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THE ROLE OF THE STATE AS INVESTOR IN PROMOTING SUSTAINABILITY: AN EMPIRICAL ANALYSIS

We study the barriers and drivers for market actors' contribution to the UN Sustainable Development Goals within planetary boundaries, with the aim of achieving Policy Coherence for Development.

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The Role of the State as Investor in Promoting Sustainability: An Empirical Analysis

Authors: Jukka Mähönen and Heidi Rapp Nilsen
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1. Introduction

1.1. Different roles of public actors

Public entities as federations, states, regions and municipalities have several roles in the market. Two historical basic models of public entities’ market roles can be recognised: (1) the public’s role as a regulator, often combined often with a supervisory role, and (2) the public’s role as an ‘owner’, through wholly or partially controlled market entities (“enterprises”).

Public entities as active market actors are not a recent phenomenon. States and other public entities have of course always constituted (with privileges, letters patent, licences and concessions) and regulated the markets and private market actors. A well known example is the great trade companies as English and Dutch East Indian Company in the sixteenth and seventeenth century. However, a specific trend of regulation can be recognised from the mid-nineteenth century onwards, when regulation was focused on creating new private market entities (especially the new invention, companies with limited liability) and regulating their market activities, especially from competition and market place structure point of view, for instance by trust legislation in the late nineteenth century, or securities regulation and supervision reforms after the Great Depression in the early 1930s, both firstly in the United States (US) but then spreading all over to the world.

From the Great Depression onwards, and especially after World War II, the public’s role as an entrepreneur and owner was however emphasised, usually through specific state-owned enterprises (SOEs)

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1 To ‘own’ and ‘ownership’ are used here meaning control rights to enterprises, factors of production and value chains, not in narrow property law dogmatic meanings. ‘Ownership’ of control uses of course often legal ownership as a tool; as an example can be mentioned a state owning shares in a limited liability company. As Henry Hansmann describes it, using a cooperative as an example, ‘saying here that a cooperative is “owned” by its patrons we mean that the patrons share in the two rights that, together, conventionally define ownership: the right to share in the organization’s profits and the right to share in control of the organization’; see Henry Hansmann, ‘All firms are cooperatives – and so are governments’, Journal of Entrepreneurial and Organizational Diversity, 2:2 (2013), 1–10, p. 2. In a public company, its shareholders own their shares, which grants them numerous rights (for example, the right to vote in general assemblies on proposals included in the proxy statement) but they do not own the company, as a legal entity, nor the firm as an economic (productive) entity; see Antoine Rebérioux, ‘Does shareholder primacy lead to a decline in managerial accountability?’, Cambridge Journal of Economics, 31 (2007), 507–524, p. 508.
and government sponsored enterprises (GSEs). Through SOEs and GSEs the public entities participate directly the markets as seller and buyer in various value chains. This kind of public action, by a use of public powers for direct market operations can be called as ‘ownership as regulation’. By controlling enterprises and using other market based ownership rights to local and global value chains, instead of using conventional direct public regulation, public entities have shaped, managed and controlled economies and societies. In this ‘ownership as regulation’ model private law ownership rights and public law regulation powers are fused. Ownership rights to control enterprises and value chains give public actors internal control to factors of production, while at the same time regulation provides them with the opportunity externally control market and social forces in and beyond the areas of activity of relevance to the enterprises and assets. Private firms face idiosyncratic or firm-specific nonfinancial risks as legal risks from negative environmental, social or governance practices that increase potential liability exposure and regulatory risks that increase the likelihood that costly regulatory changes will be imposed. For public actors these risks are more controllable domestic as regulation is for them endogenous factor.

The tide of public market ownership changed in the 1980s and 1990s, partially due to Reaganism and Thatcherism, partially due to the collapse of the Soviet Union and the Eastern Bloc. Public ownerships were privatised, and an idea of a ‘level playing field’ for public, public-private and private market actors was spread. In the new model, ‘ownership’ and ‘regulation’ was separated, not only in control of firms but also in contracting generally, usually called as ‘public procurement’.

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2 A government-sponsored enterprise (GSE) is a US concept, a financial services corporation created by the Congress.
4 With value chain I mean the whole life-cycle of commodities, including supply chains, production chains, and distribution chains, from raw materials to reuse of “waste”.
During the last decade, partially due to the financial crisis 2007–2008, the tide has turned back however. Public ownership has been seen as a last resort for financial problems even in the US. At the same time, the economic power of governments in Asia as People’s Republic of China (PRC) and oil producing countries as Russian Federation (RF) and Norway has been channeled through public ownership. This new wave of ‘publicisation’ or ‘re-publicisation’, after decades of ‘privatisation’ does not take place solely through wholly owned SOEs anymore.

Governments, especially the PRC and the RF but also other countries as Norway, use still SOEs but not so much as only as sovereign operators with ownership but as investors, in cooperation with other investors, retaining themselves either majority or minority stakes. Additionally, governments around the world have transformed state capitalism into new more complex governance models in which the government works hand in hand with domestic and foreign public, private and other hybrid investors to develop new strategic capabilities using novel governance arrangements, providing both financial and political capital, for example preferential treatment, strategic support using subsidized credit and/or other protections or through policies stimulating new firm capabilities and upgrading. The new roles of the public market entities are so not limited to formal control. Through public entities’ leverage over key actors in business groups and value chains, they can exercise their influence over other business group or network members without formal control rights. As new firms are added to networks of interconnected private, public and hybrid actors the public influence is spreading in the economy.

The public entities’ indirect participation take place more and more through their specific public investment vehicles as national wealth funds (NWFs) and national holding companies, sovereign wealth funds (SWFs), sovereign development funds (SDFs), sovereign patent funds (SPFs) and public pension reserve funds

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(PPRFs), to name a few. In many cases these new forms of public market entities come from the developing countries channeling their natural resource or commodity based export revenues to the international financial markets.

The rise of the public entities concerns not only the developing countries, however. Before the enlargement plans of the Public Invest Fund (PIF) of Saudi Arabia according to ‘Vision 2030’, the largest SWF in the world is the Norwegian Government Pension Fund Global (GPFG), with USD 1 trillion of assets under management. The Norwegian state is however still also a directly controlling shareholder in many listed and non-listed important companies as Equinor (previously Statoil), Telenor, Yara, Kongsberg Gruppen and Statkraft. What makes a state and other public entities special as market actors is that they must face their public functions also when they behave as market actors, fulfilling them through regulation and ownership, as they have done previously.

1.2. Unsustainability of modern business models

During the decades of public actors’ absence from ownership, the mainstream corporate doctrine however evolved according to the dogma of separating those ownership and regulation tools: private firms were geared towards short-term maximisation of financial returns for ‘owners’ of private

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13 Currently, nearly 20 per cent of the top 100 corporations and over 10 per cent of the top 2,000 publicly traded multinational corporations are SOEs. Their market value corresponds to 11 per cent of the market capitalization of all listed companies worldwide, and their overseas investments account for roughly 11 per cent of global foreign direct investment flows.

14 In 2013 developing economies generated more than 33 per cent of world outflows of foreign direct investment, when in 2000 they represented 12 per cent. The worldwide value of SWFs’ assets under management (AUM) only was in 2016 at least 5.7 trillion euros.


enterprises, slated as ‘shareholder primacy’ social norm or ‘legal myth’,\textsuperscript{18} based on the conveniently just developed contract and agency theories.\textsuperscript{19}

As we have seen not only from the financial crisis of 2007–2008 but also for instance from climate change, this has been however detrimental to both the planet and its societies but also private firms’ own long-term existence, long-term planetary and societally tolerable economic behaviour being a non-negotiable requirement for the firms’ own survival in the long run albeit possible still in the short run.\textsuperscript{20} We face unprecedented social-ecological interactions, feedbacks and potentially catastrophic tipping points in an increasingly turbulent world. Identifying the ecological limits that define a safe operating space for planetary and societally sustainable economy, to ensure ‘a safe and just operating space’ with a resilient biosphere, a society with equity and an efficient economy,\textsuperscript{21} for humans also in the future,\textsuperscript{22} is however crucial.

The overarching objective of Sustainable Market Actors for Responsible Trade (SMART) project is to do research that will contribute to global, sustainable development within a circular, zero-emission economy compatible with planetary boundaries (PBs) and in line with the United Nations’ Sustainable Development Goals (SDGs), with greater policy coherence for development as a red thread throughout the project. SMART is funded under the H2020 call: Europe as a global actor: in search for greater policy coherence for development. This mapping of states as investors is part of the project. The public sector in its many roles as market actor is crucial to achieving the EU’s development goals.

The SMART project defines sustainable development as ‘development that meets the needs of the present while safeguarding Earth’s life-support system, on which the welfare of current and future generations

\textsuperscript{19} See, for instance, Oliver Hart, Firms, Contracts, and Financial Structure (Oxford University Press, 1995).
\textsuperscript{20} Benjamin J. Richardson, Fiduciary Law and Responsible Investing: In Nature’s Trust (Routledge 2013)
depends’. The SMART project explores the sustainable development framework in more detail as the project evolves, looking into inter alia how the UK’s former Sustainable Development Commission brought governance and the evidence-base into their framework as well as economics.

With our focus on the market actors, private, public and hybrid, our goal may be expressed as achieving corporate sustainability. Corporate sustainability may be defined as when economic actors (our market actors, private, public and hybrid) in aggregate create value in a manner is (a) environmentally sustainable in that it ensures the long-term stability and resilience of the ecosystems that support human life, (b) socially sustainable in that it facilitates good governance, the respect and promotion of human rights and other fundamental social rights, and promotes a development that secures not only a safe but also a just operation space for humanity, and (c) economically sustainable in that it generates wealth in a way that satisfies the economic needs necessary for stable and resilient societies.

Global economic development has been a world-changing phenomenon bringing immense benefits and opportunities. For the first time, a world without absolute poverty has become an agreed goal of development policies globally, and in the EU. However, this social momentum collides with the advent of the Anthropocene: humanity now constitutes the largest driver of change on Earth. Over the coming decades, many now argue that we face unprecedented social-ecological interactions, feedbacks and potentially catastrophic tipping points in an increasingly turbulent world.

Understanding and addressing these rapid global changes is an urgent scientific challenge, and an intrinsic dimension of an integrated and comprehensive approach to policy coherence for development.

The planetary boundaries (PBs) framework attempts to define the biophysical conditions that provide the world with a high chance that Earth will remain in a stable ‘Holocene-like’ state – the only state of

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the planet that we know can support modern world development. Since its publication in 2009, PB research has been closely scrutinized by scientific peers, deepening the concept in potential application contexts.

Based on the best available knowledge of Earth’s dynamics, the PB framework represents steady progress in Earth system science and resilience theory. PB framework builds on evidence of processes that regulate Earth system stability, and its response to human perturbations. The PB define global sustainability criteria for critical environmental processes that regulate the stability of Earth system components. By quantifying boundaries, based on the scientific assessment of when these critical processes enter a danger zone with risks of large-scale thresholds, the framework can define a safe operating space for development. It is estimated that humanity has already transgressed at least four of the currently identified nine PBs: climate change, biosphere integrity, the biogeochemical flows of phosphorus and nitrogen, and land-system integrity. The other five are global freshwater use, ocean acidification, chemical pollution, atmospheric aerosol loading, and stratospheric ozone depletion.

Tiina Häyhä, Paul L. Lucas, Detlef P. van Vuuren, Sarah E. Cornell and Holger Hoff, ‘From Planetary Boundaries to national fair shares of the global safe operating space — How can the scales be bridged?’, *Global Environmental Change*, 40 (2016), 60–72.

27 Steffen, Richardson, Rockström, Cornell, Fetzer, Bennett, Biggs, Carpenter, de Vries, de Wit, Folke, Gerten, Heinke, Mace, Persson, Ramanathan, Reyers and Sörlin, ‘Planetary boundaries’. 
Current status of the control variables for seven of the PBs. The green zone is the safe operating space, the yellow represents the zone of uncertainty (increasing risk), and the red is a high-risk zone. The PB itself lies at the intersection of the green and yellow zones. The control variables have been normalized for the zone of uncertainty; the center of the figure therefore does not represent values of 0 for the control variables. The control variable shown for climate change is atmospheric CO₂ concentration. Processes for which global-level boundaries cannot yet be quantified are represented by gray wedges; these are atmospheric aerosol loading, novel entities, and the functional role of biosphere integrity.  

28 Steffen, Richardson, Rockström, Cornell, Fetzer, Bennett, Biggs, Carpenter, de Vries, de Wit, Folke, Gerten, Heinke, Mace, Persson, Ramanathan, Reyers and Sörlin, ‘Planetary boundaries’, p. 736.
The environmental precautionary principle is of essence, and the conceptual PB framework itself proposes a strongly precautionary approach.29

Raworth’s extension of the PB concept to include social objectives has produced a framework that has become known as the ‘Oxfam doughnut’.30 It points to the need for an explicit focus on the social justice principles underpinning sustainability. While the ‘doughnut’ has been influential in the context of sustainability policy and practice, truly integrative research on the environmentally safe and socially just pathways for humanity is still urgently needed. The key scientific challenge remains to explore whether (and under which conditions) the twin objectives of achieving world development aspirations on a stable and resilient planet are possible in the Anthropocene. Leach, Raworth and Rockström integrate PBs and the social foundation into one framework with the aim of identifying alternative pathways to sustainability and inform deliberation about their social and political implications.31 The framework sets out the social and PBs between which humanity can thrive:32

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29 Rockström, Steffen, Noone, Persson, Chapin, Lambin, Lenton, Scheffer, Folke, Schellnhuber, Nykvist, de Wit, Hughes, van der Leeuw, Rodhe, Sörlin, Snyder, Costanza, Svedin, Falkenmark, Karlberg, Corell, Fabry, Hansen, Walker, Liverman, Richardson, Crutzen and Foley, ‘A safe operating space for humanity’.
30 Raworth, ‘A safe and just space for humanity’; Kate Raworth, Doughnut Economics : Seven Ways to Think Like a 21st-Century Economist (Cornerstone, 2017).
32 Raworth, Doughnut Economics.
The main obstacle for a sustainable economy is humans’ desire to fulfil their short-term demands. The mainstream legal and political regime prioritises humans’ needs at the expense of the biosphere, emphasising social and economic growth-based progress. In economic activities, this has that what has been considered are the present and future private interests of economic entities’ members, employees, clients and other participants of their value chains (firms’ joint activities to deliver commodities for the markets), as well as interests of pressure groups and local communities.33 This emphasis on societal equity and economic efficiency ignores the non-negotiable need for a resilient biosphere. This dilemma is seen clearly also in the ambiguity of public investors’ overall decision-making: it is increasingly difficult for public institutional investors to claim the ability to cut out the ‘messy’ business of politics, sustainability and ethics from their investment decision-making.34

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1.2.1. Problems of ‘corporate sustainability’

In strategic terms, a sustainable financial system supports sustainable development by meeting the needs of the present without compromising the ability of future generations to meet their own needs. It enables households, firms and governments to store and access their incomes and assets reliably for present and future use. It ensures capital is available to support productive and sustainable financing, investment, innovation and consumption. And it is transparent and accountable, providing lenders, investors and society with information on both how their capital is being used and how to hold firms and asset managers to account. The main problem of discussion on long-term planetary and societally sustainable economic behaviour has however been that there have not been viable alternatives to challenge shareholder primacy social norm as a driver for economic activity. The vagueness of different kind of ‘sustainability’ concepts themselves, combined with its growing level of importance in national and international policy-making, has however led to an extensive debate and a wide variety of definitions of ‘sustainability’. So, although it is clear that ‘sustainability’ of business activities includes a holistic approach to the consequences of firms’ behaviour to planetary ecosystems and the human economic and social systems, a theoretical basis for it is a mess. The problem is that most ‘sustainability’ and especially ‘corporate sustainability’ theorisations as ‘corporate social responsibility’, ‘triple bottom line’ and ‘sustainable business model’ approaches are just vague attempts to satisfy the ‘stakeholders’ private needs, not taking into consideration requirements for a resilient biosphere, a society with equity, and an efficient economy. Stakeholder approaches dilute managerial accountability and leads too to a (sub-optimal) ‘politicisation’ of the board. Narrow shareholder

36 See Richardson, Fiduciary Law.
39 Rebérioux, ‘Does shareholder primacy lead to a decline in managerial accountability?’, p. 508.
primacy dogma is replaced with nearly as narrow stakeholder engagement social norm or legal myth, often in a populist tone. Stakeholder based approaches tell however very little of the elements of a planetary and societally tolerable markets, a resilient biosphere, a society with equity, an efficient economy, themselves.

So, while stakeholder based thinking has become mainstream besides shareholder based thinking, a more comprehensive and analytical thinking is required. The compartmentalisation and narrowness of ‘sustainability’ discussion, albeit waste of time and often detrimental to sustainability itself, cannot undermine that the problem of sustainable behaviour is itself complex and escapes comprehensive approaches. Sustainability paradoxically escapes contents as attention in sustainability discussion is fixed to specific input and outflows only. Life sciences give input but how it is processed in organisations and populations requires understanding of human and organisational behaviour, as life sciences are able to provide only partly to them, for instance concerning normative processes. So, it must be understood that ‘sustainable development’ does not denote a specific content, but rather a continuous process of actions where the need for indefinite existence of human systems is balanced with both the carrying capacity of eco-system and the human economic and social systems for a resilient biosphere, a society with equity, an efficient economy.

Although ‘the interplay between nature and society has long history and deep legacies’, ‘sustainability’ discussion is still problematic as the prospect of social and economic progress and conventional anthropocentric human rights doctrine collides with the threat of unprecedented social-ecological systems consequences resulting from economic activity transgressing the PBs, the ecological limits of human behaviour that form the space within which all economic and social development is to take

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42 See the literature above in this chapter.
place (see above). The real challenge of ‘sustainability’ is to integrate development goals to PBs with a resilient biosphere, a society with equity and an efficient economy. As an example can be taken the integration of biosphere, society and economy developed by Carl Folke from the Stockholm Resilience Centre to the UN Sustainable Development Goals (SDGs) concept, as presented by Johan Rockström and Pavan Sukhdev in 2016:46

Figure 3: An evidence-based approach to the SDGs.

The SES approach emphasizes that people, communities, economies, societies and cultures are embedded parts of the biosphere and shape it, from local to global scales. At the same time people, communities, economies, societies and cultures are shaped by, dependent on, and evolving with the biosphere.47

46 Folke, Biggs, Norström, Reyers and Rockström, ‘Social-ecological resilience’.
1.2.2. Public actors for (un)sustainability

The modern ways how the public entities participate the markets either for or against sustainability is so very complex and even the most recent theories and typologies are not able to fully grasp them.\(^48\) According to Musacchio, Lazzarini and Aguilera, the very essence of a state-owned enterprise is to pursue social objectives instead of short-term profitability, for instance taking into consideration long-term development effects and quality-based dimensions of the value chain or consideration on less-profitable customer segments or geographically remote areas or otherwise a positive social net present value.\(^49\) Besides SOEs and GSEs, however, governments use sophisticated vehicles as NWFs, SWFs and SDFs for portfolio investments in several firms, more and more in concert with each other but also with private entities, forming complex public private partnerships (P3s). They use also other contractual networks and value chains to gain their goals, usually labelled as ‘public procurement’. Finally, the public entities use they regulatory powers to gain market force and operate in the markets, using ‘regulation as ownership’, a governance model in which a governmental agency acts as an active market operator, for instance by supervising and selling nuclear facilities simultaneously or regulating, supervising and actively managing state-owned companies simultaneously.

Our existing knowledge of the role of public entities in the markets and their impact to sustainability, although already well researched,\(^50\) is however underdeveloped and true understanding of them requires new approaches. What we know is that public entities as market actors on different levels of public governance (local, subnational, state, federal) and in different sectors of society and the economy are crucial either as drivers or as obstacles to long-term corporate behaviour and thinking.\(^51\) Public market actors are inseparable and deeply interconnected parts of economic organisms but in a more complex way than usually understood. They do not only intervene in private economic activities from outside as regulators and supervisors; they also directly conduct such activities as a means of achieving public policy goals in various and complex roles.\(^52\)

\(^{48}\) See, for instance Musacchio, Lazzarini and Aguilera, ‘New Varieties of State Capitalism’.


\(^{50}\) See the numerous references in this paper.

\(^{51}\) Mariana Mazzucato, The Entrepreneurial State: Debunking Public vs. Private Sector Myths (Revised ed, Anthem Press, 2014).

At the same time, the public dimension of their activities brings to the frame their constitutional holding. Public entities in different levels and sectors have so several roles they must fulfil at the same time. They legislate, they regulate, they own, and they contract. It is naïve to think they keep these roles separate; even separating regulation and ownership is impossible, as we have seen. To analyse the evolution of public entities as market actors and their behaviour with each other, and other actors in changing markets, we need also new methodological tools.

It is necessary so to transcend the conventional public-private dichotomies both concerning the public’s role but also the private’s role, with new out-of-the-box thinking of the role of public entities as market actors and challenging their conventional regulatory role. At least four roles for public entities as market actors can be recognised: (1) a direct investor through public, private and hybrid economic entities or a venture capitalist through private entities in charge of public-nature activities with state control (for instance, in infrastructure companies); (2) a portfolio investor such as a NWF, SWF or SDF and other public investment fund to public and private targets; (3) a regulator and supervisor (both as legislator and financial and securities markets supervisor in their market roles); and (4) a procurer and contractual counter-partner in value chains and networks.

Direct investment take place not only through conventional SOEs and GSEs, but more and more through public-private and hybrid economic entities or ventures for instance, in infrastructure companies in which a SWF or a SDF is a partner. Similarly, indirect investments take place not only conventional state holding companies, NWFs, SWFs, SDFs and public pension reserve funds (PPRFs) but more and more through P3 funds investing to both public and private targets, maybe through joint mergers and acquisitions. Public activity as regulator and supervisor does not take place only in the traditional legislator and financial and securities markets supervisor role but also as an active market participator creating negative and positive incentives to competition or even participating the markets themselves. Contractual participation takes place both in the traditional role of public procurer but also as a contractual counter-partner in complex value chains and networks.

