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Report from the Nordic Conference on Green Investments and Nordic Pension Funds

CICERO

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1. Background

The Nordic Council of Ministers' Working Group on Sustainable Consumption and Production, in collaboration with the Working Group on Environment and Economy, held a Nordic Conference on Green Investments and Nordic Pension Funds in Oslo, 27 May 2015. The aim of the Conference was to discuss how to deepen and strengthen green, sustainable and socially responsible investments by Nordic Pension Funds and institutional investors.

The Conference was attended by almost 100 participants. *Mr. Terje Svabø* chaired the conference and moderated discussions. Participants were Nordic decision makers in the fields of environment, economy, business and energy, but also representatives from pension managers and the financial sector, NGOs, international experts, and the research community attended the Conference.

The Norwegian Minister of Climate and Environment Ms. Tine Sundtoft and State Secretary Mr. Paal Bjørnstad from the Norwegian Ministry of Finance opened the conference with some introductory remarks. *Minister Sundtoft* referred to science and underlined the need for a green shift in the economy. The financial market is essential to finance the needed shift. For long-term investors climate and environmental risks need to be integrated into investment decisions. 2015 is the year of international negotiations to reach a new climate agreement in Paris in December. Expectations for carbon prices and commodity prices could shift, and thereby future returns on investments. According to the Global Risk Report from the World Economic Forum, risks related to climate change are on the Top Five List of concerns for long-term global development. The Nordic Pensions Funds have according to the Minister been in the forefront of integrating sustainability and climate risks in their financial investments.

State Secretary Bjørnstad presented the status of the political discussions on the Norwegian Government Pension Fund Global's (GPFG) use of exclusion and ownership strategies in coal and petroleum companies. The Government Pension Fund comprises Government Pension Fund Global and Government Pension Fund Norway, managed by Norges bank and Folketrygdfondet, respectively. Their mandates are set by the Ministry of Finance. Integrating environmental and climate considerations into investment decisions is an on-going process. Norges bank has had climate change as a focus area since 2006. An annual report was presented to the Norwegian Parliament in April.¹ The government concludes in the report that active ownership and dialogue should remain the key tools in addressing climate issues in the management of the fund. At the same time the government suggested a new criterion to exclude companies whose conduct to an unacceptable degree contain greenhouse gas emissions. He ensured that climate change risk will be high on the fund's agenda, but also stressed that the Norwegian Government Pension Fund Global is a financial investor and not a political tool to foster climate change development.

¹ <https://www.regjeringen.no/no/dokumenter/meld.-st.-21-2014-2015/id2405360/>

2. Summary of presentations and panel discussions

The conference was divided into two parts. The first part focused on climate and environmental considerations when managing investments, while the second part focused on pension funds and green investments. The conference alternated between presentations and panel discussions. Contributors were mainly based in the Nordic countries, but also the OECD Environmental Directorate and Urgewald, a German NGO with particular focus on coal, were invited to share their thoughts and provide valuable inputs.

Part 1 Climate and environmental considerations when managing investments

The first presenter after the introductory remarks was *Mr. Simon Upton, Director, Environment Directorate, OECD*. He talked about climate and environmental considerations when managing investments. He reminded us that we should not forget that the market is limited by its physical environmental constraints, and presented on-going OECD modelling work on feedback loops from environmental damage to economic growth and regional costs of climate change. He also presented some key recommendations on how to overcome barriers in order to mobilize institutional investors to finance more needed green infrastructure. Investment from institutional investors in infrastructure is currently very low. OECD has recently published a paper on green finance and investment entitled “Mapping Channels to Mobilise Institutional Investment in Sustainable Energy”.² He mentioned a proposal of establishing a green investment bank to crowd-in necessary private capital that attracted attention at a high level OECD meeting in Paris held the week before the conference.

Mr. Åke Iverfeldt, Executive Director of Mistra. *Mr. Iverfeldt* followed up by presenting lessons learnt from promoting transformative investments through scientific research and active asset management. The Swedish Government established Mistra in 1994. Since the start, Mistra has invested more than SEK 3.5 billion in world-class environmental research of strategic importance. According to *Mr. Iverfeldt* financial systems will play a crucial part in the shift to a more circular economy. Mistra is therefore offering funding for a new research programme on the financial system’s possibilities and limitations, and on the changes needed to enable this system to contribute to sustainable development of society. He argued that it makes sense from an economic perspective to invest green.

