NORGES BANK
INVESTMENT MANAGEMENT

Ministry of Finance
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Government Pension Fund Global – Reporting on climate risk

We refer to the Ministry's letter of 2 October 2017 on climate risk reporting. The Ministry asks the Bank to assess whether the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) will have implications for the Bank's work on climate risk in the Government Pension Fund Global. The TCFD was set up by the Financial Stability Board and published its recommendations in a report on 29 June 2017.

Introduction

The Ministry of Finance, as owner, has laid down a general framework for the management of the fund, including objectives, investment universe, benchmark index, risk limits and reporting requirements. Norges Bank is to manage climate risk within this framework. This limits the freedom we have, as manager, to adjust to financial consequences of climate change. For example, the rules do not permit major changes to the composition of the fund's investments, or investment in certain asset classes that are more directly involved in the energy transition, such as infrastructure.

We do, however, have certain tools available to us as a manager, and climate change has been a strategic focus area for the fund since 2006. The TCFD provides specific guidance for asset managers. The recommendations reflect the aspects of companies' climate activities and reporting that we have focused on over time. Norges Bank's management of climate risk is largely aligned with the main aspects of the TCFD recommendations, and we will apply them in future to the extent permitted by the fund's management framework and available information and methods.

In this letter, we first present the TCFD recommendations and Norges Bank's climate reporting. We then discuss our climate work in more detail, covering both active ownership and investment decisions, and our work on climate issues in unlisted real estate.

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The TCFD recommendations and Norges Bank's climate reporting

The TCFD recommends that reporting on material climate risks is integrated into companies' ordinary financial reporting. The TCFD divides its recommendations into governance, strategy, risk management, and metrics and targets. This means that companies are to disclose information on (1) the role of the board and management in the company's climate work, (2) strategic planning in relation to climate change over different horizons, (3) the integration of climate risk into risk management, and (4) performance against indicators resulting from these strategy and risk measures. The TCFD underlines the role of investors in promoting corporate disclosure. Reporting on greenhouse gas emissions and scenario analyses are specifically discussed, highlighting how such analyses will also evolve over time.

Norges Bank submitted two consultation responses to the TCFD. We were positive about the TCFD's work, but also noted a few informational and methodological challenges in the operationalisation of the recommendations, including when it came to scenario analyses. At the One Planet Summit in Paris in December 2017, we made a formal statement in support of the TCFD recommendations.

Norges Bank has reported on its climate work for many years. We will continue to develop this reporting in line with the principles behind the TCFD recommendations. We will report on our climate work both in our ordinary financial reporting for the fund and in our extended reports on responsible investment. We will also contribute to the climate disclosures made by the Ministry as owner of the fund. The Ministry's reporting to the Principles for Responsible Investment (PRI) will include reporting against the TCFD recommendations from 2018 onwards.

Climate change and the fund's active ownership

The TCFD underlines the importance of investors following up climate strategy and disclosures at the companies they invest in. Active ownership is a key instrument for Norges Bank in the effort to contribute to the companies in its portfolio being well positioned for the transition to a low-carbon society. Through our active ownership, we promote sustainable market solutions, long-term value creation and reduced climate risk, as envisaged by the TCFD recommendations.

These are areas that we have been working on for a long time. We first published an expectation document on climate change back in 2009. This was subsequently extended to include deforestation. The document is aimed at the companies we invest in, and serves as a starting point for our active ownership work. The document was revised significantly in 2015 following input from experts, companies and NGOs. The TCFD recommendations largely reflect our expectations and the aspects of companies' climate activities that we have focused on over time. We emphasise the board's role and responsibilities, and expect companies to integrate climate analyses, including a 2°C scenario, into strategic plans, risk management and reporting. We made a number of minor adjustments to the expectation document in 2017 to bring it even more closely in line with the TCFD recommendations. The updates mainly entailed more specific information on disclosures. For example, we ask companies to be transparent about the assumptions underlying their scenario analyses. We also now make specific reference to the TCFD in the document.

Our climate analyses rely on satisfactory corporate disclosure. We have assessed climate reporting by companies in high-risk sectors since 2010. We assessed 1,701 companies in 2017, including, for the first time, the bank and insurance sector. In this work, we have regular contact with selected companies that could improve their reporting. We believe that this kind of follow-up makes an important contribution to improving reporting over time. We launched a dialogue with selected major banks in 2017 on climate reporting and how they will work with the TCFD recommendations. We have also encouraged the TCFD recommendations to be reflected in established frameworks for corporate climate reporting, including reporting to CDP. The development of standardised and consistent disclosure of quantitative climate indicators will help enable adequate assessment of climate risks and opportunities by investors.

