclusion had been met or about the future developments of the company, or where for other reasons deemed appropriate.<sup>100</sup>

Changes to the management and the strategies available in the Ethical Guidelines were also made. The exercise of ownership was taken out of the Guidelines and put into the management mandate of the GPF. Hence, NBIM's role was described separately, but it was still to manage the GPF on behalf of the Ministry of Finance. This was done to strengthen the active ownership mechanism. The Council on Ethics would continue to monitor the Fund's portfolio with a goal of identifying companies that were contributing to or were responsible for unethical behavior or production. Based on this monitoring, the Council on Ethics was to issue recommendations to the Ministry of Finance. In addition, the Council on Ethics was now at the request of the Ministry of Finance to issue recommendations on

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<sup>97</sup> (St.meld. nr. 20 (2008–2009), p. 21)

<sup>98</sup> (Council on Ethics, n.d.-b)

<sup>99</sup> (Finansdepartementet, 2010)

<sup>100</sup> (Finansdepartementet, 2010)

whether an investment was violating Norway's obligations under international law. The Ministry of Finance's role remained unchanged, if not strengthened.<sup>101</sup> As a result of these changes and describing NBIM's role separately, the original Ethical Guidelines from the Graver Committee was now split in two separate documents.

In 2008, the government also adopted changes to the management mandate of the GPF. The changed mandate entered into force January 2011.<sup>102</sup> The revisions of the management mandate was motivated by a number of factors and considerations. The most important factors were the Fund's significant growth in value and complexity since its establishment, the mandate reflecting that it had been continuously developed over time, and the evaluation and implementation of the revised Ethical Guidelines.<sup>103</sup> NBIM was still restricted from investing in certain countries' government bonds. At the time, Myanmar was the only country on the restriction list. However, the changed mandate opened up for other countries to be included. In January 2014, the result of this was illustrated when the government revised the guidelines for government bonds, removing Myanmar from the list and adding Syria, Iran and North Korea.<sup>104</sup> Other measures that were adopted were that NBIM was to have stronger demands to integration of ESG issues in the investment activities, and these demands were to be rooted in international principles, such as the UNPRI.<sup>105</sup>

In 2015, a new set of revised guidelines was issued. The criteria themselves remained unchanged. However, in section three, criteria for conduct-based exclusion, the observation mechanism was included in the text. Previously, this mechanism had existed as an own paragraph. The largest change in the new guidelines was that the procedures for deciding whether a company should be excluded or put under observation changed. The Council on Ethics still monitors the Fund's portfolio, but it now issues its recommendations to the Norwegian Central Bank instead of the Ministry of Finance, as it previously had. After receiving recommendations from the Council on Ethics, the Norwegian Central Bank makes decisions on observation and exclusion in accordance with the Ethical Guidelines.<sup>106</sup> The

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<sup>101</sup> (Finansdepartementet, 2010)

<sup>102</sup> (Hoelseth, 2010)

<sup>103</sup> (St.meld. nr. 20 (2008–2009), p. 37)

<sup>104</sup> (Mestad, Hessen, Lindberg, Olsson, & Rathe, 2013, p. 11)

<sup>105</sup> (St.meld nr. 10 (2009-2010), p. 90)

<sup>106</sup> (Finansdepartementet, 2014)

Ministry of Finance only holds a limited role, which distances the management of the Fund from the government. These changes were a large step towards making the divestment decision less political. In moving the decisions away from the Ministry of Finance and to the Norwegian Central Bank, the divestment decisions were moved from a democratic organ that can be held accountable of the Norwegian Parliament to a less transparent management body. This change was desirable by many actors, who meant that some of the previous decisions had been political and said there was a risk that the divestment decisions conducted by the Ministry of Finance was perceived internationally as the Norwegian government's view on a company or a country.<sup>107</sup>

In addition to the abovementioned amendments, the government decided during 2015 that the Fund was to divest from companies that receives more than 30 percent of its revenues from producing thermal coal or that based more than 30 percent of its business activity on coal.<sup>108</sup> The new criterion regarding mining companies and power producers entered into force 1 January 2016, and new Guidelines were issued in February 2016.<sup>109</sup>

### **3.1.4 The current Ethical Guidelines.**

On 1 February 2016 the new Ethical Guidelines were adopted. The current guidelines are similar to the previous ones. The criteria for product-based observation and exclusion of companies are the same with one additional criterion concerning mining companies and power producers. The new criterion reads as follows:

Observation or exclusion may be decided for mining companies and power producers which themselves or through entities they control derive 30 per cent or more of their income from thermal coal or base 30 per cent or more of their operations on thermal coal.<sup>110</sup>

The criteria for conduct-based observation and exclusion of companies are also similar, with one additional criterion. In addition to not being invested in companies that contribute to or is responsible for serious violations of human rights, rights of individuals in situations of war or

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<sup>107</sup> (Meld. St. 19 (2013-2014), p. 48)

<sup>108</sup> (Stortinget, 2015)

<sup>109</sup> (Slettholm, 2015)

<sup>110</sup> (Finansdepartementet, 2016a)



conflict, gross corruption, environmental damage and other particularly serious violations of fundamental ethical norms, the Fund shall not be invested in companies that contributes to or is responsible for:

acts or omissions that on an aggregate company level lead to unacceptable greenhouse gas emissions.<sup>111</sup>

NBIM has, in addition to the Ethical Guidelines developed focus areas to which it pays special attention. These focus areas, dealing directly with environmental and social issues, are children's rights, climate change, water management and human rights. In these areas, NBIM has formulated clear expectations for how companies should manage risk and report their activities.<sup>112</sup> The focus area of human rights was adopted in February 2016. After this change in NBIM's focus areas, companies in which the GPFG is invested in are expected to respect human rights and to have the relevant measures integrated into the business strategy, risk management and reporting. These strategies for responsible business conduct should according to NBIM follow the UN Guiding Principles.<sup>113</sup> The inclusion of human rights as a focus area is by many commentators seen as groundbreaking, and places additional pressure on businesses to report on their behavior and act responsibly in order to keep the GPFG as an investor.

## **3.2 New Zealand Superannuation Fund**

### **3.2.1 The establishment and management of the Fund.**

The New Zealand Superannuation Fund was established in 2001 by *The New Zealand Superannuation and Retirement Income Act 2001* (from now on the Act) by then Minister of Finance, Michael Cullen. Consequently, the Fund is known as the "Cullen Fund". The Labour-led government decided to establish such a fund to ease the future financing burden of the country's pension payments, New Zealand Superannuation.<sup>114</sup> New Zealand's retirement income scheme is universal and financed from general taxation revenue, where residents over the age of 65 receive a pension irrespective of their personal wealth. With an

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<sup>111</sup> (Finansdepartementet, 2016a)

<sup>112</sup> (Norges Bank Investment Management, n.d.-b)

<sup>113</sup> (Norges Bank Investment Management, 2016a)

<sup>114</sup> (Orr, 2012, p. 212)

aging population, the government saw that there in the future would become a significant pressure on public revenue to sustain. Hence, there was a need to find new ways to finance future pensions. The Fund began operating in 2003 and was to be built up from government contributions funded from budget surpluses. Since 2003, the Fund has grown rapidly to about NZ\$ 28.08 billion of assets as of 29 February 2016, with investments principally in global equities, fixed income, infrastructure and property both domestically and internationally.<sup>115</sup>

In establishing the Fund's legislation, the government drew extensively on the experiences of the Canada Pension Plan Fund and the Working Groups working with the planning and establishment of the Irish National Pensions Reserve Fund.<sup>116</sup> This resulted in the management structure of the Fund having similarities with both the Canadian and the Irish funds, which were designed to keep the assets far from politicians' reach.<sup>117</sup> The NZSF is managed by a separate entity called the Guardians of New Zealand Superannuation. The Guardians, which has operational independence regarding its investment decisions, invests the money the government has contributed to the Fund. By doing this, the Fund act as a piggybank, saving money for the future, which improves the ability of future governments to pay for superannuation.<sup>118</sup> The Guardians exercises the overall control over the Fund, but has outsourced some work to external fund managers.<sup>119</sup> It is overseen by the Board of the Guardians of New Zealand Superannuation (from now on the Board), who is also responsible for setting the investment policies of the NZSF. The Board consists of between five to seven members, appointed by the Governor-General, i.e. the personal representative of New Zealand's Head of State Queen Elizabeth II of New Zealand, on the recommendation of the Minister of Finance, after nominations from an independent nominating committee and consulting with representatives of other political parties.<sup>120</sup> The only persons that may be members of the Board are persons with "experience, training and expertise in the management of financial investments."

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<sup>115</sup> (Guardians of New Zealand Superannuation, 2016; Nzsuperfund, 2015)

<sup>116</sup> (New Zealand Treasury, 2000, pp. 117-125)

<sup>117</sup> (Clark & Monk, 2011, p. 19)

<sup>118</sup> (Nzsuperfund, n.d.-d)

<sup>119</sup> (Controller and Auditor-General, 2008, pp. 62-63)

<sup>120</sup> (Nzsuperfund, n.d.-a)

New Zealand, who is a country renowned for some of the most progressive environmental legislation in the world, has sought to promote socially responsible investing through the NZSF.<sup>121</sup> Consequently, the Fund and the Guardians are, and have been since they started operating, required to invest ethically. This obligation to invest ethically is seen in the Guardians' governing legislations, which states that the Guardians' primary duty is to:

invest the Fund on a prudent, commercial basis and, in doing so, must manage and administer the Fund in a manner consistent with (a) best-practice portfolio management; and (b) maximizing return without undue risk to the Fund as a whole; and (c) avoiding prejudice to New Zealand's reputation as a responsible member of the world community.<sup>122</sup>

None of these three criteria has precedence over the other, meaning that the Guardians has to take them all into account when considering investment issues.<sup>123</sup> This obligation is less normative than the regulations of the GPFG. The legislation also does not define the terminology, and offers no real guidance on how to solve any conflicts between the different goals. This leaves the Guardians to enjoy a certain freedom in the interpretation of its obligations. For instance, the governing legislation states that NZSF must avoid prejudice to New Zealand's reputation internationally. When establishing the Fund, the New Zealand Treasury interpreted it as a requirement that the Board had: "a policy regarding ethical investment. It does not prescribe any particular approach to, or emphasis on, ethical investment."<sup>124</sup> Hence, consideration and promotion of responsible investments and social, environmental and governance issues, which the Guardians do today, were not required.

There have been suggestions and discussions in Parliament that have sought to strengthen the legislation, and the ethical investment framework of the NZSF. This was seen in 2006, when the New Zealand Parliament debated a Private Member's Bill that sought to provide a framework for socially responsible investment mandates for the government's Crown Financial Institutions. The Bill went in to the ballot, but was withdrawn when the proposer of the Bill, Maryan Street, was appointed to Cabinet and was among other jobs given the

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<sup>121</sup> (Richardson, 2008, p. 365)

<sup>122</sup> (Ministry of Social Development and the Treasury, 2001, p. 35)

<sup>123</sup> (Guardians of New Zealand Superannuation, 2015, p. 3)

<sup>124</sup> (McCulloch & Frances, 2003, p. 29)

responsibility for the Accident Compensation Corporations' portfolio, an organization which the Bill was relevant to.<sup>125</sup> In 2010, the Parliament again debated an Ethical Investment Bill that would have obliged the Guardians “to promote socially responsible and environmentally sustainable development” and to implement investment policies that take into account international norms and conventions supported by the New Zealand government. The proposer of the Bill, Grant Robertson from the Labour Party wanted the NZSF and other Crown Financial Institutions to invest the money of New Zealanders in an ethical manner, and wanted to achieve this by amending the relevant legislation. This Bill was also voted down, as the majority of the voters did not see the need for legislation to be amended, as they meant that the Guardians had already established measures to invest responsibly.<sup>126</sup>

### **3.2.2 The normative basis of the Responsible Investment Framework.**

During the process that established the NZSF, there were discussions of whether investment objectives that could be used to achieve social outcomes should be included. Three categories were highlighted: limitations on investments in socially undesirable firms and industries, requirements to invest commercially in particular areas, and requirements to invest socially in particular areas. All of these areas of broader social outcomes were excluded because the investment strategy of the Fund was to be value maximizing, and this had to be the primary investment objective in order to secure future New Zealand Superannuation.<sup>127</sup> Thus, the financial objective excluded other potential objectives for the investment strategy.<sup>128</sup> This line of thought, prioritizing the financial objective above all other objectives, was defended by referring to internationally public pension funds that were performing badly after having directed their investments towards objectives of broader social outcomes and improvement of the domestic economy.

Although the broader social outcomes were excluded from the Act and the mandate of the Guardians, the duty to “avoid prejudice” may be seen as a form of deontological ethics in the way the Guardians has interpreted this duty. This is because, by having interpreted the duty to “avoid prejudice” to justify the exclusion of entities involved in whaling, the manufacture of tobacco products, cluster munitions and anti-personnel mines, and the production and testing

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<sup>125</sup> (Street, 2008)

<sup>126</sup> (House of Representatives, 2010)

<sup>127</sup> (New Zealand Treasury, 2000, p. 37)

<sup>128</sup> (McCulloch & Frances, 2003, p. 21)

of nuclear explosives, the Guardians is avoiding certain companies that are considered to be unethical and have the potential to harm New Zealand's reputation. By avoiding these industries, the NZSF is acting as a responsible member of the world community – not because it is pursuing a financial goal, but because it is perceived as the right way to act. In addition to this, the ethical obligation or the duty to “avoid prejudice” also appear to be linked to international norms and laws by demanding that the Guardians avoid hurting New Zealand's reputation as a responsible member of the world community with the investments.<sup>129</sup> This link to international law and norms might be because a responsible member of the global community is usually thought of as one that respects legal standards, and act according to set frameworks.