Mr. John Howchin, Secretary-General, Ethical Council – Swedish National Pension Funds (AP-funds). *Mr. Howchin* gave a presentation on how to integrate climate change considerations into an investment strategy. The Swedish AP-funds’ investment mandates include environmental and ethical considerations without infringing returns. How to operationalize these mandates has been a learning process. He underlined the

² <http://www.oecd.org/g20/topics/financing-for-investment/mapping-channels-to-mobilise-institutional-investment-in-sustainable-energy-9789264224582-en.htm>

importance of understanding the market trends in order to take the right investment decisions. In particular the shale gas revolution and the dramatic drop in the costs of solar energy have made coal investments less profitable. On the topic of divestment he recommended to read the 2015 Credit Suisse global investment return yearbook, which concludes that it is not obvious that divestment works.³ He noted that the investments with the highest returns in a 100-year perspective are those in tobacco, alcohol and weapons. The Swedish AP funds have been frontrunners in both investing in green bonds and tracking their carbon footprint of their investment portfolio.

Ms. Heffa Schücking, Director, German NGO Urgewald. Urgewald last year published a report on Norwegian Government Pension Fund Global investments in coal (Dirty and Dangerous). In order to understand institutional investors exposure to coal investments the full supply chain, from mining to burning, needs to be studied. She proposed five criteria for meaningful divestment for the Norwegian Pension Fund Global. The fund should divest if the share of coal related business or coal fired power generation is higher than 30 %, production of coal is more than 22 million tons, if the company operates or is planning coal-to-liquid or coal-to-gas facilities, or large scale expansion plans in the coal sector. According to *Ms. Schücking* applying these criteria, the Norwegian Pension Fund Global would only need to divest from companies worth 1.19 % of the value of the fund.

These four presentations were followed by a panel discussion on managing climate and environmental risks. Strategies to change companies' behaviour on climate issues, active ownership vs. divestment, were discussed. Are such strategies complementary? *Mr. Upton* moderated this panel discussion. The discussions were kicked off with two short presentations. *Mr. Hans Christian Bugge, Vice-chair, Council on Ethics for the Government Pension Fund Global* firstly presented the experiences and the mandate of the Council of Ethics Norway, followed by *Mr. Nils Bastiansen, Executive Director Equities, Folketrygdfondet*.

Prof. Emer. Bugge said that unacceptable climate behaviour so far hasn't been included as a criterion for exclusion from the Pension Fund Global's portfolio. This will however now change with the new government proposal. The Council of Ethics is supposed to coordinate its work with the fund. The aim is to ensure a continuous and consistent link of instruments in treatment of companies including dialogue, active ownership and as a last resort divestment.

Mr. Bastiansen informed that Folketrygdfondet sees climate change as a financial risk, but also as a business opportunity. Folketrygdfondet believes in active ownership as a tool to influence and promote awareness of climate and Environmental Social and Corporate Governance (ESG) issues, while divestment will be the least responsible thing to do because it could create other financial risks in their portfolios. The fund has set two clear targets. Firstly, Folketrygdfondet wants the number of companies that report on climate to increase and secondly it wants to reduce the carbon intensity in their portfolio over time. The fund wants to achieve the latter through dialogue and not by portfolio engineering.

³ <https://www.credit-suisse.com/uk/en/news-and-expertise/research/credit-suisse-research-institute/publications.html>

The succeeding panel discussion also included previous presenters *Mr. John Howchin*, *Mr. Åke Iverfeldt* and *Ms. Heffa Schücking*. They discussed if it is possible for investors to change climate behaviour in companies. Some argued that it is difficult to change the behaviour of pure play coal companies, while it is more likely to succeed with utilities. There are examples that utilities are changing their strategies taking into account climate considerations such as Vattenfall, EON and companies in China. It was further argued that a benchmark is needed when you do divestment. A prerequisite for a successful active ownership strategy is access to necessary information. It might be easier for an investor to influence behaviour of a company through active ownership if core values are shared between the investor and the company. Carbon is today mispriced because of lack of government action. Companies that have taken the wrong strategic decisions on climate deserve to be out of business, but some companies e.g. in the energy sector are too important for society and hence governments can't let them fail.

