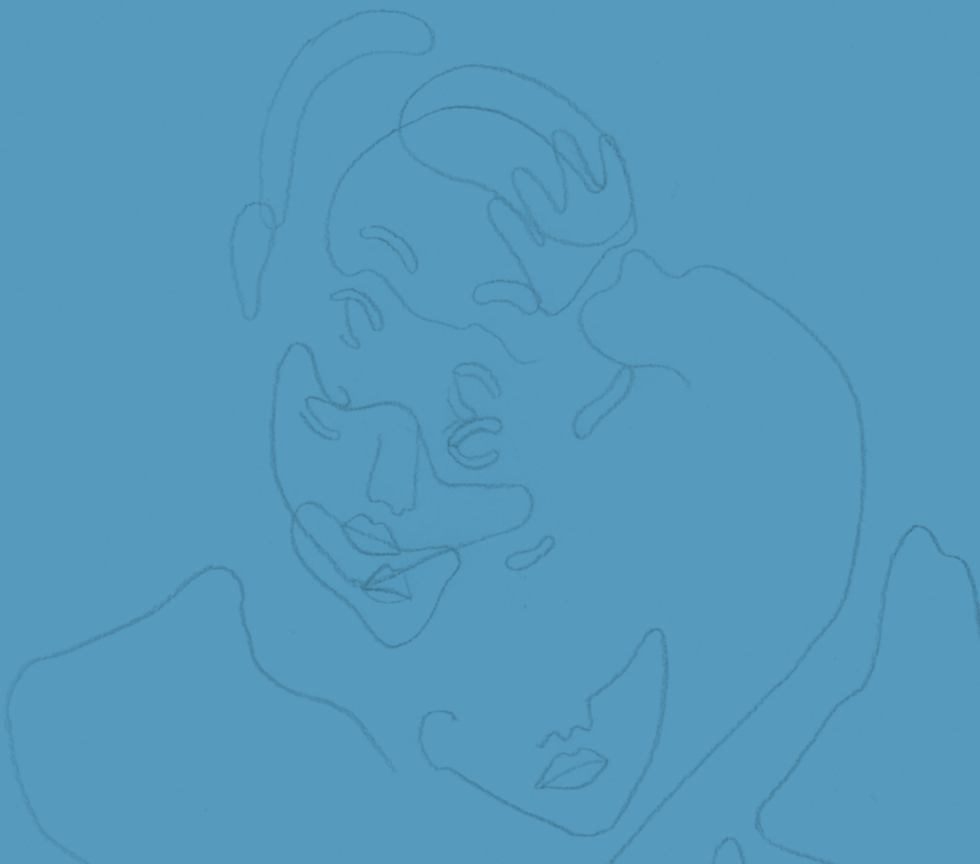
Folketrygdfondet

FOLKETRYGDFONDET'S EXPECTATIONS

Guidance for companies on the handling of corporate governance, environmental and social issues



In accordance with Folketrygdfondet's management mandate, we communicate clear expectations to the companies regarding their handling of ownership issues and environmental and social conditions.

To make our dialogue with the companies as effective as possible, we have developed guidance documents on

- Financial targets and capital structure
- Anti-corruption
- Executive remuneration schemes
- Climate change
- Human rights
- Workers' rights
- Environmental issues

In our view, assessing how companies deal with such issues can reduce risk and help maximise the value of Folketrygdfondet's portfolio.

THE PURPOSE OF THE GUIDANCE

The purpose of Folketrygdfondet's guidance for companies is to facilitate effective dialogue. This document sets out Folketrygdfondet's essential expectations.

For further information, see www.folketrygdfondet.no. Click on "Our investment management".

STRATEGY, CAPITAL STRUCTURE AND FINANCIAL TARGETS

This document sets out Folketrygdfondet's expectations regarding portfolio companies' communication of their long-term strategy, capital structure, financial targets, dividend policy, risk profile, and tax policy.

What is expected?

Folketrygdfondet's expectations

Financial considerations underlie Folketrygdfondet's efforts to understand portfolio company strategy. Insight into company strategies for growth and long-term value creation is critical in order to understand the potential for shareholder value. In Folketrygdfondet's view, the ability to generate robust, long-term returns depends on development that is sustainable from a financial, environmental, and social perspective. Moreover, companies that account for a broader range of stakeholders often achieve a competitive advantage, which contributes positively to stock price development and shareholder value.[1] Empirical data shows that companies that adopt strategies incorporating a long time horizon and clear targets, instead of prioritising short-term profitability, achieve greater value creation over the long term.[2]

For companies, a clear, well-founded long-term strategy with defined financial targets and a considered risk profile will contribute to effective corporate governance, efficient resource utilisation and well-functioning operations. An efficient capital structure and stable operations in turn contribute positively to corporate value creation.