The governing legislation of the Guardians also has linkages to teleological ethics, especially consequentialism. This is because the Guardians has to consider the consequences of its investments and whether they may harm New Zealand's reputation. If the consequences of the investments are found to be harmful to New Zealand's reputation as a responsible member of the world community, the investments cannot be made. Consequentialist ideas and purposes can also be found in the Fund's active ownership strategy. This is because, according to consequentialism, one is obliged to try to influence a development in the desired direction and choose the strategy that gives the best result. Active ownership does this by being used as a tool to secure the Fund's future returns by promoting socially responsible investments and sustainable development.

### **3.2.3 The Responsible Investment Framework from 2003 to 2016.**

According to the Act, the Guardians was to develop the ethical policy. This enabled it to establish a range of processes and policies. As a result, the Responsible Investment Framework of the NZSF and how it has been governed has developed significantly over the years. To help establish an ethical policy for the Fund, the Board appointed a Responsible Investment Committee. This Committee was to help draft ethical policies, monitor the ethical policies' implementation, and generally advise the Guardians' Board on socially responsible investment matters. This structure had similarities with the governance structure of the Norwegian Government Pension Fund Global. However, the Committee was disabled in

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<sup>129</sup> (Richardson, 2015b, p. 367)

2009, when the Board assumed direct oversight of the ethical policies as part of a commitment to embed SRI considerations throughout the Fund's decision-making process.<sup>130</sup>

The original Responsible Investment Framework of the NZSF was loosely defined and developed to avoid hurting New Zealand's reputation. Investments in any activity consistent with the laws of New Zealand were permitted, unless or until that investment breached the standards set out in *The Statement of Investment Policies, Standards and Procedures*.<sup>131</sup>

These standards were:

- Gross abuses of fundamental human rights;
- Serious infringements of labor and employment standards;
- Serious infringements of environmental standards;
- Promoting transnational organized crime or terrorism; or
- Other conduct so reprehensible that it may prejudice New Zealand's reputation as a responsible member of the world community or its reputation as a responsible global investor in sovereign and corporate securities.<sup>132</sup>

It was considered a breach of policy if a sovereign or corporate issuer of securities were widely regarded internationally as having participated in any of the abovementioned activities. If a sovereign or corporation were close to breaching the standards, the Guardians had the opportunity to either engage with that entity to encourage a change to its behavior, or to divest.<sup>133</sup> Divestment was also to be conducted if an investment gave rise to a risk of prejudice.

In 2006, as the Fund signed the UN Global Compact and became one of the founding signatories of the UN Principles for Responsible Investment, the Responsible Investment Framework of the Fund was revised. In signing the UNPRI, the NZSF committed itself, where consistent with its fiduciary duties and responsibilities, to incorporate environmental, social and governance insights into the management of the portfolio.<sup>134</sup> This focus on ESG issues became evident in the revised Framework. While the general policy of the Fund

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<sup>130</sup> (New Zealand Superannuation Fund, 2010, p. 44)

<sup>131</sup> (New Zealand Superannuation Fund, 2004, p. 25)

<sup>132</sup> (New Zealand Superannuation Fund, 2004, p. 26)

<sup>133</sup> (New Zealand Superannuation Fund, 2004, p. 25)

<sup>134</sup> (New Zealand Superannuation Fund, 2006, p. 16)

remained that any activity that was consistent with the laws of New Zealand were permitted, the standards expected of the companies in which the Fund invested was changed. The UN Global Compact was now adopted as a benchmark in which the NZSF measured the non-financial performance of the companies it invested in. As a result, the original standards was removed, and it was now considered a breach of policy if a company was regarded internationally as having materially failed to meet the principles of the UN Global Compact. Where a company was in breach of the standards, the Fund's approach was still to engage with that entity to encourage a change to its behavior.<sup>135</sup> Divestment was also an option if a company was severely breaching the responsible investment standards. In addition to this, divestment was to be conducted if it was determined that an investment had been made in a business activity that was illegal in New Zealand, even if it was legal in a foreign jurisdiction.<sup>136</sup>

During the year of 2006, the rules for divestment was further developed when the Board decided to exclude companies that were involved in the production of landmines from its portfolio. That same year, companies involved in the processing of whale meat were also divested from and excluded from the portfolio.<sup>137</sup> Both of these exclusions were made because it was found that these activities were in violation of New Zealand Law and international agreements. Even though the Guardians during 2006 developed the exclusion criteria to become more unique to the NZSF, with the inclusion of a criteria concerning companies involved in the processing of whale meat, it did not develop the whole Responsible Investment Framework to become a unique framework for the Fund, as Norway did with the Ethical Guidelines of the GPF. Instead, the Guardians tied the Responsible Investment Framework closer to international standards by incorporating international standards, such as the UNGC, and removing the original criteria for what was considered a breach of the Fund's policy.

In 2007, the list of exclusions was further expanded, when the Guardians decided to exclude and divest from companies that were involved in the manufacturing of tobacco.<sup>138</sup> The justification for the exclusion was based on New Zealand's participation in international

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<sup>135</sup> (New Zealand Superannuation Fund, 2006, p. 29)

<sup>136</sup> (New Zealand Superannuation Fund, 2006, p. 16)

<sup>137</sup> (R. Norman, 2007, p. 4)

<sup>138</sup> (New Zealand Superannuation Fund, 2007a, p. 28)

conventions aimed at curbing tobacco consumption. In the divestment process it was also concluded that continued investment in tobacco production was contrary to clear government policy, and that engagement with the companies involved would not lead to changed business practices.<sup>139</sup> Over the course of the following year, companies involved in the manufacture of cluster munitions, or the manufacture of *key components* of cluster munitions, and of testing or manufacturing nuclear explosive devices were added to the exclusion list.<sup>140</sup> This happened as a result of the New Zealand government signing the *Convention on Cluster Munitions*, a comprehensive review of the nuclear weapons issue, and a realization that manufacturing of nuclear explosive devices was illegal under the *New Zealand Nuclear Free Zone, Disarmament, and Arms Control Act 1987*.<sup>141</sup> In 2013, the group of companies excluded under the nuclear explosive devices decision was extended to include a group of nuclear base operators.<sup>142</sup> These base operators was included because they were to an increasing extent involved, as part of the life extension programs of nuclear stockpiles in the US and UK, in the modification and upgrade of nuclear explosive devices. The decision to exclude nuclear base operators led to seven companies being excluded.

In 2009, as the Responsible Investment Committee was disabled, the NZSF expanded its due diligence process to include responsible investment criteria. As a consequence, ESG factors became more important factors in the Fund's practices and documentation. Where possible, formal requirements for ESG due diligence, management and reporting, were now included in private equity, infrastructure, and timber investment documentation. The Fund's property advisor was also required to include ESG factors in their manager selection criteria. All new investment mandates or managers were required to take responsible investment considerations.<sup>143</sup> With this development, the NZSF initiated investment measures to deliver environmental and social returns in addition to sufficient investment returns.

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<sup>139</sup> (New Zealand Superannuation Fund, 2007b)

<sup>140</sup> (Nzsuperfund, 2008)

<sup>141</sup> (Nzsuperfund, 2008)

<sup>142</sup> (Nzsuperfund, 2013)

<sup>143</sup> (New Zealand Superannuation Fund, 2010, p. 132)



### **3.2.4 The current Responsible Investment Framework.**

The Guardians has focused on responsible investment since it began operating, and believes that ESG factors are vital to long-term financial returns. Consequently, ESG considerations are integrated into all the aspects of the Fund's investment activities. The Responsible Investment Framework and program is closely aligned to the UNPRI, and the UNGC functions as the benchmark for expected standards of corporate behavior.<sup>144</sup> Consequently, these international standards – the UNPRI and UNGC – and the focus on ESG factors form the basis of the Guardians responsible investment policy.

Under the Responsible Investment Framework, the two main work streams are integration and ownership. Integration refers to identifying environmental, social and governance risks with specific investments, and understanding how to mitigate those risks. Ownership is about the monitoring and ongoing oversight of responsible investment requirements across the Fund's portfolio post-investment. Ownership also covers engagement with and exclusion of companies.<sup>145</sup> The Fund's portfolio is monitored against the UNGC, which is a set of global standards on human rights, environment, labor and anti-bribery and corruption. If breaches to these standards are discovered, the Guardians engage with the company in question in an attempt to alter their policy. If change does not occur or the breaches are too severe, the Guardians may decide to exclude the company.

The Guardians also excludes companies due to the nature of their business activities. Currently, the NZSF excludes companies that are directly involved in:

- The manufacture of cluster munitions;
- The manufacture or testing of nuclear explosive devices;
- The manufacture of anti-personnel mines;
- The manufacture of tobacco; and
- The processing of whale meat.<sup>146</sup>

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<sup>144</sup> (Nzsuperfund, n.d.-e)

<sup>145</sup> (Whineray, n.d.)

<sup>146</sup> (Nzsuperfund, n.d.-b)

In addition, the Fund also excludes investments in the government bonds of any nation state where:

there is widespread condemnation or sanctions by the international community and New Zealand has imposed meaningful diplomatic, economic or military sanctions aimed at that government.<sup>147</sup>

### **3.3 California Public Employees' Retirement System**

#### **3.3.1 The history and management of the fund.**

California Public Employees' Retirement System was established by California State Law in 1931 as the State Employees Retirement System. The Fund is an agency in the California executive branch that serves more than 1.7 million members in the CalPERS retirement system and administers benefits for nearly 1.4 million members and their families in their health program. Today, CalPERS is the largest public pension fund in the United States, with a market value of over \$300 billion.<sup>148</sup> Its capital comes from employer contributions from the California State government, and by public employees who are members of CalPERS. This capital is invested in stocks, bonds, real estate, private equity, inflation-linked assets, and other public and private investment vehicles in California, the US and internationally.<sup>149</sup>

The Fund is governed by a Board, the Board of Administration, which consists of 13 members who are elected, appointed, or holds *office ex officio* for four-years terms.<sup>150</sup>

Constituting these 13 members are:

- Six elected members: two elected by and from all CalPERS members; one elected by and from all active state members; one elected by and from all active CalPERS school members; one elected by and from all CalPERS public agency members; and one elected by and from the retired members of CalPERS.
- Three appointed members; two appointed by the governor; and one appointed jointly by the Speaker of the Assemle and the Senate Rules Committee.

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<sup>147</sup> (Guardians of New Zealand Superannuation, 2015, p. 17)

<sup>148</sup> (California Public Employees' Retirement System, 2015e)

<sup>149</sup> (California Public Employees' Retirement System, 2015i)

<sup>150</sup> (California Public Employees' Retirement System, 2015b)

- Four *Ex Officio* members; the State Treasurer, the State Controller, the director of the California Department of Human Resources and a designee of the State Personnel Board.<sup>151</sup>

The composition of the Board is mandated by law and cannot be changed unless approved by a majority of the registered voters in the state.<sup>152</sup> The Board of Administration is responsible for the control of CalPERS and has the investment authority and sole fiduciary responsibility for the management of CalPERS' assets. It is governed by policies, delegations, guidelines and different beliefs, and has under the California Constitution a fiduciary duty to act in the best interest of its members and employers.<sup>153</sup> Hence, the legal authority for the activities of CalPERS can be found in the Constitution, laws, and regulations of the State of California.