54 As an example can be mentioned the transaction in which the RF government sold a 19.5 per cent stake, retaining however its control with approximately 50 per cent and the British BP owning a stake of 19.75 per cent, in the state-controlled oil company “Rosneft” (ОАО НК «Роснефть») to a consortium of Glencore plc and the Qatar Investment Authority (QIA), the Qatari sovereign-wealth fund, in its own part the largest shareholder in Glencore.
Novel understanding is so required on these various roles of the public in the regulatory complexity that constrains or enables a resilient biosphere, a society with equity, and an efficient economy; a new interdisciplinary way of research into the complex regulatory systems shaping business behaviour is required. Regulating complex societal goals, in this case planetary and societally sustainable business, raises however multi-dimensional questions and is as such very complex or ‘wicked’ problem, even a ‘social mess’. In the complex and interdependent world of finance, it is indeed increasingly difficult for especially public institutional market actors to combine their investment decision-making and the messy business of interest-based politics, ‘sustainability’ and ethics.\(^{55}\) This kind of social messes cannot be managed by one discipline, organisation or jurisdiction alone but require trans-disciplinary approaches. From a methodological point of view this requires acknowledging public entities as complex regulatory systems, requiring systemic and evolutionary, trans-disciplinary comparative ecological analysis of behaviour of public entities in different economic and legal environments when engaging with local and global private and hybrid corporate behaviour.

1.3. Public market actors in the regulatory ecology

On the surface, public market actions are indistinguishable from actions of private market participants: as private actors, public actors buy, sell, lend, borrow, insure, and securitise. This is no wonder as in the matter fact also governments are enterprises, consumer cooperatives by their nature, providing services to their members.\(^{56}\) However, what sets public actors apart is their express orientation toward using private market operations primarily in order to achieve public policy goals.\(^{57}\) They are for instance capable of acting counter-cyclically when no private actor can afford to do so, due to their size, funding, long-term investment horizon, and legal privileges. Due to these advantages, they are able to overcome market failures and to provide public goods under provided by private actors.\(^{58}\) What is important they are provided by political capital, representing a close relation to the government or politicians, bringing benefits such as preferential treatments, lighter taxation, relaxed regulatory, or

\(^{55}\) Hachigian, ‘Ambiguity, discretion and ethics’, p. 625.
\(^{56}\) Hansmann, ‘All firms are cooperatives’, p. 4.
stiffer regulatory enforcements over their rivals, and other useful resources. So, it is no wonder that there is a positive relation between state-controlled firm ‘ownership’ and the sustainability performance of firms, whereas the other types of controlling ownership as institutional investments by pension funds, mutual funds and insurance companies have no impact on sustainability performance, emphasising the importance of governmental share ownership in shaping firms’ sustainability responsibility performance in an international context.

1.3.1. Different forms of public investments

Being coordinated, liberal or state-led market economies, all modern governments play some kind of leading role in their nations’ economic affairs, and they conduct direct financial interventions through a wide range of entities. Albeit since the 1970s there has been a change from ‘entrepreneurial’, ‘positivist’ and ‘interventionist’ state that uses ownership as a regulatory instrument in the public interest to ‘regulatory’ state, from an active market participator to a market facilitator. Governments sort of ‘constitute’ or ‘found’ markets by formulating and enforcing their ‘rules of the game’. Government is still ‘internal’ to markets but in the way that genetic structure is internal to an organism or rules are internal to games they define. It determines the shape and indeed possibility of the market as DNA structures a life form and is prerequisite to such forms.

61 In coordinated market economies as Germany and Japan organised interests such as business associations and trade unions play a dominant role in coordinating the economy. In liberal market economies as the UK and the US the market is the dominant logic for coordinating economic activities. In state-led market economies as France and South Korea the state plays the dominant role. See Peter A. Hall and David Soskice, ‘An Introduction to Varieties of Capitalism’ in Peter A. Hall and David Soskice (eds) Varieties of Capitalism: The Institutional Foundations of Comparative Advantage (Oxford University Press) pp 1–68; Nahee Kang and Jeremy Moon, ‘Institutional complementarity between corporate governance and Corporate Social Responsibility: a comparative institutional analysis of three capitalisms’, Socio-Economic Review, 10 (2012), 85–108.
The evolution has not been straightforward, however. Governments act still as market actors, fulfilling still their public ends. Regulation by ownership has not disappeared, it has changed, prevailing privatisation processes notwithstanding, SOEs and GSEs have persisted and even thrived during the past decades, especially in Asia. As an example can be mentioned the systemic ‘renationalisation’ of the in the 1990s privatised Russian companies by large RF SOEs since 2004, substantially boosting state control over the Russian economy.

In the matter fact, the last decade has seen a general trend of ‘publicisation’: currently, nearly 20 per cent of the top 100 corporations and over 10 per cent of the top 2,000 publicly traded multinational corporations are SOEs. Their market value corresponds to 11 per cent of the market capitalization of all listed companies worldwide, and their overseas investments account for roughly 11 per cent of global foreign direct investment flows.

At the same time, we have seen a transformation of SOEs into new models of state capitalism in which governments work hand in hand with domestic and foreign private investors using novel networking and governance arrangements, holding either a majority or minority equity position in companies or provide strategic support to private firms using subsidized credit or other protection. Many of these new varieties of state capitalism have an important role in global economy.

State control over enterprises of strategic importance takes different forms and has different consequences. Unlike traditional SOEs, modern state-controlled companies are often publicly traded.

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65 Hockett and Omarova, “‘Private’ Means to ‘Public’ Ends’, p. 56.
and thus state shareholder interests must be reconciled with private shareholder interests. On the other hand, there are big cultural and political differences in public market actor governance. At one extreme are official state ministries, such as the Treasury or the Finance Ministry, while at the other extreme are legally separate, individually incorporated SOEs through which states exert influence as the controlling shareholder. In between these organizational poles lie regulatory agencies, boards and commissions (such as the US Securities and Exchange Commission [SEC] and the Social Security Administration); state-owned but separately capitalized commercial and development funds and banks (such as Brazil’s Banco Nacional de Desenvolvimento Econômico e Social [BNDES] and Germany’s Kreditanstalt für Wiederaufbau [KfW]); and, most important of all, central banks, which are integrated organs of government, even when granted substantial operating autonomy. There is a wide variation in the degree to which these institutions are under the direct political control of the national government, how much operational discretion the entity’s managers can exercise. At the same time, the role of public entities as institutional investor has strengthened. There are two main types of public institutional investors, namely SWFs and PPRFs. However, modern public participation in corporations can take many forms, from fully state-owned SOEs and GSEs to non-block shareholdings in listed companies. The indirect public participation takes place in various forms of not only in SWFs and PPRFs but NWFs, SDFs and sovereign patent funds (SDF).

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71 Grosman, Okhmatovskiy and Wright, ‘State Control and Corporate Governance’, p. 214.
1.3.2. Public market actors as direct investors

The nature of public ownership matters. In this respect a difference should be made between SPRFs and SOEs. Unlike public employee pension funds that are vulnerable to being used as a vehicle for advancing partisan/stakeholder-specific social goals unrelated to shareholder and public policy interests generally, the state (government) as a market actor might be in a different position. State’s actions are governed not only by market rationality and corporate law and social norms as in private institutional investors but also by public law considerations. This is not to say separating partisan and public policy goals is easy. For instance, there might be a risk of collusive relationships: firms with state control are more likely to receive state benefits and to provide services that benefit the state. On the other hand, SOEs often rely on regulatory support from the government and this practice benefits private shareholders investing in SOEs. However, there are checks and balances as a state investor’s governance structure is regulated by constitutional and administrative law, and its actions by judicial review. This has several implications.

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74 Grosman, Okhatovskiy and Wright, ‘State Control and Corporate Governance’, p. 211 (using the RF as an example).
75 Kahan and Rock, ‘When the Government Is the Controlling Shareholder’.
Firstly, a public entity owned control block provides them with a totally new kind of power from the traditional power of the regulator or a supervisor; a power that, depending on how it is structured, can be exercised more informally and with more discretion, outside of the formal regulatory process and the accompanying public scrutiny, and more directly by politicians rather than by appointed bureaucrats. As an example can be mentioned the RF “Rosatom” State Atomic Energy Corporation (Государственная корпорация по атомной энергии “Росатом”). “Rosatom” is a state corporation. It is the regulatory body of the RF nuclear complex but at the same time a leading international vendor of nuclear industry’s entire range of products and services. Simultaneously, it runs all nuclear assets of the RF, both civil and weapons. Besides, it has the authority to fulfil on behalf of the RF the international commitments undertaken by the nation with regard to the peaceful use of atomic energy and non-proliferation. “Rosatom” acts so in a triple role of a domestic regulator/supervisor, international authority and a multinational leading vendor of nuclear energy technology.

Secondly, a state share ownership provides periodic opportunities to interfere. Every year, shareholders elect board members and vote on shareholder proposals, compensation plans, auditors, etc. A controlling shareholder’s vote will typically be decisive. As a result, once one has control, one has virtually no choice but to decide critical issues. If the State does not attend the meeting, in person or by proxy, no actions can be taken for lack of a quorum. If they do attend, their vote is decisive. Thirdly, an existing share position minimizes the political cost of interference compared to normal lobbying. The power and periodic opportunities provided by share ownership will change the cost of interference during ordinary times, even if it will not eliminate those costs.

For instance, the US does not have much history with government ownership of private industry. As a matter of fact, government ownership is only a product of the financial crisis as a ‘reluctant shareholder’. As a result of ad hoc governmental interventions, the terms of the government’s

77 Kahan and Rock, ‘When the Government Is the Controlling Shareholder’.
78 Verret, ‘Treasury Inc.’.
79 Black, ‘The U.S. as Reluctant Shareholder’.
ownership positions vary widely among portfolio companies. Due to this, government ownership does not have a well-worked-out structure of accountability when the government is the majority holder of a for-profit corporation.\textsuperscript{80}

As an example of the complexity of public direct investments can be mentioned the new types of upside-down public wealth funds as investment management entities consisting of private equity funds in which the management entity is a general partner and calling for private investors as limited partners, instead of SWFs investing public funds on private listed equity and real estate (as the Norwegian GPFG does).\textsuperscript{81} The Russian RDIF is a leading example of these kinds of new upside down private equity SWFs. A more traditional P3 model is Petróleo Brasileiro S.A. (Petrobras), concerned as the world’s most sustainable oil company,\textsuperscript{82} with 54 per cent direct Brazilian government share ownership, while the BNES and Brazil’s SWF Fundo Soberano each control 5 per cent, bringing the Brazilian State's direct and indirect ownership to 64 per cent. The privately held shares are traded on Bolsa de Valores, Mercadorias & Futuros de São Paulo (BM&F Bovespa).

As stated by Larry Catá Backer among others, the current driving force in European SOEs are the Nordic states under the so-called policy of ‘Nordic Capitalism’.\textsuperscript{83} It is guided by principles of profitability and exemplary responsibility: profits rendered to the state and the state directing the form and effect of the responsibilities it meant to impose. For example in Swedish SOEs the Swedish state “has a major responsibility to be an active and professional owner. The Government's overall objectives are for the companies to generate value and, where applicable, to ensure that specially commissioned public policy assignments are well performed.”\textsuperscript{84} Other European states also maintain state enterprises.

As described by Backer,\textsuperscript{85} in Sweden, the state is a significant owner of enterprises operating in Sweden and abroad. The Swedish state controls, wholly or partially, forty-nine enterprises, two of which are

\textsuperscript{80} Kahan and Rock, ‘When the Government Is the Controlling Shareholder’.
\textsuperscript{81} Davidoff, ‘Uncomfortable Embrace’.
\textsuperscript{82} Matos and Silvestre, ‘Managing stakeholder relations’, p. 65.
listed. Moreover, the Swedish government accepts the responsibility to be an active and professional owner, with general objectives to generate value and in some cases to ensure that public policy assignments are adequately performed. Beside this overall goal, Swedish SOEs are tasked with multiple objectives, including obtaining balanced gender distribution, reaching economic goals, reporting requirements, ensuring sustainable enterprises, and ensuring completion of assigned public policy assignment tasked to some Swedish SOEs. Furthermore, Swedish SOEs are managed and developed by an organization of the Ministry of Enterprise and Innovation that specializes in corporate governance and company management. This management “is conducted in accordance with the State’s corporate governance documents, compiled in the State’s Ownership Policy,” which includes Swedish Code for Corporate Governance, board nomination process, financial targets process, sustainable business, guidelines for remuneration, and guidelines for external reporting. Finally, governing boards of Swedish SOEs are made up of approximately 282 board members.86

According to Backer, similar to Sweden, the Norwegian state plays a very active ownership role. In fact, the state “has direct ownership, managed by the ministries, in 70 companies. The total value of the state’s commercial ownership was estimated to around NOK 644 billion at year-end 2015.”88 Much like Sweden, the Norwegian state recognizes the importance of transparent, responsible corporate governance and recognizes adherence to generally acceptable principles of corporate governance. Similar to the Swedish approach, Norwegian SOEs are tasked with primarily generating as much revenue as possible and, in the case of a certain category of SOEs, achieving sectoral policy objectives.

1.3.3. Public market actors as portfolio investors

1.3.3.1. Shares

In modern listed public companies, there are two types of shareholders: the active marginal traders who set the market prices and the activist (or potentially activist) institutional investors who exert

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pressure on the companies. Both types of equity investors are represented by a group of agents that we can call 'money managers'. For those involved with listed companies, would they be the board members, management or other labour, corporate life means life with money managers: the managers and board members of the target corporations are dealing with largely anonymous ‘owners’, represented by these ‘money managers’ buying and selling securities, balancing between quarterly results to keep the corporate management sharp and long-term investments to keep the companies growing. Most of corporate literature is of the duties of corporate managers and board members towards these ‘owners’.

However, after a century of utter dominance, the public company is showing signs of wear. One reason is that corporate managers, both in productive and non-productive corporations, tend to put their own interests first. The shareholder value revolution of the 1980s was supposed to solve this by incentivising corporate managers to think like owners, but it backfired. Loaded up with stock options, managers acted like hired guns instead, massaging the share price so as to boost their incomes. At the same time, the relationship between capital and labour changed dramatically. Both the corporate management and the other employees do not only offer their intellectual and human capital to companies as factor of production but financial capital, too, by sharing an interest in its equity and through that the equity markets by transforming their toil, either directly or indirectly to capital, unlike in the early stages of capitalism when capital providers and the managerial class were virtually indistinguishable and at the same time distinguishable of ‘labour’.

Those days are, however, long gone. In the US but also other countries, an employee is provided with an employer-provided pension plan, with monthly investments by both the employee and the employer to an intermediary who invest their money on their behalf. So, most ordinary people have little choice but to invest in the market. They are, as Leo E Strine, Jr. (2007) calls them, ‘forced capitalists,’ even though they continue to depend for their economic security on their ability to sell their labour. These forced capitalists have no interest in quarter-to-quarter earnings or to beat the market for quick bursts of cash at the expense of sustainable growth.

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91 Strine, ‘Toward Common Sense’.
Due to the complexity in modern listed firms, the financial intermediaries have come in the centre of corporate ownership and debate. It is the intermediaries, or their ‘money managers’, not the forced capitalists themselves, who determine how their capital is put to work and how the mountain of shares owned is used to influence the management of listed companies. Given the directional momentum of public policy in the US and Europe, the inflow of funds from forced capitalists to these intermediaries is likely to continue to increase.  

When the shareholder-value maximization defenders have seen aggressive activist shareholders as hedge funds as their champions, more critical voices have been raised to defend long-term corporate profitability. Instead of traditional activists, they give hope to active traditional institutional shareholders, such as pension funds and companies, mutual funds and insurance companies.

A specific group of these kinds of intermediaries are SWFs. As an example can be used the Norwegian GPFG that is one of the largest SWFs in the world. For the GPFG, the ultimate beneficiaries are the future Norwegians: The GPFG is ‘saving for future generations in Norway. One day the oil will run out, but the return on the fund will continue to benefit the Norwegian population.’ The GPFG invests on equity investments (61.2% by the end of 2015), fixed-income investments (35.7%) and real estate investments (3.1%). However, all SWFs are not similar: some are saving funds as the GPFG but some are stabilization funds created to reduce the volatility of government revenues, as the Russian Reserve Fund (RRF). Russian Direct Investment Fund (RDIF) is on the other hand a hybrid, acting as a private equity fund where it co-invests as a ‘managing partner’ with ‘limited partners’.

What is important SWFs and SPRFs can use a power over their often restricted nominal shareholdings. Modern businesses are complex corporate groups, transactional networks and supply chains which span the globe. Traditional corporate law generally identifies shareholders’ equity with residual risk-bearing and accepts the intuitively just principle of reserving voting and management rights in a particular enterprise to the shareholders most exposed to the risk of its failure. The intuition behind this principle is that shareholders should be able to take preventative measures lowering their risk of loss.

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92 Strine, ‘Toward Common Sense’.  
93 Hockett and Omarova, ‘Public Actors in Private Markets’.
Identifying and understanding key drivers of the short-termism that informs the financially, environmentally and socially unsustainable economic activity that corporations engage in, involves understanding the financiers, the financial markets and the financial institutions by using the SWFs as an example. It requires an appreciation of the depth of financialisation of the modern economy, which exacerbates the power and control exercised by financial institutions and elites over economic outcomes. The research will investigate financial motives, norms and actors that drive unsustainable business, including performance measurement, controlling investors, financial intermediaries, financial management and the role of financial markets.

1.3.3.2. Patents

Intellectual property (IP) policy is an important part of public market activities. As an example can be taken the PRC. The Chinese IP policies have maintained a bias toward facilitating assimilation of technology from abroad, rather than adequate IP enforcement or incentivising real innovation. The Chinese patent framework is tailored to accommodate the needs of Chinese SOEs who seek primarily to minimise their licensing costs, and seek protection against foreign competition. There is also a discriminatory selection for funding in favour of ineffective SOEs, rather than foreign-invested firms or domestic private firms, such as Lenovo and Huawei with real market and export potential.94

A more recent phenomenon is however public patent pools. Local and subnational governments in China (who are often in charge of R&D and industrial policy) have established patent pools – the Zhong Guan Cun Science Park in Haidian District in Beijing, has, along with the local government, pooled funds to defend domestic companies.95 More recently, public entities acquire existing patents, often originating from other countries than they set out to promote. As other public entities, public patent pools tend to have a political objective that goes well beyond the traditional government role of creating incentives for promoting or facilitating innovation. Patents are often acquired to be used as political instruments, rather than for commercial purposes.96

95 Lee-Makiyama and Messerlin, ‘Sovereign Patent Funds’.
96 Lee-Makiyama and Messerlin, ‘Sovereign Patent Funds’.
1.3.3.3. Sovereign wealth funds

Especially, when a country exports more than it imports, the surplus in income from trade often flows to other countries as foreign investments. When other countries need that investment to propel their economies, this natural flow of funds is great for everybody. In the last few decades, most of net oil exporting countries – Norway, the UAE, Algeria, and the RF – has created state-owned investment funds investing in real and financial assets such as stocks, bonds, real estate, precious metals, or in alternative investments such as private equity fund or hedge funds from revenues from the export of petroleum resources. Governments direct these SWFs to channel financial capital into international investments that directly or indirectly help oil-producing SOEs acquire petroleum resources across the world. Additionally, SWFs are used by other countries as in the PRC for management of their reserve liquidity.

The SWFs are mercantilist by their nature. On the other hand, a typical SWF is a hybrid structure, allowing for government ownership without government management. As stated by Bernardo Bortolotti, Veljko Fotak and William Megginson, in societies in which the state plays a dominant economic role, SWFs might be the only real, feasible alternative to full governmental control. Additionally, governments direct their SWFs to channel financial capital into international investments that directly or indirectly help their oil producing and other SOEs acquire petroleum and other resources across the world. The presence and influence of SWFs especially in the acquisition of petroleum resources possibly highlights the aspiration among some countries to increase their geopolitical position and power, but also alliances, especially between the PRC, the RF and the UAE, being one of the world’s most important exporters of capital, due to their comfortable fiscal positions, internal savings rates and an abundance of raw materials. In this regard these countries play an increasingly important role as sources of foreign direct investment in the world: in 2013 developing economies generated more than 33 per cent of world outflows of foreign direct investment, when in

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2000 they represented 12 per cent. Indeed, an essential part of modern global financial markets after the global financial crisis is the public private financial network building initiated by the SWFs.

Generally, the worldwide value of SWF assets under management (AUM) was in 2016 at least 5.7 trillion euros. Additionally, there was AUM of 6.5 trillion euros held in other sovereign investment vehicles, such as pension reserve funds, development funds and state-owned corporations’ funds and AUM of 7.3 trillion euros in other official foreign exchange reserves. Of this, the Norwegian GPFG, the world’s largest SWF, covers alone nearly AUM of 0.93 trillion euros (AUM), holding 1 per cent of global equity markets and 1.78 per cent of all European stocks (being the largest shareowner in Europe). China Investment Corporation (CIC), the largest of the several PRC SWFs and responsible for managing major part of the PRC’s foreign exchange reserves, has an AUM of over 0.84 trillion euros. The RF RDIF, Russian National Wealth Fund (RNWF) and RRF, although smaller than the previous, managed together the considerable amount of 135 billion euros in assets on behalf of the RF. Taken together, governments of SWFs, largely those in emerging economies, have access to an AUM pool of 18 trillion euros.

There are different ways to categorise SWFs. The International Monetary Fund (IMF) uses five broad types of SWFs according to their purpose: 1) stabilization funds which insulate governments’ budgets against commodity price fluctuations (volatility); 2) savings funds, which seek to convert non-renewable assets (such as hydrocarbons, minerals or metals) into a diversified portfolio of assets, 3) reserve investment corporations, which invest excess foreign exchange reserves in riskier assets to bolster the return on reserves, 4) public pension reserve funds (PPRFs) which seek to manage contingent pension liabilities on a government’s balance sheet via the investment of budget surpluses in global markets and 5) sovereign development funds (SDFs), which finance socio-economic projects and promote industrial policies. RDIF is a typical sovereign development fund as are Central Huijin Investment Ltd. of the PRF, BNDES of Brazil and Temasek Holdings Private Limited of Singapore. Typically these funds invest domestic or regionally, as Temasek for example does.

