SPOTT

April 2021
Case study #7

Sustainable finance and tropical forestry

Monitoring for ethical investment

Council on Ethics for The Government Pension Fund Global (Norway)

The Norwegian Government Pension Fund is a Sovereign Wealth Fund and is invested in equities, bonds and real estate. As of 2020 The Fund's market value is about 1 trillion USD, and has holdings in roughly 9000 companies in 74 countries. It is owned by the Ministry of Finance, on behalf of the Norwegian people, and it is managed by NBIM, which is the investment management arm of Norges Bank (the Central Bank). The Council on Ethics is an independent body, appointed by the government to give advice to Norges Bank on whether the Fund's investment in specified companies is inconsistent with its Ethical Guidelines. Companies may be excluded from the Fund if they contribute to or are themselves responsible for serious violations of norms, including severe environmental damage, serious or systematic human rights violations or gross corruption. The Council on Ethics monitors the Fund's portfolio with a view to detecting whether companies should be excluded and submits recommendations for the exclusion and observation of specific companies to Norges Bank. Norges Bank makes the final decision. This decision and the Council's recommendation are made public.

Why consider the timber and pulp sector?

Commercial logging and conversion of tropical forest into plantations is considered one of the greatest threats to the preservation of ecosystems and biodiversity, particularly in the tropics . As per the fall of 2011, around 40 companies in the GPFG were engaged in logging and/or plantation operations in Asia and Africa, including 35 in Indonesia and Malaysia. That year the Council on Ethics decided to survey companies in the GPFG involved in environmentally destructive logging of tropical forest or the conversion of such forest into plantations. Four recommendations have been published that concern the exclusion of logging companies.

Timber and pulp plantations: relevant non-financial information

For plantation companies, the Council seeks to clarify to what extent the companies are in fact engaged in activities that damage tropical forest and biodiversity, the scale of the activities and what damage these cause. The Council always begins by requesting information from the company, such as the location of the licence areas, whether there are forests or peatlands in the licence areas, the state of the forest if present, Environmental Impact Assessments and High Conservation Value (HCV) area assessments reports. Based on this information as well as additional research, the Council conducts an individual evaluation of each company to assess the risk of severe environmental damage in connection with forest conversion.

Triangulating information

In its assessment the Council will emphasise the scale of conversion, the extent to which the company's concession areas overlap with areas containing important ecological values, and the consequences of conversion for threatened species and their habitats.

A key challenge is that publicly available information and disclosures are often insufficient. The assessments process aims to substantiate the company's potential impact by understanding its landscape of operation and whether the licence areas are located in, or harm, areas of ecological importance.

" With the help of experts and local consultants we obtain public information locally. We use experts to interpret satellite images and assess the documents that are available about the company's activities, we try to get a picture of the actual impacts on the ground. What is the risk of environmental damage, how will people's livelihoods and health be affected, what has the company has done to alleviate impacts ? "

Hilde Jervan
Chief advisor
COUNCIL ON ETHICS FOR THE GOVERNMENT PENSION FUND GLOBAL (NORWAY)

Such areas may include UNESCO World Natural Heritage Sites and other important protected areas, habitats for IUCN red list species, areas identified as Important Bird Areas or Key Biodiversity Areas or other High Conservation Value Areas.

The findings are documented in detail in a report which includes the Council's draft recommendation to place the company under observation or exclude the company from the Fund. This document, is sent to the company, giving the company an opportunity to comment on the report and provide any additional information.

The impacts of logging in natural forests concessions

It is well documented that commercial logging in natural forest concessions may cause long term deforestation and lead to negative impacts on forests or biodiversity.

When it comes to logging companies, the Council has primarily raised concerns about logging in ecologically sensitive areas and potentially illegal logging. Companies may be felling forest in contravention of official requirements: logging more trees than allowed, immature trees, protected species. Where trees are felled may also matter if a company is felling trees outside of the agreed boundaries, for example in HCV areas which should be preserved for conservation, or even outside of its concessions' boundaries. Any of these activities have potential to increase the environmental damage caused by the logging.

Four of the companies excluded by NBIM due to "severe environmental damage" based on the recommendations of the Council were logging companies operating in natural forest concessions.

What this means for companies

Research is the first step in assessing whether companies should be excluded from the fund. The Council on Ethics seeks to engage with the company at an early stage of the assessment process and later on shares its draft recommendation.

Often the real dialog with the company starts when the company has received the draft recommendation. This engagement period and the quality of interactions between the Council and the company are considered by the Council and, if the Council decides to recommend the exclusion of the company, reflected in the final recommendation.