The Board of Administration consists of six committees and subcommittees, and each Board member has to serve on at least one committee.<sup>154</sup> The responsibility of these Committees differs, but their main objectives are to review programs, projects or issues and make recommendations to the Board. One of these committees is the Investment Committee, which reviews and approves the portfolio performance, asset allocation, investment transactions, and investment manager performance. The Committee also establishes investment strategies and policies in accordance with law.<sup>155</sup> With the Board's guidance, the Investment Committee and an Investment Office carry out the activities of the Investment Program. Hence, the Investment Office invests and manages CalPERS' daily investment activities. An internal trading staff and external equity managers manages the investments on behalf of the Board of Administration.<sup>156</sup> This structure was established with a goal of having minimal political involvement in CalPERS' investments and investment policies. However, an amendment to the State Constitution in 1992, which sought to eliminate political interference in pension fund investing, left the Legislature free "to continue to prohibit certain investments by a retirement board where it is in the public interest to do so."<sup>157</sup>

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<sup>151</sup> (California Public Employees' Retirement System, 2016a)

<sup>152</sup> (California Public Employees' Retirement System, 2016b)

<sup>153</sup> (California Public Employees' Retirement System, 2015h)

<sup>154</sup> (California Public Employees' Retirement System, 2015a)

<sup>155</sup> (California Public Employees' Retirement System, 2015a)

<sup>156</sup> (California Public Employees' Retirement System, 2015i)

<sup>157</sup> (California Constitution, 1974)

California is known for being radical in its politics, a proponent of new ideas and willing to go different ways to make a difference and change behavior. This may best be seen in the state's environmental policy, in which it in many areas is a leading party in the US.<sup>158</sup> As with California's characteristic of being a proponent of new ideas and new thinking, CalPERS has been known to always be among the first investors to identify the next "big thing" for investing. For instance, in 2004 it passed an Environmental Investing Program, pledging to invest up to \$ 500 million in environmental public equity funds.<sup>159</sup> By doing that, CalPERS also approved investments in clean technology, and became the first public fund to do so. In addition to this, CalPERS has been used as a tool for changing behavior and influencing companies to act according to the State of California's expectations. The Fund was one of the earliest institutional shareholder activists and a leading party working for improved corporate governance. Consequently, CalPERS' fund managers are cited as having revolutionized corporate governance in the US in the 1980s and 1990s.<sup>160</sup>

The Fund started its Corporate Governance Program in 1984 and launched a Focus List Program in 1987 under CEO Dale Hanson. Both of these corporate governance programs were a reaction to the intense merger and takeover activities that were seen in the 1980s. These takeover activities, CalPERS believed was wreaking havoc on the pension fund's investments, hence the Fund needed to act against such them.<sup>161</sup> The Focus List Program is a program that each year selects a small number of companies in the United States, which CalPERS believes are underperforming on both stock returns and governance factors, to improve the companies' governance practices. The idea is that this process will lead to better stock performance.<sup>162</sup> In the early years, CalPERS activism would only become public when CalPERS formally sponsored a shareholder resolution. However, in 1992 CalPERS began to publicly announce its Focus List as an effort to apply public pressure to the targeted companies.<sup>163</sup> With this public naming and shaming, targeted companies seemed to begin

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<sup>158</sup> (Europaportalen, 2008)

<sup>159</sup> (Castaneda, 2007, p. 190)

<sup>160</sup> (Blowfield & Murray, 2014, p. 238)

<sup>161</sup> (Castaneda, 2007, p. 139)

<sup>162</sup> (California Public Employees' Retirement System, 2015g)

<sup>163</sup> (Barber, 2007, p. 71)

changing their behavior. As a result, the Fund's engagement and shareholder activism became known as the "CalPERS Effect".<sup>164</sup>

In addition to being one of the earliest shareholder activists, the Fund has played a leadership role in demonstrating how environmental, social and governance factors can be incorporated into pension fund strategies, and the impact this has on the financial performance of socially responsible investments.<sup>165</sup> In 1994, the Fund developed a Real Estate's Responsible Contractor Program Policy, aimed to promote fair labor practices such as fair wages and benefits and equal opportunity hiring.<sup>166</sup> The Fund also began to take into account how a corporation treated its employees when making investment decisions.<sup>167</sup> In 1996, CalPERS expanded and made its Corporate Governance Program international.<sup>168</sup>

Although the Fund had been acting with an organized shareholder campaign since 1984, the Fund's effort with socially responsible investments, however, is said to have fully have begun in 2000, when then State Treasurer of California and CalPERS Board member, Philip Angelides, suggested that the pension fund should adopt his "double bottom line" initiative. The "double bottom line" initiative was based on a philosophy of profits and social reform. It was to direct a portion of CalPERS' investments in California to the state's underserved markets.<sup>169</sup> The rationale behind this idea was that this would spur economic growth in those California communities left behind during the economic expansion of the past decade.<sup>170</sup> This was to be known as the California Initiative. In addition, the Fund was to drop its investments in countries that lacked a free press, labor unions, and other hallmarks of democracy because these investments were doing poorly.<sup>171</sup> Angelides used his position as State Treasurer and a member of the CalPERS Board to advance his ideas, persuade fellow Board members and

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<sup>164</sup> (P. C. English, Smythe, & McNeil, 2004, p. 158)

<sup>165</sup> (Fung et al., 2010, pp. 140-141)

<sup>166</sup> (CalPERS, 2012, p. 7)

<sup>167</sup> (Boatright, 1999, p. 22)

<sup>168</sup> (Castaneda, 2007, p. 234)

<sup>169</sup> (Rubin, 2011, p. 111)

<sup>170</sup> (Angelides, 2011, pp. 4-5)

<sup>171</sup> (Palmeri, 2008)

push for the Fund to adopt this initiative.<sup>172</sup> The Board approved the “double bottom line” and California Initiative as part of the Economically Targeted Investment Program.<sup>173</sup>

Today, CalPERS actively considers environmental, social and governance factors in what it calls the ESG approach. The Fund is one of the founding members of the UN Principles for Responsible Investment, and has adopted the Global Sullivan Principles of Corporate Social Responsibility: the objectives of which are to support economic, social, and political justice. CalPERS is also urging businesses to adhere to the human rights, labor, environmental, and anti-corruption principles of the UN Global Compact.<sup>174</sup> The Fund utilizes different mechanics for influencing companies to improve their behavior and ESG focus. Company engagement, as seen with the Focus List Program, exercising shareholder rights, and in some limited cases exclusion and divestment, are some of the mechanisms that are being applied. Engagement with companies is, as for the GPF and NZSF, always preferred to divesting as a means of affecting corporate behavior.<sup>175</sup> In addition to the already mentioned international frameworks, three forms of economic capital set the framework for CalPERS’ environmental, social and governance integration.<sup>176</sup> These are: financial capital, which is based on the idea that good corporate governance is vital to ensuring an alignment of interest between a company’s management and its shareowners, physical capital, which is based on the idea that the environment matter because companies rely upon inputs from the environment, and human capital, which is based on the idea that social issues matter because human resource policies have impact on productivity, attendance, and employee quality of life.<sup>177</sup> CalPERS sees these three forms of economic capital as vital for long-term financial return.

### **3.3.2 Why does CalPERS invest responsibly?**

CalPERS’ responsible investments are framed and defended from a financial aspect. Its principal job is to provide retirement benefits to all of its members and their family, and it has a strict mandate that forces it to justify all investment policies on the basis of financial returns. In fact, it has under the California Constitution a fiduciary duty to act in the best

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<sup>172</sup> (Rubin, 2007, p. 141)

<sup>173</sup> (Rubin, 2011, p. 111)

<sup>174</sup> (CalPERS, 2012, p. 1)

<sup>175</sup> (California Public Employees' Retirement System, 2015c, p. 13)

<sup>176</sup> (CalPERS, 2014, p. 4)

<sup>177</sup> (CalPERS, 2014, p. 4)

interest of its members and employers. As a consequence of this objective, the Fund's overriding investment priority is to grow the Fund's portfolio in a way that ensures that CalPERS meets its commitment to its beneficiaries, not just today, but also to the future members of the pension plan.<sup>178</sup> Its approach to responsible investments and ESG issues is framed by this financial duty.

The Fund invests responsibly because it believes that environmental, social and governance issues can positively affect the performance of investment portfolios.<sup>179</sup> It believes that an increasing focus on ESG issues can increase the invested company's performance and thereby its sustainability, and hence increase the Fund's long-term returns. In fact, CalPERS believes a focus on ESG issues is vital for the Fund's long-term value creation and performance. For instance, CalPERS sees company employees as an important part of the wealth creation in companies. If the Fund influences companies to have a larger focus on the wellbeing and the rights of its employees, the Fund is contributing to a healthy, productive, and motivated workforce. As a result, the companies' wealth creation can increase because the company employees are working harder and being more productive. Hence, there is a chance that the Fund's long-term returns will increase. As an opposite, if companies do not consider the wellbeing of their employees, there is a risk of the companies' reputation being hurt. If companies violate their workers' rights the companies risk potential litigation, their reputation, and their ability to operate. This will most likely affect the companies' value, and hence it will be a bad investment for CalPERS and its members because its holdings will decrease in value and not provide good long-term returns.<sup>180</sup>

Even though CalPERS seems to be highly influenced by financial motivations in its responsible investing, some criteria in its investment framework appear to be based on moral considerations. This mainly applies to some of the investment criteria introduced by the government, hence those restrictions that are required by law and influenced by politicians. For instance, after having passed Senate Bill no. 185, prohibiting CalPERS from making new investments in companies generating more than 50 percent of its income from thermal coal, Senator Kevin de León said, "We have a moral obligation to protect our children, as well as

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<sup>178</sup> (CalPERS, 2012, p. 4)

<sup>179</sup> (CalPERS, 2012, p. 35)

<sup>180</sup> (California Public Employees' Retirement System, 2015f)

an economic imperative to get out of this sinking asset.”<sup>181</sup> Moral considerations was also the reason for the exclusion of manufacturers of assault weapons that are illegal for sale under California Law, which came into place after the shooting at Sandy Hook Elementary School in 2012.

It is also possible to find ideas from ethical or normative theory in the Fund’s SRI strategy. For instance, CalPERS applies active ownership as a strategy and in this strategy consequentialist ideas and purposes can be found. Active ownership is a strategy that is designed and serves the purpose of influencing companies in the direction the owner desires, in this case CalPERS. When CalPERS is able to influence the targeted company it will change its behavior in the direction CalPERS put it. Hence, the outcome is good for CalPERS and it will most likely achieve the result it was looking for by promoting its ideas through the active ownership. The consequentialist ideas found in this case is the idea that one is obliged to try to influence a development in the desired direction and choose the strategy that gives the best result. As seen, active ownership does this by being applied as a tool to secure CalPERS future returns by promoting the Fund’s desires and ideas.

### **3.3.3 The Investment Framework from 2000 to 2016.**

CalPERS has a long tradition of shareholder activism and investing responsibly. It has done so since the 1980s. Over the course of several years, the Fund’s focus on shareholder activism and corporate governance has developed and come to include different factors and aspects. During the 1980s, the Fund appears to have focused mainly on improving the governance of companies within the US. Nevertheless, in 1988 the California Legislature required CalPERS to sell its shares in companies that did business in South Africa due to the government’s apartheid policy. CalPERS upheld this exclusion until 1991, when South Africa lifted its apartheid regime.<sup>182</sup> During the 1990s, the Fund’s activism seems to have expanded to also focus on international corporations. In addition, and in line with the spirit of the time, human capital and human rights became increasingly important issues. For instance, in 1999 the California Legislature enacted a statute that required CalPERS to monitor and annually report on investment holdings in companies that did business in California and that owed compensation to victims of slave or forced labor during World War II. During the same

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<sup>181</sup> (Fossil Free USA, 2015)

<sup>182</sup> (Castaneda, 2007, p. 205)



year, CalPERS also became required to annually investigate and report to the Legislature on the extent to which CalPERS domestic and international portfolio companies operating in Northern Ireland were adhering to the principles of nondiscrimination and freedom of workplace opportunity, in compliance with the laws of Northern Ireland.<sup>183</sup>

In the year of 2000, CalPERS divested from and excluded tobacco companies. This was decided after the Board voted seven to five to divest the entire holding in tobacco firms, despite resistance from CalPERS' staff.<sup>184</sup> This decision was a result of both State Treasurer and Board member Angelides' "double bottom line" initiative, and the specter of costly lawsuits and other blows to the tobacco industry that had been seen due to the health risks that persuaded.<sup>185</sup> The decision was made at the time when tobacco stocks were performing poorly, and the tobacco industry was being highly criticized.<sup>186</sup> According to the press accounts of the decision, it was not political or moral considerations that made the CalPERS Board to arrive at the decision, the stocks were just performing too badly for CalPERS to continue its investments.<sup>187</sup> "The unusual and unique challenges that the tobacco industry faced, including the threat of extensive litigation ... threatened to substantially reduce our shareowner value in tobacco", Board Member George Diehr explained, "so we divested to protect our members' assets in the long term."<sup>188</sup>

In 2002, the Fund announced that it would sell its holdings in the Philippines, Thailand, Indonesia, and Malaysia because these countries did not meet CalPERS' human rights standards. The decision was made as a result of Angelides' "double bottom line" initiative, and a realization after the Asian financial crises in 1998, that the Fund's increased exposure to emerging markets left it more vulnerable to higher levels of risk in its investment portfolio.<sup>189</sup> As a result of this decision, CalPERS did not invest in a large number of emerging markets due to risk of potentially investing in companies or other entities that abused labor rights or violated human rights. The Fund operated with a "Permissible Country List" that screened out and essentially prohibited equity investments in certain countries. This

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<sup>183</sup> (California Public Employees' Retirement System, 2015j)

<sup>184</sup> (Los Angeles Times, 2000)

<sup>185</sup> (Castaneda, 2007, p. 205)

<sup>186</sup> (Barber, 2007, p. 77)

<sup>187</sup> (The New York Times, 2000)

<sup>188</sup> (Castaneda, 2007, p. 205)

<sup>189</sup> (Hebb, 2008, p. 65)

marked the first time that CalPERS applied criteria linking investment decisions in emerging markets to social issues and non-financial criteria.<sup>190</sup> The decision to screen at a country-level rather than company-level was highly criticized for creating financial loss, since CalPERS was prohibited from investing in many important and growing markets.<sup>191</sup>

In 2007, the Fund reviewed its Emerging Market Policy, concluding that the “Permissible Country List” both hurt the Fund’s returns by reducing its investable universe, and also reduced its ability to be a positive influence on these markets.<sup>192</sup> Further, it was concluded that where unacceptable social issues were found, it would be more effective to exclude individual companies, rather than entire countries. Where possible, CalPERS was from then on to use engagement to improve standards and generate enhanced performance of companies. This development and the removal of the “Permissible Country List” led to the establishment of the Emerging Equity Market Principles. These principles state CalPERS’ basic requirements in terms of productive labor practices, transparency, political stability, corporate social responsibility, market regulation, transaction costs and capital market openness.<sup>193</sup> In sum, after the review of the Emerging Market Policy in 2007, the Fund moved away from a screening at the country-level to a company-level screening, and adopted a principled-based approach to its Emerging Markets Policy.