104 According to the SWFI fund rankings, the GPFG is the largest SWF in the world by assets under management, see http://www.swfinstitute.org/sovereign-wealth-fund-rankings/.
There is especially great variation between countries in how effectively SWFs are shielded from politics. At one extreme lies Norway’s GPFG, wherein investment policy is set by an independent board of experts based on strategic guidelines established by the nation’s legislature. The fund’s managers are fully protected from partisan political pressures, even though the fund is administered by Norges Bank Investment Management (NBIM). At the other extreme lie Abu Dhabi Investment Authority and Government of Singapore Investment Corporation, both of which report only to the nation’s rulers and refuse to disclose the total amount of their assets.106 If indexing accountability, transparency and the political distance from the host/sponsoring government (“Truman Scores”), GPFG gets the highest score, the Qatar Investment Authority (QIA) the lowest.107

Another important point is the specialisation of SWFs. The PRC has five SWFs, two of which are among the largest in the world, CIC and the State Administration of Foreign Exchange (SAFE). CIC was created and separated from SAFE in 2007 and has grown exponentially since then, from asset under management (AUM) $200 billion originally to over $800 in 2015. SAFE is a hybrid, an administrative agency tasked with drafting rules and regulations governing foreign exchange market activities, developing and supervising of the foreign exchange market, and managing the PRC foreign exchange reserves. While CIC and SAFE competed previously globally for deals and domestically for political favours, the Chinese government seems to have split their respective roles, with CIC becoming a global financial player and SAFE remaining a strategic fund. According Aguilera, Capapé and Santiso, avoiding competition between same-country funds can be an important driver behind this movement, helping to create funds with financial goals with a focus on foreign listed equity and keeping others with more strategic objectives, typically domestic.108

### 1.3.3.4. National wealth funds

A NWF is a public asset manager (holding company), concerned with active management of a state’s operational public assets as a portfolio. Its purpose is usually to maximize the portfolio value through active management including the development, restructuring and monetization of the individual assets.109 An example is Temasek of Singapore, with USD 177 billion of AUM.110 Another example is the

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Finnish Solidium Oy with AUM of USD 11 billion, the holding company for Finnish government shares in listed companies of national interest. The line between a NWF and SWF (or SDF) is not clear however as a NWF can be in the control of a central SWF: the world’s biggest NWF, Central Huijin with AUM of USD 412 billion is controlled by CIC, the PRC SWF responsible for managing part of the PRC foreign exchange reserves. Similarly, Diah Qatar, with AUM of USD 42 billion is owned through the QIA, the Qatari SWF.

Over the past few years, SWFs have displayed an increasing desire and ability to team up and find opportunities for co-investments with other SWFs and NWFs or other financial investors and through joint ventures. These sovereign private partnerships (SPPs) have typically taken the form of direct equity co-investments in the same target, epitomized by 2015 high mark acquisition of the Swiss-based Dufry AG, one of the largest airport retailers, by the pooled resources of QIA, Temasek, and GIC. But the most recent trends reveal a change in strategy. Rather than teaming up among themselves, SWF engage in deal making with private partners, either companies but also private financial institutions as pension funds or private-equity, venture capital funds.

1.3.3.5. Public pension reserve funds

Although categorised as SWFs by IMF, according for instance to the OECD, although there is no single widely accepted definition, public pension reserve funds (PPRFs) can be defined as separate funds from SWFs and NWFs, set up by governments or public social security institutions with the objective of contributing to finance the relevant pay-as-you-go pension plans. Although all PPRFs have the same ultimate objective (i.e. meeting the potential financial liabilities relating to the social security system), they vary in terms of funding sources, investment strategies, and pay-out phases, among others. There are so two types of PPRFs: those belonging to the overall social security system (social security reserve funds, or SSRFs) and those set up and owned directly by government.

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pension reserve funds, or SPRFs). In a SSRF the inflows are mainly surpluses of employee and/or employer contributions over current pay-outs, as well as top-up contributions from the government via fiscal transfers and other sources. A SPRF refers to those funds which are established directly by the government (completely separated from the social security system), and whose financial inflows are mainly from direct fiscal transfers from the government. Unlike SSRFs, those within this category have been set up by governments to meet future deficits of the social security system. Some are not allowed to make any pay-outs for decades.

All of these funds are under autonomous management entities. Examples include the Australia Future Fund, the New Zealand Superannuation Fund, the Norwegian Government Pension Fund Norway (GPFN), and the French Fond de Réserve pour les Retraites. These funds are also sometimes classified as SWFs though they do not all have high foreign investment allocations as SWFs typically have. So, the OECD classifies not only the GPFN but even the GPFG as a SPRF as it has at least a partial pension objective. All in all, there is a tremendous heterogeneity among funds, and thus any attempt to ‘classify’ them or draw conclusions from the classifications should be viewed with extreme caution.

It is so difficult, controversial and even arbitrary to make a difference between sovereign wealth funds, sovereign development funds and public pension reserve funds. As done by IMF, SPRFs may be considered a type of SWF with a specific mandate to finance future public pension expenditures. On the other hand, not all SSRFs may be considered SWFs. Some are legally independent of government and their balances are not integrated for national accounting purposes into the government accounts. So, although the US Federal Old-Age and Survivors Insurance Trust Fund and Federal Disability Insurance Trust Fund (collectively, the Social Security Trust Fund or Trust Funds) are SWF-like, they are not counted as such but as SSRFs. However, they manage the greatest pool of public assets in the world, AUM of 2.5 trillion euros. The largest genuine PPRF is the Japanese SSRF, the Government Pension Investment Fund (GPIF), with AUM of 1.1 trillion euros. Other important SSRFs are the Danish Social Security Fund and the municipality-run Norwegian Kommunal Landspensjonskasse KLP. These funds

116 OECD, p. 6, fn. 10.
may be managed by the social security institution itself, or an independent (often public sector) fund management entity.

1.4. Importance of public market actors

The regulatory ecology of public market actors enables us to identify and understand better the mix of regulation and governance through public entities by these and other different legal forms with direct or indirect public influence, both individually and across markets and business networks, thus including supervisory and regulatory market participation and various financial and non-financial contractual arrangements. Public control – or lack of it – challenges the theoretical underpinnings of mainstream corporate law theory, based on agency theory and the ‘contractarian’ (nexus of contracts) theory, shareholder primacy social norm as well as their critical counterparts as ‘team production’ theory\(^{119}\) and other stakeholder engagement based social norms or myths.\(^{120}\) The motives of the public ‘owner’ differentiates from profit maximisers, additionally, it can change the ‘rules of the game’ as regulator. According to shareholder primacy theory, the shareholders are not accountable, unlike the public ‘owner’.

On the other hand, public influence has a gender impact on corporate management that must be addressed. US examples show that also government favours ‘independent directors’ that are white males who are retired CEOs or senior management, chosen because of their general business experience and gravitas,\(^ {121}\) but not necessarily knowledge of the firm and of its productive and commercial dynamics or idea of its strategy and risks, all requiring insider information.\(^ {122}\) One of the questions is whether the government should put more emphasis on public interest and perspective in its board member nominations. On the other hand, there have been occasions where due to the government’s lack of direct control and power over executive compensation allowed, these entities


\(^{120}\) From theoretical perspective, see Yahav Lichner, ‘Should Shareholders’ Interests Be the Mainstay of Corporate Governance?’, *European Business Law Review*, 20:6 (2009), 889–908.


have paid undue amounts to their employees at the government’s expense. \(^{123}\) The situation is exaggerated in ‘social democracy’ systems with a leftist government, strict labour protection regulation and generous government consumption expenditure. \(^{124}\)

In this respect, for instance the US government’s behaviour deviates from private equity firms that are defined by the control they assert post-acquisition through which they eliminate many of the agency costs associated with public, dispersed ownership. The government may have acted like a private equity firm prior to obtaining control, but its forfeiture of post-ownership control instead appears to be more akin to a short-term institutional investor. Like an institutional investor, the government relied on extrinsic market forces and norms to ensure that it could continue to exert control over these entities after acquisition of ownership. \(^{125}\)

All in all, in modern economies the regulatory and ownership dimensions of public entity activities are somewhat fused. However, when analysing the different roles of the public market actor, as a starting point can be taken Thynne’s analysis of regulation and ownership. \(^{126}\) He separates on the one hand (1) ‘ownership as regulation’ in centrally planned and developing economies, and on the other hand (2) ‘ownership and regulation’ in at arms length contractual arrangements and regulatory/supervisory agencies. \(^{127}\) By using a game example distinguishing umpires from players, public ownership as regulation is a form of organisational solitaire of considerable public importance with player and umpire being one and the same entity. In a competitive market, players however are in competition with one another and overseen by, if not directly subject to, the same independent umpire on an equal footing. \(^{128}\)

As emphasised by Ian Thynne, share ownership in companies is a tool for the entrepreneurial ‘ownership as regulation’ state for ‘regulation through production and provision’, to internally control enterprises and their assets, while as a regulatory ‘regulation and ownership’ state its governmental powers provide it with an opportunity externally to regulate market and social forces in and beyond

\(^{123}\) Davidoff, ‘Uncomfortable Embrace’.
\(^{124}\) Belloc and Pagano, ‘Co-evolution’, p. 110.
\(^{126}\) See also W.L. Meggison, The Financial Economics of Privatization (Oxford University Press, 2005).
\(^{128}\) Thynne, ‘Ownership as an Instrument of Policy’, p. 185.
the areas of activity of relevance to the enterprises and assets.129 ‘Entrepreneurial state’ has transformed into a ‘shareholder state’.130

This separation of ownership and regulation is however as only half of the truth, being itself as artificial a concept as another separation of state roles mentioned by Thynne, namely the state as a public procurer and provider of policy formulations and policy implementation.131 The fuzzy separation between ownership and regulation can be seen not only from the point of view of the state’s ownership function approaching its regulatory function but vice versa, when state uses its regulatory and supervisory powers as ownership, participating actively to market transactions, by for instance when giving licenses or otherwise limiting competition from private, often foreign private market actors.132

Thynne’s picture is so misleading as the roles of the public entities are far more colourful than ‘ownership as regulation’ and ‘regulation and ownership’ modes. Firstly, to continue from Thynne, a third relationship between ownership and regulation can be recognised, namely regulation as ownership. The Russian “Rosatom” State Atomic Energy Corporation (Государственная корпорация по атомной энергии “Росатом”) is an example of this kind of actor.133 “Rosatom” is a state corporation. It is the regulatory body of the RF nuclear complex but at the same time a leading international vendor of nuclear industry’s entire range of products and services. Simultaneously, it runs all nuclear assets of the RF, both civil and weapons. Besides, it has the authority to fulfil on behalf of the RF the international commitments undertaken by the nation with regard to the peaceful use of atomic energy and non-proliferation. “Rosatom” acts so in a triple role of a domestic regulator/supervisor, international authority and a multinational leading vendor of nuclear energy technology. As another

example can be mentioned the PRC State-owned Assets Supervision and Administration Commission of the State Council (国务院国有资产管理委员会) (SASAC). SASAC, founded in 2003 through a consolidation of various other industry-specific ministries, is a special commission of the PRC, directly under the State Council. SASAC is responsible for managing the SOEs, including appointing top executives and approving any mergers or sales of stock or assets, provided by veto rights in the SOEs as well as drafting laws and regulations related to state-owned enterprises.\textsuperscript{134} However, the leaders of central SOEs are appointed in accordance with a sharing arrangement between the Chinese Communist Party and the SASAC. The chairs of the board, the CEOs and the party secretaries are appointed and evaluated directly by the Central Organization Department of the CCP, many being members or alternates of the CCP Central Committee.\textsuperscript{135}

Secondly, there is no ‘conceptual boundary’\textsuperscript{136} between instances in which the public entities act primarily in its capacity as procurer, as a consumer or provider of specific services or goods, on the one hand, and instances in which the same government’s primary intent in entering into a market transaction is to ‘make’, ‘move’, ‘lever’, or ‘preserve’ the target market, on the other hand. Unlike Thynne claims,\textsuperscript{137} it is impossible to make a separation between the public entity as a purchaser and as a provider of policy formulation and policy implementation. As far as the public markets actors are concerned, small is always big for them and nothing is insignificant.

Similarly, Hockett and Omarova are wrong claiming that the mere fact of public ownership of an economic enterprise does not automatically render the government a market-actor within the meaning of their argument. Public utilities are never ‘normal’ market participants, in good or bad. Public enterprises are always used, either deliberately or indeliberately and either in a constructive or deconstructive manner, as vehicles for causing an endogenous change in private markets. By using the Thynne example but upside down, a fourth pattern to use procurement as regulation can be recognized. By using public entities’ roles through ownership and regulation, ownership as regulation, regulation


\textsuperscript{135} Du, ‘China’s State Capitalism’, p. 418.

\textsuperscript{136} Hockett and Omarova, ‘Public Actors in Private Markets’, p. 119.

\textsuperscript{137} Thynne, ‘Ownership as an Instrument of Policy’, p. 185.
as ownership and procurement as regulation, four roles can be recognised for the public entity: a direct investor, a portfolio investor, a regulator/supervisor as market participant, and a procurer/contractual partner. Using these roles, the corporate regulatory ecology of public actors can be approached with a systematic comparative trans-disciplinary method comprising comparative law, comparative economics and finance and comparative behavioural law and economics. Through these four topics, comparative regulatory ecology of public actors has however a wider influence in systemic corporate research: it covers directly or indirectly major parts of the regulatory ecology of corporations broadly defined; encompassing all types of business enterprise, whatever the legal form, in which the public actors have a direct or indirect stake, for example SWFs and public private partnership special purpose vehicles. SWFs must be separated by direct state ownership in public companies. If the state becomes a controlling shareholder in a private company, it ‘changes everything’. 138

For instance, in this in many jurisdictions new regulatory environment, the public sector acts as a regulator and administrator, procurer-counterparty, and direct or, due to lack of resources, more and more indirect investor (for instance as a provider of financial assistance to private sponsors and investors), with complex legal mechanisms and arrangement as direct state and other public entity ownership, contractual arrangements as P3s and project financing deals, usually governed by a special purpose vehicle (SPV), being a centre of a complex network of contracts, both financial and non-financial. 139

Additionally, in this environment, more and more emphasis is put on the political risks connected to the public sector, especially when the robustness of rule of law, clear and transparent institutional and regulatory environment, for instance in procurements, are concerned. Investors require a regulatory regime that is able to outlive a particular government or a political majority and their political interference as well as the home-state bias. Financing and political infrastructure are interlinked: high public intervention with financial support typically triggers a higher probability of political interference

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139 OECD 2014, dividing P3s institutional P3s, where the public sector becomes the equity partner of a group of private developers, and contractual P3s where the public sector retains a planning and regulatory role with or without intervention in the project as a purchaser of the services.
in project management and of contract renegotiation, something that private investors are not comfortable with.\textsuperscript{140}

Private market actors have traditionally tried to influence regulatory policy to make it more investor friendly, and making their investments in the hope of a particular government policy.\textsuperscript{141} Active private market actors such as hedge funds or private pension funds may seek favourable regulatory treatment, as have investors who have purchased failed banks from government receivers in the past, or they may seek administrative law investigations of firms in which they hold a short position. In particular, privatisation of government services is a perpetual idea.

The relationship between private market actors and public entities as regulators and supervisors is however complicated and on the direct corporate level, even novel. Regulators and supervisors can be seen as providers of political capital, representing a close relation to the government or politicians. Political capital may bring enterprises benefits as preferential treatments to market access, government contracts, permits and licenses, lighter taxation, relaxed regulatory, or stiffer regulatory enforcements over their rivals, and other useful resources.\textsuperscript{142} By means of policies and regulations, governments determine rules of commerce and market structure through barriers to entry and changes in cost structures using regulation tools, subsidies and taxation.\textsuperscript{143}

The Russian “Rosatom “was established just in 2007 as a hybrid regulator-supervisor-vendor. A presence of a vibrant private shareholder activist force may be a compelling counter force to push towards the creation of more of these types of hybrid entities, functioning as a disciplinary mechanism and a way to harness both the private goods of the public sector and the public goods of the government.\textsuperscript{144} An example is the PRC SAFE whose responsibilities include drafting policies and regulations related to foreign reserves and foreign exchange, supervising and inspecting foreign exchange transactions, and managing the PRC's foreign exchange and gold reserves and foreign exchange transactions, and managing the PRC's foreign exchange and gold reserves and foreign

\textsuperscript{140} OECD, Private financing and government support to promote long-term investments in infrastructure, September 2014.

\textsuperscript{141} Davidoff Solomon and Zareff, ‘After the Deal’.


\textsuperscript{144} Davidoff Solomon and Zareff, ‘After the Deal’.
currency assets. In the same time, it is a SWF, taking stakes in some of the biggest PRC banks, to support Chinese stock market.\textsuperscript{145}

The situation is even more complex vis-à-vis other public market actors such as PPRFs. Public employee pension funds are vulnerable to being used as a vehicle for advancing special-interest political or social goals unrelated to the long-term interests of the firm and its other stakeholders.\textsuperscript{146}

Due to the political connections between public market actors in their various roles, the temptation to generate gratuitous windfalls to private parties, as it has happened with privatization of public infrastructure utilities, or to socialise the private risk, as it has happened in the aftermath of the financial crisis with public banks and financial institutions, and with some productive companies, too. Additionally, the public element can give activist private shareholders as hedge funds even new tools, for instance to require the state favourable regulatory treatment, or they may use administrative tools to require non-corporate law investigations on the behaviour of the public shareholder.\textsuperscript{147}

Another example is anti-competition measures. The PRC sees competition law as an avenue to shore up its defence against foreign patent litigations due patent infringement by Chinese competitors of Western patent-holders. One of the PRC’s competition authorities, the Ministry of Commerce (Mofcom) plays a triple role of trade negotiator, competition authority and industrial planner. In these multiple roles, it has demanded unprecedented concessions in return for clearing recent acquisitions: It for instance barred both vendor and seller of the Finnish Nokia assets to use patent litigations against any Chinese firm, and similar concessions were taken out against the US Motorola’s patent assets in its acquisition by also US Google.\textsuperscript{148}

The role of the public market entities is not limited to formal control. For instance, through its leverage over key actors in business groups, they can exercise their influence over other business group members without formal control rights. As new firms are added to networks of interconnected private,

\begin{thebibliography}{9}
\bibitem{146} Stephen M. Bainbridge, \textit{Corporate Governance After the Financial Crisis} (Oxford University Press, 2012).
\bibitem{148} Lee-Makiyama and Messerlin, ‘Sovereign Patent Funds’.
\end{thebibliography}
public and hybrid actors the public influence is spreading in the economy.\textsuperscript{149} Political embeddedness must also be taken into consideration: private and state actors are connected through networks of political ties, not only in emerging economies but also in developed ones as Norway.

Public procurement law, the rules regulating purchase of goods and service by public actors, is an area of great economic interest. In the PRC, public procurement market can be estimated being in 2013 more than 20 per cent of its national GDP or over trillion euros. In the EU, total public expenditure on goods, works and services amounted to over 16 per cent of the EU GDP or 1.7 trillion euros, also in 2013.\textsuperscript{150} In the PRC, public procurement is largely closed from foreign companies being in the hands of Chinese SOEs. In the EU, public procurement is the main source for corruption although public procurement in the EU is highly regulated by pro-competition, transparency, non-discrimination and anti-corruption rules.\textsuperscript{151} However, the often short-term cost-minimizing nature of public procurement collides with long-term sustainability as procurement regulation tends to create barriers to using procurement to facilitate a sustainable economy on the level of national practice, national law and for instance EU law.

For example, the new EU Procurement Directives of 2014 try to provide opportunities to foster sustainability considerations in public procurement. According to the Directives, the Member States are obligated to ensure compliance in the performance of public contracts with applicable obligations in the fields of environmental, social and labour law established by Union law, national law, collective agreements or by the international environmental, social and labour law provisions. Due to the complexity of public market actors in their various roles, the obligation is on state governments, rather than directly on the contracting public market authorities such as municipalities.\textsuperscript{152}

There is clearly a potential for public procurement to act as a front-runner and driver for sustainability. PBs and UN SDGs could serve as a guideline for public procurement regulation. States’ international

\textsuperscript{149} Grosman, Okhmatovskiy and Wright, ‘State Control’, p. 214.
\textsuperscript{150} Du, ‘China’s State Capitalism’, p. 425; \url{http://ec.europa.eu/trade/policy/accessing-markets/public-procurement/}.
\textsuperscript{152} Beate Sjåfjell, ‘Sustainable public procurement as a driver for sustainable companies? The interface between company law and public procurement law’ in Beate Sjåfjell and Anja Wiesbrock (eds), \textit{Sustainable Public Procurement: New Perspectives on the State as Stakeholder} (Cambridge University Press, 2016), pp. 182–205.
commitments and national constitutions may similarly provide legislative goals and guidelines for their policy choices.\textsuperscript{153} Additionally, public procurement is a clear example of the regulatory complexity of public market actors. Traditionally, procurement legislation has been seen regulating public expenditure with a tradition for pursuing public policy goals as well, whilst corporate law has been seen regulating the legal entities that tend to be perceived as private actors only.\textsuperscript{154} As discussed above, the latter notion is false and so is the first-mentioned, too. States should be required to adopt more stringent and mandatory sustainability-focused provisions on procurement, to prevent public market actors using procurement as an obstacle to it.

\textsuperscript{153} Sjåfjell, ‘Sustainable public procurement’.

\textsuperscript{154} Sjåfjell, ‘Sustainable public procurement’.
1.5. The most important public market actors in Europe

According to Sovereign Wealth Fund Institute, the largest European public funds are:155

- Government Pension Fund Global (GPFG) (Norway) (SWF), AUM USD 1 trillion;
- Stichting Pensioenfonds ABP (Netherlands) (PPRF), AUM 444 billion; and
- Ireland Strategic Investment Fund (ISIF) (Ireland) (SDF), AUM USD 8.5 billion.

The French SWF Fonds stratégique d'investissement (fsi) was merged to the French investment bank Banque publique d'investissement in 2013. The Italian SWF Fondo Strategico Italiano (FSI) was transformed in 2016 as CDP Equity S.p.A.

Among OECD countries, the largest SOE sectors as measured by share of nonagricultural dependent employment are found in Norway, France, Slovenia, Portugal and Estonia. Norway takes the lead at almost 10 per cent of domestic employment, which in large part reflects the corporatisation of this country's healthcare system; almost half of Norway's SOE employment is in health services SOEs. Norway is followed by France and Slovenia (about 6 per cent of national employment), then by Portugal and Estonia (about 5 per cent). If the employment comparison is broadened to include minority-owned listed entities, a different picture emerges, with the share of national employment jumping to over 10 per cent in Norway, France and Finland, reflecting minority stakes these countries have in large listed companies. In France for example, the state is a minority owner of companies in the air transport, electricity, manufacturing and telecoms sectors. In Finland, the largest minority holdings are found in the telecoms, manufacturing and financial sectors. Sweden and Hungary follow, each with an employment share in all state-invested listed entities of around 5 per cent.156

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1.6. Ongoing research

1.6.1. SWFs in Europe

To which degree are SWFs in Europe considering the PBs, in their strategies and practices? This is the theme in a working paper by Maria Jesús Muñoz-Torres, Elena Escrig Olmedo and Heidi Rapp Nilsen, presented at a workshop in May 2017 hosted by the ‘Daughters of Themis: International Network of Female Business Scholars’. The paper is currently under review and consideration for a joint publication with other contributions presented at this workshop. In the following paragraphs we give a short presentation of the background for the working paper, and results.