Company boards are responsible for developing a clear, well-founded long-term strategy

Folketrygdfondet expects the boards of its portfolio companies to develop and implement a clear, well-founded long-term corporate strategy that includes financial targets, dividend policy, a detailed risk profile, and tax policy. Accordingly, the entire company must be familiar with the company's overarching strategy and financial targets, and these must also be incorporated into the corporate management system.

Company strategy emphasises a long-term perspective, sustainability, and clear targets

Company strategy should encompass vision, values, business model, long-term growth plans, resource needs and assessments linked to risk, capital structure and tax. Financial targets for growth and return on capital, as well as other strategic targets, should reflect the company's view of the market outlook, other key assumptions, and the company's competitive advantage. It is also important to identify other material value drivers that foster long-term value creation.

Long-term capital structure targets

The board of directors should specify capital requirements and allocations, as well as other significant future resource needs. Folketrygdfondet expects companies to adopt long-term capital structure targets based on their overarching strategy and risk assessments.

[1] HBR2016: Kramer, Pfitzer: The Ecosystem and Shared Value, HBR 2011: Porter, Kramer: Creating Shared Value.
[2] HBR 2017: Barton, Manyika, Williamson: Finally, Evidence That Managing for the Long Term Pays Off.

Clear, predictable dividend policy

The board of directors should adopt a clear and predictable dividend policy. Clear dividend policy communication is a prerequisite for predictability. While various dividend policy models may potentially be used, the critical factor is that each company selects the most appropriate model in view of its development phase and industry sector. An efficient capital structure is crucial for maximising long-term value creation. Folketrygdfondet expects that cash flow, net of investments for growth and maintenance, will be distributed to shareholders. Dividends can be regarded as a residual. Any discrepancies between long-term capital structure targets and actual capital structure should be explained. Wherever possible, a company's dividend policy should specify the preferred form of distribution: cash dividends or alternative forms, such as share repurchases/capital reductions.

Portfolio companies must undertake the necessary analysis to assess their risk exposure

Folketrygdfondet expects portfolio companies to survey and assess risk related to their corporate strategy and capital structure. This includes evaluating whether a given capital structure is sufficiently flexible and robust to implement the company's strategy effectively. On the other hand, companies should not be over-capitalised to such an extent that the risk arises for capital investments in initiatives that reduce shareholder value. Equally, risk associated with a company's business model and long-term strategy should be evaluated by reference to the company's position in the supply chain, necessary resource use, anticipated market developments, political and other market-related framework conditions, as well as risk linked to corporate governance and environmental and social conditions, including climate risk.[3]

Responsible tax policy

Folketrygdfondet expects portfolio companies to take a judicious approach to tax planning that excludes aggressive strategies. Tax should be paid where financial value is created. As a minimum, companies should comply with the OECD Guidelines for Multinational Enterprises, which provide that multinational companies must comply with local tax laws and provide appropriate authorities with relevant information. Further, enterprises must ensure that transfer pricing occurs on an arm's-length basis. Corporate tax policies should explain which principles the company follows, and if relevant, any deviations from the principle that tax should be paid where financial value is created.

Transparency and communication regarding corporate strategy, financial targets and tax policy

Folketrygdfondet expects portfolio companies to communicate clearly — both internally and externally — their strategy for long-term value creation, financial targets and tax policy; and to report progress against targets. In addition, we expect companies to be transparent about their tax activities and report on these.

[3] Task force on Climate-related Financial Disclosures (TCFD 2017) – proposed framework for climate risk reporting.

As regards the communication of long-term strategy to the capital markets, inclusion of the following 10 points[4] will promote effective dialogue with shareholders and investors:

1. Formulate a clear vision, mission, strategy and values.
2. Explain how the company's business model generates long-term value, by identifying key value drivers at the reporting level.
3. State management's view of the market, important trends that affect development, growth potential, the company's relative position in the market, and material underlying assumptions, such as macroeconomic developments and other relevant framework conditions.
4. Emphasise competitive advantages such as employee expertise and talent, access to resources, and other assets and advantages that enable the company to implement its strategy and gain market share.
5. Publish strategic targets that are ultimately tied to drivers for long-term value creation, including return on investment and growth. These targets should be based on present and future market trends and the company's competitive advantages.
6. Lay out a detailed execution road map defining short-, medium- and long-term measures linked to milestones and strategic targets designed to ensure long-term value creation.
7. Specify medium- and long-term metrics and measures that give insight into the company's ability to deliver on its strategy – such as customer satisfaction over time, brand strength and investment in product innovation – as well as achieved returns. Explain how the selected metrics will be assessed and tracked consistently.
8. Explain how capital-intensive and other investments will foster competitive advantages and long-term value creation.
9. Present an overview of risks and detail risk-management plans, including challenges related to sustainability factors (environmental, social and corporate governance), such as climate risk.
10. Describe how executive remuneration is aligned with long-term value creation and strategic targets.