In 2006, one witnessed a new development in the Investment Framework of CalPERS, when CalPERS backed a resolution from the Californian government encouraging CalPERS to persuade companies doing business in Sudan to avoid taking actions that promoted or enabled human rights violations in the country. Concerned by the potential risk to its portfolio and affected by the war in Darfur and the political debate, CalPERS issued a Position Statement on Sudan. The Position stated that companies undertaking business in Sudan might be unwittingly furthering the human rights violations occurring in Sudan, and that companies associated with the violations posed a serious risk to the Fund’s long-term returns. As a part of the Position Statement, the Fund passed a motion to ban investments in nine companies identified as providing monetary or military support to the Sudan government, while showing little or no interest in the violence in Darfur or willingness to

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<sup>190</sup> (Reuters, 2002)

<sup>191</sup> (Tozer, 2006, p. 6)

<sup>192</sup> (CalPERS, 2012, p. 29)

<sup>193</sup> (CalPERS, 2012, p. 29)

improve the welfare of the Sudanese people.<sup>194</sup> Later that same year, the California State Assembly passed the Sudan Act prohibiting CalPERS from investing in companies that had active business operations in Sudan, i.e. a company engaged in business operations that provided revenue to the government of Sudan or a company engaged in oil-related activities. The Sudan Act further required CalPERS to sell or transfer any investments in a company with active business operations in Sudan, and the Board was not to invest in a company with business operations in Sudan that met all of the following criteria:

(1) The company is engaged in active business operations in Sudan. If that company is not engaged in oil-related activities, that company also lacks significant business operations in the eastern, southern, and western regions of Sudan.

(2) Either of the following apply:

(A) The company is engaged in oil-related activities or energy or power-related operations, or contracts with another company with business operations in the oil, energy, and power sectors of Sudan, and the company failed to take substantial action related to the government of Sudan because of the Darfur genocide.

(B) The company has demonstrated complicity in the Darfur genocide.<sup>195</sup>

CalPERS is required to report to the California Legislature on an annual basis on any investments in companies with business operations in Sudan. This Law, the Sudan Act, was to remain effective until the government of Sudan halted the genocide in Darfur for 12 months, as determined by both the US Department of State and the Congress of the United States, or until the United States revoked its sanctions against Sudan.<sup>196</sup> As a result of California, CalPERS, other state governments and US pension funds introducing the Sudan Act, the US government in December 2007 followed their lead and passed the Sudan Accountability and Divestment Act, prohibiting direct investments in Sudan that included

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<sup>194</sup> (The United Nations Environment Programme Finance Initiative (UNEP FI) Asset Management Working Group (AMWG) & The United Kingdom Social Investment Forum (UKSIF) Sustainable Pensions Project (SPP), 2007, p. 28)

<sup>195</sup> (Assembly Bill No. 2941, 2006)

<sup>196</sup> (Assembly Bill No. 2941, 2006)

power production activities, mineral extraction activities, oil-related activities, or the production of military equipment.<sup>197</sup>

A new amendment to the framework happened during 2007 when the California Senate and Assembly passed, by unanimous vote, a bill creating the *California Public Divest from Iran Act*. The law was inspired by the Sudan efforts and the cooler relationship between Iran and the US after Iran refused to back away from its pursuit of nuclear weapons.<sup>198</sup> At the time, many states, state representatives and state legislatures had a goal of “terror-free” investing.<sup>199</sup> Joel Anderson’s, the Republican Assemblyman who introduced the Act, statements are an expression of the spirit at the time: “Who’s funding terrorism? It sure as hell shouldn’t be our public employees”, “When you’re looking at the war on terrorists, this is one of the best weapons we have — just defunding them.”<sup>200</sup> The Iran Act was approved in October 2007, and prohibits CalPERS from investing in a company with business operations in Iran that is:

invested in or engaged in business operations with entities in the defense or nuclear sectors of Iran, or the company is invested or engaged in business operations with entities involved in the development of petroleum or natural gas resources of Iran, and that company is subject to sanctions under federal law, as specified, or the company is engaged in business operations with an Iranian organization that has been labeled as a terrorist organization by the United States government.<sup>201</sup>

The Law also required CalPERS to sell or transfer investments in companies with business operations in Iran until Iran was removed from the US Department of State’s list of countries that had been determined to repeatedly provide support for acts of international terrorism, and the President of the United States determined and certified that Iran had ceased its efforts to design, develop, manufacture, or acquire a nuclear explosive device or related materials and technology.<sup>202</sup>

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<sup>197</sup> (United States Congress, 2007, p. 2518)

<sup>198</sup> (Kimmitt, 2007)

<sup>199</sup> (Munnell, 2007, p. 1)

<sup>200</sup> (Bloomberg News, 2007)

<sup>201</sup> (Assembly Bill No. 221, 2007)

<sup>202</sup> (Assembly Bill No. 221, 2007)

In 2011, as the US government was strengthening its sanctions against Iran, amendments to the Iran Acts were made with the passing of Assembly Bill 1151. The new amendments required CalPERS to also determine whether a company was taking substantial action to end or curtail business operations in Iran. The phrasing of the original Law was also amended, and CalPERS was no longer allowed to invest in companies with business operations in Iran that met either of the following criteria:

- (1) The company (A) is invested in or engaged in business operations with entities in the defense or nuclear sectors of Iran or (B) has an investment of twenty million dollars (\$20,000,000) or more in the energy sector of Iran, including in a company that provides oil or liquefied natural gas tankers, or products used to construct or maintain pipelines used to transport oil or liquefied natural gas, for the energy sector of Iran, and that company is subject to sanctions under Public Law 104-172, as renewed and amended in 2001 and 2006.
- (2) The company has demonstrated complicity with an Iranian organization that has been labeled as a terrorist organization by the United States government.<sup>203</sup>

Following the school shooting at Sandy Hook Elementary School in Newton, Connecticut in 2012, a national debate regarding gun control emerged in the US. As a result, CalPERS Board Member, Investment Committee member and State Treasurer Bill Lockyer called on CalPERS to review its investments in manufacturers of assault weapons that were illegal for sale under California Law. Following this review, the CalPERS Board decided in February 2013 to divest and exclude investments in companies manufacturing such weapons.<sup>204</sup> This resulted in the Fund divesting from two companies.

In 2013, an additional change was seen in the responsible investment framework of CalPERS, when the CalPERS Board of Administration adopted a set of ten Investment Beliefs intended to provide a basis for strategic management of the investment portfolio and to inform organizational priorities. This adoption strengthened the focus on environmental,

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<sup>203</sup> (California Law - Government Code 7513.7, 2012)

<sup>204</sup> (Glazier, Pacheco, & DeAnda, 2013)

social, and governance issues, which had been integrated as a strategic priority across CalPERS' portfolio since 2011.<sup>205</sup> The newly adopted Investment Beliefs were to guide CalPERS' decision-making, facilitate the management of its portfolio, and enhance consistency. Today, these Beliefs have developed to become the framework for how CalPERS manages its investments and helps the Fund determine its priorities.<sup>206</sup>

The latest development to the investment framework came in 2015, with the passing of Senate Bill No.185. This Law, pushed by Democrat Senator Kevin de León as a way to emphasize more secure environmentally friendly investments, prohibits CalPERS from making new investments or renewing existing investments in thermal coal companies, i.e. publicly traded companies that generates 50 percent or more of their revenue from the mining of thermal coal.<sup>207</sup> In addition, the Board is required to liquidate investments in thermal coal companies on or before 1 July 2017. In making a determination to liquidate investments, the Board is to constructively engage with the thermal coal companies to establish whether the companies are transitioning their business model to adapt to clean energy generation, such as through a decrease in their reliance on thermal coal as a revenue source.<sup>208</sup> If a company does not transition its business model after engagement, CalPERS has to sell or transfer any investment in that company.

### **3.3.4 The current Investment Framework.**

The current investment policies and restrictions of CalPERS have developed as a result of both state legislation and the Fund's own push for socially responsible investments. Today, CalPERS integrates environmental, social and governance factors into its investment decisions to support long-term value creation and risk-adjusted returns. Ten Investment Beliefs and sub-beliefs are a basic framework and guide for how CalPERS is to prioritize and manage its investments. These ten Beliefs are:

- Liabilities must influence the asset structure.
- A long time investment horizon is a responsibility and an advantage.

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<sup>205</sup> (California Public Employees' Retirement System, 2015k)

<sup>206</sup> (California Public Employees' Retirement System, 2015f)

<sup>207</sup> (Senate Bill No. 185, 2015)

<sup>208</sup> (Senate Bill No. 185, 2015)

- CalPERS investment decisions may reflect wider stakeholder views, provided they are consistent with its fiduciary duty to members and beneficiaries.
- Long-term value creation requires effective management of three forms of capital: financial, physical, and human.
- CalPERS must articulate its investment goals and performance measures and ensure clear accountability for their execution.
- Strategic asset allocation is the dominant determinant of portfolio risk and return.
- CalPERS will take risk only where we have a strong belief we will be rewarded for it.
- Costs matter and need to be effectively managed.
- Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error.
- Strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives.<sup>209</sup>

In addition to these Beliefs, CalPERS shall evaluate its investments in emerging markets according to the following principles: political stability, transparency, productive labor practices, corporate social responsibility and long-term sustainability, market regulation and liquidity, capital market openness, settlement proficiency and transaction costs, and appropriate disclosure on environmental, social, and corporate governance issues.<sup>210</sup>

As required by State Law in 2006 and 2007, CalPERS is monitoring and excluding companies invested in Sudan and Iran. According to the Sudan Act, the Fund is required to monitor, engage and ultimately divest from companies with business activities in Sudan, unless exempt on humanitarian grounds. The Fund is also required to identify, monitor, and ultimately divest from companies in the international nuclear, defense, oil, and gas sectors in Iran. Additionally, CalPERS excludes and divests from companies producing tobacco, and companies that manufacture assault weapons that are illegal to sell under California Law.<sup>211</sup> The Fund is also restricted from making new or renewing existing investments in companies that generate 50 percent or more of their revenue from mining thermal coal, and to sell or

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<sup>209</sup> (California Public Employees' Retirement System, 2015d)

<sup>210</sup> (California Public Employees' Retirement System, 2013)

<sup>211</sup> (CalPERS, 2014, p. 19)

transfer all its investments in such a company if the company does not change its behavior after CalPERS has engaged with it.<sup>212</sup>

CalPERS also monitors and annually reports on investment holdings in companies and their affiliates that do business in California and that owe compensation to victims of slave or forced labor during World War II. Further, the Fund is required to investigate and annually report on the extent to which CalPERS domestic and international portfolio companies operating in Northern Ireland are adhering to the principles of nondiscrimination and freedom of workplace opportunity, in compliance with the laws of Northern Ireland.<sup>213</sup>

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<sup>212</sup> (Baggesen & Eliopoulos, 2015)

<sup>213</sup> (CalPERS, 2014, p. 19)



## **4 Comparing the Funds' Approach to Responsible Investing**

The presentation of the three funds shows that there are differences in how the funds understand responsible investing and what criteria and companies that are considered unethical and to be avoided. This suggests that the understanding of SRI may vary dependent on the culture and context the funds are located in. The presentation also shows that the funds have different obligations, which may have affected the funds' rationales for investing responsibly. In addition to this, the presentation shows that the actors that are involved in the establishment and development of the responsible investment frameworks and the management of the funds may also influence how the funds invest. For instance, CalPERS, which has a high degree of involvement from politicians, appear to also use the Fund's investments to "do good" in the State of California. This is seen with the California Initiative, suggested by State Treasurer Philip Angelides, which directs investments towards underserved markets in California with the hope of spurring economic growth.

This section will look further into these differences by comparing and contrasting the three funds responsible investment frameworks and their approach to responsible investing. It will do so by analyzing the objective and rationale behind the responsible investing and the frameworks, the actors involved in the establishment and development of the frameworks, the actors involved in the management of the funds, and the SRI strategies the funds employ. Hence, this section will compare the three funds using the following four analytical categories: objective and rationale, actors, management structure, and SRI strategies.

### **4.1 Variations in the Funds' Rationales and Objectives**

The Ethical Guidelines of the GPF has the function of limiting and assisting in defining the investment universe of the Fund. It is the Ministry of Finance who decides where the fund managers are allowed to locate the investments and thereby defines the overall investment universe of the Fund. However, within this universe there are certain types of businesses that the government do not want the Fund to be invested in due to different ethical considerations. And if the Fund has already invested in such a company, the company should be divested from and excluded from the portfolio. It is for this reason the Ethical Guidelines are established. The Guidelines set limitations and define what kind of companies that the Fund

is *not* allowed to invest in, and which companies that should be excluded from the investment universe and portfolio or put under observation.

There are two main rationales or ethical obligations underlying the Ethical Guidelines of the GPF. Firstly, the Fund has an obligation to ensure that the owners of the Fund, i.e. current and future generations of Norwegians, achieve favorable long-term returns. This objective is based on the assumption that good long-term returns are dependent on sustainable development in economic, environmental and social terms, as well as well-functioning, legitimate and efficient markets.<sup>214</sup> Secondly, the Fund is to avoid investments that entail an unacceptable risk that the Fund contributes to certain specified gross or serious ethical violations. In a way, this objective was based on the outlook that Norwegians were to be able to sleep well at night knowing that the money they are investing are not being used to violate human rights, or commit other ethical violations.<sup>215</sup> It is also based on the presumption that avoiding certain businesses that are involved in unethical actions is the right thing to do.