To avoid catastrophic environmental damages it is necessary to operate – and invest - in a safe space delineated by the PBs. The PBs and the aftermath of the financial crisis, demand that social and environmental considerations are fully integrated into the decision-making investment process. This is especially important for large institutional investors as they have the potential to promote best practices and thereby influence other fund’s investment profiles in a more sustainable direction, as well as encourage and put pressure on firms to change unsustainable practices. Therefore, the challenge of integrating sustainable and responsible investment (SRI) criteria into sovereign wealth funds, the largest accumulation of capital in history, is crucial for the financial market’s contribution to securing the functioning of Earth systems and thereby a safe operating space for humanity.

The main objective of this qualitative desk study is to analyze the profiles of four SWFs in Western Europe with the aim of illuminating their different commitments to SRI, both in policy and in practice. More specifically we discuss these funds’ contributions to staying within the PBs, and we classify them into different generations of SRI funds.

The results show that three of these four institutional investors in Europe are integrating SRI considerations into their investment strategies, and two of these SWFs can be characterized as belonging to advanced generations of SRI funds. More specifically, the results reveal that the largest SWFs in Europe, the Norwegian Government Pension Fund Global (GPFG) and Ireland Strategic

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157 Professor, Jaume I University.
158 Assistant Lecturer, Jaume I University.
159 There is a SWF in Russia, which we do not look into in the working paper described here, but which is described shortly in the last chapter of this mapping-paper.
Investment Fund (ISIF) are integrating aspects related to the planetary boundaries, in an explicit way, in their investment strategies. Specifically, of the 9 PBs, climate change is the PB most integrated into SWFs profiles, followed by biodiversity and land-system integrity. Another PB which is mentioned is water. Besides this no other PB is mentioned. This is especially alarming with regard to the biogeochemical flows of phosphorus and nitrogen – which is the PB which is mostly transgressed. These two funds coincide with those using more innovative and developed investment strategies like thematic funds or microfinance funds and therefore could be defined as belonging to the generation of advanced SWFs. Moreover, these two funds apply principles of thematic investing. This is considered as a strategy that can facilitate, in a more direct way, that SWFs take PB into account. However, it is important that the advanced strategy is applied in practice for the larger part of the portfolio. If not the result of the advanced strategy is countervailed by the part of the portfolio which is not included by such a strategy and instead maximize profit without any SRI strategy. In the case of Norwegian GPFG that invests in almost 9,000 companies, we question if this SWF can ensure a proper evaluation of their portfolio in ESG terms. An alternative is to decrease number of companies in their portfolio, by enhancing their share in a portfolio encompassing fewer firms.

With respect to the former Italian as well as the French SWF, they should make more efforts to integrate into their investment policy ESG criteria, and in particular the PB.

The study has some limitations. Firstly, the results are conditioned by the sample, with only four SWFs in Europe, with the exemption of the Russian SWFs (see above). The GPFG is a giant, the largest SWF in the world. ISIF, the second largest SWF in Europe, is much smaller, and the French and the Italian SWFs are even smaller. Due to these vast differences and due the transforms that have taken place in France and Italy, they are difficult to be compared.

Secondly, the availability of information from the SWFs, especially on the effect of the strategies, is very limited. We need more information to test the robustness of the results, possibly by means of several expert interviews. Still, with these limitations, this working paper demonstrates that institutional investors in Europe are beginning to integrate SRI considerations including PB into their investment strategies. However, further efforts are needed to take into account the PB in the definition of their missions, visions, values and strategies. So far, it is mostly climate change which is being targeted, and it is also the only factor where there is an attempt to measure the development within
the portfolio. We expect that strategies and investments by mainstream institutional investors in staying within the other PBs as biodiversity, land-system integrity, global freshwater use etc. will increase in the coming decade. This increase both necessitates, as well as can stimulate, more information and evaluation of the portfolios strategies and practices. However, this also depends on the development of regulatory frameworks\textsuperscript{160}. Summing up, this study contributes to the discussion about the implications of PB conditions for the financial sector, concretely the European SWFs.

Through their investment policy, SWFs can change the behavior of companies which damage the environment. However, many states do not seem to be aware of this great potential, or they do not want to act upon this opportunity.

Another article, published on the Social Science Research Network and accepted for publication in *Wake Forest Law Review*, is investigating the Norwegian GPFG especially. The title of the article is ‘Investing in sustainability or feeding on stranded assets? The Norwegian Government Pension Fund Global’ and the authors are Beate Sjåfjell, Heidi Rapp Nilsen and Benjamin J. Richardson\textsuperscript{161}. The following paragraphs in the rest of this subchapter are excerpt from the concluding section of this paper.

The Mandate of the Fund integrates sustainability in the framework of the management of the Fund \textsuperscript{162}. There are some positive signs that risk assessment can be a key to truly integrating responsible investment into its management. Here, Norges Bank Investment Management (NBIM) and the Council on Ethics for the Government Pension Fund Global together could ensure the GPFG’s contribution to sustainability. However, in practice we see that the GPFG is still a case in point for a misleading dichotomy between the economy and ethics. The economy is perceived as the basis for our societies. Ethics are something society wishes to consider but not at the expense of the economy. Ironically, an attempt to give priority to economic considerations actually leads to increased financial risk and serves to keep society on an unsustainable track of business as usual.

\textsuperscript{160} We do not get into detail here, and only mention two – among many - relevant regulatory frameworks; Regulation on European social entrepreneurship funds (EuSEF) and the EU Conflict Minerals Regulation.

\textsuperscript{161} Professor, University of Tasmania, Faculty of Law; member of the SMART team.

The positive tendencies are too incremental and illustrate the insufficiency of negative screening—the GPFG’s reaction to climate change and, more specifically, the Dakota Access Pipeline, are examples of this. While the GPFG itself may only be nudging incremental change within its own investment portfolio, it has the capacity to be a catalyst for wider change as already evident in the growing fossil fuels divestment movement that has benefited from the publicity given to the GPFG’s recent efforts to reduce its holdings in coal mining companies. To realize this potential and be a frontrunner, changes are necessary to the GPFG’s Mandate and management. The great challenge of our time is indeed how to achieve the social and human rights objectives of the SDGs while staying within PBs. The climate is only one of nine currently identified planetary boundaries which we need to respect in order to achieve a safe operating space for humanity. For example, reduced biodiversity and excessive use of nitrogen and phosphorous are threatening the planet’s ability to produce food, with potentially devastating ramifications. We risk societal breakdown unless sufficient capital is channeled to environmentally, socially, and economically sustainable projects within the PBs. In a scenario of societal breakdown, it will not be possible to achieve a stable return on any investment. The unsustainability of global market capitalism is a systemic issue rooted in mainstream paradigms of economic and demographic growth, private property, and open borders. Clearly a fundamental shift is required in the way that international commerce and trade, and indeed business and finance in general, are conducted so that they meet sustainability criteria, economically, socially, and environmentally. The GPFG is one of the few actors with the financial position and global profile to leverage some positive change. This requires political courage and will. With the adoption of the SDGs (and the 2015 Paris Agreement), there seems to be a new impetus in the debate. President

Trump’s declaration that the United States will withdraw from the Paris Agreement emphasizes the significance of sustainability-oriented business and finance leading the way.\textsuperscript{167}

The Norges Bank’s own proposal that its Mandate should be changed to allow the GPFG to invest in renewable infrastructures is a positive sign. However, in spite of the encouraging report on potentially high returns, the strong arguments for such investment to mitigate the enormous investment gap for the shift from fossils to renewables, and the aim of achieving the SDGs, the Norwegian Ministry of Finance advised against such a change.\textsuperscript{168} The Norwegian Minister of Finance’s argument, that the Fund is meant to secure the economic basis for future generations and “should not be used as a tool for foreign or climate policy,”\textsuperscript{169} illustrates the depth of the lack of understanding of economics and of sustainability in the Norwegian government. Members of the Norwegian Parliament in favour of this change, unfortunately, turned out to be in the minority.\textsuperscript{170}

Even if the Mandate is changed to allow for five percent investment in renewable infrastructure, the question remains whether we will continue to be on a path of incremental improvements or whether this will herald the beginning of the necessary fundamental shift. A starting point for the necessary fundamental shift is to stop discussing sustainability as a question of ethics over economics and recognizing that long-term global economic development—like everything else—is dependent on stable living conditions on Earth.

If there were the political will to make the necessary changes to ensure the Fund’s contribution to sustainability, and thereby the GPFG’s potential for continued good returns in the long run, a broader set of reforms would need to be put into place. Sustainable investment requires positive screening or impact investing, which would require a change of the Mandate and the removal or nuancing of the dictate to stay broadly invested in the investment universe. The approach of the GPFG would need to be changed from responsible investment within the goal of highest possible returns to good returns.


\textsuperscript{169} Id.

\textsuperscript{170} Id.
within truly responsible investment—within sustainability. That a new approach is needed to achieve high returns in the long run is illustrated by the IEEFA report on renewables infrastructure\textsuperscript{171}.

If the Mandate and the management of the Fund get it right, positioning its search for good returns within planetary boundaries and supporting social and economic foundation of sustainability, it gives rise to the question of whether we even need a Council on Ethics.

There is a scope for guidelines on ethical issues that fall outside of good returns within a goal of sustainability. A Council on Ethics could have a role in leading discussions about value-based issues that are facing both Norway and other nations or that may face humans, nature, or space in the future. Such issues may include gene technology, animal welfare, including for farmed fish, and pollution in space. The issues should be chosen not because we estimate that they threaten sustainability (to the extent that they do, they would in a revised system belong within the Fund’s ordinary management), but because they can define and create understanding about who we are, who and how we want to be, in which direction our society is moving, and alternative pathways. This is not consistent with a basis of overlapping consensus (see section 2 below) on norms. Such discussions must dare to delve deeply into different ethical theories and ontologies and formulate recommendations for both investments and divestments based on discussions of ethics. Getting rid of the basis of overlapping consensus should not be that controversial as it has never been properly followed up anyway.

Alternatively, if the basis of overlapping consensus is kept, the Council should be known as the Council on Norwegian Norms to make it clear that the overall standard is how the ultimate beneficiaries of the GPFG themselves believe they should act and live. The Council’s Ethical Guidelines could then deal with issues on which the Norwegian people might reach consensus, depending on the moral standards of each generation. The overlapping-consensus approach would then be more legitimate. Making our values and especially our priorities between these values more visible and explicit would make it more apparent that we each can contribute toward a more sustainable future. Today, we are instead hiding behind an imaginary sustainable ethical standard.

A significant barrier to responsible investment decisions is the lack of relevant and reliable information from the companies themselves. Corporate law reforms and changes to the current reporting frameworks are arguably necessary as it is extremely difficult for businesses to shift to more adequate reporting by themselves within the current system. However, requirements from an investor of the Fund’s size may also be an important driver for change. For this to work, NBIM must show a willingness to use already available information to substantiate the effect of engagement and not only disclose the number of shareholder meetings at which it votes and number the meetings held with companies\textsuperscript{172}. Also, NBIM should follow the Council on Ethic’s lead and make public its risk-based divestments. Doing that with a justification based on risk because of environmental, social, and governance issues could contribute to the Fund’s position as a responsible investor. With its financial muscles, the Fund has the potential to shift the direction of global investments—highly significant in itself—and to be a potential facilitator for the other reforms. Although the Fund is limited to owning a maximum of ten percent of the shares in any company\textsuperscript{173}, it is in the highly dispersed shareholding structures of many companies a relatively large investor\textsuperscript{174}. And it is certainly an influential one, with its reputation as the gold standard of responsible investment. It is time to put this to good use before the gold standard fades completely.


2. Selection of issues and methods

2.1. Regulatory frameworks

2.1.1. International

State-driven market actors, SOEs, SWFs, NWFs, SDFs and PPRFs have increased their global economic activities during the last ten years. There has however been little successful effort to manage their behaviour in the international sphere. There is however some attempts for multilateral “soft law” instruments to manage public market actions with respect to human rights, sustainability, and a fidelity to the numerous international instruments that have sought to develop global consensus norms about economic behaviour.

2.1.1.1. UN Guiding Principles

The United Nations’ ‘Guiding Principles on Business and Human Rights: Implementing the United Nations ‘Protect, Respect and Remedy’ Framework’ (UNGP) were developed by the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises. The Special Representative annexed the Guiding Principles to his final report to the Human Rights Council (A/HRC/17/31), which also includes an introduction to the Guiding Principles and an overview of the process that led to their development. The Human Rights Council endorsed the Guiding Principles in its resolution 17/4 of 16 June 2011.

The UNGP are structured along three ‘pillars’: a first Pillar is the state duty to protect human rights, a second Pillar is the responsibility of corporations to respect human rights, and a third Pillar touches on the remedial mechanism that must be established to implement the state duty and corporate responsibility. SOEs occupy a dual place within the UNGP. They are to some extant an instrumentality

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175 For this mapping, based on own plans for own research in the SMART project as well as any event(s) with call for papers to complement own research.
of the state and thus potentially subject to the state duty to protect. At the same time they function as commercial ventures and are thus subject to the less legalized provisions of the corporate responsibility to respect. Yet their owners have a duty in exercising their ownership responsibilities that may also be constrained by the state duty to protect human rights.\textsuperscript{179}

2.1.1.2.  
\textit{OECD Guidelines for Multinational Enterprises}

In the context of SOEs, UNGP has proven most relevant.\textsuperscript{180} The provisions of the UNGP have been substantially incorporated into the OECD framework through its ‘Guidelines for Multinational Enterprises’.\textsuperscript{181} These are also non-binding soft law but they incorporate a remedial mechanism in the form of ‘special instances” (complaints) that may be lodged by individuals and others against enterprises alleging violation of the Guidelines before a ‘National Contact Point’, an administrative office maintained by states to comply with their OECD member state obligations.\textsuperscript{182}

Since its endorsement in 2011, formal international engagement with the UNGP have been undertaken through a United Nations Human Rights Office of the High Commissioner’s Working Group on Business and Human Rights and Transnational Corporations and Other Business Enterprises that was established by the UN Human Rights Council at the time of that enforcement in 2011 (resolution 17/4). The Working Group is composed of five independent experts, of balanced geographical representation. The Council renewed the Working Group’s mandate in 2014 (resolution 26/22) and 2017 (resolution 35/7).\textsuperscript{183}

The Working Group and the OECD have recently been considering application of multilateral soft law frameworks to hybrid entities—SWFs and SOEs. The object is to extend the scope of the UNGP and the Guidelines for Multinational Enterprises, but also to make the application of those instruments more coherent. At the same time, they have been following a policy of encouraging states to ‘lead by example’, supported in this endeavor by supporting Nordic States especially in the context of their efforts touching on SOEs and human rights.\textsuperscript{184}

\textsuperscript{179} Backer, ‘The Human Rights Obligations’, p. [9].
\textsuperscript{180} Backer, ‘The Human Rights Obligations’, p. [9].
\textsuperscript{181}  \url{http://www.oecd.org/corporate/mne/}.
\textsuperscript{182} Backer, ‘The Human Rights Obligations’, p. [9].
\textsuperscript{183}  \url{http://www.ohchr.org/EN/Issues/Business/Pages/WGHRandtransnationalcorporationsandotherbusiness.aspx}.
\textsuperscript{184} Backer, ‘The Human Rights Obligations’, p. [10].
During the summer of 2016, the Working Group delivered its Report to the Human Rights Council: Report of the Working Group on the issue of human rights and transnational corporations and other business enterprises (the 2016 Working Group Report). The focus of the 2016 Working Group Report was to examine “the duty of States to protect against human rights abuses involving those business enterprises that they own or control, which are generally referred to as State-owned enterprises. . . . The report calls attention to and clarifies what States are expected to do in their role as owners of enterprises and why. . . . In the present report, the Working Group suggests a range of measures that States could take to operationalize the call to take additional steps with regard to State-owned enterprises, by building on existing international guidance and national practices related to the corporate governance of those enterprises.”

2.1.1.3. OECD Guidelines on Corporate Governance of State-Owned Enterprises

The goal of the OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOE Guidelines) is to give concrete advice to countries on how to manage more effectively their responsibilities as company owners, thus helping to make state-owned enterprises more competitive, efficient and transparent. First developed in 2005, the SOE Guidelines were updated in 2015 to take into account developments since their adoption and to reflect the experiences of the growing number of countries that have taken steps to implement them. The updated SOE Guidelines were adopted by the OECD in July 2015 as part of a Recommendation of the Council.

The primary goal of SOE Guidelines is to ensure that SOEs operate like their private counterparts, that is, to mitigate the public character of these enterprises.

2.1.1.4. G20/OECD Principles of Corporate Governance

The updated Principles of Corporate Governance were launched at the meeting of G20 Finance Ministers and Central Bank Governors in Ankara on 4-5 September 2015. They were subsequently

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endorsed at the G20 Leaders Summit in Antalya on 15-16 November 2015. Originally developed by the OECD in 1999, then updated in 2004, the 2015 revision of the Principles of Corporate Governance is assumed to provide “an indispensable and globally recognised benchmark for assessing and improving corporate governance”. The Principles have been adopted as one of the Financial Stability Board’s key standards for sound financial systems, and have been used by the World Bank Group in more than 60 country reviews worldwide. They also serve as the basis for the guidelines on corporate governance of banks issued by the Basel Committee on Banking Supervision.

2.1.1.5. Santiago Principles

The Santiago Principles of the International Forum of Sovereign Wealth Funds (IFSWF) consists of 24 generally accepted principles and practices voluntarily endorsed by IFSWF members. It is noteworthy however that the Norwegian GPFG is not an IFSWF member, unlike the Irish ISIF.

The Santiago Principles’ goal is to promote transparency, good governance, accountability and prudent investment practices whilst encouraging a more open dialogue and deeper understanding of SWF activities. Drafted by the International Working Group of SWFs and welcomed by the IMF’s International Monetary Financial Committee in 2008, the objectives of the Santiago Principles are:

- To help maintain a stable global financial system and free flow of capital and investment;
- To comply with all applicable regulatory and disclosure requirements in the countries in which SWFs invest;
- To ensure that SWFs invest on the basis of economic and financial risk and return-related considerations; and
- To ensure that SWFs have in place a transparent and sound governance structure that provides adequate operational controls, risk management, and accountability.

The Santiago Principles demonstrate that SWFs invest as economically and financially oriented entities in both their domestic markets and globally. By doing so, SWFs contribute to the stability of the global financial system, reduce protectionist pressures and help maintain an open and stable investment climate. The knowledge sharing activities of the IFSWF also serve as a tool for continuous improvement and innovation for all IFSWF members.

2.1.1.6. **Principles of Responsible Investment**

The ‘Principles for Responsible Investment (PRI) is a global investor association that advances responsible investment with over 1,800 signatories representing over $70 trillion AUM.\(^\text{190}\) The PRI was founded in 2005 with the backing of the United Nations, with the objective of promoting the six principles for responsible investment and helping institutional investors who sign to implement them. Devised by the investment community itself, the principles form a framework for incorporating ESG issues into investment decision making. They are based on the conviction that ESG factors have an impact on the performance of investments.\(^\text{191}\) The six principles are flexible:

“Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.”

2.1.2. **National**

Scandinavian and Finnish economies are typical examples of ‘mixed ownership’ model\(^\text{192}\) in which public entities as states and municipalities have important role as shareholders in both closed and listed companies. This is reflected in their regulatory systems.

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\(^{190}\) [https://www.unpri.org/about](https://www.unpri.org/about).

\(^{191}\) Arleta A. A. Majoch, Andreas G. F. Hoepner and Tessa Hebb, ‘Sources of Stakeholder Salience in the Responsible Investment Movement: Why Do Investors Sign the Principles for Responsible Investment?’, *Journal of Business Ethics*, 140 (2017), 723–741, p. 724. Institutional investors are defined as organisations that manage and invest on behalf of clients and beneficiaries. This includes pension funds, banks, asset managers, and insurers among other types of organisations.

2.1.2.1. **Sweden**

The Swedish state is a significant company owner in Sweden. The state’s company portfolio contains 48 wholly or partially owned companies, of which two are publicly traded (Scandinavian Airlines System Aktiebolag and Telia Company AB. In addition, two business foundations are administered. In total, the state-owned enterprises employ approximately 137,000 people. The estimated total value of the state company portfolio amounts to SEK 510 billion.\(^{193}\) The State sees as its major responsibility to be an active and professional owner. The Government's overall objectives are for the companies to generate value and, where applicable, to ensure that specially commissioned public policy assignments are well performed.\(^{194}\)

The Swedish state sees state-owned companies as role models in terms of having a high proportion of female board members and now also in terms of the number of female chairs. The boards, including chairs, of wholly state-owned companies are made up of close to 50 per cent women. According to SIS Ownership Service (SIS Ägarservice), the proportion of women on the boards of publicly listed companies is 26 per cent. The Government’s objective is that all boards of state-owned companies should have a gender quota of at least 40 per cent. Not less than 41 per cent of the chairs of wholly state-owned companies are women, compared with 43 per cent the previous year and 23 per cent in 2006. According to SIS Ownership Service, only five per cent of the chairs of publicly listed companies are women.\(^{195}\)

When state-owned companies have the same economic demands on their operations as other organisations, competitiveness, value development and capital efficiency are increased. At the same time, this reduces the risk of distorted competition. Economic goals are set in consultation between owners and companies and adopted by the Annual General Meeting. The aim of setting economic goals for the companies is to:

- ensure that value is generated,

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- achieve capital efficiency,
- maintain a reasonable level of financial risk,
- guarantee the owner a sustainable and predictable return, and
- make it possible to evaluate the company's profitability, efficiency and level of risk. 196

The state sees it natural that the State and state-owned companies are at the forefront of ‘sustainable enterprise’ by acting in an exemplary way in the area. Sustainable enterprise involves more than simply complying with rules and regulations. Employers with a clear set of core values will attract and retain the best employees. Corporate culture and leadership must manage sustainability issues as naturally as any other business decision, as sustainability challenges also affect global attitudes towards the company’s business, which in turn affects its long-term profitability. In all likelihood, companies developing products and services that help customers reduce energy consumption and carbon dioxide emissions will make money in the future too. Sustainable enterprise involves running the organisation in a way that satisfies today’s needs without endangering the chances of future generations to satisfy their own needs. 197

The Swedish state, in its capacity as Sweden’s largest company owner, integrates sustainable enterprise into its corporate governance in order to ensure sound long-term growth in the value of its holdings. In 2012, each company board was made responsible for defining and adopting relevant sustainability goals and overall strategies for achieving these. Each individual company has its own specific business opportunities and risks linked to sustainability. 198 The sustainability goals, which are adopted by the company boards, are to be a small number of strategic and measurable goals and are evaluated by the owner beginning in 2014. 199 State-owned companies have been instructed to report on their sustainability performance in accordance with the guidelines of the Global Reporting Initiative (GRI). 200

Several state-owned companies have a specially commissioned public policy assignment from the Riksdag. Evaluation of how well the public policy assignment is performed is facilitated by an explicit formulation of goals. The ambition of the Government Offices is to improve the monitoring of how well the public policy assignments are performed within the scope of corporate administration. In relevant cases, this will take place through one or more assignment goals being adopted by the Annual General Meeting. A specially commissioned public policy assignment exists when a company has an assignment from the Riksdag to undertake activities that aim to generate effects other than a financial return for the owner. The State's goal is for the assignment to be performed well and as efficiently as possible, which is why it is meaningful for companies with specially commissioned public policy assignments to combine assignment goals with economic goals.  