Part one of the conference was rounded up before lunch by *Mr. Erik Westin* delivering a statement from the Swedish Minister for Financial Markets and Consumer Affairs. The Swedish government is very committed when it comes to climate policies. Sustainable investment has developed from a narrow niche to mainstream in a very short time. He noted that not only is the government acting on climate, financial investors in the Nordic countries should also be proud of their green investments.

Part 2 Pension funds and green investments

Mr. Ole Buhl, Head of Responsible Investments, ATP & Green Investments. The ATP is the largest Danish Pension Fund working independently from the Government. ATP's only goal is to deliver risk-adjusted pensions to their pensioners. He said that climate change will influence investment decisions, but also noted that fossil fuels, even coal, will be part of the energy mix for the foreseeable future. He welcomed more regulations from government but changes need to be predictable. The ATP lost a lot of money in Spain as a consequence of policy framework changes (unexpected withdrawal of renewable energy subsidies). Focus should not only be on infrastructure investments, the entire value chain needs investments. E.g. investments in how to make renewable energy less expensive are crucial for succeeding in up-scaling investments.

Mr. Idar Kreutzer, CEO, Finans Norge, Pension funds' role and opportunities in long-term investments. Trillions of dollars are needed to transform the economy from high carbon to low carbon. Pension funds with liabilities towards their pensioners are the largest institutional investors. On a global scale they represent 29 trillion dollars. Pension funds are investing long term because their liabilities towards their pensioners typically are 15-20 years. Given these long-term liabilities, just a small percentage change in interest will increase the pension funds liabilities substantially. A pension fund is therefore looking for investment opportunities where cash flows from assets match their liabilities. This should be a good match with infrastructure investments, but the share of institutional investors in such investments are below one per cent. Changing framework conditions such as new financial regulations to ensure financial stability affect investors' ability to invest long-term. There is a need to study and try to strike the right balance between the need to ensure a stable financial market and the need for new greener infrastructure investments.

Mr. Trond Grande, Deputy CEO, Norges Bank Investment Management (NBIM) Responsible Investments. The Norwegian Pension Fund has only one objective, similar to the Danish ATP fund, which is to achieve the highest risk-adjusted return possible. NBIM owns equities in more than 9000 companies (50 per cent of the investments are in 250 companies) representing 1.3 per cent of all listed companies globally. Climate change is one focus area of the fund and a new climate expectation document has recently been developed. The fund received input to this document from different stakeholders including companies, NGOs and researchers. The fund's responsible investment approach is based on three pillars. These are standard-setting, active ownership, and risk management. On standard-setting the fund is collaborating with the Carbon Disclosure Project. There is however a need for more quantifiable data. It is important that the companies report climate data in order to make information publicly available. NBIM has sent out letters to the biggest utilities and mining companies with questions about their strategies on climate including timeline for phasing out coal in power generation.

These three presentations were followed by a panel discussion on pension funds, green investments and green bonds. *Dr. Asbjørn Torvanger, Researcher at CICERO,* gave some introductory remarks about green bonds. According to *Dr. Torvanger* green bonds could play an important role in shifting investments in a more green direction. CICERO is a market leader in providing green bonds second opinions. CICERO assesses to what extent a green bond framework contributes to a low carbon and/or climate change resilient economy. CICERO's second opinions are graded dark green, medium green or light green reflecting the climate and environmental ambitions of the bonds. The grading is primarily defined by the project type that will be financed by the green bond, but also governance and transparency considerations factor in, as they can give an indication whether the institution that issues the green bond will be able to fulfil the climate and environmental ambitions of the investment framework. Green bonds as a financial instrument is a promising tool, but need to be further developed, in particular when it comes to defining and assuring green.