These two objectives are integrated into NBIM's mandate. Hence, NBIM considers both of these objectives in its operations, finding its mission to safeguard and build financial wealth for future generations in the first one, and finding its limitations on how it can achieve good financial returns in the second. In addition to these two objectives, NBIM is according to its mandate required to establish a set of principles based on considerations of good corporate governance and environmental and social conditions, for the responsible management of the investment portfolio.<sup>216</sup> This, responsible management of the Fund, NBIM has interpreted to be concerned with business' behavior and how they act. Consequently, clear and long-term expectations to the companies the GPF is invested in, based on internationally recognized principles, form the foundations for NBIM's work on responsible investments.<sup>217</sup>

In the NZSF, responsible investing has a slightly different objective than the investments of the GPF. For the NZSF too, the exclusion criteria help define the investment universe and screen investments that are to be avoided. In other words, the exclusion criteria limit the investment universe. The rationale behind this is that by applying these criteria and avoiding

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<sup>214</sup> (Finansdepartementet, 2016b)

<sup>215</sup> (The Sustainable Companies Project, 2013)

<sup>216</sup> (Finansdepartementet, 2016b)

<sup>217</sup> (Norges Bank Investment Management, 2015, p. 7)

certain businesses that are considered to be unethical, the NZSF hopes to fulfill its obligation of avoiding harming New Zealand's reputation as a responsible member of the world community. This objective is also the reason why the Guardians has adopted and invest with a focus on ESG issues. The Guardians believes that responsible investors consider and have concerns for companies' focus on ESG issues. Hence, by adhering to a responsible investment framework, the Guardians believes the NZSF will be viewed as a responsible actor and that the Fund's investments will not violate its objective. In other words, the NZSF invest according to a Responsible Investment Framework as a way of protecting New Zealand's reputation.

The focus on ESG issues appears to be stronger in the NZSF than the GPF. The integration of ESG issues also have another function. In the NZSF, ESG considerations are integrated into all aspects of the Fund's investment activities. That means from the investment selection and due diligence to ownership activities such as monitoring the external investment managers, the exercise of ownership rights and the engagement with companies to improve their ESG policies and practices.<sup>218</sup> This is done not only to safeguard New Zealand's reputation, but also because the Guardians believes that the ESG factors are important to the long-term returns. The Guardians believes that by improving ESG performance a company can improve its long-term financial performance, and hence creating value for long-term investors such as the NZSF.<sup>219</sup> The Guardians therefore engages with companies and uses its influence as a shareholder to encourage companies to manage and report on their ESG risks, and tries by managing and identifying these ESG factors to allocate more capital towards more attractive areas.<sup>220</sup>

The Investment Framework of CalPERS sets limitations on the investment universe of the Fund. However, the Fund appears to operate with fewer restrictions on its investments than the GPF and NZSF. In essence, this means that CalPERS operates with fewer exclusion criteria than the other two funds, and that it has a larger investment universe. For CalPERS, the divestment criteria are largely influenced by politicians and the political landscape, meaning that the criteria are more influenced by politics than what is seen with the GPF and the NZSF. Consequently, the exclusion criteria appear to be based more on political

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<sup>218</sup> (Nzsuperfund, n.d.-e)

<sup>219</sup> (Nzsuperfund, n.d)

<sup>220</sup> (O'Connor, Rae, & Sethi, 2015, p. 5)

considerations than what is seen with the GPF and the NZSF. As a result of the political influence some of the divestments appear to be based on moral reasoning. For instance, the divestments from assault weapons that are illegal for sale under California Law appear to be based on the idea that it is wrong to invest in such products, and the divestment from thermal coal was influenced by the moral obligations towards the next generation.

Even though the exclusion criteria of CalPERS appear to be largely influenced by politicians and the political situation, the strong focus that is on sustainability and ESG issues in the Investment Framework appear to be based on a different rationale, and more influenced by other actors. As with the GPF and the NZSF, CalPERS too, has an obligation to secure good financial returns for its beneficiaries. In fact, this is CalPERS' main objective. To achieve this, and hence fulfill its fiduciary duty, the Fund is dependent on a strong and durable economy. As a way of achieving this and lower the Fund's risk, it has integrated a strong focus on sustainability. The concept of sustainability is grounded in economics and the understanding that long-term value creation requires effective management of three forms of capital – financial, physical, and human.<sup>221</sup> CalPERS has therefore integrated and has an interest in ESG factors through the investment decision-making process and the engagement with companies. The idea is that by promoting ESG factors and encourage companies to for instance use scarce resources wisely and consider the impact the company has on the environment; the Fund can contribute to manage the environmental risk, which is seen as vital for long-term performance.

## **4.2 Differences in the Involvement of NGOs, Politicians and Finance Professionals in the Development of the Frameworks**

The differences in the objectives and rationale behind the responsible investment frameworks might be explained by the different actors which are, and was involved in the development and establishment of the three funds responsible investment frameworks. As seen in the presentation of the funds, all three funds have different ties to politicians and NGOs, which appear to have influenced the way the responsible investments are being applied, defined and understood.

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<sup>221</sup> (CalPERS, 2014, p. 4)

The Ethical Guidelines of the GPFG has close ties to politicians, which it has had since its establishment. Although the Guidelines was developed by the Graver Committee, it was the Parliament who had the last say in approving the Guidelines, and decided the way the Guidelines was to be managed. It is also the Parliament and the Ministry of Finance who decides the criteria in the Guidelines, which gives politicians and the Parliament an influential role in how the Fund defines ethical investing. Originally, it was also the Ministry of Finance who decided which companies that were to be excluded after recommendations from the Council on Ethics. This changed in 2015, when the responsibility of the exclusions was given to the Norwegian Central Bank, resulting in the divestment decisions and exclusions becoming less political by being less tied to politicians and the government.

Despite the Parliament and the Ministry of Finance predominantly deciding the criteria in the Ethical Guidelines, they are not the only actors who can influence the criteria and the Guidelines. Through the establishment of the Ethical Guidelines and the development that has occurred since they entered into force in 2004, NGOs, and especially The Future in Our Hands and Changemaker, have played a significant role. It was NGOs who pushed for the Fund to become subject to ethical guidelines in the first place, and these actors have continued to be prominent in the debates regarding the ethics and management of the Fund. Today, these actors are pushing for the Ethical Guidelines to be expanded and for the Fund to change the way it invests. For instance, during the spring of 2016, Changemaker and the Norwegian Church Aid (*Kirkens Nødhjelp*) carried out a campaign pushing for the Fund to move their investments away from oil, gas and coal industries, and into renewable energy.<sup>222</sup>

NGO campaigns have often been influential and successful in influencing politicians, resulting in changes in the Ethical Guidelines and the managing mandate of the Fund and hence the conduct of NBIM. This was seen in February 2016 when NBIM introduced a new focus area on human rights. The adoption of the new focus area was a result of a campaign started by the Norwegian Students' and Academics' International Assistance Fund (*Studentenes og Akademikernes Internasjonale Hjelpesfond – SAIH*) in 2014. SAIH published a report showing that the Fund was complicit in violations of indigenous peoples rights through investments in mining companies in Guatemala and Colombia, and asked for the

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<sup>222</sup> (Kirkens Nødhjelp, n.d)

Fund to consider indigenous peoples rights in the investment process.<sup>223</sup> This campaign grew into a joint campaign between SAIH, the Norwegian People's Aid (*Norsk Folkehjelp*), The Norwegian ForUM for Development and Environment (*ForUM for Miljø og Utvikling*) and the Rainforest Foundation Norway (*Regnskogfondet*), pushing for the Fund to establish a strategy on human rights.<sup>224</sup> As a result of the campaign, the Ministry of Finance asked NBIM to consider an expectation document on human rights, which NBIM subsequently published in February 2016.

These close ties with NGOs and the influential role of the organizations have been allowed to play, are not found in the development of the responsible investment frameworks of the NZSF and CalPERS. Although both American and New Zealand NGOs have been active and had campaigns pushing for changes and expansions of the responsible investment frameworks of CalPERS and the NZSF, these organizations do not appear to have been as successful as in Norway. In fact, the actors involved in the establishment and development of the responsible investment framework of CalPERS and the NZSF differ from the actors involved in the establishment of the Ethical Guidelines of the GPFG.

Within the NZSF, the Guardians has been responsible for defining and developing an ethical investment framework. When establishing the Fund, the government gave no other instructions than the Guardians having the obligation to invest according to the criteria in the Act, and that the Board of the Guardians was to have a policy regarding ethical investments. What this policy was to be, the Board themselves had to define. To help develop and establish such a policy the Board of the Guardians decided to establish a Responsible Investment Committee consisting of Board Members. This Committee came to consist of one lawyer and former Member of Parliament, two investors, a consultant and an investment banker, and a person with good experience working within the industry body for superannuation funds.<sup>225</sup> As a result, it was mostly professionals within finance that were to assist in the development and establishment of a responsible investment policy.

Although the Board and the Guardians are acting at an arm's length for the government and have been free to define and develop a Responsible Investment Framework, they are not fully

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<sup>223</sup> (Fjellheim, 2014)

<sup>224</sup> (Studentenes og Akademikernes Internasjonale Hjelpfond, 2016)

<sup>225</sup> (New Zealand Superannuation Fund, 2004, pp. 19-20; 2005, pp. 18-19)

without influence from the government and national politics. Having to respect New Zealand Law, the Fund has expanded its responsible investments when the New Zealand government has signed new laws and conventions that also concern the investments of the Fund. For instance, companies involved in the manufacture of key components of cluster munitions were excluded from the investment universe after the New Zealand government signed the *Convention on Cluster Munitions*. Consequently, what constitutes unethical actions may be influenced by politics and the political climate. Still, the influence of politicians and politics in the development of the Responsible Investment Framework of the NZSF is very limited compared to the GPF and CalPERS.

The Investment Framework and especially the exclusion criteria of CalPERS are highly influenced by politicians. Having its exclusion criteria to a large extent decided by law, they are decided by politicians and the political situation. Although not all the screening criteria are decided by law, they all seem to have some political influence. This is because the Investment Committee, which has politicians serving in it, decides the investment policies and strategies. As was seen with both Philip Angelides and Bill Lockyer and their calls for the “double bottom line” initiative and the exclusion of assault weapons illegal respectively, the politicians serving in the Committee appear to have used their position in it, and on the Board to fight through their personal beliefs. Indeed, CalPERS’ Board members have started many of CalPERS responsible investment initiatives, some of which have been highly controversial.<sup>226</sup> As a result, CalPERS’ exclusion criteria appear to be more influenced by politicians than what is the case with both the GPF and NZSF.

Although the exclusion criteria of CalPERS are highly influenced by politicians, the incorporation of ESG issues in the Investment Framework appear to be more influenced by financial considerations, economic beliefs and professional opinion than political considerations. Since politicians serve on this Committee, the integration of ESG issues is *not* without political influence, but it appears that financial consideration and economic beliefs is the main rationale for the integration of these issues. Hence, there are reasons to believe that the professionals serving on the Committee have had their say in the process. As a result, the Investment Framework of CalPERS appear to be highly influenced by politicians when it comes to the negative screening, but when it comes to the integration of ESG criteria, it

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<sup>226</sup> (Barber, 2007, p. 70)

appears to be influenced also by professional opinion, and not only political considerations.

### **4.3 Professionalism Vs. Political Influence in the Management**

The difference in influence of politicians is not only seen in the development of the three funds' responsible investment frameworks, it is also seen in the management of the funds. The three funds operate with fund managers who invest on behalf of the fund, but the actors involved in the management of the funds and how these managements are structured, varies.

The governance structure of the GPFG puts NBIM in charge of managing the Fund on behalf of the Ministry of Finance and the Norwegian people. NBIM, being a financial institution that is supervised by the Norwegian Central Bank is to a high degree characterized by professionalism. In NBIM well trained and skilled finance professionals and economists work and invest with the aim of increasing the Norwegian wealth at the lowest possible risk. The fund managers invest according to the investment mandate set by the Ministry of Finance and inside the investment universe that the Ethical Guidelines help define. Within this universe and according to the investment mandate, NBIM invests with financial goals and the aim of getting the highest possible return on the Fund. As a result, the investments conducted by the GPFG are to a large extent based on financial considerations with an objective of increasing the Norwegian wealth and getting the highest possible returns.

Although NBIM is an independent financial investor operating under the Norwegian Central Bank, the management of the GPFG is not completely free from political influence. The Ministry of Finance and the government have a great ability to influence the Fund, its management mandate and how the Fund is to invest, since they are responsible for deciding the policies and frameworks of the Fund. Having this responsibility gives the politicians and the Ministry of Finance a certain influence on the investments, since they decide the politics and the policies of the Fund, and NBIM just having to follow these policies and acts within the limitations set by the government.

The NZSF is structured in a similar manner to the GPFG in that it operates with an investment manager – the Guardians – that consists of professional investment personnel and operates at a distance from the government. This means that the Guardians has independence regarding their investment decisions and that it operates freely within the defined investment



universe. In addition to this, the NZSF is similar in that a committee – the Board – independent from the government supervises it. Thus, the NZSF, too, is characterized by a high degree of professionalism in its investments.