In 2013, the Government Offices developed a procedure for setting assignment objectives, which is now being done in relevant cases in connection with a review of economic targets. The purpose of setting assignment objectives is to:

- ensure that the specially commissioned public policy assignments are performed well,
- increase transparency of the cost of performing the specially commissioned public policy assignment,
- enable follow-up and reporting to the Riksdag and other stakeholders, and
- clarify the prerequisites for achieving the economic targets.

2.1.2.2. Norway

In Norway, state-owned enterprises are important in the energy and oil sector, both wholly-state owned (Statkraft AS) and listed (Equinor ASA). Additionally, oil-revenue based Norwegian sovereign wealth fund, Government Pension Fund Global (GPFG) is an important global investor both in equities, bonds and property with its $1 trillion assets under management.

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The level of state ownership in Norway is higher than in any other OECD country and comparable to that of large emerging economies.\textsuperscript{203} Significant state-ownership of enterprises derives from the post-World War II period, when the weakness of local capital markets prevented private firms from financing industrial development. Following the discovery of vast oilfields off its shore, Norway established state-owned enterprise Den Norske Stats Oljeselskap A/S (nowadays government-controlled Oslo Børs listed Equinor ASA) in 1972 as part of its institutional infrastructure to retain control over natural resources while shielding its economy from Dutch disease. Government ownership in the banking industry increased dramatically in response to a financial crisis in the late 1980s. In the last decade, state shareholdings have represented roughly between 35-40\% of Oslo Børs market capitalization, up from approximately 15\% in the 1990s.\textsuperscript{204} According to Milhaupt and Pargendler increase is largely due to IPOs of major SOEs — including Statoil (now Equinor) and telecom company Telenor ASA—during the early 2000s.\textsuperscript{205} In Telenor, the Norwegian state owns 54.3 per cent of the shares and Folketrygdfondet which administers the Government Pension Fund Norway 5.0 per cent.\textsuperscript{206} Previously wholly-stateowned Telenor was partially privatised with an IPO in December 2000 when the company was listed in Oslo Børs and NASDAQ. The privatisation gave the company NOK 15.6 billion in new capital, with the Government of Norway owning then 77.7 per cent of the shares.

The Norwegian state is still the largest shareholder in Statoil with 67 per cent ownership of shares and voting rights. The ownership interest is managed by the Norwegian Ministry of Petroleum and Energy. Statoil was partially privatised and listed on the stock exchange on 18 June 2001, when it became a public limited company. After the initial offering, the government retained 81.7\% of the Statoil shares. Through public share offerings in 2004 and 2005 the state reduced its shareholding in Statoil to 70.9\%. Pursuant to the agreed exchange ratio as part of the merger with Norsk Hydro ASA's (in which the Norwegian state owns 43.8 per cent nowadays, a further 6.5 per cent of shares owned

\textsuperscript{206} https://www.telenor.com/investors/share-information/major-shareholdings/.
by Folketrygdfondet) oil and gas activities, the State's ownership interest in Statoil was 62.5 per cent on 1 October 2007. In accordance with the Storting's decision of 2001 concerning a minimum state shareholding of two-thirds in Statoil, the Government expressed its intention to increase the state's shareholding in Statoil over time to 67 per cent. During 2008, the Government built up the State's ownership interest in Statoil by buying shares in the market. On 5 March 2009 the Government announced that the State's ownership interest had reached the present 67 per cent.207

The ‘Norwegian model’ for the oil sector— premised on the separation of policy, regulatory, and commercial functions—has become a blueprint for resource-rich countries.208 Under Constitution, state-owned enterprises fall under the administration of government ministries, but the Storting has express authority to instruct the government with respect to SOEs. This framework requires the prior consent of the Storting for changes in the state’s shareholdings (acquisitions and divestitures), as well as for capital increases entailing disbursements by the state. However, SOEs are generally able to buy and sell shares in other companies without a Storting approval when this is part of their regular business activities. The Office of the Auditor General of Norway oversees the administration of SOEs by the relevant ministry and provides annual reports to the Storting.209

The pursuit of formal differentiation between the state’s role as shareholder and regulator is a hallmark of the Norwegian model.210 Norway has followed the trend toward centralization of shareholdings by allocating interests in most commercial SOEs to the “ownership department” of the Ministry of Trade, Industry and Fisheries, especially since 2001.211 For instance, the ownership department exercises the shareholding function of Telenor, while the Ministry of Transportation and Communication serves as the company’s regulator. Nevertheless, important exceptions to


210 Milhaupt and Pargendler, p. 19.

211 OECD, Regulatory Reform in Norway. Overall centralization of SOE shareholdings (including non-commercial SOEs) has been less extensive, however, with 65 per cent of SOEs remaining under the supervision of sectoral ministries as of 2005; see Stine Ludvigsen, State Ownership and Corporate Governance: Empirical Evidence from Norway and Sweden (2010) (A dissertation submitted to BI Norwegian School of Management for the degree of PhD, http://web.bi.no/forskning%5Cpapers.nsf/wSeriesDissertation/4F488755C624C943C125771F0030605F; referred to in Milhaupt and Pargendler, p. 20.
centralization persist, as in Equinor, whose shareholdings are administered by the Ministry of Petroleum and Energy.\textsuperscript{212} Still, even here there is a formal separation of functions: Equinor, like private oil firms, is subject to regulatory oversight by the Norwegian Petroleum Directorate, a technical advisory agency.\textsuperscript{213}

In the mid-2000s, Norway carefully considered but ultimately rejected the possibility of instituting a holding company model. A 2004 report by the preparatory committee in charge of reviewing the organization and administration of state ownership offered only timid support for the institution of a holding company to manage state shareholdings with purely value-maximization objectives and pointed to the need for further assessments. The same committee counselled against the use of a holding company structure for SOEs serving the goal of keeping head office functions in Norway, in view of the perceived need for continued political governance and supervision. The government eventually discarded the need for a holding company, which it regarded as leading to unnecessary duplication of functions and confusion in terms of responsibility. It argued that ‘ownership matters are of such a character that they need to be handled through a political body,’ and that ‘[t]he current ministerial affiliations ensure transparency concerning ownership and ensure considerations of democratic control.’\textsuperscript{214}

Norway’s listed SOEs are subject to the same corporate and securities laws governing private firms, including the Public Limited Liability Companies Act and the Oslo Børs regulations. Norway’s, as all Nordic countries (see below) corporate law provides for a strong principle of equal treatment.\textsuperscript{215} Majority shareholders have significant decision-making powers under Norwegian law, but may not act in abuse of power to the detriment of the company and other shareholders.\textsuperscript{216}

\textsuperscript{212} 2013-2014 White Paper, p. 29.
\textsuperscript{213} Thurber et al., p. 2.
There is special concern that the state as a shareholder does not receive preferential access to information not available to private shareholders.\textsuperscript{217} Oslo Børs has also contributed to enforcement of the equal treatment norm by issuing letters questioning whether statements by Statoil management reflected private information not available to public investors or resulted from non-financial considerations.\textsuperscript{218} Oslo Børs and the Norwegian Annual Accounts Act also require all listed companies to report on their adoption of the Norwegian corporate governance code (Code of Practice for Corporate Governance) on a “comply or explain” basis.\textsuperscript{219}

The state’s involvement as a shareholder must take place through the shareholder meeting, in accordance with the Norwegian Public Limited Liability Companies Act, though the Ministry of Oil and Energy has admitted to exercising influence through informal meetings as well.\textsuperscript{220} At the shareholder meeting, shareholders of large companies elect two-thirds of the members of the corporate assembly, with workers electing the remaining one-third. The corporate assembly elects two-thirds of shareholder representatives and one-third of worker representatives to the board. Companies may, however, opt out of the requirement of a corporate assembly by obtaining workers’ consent, in which case shareholders and workers directly elect approximately two-thirds and one-third of board members, respectively. While some listed SOEs such as Equinor and Telenor have a corporate assembly, there are others which have opted out of this requirement.\textsuperscript{221}

The board of directors appoints the CEO, who according to the Code may not be a board member, and sets her salary. There are no state representatives on the board of listed SOEs, but ministry representatives engage, directly or indirectly, with the nomination committee. Although listed companies are not technically required to have a nomination committee, all listed SOEs in Norway


\textsuperscript{218} OECD, Regulatory Reform in Norway, p. 23.

\textsuperscript{219} Milhaupt and Pargendler, p. 21.

\textsuperscript{220} Sjåfjell, p. 6.

\textsuperscript{221} Milhaupt and Pargendler, p. 21.
have adopted a nomination committee, as recommended by the Code.\textsuperscript{222}

The nomination committee, which is composed of shareholders or shareholder representatives, submits recommendations to the shareholder meeting and the corporate assembly (if there is one) for the appointment of the respective shareholder-elected members and the setting of their compensation. In practice, there seems to be moderation in the state’s involvement: even though the state holds 67\% of the capital in Equinor, it has recently appointed only one member (from the Ministry of Petroleum and Energy) out of four members of the nomination committee.\textsuperscript{223}

A distinctive trait of the Norwegian system compared to other countries is that currently serving politicians and public servants from the central government may not serve on SOE boards. This prohibition traces back to a 1962 fatal accident involving a state-owned mining company, which had the Minister of Industry serving on its board.\textsuperscript{224} The incident, which came to be known as the “King’s Bay affair,” resulted in allegations of negligence, and ultimately brought down the ruling labour government. The original rationale for the ban was not primarily to prevent political interference in management, but rather to mitigate conflicts of interest in the government’s oversight of SOEs and to discourage Parliament from holding the government accountable for the business decisions of state-owned companies.\textsuperscript{225} The existing restriction on board membership, however, does not encompass former politicians, whose participation in SOE boards remains relatively common.\textsuperscript{226}

Norway has continuously strived to strengthen the corporate governance of SOEs, which is touted as “of vital importance for the market’s confidence in the companies and hence also for the companies’ capital costs.”\textsuperscript{227} Moreover, the state has repeatedly acknowledged that, given its large participation in listed companies, “[t]he manner in which the State acts as an owner therefore has great influence on public and investor confidence in the Norwegian capital market.”\textsuperscript{228} The state has chosen

\textsuperscript{222} Milhaupt and Pargendler, p. 21.
\textsuperscript{223} 2014 Board Statement, pp. 4-6; Milhaupt and Pargendler, p. 21.
\textsuperscript{224} Thurber & Istad, supra note 101; Milhaupt and Pargendler, p. 21—22.
\textsuperscript{225} OECD, Regulatory Reform in Norway, p. 14; Ludvigsen, p. 39; Milhaupt and Pargedler, p.22.
\textsuperscript{227} 2006-2007 White Paper, p. 22.
\textsuperscript{228} 2006-2007 White Paper, p. 22.
to follow the principle of proportionality between capital invested and voting rights in SOEs, avoiding
the introduction of special rights to the state as shareholder. In the International Monetary Fund's
assessment of SOEs in Norway, “[m]ost large enterprises operate on a commercial basis and are
profitable.”

In 2002, the Norwegian government formulated ten principles of corporate governance for SOEs,
with the goal of increasing predictability in the exercise of ownership by the state. These principles
were subject to modest amendments in 2014 to further underscore the role of the board of directors
in SOE governance and administration and the commitment to corporate social responsibility. As
emphasized by the Norwegian government, its principles essentially correspond to the OECD
Guidelines on the Corporate Governance of State-Owned Enterprises. The Norwegian state's
principles of corporate governance (2014) are as follows: “1. All shareholders shall be treated equally;
2. There shall be transparency in the State’s ownership of companies; 3. Ownership decisions and
resolutions shall be made at the general meeting; 4. The board is responsible for elaborating explicit
objectives and strategies for the company within the constraints of its articles of association; the state
sets performance targets for each company; 5. The capital structure of the company shall be
appropriate given the objective and situation of the company; 6. The composition of the board shall
be characterized by competence, capacity and diversity and shall reflect the distinctive characteristics
of each company; 7. The board assumes executive responsibility for administration of the company,
including performing an independent supervisory function vis-à-vis the company’s management on
behalf of the owners; 8. The board should adopt a plan for its own work, and work actively to develop
its own competencies and evaluate its own activities; 9. Compensation and incentive schemes shall
promote value creation within the companies and be generally regarded as reasonable; 10. The
company shall work systematically to safeguard its corporate social responsibility.”

Since 2006, the government has also issued guidelines on the remuneration of senior executives of
SOEs, partly out of concern over a widening gap between the remuneration of senior employees and

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230 Dowling et al., p. 35.
231 Milhaupt and Pargedler, p. 22.
233 See Milhaupt and Pargedler, p. 22.
that of the rest of the workforce. According to the 2015 version of the guidelines, which are applied on a “comply or explain” basis, executive salaries should be competitive (but not wage leading), the main element of compensation should be the fixed salary, and the use of stock options and similar arrangements is prohibited. Norway’s Code of Practice for Corporate Governance encourages stock ownership by board members, and the state takes a positive view of this strategy.

Also starting in 2006, Norway implemented prior recommendations by the preparatory committee on state ownership to clarify the fundamental objectives served by state ownership in each case, with the objective of reducing uncertainty in capital markets and thus lowering financing costs. The committee proposed the classification of SOEs into four categories: (1) companies with commercial value maximization objectives; (2) companies with commercial value maximization objectives, and ensuring head-office functions in Norway; (3) companies with commercial value maximization objectives and other specific defined objectives; and (4) companies with sectoral policies objectives. From the eight listed SOEs in Norway, six fall within category 2 (including Equinor, Telenor, and financial firm DNB), and two fall within category 1. Categories 3 and 4 are composed exclusively of non-listed SOEs. The 2010-2011 Report to the Storting highlighted the contribution of extensive state ownership to the success of the Norwegian economy, and the plan to strengthen the state’s ownership administration. More recently, however, the current Conservative administration has vowed to reduce the level of state ownership in the economy, despite the fact that “[i]n the government’s assessment, the governance of direct state ownership is handled in a professional and responsible way.”

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235 Guidelines for remuneration of senior executives in companies with state ownership (Adopted by the Ministry of Trade, Industry and Fisheries with effect from 13 February 2005, replacing the previous guidelines of 31 March 2001), https://www.regjeringen.no/contentassets/4391143c1f0a472faa0b3975e00e3c78/guidelines-forremuneration.pdf; Milhaupt and Pargendler, p. 23.
The objective is to partially or fully divest companies in category 1, while maintaining at least 34% of stockholdings (enabling “negative control” through veto rights) in companies within category 2.241

The government argues that three particular challenges associated with state ownership persist: (i) conflicts between ownership of companies and the state’s other roles; (ii) the risk of a concentration of powers which weakens the private sector; and (iii) limitations in industry expertise. Specifically, the government has suggested that, notwithstanding effective governance arrangements, “[a]s long as the state has ownership interests, it is however effectively impossible for the state to be organised and to act in such a way as to prevent or discourage doubt being raised about its neutrality in exercising authority.”242 This initiative has already resulted in the IPO of Entra, a state-owned commercial real estate company, in 2013.243

2.1.2.3. Finland

The Finnish state ownership policy and ownership steering are governed by the Ownership Steering Act (1368/2007). The Act applies to decision making involving state shareholdings and shareholder control in both state majority-owned companies and associated companies. It defines the powers of the Government and Parliament when decisions are made to acquire or relinquish control in a state-owned company. The Act also specifies the division of powers between the Government plenary session and the ministry responsible for ownership steering. In addition, it includes provisions related to the sale of shares and corporate restructuring.

Parliament decides the companies in which the State may relinquish its sole ownership (100% of votes) or its control of ownership (50.1% of votes). Similarly, Parliament decides on the acquisition of control by the State if the company involved is of major importance. While the decisions on state ownership, i.e., the acquisition and sale of shares, are made by the Government, the ministry responsible for ownership steering makes decisions on most issues concerning ownership steering and the exercise of shareholder control.

Aside from the State Shareholdings and Ownership Steering Act, some state-owned companies are subject to special legislation governing the field of activity involved, such as the Act on Credits and Guarantees Provided by the State-Owned Specialist Financing Company and the laws concerning alcoholic beverages.

The activities of all limited companies are governed by the Limited Liability Companies Act. Additionally, listed companies are required to comply with the Securities Markets Act and the guidelines issued by the Financial Supervisory Authority and the Helsinki Stock Exchange.

Good corporate governance refers to good overall decision making and control that works smoothly. State ownership steering complies with the OECD Principles of Corporate Governance.244

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3. Analysis of barriers and possibilities

3.1. Introduction

In this chapter we synthesise the information from the above chapters on barriers associated with the different investment strategies, followed by an overall analysis and summing up of possibilities. As an examples of public market actors we use the largest SWFs in Europe, the Norwegian GPFG and the Irish ISIF, and the some largest listed state-controlled listed companies in Europe, the Norwegian Equinor ASA (67 per cent Norwegian state holding), DNB ASA (34), Telenor ASA (53.97)), Yara International ASA (36.21) and Norsk Hydro ASA (34.26).

As far as SWFs are concerned, recent research has classified different types of sustainable investment strategies into different generations. Broadly speaking, the first generation use *negative screening*, the second generation use *positive screening*, and the last generation has evolved to *impact investing*. This evolution shows the complexity which sustainability issues have reached in the last years and how it has affected the financial product design. However, it is important that the advanced strategy is applied in practice for the larger part of the portfolio. If not the result of the advanced strategy is countervailed by the part of the portfolio which is not included by such a strategy and instead maximize profit without any SRI strategy.

We start by specifying two broad types of motivation – or rationales - for investors to invest in firms which contribute to a sustainable development, or to disinvest from firms which do not contribute to a sustainable world. The first is what we call *ethical based motivation*, and the other is *risk based motivation*.

In table 1 we show how these different motivations are not mutually exclusive. It is for instance possible to argue to disinvest from tobacco and coal both based on risk and based on ethics. In this figure we use examples from the previous chapters, primarily the GPFG and ISIF, to illustrate who argue how.

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Regarding the GPFG, they can invest or disinvest based on advice from two different actors, *Norges Bank Investment Management* (NBIM) and the *Council on Ethics* of the GPFG\(^\text{246}\).

**Table 1. Motivation for screening of portfolio based on products and based on conduct.**

<table>
<thead>
<tr>
<th>Risk based motivation</th>
<th>Ethical motivation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negative screening.</td>
<td>Positive screening.</td>
</tr>
<tr>
<td>Examples theme</td>
<td>Examples theme</td>
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<tr>
<td></td>
<td>(GPFG/Council on</td>
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<tr>
<td></td>
<td>Ethics)</td>
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<tr>
<td><strong>Product</strong></td>
<td></td>
</tr>
<tr>
<td>a) Oil sand and coal</td>
<td>Renewable energy</td>
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<tr>
<td>(GPFG/NBIM)</td>
<td>(ISIF)</td>
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<tr>
<td>Fossil fuels (ISIF)</td>
<td>Real estate</td>
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<tr>
<td>Tobacco (ISIF)</td>
<td>(GPFG/NBIM)</td>
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<tr>
<td></td>
<td>c) Coal Tobacco</td>
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<tr>
<td></td>
<td>Renewable energy</td>
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<td></td>
<td>(Impact investing)</td>
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<td></td>
<td>E.g. standards</td>
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<td></td>
<td>like Fairtrade</td>
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<tr>
<td><strong>Conduct</strong></td>
<td>d) Environmental</td>
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<td></td>
<td>damage (so far not</td>
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<tr>
<td></td>
<td>climate)</td>
</tr>
<tr>
<td></td>
<td>Human rights</td>
</tr>
</tbody>
</table>

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3.2. Barriers

3.2.1. Barriers associated with negative screening

Exclusion of holdings from investment universe also referred to as divestments are negative screening strategies and is the most basic type of SRI policy that an organization or a fund can adopt. In line with table 1 there are two main types of motivation for negative screening, as well as the two categories of product and conduct. We discuss these 4 cells a)-d) in the following paragraphs.

a) Negative screening based on product, motivated by increased risk for negative effect on profit. The most common products here are certain types of weapon, tobacco, and to an increasing degree; coal and other fossil fuels. The screening then excludes specific companies or industries which produce these products. Once excluded from the investible universe of the portfolio there is no continuous evaluation of how a company is developing, for instance in terms of environmental and social performance. This screening may be an initial mechanism into the investment process, or new product specific criteria may be added as a result of changes in the policy or strategy of the fund. New product specific exclusionary criteria may also be added due to external factors like a worsening of the environmental situation which the firm either negatively affect or is negatively affected by.

Negative screening based on product has the potential to be an effective tool towards a sustainable portfolio. However this presupposes that the screening criteria are updated in line with physical environmental limitations as the planetary boundaries, or specific criteria for social sustainability e.g. the effect products (as weapons) has on human rights or products effect on human health (as tobacco). With regard to environmental limitations it is so far by and large specific criteria for contributions to, or risks to be affected by, climate change. This goes for both the ISIF and GPFG.

b) Negative screening based on conduct, motivated by increased risk for negative effect on profit. According to our knowledge, the GPFG is the only fund in our mapping which utilizes this tool. As we see from table 1, the GPFG has excluded 142 firms based on conduct, by the end of 2016.