Some companies may be placed in observation, others may be excluded, but it is worth noting that The Council on Ethics regularly assesses whether the basis for observation or exclusion still exists. In light of new information, the Council may recommend that the Bank revoke an observation or exclusion decision.

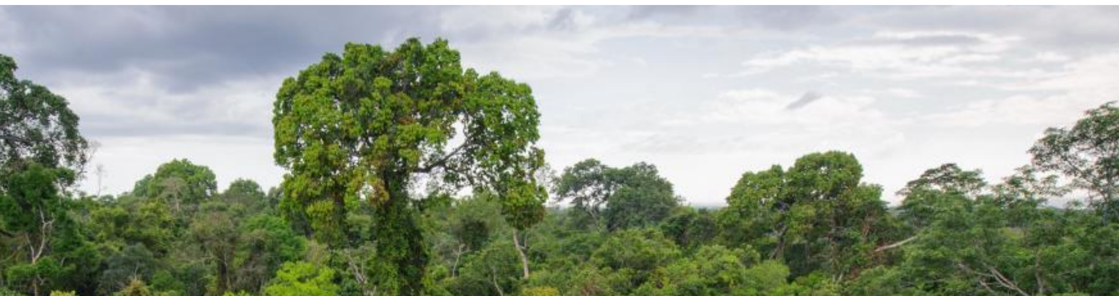
> *"Some companies respond, some provide very limited information, and some submit full reports and documents, many of them of high quality. In addition to information provided by companies, we carry out our own documentation effort. It is therefore not a good strategy for companies to limit disclosures to a minimum or refuse to engage in order to avoid scrutiny: whether companies engage or not, the Council conducts its own research and, among other things, will seek to discover the location of the licence areas. In such cases, the Council emphasises in its recommendation that the lack of data and the company's lack of transparency raise the risk of severe environmental damage. This means that companies have an interest in engaging with the process."*

Hilde Jervan
Chief advisor
COUNCIL ON ETHICS FOR THE GOVERNMENT PENSION FUND GLOBAL (NORWAY)

Lessons learnt

Companies differ in their approach to environmental, social and governance issues. Some seem to have little consideration for their impacts and have implemented few measures to mitigate them or even operate illegally. Other companies seem to have a genuine understanding of the ecological issues involved and the impacts caused by their operations and are committed to mitigating them.

- **Policies are not enough** – All companies excluded by the fund claimed to manage their concessions sustainably. Policies are often not implemented and the situation on the ground is often not aligned with commitments
- **Companies must be asked about their governance systems** and the way they ensure that measures in fact are implemented on the ground, and that policies from headquarters and actions at site level match up.



Call to action

For more than a decade, the Council has worked on cases where loss of biodiversity formed the basis for the exclusion of companies from the GPFG. Biodiversity loss as a standalone is not given sufficient attention. Financial institutions and supply chain companies should seek to actively address the wider biodiversity impacts of commodity production. They can play an important role by understanding and take action to mitigate adverse impacts on nature. High risk sectors need monitoring, reporting and verification frameworks and this means obtaining and using types of data that are not currently available through mainstream data providers.

Further reading

- Guidelines for observation and exclusion of companies from the GPFG: https://www.nbim.no/contentassets/4702e3a1c60f468296b8e9005ee9b46e/etikkraadet_guidelines-_eng_2017_web.pdf
- Article on "Loss of biodiversity" from the Council on Ethics' 2019 annual report: https://nettsteder.regjeringen.no/etikkradet3/files/2020/03/05_Etikkradet_arsmelding_2019_engelsk_Loss-of-biodiversity.pdf
- The Council on Ethics' 2019 full annual report: https://nettsteder.regjeringen.no/etikkradet3/files/2020/03/Etikkradet_arsmelding_2019_engelsk_UU.pdf

ZSL would like to thank Hilde Jervan for preparing this case study.

Developed by ZSL (Zoological Society of London), SPOTT is a free, online platform supporting sustainable commodity production and trade. By tracking transparency, SPOTT incentivises the implementation of corporate best practice. SPOTT assesses commodity producers, processors and traders on their public disclosure regarding their organisation, policies and practices related to environmental, social and governance (ESG) issues. Investors, buyers and other key influencers can use SPOTT assessments to inform stakeholder engagement, manage ESG risk, and increase transparency across multiple industries.

The SPOTT initiative is funded by UK aid from the UK Government, however, the views expressed do not necessarily reflect the UK government's official policies.