Ms. Annie Bersagel, Advisor, Responsible investments, KLP. KLP is Norway's largest life insurance company that manage pension assets of 800 000 people. Last summer KLP received a letter from a Norwegian municipality that asked them to evaluate whether it was possible to divest from all fossil fuels without effecting the portfolio's risk and return profile. KLP thought this was a timely request and decided to do a study on the subject. KLP looked at divestment, active ownership and direct investment in renewable energy, and concluded in their study that they could not divest from oil and gas without impacting the likely risks and return characteristics of their portfolios. It would, however, be possible to divest from coal companies. KLP therefore decided to divest from companies that obtain a high percentage for their revenues from coal (50 per cent or higher proportion of revenues from coal based activities). In addition KLP based on this study decided that they shall earmark EUR 60 billion in renewable energy capacity and exercise active ownership in companies with high carbon emission intensity.

Mr. Ole Petter Langeland, Head of fixed income, AP2. AP2 is one of the four Swedish pension funds based in Gothenburg. AP2 publishes their sustainable financial investments in their annual report including their carbon footprint. Sustainability is key and AP2 does not see any conflict with financial return. Following a comprehensive risk

analysis last year AP2 divested from twelve coal companies and eight oil and gas companies. *Mr. Langeland* thinks green bonds is a good financial product that fits well with their existing investable universe. AP2 took part in developing the first green bonds and took part in the first issuing. In going forward he welcomed more impact reporting of green bonds.

Also taking part in the succeeding panel discussions on pension funds and green investments were *Mr. Ole Buhl* and *Mr. Idar Kreutzer*. It was argued that the understanding of climate and environmental risks had deepened substantially the last 10-15 years. But while the relationship between risks and good governance are well documented in general, the relationship between environmental risks and financial returns are less understood. More and more data is now becoming available on climate and green issues. These data needs to be studied and systemized. Hence there is a need to support more research. Municipalities and large trade unions are frontrunners in asking for sustainable investments. A point mentioned was that it is important to take a holistic approach to what is green. Many now agree that coal investment in a long-term investment perspective should be avoided. However, if you want to replace coal as a base load with biomass, you first need to know that the biomass comes from a sustainable source. Part of the problem on defining what is green is that there exist different views on where we will be in 2050. Is a two-degree scenario realistic, or will we end up more following a four-degree pathway? Even though there are investments opportunities in being sustainable, some companies will succeed better than others. This is important to factor in when doing investments. In the beginning there were as much as fifteen rail companies in the US. Now there are only two-/three companies left.

Ms. Thina Saltvedt, Market analyst in Nordea. *Ms. Saltvedt* gave a presentation focusing on trends in the oil market including explaining the latest drop in oil prices of more than 60 per cent. She said this drop had to do with major changes in both supply and demand. OPEC that represents 30 per cent of the oil market changed its strategy last year. OPEC wants to squeeze out more expensive oil production. We have also seen more shale oil and gas coming to the market and Russia is producing at its highest level since the Soviet Union. But maybe even more important are the changes on the consumer side. We are now seeing greener alternatives to oil in the transport sector emerging, e.g. electric cars. Swedish researchers have presented data that we are six years ahead of previous projections on falling costs of producing batteries. Politicians in China are expected to guide Chinese consumption away from coal and maybe away from oil as well. Saudi Arabian Energy Minister recently came out with a remarkable statement that in 30-40 years from now, we will probably not need oil. *Saltvedt* expects oil prices not to go back to 110 dollars but more to stabilize at around 80 dollars a barrel. Many oil companies have included a carbon price in their production costs but haven't so far taken into account changes on demand side. Opportunities in the green shift exist for oil companies, e.g. drilling rig technology could be used in offshore wind.