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Table 2. GPFG: Number of firms divested from GPFG from per 2016, and percent of the fund invested based on positive screening.

<table>
<thead>
<tr>
<th>Risk based motivation, by NBIM</th>
<th>Ethical motivation, by Council of Ethics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negative screening category (number of divestments).</td>
<td>Positive screening</td>
</tr>
<tr>
<td><strong>Product</strong></td>
<td><strong>GHG emissions (68)</strong></td>
</tr>
<tr>
<td><strong>Conduct</strong></td>
<td><strong>Deforestation (54)</strong></td>
</tr>
<tr>
<td><strong>Social and governance (44)</strong></td>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

The themes for exclusions are deforestation with 54 exclusions, water with 44 exclusions, and social and governance with 44 exclusions. The exclusions are based on qualitative assessments on a case to case basis. The advantage is that it opens up for a multitude of considerations in an often complicated landscape.

The disadvantages of this method with regard to assessing consequences for sustainability, is by and large lack of transparency. And it is lack of transparency both from the GPFG, and from firms which may be or are being investigated for potential exclusion. The first type of lack of transparency makes it difficult to assess if the portfolio is moving in a more sustainable direction, and it also makes it difficult to assess the consistency in the portfolio with regard to exclusions based on the same type of misconduct. The argumentation for exclusions are on a general level, and not thorough on what exactly constitutes the risk and how, as exemplified in this quotation from NBIM:
“When considering companies for divestment, we focused on those operating in high-risk sectors with exposure to high-risk markets and indications of insufficient risk management related to corruption and corporate governance. We divested from three companies as a result of our assessment of corruption risk in 2016.”

Lack of transparency from firms or even sectors makes negative screening difficult, both based on product and conduct. Still it is more difficult to find reliable information on possible misconduct, than on product, as there is often need of broader types of information. Again, a quotation from NBIM serves to illustrate our point:

“This additional analysis and monitoring has given us valuable insight into the sector. However, persistent challenges related to complex supply chains and a lack of adequate data at the company level mean that we did not make any risk-based divestments from these sectors in 2016.”

Regarding cells c) and d) in table 1, negative screening based on ethical motivation can only found as recommendations from *The Council on Ethics* for the GPFG. The Council on Ethics uses its *Ethical Guidelines* for observation and exclusion from the GPFG, based on product (c) and conduct (d).

**c) Negative screening based on product, motivated by ethics.** This product based criteria says the GPFG shall not be invested in companies which themselves or through entities they control produce - amongst others - weapons that violate fundamental humanitarian principles through their normal use, produce tobacco, coal, or sell weapons or military materiel to states that are subject to investment. See table 2 for number of exclusions based on this criteria.

ISIF’s head of responsible investment activities says ISIF will not be an ethical investor, as it would be a breach with their commercial mandate. “We are not an ethical or values based investor – other than cluster munition and landmines it will not exclude investments of sectors of the economy” (ISIF, 2017). This statement may have to be revised with regard to tobacco, and maybe also soon with regard to fossil fuels. In December 2016, news was released on divestment from tobacco manufacturing and tobacco-related assets (SWF Institute, 2016). But a main point here, as illustrated in table 3.1, is that

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249 Id.

ISIF and GPFG have different motivation for excluding the same categories: tobacco, certain types of weapon and fossil fuels.

d) Norm-based screening evaluating companies against specific ESG norms and standards such as corruption or human rights violations. Severe environmental damage is also an exclusionary criteria, not linked to the product as such. There are several challenges with this approach with regard to sustainability, as also mentioned under b). Violations are not that obvious as with the product based exclusions, and so the GPFG must have some kind of active surveillance of the portfolio to know which firms to look into. Next, once a firm or a specific industry is suspected to violate the Ethical Guidelines, the criteria for exclusion necessitates some kind of investigation of the firm’s conduct, followed by an interpretation of the findings against the exclusionary criteria. Lack of transparency or lack of documentation from the firm is often a challenge in the phase of investigation. The results of the investigation and interpretation of the findings is then to lead to a recommendation to divest or to keep the firm in the portfolio. Lack of cooperation from the investigated firm may also lead to a recommendation to divest. An advantage for d) over b) is that the investigations done by the Council of Ethics are much more thorough and public. A disadvantage for d) compared to b) is that the more thorough investigations are very time-consuming, and hence the time-span from investigation till conclusion and possible divestment. In the meanwhile, when these investigations are taking place - firms in the portfolio can operate in unsustainable manners – for years and decades.

In a fund of this size, the final divestments may not countervail the aggregated unsustainable practices in the portfolio yet to be investigated. This problem is bigger with regard to conduct-based, than with product-based, as the former are more complex to investigate.

The last and most problematic features of strategy d) is still that a recommendation to divest based on violations against ESG criteria is often subject to discussions and balanced against other goals and often more overarching goals as typical profit maximization. This is probably one of the reasons why NBIM since 2012 has divested from more companies than exclusions based on recommendations from the Council on Ethics. This last point makes d) weaker than c) with regard to integrity of the criteria. The overall goal of the fund is still profit maximization, even though responsible investments are integrated into the investment strategy. A more sustainable approach would be to turn in the other way around; within an overall framework of responsible investments we aim for good returns.
A positive potential and sometimes the outcome of a process of negative screening based on conduct is that the investigated firm change their conduct in line with the fund's ESG strategy. This change may happen before the firm is excluded and resulting in the firm being kept in the portfolio, or it may happen after it is being excluded and then taken back into the portfolio again. Either way, exclusion based on conduct may act as an incentive for the firm to change its conduct.

### 3.2.2. Lack of indicators on sustainability performance

Our mapping in the previous chapters show that 3 of 4 institutional investors in the EU are integrating SRI considerations into their investment strategies. More specifically, the results reveal that the Norwegian GPFG and Irish ISIF are integrating aspects related to the planetary boundaries, in an explicit way, in their investment strategies. Specifically, of the 9 PBs, climate change is the PB most integrated into the SWFs’ profiles, followed by biodiversity and land-system integrity. Another PB which is mentioned is water. Besides this no other PB is mentioned. This is especially alarming with regard to the biogeochemical flows of phosphorus and nitrogen – which is the PB which is mostly transgressed.

Climate change is one of the fundamental sustainable challenges of our time. But in line with research from the planetary boundaries’ framework, there are other environmental challenges just as severe. There is hardly any focus on making indicators on portfolio performance, besides carbon intensity. This is a severe barrier with regard to ecological sustainability.

### 3.2.3. Lack of policy goal to make the funds sustainable – other priorities more important

Several SWFs have been changed into national development funds – where for instance national job-creation is the overall goal.
3.2.4. Overlapping consensus

The Ethical Guidelines of the GPFG are to be rooted in main normative characteristics that are consistent over time. The theoretical foundation is the principle of “overlapping consensus,” which is meant to achieve stability within a socially just system.\(^{251}\) The consensus is “overlapping” in that it allows people to have different reasons, premises, and arguments for supporting a system.\(^{252}\) This means that it is the common norms of Norwegians, the ultimate beneficiaries of the Fund, that ultimately decides what is ethically acceptable\(^{253}\) and not for instance planetary boundaries. As it is demonstrated that Norwegian norms are not that sustainable, for instance regard to level of consumption, basis of overlapping consensus on Norwegian norms is therefore a barrier for sustainable investments for the world’s biggest SWF.

3.3. Possibilities

- Impact investing
- Positive screening

The above mapping concluded that two funds in the EU use positive screening, also known as thematic investing – also illustrated in table 1. This is considered as a strategy that can facilitate, in a more direct way, that the SWFs take PBs into account. However, it is important that the advanced strategy is applied in practice for the larger part of the portfolio. If not the result of the advanced strategy is countervailed by the part of the portfolio which is not included by such a strategy and instead maximize profit without any SRI strategy. In the case of Norwegian GPFG that invests in almost 9,000 companies, we question if this SWF can ensure a proper evaluation of their portfolio in ESG terms. An alternative is to decrease number of companies in their portfolio, by enhancing their share in a portfolio encompassing fewer firms.

- SRI Indicators

\(^{252}\) *Id.* at 1.
We expect that strategies and development of SRI indicators in addition to carbon footprint will increase in the coming decade, and especially within other defined PBs as biodiversity, land-system integrity, and global freshwater use. However, this also depends on the development of regulatory frameworks.\footnote{We do not get into detail here, and only mention two – among many - relevant regulatory frameworks; Regulation on European social entrepreneurship funds (EuSEF) and the EU Conflict Minerals Regulation.}

- Own larger shares in companies, and use this influence by engagement (“voice”)

### 3.3.1. The role of institutional investors

In a modern listed public company, there are only two types of shareholders: the active marginal traders who set the market prices and the activist (or potentially activist) institutional investors who exert pressure on the companies’ governance.\footnote{Leo E. Strine, Jr., ‘Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law’, \textit{Columbia Law Review}, 114:2 (2014), 449–502, p. 452 fn 6.} There is a voluminous amount of literature discussing these types and roles of institutional investors, and especially them as a source or disincentive for management’s myopic behaviour. One of the main problems is that empirical evidence on institutional shareholders’ preferences on productive firms’ long term sustainable performance remains ambiguous.\footnote{Kerstin Lopatta, Reemda Jaeschke, Felix Canitz and Thomas Kaspereit, ‘International Evidence on the Relationship between Insider and Bank Ownership and CSR Performance’, \textit{Corporate Governance: An International Review}, 25:1 (2017), 41–57, p. 43.}

However, institutional investments do matter. As stated in the G20/OECD Principles of Corporate Governance, the real world of corporate governance and ownership is no longer characterised by a straight and uncompromised relationship between the performance of the company and the income of the ultimate beneficiaries of shareholdings. In reality, the investment chain is often long and complex, with numerous intermediaries that stand between the ultimate beneficiary and the company.\footnote{OECD (2015), G20/OECD Principles of Corporate Governance, OECD Publishing, Paris p. 29. \url{http://dx.doi.org/10.1787/9789264236882-en}.} In this environment, invest\textit{ments} themselves are short-term, not only investors: for instance in the US, the shareholder base of public companies turns over almost completely on annual basis.\footnote{Leo E. Strine, Jr., ‘One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?’, \textit{The Business Lawyer}, 66:1 (2010), 1-26, p. 17.}
At the same time, again in the US but also other countries as Finland, an employee is provided with an employer-provided pension plan, with monthly investments by both the employee and the employer to an intermediary who invest their money on their behalf. So, most ordinary people have little choice but to invest in the market. People are, as Leo E Strine, Jr. calls them, ‘forced capitalists,’ even though they continue to depend for their economic security on their ability to sell their labour. These forced capitalists have no interest in quarter-to-quarter earnings or to beat the market for quick bursts of cash at the expense of sustainable growth unlike their asset managers.

The rise of big financial institutions that hold about 70 per cent of the value of the US stock markets has further weakened the link between the people who nominally own companies and the companies themselves. In the United Kingdom (UK) only ten per cent of the public equity is held by physical persons any more. Due to institutional shareholder complexity, financial intermediaries have become in the centre of corporate ownership and debate. It is these intermediaries, or to be exact their ‘money managers’, not the forced capitalists themselves or the board members of the productive companies as before, who determine how their capital is put to work and how the mountain of shares owned for their benefit is used to influence the management of listed companies. Given the directional momentum of public policy in the US and Europe, the inflow of funds from forced capitalists to these intermediaries is likely to continue to increase. Fund managers have to deal with an ever-growing group of intermediaries, from regulators to their own employees, and each layer has its own interests to serve and rents to extract. No wonder fund managers usually fail to monitor individual companies.

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259 Examples are from the Nordic countries, especially from Finland and Norway.
262 In this paper, I use generic expression ‘board member’ instead of ‘director’ that is used in Anglo American company law tradition, unfamiliar for example to Nordic or Continental European tradition.
What is important many of these institutional investors are either public entities or controlled by them. Generally, the role of public entities as market actors is manifold. Federal, national, subnational and local governments and authorities act in the markets at least in four roles, as direct investors, portfolio investors, regulator-supervisors and procurers. Public entities have been investing directly both unlisted and listed companies especially in the utility and energy sectors, infrastructure as transport, and real estate. Portfolio investments are usually done through special purpose vehicles, as pension and investment funds but also investment companies. Many governmental regulatory and supervisory agencies have also active market participant role. Lastly, public entities participate the markets as contractual partner not only in public procurement but also in other contractual networks and value chains.

Although the empirical evidence is ambiguous, it is clear that the nature of shareholders matter. Although it is unclear whether institutional investments or block-holdings per se are positively or negatively related to a firm’s long-term sustainable performance and whether institutional shareholder activism appear positively or negatively to it, it seems that shareholdings by employees, individuals, and firms are negatively associated with sustainability, whereas ownership by state, banks, or institutional investors seems to have at least no negative influence, and according to some empirical

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265 See also Jukka Mähönen, Comparative regulatory ecology and public entities as market actors (paper in progress).
266 For instance, the Norwegian government in the unlisted Statkraft AS and in the listed Statoil ASA.
267 For instance, the Norwegian government in the unlisted Norges Statsbaner AS, a Norwegian transport group, Bahn NOR SF, a railway infrastructure state corporation, and Avinor AS, airport operation and airspace control company.
268 For instance, the Norwegian government in the unlisted Rom Eiendom AS, through Bahn NOR SF.
269 For instance, the Norwegian Kommunal Landspensjonskasse Gjensidig Forsikringsselskap (KLP).
270 For instance, the Norwegian Government Pension Fund Global (GPFG) and the Norwegian Government Pension Fund Norway (GPFN).
271 For instance, the Norwegian government in Argentum Fondsinvesteringer as, a venture capital investment company.
272 For instance, the Russian Rosatom State Atomic Energy Corporation (Государственная корпорация по атомной энергии "Росатом") is a state corporation. It is the regulatory body of the Russian Federation (RF) nuclear complex but at the same time a leading international vendor of nuclear industry’s entire range of products and services. Simultaneously, it runs all nuclear assets of the RF, both civil and weapons. Besides, it has the authority to fulfill on behalf of the RF the international commitments undertaken by the nation with regard to the peaceful use of atomic energy and non-proliferation.
273 Every year, over 250,000 public authorities from municipalities to national states just in the European Union (EU) only spend in public procurements around 14 per cent of the EU GDP on the purchase of services, works and supplies.
research, positive at least to stakeholder and environmental sustainability.\textsuperscript{274} It seems also that ownership by banks and other financial institutions correlates positively to demands of sustainable behaviour.\textsuperscript{275}

However, in this paper we focus on public entities\textsuperscript{2} as states\textsuperscript{3} and municipalities\textsuperscript{4} role as institutional investors and how they can affect corporate behaviour. As far as institutional investors’ behaviour in their portfolio companies’ governance is concerned, they have two choices available if they are unhappy with the portfolio company: (i) they can engage with management to try to effect change (‘voice’ or direct intervention) especially in matters as strategic initiatives, the appointment of board members and managerial remuneration, or (ii) they can use trading decisions and especially leave the firm by selling shares (‘exit’ or ‘voting with their feet’). The important thing is that the mere threat of exit can also discipline the management of the portfolio company. However voice, especially when conducted behind the scenes with the board, is also important.\textsuperscript{276}

In the following, we will discuss these issues from public institutional investors’ point of view and test these claims especially based on European examples. A specific attention is given to ‘block-holding’, the role of how a big (over 5 or 10 per cent) stake an investor has in the productive company affects her behaviour. Generally, block-holders are a diverse class of investors, comprising of hedge funds, mutual funds, public and private pension funds, national (NWFs) and sovereign wealth funds (SWFs), individuals, and corporations, including civil law foundations. These different investors may engage in different forms of governance, be affected by firm characteristics in different ways, and have different effects on firm outcomes.\textsuperscript{277}

\textsuperscript{275} Lopatta, Jaeschke, Canitz and Kaspareit, ‘International Evidence’, p. 43.
5.3.2. Why institutional investors are important

According to the standard governance theory, powerful and dominant shareholders have incentives to monitor and supervise corporate managers (that is, the board and the executive management) properly, as they have stronger incentives than the managers do to act in the interest of the corporation. However, the controlling shareholders’ behaviour can be harmful to the minority shareholders only if the controlling shareholders are ‘stealing’ corporate assets by private benefits, for instance by ‘tunnelling’ at the expense of the corporate interest. In reality, there are bluntly speaking no such things as majority and minority ‘shareholders’. Both types of equity investors that exist nowadays, the marginal traders and the institutional investors are represented by a group of agents that can be called as ‘money managers’ or ‘asset managers’. For those actors involved with listed companies, would they be the board members, members of the management, or other labour, corporate life means life with these money managers: the managers and board members of the productive companies to make a difference with the corporations investing in them) are dealing with largely anonymous ‘owners’, represented by these ‘money managers’ buying and selling securities, balancing between quarterly results to keep the corporate management sharp and long-term investments to keep the companies growing. Most of corporate literature is of the duties of corporate managers and board members towards these ‘owners’.

What is important, however, is that there are two kinds of institutional investors, active and passive. Activists, traditionally hedge funds and mutual funds, using withhold campaigns, proxy contests and proposals to eliminate takeover defences, proposals to increase shareholder power over key areas of corporate decision-making, and campaigns to change corporate business plans, has changed the behaviour of especially ‘independent’ board members, willing more to compromise than stand on

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280 In legal sense, shareholders of course do not own the company they have invested in, they own shares that bring rights and duties in the company.
282 See, for instance, Strine, ‘One Fundamental’.
principle.\textsuperscript{283} According to their view in the end of the day, especially US corporate law makes corporate managers accountable to only one constituency, the shareholders, and that accountability has been tightened because of market developments concentrating voting power in institutional investors and information technology innovations easing communication and joint action among shareholders.\textsuperscript{284}

The idea that a US public corporation has as its purpose to maximize financial gain for its shareholders is not new, of course, as it was first articulated in \textit{Dodge v. Ford Motor Company}\textsuperscript{285} in 1919. From pure legal point of view, the case lacks precedent value. Besides, the corporate law in most Anglo-Saxon countries confers unanimously the ultimate power to the board, not shareholders. Besides, the board’s powers are enhanced by dispersed and heteronomous shareholdings.\textsuperscript{286} However, over the time, through both law and custom, and especially through the mainstream \textit{agency theory}, the concept of ‘\textit{shareholder primacy}’ has come to be widely accepted social norm. Shareholder primacy was recently reaffirmed by the Delaware Chancery Court itself in \textit{eBay Domestic Holdings, Inc. v. Newmark}\textsuperscript{287}, stating that a non-financial mission that ‘seeks not to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders’ is inconsistent with the board members’ fiduciary duties.

Shareholder activism itself has its roots in the 1980s’ ‘corporate raiders’ film director \textit{Oliver Stone} immortalized in his \textit{Wall Street}’s Gordon Gekko,\textsuperscript{288} becoming a symbol and the role model for the short-term profit maximization culture getting power in the same time both in corporate academia and practice. Later the picture on corporate raiders has become more colourful, more critical and more robust, as has happened to the general idea of the purpose of a listed company and the agency relationships prevailing in it.\textsuperscript{289}

\textsuperscript{287} \textit{eBay Domestic Holdings, Inc. v. Newmark}, 16 A.3d 1 (Del. Ch. 2010).
\textsuperscript{289} One side of the debate on shareholder activism is the discussion on advantages and disadvantages on takeover bids and their regulation, both in the United States and Europe. As an example can be mentioned the right to takeover defenses against hostile takeover attempt; see Beate Sjåfjell, \textit{Towards Sustainable European Company Law: A Normative Analysis of the Objectives of EU Law, with the Takeover Directive as a Test Case} (Wolters Kluwer, 2009), especially pp. 117–121 and 377–378.
During the last decade, the debate shareholder activism has focused on the US activist hedge funds, their inherent nature and the almost revolutionary change in the US corporate governance. In particular, Lucian Bebchuk, Alon Brav and Wei Jiang have seen hedge funds as an essential catalyst for change in an aggressive corporate governance reform, and, above all, in an endeavour to move corporate decision-making power from the board to the general meetings. As examples of this trend can be mentioned abandoning the above-mentioned staggered board structures, and so increasing the shareholders' ability to change the whole board instead of a stepwise selection. Generally, they emphasise the role of hedge funds as agents of passive shareholders and, even more generally, as a means of bridging the ‘Berlean–Meansian’ gap between ownership and management (see below).

As Ronald Gilson and Jeffrey Gordon argue, institutional ownership implemented through pension and mutual funds has created a new agency relationship besides the three traditional ones (shareholders / management, minority shareholders / majority shareholders, creditors / company): an agency relationship between the final beneficiaries as the pension insured and their agent, the pension institution. If the institutional investors remain passive owners, the shareholder passivity described by Adolf Berle and Gardiner Means in ‘The Modern Corporation and Private Property’ (1932) is shifted from the traditional principal level to the agent level. Shareholder activism as the activism of hedge funds can be seen as a reaction to this new passivity problem. Institutional investors’ passivity is not, however, rational apathy of traditional shareholders in dispersed ownership, but a rational ‘reticence’ to intervene managements’ affairs. So, activists act as agents for these reticent agents of passive principals.