Since 2015, we have been developing our own database of information on environmental, social and governance issues. The database includes climate-related information such as emissions data from companies, calculations by third parties, information on industrial facilities, and reserves and upstream data for selected oil and gas companies. We published our first calculations of the fund's greenhouse gas emissions in 2015 and have subsequently developed these analyses to cover corporate bonds as well as equities. We disclose both absolute figures and emission intensity. We provide historical information and look at both scope 1 and scope 2 emissions, including at sector level. We also disclose our calculation methods. The fund's carbon footprint – emissions from the companies in its portfolio – has decreased over time. However, emissions data in isolation do not provide a sufficient basis for assessing climate risk. Our risk assessments therefore look at emissions analyses in the context of other factors, such as water intensity, air pollution, age of facilities, and carbon capture and storage.

Few companies currently report scenario analyses. In 2018, we will continue to work on scenario analyses for selected sectors, markets and companies. To promote the development of better practices, we are participating in a working party under the UN Environment Programme to draw up guidance for investors on working with the TCFD recommendations.

Climate change and the fund's investments

As we are a long-term investor, climate change is also an important part of our investment strategy. We have argued since 2006 that climate change could impact on corporate earnings and the portfolio's return and risk, but also that it presents opportunities. The fund's investment strategy in terms of climate change has three main elements: investing specially in climate solutions, adjusting the portfolio through divestments, and considering climate issues in investment decisions. As with our active ownership, this work has evolved over time.

Through our environmental mandates, we have invested since 2011 in companies that contribute to solutions to climate-related problems. This includes investing in low-emission energy and alternative fuels, clean energy and energy efficiency. Besides dedicated in-house resources, we have access to additional expertise in various sectors, markets and technologies via our external managers. Our environmental investments have also included green bonds since 2014.

In 2012, we commenced risk-based divestments within the permitted limit for deviation from the benchmark index. The first such divestments were of palm oil producers. This was followed by divestments from coal-mining companies in 2014 and 2015. We have also sold some oil companies. The coal divestments were followed up in 2016 with a coal-based criterion for exclusion from the fund. This divestment from coal means that the fund does not generally invest in an energy source that will probably not survive the transition to a low-carbon society. The fund's exposure to climate risk therefore differs from that of a general, market-weighted portfolio.

Climate issues form part of the assessments that our portfolio managers make in the management of the fund. In some sectors, such as power production, mining and other heavy industry, the development of climate regulations and new technologies is an important factor in our assessment of companies' future earnings. We also attach importance to such considerations when selecting and monitoring our external managers. Since 2016, we have had specific sector restrictions for our external managers in relation to environmental, social and governance risks.

When it comes to unlisted real estate, the Ministry has set out how the Bank should prioritise issues such as energy efficiency, water consumption and waste management. Long-term climate change is of relevance to our investment strategy, property- and portfolio-level sustainability metrics, and operational plans. We believe that green building certification will increasingly be valued by large tenants and will contribute to an increase in the value of the portfolio over time. Certification reduces the risk from more stringent official requirements for buildings' energy efficiency. At the end of 2017, 60 percent of our portfolio of properties with a net rentable area of more than 2,000 square metres was certified.

In 2015, we launched a programme of research into the implications of climate change for markets and investors. We are supporting two research projects in this area in 2018 via the Norwegian Finance Initiative (NFI). Given the current mandate, however, there are some climate risks that it will be hard for Norges Bank to adjust to through its investment decisions. We would refer here to our recommendations in 2015 and 2016 that the fund is permitted to invest in infrastructure, including infrastructure for renewable energy.

Summary

The TCFD provides separate recommendations for asset owners and asset managers. As a manager, we support the recommendations and will follow them up with the companies in our portfolio. Within the framework laid down for the management of the fund, we have had a strategic focus on climate change since 2006 and have long worked for better climate reporting.

The TCFD recommendations largely reflect our own expectations and the aspects of companies' climate activities that we have focused on over time. Our analyses rely on good information about the companies we invest in. We encourage increased data availability and quality, and contribute to the development of knowledge and methods, including scenario analyses. We report on our work on climate issues in our ordinary financial reporting on the management of the fund. We will apply the TCFD recommendations in this reporting to the extent permitted by the fund's management framework and available information and methods.

Yours faithfully

Yngve Slyngstad   Carine Smith Ihenacho