As an introduction to the panel discussion on market trends and branding of investment portfolios *Dr. Svenne Junker, PhD/Policy officer, Naturskyddsföreningen*, presented the fair finance guide, a tool to mobilize consumers for sustainable investments. Naturskyddsföreningen is a Swedish environmental NGO with 225 000 members, a number that makes them one of the largest in the world. The fair finance guide is a tool that ranks banks according to their environmental and transparency investment

policies. It is an interactive web site where consumers can compare banks. The plan is to soon include pension funds in the guide. The guide is present in 7 countries (Netherlands, Belgium, Brazil, France, Sweden, Japan, and Indonesia.) In Sweden the website has had 40 000 views since its launch in February this year. Methodology is the same in all countries. The banks seem to care about their rating and are providing constructive feedback to consumers that ask questions.

Dr. Junker was followed by a short introduction from *Ms. Christine Meisingset, Fund Manager and Head of Sustainable Investments, Storebrand*. Storebrand's core business is long term saving and pensions. Sustainability is a strategic issue for Storebrand. Ecosystems are under pressure and this influence companies' ability to create value. Individual consumers are gradually shifting their focus towards more sustainable products. In order to reduce risks and grasp opportunities in sustainable investment Storebrand divested from pure play oil sands companies and coal companies three years ago. At the same time Storebrand is following closely companies with oil sands as a smaller part of their portfolio. Storebrand has developed an in-house sustainability rating of potential investment candidates. They also make use of new green financial products such as green bonds. The power of consumers is underestimated. But beware of the niche funds only since we want to shift large amount of capital. Niche funds and ethics alone don't do that.

Mr. Björn Erik Lönn, Senior Adviser, Nordic Eco Labelling, gave a presentation of the Nordic Swan that was established in 1989 by the Nordic Council of Ministers. The Swan label is based on strict but reachable criteria. These criteria are continuously being revised. In the beginning mostly products were labelled, but now more and more services are labelled as well. The Swan label is now also present in the building sector where it has found a niche. The Nordic Swan is now looking at possibilities for eco-labelling financial products, based on a request from the Nordic Council of Ministers, and encouraged e.g. by the Austrian example.

The panellist agreed that consumer power could be used more, but consumer power can't solve it alone. Government actions are important. It is important to try to leverage the knowledge of the consumers. Local politicians are responsible for many green investment decisions, hence it is important not to forget to influence them.

3. Main arguments and conclusions

In this section main arguments and conclusions from the full day of presentations and panel discussions on green investments and Nordic pension funds, and some reflections and explanations, are summed up.

Public and private pension managers represented at the conference all underlined that their investments mandates don't allow for investments just because they are sustainable or green. They will invest if they see that it makes sense from a financial perspective. They look at the risk-adjusted financial performance of the asset. The same presenters said, however, that because there are substantial financial risks associated with climate change, both physical changes that require adaptive behaviour and regulatory risks associated with carbon emissions, **it make sense to incorporate assessments of climate risks in investment decisions.**

Institutional investors and pension funds aim at diversifying their investment. The standard is to own shares that match their weight in the market. Because taking a position different from the benchmark implies a higher risk exposure, they continually rebalance their investments to maintain their weighted position. If investors are convinced that the market is underestimating the risk that policy will change, and therefore e.g. fossil fuels are overvalued, they will act on this insight. If enough investors act accordingly, the relative share prices of fossil fuel companies would fall and markets would rebalance. Said in other words, **today's market prices reflect average expectations about whether climate and environmental policies will be implemented, and how strongly**. It is a bet on the extent the world will choose a green, low carbon and climate change resilient pathway.

Many stressed the **need for a green shift in new investments, in particular there is a need for new investments in sustainable energy infrastructure**. The banking sector and institutional investors play important roles in enabling this needed transition. According to an OECD report institutional investors in OECD countries alone held USD 93 trillion in assets in 2013.⁴ Policy makers have made a priority to search for new ways to finance long-term growth. Hence it is important to understand better where the finance could come from.

Presenters and panellist agreed that **investments in sustainable infrastructure**, provided that the perceived country's sovereign risks are not too high, **should be a good match for institutional investors** to help meet their long-term commitments such as pension pay-outs or insurance policies. Yet the OECD report⁵ shows that matching investment demand (for new infrastructure) and supply (from institutional investors) remains elusive. Only 1 per cent of institutional investors' assets were in infrastructure, and only 3 per cent of that 1 per cent share was sustainable energy investments. The New Climate Economy Report shows that USD 90 trillion will be invested in key infrastructure the next 15 years.⁶ Despite pension funds' long time horizon, institutional investors tend to prefer to invest in liquid assets in order to be able to change their investment strategies if the investment landscape changes. In this report it is argued that large-scale funds could be better positioned to increase investment in green infrastructure and other illiquid assets, because they could develop their own methods to handle risks in order to increase confidence in investments and reduce the need for liquidity.