Reticency is rational as the cost of activism may exceed its benefits, and these benefits are shared equally by other shareholders who can free-ride on the activist’s efforts. Hedge funds have a positive

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cost-benefit result due to their short-termism to be able reap the benefits of their activism; they are willing to bear the costs because can cash the gains in the form of accelerated dividend pay-outs and potential rise in the share price.\footnote{Harper Ho, ‘Risk-Related Activism’, p. 678.} For other institutional investors with a longer investment horizon this possibility does not exist, especially for those investors with voluntarily or regulatory forced (as pension funds and mutual funds) diversified portfolios and facing unfunded obligations to beneficiaries, some forms of activism may simply prove too costly, the cost is too high to be feasible active.\footnote{Harper Ho, ‘Risk-Related Activism’, p. 677.}


What is clear the activist hedge funds have contributed to a fundamental change in the division of powers between the corporate organs in listed companies, particularly in the US, where the board...
selection has traditionally been staggered\textsuperscript{298} to prevent sudden policy changes and where it has been vested with general competence also in material and fundamental decisions, as it is in the PRC or Scandinavian countries still, but unlike in continental Europe or in the UK.\textsuperscript{299} The corporate governance environment has, however, changed decisively in the US since the 1980s, narrowing of the board’s competence and expanding that of the annual general meeting, in particular in board member selection and in major corporate transactions.\textsuperscript{300} Much of this is praised or damned the hedge funds. As a counter reaction against hedge funds and other activist shareholders promoting aggressively short-term shareholder value maximization, voices have been raised requiring re-increase of the power of the board in defence of long-term interest of the company.\textsuperscript{301}

In Europe, shareholder activism is a more recent phenomenon.\textsuperscript{302} It is, however, seen there in a far more positive light than in the US, as illustrated for example by the European Commission’s desire to increase the shareholders’ say in European listed companies and by a neutral attitude towards hedge funds and proxy advisors working with them. According to the EU 2012 Company Law Action Plan, effective corporate governance framework is of crucial importance and so is the shareholders’ role in the promoting of corporate governance. By doing so, they can have positive effect on both the companies’ and their own interests.\textsuperscript{303} In the 2014 European Commission proposal for amending the Shareholders’ Rights Directive,\textsuperscript{304} the Commission iterates that effective and sustainable shareholder engagement is one of the cornerstones of listed companies’ corporate governance model.\textsuperscript{305} According to the Commission proposal,\textsuperscript{306} effective shareholder control is a pre-requisite to sound corporate governance and should therefore be facilitated and encouraged.

\textsuperscript{298} A staggered or classified board is a board that is made up of different ‘classes’ of members, each class serving for a different term length than the others. At each election, shareholders fill (or refill) only those seats that have become vacant, not all seats.

\textsuperscript{299} From Finnish Companies Act of 2006 point of view, see Jukka Mähönen and Seppo Villa, ‘Tärkeät päätökset ja toimivalta osakeyhtiössä’ [Important decisions and competence in a limited liability company], Lakimies, 109 (2011), 3–18.


\textsuperscript{301} See Bebchuk, Brav and Jiang, ‘The Long-Term Effects’, especially pp. 1148–1149.


\textsuperscript{303} Action Plan, p. 3.

\textsuperscript{304} Commission proposal.


\textsuperscript{306} Para 3 of the Preamble of the Commission proposal.
Although being concentrated on hedge funds as main type of activists, it must be emphasised that all activist shareholders are not identical. Institutional investors' investment motives and horizons may differ materially.\footnote{Coffee and Palia, 'The Wolf at the Door', p. 104.} When the shareholder-value maximization defenders have seen aggressive activist shareholders as their champions, more critical voices have been raised to defend long-term corporate profitability. Instead of traditional activists, they give hope to active traditional institutional shareholders, such as pension funds and pension companies, mutual funds, insurance companies, and sovereign wealth funds, who appreciate more interactive means in the communication between shareholders and the board members, long-term investment returns, investment of profits in the company itself and sustainability instead of short-term dividends and share buy-backs, and who are willing to use their influence to achieve these goals instead of passivity and freeriding.

It is true that some institutional investors have recently activated and started to criticise their former champions.\footnote{Examples from the United States, see Coffee and Palia, 'The Wolf at the Door', p. 61–62.} For example, in January 2015, Europe's third largest pension fund (after Norwegian GPFG and Stichting Pensioensfonds ABP), the pension fund for the Netherlands' health and welfare care workers Pensioensfonds Zorg en Welzijn (PFZW), terminated its entire hedge fund portfolio of four billion euros due its disappointment to its costs, complexity, and low returns. At the same time, the pension fund criticized the whole hedge fund sector oversized fees and low level of social and environmental responsibility. Similarly, California Public Employees' Retirement System (CalPERS), the largest US state pension fund, has sold its whole $4 billion hedge fund portfolio, asserting that it was not any longer suitable for its investment objectives.\footnote{Johnson, Miles, 'Hedge fund pay down as top 25 managers bank total of $11.6bn', Financial Times, May 5, 2015, available at http://www.ft.com/intl/cms/s/2/6a0239e2-f32f-11e4-a979-00144feab7de.html#axzz3ZKPna8ON (Johnson 2015a); see also Richard Blackden, Stephen Foley and Ed Crooks, 'Nelson Peltz fails to win board seats at DuPont', Financial Times, May 13, 2015, available at https://www.ft.com/content/e57adbe-f97b-11e4-ae65-00144feab7de.}

However, these are exceptions, due largely to their public, stakeholder or trade union based nature,\footnote{See Rock, ‘Institutional Investors’, p. 7–8.} as other institutional investors invest more and more in hedge funds.\footnote{Steve Johnson, ‘Institutional money keeps rolling in to hedge funds’, Financial Times, March 29, 2015, available at http://www.ft.com/intl/cms/s/0/12ea2b9e-d497-11e4-9bfe-00144feab7de.html#axzz3ZKPna8ON (Johnson 2015b); Rock, ‘Institutional Investors’, p. 29.} They tend to operate passive-
aggressively: if an activist shareholder does not provide them the carrot of abnormal returns, they go
down to their normal rational restraint, not interested in supporting the management to develop the
company; if they are offered a carrot, they are eager to support the activists against the management.  

The reason is partially in public pension funds’ fiduciary duties, partially in information asymmetry. 
For instance, in the US, the ‘prudent investor standard’, which is the core fiduciary duty standard under
Employee Retirement and Income Security Act of 1974 (ERISA) and comparable state laws applying
to public pension funds requires fiduciaries to act solely in the interests of the fund’s beneficiaries. 
The US federal Department of Labor, which enforces ERISA indicates that shareholder activism is
only consistent with institutional investor fiduciary duties if it is justified by the expected economic
benefit to fund beneficiaries.313 On the other hand, institutional investors lack the motivation to
expend costs to get acquainted with their investments and to participate actively in their corporate
governance. This is rational; the problems of shareholder primacy social norm can be explained by
agency theory according to which the company's management always has an information advantage
over shareholders. As a result, according to the mainstream theory, the management has duty of loyalty
towards the company and all its shareholders, and their right to insider transactions is limited. Passive
shareholders trust to the management’s loyalty. Activist shareholders have in their part a motivation
to challenge it, or at least the proxy advisors who provide voting of recommendations to hedge funds
as well as institutional investors, and which they also tend to rely on. Leading proxy advisors drive
heavily elimination of staggered board elections, shareholder activism, takeovers, and ultimately
maximization of shareholder power. 314

In the end of the day, it is about value creation for the public institutional investors also. As stated by
the Norwegian government, one of the most important institutional investors in the world through its
direct shareholdings in major Norwegian listed firms as Equinor, Telenor and Yara International, and
especially through GPFG, ‘[t]he overarching goal of state ownership is value creation. The objective

313 Harper Ho, ‘Risk-Related Activism’, p. 663. 
for companies in which the state’s ownership has commercial objectives is to achieve the highest possible return on invested capital over time.\(^{315}\) The question is just, what ‘over time’ means.

### 3.3.2. The role of financial engineering

The dynamics between activist and passivist institutional investors is based on financial engineering. As corporate law itself is based on the nineteenth-century assumptions of optimal risk alignment it has not followed the pace of modern financial engineering opportunities.\(^{316}\) In the face of law, there are still ‘shareholders’ that pay for shares issued by the company, and creditors, who issue debt to the companies. Corporate law is especially helpless when it must face share ‘decoupling’: investors separating economic rights associated to a share the company has issued from voting rights attached by the company to it.\(^{317}\) This intentional deconstruction of equity investments can take two forms: first, an institutional investor may want to reduce the risk that is usually associated with an equity investment by selling the economic rights attached to a share but retaining its voting rights. The investors do this for obvious reasons: a shareholder with reduced risk exposure retains its voting power and its influence in the company, but it does not bear the risk of negative returns. This strategy is what can be called ‘negative decoupling’.\(^{318}\)

Second, an investor can attempt to produce the opposite effect: she acquires an economic stake in a company without gaining voting power. This may take place during takeover situations if law requires the disclosure of voting positions but not economic exposure. Here the economic risk is higher than the voting power; it can be called ‘positive decoupling’.\(^{319}\) Risk-decoupling strategies create both agency and information costs for institutional investors. Furthermore, they generate challenges for traditional categories of corporate finance, aiming to extract the ‘best of both worlds’ of both debt and equity.\(^{320}\)

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\(^{318}\) Ringe, ‘Hedge Funds’, p. 1030.

\(^{319}\) Ringe, ‘Hedge Funds’, p. 1030.

\(^{320}\) Ringe, ‘Hedge Funds’, p. 1031.
The lender is usually a sophisticated institutional investor, many times a public, predominantly large and passive institutional investor whose investment targets are well known to publicly held productive companies. Big custody banks lend as agents or intermediaries on behalf of these large institutional owners such as pension funds, public retirement funds, mutual funds, and endowments. For example, the Norwegian GPFG is an important securities lender. In 2015, its income from lending was NOK 3.27 billion and value in the balance sheet NOK 123 billion, compared to NOK 2.75 billion and NOK 45 billion in 2014. Part of the GPFG’s lending is so called ‘agency securities lending’. GPFG enters an agreement into with an external agent regarding securities lending, giving this agent the right to lend securities held by the GPFG to other market participants with securities borrowing requirements. Both equities and bonds are lent. The purpose of the lending activity is to generate additional returns from security holdings. A net income is earned from the securities lending programme.

The agent acts on behalf of, and in the interest of the GPFG. The GPFG is exposed to counterparty risk from securities lending. Collateral is used to mitigate losses in case of a borrower default. When a security is lent, the borrower transfers collateral to the agent in the form of cash or securities. The collateral includes a margin and is held on behalf of the lender. In the event of a borrower default, the borrower will not return the lent securities. The GPFG will be exposed to losses in the event a borrower defaults and the collateral received is insufficient to buy back the lent securities in the market.

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Generally, institutional investors benefit from the rental fee, and as long as the other shareholders do not lend out their shares, the possible abuse of their voting rights by the borrower is unlikely.\textsuperscript{327} According to Georg Ringe, this mirrors the basic problem of collective action that we know from share voting—when it comes to lending out shares, the same issue of freeriding can be noticed. A more charitable account would argue that institutional investors will always balance the fees they obtain from lending, on the one hand, with the cost of a recall and an informed exercise of their voting rights on the other.\textsuperscript{328}

However, share lending can be used also for ‘record date capture.’ Most jurisdictions worldwide have introduced a system where there is a cut-off date to register for the general meeting.\textsuperscript{329} As the date is some time before the meeting actually takes place. The record date system favours legal certainty over commercial reality,\textsuperscript{330} a share borrower may exploit the divergence between the record date and the date of the general meeting in order to produce a situation resembling a risk-decoupled shareholder.\textsuperscript{331} The borrower borrows the shares precisely over the record date, subsequently return them, and therefore acquire the right to vote at the general meeting.\textsuperscript{332} As noted by Jaap Winter, companies whose shares are traded on various stock markets can take advantage of different record date arrangements for the manipulation purposes of two different markets.\textsuperscript{333} For example, if a European company is listed on both a European and an American stock exchange, it is conceivable that an investor votes twice. First, she may obtain a voting entitlement according to the American record date, which is usually about sixty days before the annual general meeting. If she then switches his American shares into European shares, he may possibly be entitled to vote according to their national system a second time at the same meeting.\textsuperscript{334}

\textsuperscript{328}Ringe, ‘Hedge Funds’, p. 1045.
\textsuperscript{329}Article 7 of the EU Shareholder Rights Directive makes a record date system mandatory for all EU Member States and sets thirty days as the maximum period before which a general meeting could be held.
\textsuperscript{330}Ringe, ‘Hedge Funds’, p. 1053.
\textsuperscript{331}Ringe, ‘Hedge Funds’, p. 1050.
\textsuperscript{332}Ringe, ‘Hedge Funds’, p. 1054.
\textsuperscript{334}Ringe, ‘Hedge Funds’, pp. 1054–1055.
So, there is a market for votes or borrowed securities.\textsuperscript{335} However, according to empirical research, a regular and legal process of ‘vote buying through share buying’ occurs only on a rare basis, and the temporary borrowing of shares is advantageous for activist investors.\textsuperscript{336} According to Susan Christoffersen et al, institutional investors lending shares are letting the votes go without selling them, as the price charged for the votes is zero. As an explanation they offer information asymmetry: investors would be better off voting in their interest if they knew how, which suggests they do not have this expertise.\textsuperscript{337} According to Christoffersen et al, from a policy perspective vote trading may serve the socially beneficial role of incorporating more information into corporate votes, a role that regulators could facilitate by reducing frictions imposed on vote trading.\textsuperscript{338}

3.3.3. Exit and voice

3.3.3.1. Why exit is important?

As shown, according to the traditional view of corporate governance institutional investor activism takes place through direct intervention in a firm’s operations. However, as Alex Edmans (2009) has stated, they can exert governance even if they cannot intervene in a firm’s operations by using their exit rights. By trading on private information (following the ‘Wall Street Rule’), they cause prices to reflect fundamental value of the productive companies rather than their current earnings. This encourages managers to invest for long-run growth rather than short-term profits.\textsuperscript{339} This view is in contrary to the view that liquid securities markets and transient institutional shareholders exacerbate myopia. However, the effectiveness of activism depends on the threat to sell shares and exit the productive company, which is greater for investors with larger stakes of shares.\textsuperscript{340} Institutions with larger economic stakes should be better able to overcome the free-rider problem and thus have greater incentives to both monitor and govern through voting.\textsuperscript{341} On the other hand, for instance mutual

\textsuperscript{336} Christoffersen, Geczy, Musto and Reed, ‘Vote Trading’, p. 2908; Ringe, ‘Hedge Funds’, p. 1057.
\textsuperscript{337} Christoffersen, Geczy, Musto and Reed, ‘Vote Trading’, p. 2927.
\textsuperscript{338} Ringe, ‘Hedge Funds’, p. 1108.
\textsuperscript{339} Edmans, ‘Blockholder Trading’.
\textsuperscript{340} Edmans, ‘Blockholder Trading’.
funds with smaller share ownerships and shorter investment horizons are more likely to exit than to vote against management.\textsuperscript{342}

As emphasised by Edmans, a larger shareholder or ‘block-holder’ (defined usually as a shareholder who holds at least 5 or 10 per cent of the total shares) does not suffer of the ‘rational apathy’ of shareholders in listed companies; they have strong incentives to gather costly information about the firm’s fundamental value, that is, to learn whether weak earnings result from low firm quality or desirable long-term investment. According to Edmans, if the cause is low quality, a block-holder profits by selling her stake, depressing the share price. If the cause is desirable investment, she does not sell, which attenuates the stock price decline caused by weak earnings. In both cases, the block-holder causes share prices to reflect fundamental value rather than short-term earnings. What is the most important, owing to her sizable holding, she has the incentive to ask the management questions first and not automatically sell upon losses.\textsuperscript{343} Secondly, what is important in this model, a block-holder does not promote her investment simply by sitting on her investment, being a ‘long-term’ investor who never sells; by contrast it is the possibility of selling in the short-run that encourages the managers to make long-term decisions.\textsuperscript{344}

Block-holder exit can be seen as a solution to the ‘Berlean-Meansean’ dilemma. The fragmentation of ownership through stock exchange listing had fundamental but unintended consequence of the rise and development of the public company. In the nineteenth century, the US government set limits on banks’ ability to lend restricted credit, but a strong legal system supported contractual agreements. That enabled capital to be raised through direct public offerings, which were instrumental in the early development of American industry. Over time, mechanisms emerged to trade these direct offerings in regional and national financial markets. Stock markets were not the only source of finance and the joint-stock company not the only model of ownership. However, big public companies became the capitalist norm.\textsuperscript{345} A result of this ‘democratisation’ of ownership was its dilution and the loss of one of its components – control. Shareholders lost their grip on ownership and the collective strength to

\textsuperscript{342} Duan and Jiao, ‘The Role of Mutual Funds’, p. 512.
\textsuperscript{343} Edmans, ‘Blockholder Trading’, p. 2482.
\textsuperscript{344} Edmans, ‘Blockholder Trading’, p. 2496–2497.
manage their agents, who ran companies. In 1932 Berle and Means argued in ‘The Modern Corporation and Private Property’ that the outcome was that companies became akin to sovereign entities, divorced from the influence of their ‘owners’ by retained earnings that allowed managers to invest as they chose. When a firm’s managers are distinct from its ultimate beneficiaries, they have inadequate incentives to maximize its value. For example, they may exert insufficient effort, engage in wasteful investment, or extract excessive salaries and perks.

The potential for such value erosion leads to a first-order role for corporate governance mechanisms to ensure that managers act in shareholders’ interest. As the source of agency problems is that managers have inadequate stakes in their firms, block-holders can play a critical role in governance, because their sizable stakes give them incentives to bear the cost of monitoring managers.347

3.3.3.2. Why voice is important?

However, especially for block-holders, exit might be an empty threat. For a block-holder, exit might not be an option since a position that is large enough to cause a noticeable drop in the share price when liquidated may be difficult for the investor to sell without a loss, and the markets know this their long-term locked-in position well. For investors who want to change corporate behaviour, exit may also be less attractive than voice since, like consumer boycotts, it will have little impact on the firm unless the investor directly communicates its reasons to firm management.349 So, exit is not enough without a voice.

As said above, most large pension funds, mutual funds, and other institutional investors have a securities lending program as an important source of revenue. In 2010, the total value of securities on loan globally was estimated at $2,500bn, pension funds only generating an estimated $0.8bn of revenue annually from lending their securities.350 Equity lending transfers voting rights to the borrower, typically a hedge fund, and hence lenders cannot vote shares that are on loan on the voting record.

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346 Berle and Means, *The Modern Corporation and Private Property*.
date. Institutional investors must therefore decide whether to recall shares the shares before the record
date, restrict the right to use voting rights before lending, or to make shares available for borrowing
with voting rights for an associated fee and the transfer of voting rights.  

According to Aggarwal, Saffi and Sturgess (2015), against the conventional wisdom, lending
institutional investors tend to place a higher value on their vote than burrowers. They tend to recall
shares to retain voting rights, suggesting that institutional investors value the right to vote and use the
voting process as an important channel for affecting corporate governance. However, not all
institutional investors value their voting rights in the same way, and there is a considerable
heterogeneity in their preferences. Secondly, the decision to recall shares on the voting record date
varies with firm and proposal characteristics, which typically affect the value of control rights. Finally,
the share recall tends to be associated with less support for management in the subsequent voting
outcome.  

However, the heterogeneity in share recalls suggests that institutional investors systematically differ in
their desire to exert governance via voting. For instance, according to Shleifer and Vishny (1986), the
willingness of a shareholder to intervene to corporate governance increases with the size of her stake
and the value creation stemming from such intervention, but decreases with the cost of monitoring.  
Other relevant factors are her investment philosophy, investment time horizon, fiduciary
responsibilities to beneficiaries, and ability or incentives to engage with management and/or invest in
the private information necessary to effectively monitor. The problem is not in share lending itself
as an activity but in the lenders of share.

Here, we look more carefully the nature of public institutional investors as, for example, the
Norwegian GPFG is an important lender, but the Norwegian municipality owned public pension fund
*Kommunal Landsfondsksasse* (KLP), is not.

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3.3.4. Why are sovereign wealth funds special?

Unlike pension funds, SWFs do not serve present and future retirees as beneficiaries. As an example, for the Norwegian GPFG, the ultimate beneficiaries are the future Norwegians: ‘The Government Pension Fund Global is saving for future generations in Norway. One day the oil will run out, but the return on the fund will continue to benefit the Norwegian population.’ The GPFG invests on equity investments (61.2 per cent by the end of 2015), fixed-income investments (35.7 per cent) and real estate investments (3.1 per cent). The GPFG’s importance is so still mostly in the listed companies. In modern literature, the GPFG has been seen as a ‘corporate governance global watchdog’ and as such, an ‘organizational innovation’.

In practice however, the GPFG use exit as its governance tool. The Norwegian Ministry of Finance has adopted guidelines for the observation and exclusion of companies from the GPFG. Certain criteria exclude companies based on their products, for example tobacco, weapons and coal. Other exclusion criteria are based on conduct, such as serious human rights violations and severe environmental damage. The Council on Ethics for the GPFG (see above) recommends companies for exclusion or observation, and the final decision rests with Norges Bank. In 2016, two new criteria have been included in the guidelines for observation and exclusion, reflecting the Storting’s (the Norwegian Parliament’s) feedback on the report on the Fund for 2014 and on the National Budget 2016. One of the criteria targets conduct resulting in unacceptable greenhouse gas emissions at an aggregate company level. The other criterion is product-based, and targets mining companies and energy producers who derive 30 per cent or more of their revenues from thermal coal or base 30 per cent or more of their operations on thermal coal.

The GPFP has not, however, developed itself as a block-holder. Its investment strategy is described to hold six elements: (1) long term horizon and little need for liquidity; (2) better tolerance of return volatility and short-term capital flows compared to most institutional investors; (3) size making

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358 Aguilera, Capapé and Santiso, ‘Sovereign Wealth Funds’. p. 32.
360 Until 2015, such decisions were made by the Ministry of Finance; Norwegian Ministry of Finance, p. 14.
exploiting liquidity and volatility risk premiums impractical; (4) capacity issues, such as a small staff, that favour benchmarks that are at least loosely linked to market capitalization; (5) capability to most effectively earn liquidity and other premiums by serving as an opportunistic liquidity provider purchasing unpopular assets in illiquid markets; and (6) as long as oil remains a significant underground resource, less need for inflation hedging than most investors.  

In principle, the GPFP may own up to 10 per cent of the voting shares in one company. In reality, the shares are far more modest. At the end of 2015, the GPFG was invested in 9,050 companies, down from 9,134 a year earlier. It had stakes of more than 2 per cent in 1,074 companies, down from 1,205 companies a year earlier, and more than 5 per cent only in 29 companies, down from 57 companies a year earlier. The fund’s average holding in the world’s listed companies, measured as its share of the FTSE Global All Cap stock index, was 1.3 per cent at the end of 2015, unchanged from a year earlier. Ownership was highest in Europe at 2.3 per cent, down from 2.4 per cent at the end of 2014. Holdings in developed markets averaged 1.3 per cent, while holdings in emerging markets (including frontier markets) averaged 1.4 per cent. The reason for fewer large equity stakes at the end of 2015 than a year earlier was the GPFG’s gradual shift away from Europe and a transfer of equity assets into its real-estate portfolio.