Company boards are expected to adopt and explain the rationale for chosen financial metrics, which should be adapted to their specific sector, strategy and potential for value creation. Relevant targets/key figures/parameters can include:

Target	Key figure/parameter
Return on investment	ROIC, ROCE, ROE, ROA, CROGI
Growth	Sales growth: organic; acquisition EBIT margin; EBITDA margin
Cost of capital	WACC; Ke (required rate of return on equity)
Capital structure	Equity ratio; debt/equity; EBITA/interest; EBITDA/interest; net debt/EBITDA; loan terms

[4] FCLT Global 2015: Straight talk for the long term.

ANTI-CORRUPTION

Folketrygdfondet's anti-corruption efforts are financially motivated. We consider that the absence of corruption is a prerequisite for well-functioning markets and long-term value creation. Efforts to combat corruption are also important because failure to address such issues may give rise to costs in the form of legal proceedings and fines, as well as the loss of market access, assets and operational licenses.

What is expected?

Companies are expected to avoid and prevent corruption
We expect the companies in which we invest to refrain from actions that involve corruption or that encourage or contribute to corruption.

Companies are expected to exercise due care and conduct necessary analyses to understand their risk exposure
We expect the companies in which we invest to identify and assess whether corruption constitutes a material risk. This includes understanding where in the supply chain such risk may arise. The analysis is also expected to include due diligence assessments to identify potential corruption-related challenges before new agreements or investments are entered into.

Companies are expected to include material corruption-related challenges in their performance management
We expect companies to have a performance management structure in place that is capable of dealing with material corruption-related challenges satisfactorily. This structure should be adapted to the requirements of the individual company and the activities pursued. The structure may include:

- Policies
- Procedures and processes for dealing with corruption-related challenges
- Targets and KPIs related to the handling of corruption-related challenges
- Action plans to prevent or reduce high risk

Allocation of roles and responsibilities in work related to anti-corruption
We expect company boards and management to allocate sufficient resources to enable material corruption-related challenges to be identified, understood and managed.

Transparency and communication related to anti-corruption
We expect the companies to report externally on their approach to anti-corruption. This includes risk and materiality analyses and resulting measures to manage any identified challenges. The reporting should cover:

- Policies
- Targets
- Implementation measures
- Results

EXECUTIVE REMUNERATION SCHEMES

Folketrygdfondet focuses on executive remuneration schemes because executive remuneration can be an instrument for promoting long-term value creation and thereby unifying the interests of management and shareholders.

What is expected?

Companies are expected to offer competitive executive remuneration
If variable pay is offered, the total amount of fixed and variable pay should not be unreasonable.

Company boards are expected to apply the following criteria when introducing incentive-based remuneration schemes:
- The scheme must be capped.
- The scheme must be linked to measurable and performance-based criteria that reflect achieved performance at the individual, department/unit and overall levels.
- The scheme must encourage long-term value creation.
- The relative performance criteria should not be determined by external circumstances outside the control of management.
- There should be a clear connection between the performance criteria and value creation on behalf of shareholders.

Company boards are expected to apply the following criteria to share-based schemes, including options and subscription rights:

- A minimum lock-in period must apply (normally at least three years).
- Accrual criteria must be specified.
- The actual value of the option schemes, as well as the accounting consequences for the company and potential dilution effects, should be calculated.

Shareholder-elected board members should not be included in incentive-based remuneration schemes

Transparency and communication related to executive remuneration
The executive remuneration statement must be presented to the general meeting for an advisory vote. In this connection:

- The executive remuneration statement should be included in the summons to the general meeting, preferably in a separate, self-contained enclosure.
- Thorough information on the above criteria should be provided to enable assessment of the scheme's:
  - size
  - encouragement of long-term value creation
  - linking of performance criteria with value creation on behalf of shareholders.

If the executive remuneration statement includes pay in the form of shares, subscription rights, options or similar instruments, or is otherwise linked with developments in the company's share price, this aspect must be approved by the general meeting.

Where an executive remuneration statements requires both an advisory vote and an approving vote, these should be presented to the general meeting as two separate agenda items.