The NZSF is not only similar to the GPF in that it invests with a professional financial investor. It is also similar to the Norwegian Fund in that its investments are not completely free from political influence. However, the political influence in the NZSF appears to be much more limited than what is the case with the GPF, and it has a different function. In some limited cases, and as long as it is consistent with the duty to invest the Fund on a prudent, commercial basis and has been tabled in Parliament, the Minister of Finance may give directions to the Guardians regarding the Government's expectations of the Fund's performance.<sup>227</sup> The Fund is required by law to consider the government's advice, but must weigh it against the obligations for prudent commercial investments. These directions have in some cases been effective and resulted in the Guardians having to change their investments. For instance, in 2009 the Minister of Finance issued a direction requiring the Fund to increase its investments in New Zealand, and thereby aiding the domestic economy, infrastructure, and capital markets.<sup>228</sup> As a result, the Fund increased its domestic investments in New Zealand.

CalPERS, on the other hand slightly, differs from both the GPF and the NZSF in its governance structure. It has a structure in which politicians serve in the Investment Committee, that is responsible for establishing investment strategies and policies, reviewing and approving the portfolio performance, asset allocation, investment transactions, and investment manager performance. Although it is an Investment Office consisting of professional workers who are responsible for the daily investments and operations, CalPERS' structure ties the investments closer to politicians and enhances their ability to directly influence the investment decisions. Hence, CalPERS' governance structure has larger ties to politicians and the government than what is seen with the more independent financial institutions of the GPF and the NZSF.

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<sup>227</sup> (Nzsuperfund, n.d.-c)

<sup>228</sup> (B. English, 2009)

#### **4.4 Same SRI Strategies, Different Screening Criteria**

Although the three funds have different rationales and objectives for investing responsibly, in addition to their fund management being structured differently, they all employ both negative screening and active ownership as responsible investment strategies. Thus, they all believe that certain companies should be avoided and that other companies are worth engaging with in order to exert their influence over them and thereby attempt to change their behavior. However, the negative screening criteria and how the active ownership strategies are employed slightly vary. In addition to the variations in the employment of negative screening and active ownership, both CalPERS and the NZSF appear to employ a form of impact investing as a part of their responsible investment strategy. Impact investing is investing with the aim to generate specific beneficial social and environmental effects in addition to financial gain.<sup>229</sup> Such investing is not seen to the same extent in the GPFG.

All three funds employ negative screening as a way of limiting the funds' investment universe and avoid certain types of businesses or business behavior. The criteria for what kind of businesses and business behavior that should be screened out and avoided differ, however, among the three. For instance, the NZSF excludes companies involved in the processing of whale meat, which neither CalPERS nor the GPFG do. CalPERS exclude businesses conducting certain business activities in Sudan, while neither the GPFG nor the NZSF excluded such companies. And the GPFG has a criteria concerning emission of greenhouse gasses, which neither the NZSF nor CalPERS have. However, some similarities in the criteria also exist. They all exclude companies producing tobacco from their portfolio, as well as companies that manufacture certain types of weapons. CalPERS differ from the GPFG and NZSF in that it only excludes companies that manufacture weapons that are illegal to sell under California Law. By comparison, the GPFG and NZSF exclude all companies that are involved in manufacture of nuclear weapons, cluster munitions and anti-personnel landmines. The GPFG takes the exclusion of companies that manufacture weapons one step further by placing additional weapons on its list.

The funds operating with different negative screening criteria might be influenced by the funds being located in different contexts, having different objectives with their investments, having different actors involved in the development of the responsible investments and the

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<sup>229</sup> (Investopedia, n.d-a)

different rationales behind the responsible investment frameworks. For instance, in administering the GPF, NBIM is subject to more comprehensive and detailed guidelines than those of the NZSF and CalPERS. This may be seen in the funds' exclusion policies. The GPF's policy is determined based on both the economic sector of a company and its individual practices, while the policy of the NZSF for example is mainly determined on the basis of a company's economic sectors. CalPERS on the other hand, divest from companies mainly based on the company's economic sector, but in certain cases also due to the conduct and practice of the company. This may be explained by the latter two facing a greater pressure to meet financial returns, as they must provide for pension benefits, respectively in the future and now. Although the GPF also carries the name pension fund, it does not have the same financial liabilities, and its role in building national savings is less explicitly tied to pension income. Hence, it may have a greater leeway in indulging its ethical mandate alongside the financial.

In their active ownership strategy the funds operate with and base their strategy on the same criteria and standards – namely the UN Global Compact and UN Principles for Responsible Investment. This means that, when engaging with corporations, the funds have overarching standards to promote, and demand that corporations respect these standards. In assessing a corporation, the funds are also using these standards to decide whether the corporations are fulfilling their responsibility and acting as responsible actors. By applying the same SRI strategy and relating their work to the same standards, the three funds are trying to improve the same issue areas in corporations. In that sense, the funds are pulling their work with environmental, social and governance issues in the same direction. Hence, they are raising the odds for improved business conduct across the globe.

In addition to applying the same international standards in their active ownership and engagement, the funds are similar in that they all view engagement as the most effective tool for changing corporate behavior. They all prefer to engage with corporations in order to influence them from within, instead of divesting and ending all dialogue. The funds therefore try to continue the dialogue for as long as possible, before divesting if the companies do not show intentions of or change their behavior. Although the funds base their active ownership on the same standards, the areas they have chosen to focus the most on vary. For instance, NBIM has developed four focus areas – climate change, water management, children's rights and human rights – in which it pays special attention to and have formulated expectations for

how companies should manage risk and report on their activities in these areas.<sup>230</sup> CalPERS on the other hand, have among other a strong focus on corporate governance in its engagement with companies focusing on five core issues: board quality and diversity, corporate reporting, investor rights, executive compensation, and regulatory effectiveness.<sup>231</sup> The NZSF has three focus areas in its engagement; human rights (child and slave labor; worker safety; operation in weak states), bribery and corruption, and severe environmental damage.<sup>232</sup>

In addition to operating with negative screening and active ownership both CalPERS and the NZSF appear to conduct impact investing as a part of their investment process. For instance, CalPERS has provided capital through private equity funds for innovative companies that create more efficient and less polluting technologies than current products.<sup>233</sup> The California Initiative is another example of impact investing. The NZSF's investments domestically shows it in certain cases invest with the goal of also create positive impact. The Guardians also say in the Fund's investment framework that the Responsible Investment Framework focuses on "considering investments which provide positive social returns in addition to the required financial return."<sup>234</sup> Although the GPF have an environment mandate that directs some of the Fund's investments to more environmental friendly companies, the investments with the goal of creating positive impact in addition to the financial returns is not as apparent in the responsible investment framework or manage mandate of the GPF, as it is with mandates and frameworks of the NZSF and CalPERS.

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<sup>230</sup> (Norges Bank Investment Management, 2016b)

<sup>231</sup> (CalPERS, 2014, p. 5)

<sup>232</sup> (New Zealand Superannuation Fund, 2015, p. 75)

<sup>233</sup> (CalPERS, 2012, p. 21)

<sup>234</sup> (Guardians of New Zealand Superannuation, 2015, p. 4)

## 5 What can be Achieved with Responsible Investing?

Chapter four found that there are differences in the funds' objectives and rationales for investing responsibly, the actors involved in the development of the investment frameworks, their management structures and the criteria employed in the negative screening strategy. In the active ownership strategy however, the funds base their approach on the same international standards. Nevertheless, they add their focus to slightly different areas in their engagement with companies. In addition, both CalPERS and the NZSF appeared in certain cases to apply impact investing as a strategy, which is not seen to the same extent in the strategy of the GPFG.

Of the three funds, CalPERS stand out as being the fund with the closest ties to the national or state government, while the NZSF appears to be the fund that operates furthest from political influence. CalPERS appears to be the fund that is to the largest extent influenced by moral in the investment process, while the Ethical Guidelines of the GPFG is the investment framework that seemingly is most based on ethics and moral considerations. The GPFG is also the fund that appears to operate with the most extensive and detailed responsible investment framework, assessing on both the economic sector and the individual practice of the companies.

These differences are evidently influenced by the different cultures and contexts in which the funds are located. For instance, CalPERS, which is located in California, a state that is known for being innovative and being concerned with the environment, has a strong focus on the environment in its investments and engagement, and was the first public fund to direct its investments to "cleantech". The focus on the environment in the engagement became even more evident in March 2016 when the Investment Committee voted to start requiring corporations that CalPERS is invested to include people on their boards who have expertise in climate change risk management strategies.<sup>235</sup> The NZSF's decision to divest from companies involved in the processing of whale meat is most likely a result of the fund's context, and appears to be fairly unique to New Zealand investors. The Ethical Guidelines of the GPFG, a fund that is located in Norway, a country who has long traditions of a strong

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<sup>235</sup> (Farmer, 2016)

civil society, is influenced by NGOs both in the establishment and the continues development of the Guidelines and the Fund's management mandate.

This section will, by focusing on the Norwegian Government Pension Fund Global, discuss what can be achieved with responsible investing. It will do so by focusing the SRI strategies and their objective, the reputation of the Fund and its size, while keeping in mind that the cultural and contextual differences influences the understanding of socially responsible investing, and that different investors and companies have different understanding of what socially responsible investing is and what responsible behavior and actions are.

## **5.1 Influencing Corporations and Investors by Being Transparent and Receiving Extensive Media Attention**

The exclusion mechanism of the GPFG is primarily based on a deontological approach, with the objective being to avoid contributing to certain unethical acts or omissions, or the production of certain products, and not to influence companies' conduct. Hence, one can say that the divestments and the negative screening mechanism was adopted in order for the Norwegian people to be able to sleep well at night knowing that their investments are not contributing to ethical violations. Therefore, the Council on Ethics' recommendations regarding divestments is meant to represent the values of the Norwegian people, and their assessment of what is considered unacceptable. Consequently, the divestments of the GPFG do not have the intention to change companies' behavior, only to protect the Norwegian people from being complicit in unethical actions.

Still, due to the virtue of the Fund's size and its position both nationally and internationally, the divestments of the Fund draw a lot of attention to the Fund and its decisions. This has in certain cases lead to the divestments of the Fund having larger ramifications than what was expected of the Council on Ethics, NBIM and the Ministry of Finance. The divestment from Wal-Mart in 2005, due to among other reasons discrimination of women, violations of workers' rights and prevention of unionizing, is an illustration of divestments receiving more attention than expected. After the Ministry of Finance announced that it was divesting from the American corporation, the American Ambassador to Norway at the time, Benson K. Whitney criticized the decision and accused Norway of a sloppy screening process and for

unfairly singling out American companies.<sup>236</sup> The Ambassador disagreed with the decision and the divestment strategy. “An accusation of bad ethics is not an abstract thing. They’re alleging serious misconduct. It is a national judgment of the ethics of these companies”, Whitney stated after the exclusion.<sup>237</sup> In a speech to the Norwegian Institute of International Affairs in 2006, Whitney offered a more nuanced critique and highlighted that the divestments of the Fund might have consequences beyond the intentions of the divestments:

I respectfully ask the Norwegian government and people to fully recognize the seriousness of what Norway is doing with divestment decisions like these. Norway is not just selling stock – it is publicly alleging profoundly bad ethical behavior by real people. These companies are not lifeless corporate shells. They represent millions of hard working employees, thousands of shareholders, managers and Directors, all now accused by Norway of actively participating in and supporting a highly unethical operation. The stain of an official accusation of bad ethics harms reputations and can have serious economic implications, not just to the company and big mutual funds, but to the pocketbooks of workers and small investors.<sup>238</sup>

The decision to exclude Wal-Mart was controversial and led to a media storm, raising the attention to the alleged behavior of Wal-Mart, the fact that large corporations have responsibilities of the behavior of companies down its supply chain, and the ethical policy of the GPF. Being the first exclusion due to human rights violations, the divestment from Wal-Mart and the attention that followed showed the potential implications and ramifications the decisions of the Fund could have. It also showed that the exclusion decisions of the GPF attracted considerable international attention. This attention came to some extent as a surprise to the Council on Ethics and the actors involved in the process.<sup>239</sup>

The Wal-Mart case is also an illustration of how the divestments of the GPF can impact companies’ reputations. The media attention that in certain cases follow the divestments of the GPF, resulting in the companies being portrayed as unethical, have in certain cases given the divested companies a scratch in their reputation. This was also observed by former

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<sup>236</sup> (Landler, 2007)

<sup>237</sup> (Landler, 2007)

<sup>238</sup> (Whitney, 2006)

<sup>239</sup> (Skredderberget, 2015, p. 131)

chair of the Council on Ethics, Ola Mestad, who in a lecture given at the University of Oslo during the fall of 2015, explained that some companies that had been divested from in some cases wanted to be re-included in the Fund's portfolio, because the negative publicity was hurting the companies and their reputation. Even just being on the observation list of the GPFGE had this effect. One reason for this, the companies said, was that when people were "googling" the company, one of the first search results that appear would be the post showing that the company was under observation of the GPFGE, or had been excluded from the Fund's portfolio. Another consequence of the divestments, which led to corporations wanted to be re-included, was that in some cases the shares of a company dropped in value after the divestment. This was seen with the stocks of the Malaysian company IJM Corporation Berhad, who was divested from in 2015, due to an unacceptable risk that the company was responsible for severe environmental damage as a result of its conversion of tropical forest into oil palm plantation.<sup>240</sup> However, there is no evidence that the divestments of the GPFGE will significantly impact the stock prices.<sup>241</sup>

The Fund's divestments have and are receiving extensive media attention both in Norway and internationally. This is both due to the Fund's size and its position as a responsible investor. This publicity in conjunction with the publicly available recommendations of the Council on Ethics leads to the divestments of the GPFGE having the effect of a naming and shaming campaign. Consequently, other investors have divested from companies after the GPFGE has done so. For instance, after the Norwegian government decided to include a criterion on coal in the Guidelines in 2015, both the Norwegian financial service company *Storebrand* and the insurance company *Kommunal Landspensjonskasse* (KLP) adapted their policy on coal to follow the standard set for the GPFGE.<sup>242</sup> Previously both of these companies had operated with a screening criterion on coal that screened out companies who received 50 percent of their revenues from coal, the same criteria CalPERS adopted in 2015. These adaptations and divestments that follow the actions of the GPFGE, may happen as a way of avoiding being accused of investing in companies that the Norwegian fund has called into question. For instance, the NZSF has in several cases been accused of continuing to invest in companies that the GPFGE excludes.<sup>243</sup> The divestments of the GPFGE has also been used by New Zealand

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<sup>240</sup> (Daily Express, 2015)

<sup>241</sup> (Beck & Fidroa, 2008, p. 4)

<sup>242</sup> (Haug, 2015)

<sup>243</sup> (R. Norman, 2007, 2011)



NGOs and the New Zealand Green Party as a pressure point in order to influence the Guardians to divest from the same companies as the GPFG has.