On the other hand, SWFs usually do have no explicit liabilities unlike, for example, heavily levered hedge funds or pension funds that have to budget for periodic cash outflows. For this reason they

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The GPFG’s blockholdings in the equity markets as at 31 December 2015 were Smurfit Kappa Group Plc Ireland, 9.2%; UPM-Kymmene OYJ, Finland, 7.7%; CNinsure Inc, PRC, 6.8%; Linde AG, Germany, 6.7%; Delta Lloyd NV, Netherlands 6.5%; Telecity Group Plc, UK, 6.3%, Aflac Inc5 US, 6.3%, Tesco Plc UK 6.2%; Boliden AB, Sweden, 6.0%, Cherkizovo Group PJSC, RF, 5.7%; Svenska Cellulosa AB SCA, Sweden, 5.7%; BlackRock Inc, US, 5.6%; Balfour Beatty Plc, UK, 5.5%; China Singyes Solar Technologies Holdings Ltd, PRC, 5.3%; Volvo AB, Sweden, 5.3%; Tocalo Co Ltd, Japan, 5.3%; BSD Crown Ltd, Israel, 5.1%; Elemental Holding SA, Poland, 5.1% Equatorial Energia SA, Brazil, 5.0%; and Balrampur Chini Mills Ltd, India, 5.0%.
364 Hovland and Clark, ‘Rare Glimpse’.
have the potential to be true long-term shareholders, with very long investment horizons and very low liquidity requirements, possibly becoming the highly effective monitors. That might be hampered by low staffing levels though, as well as the SWFs political objectives, and a mistrust of a foreign government as a shareholder.\footnote{Megginson and Fotak, ‘Rise of the fiduciary state’, p. 746.}

All the larger SWFs tend to have very small staffs. The Norway’s GPFG, the PRC’s CIC, and Abu Dhabi’s ADIA collectively have fewer than 3000 employees, yet have combined AUM of over 2.11 trillion euros. In comparison, privately-owned \textit{Fidelity Investments} has a comparable amount of assets under management [1.87 trillion euros as of September 2014], but employs over 41,000 people.\footnote{Megginson and Fotak, ‘Rise of the fiduciary state’, p. 743.} Due to this even large SWFs can play only limited direct corporate governance role in the companies in which they invest.\footnote{Megginson and Fotak, ‘Rise of the fiduciary state’, p. 744.} So, the lack of block-holding makes the GPFG unable to assign its relatively small staff to sit on corporate boards or interact intensively with investee firm managers. Other sovereign wealth funds, which do not spread their equity investments as broadly as GPFG, can sometimes assign staff to sit on the boards of a few large investee firms, but almost always in domestic rather than foreign companies. Even in those cases, the funds are much more likely to nominate an employee of a fund subsidiary company than from the parent fund itself.\footnote{Megginson and Fotak, ‘Rise of the fiduciary state’, p. 744.}

A larger stake generally improves governance through both voice and exit, and such governance in turn enhances firm value.\footnote{Edmans, ‘Blockholders and Corporate Governance’, p. 24.} Decrease in individual holdings give the impression the GPFG has no motive to participate to the productive companies’ governance, besides its exit. The smaller the stakes in productive companies are, the smaller is the impact of a threat of exit. From that perspective, the GPFG has lost its voice during the last year.

The GPFG can be compared with the Qatari QIA (either directly or through its subsidiary \textit{Qatar Holding LLC}) that is the champion of a much more active role for a SWF, making fewer, larger and more visible investments both in equities and, even more, in real-estate deals as well as playing the part of a deal-maker, as in the 2013 \textit{Glencore plc} acquisition of \textit{Xstrata} (the QIA being now Glencore’s largest
shareholder) and the recent joint QIA-Glencore acquisition of nearly 20 per cent of Rosneft PJSC.\textsuperscript{370} On the other hand the RDIF has been courting the CIC and QIA to invest in Russian projects.\textsuperscript{371} The Abu Dhabi NWF Mubadala Development Company PJSC has created bilateral funds with the Russian government. Similarly, France has set up bilateral funds with Abu Dhabi and Qatar to invest in on added-value investments, technology, biotechnology and renewable energy sources as well as generally medium-sized French companies.\textsuperscript{372}

Statistics give an impression this is true. In 2015, Norges Bank arranged a total of 3,520 meetings between the GPFG representatives and company executives and specialists. This is a considerable number as such. Companies were prioritised based on investment value, ownership share, selected topics and challenges specific to the individual company. In 2015, Norges Bank prioritised five topics in its interaction with companies: nomination processes in connection with board elections, equal treatment of shareholders, corporate governance form in Japan, corruption and sustainability.\textsuperscript{373} However, according to the annual report of the Council of Ethics, Norges Bank received only eight recommendations for exclusion from the Council in 2015 and had at year-end made a decision on five of these.\textsuperscript{374} In 2015, the Council was in contact with only 42 companies and held meetings with 11 of them. The productive companies’ responses are interesting: while some companies respond well on how they seek to prevent environmental damage, corruption or human rights violations, while others seem to believe that investors have no grounds for asking for detailed information on, for example, working conditions or environmental management systems. The percentage that replies has been particularly low in relation to working conditions in the textile industry.\textsuperscript{375}

As far as voting is concerned, Norges Bank itself regards voting at general meetings as the most important tool for influencing companies.\textsuperscript{376} Norges Bank has adopted a set of voting principles which provide, for example, that Norges Bank shall generally vote at all shareholder meetings and that its

\begin{thebibliography}{99}
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\item[373] Norwegian Ministry of Finance, p. 68.
\item[374] The Council of Ethics, p. 7.
\item[375] The Council of Ethics, p. 9.
\item[376] Norwegian Ministry of Finance, p. 68.
\end{thebibliography}
voting decisions must be published. Voting must reflect the GPFG’s long-term interests and take into account ‘long-term value creation, sustainable business operation, board liability, shareholder rights, equal treatment of shareholders and transparent company communication’. According to the Norwegian Ministry of Finance, Norges Bank’s voting guidelines and principles are based on the G20/OECD Principles of Corporate Governance.377

Norges Bank voted on 112,601 resolutions in 11,562 general meetings in 2015. Some 98 per cent of the resolutions were proposed by the companies themselves, whilst only 3 per cent were proposed by shareholders.378 There is a striking difference with US mutual funds; according to Duan and Jiao, in 2003–2012, 51.31 per cent of mutual funds voted against management on oppose-management proposals, whereas only 3.48 did so on other proposals. A total of 9.75 per cent of mutual funds exit in the case of oppose-management proposals, and 8.73 per cent do so for other proposals. So, the probability of mutual funds voting against management is 53.71 per cent higher for oppose-management proposals than for other proposals, and their probability of exit is 1.88 per cent higher.379 On the other hand, the GPFG sees securities lending only as a source of revenue.380 It does not have a stated policy concerning recall of shares before the record date. From this point of view, it seems to be a passive shareholder.

As another example of Norwegian SWFs can be taken the already above-mentioned Government Pension Fund Norway (GPFN), an asset pool managed in accordance with specific management provisions set out by the Ministry of Finance by Folketrygdfondet, a special-legislation asset managing company wholly owned by the state through the Ministry. At the end of 2015 GPFN had a market value of 21.6 billion euros. The objective of the GPFN is straightforwardly to achieve the highest possible return measured in Norwegian kroner and after costs.381 Folketrygdfondet invests the GPFN in listed shares and bonds primarily in Norway but also in a smaller extent in Sweden, Denmark and Finland.382

377 Norwegian Ministry of Finance, p. 68.
379 Duan and Liao, pp 490–491.
381 Norwegian Ministry of Trade, Industry and Fisheries, p. 118.
The company is one of the largest financial investors on the Oslo Stock Exchange. The Norwegian equity investments correspond to about 5 per cent of the total market value listed on the Stock Exchange, and the average stake in Norwegian shares that Folketrygdfondet was invested in at year-end 2015 was 5.8 per cent.\textsuperscript{383} In the end of 2015 GPFN owned shares in 137 companies of which 55 were listed in Oslo Stock Exchange and 82 in Danish, Finnish and Swedish stock exchanges. It had 128 dialogue meetings with the management of 49 Norwegian companies on environmental, social and corporate governance issues. Outside Norway, it conducted a dialogue with one company only.\textsuperscript{384}

Share lending is important to GPFN, too. Folketrygdfondet lends its shares regularly for profit, in 2015 to 12 counter parties. Its total income from share lending in 2015 was NOK 90 million of 168 million total, with market value varying in 2015 from NOK 9.6 billion to 16.7 billion.\textsuperscript{385}

\textbf{3.3.5. Why public pension funds are special}

As a comparison to the largest sovereign wealth fund in the world, can be taken the largest public pension reserve fund in the world, \textit{Government Pension Investment Fund} (GPIF) of Japan, with total assets of 1.1 trillion euros. Until 2000, the assets were required to be deposited with the Ministry of Finance (MOF). The arrangement was drastically changed in 2001–2009, when the funds deposited with MOF were returned to the GPIF and invested in the markets. GPIF is now the world’s largest pension fund investing in investment markets.\textsuperscript{386}

What is interesting in GPIF, in investments, it relies on external money managers.\textsuperscript{387} Secondly, as the GPIF’s goal is financial return only, political and social investment objectives that tend to have a negative impact on returns should be formally rejected.\textsuperscript{388}

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\footnote{383}{Norwegian Ministry of Trade, Industry and Fisheries, p. 118.}
\footnote{384}{Folketrygdfondet, \textit{Årsrapport og eierrapport 2015} [Annual report and ownership report 2015] (available in Norwegian only), pp. 4, 11, 13, 74–75.}
\footnote{385}{Folketrygdfondet, p. 11, 46.}
\footnote{387}{Tamaki, ‘Managing Public Pension Reserve Funds’, p. 23.}
\end{footnotes}
The above-mentioned Norwegian Kommunal Landspensjonskasse (KLP) manages the pensions saving for employees and former employees of Norwegian municipalities and enterprises, county administrations and health enterprises. KLP also provides non-life insurance, banking services and investment products. In the end of 2015 KLP managed around 46.4 billion euros of assets, of which shares 8.7 billion euros, and lending 5.6 billion euros.\(^{389}\) Similarly than the GPFG, KLP uses exit actively as its governance tool. Following the GPFG’s example, it has decided to divest all of its investments in coal companies, investing those funds in renewable-energy production companies in emerging economies.\(^{390}\) As examples of other excluded companies can be mentioned the Brazilian Petróleo Brasileiro S.A. (Petrobras), the Japanese Tokyo Electric Power Company, the PRC ZTE Corporation, the RF OJSC MMC Norilsk Nickel, and the Jersey-Swiss Glencore plc.\(^{391}\) KLP announces using its voting rights actively, too,\(^{392}\) and uses its voice especially in Norwegian listed companies.\(^{393}\) However, its main voice tool is dialogue, varying in scope, form, topic and time perspective. KLP publishes lists of companies approached and been in dialogue with regarding environmental, social and governance issues.\(^{394}\) Through the Nordic Engagement Cooperation, KLP is also having dialogues with companies together with the Finnish Ilmarinen Mutual Pension Insurance Company from Finland and the Swedish Folksam.\(^{395}\) As far as share lending is concerned, it is not included in the KLP investment policies at all,\(^{396}\) emphasising KLP’s activism in using its voice.

In principle, public pension funds as KLP should have a long-term orientation as they are obligated not only to existing but also to future retirees. To meet their future obligations, they must invest their assets with an eye toward long-term sustainability. However, their current obligations are even more important: especially US public pension funds have traditionally been structured as defined benefit

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\(^{389}\) KLP, Annual report, 2016, especially p. 59.


plans, meaning that the employer has promised its employees’ pension benefits that are definite in amount. These kinds of pension funds must pay their existing retirees each month in amounts that are contractually determined. It is therefore up to the managers of these funds to ensure that the plan assets earn sufficient returns to meet their commitments to retirees.\footnote{Millon, ‘Shareholder Social Responsibility, p. 930.}

Due to these reasons, most public pension funds prefer passive investment strategies.\footnote{Virginia Harper Ho, ‘Risk-Related Activism: The Business Case for Monitoring Nonfinancial Risk’, \textit{The Journal of Corporate Law}, 47 (2016), 647–705, p. 652.} They are as \textit{Ronald Gilson} and \textit{Jeffrey Gordon} define it,\footnote{Ronald J. Gilson and Jeffrey N. Gordon, ‘The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights’, \textit{Columbia Law Review}, 113 (2013), 863–927.} not passive, but ‘rationally reticent’, unlikely to initiate activism, but willing to follow proposals initiated by hedge fund activists.\footnote{Harper Ho, ‘Risk-Related Activism’, p. 653.} In most of the cases, their incentives are similar, especially in the US: the ‘prudent investor standard’, which is the core fiduciary duty standard under Employee Retirement and Income Security Act of 1974 (ERISA) and comparable state laws applying to public pension funds requires fiduciaries to act solely in the interests of the fund’s beneficiaries. The US federal Department of Labor, which enforces ERISA indicates that shareholder activism is only consistent with institutional investor fiduciary duties if it is justified by the expected economic benefit to fund beneficiaries.\footnote{Harper Ho, ‘Risk-Related Activism’, p. 663.}

Hence, PPRFs manage assets to meet these clearly defined liabilities, while SWFs tend to have broad objectives and are rarely assigned to meet specific government expenditures. For this same reason, the investment horizon of PPRFs tends to be better defined and longer than that of SWFs. Clear objectives and investment timeframes shed much clarity to the mission of PPRFs and are conducive to better governance and more efficient investment management than for SWFS. However, PPRFs face strong pressures to invest their resources domestically and conservatively. This is more the case of PPRFs managed within the social security system.\footnote{Blundell-Wignall, Hu and Yermo, ‘Sovereign Wealth and Pension Fund Issues’, p. 9.} Especially in emerging markets, where institutional investors and capital markets are underdeveloped, it is sometimes felt that PPRFs should help promote domestic investment and financial sector development. These concerns contrast with those of SWFs that are by construction mainly or solely invested in foreign assets.\footnote{Blundell-Wignall, Hu and Yermo, ‘Sovereign Wealth and Pension Fund Issues’, p. 10.
On the other hand, the nature of the benefit plan for the beneficiaries plays a role. Defined benefit plans differ from defined contribution plans, in which the employer commits to only a specified contribution toward the employee’s retirement. It is then up to the employee to invest these contributions so as to meet his or her retirement objectives. Employees bear the investment risk in defined contribution plans, while that risk falls on the pension fund itself in defined benefit plans. A pension fund’s need for large amounts of cash on a monthly basis influences its investment targets. According to David Millon, to meet their current obligations, US public pension funds have historically assumed an annual rate of return of 8 per cent, give or take a half point depending on the plan, although some plans are considering reducing their assumed rate of return by a point or so. If plans do not attain the 8 per cent target, they may have insufficient investment income to pay their retirees, and they may turn to other sources of funds such as proceeds from asset sales.

It the pension plans are ‘underfunded’, that is if they do not hold sufficient assets to generate the income needed to pay the pensions owed to current and future retirees, the pressure to generate strong returns may be even greater.

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405 Millon, ‘Shareholder Social Responsibility, p. 931.
3.4. Public institutional investors and sustainability

Traditionally the public institutional investors use exit instead of voice. This is clear from the Norwegian examples. Exclusion strategy is follows a general trend: according to a recent MIT Sloan report ‘Investing For a Sustainable Future: Investors Care More About Sustainability than Many Executives Believe’, a growing number of investors are paying attention to productive firms’ ‘ESG’ performance, as evidence mounts that sustainability-related activities are material to the financial

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Unruh, Kiron, Kruschwitz, Reeves, Rubel and zum Felde, ‘Investing for a Sustainable Future’, p. 3. The report is based on a global survey of managers about corporate sustainability. The survey response set included 7,011 respondents from 113 countries. The report is based on a smaller subsample of 3,057 respondents from commercial enterprises. Within this commercial sample, 579 survey respondents self-identified as investors. Most were strategic (39%), institutional (24%), or retail (11%) investors. Few identified themselves as mission-oriented or socially responsible investors. The sample included respondents from pension funds, endowment organizations, insurers, banks, and asset management companies. Among these groups, a significant number of respondents came from asset management companies (36%).
success of a company over time. According to the report, investors care more about sustainability issues than many executives believe: 74 per cent of senior executives in investment firms agree that a company’s good sustainability performance is materially important when making investment decisions, but only 60 per cent of managers in publicly traded companies believe that good sustainability performance is materially important to investors’ investment decisions.

The problem is however the same than with the Norwegian public investor examples: there is more ‘exit’ than ‘voice’. A change is in the air, however: according to the report, there is a shift from ‘exclusion’ to ‘inclusion’. In the past, investors who cared about sustainability had data and information to develop only exclusionary strategies — identifying ‘bad apple’ companies that harmed the environment. Although investors are taking a stand and divesting from stocks that have poor sustainability track records, they have yet to stimulate clear and robust discussions about sustainability with the firms where the remain as shareholders.

In inclusion, there are two steps: transparency and action. In the first phase, institutional investors exert pressure for firms to be transparent in their disclosure of sustainability risks. According to Raj Aggarwal and Sandra Dow, it is clear that failure to respond effectively will reduce firm value. More sophisticated data and analytics are broadening investors’ fields of vision by including more ‘inclusionary’ factors. Integrating ESG indicators into investment models is the crux of these inclusionary performance indicators.

Transparency is not enough, however. The main conclusion of the report is that voice is important besides exit. However, institutional investors must be active: absence of discussions between the investor and the management creates uncertainty about investors’ expectations, and the discrepancy mentioned above. This is as much the management’s as the investors’ problem; the investors need to define the criteria of what they expect from sustainability: ‘A stringent review of these criteria is critical in order to detect and react to early warning signs that a sustainability investment is potentially losing

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value.’ Investors should discuss sustainability measures with companies and incorporate sustainability criteria into their investment strategy. Specifically, investors should do the following:

- To consider mid- and long-term investment strategies in the context of sustainability issues;
- To integrate sustainability into their investment strategies;
- To develop valuation methods that account for nonfinancial sustainability issues;
- To avoid relying on sustainability indices, which can be misleading.\textsuperscript{413}

On the other hand, companies should be ready to take this feedback. Institutional investors’ attention to a broader range of long-term risks than purely financial ones requires new capacities from productive firms’ boards, for instance ‘sustainability committees’ or other specialised committees in addition to the traditional audit committees that do not necessarily the ability or resources, often constrained by the board member ‘independence’ requirements, to effectively oversee operational and systemic sustainability risks.\textsuperscript{414}

\textsuperscript{413} Unruh, Kiron, Kurshwitz, Reeves, Rubel and zum Felde, ‘Investing for a Sustainable Future’, p. 14.

\textsuperscript{414} Harper Ho, ‘Risk-Related Activism’, p. 697.
4. Conclusion on barriers and possibilities

Analysing the behaviour of public institutional investors tools developed in finance research can be used and some preliminary conclusions can be made.

Firstly, it is not enough to blame public institutional investors for passivity and freeriding short-term profit maximising activists. More important than incentivising public investors to be alert is to encourage them not to give tools to short-term activists by lending shares to them. The Norwegian examples show however that for them, securities lending is just a source of revenue. However, according to Aggarwal, Saffi and Sturgess, recall of borrowed shares should be higher for investors with stronger incentives to monitor and exert governance, as long as their economic stake is large enough or economic benefit great enough to overcome the free-rider problem that arises from dispersed ownership. Seemingly, public institutional investors do not have incentives big enough to be alert.

Secondly, an activist strategy is a combination of exit and voice. The Norwegian examples are world-famous as far as exclusion is concerned, although the rather random selection of companies that are assessed for exclusion, can be criticised. For voice, the results are not so promising. Although Norges Bank engages in a dialogue with the productive companies’ management, the treatment by the Council of Ethics is less positive. One sign of that is the ignorant responses they get from their target companies. Answers reported as for example that it is not the investors’ job to ask management how business is conducted are alarming. KLP seems to be more active in its voice, due perhaps a far lesser amount of companies it is investing in.

It seems that one of the reason why the Norwegian examples are not the best possible from the point of view of fighting for sustainability, is motivation. They have few block-holdings in major listed companies and so no real incentives to be active. The annual report from the Council of Ethics for the GPFG is revealing: The Council investigated a total of 184 companies in 2015. This is a small number considering that the GPFG has a stake in almost ten thousand companies. One reason might be that investigations are very time-consuming although in some cases the facts were more apparent.

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416 Council of Ethics, p. 10.
It might be that bigger stakes and fewer target companies could help the Council to use its limited resources more efficiently. Institutions with larger economic stakes should be better able to overcome the free-rider problem and thus have greater incentives to both monitor and govern.\textsuperscript{417}

There are lots of interesting issues that do not fall under the scope of this paper but could be addressed afterwards.

One question is public investments to private equity and infrastructure. The GPFG has hesitated to invest unlisted markets besides real estate. According the Norwegian Ministry of Finance, unlisted markets do not offer the same opportunity to diversify risk through broad-based ownership and small ownership shares. Operational management is more complex, and requires different, more specialised expertise. Risk and return cannot be measured regularly as in listed markets, since changes in value are estimated, for example through appraisals.\textsuperscript{418} Especially infrastructure investments are exposed to high regulatory or political risk, containing long-term contracts where profitability is subject to the direct influence of political authorities and setting of tariffs or other regulation.\textsuperscript{419}

Another aspect that has been raised with the Japanese GPIF is the asset size: in an illiquid market such as private equity, the marginal rate of return is likely to fall as investment increases, since one must then invest in less promising deals. In other words, the law of diminishing rate of returns works more strongly against a large investor in a more illiquid market, where fund size does matter.\textsuperscript{420}

Third interesting question is \textit{visibility}. As one reason to GPFG declining unlisted infrastructure investments he Norwegian Ministry of Finance Fund list a reputational risk: as the ownership share in this kind of investments is generally large, the GPFG would ‘be more visible and more likely subject to criticism’.\textsuperscript{421} Additionally, there is a risk of conflicts with the authorities of other countries that are generally difficult to manage, and can entail reputational risk for the GPFG.

\textsuperscript{418} Norwegian Ministry of Finance, p. 11.  
\textsuperscript{419} Norwegian Ministry of Finance, p. 12.  
\textsuperscript{420} Tamaki, ‘Managing Public Pension Reserve Funds’, p. 23.  
\textsuperscript{421} Norwegian Ministry of Finance, p. 12.
APPENDIX List of figures and tables

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