Presenters welcomed a **more ambitious green investment framework** including a higher and a broader scoped carbon price. Sudden changes to the framework are not favourable for long-term investments and should therefore be avoided. The withdrawal of the renewable subsidies in Spain is not an example to follow.

Market trends that make environmental investments more profitable exist. Shale gas has outcompeted coal in the US, and coal demand in China has peaked. The US shale gas revolution has dramatically increased supplies of low-cost natural gas, upended US coal markets, and led many electric utilities to switch from coal to natural gas, reducing

⁴ <http://www.oecd.org/finance/private-pensions/pensionmarketsinfocus.htm>

⁵ <http://www.oecd.org/g20/topics/financing-for-investment/mapping-channels-to-mobilise-institutional-investment-in-sustainable-energy-9789264224582-en.htm>

⁶ <http://newclimateeconomy.report/>

air pollution and greenhouse gas emissions. Price of solar has dropped significantly over the last few decades. New technologies such as electric cars influence growth forecasts in demand contributing to the fall in the price of oil.

The use of coal is the main contributor to climate change. **Different perspectives on active ownership and divestment were presented at the conference.** When looking at coal companies the whole supply chain has to be studied, from mining to burning. More and more investors divest from coal companies. Questions were raised, however, if exclusion criteria work. Some argued that shares will be picked up by other investors. Hedge funds now pick up coal shares.

A growing focus on **carbon footprint reporting** exists. With many companies in the portfolio there is a need to take one step at the time. When companies systematically start reporting on climate it is easier for researchers to collect and compare data and make them accessible for investors. More research is needed. **Consumer power focusing on sustainability is underutilized** in the financial sector. Initiatives that engage consumers to ask questions about sustainability should be encouraged.

4. Further work and follow up

The Norwegian Minister of Climate and Environment Ms. Tine Sundtoft invited the conference in her introductory remarks to look for Nordic Cooperation opportunities on Green Investments and Pension Funds. In this section CICERO is suggesting further work and follow up from the conference in that regard.

Further work and follow up could include organizing workshops and fund further research on more specific topics on green investments and institutional investors.

A much-debated topic is whether **divestment and active ownership** work in shifting investment in a more green and climate-friendly direction. Another topic could be **Nordic pension funds' investments in much needed green infrastructure projects.** New financial regulations designed to increase the banks' capital in order to reduce their exposure to long-term debts have been implemented. These regulations could at the same time discourage illiquid green infrastructure investments. Introduction of accounting rules to increase transparency and consistency in financial statements could further be hard to apply to such more illiquid investments. Further developments of **new financial green investment products**, e.g. green bonds, and non-fossil fuel indices, is another candidate for further research. Development of methods for a more systematic presentation of **new data on climate risks in investment portfolios**, including carbon footprint approaches, and to what extent climate risk reduction approaches affect financial performance, could also be interesting to examine.

In addition to workshops and more research a **network of Nordic investment funds, Nordic banks and other financial decision makers** could be established to facilitate discussions and enhance the understanding of what is needed to enable the necessary green shift. Such a network could look into the possibility of agreeing on a **statement** to be made public at COP 21 in Paris later this year. Such a statement could focus on some key issues on climate finance from an investor's perspective. It should be concrete and

concise in its approach, and aim at impacting further developments towards more green investments. A roundtable, supported by a secretariat, where key Nordic financial stakeholders are invited in September/October 2015 could aim at drafting some strong concise key messages. Such a statement could e.g. focus on further steps necessary to develop green bonds, carbon tracking, and other new green financial products, and could fit well with the strategy of the COP 21 French Presidency to bring positive momentum from the outside world to the UNFCCC negotiations.