The publicity, and being referred to as being an unethical company, may hurt the company's reputation, which in turn can affect the consumers demand and raise the cost of capital by increasing the perception of investment risk when a company seeks to raise money in bond markets.<sup>244</sup> This may result in a high pressure on the targeted company to change its behavior. Seemingly sectors that are most affected by this pressure are high-value consumer industries. Mining and other companies farther from the consumer might not feel the same pressure to adapt their behavior. Consequently, there is a larger likelihood that companies close to consumers and depended on a good reputation change their behavior after being divested from.

That the Fund's divestments may have these consequences can lead to the divested companies changing their behavior in order to be re-included in the Fund's portfolio or avoid being divested from. Hence, the divestments – or the threat of divestments – may have a positive impact on companies. The divestments may also lead to other investors changing their policies or follow the GPFG's lead and divest from the same companies. This has been seen with Norwegian investors such as Storebrand and KLP, and in some cases with the NZSF.

## **5.2 Standard Setting and Signaling Effects**

That the divestments of the GPFG may have these ramifications, without being the intention of the Fund, shows that the Fund and its divestments also have strong signaling effects, both towards companies and others investors. By being transparent and making the recommendations of the Council on Ethics and the grounds for the decisions available to the public, the Fund is clearly expressing its reasoning behind the divestments. By doing this, the GPFG is veraciously stating what kind of actions or products it will and will not be associated with or accept. This may lead to other companies adapting their behavior and take into account the standards set by the Fund, as it fears losing a large investor if it refrains from doing so. Consequently, the divestments may also have a disciplining effect by drawing the line, and telling companies when the line is crossed.

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<sup>244</sup> (Teitelbaum, 2015)

By signaling to corporations and other investors what kind of conduct and actions the Fund does not want to be associated with, the Fund is, due to its position, contributing to setting standards for other investors to follow. For instance, after the government decided to include a criterion on coal in the Ethical Guidelines, the German insurance and finance company Allianz followed the decision of the Norwegian government and divested from coal based on the same criteria as the GPF. This showed that the acts of the GPF had symbol effects and to some extent a snowball effect.<sup>245</sup> The public recommendations of the Council on Ethics are contributing to the signaling effect, as these recommendations are available to other investors who can use and benefit from the information gathered and the analysis conducted by the Council. In some cases, other institutional investors have chosen to follow the decisions of the GPF after reading the recommendations of the Council.<sup>246</sup> Hence, the Fund contributes to setting norms and precedents for investors today and in the future.

The structure of the GPF with its Council on Ethics strengthens the GPF position as a standard setter. This structure is unique to the Norwegian fund and not seen in the NZSF or CalPERS. Having this structure and the Council who publish its recommendations and thorough analysis of companies that are recommended exclude or put under observation, makes the expectations and standards of the GPF clearer. Reading these recommendations one can get an insight into how the Fund thinks and what assessment it makes, and hence get a better understanding of what the Fund considers as unacceptable. Neither the NZSF nor CalPERS publish such thorough analysis of the companies they divest from.

Although the Fund and its decisions have had strong signaling effects since the Ethical Guidelines establishment, the publicity and attention to the divestment decision seem to have changed with the amendments in the Fund's managing mandate in 2015. Before this amendment the Minister of Finance announced the divestment decision, now the Norwegian Central Bank does. With this amendment the divestments of the Fund appear to receive slightly less attention from the media, which might reduce the Fund's signal effect. Prior to this amendment, and especially during Kristin Halvorsen's term as Minister of Finance (2005-2009) the decisions received extensive media coverage. In fact, during her term as

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<sup>245</sup> (M. Norman & Hammerstrøm, 2015)

<sup>246</sup> (Halvorssen & Eldredge, 2014, p. 107)

Minister of Finance, Halvorsen held press conferences in order to announce the divestments. By doing this, Halvorsen created a lot of blest around the decisions, and got the opportunity to directly speak to the public and announce which companies the GPFG divested from and the reason why. This gave Halvorsen an opportunity to signal to the public, to companies and to other investors what kind of behavior the Fund accepted and what behavior it did not.

The challenge with divestments and setting standards though negative screening is that, as seen in the comparison of the GPFG, the NZSF and CalPERS, responsible investors or investors in general do not act with or according to the same criteria. The investors appear to be influenced by their cultural context and location, and therefore usually apply screening criteria that are consistent with the ideas of the nation or the area in which they are located. This is for instance seen with the NZSF's criteria to excluded companies that are involved in the processing of whale meat. Consequently, responsible investors do not divest from and exclude the same companies. Therefore, the divestments of the GPFG may not result in companies changing their behavior after the GPFG has divested from them. It will usually be available capital and other investors that are willing to invest in the companies despite the GPFG having questioned their behavior. Hence, for divestments to lead to directly to change behavior it would require all investors on the planet to have a similar zero-tolerance policy. And this is evidently not the case nor is it likely to become the case, especially considering how well certain "sin industries" perform and especially during economic downturns.<sup>247</sup>

Nevertheless, the analysis of the GPFG, the NZSF and CalPERS' responsible investment frameworks found that in certain areas the funds appear to develop their negative screening criteria in the same direction. For instance, they all have excluded tobacco companies from their portfolio, and both the GPFG and the NZSF exclude companies involved in the production of cluster munitions, anti-personnel landmines. Although their criterion slightly differs, the NZSF and the GPFG both have a criterion and a policy on investments in nuclear weapons and explosives. In addition, although their criterion varies in how much revenues the company can receive from coal, both CalPERS and the GPFG have adopted a criterion on investments in coal companies. This seem to imply that investors are in certain areas, and especially in those areas that are "in the wind" at the time, choosing to adopt similar negative screening criteria. If this continues, certain industries might experience that the available

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<sup>247</sup> (Landier & Nair, 2008)

capital is decreasing or that the industry they belong to are developing a poor reputation, and hence they may adapt their behavior.

### **5.3 Changing Corporate Behavior Through Engagement and Dialogue**

The uncomfortable position that the divestment can put the companies in may represent a way to question the company and to initiate a dialogue, or may even represent a way for investors to engage with the company to improve its social, environmental and governance practices. Hence, the divestment or even the threat of divestment can function as a tool to start an engagement process or continue a dialogue. And it is probably here, as a tool to provoke engagement, that divestment has its strongest effect on company behavior. Because by engaging with companies, the funds are in active dialogue with the company and can more clearly express where the company is performing badly and what the funds expect from the company. Hence, it is easier for the funds to actually influence the companies and change their behavior.

As seen, the deontological “do no harm” aspect that is present in the divestment strategy of the GPF, is being balanced by a more proactive strategy, the active ownership, who serves a consequentialist purpose. By exercising ownership rights and interests, NBIM shall protect the long-term return of the Fund through promoting sustainable development and responsible conduct. Hence, the rationale behind the active ownership is to safeguard the financial interests of the GPF, which are assumed to be dependent on sustainable development in economic, social and environmental terms. It is based on this rationale that NBIM with its active ownership tries to influence companies in the Fund’s portfolio to respect environmental and social norms, and adhere to principles of good governance. Hence, the active ownership incorporates and strengthens measures with a clear ambition to affect business practices and markets in a direction that are deemed beneficial to the Fund.<sup>248</sup>

The GPF is a large investor with a good reputation of being a responsible actor. It owns around 1.3 percent of all listed equity in the world, and although it only owns a small number of shares in the invested companies, it is still one of the largest investors in many of the

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<sup>248</sup> (Myklebust, 2010, p. 21)

companies it is invested in.<sup>249</sup> This leads to NBIM having an extra force to its active ownership, and raises the odds for NBIM in being able to actually influence the corporations that they engaged with. For instance, it is reasonable to think that if NBIM has been successful in its engagement with a company, NBIM might attract more investors and capital to the company. If the engagement is successful, the company will most likely from then on respect ESG issues and adhere to international standards of company behavior, which is thought to improve company performance. The GPFGE can use this as a carrot in its engagement in order to influence the targeted companies to change their behavior. The assumption that successful corporate engagement might attract more investors, is supported by the findings of Elroy Dimson, Oğuzhan Karakaş and Xi Li in their article *Active Ownership* from 2015. The authors find that there is an increase in shareholdings by asset managers, pension activists, and SRI funds one year after successful corporate engagements. These findings are related to engagement due to environmental and social issues, such an increase is not apparent for successful engagement due to corporate governance issues.<sup>250</sup>

NBIM has the opportunity not only of using the size of the Fund as a carrot in the engagement process, the Fund's size can also be used as a threat. In cases where the engagement has not been successful, or have not been a suitable measure, divestment or the threat of divestment can be applied as a tool to pressure the company to pursue the dialogue. By threaten to divest, NBIM might be successful and achieve changed behavior, as the targeted company might be afraid to lose a large investor.

The active ownership of the GPFGE has an extra strength and dimension to it, as the Council on Ethics is also engaging with companies. In establishing dialogue with companies and allowing them to explain a situation and answer to the accusations they are subject to before issuing recommendations, the Council is taking part in actions that are similar to the active ownership strategy of NBIM. By doing this, the Council is promoting the ideas and norms of the GPFGE and in a way opening the eyes of the targeted companies. Even though the goal of the dialogue of the Council on Ethics is not necessary to change the companies' behavior, but rather to arrive at an understanding of the company and its actions, the dialogue may be influencing the companies and function as "a wakeup call" for them. Nonetheless, the fact

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<sup>249</sup> (Norges Bank Investment Management, n.d)

<sup>250</sup> (Dimson, Karakaş, & Li, 2015, p. 3229)

that the Council on Ethics is also engaging with companies increases the footprint and the potential of the GPF, as there are two actors engaging with the companies and promoting the Fund's values and ideas.

The size and reputation of the Fund are not the only factors that contribute to raising the odds of NBIM being influential in its active ownership. Operating with active ownership, as is the case with other large institutional investors such as the NZSF and CalPERS too, and basing its strategy on the same international standards for responsible investments and ethical considerations as those funds, the GPF, along with other large institutional investors and funds, pulling in the same direction. Having established their SRI strategy on the same line of thought as other large institutional investors, the GPF is pushing for the same ideas and hence contributing to setting the standard for what is perceived as responsible behavior of corporations. If these ethical and normative standards for what are perceived as responsible business conduct is carefully expressed and employed, then they may contribute to securing that businesses respect these standards and act accordingly. And by promoting the same standards as other large investors across large portfolios and in some cases engaging with the same companies, the GPF is strengthening its ability to create positive change through its active ownership. This line of thought corresponds with Elroy Dimson, Paul Marsh and Mike Staunton's findings, namely that responsible investment strategies are more likely to pay off when action is coordinated with like-minded activists.<sup>251</sup>

Nevertheless, active engagement may end up yielding little to no results. This can be due to a number of reasons. The corporations can prove simply not to be interested in pursuing a dialogue with its investors, as was the case with Wal-Mart when asked to respond to the allegations from the GPF before the Fund divested from the corporation.<sup>252</sup> Targeted companies may also refuse to modify their behavior in line with, and as far as, what investors would have wanted.<sup>253</sup> Companies may also disagree with the Fund and with its reasons for engaging and divesting, as was the case with IJM Corporation Berhad, who after being excluded from the Fund stated, "The main issue is we have different definition of deforestation".<sup>254</sup> Hence, there are many pieces that need to be in place for active ownership

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<sup>251</sup> (Dimson, Marsh, & Staunton, 2015, p. 27)

<sup>252</sup> (Nystuen, Føllesdal, Gade, Mestad, & Østbø, 2005, p. 1)

<sup>253</sup> (Demeyere, 2011, p. 195)

<sup>254</sup> (Daily Express, 2015)

to be successful. Many of these are factors that the GPFG and other active owners cannot influence or control. For example, Dimson, Karakaş and Li find that the active ownership strategy is more successful if corporations have some reputational concerns and the capacity to implement the changes.<sup>255</sup>

Although the active ownership strategy might not always be successful in changing companies' behavior in the desired direction, what has been achieved is promotion of the values, norms and ideas of the GPFG and of the international standards the Fund adheres to. In promoting these ideas and norms, the GPFG is contributing to making the expected standards of behavior known to corporations across the world, and putting pressure on the corporations to follow these standards. The pressure on the corporations to act according to these international standards increases as large investors, such as CalPERS and the NZSF, are increasingly applying these standards in their active ownership strategies. When these investors engage and attempt to influence corporations to change their behavior and act according to the international standards, the pressure on the corporations will increase. If they do not change their behavior, they risk being divested from, getting a scratch in their reputation and risk the loss of other investors.