CLIMATE CHANGE

Folketrygdfondet's climate efforts are financially motivated. In our view, strong long-term returns are dependent on sustainable development, including in a climate sense. Further, climate developments are important to companies because failure to act may render business models unprofitable, weaken competitiveness, cause operational disruption through emissions restrictions and trigger costs related to taxes and regulatory compliance.

What is expected?

Companies are expected to reduce their contribution to climate change
We expect the companies in which we invest to reduce their greenhouse gas emissions if their activities and operations entail material emissions or have a high emissions intensity. Companies are expected to deal with emissions throughout the supply chain. The appropriate measures are determined by where in the supply chain the emissions occur.

Companies are expected to address material risks and opportunities related to climate change
We expect the companies in which we invest to identify, understand and adapt to material risks and opportunities related to climate change. This includes, but is not limited to, the effect on business models, strategies and profitability of:

- anticipated climate related legislation
- ongoing and anticipated physical climate change
- anticipated changes in other climate-related parameters, such as consumption patterns.

Companies are expected to exercise due care and conduct necessary analyses to understand their exposure
We expect the companies in which we invest to identify and assess whether climate change presents material risks or opportunities. Such analyses should encompass company supply chains. The review is also expected to include due diligence assessments before new agreements or investments are entered into.

Companies are expected to include material climate-related risks and opportunities in their performance management
We expect the portfolio companies to have a performance management structure in place that is capable of dealing with material climate-related risks and opportunities satisfactorily. This structure should be adapted to the requirements of the individual company and the activities pursued. The structure may incorporate:

- Policies
- Procedures and processes for managing with climate-related challenges
- Targets and KPIs related to the management of material risks and opportunities
- Action plans for adaptation to material risks and opportunities, including planned investments and new products and services

Allocation of roles and responsibilities in work related to climate change

We expect company boards and management to allocate sufficient resources to enable material climate-related challenges to be identified, understood and managed.

Transparency and communication related to the handling of climate change issues

We expect the companies to report externally on their approach to issues related to climate change. This includes risk and materiality assessments and resulting measures to manage any identified issues. Companies with substantial greenhouse gas emissions, or high emissions intensity, should report to CDP [5]. Such companies should also prepare publicly available reports covering the following:

- Strategy for managing risks and opportunities, including plans for investments and new products and services
- CO_2e emissions [6]
- Absolute and relative targets, as well as measures to secure emissions cuts
- Results

[5] We encourage such companies to report to CDP (formerly known as the Carbon Disclosure Project).

[6] CO_2e stands for CO_2 equivalent, a unit that compares the emissions of different greenhouse gases to the global warming effect that emissions of one ton of Co_2 will have in 100 years. Source: SSB.

HUMAN RIGHTS

Human rights are important from an ethical perspective because Folketrygdfondet is a responsible investor, and from a financial perspective because we find that the best long-term value creation is achieved by companies with robust corporate governance systems and reliable systems for understanding, addressing and reporting on environmental and social conditions.

What is expected?

Companies are expected to avoid and prevent human rights violations
We expect the companies in which we invest not to engage in acts that infringe human rights or that encourage or contribute to human rights breaches.

Companies are expected to exercise due care and conduct necessary analyses to understand their risk exposure
We expect the companies in which we invest to identify and assess whether they are at risk of involvement in human rights violations. Such surveys should identify where in the supply chain such risk arises, and are also expected to include due diligence assessments to identify potential human rights challenges before new agreements or investments are entered into. In this assessment, we expect the companies to follow relevant guidelines on human rights, as well as the "comply or explain" and materiality principles.

Companies are expected to include material human rights challenges in their performance management
We expect companies that are at risk of involvement in human rights violations to have a performance management structure in place that is capable of addressing such risk satisfactorily. This structure should be adapted to the risk exposure of the individual company and the activities pursued. The structure may incorporate:

- Policies
- Due care procedures and action plans to identify, prevent and limit risk
- Procedures for managing any negative impacts caused or contributed to by the company
- Targets and KPIs
- Procedures for stakeholder dialogue

Allocation of roles and responsibilities in work related to human rights
We expect company boards and management to ensure that human rights are observed in all company activities, and that respect for human rights is integrated into the company culture. This includes the allocation of sufficient resources to manage the company's risk and prevent and limit any negative impacts.