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<sup>255</sup> (Dimson, Karakaş, et al., 2015, p. 3228)





## 6 Conclusion

Socially responsible investing is not a new phenomenon, however, in its present form SRI is a fairly recent incarnation. Rooting back to church organizations that were reluctant to be associated with certain industries or companies thought to be unethical, SRI has today developed into a concept that represent a broad constellation of interests campaigning for socially, ethically, and environmentally responsible financing. The diffusion of the concept is mainly a result of new actors, such as sovereign wealth funds and pension funds, embracing the concept. These actors, starting to invest according to the ideas of the SRI movement mainly from the 1990s, steered the understanding of the concept away from the ethical idea of the church investors towards a more loosely defined approach more influenced by financial considerations. Consequently, actors who adhere to the SRI movement today have different understandings of the concept and base their responsible investing on different reasoning.

The differences in the understanding of socially responsible investing, was seen in the analysis of the responsible investment frameworks of the Norwegian Government Pension Fund Global, the New Zealand Superannuation Fund, and the California Public Employees' Retirement System. Although some similarities between the frameworks and approaches to responsible investing were found, their understanding and practice of responsible investing appear to differ. Additionally, their understanding and definition of what industries and companies that are considered unethical, and that should be avoided also slightly differ. For instance, of the three funds the NZSF is the only one that excludes companies involved in the manufacture of whale meat, and while both CalPERS and the GPFG have a criterion concerning coal companies, the NZSF does not. This seem to imply that both the context and the culture in which the funds are located may have an impact on their understanding of SRI and what it entails.

The Ethical Guidelines of the Norwegian Government Pension Fund Global was established in 2004 after years of pressure from both civil society organizations and the Norwegian Socialist Left Party, and a massive media storm in 2001 and 2002 after revelations that the GPFG was invested in companies that were violating ethical norms and international law. The advocates for ethical guidelines had, since the government opened for the Fund to invest

in listed equities in 1997, argued that the investments of the Fund were not morally justifiable when the Fund invested in “the world as it was”, and were only governed by financial considerations. In order to prevent further and future investments in companies involved in unethical industries and actions, the Norwegian government decided that the Fund was to be subjected to Ethical Guidelines – an investment framework that would set limitations on what the Fund was allowed to invest in. The Ethical Guidelines that was introduced in 2004 was based on a report conducted by a government established committee, the Graver Committee, who had been appointed to develop and suggest ethical guidelines for the Fund. The main idea behind the investment framework presented by the Graver Committee, was that certain industries were not morally justifiable to invest in, hence the Fund should avoid investing in such industries. Avoiding industries considered unethical would make sure that Norway was not complicit in violations of ethical norms through the GPF’s investments.

The work with the Ethical Guidelines was to be carried out by three mechanisms: exercise of ownership rights, negative screening and withdrawal. As part of the development in the Ethical Guidelines, observation of companies has been added as an additional mechanism. The exercise of ownership rights, which meant promotion of long-term financial returns based on the UN Global Compact and the OECD Guidelines for Multinational Enterprises (later the UN Principles for Responsible Investment was also included as a standard) was to be carried out by Norges Bank Investment Management. The overall goal of the active ownership was to secure the Fund’s financial goals. Negative screening and withdrawal was to be recommended by the Council on Ethics after thorough analysis and evaluations of whether or not the Fund’s investment in specified companies was inconsistent with the Fund’s Ethical Guidelines. Whether or not the specified companies were to be excluded or divested from was up to the Ministry of Finance to decide. However, this structure changed in 2015, when the Executive Board of the Norwegian Central Bank was put in charge of the exclusion, divestment, and/or observation decisions.

The New Zealand Superannuation Fund was established in 2001 and has had an ethical obligation since it began operating in 2003. The ethical obligation of the NZSF was introduced in order to make sure that the Fund and its investments did not harm New Zealand’s reputation. Hence, the governing legislation of the Guardians, who manages the Fund, stated that the Fund had to be managed in a manner that would avoid prejudice to New Zealand’s reputation as a responsible member of the world community. In addition to this

obligation, the Fund had to be managed in a manner consistent with best-practice portfolio management and maximizing return with lowest possible risk. None of these three criteria had precedence over the other, meaning that the Guardians had to take them all into account when considering investment issues. However, what these criteria and especially “avoiding prejudice” actually meant, and how the Guardians was to achieve these goals, was not defined. Therefore, the Board of the Guardians and the Guardians themselves were responsible for developing an ethical policy and a responsible investment framework for the Fund.

The Guardians, who primarily consists of economists and professional finance personnel, has interpreted their ethical obligation to mean that certain industries should be avoided. The rationale is that certain industries has a poor reputation, and investments in these may cause harm to New Zealand’s reputation. They should therefore be avoided. In addition to avoiding certain industries, the NZSF has, as a way of fulfilling its objective and obligation, integrated a focus on ESG issues both in its investment and engagement process. To carry out its responsible investing and fulfilling its obligations to safeguard New Zealand’s reputation and maximize the Fund’s returns at a lowest possible risk, the Guardians adopted negative screening, active ownership and impact investing as strategies. The negative screening was adopted to avoid businesses or industries that could harm New Zealand’s reputation. Active ownership was adopted to secure the financial returns of the Fund, while impact investing was introduces to also “do good” with the Fund’s investments.

The California Public Employees’ Retirement System, who is an agency in the California executive branch, was one of the first shareholder activists starting its Corporate Governance Program in 1984 and launching its Focus List Program in 1987. Both of these programs were a reaction to the intense merger and takeover activities in the 1980s, and were meant to help CalPERS to take a more active and aggressive stance in order to exercise their fiduciary responsibility both for the short term and the long term. Although CalPERS was the early developer of shareholder activism its focus on responsible investing is not said to have fully started until 2000, when then State Treasurer and Board member Philip Angelides got through his “double bottom line” initiative. From then on the Fund invested not only with the goal of creating financial returns, but also with the goal of “doing good” with its investments. Consequently, while CalPERS is still characterized by its shareholder activism, its approach

to responsible investing has developed to include more criteria, more strategies and is much more comprehensive today.

In order to act as a responsible investor and owner, CalPERS has adopted negative screening, active ownership and impact investing as strategies. As part of these strategies, and as part of being a responsible investor, CalPERS has integrated a strong focus on ESG issues and has adopted certain negative screening criteria. Because politicians serve on the Board of the Fund and in the Fund's Investment Committee, is the integration of these negative screening criteria influenced by politics and the political landscape. This has resulted in some of the criteria being based on moral considerations. However, due to the Fund's objective being to secure the future benefits of its members, and because the Fund has to pay benefits to its members now, the Fund is obliged to defend and frame its responsible investing from a financial aspect. Every new criteria and strategy have to be defended from a financial aspect. Hence, one can see that some of the ideas that have contributed to the negative screening criteria and the integration of ESG issues are inspired by economic theory, and the idea that financial capital, physical capital and human capital are vital for the Fund to create long-term financial returns. It is based on this idea and the three forms of capital that the Fund has integrated a strong focus on sustainability and ESG issues in its investment process. One also recognizes these ideas in some of the negative screening criteria, as the idea is that certain industries and investments are not sustainable in the future, or will not provide good financial returns in the future. Hence, they should not be invested in.

The responsible investment frameworks of the three funds help define and limit the funds' investment universes. To rephrase, the investment frameworks act as a guide for what the funds can and cannot invest in. But why these investment frameworks are adopted, what the objective behind the responsible investing is, what the rationale behind the framework is, and what actors that are involved in the development of the frameworks, however, vary. And these variations have impact on the content of the frameworks. For instance, the comparison of the three funds found that the responsible investment framework of the GPF, whose ethical obligations are to secure favorable long-term returns on the investments, and to avoid investments that entail an unacceptable risk that the Fund contributed to certain specified ethical violations, are the more comprehensive and clearly defined investment framework of the three frameworks. Both the NZSF and CalPERS, whose rationale is to safeguard New Zealand's reputation and to secure good financial returns, respectively, operates with less

restrictions in their frameworks and a stronger focus on the more loosely defined ESG factors. The NZSF and CalPERS have also tied their responsible investment frameworks closer to the UN Global Compact and the UN Principles for Responsible Investment, than what is the case with the Ethical Guidelines of the GPFG.

These differences that were seen in the objectives and rationales of the funds' responsible investment frameworks might be explained by the funds having different objectives and obligations. For instance, both the NZSF and CalPERS have an objective to pay benefits in the near future and now, respectively, leaving them with a smaller leeway in focusing on the ethics, than what is the case with the GPFG who does not have the same financial obligations. But the differences in the investment frameworks and the negative screening criteria can also be explained by the different actors that were involved in the establishment and are involved in the continuous development of the frameworks. For instance, the GPFG who has the most comprehensive framework and the framework that is mostly based on moral considerations of the three, is the fund and framework that appear to be the most influenced by non-governmental organizations. The relationship to NGOs that is seen with the GPFG, is not to the same extent seen with CalPERS and the NZSF. Their investment frameworks are more influenced by politicians and professionals with an economics or financial background, respectively.

The same differences in involved actors can be found in the management structure of the three funds. They all have some influence by politicians in the management of the fund. But CalPERS stand out as having closest ties to politics, by having politicians serving on the Fund's Board and the Investment Committee, leaving them with great possibilities to directly influence the Fund's policies and its investment decisions. The NZSF is at the other end of the scale, having only limited influence by politicians in the management of the Fund and during the Fund's investment process. The GPFG is located between these two funds when it comes to involvement of politicians in the management of the Fund. The GPFG has close ties to politics and politicians by the government and the Ministry of Finance deciding the Guidelines and the management mandate of the Fund, but in the investment process, the financial institution and fund manager – NBIM – is free to invest as it like, as long as it is inside the set regulations.

To invest responsibly and act as responsible owners, all the funds have adopted both negative screening and active ownership as strategies. In addition, CalPERS and the NZSF have adopted impact investing, to achieve social good in addition to financial returns with their investing. Although the three funds apply negative screening as a way to avoid certain industries and companies, the screening criteria and rationale for the strategy vary. For instance, the three funds have all negative screening criteria that are unique to their fund, and that appear to be influenced by the context in which the funds are located. In the active ownership, however, the funds apply the same international standards – namely the UN Global Compact and UN Principles for Responsible Investment. Nevertheless, they appear to focus on slightly different areas. For instance, NBIM has adopted four focus areas in which it pay extra attention – climate change, water management, children’s rights and human rights – while CalPERS has a stronger focus on corporate governance issues focusing extra on; board quality and diversity, corporate reporting, investor rights, executive compensation, and regulatory effectiveness. The NZSF, on the other hand, has three focus areas in its engagement; human rights (child and slave labor; worker safety; operation in weak states), bribery and corruption, and severe environmental damage.

Although the three funds have based their responsible investment frameworks on different reasoning, act as responsible investors based on different objectives, and operates with slightly different screening criteria, their investing and actions still have impacts, and may have ramifications beyond their objectives and what the funds expect. For instance, the discussion of what the GPFG can achieve with its responsible investing showed that, although the Fund does not have an objective to change corporate behavior with its divestments, the Fund’s transparency, size, and the publicity that its divestments bring with it, can change corporate behavior, because the GPFG divesting may lead to both reputational damages and loss of investors.

In addition to having ramifications outside its objective, the divestments of the GPFG have strong signaling effect in that the Fund clearly states what behavior it accepts and do not accept. Due to its strong position internationally and nationally, and because other investors are looking to the Fund and keeping an eye on its decisions and actions, the Fund is also contributing to setting standards for other funds to follow. By having this position and sticking to a set framework for investments and divestments, and in addition publicly announcing the reasoning behind the divestments decisions, the GPFG is contributing to set

norms for how investors should invest in the future. In addition to this, the Fund's divestments may also have disciplining effects by them being public and clearly expressing when the line set by the Fund is crossed. Hence, corporations can clearly know what behavior and actions the Fund do not accept, and can therefore stay inside the line. In sum, by adhering to the Ethical Guidelines, the GPFG is able to both keep the Fund from being complicit in violations of ethical norms, and contributes to set norms and standards for other investors to follow.

The Fund has not only the possibility to influence company behavior with its divestments, it also has the potential to change corporate behavior with its active ownership. In fact, with the active ownership the goal is to change corporate behavior. Here too, the Fund's size is an asset. In many of its investments, the Fund is one of the largest owners leaving it with a certain power and influence. In addition, the structure of the Fund with a Council on Ethics that also has dialogue with corporations increases the Fund's footprint, and hence increases the Fund's potential to change corporate behavior. The active ownership has an extra strength to it, as the GPFG adheres to the same international standards as other responsible investors, such as the NZSF and CalPERS. By adhering to the same standards the funds are pulling in the same direction and pushing for companies to comply with the same standards. This increases the funds ability to change corporate behavior.





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