Transparency and communication related to the handling of human rights issues
We expect the portfolio companies to report externally on their human rights strategy. The reporting should cover:

- Risk and materiality assessments
- Policies
- Targets
- Implementation measures (including due care procedures and procedures for amelioration of any negative impacts)
- Results

WORKERS’ RIGHTS

Workers’ rights are important from an ethical perspective because Folketrygdfondet is a responsible investor, and from a financial perspective because failure to address relevant issues may lead to operational disruptions in the form of delays, reduced productivity and lower quality. Generally, we find that the best long-term value creation is achieved by companies with good corporate governance structures and reliable systems for understanding, addressing and reporting on environmental and social conditions.

What is expected?

Companies are expected to avoid and prevent breaches of workers' rights
We expect the companies in which we invest not to commit acts that violate workers' rights or that encourage or contribute to infringement of workers' rights. This includes, but is not limited to:

- Breach of the right to organise
- Forced labour
- Unlawful child labour
- Discrimination

Companies are expected to exercise due care and conduct necessary analyses to understand their risk exposure
We expect the companies in which we i nvest to identify and assess whether violation of workers' rights constitutes a material risk. This entails understanding where in the supply chain any such risks arise. The review is also expected to inclu-de due diligence assessments to identify potential challenges related to workers' rights before new agreements or invest-ments are entered into.

Companies are expected to include material challenges related to workers' rights in their corporate governance work
We expect companies to have a corporate governance structure in place that is capa-ble of addressing material workers' rights challenges satisfactorily. This structure should be adapted to the requirements of the individual company and the activities pursued. The structure may incorporate:

- Policies
- Procedures and processes for dealing with challenges related to workers' rights
- Targets and KPIs related to the handling of challenges related to workers' rights
- Action plans to prevent or reduce any negative impacts

Allocation of roles and responsibilities in work related to workers' rights
We expect company boards and manage-ment to ensure that workers' rights are observed in all company activities, and that respect for workers' rights is integrated into the company culture. This includes the allocation of sufficient resources to enable material challenges to be identified, understood and managed.

Transparency and communication related to the handling of workers' rights
We expect the companies to report exter-nally on their approach to respect workers' rights . This includes risk and materiality assessments and resulting measures to manage any identified challenges. The reporting should cover:

- Policies
- Targets
- Implementation measures
- Results

ENVIRONMENTAL ISSUES

Folketrygdfondet's environmental work is financially motivated. We believe that strong long-term returns are conditional on sustainable development, including in an environmental sense. The environment is also important to companies because failure to address relevant issues may weaken competitiveness, cause operational disruption through emissions restrictions and trigger costs related to taxes and regulatory compliance.

What is expected?

Companies are expected to avoid and prevent serious harm to the environment
We expect the companies in which we invest not to commit acts that result in serious harm to the environment. This includes, but is not limited to:

- Pollution of air, water and land
- Over-utilisation of conditionally renewable resources
- Land degradation

Companies are expected to exercise due care and conduct necessary analyses to understand their exposure
We expect the companies in which we invest to identify and assess whether the environment presents material risks or opportunities. Such analysis should encompass company supply chains. The review is also expected to include due diligence assessments before new agreements or investments are entered into.

Companies are expected to include material risks and opportunities related to the environment in their performance management
We expect the companies to have a performance management structure in place that is capable of addressing material risks and opportunities relating to the environment satisfactorily. This structure should be adapted to the requirements of the individual company and the activities pursued. The structure may incorporate:

- Policies
- Procedures and processes for dealing with environmental challenges
- Targets and KPIs related to the handling of material risks and opportunities
- Action plans for adaptation to material risks and opportunities

Allocation of roles and responsibilities in work related to the environment
We expect company boards and management to allocate sufficient resources to facilitate material challenges related to the environment to be identified, understood and managed.

Transparency and communication related to the handling of environmental issues
We expect the companies to report externally on their approach to managing environmental issues. This includes risk and materiality assessments and resulting measures. The reporting should cover:

- Policies
- Targets
- Implementation measures
- Results

ABOUT FOLKETRYGDFONDET

- Folketrygdfondet is a specialised capital management organisation that invests the Government Pension Fund Norway on behalf of the Ministry of Finance.

- Folketrygdfondet is a responsible, active and long-term investor with the aim of achieving the highest possible return over time.

- We base our investments on a benchmark index composed of 60% shares and 40% bonds, split between Norway (85%) and the rest of the Nordic region (15%).

- We are the largest institutional investor on the Oslo Stock Exchange, with shareholdings totalling approximately 5% of the Norwegian stock market as a whole and approximately 10% of the main index.

- In accordance with our management mandate, we communicate clear expectations to the companies in which we invest regarding how they should address corporate governance, environmental and social issues. We have developed these guidance documents to make our dialogue with the companies as effective as possible.

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