



# FOLKETRYGDFONDET'S EXERCISE OF OWNERSHIP RIGHTS

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## 1 FOLKETRYGDFONDET'S MISSION

The Norwegian Ministry of Finance has assigned the task of managing the Government Pension Fund Norway to Folketrygdfondet. Folketrygdfondet's management of the Fund's assets is based on the goal of achieving the highest possible returns over time within the framework of our mandate. Good returns over the long term depend on positive financial developments in the portfolio companies, sound management of the companies' corporate social responsibilities, and well-functioning and efficient markets. This is the objective and main basis for our exercise of ownership rights. Responsible investment is an integral part of our investment analyses, and there is a reciprocal link between our responsible investment activities and our active management.

Our responsible investment activities are based on chapter 2 of the management mandate for the Government Pension Fund Norway and are part of Folketrygdfondet's strategic plan for

its investment activities. Folketrygdfondet has adopted "Principles for Responsible Investment," which clarify how the principles are to be implemented in our management of the Government Pension Fund Norway and how we carry out our roles as an owner and creditor. Several guiding documents have been prepared that make clear our expectations regarding the companies, and that together with the document on our exercise of ownership rights, form the starting point for the exercise of our ownership and creditor rights.

Folketrygdfondet is a signatory to the UN Principles for Responsible Investment (UN PRI), the UN Global Compact, and the OECD Principles of Corporate Governance.

Folketrygdfondet is a member of the Eierforum group of institutional investors, which is represented on the Norwegian Corporate Governance Board (NCGB/NUES). NUES is responsible for preparing the Norwegian Code of Practice for Corporate Governance.

As the manager of the Government Pension Fund Norway, Folketrygdfondet plays an important role in providing capital to Norwegian industry. As a long-term and counter-cyclical investor, Folketrygdfondet can contribute to well-functioning financial markets. Through active management, our goal is to create, over time, an excess annual return of 0.4 percentage points (before management expenses) compared to the benchmark index stipulated by the Ministry of Finance.

The goal of our responsible investment activities is to safeguard our financial assets. Good follow-up by owners and creditors helps to strengthen the companies' value creation and reduce the risk in our portfolio.

## 2 FOLKETRYGDFONDET'S UNIQUE CHARACTERISTICS AND INVESTMENT PHILOSOPHY

Folketrygdfondet is a financial investor with several unique characteristics that distinguish it from other investors. These characteristics also have implications for the way in which we organise our responsible investment activities.

Folketrygdfondet and the assets it manages have a state owner with a long-term perspective. A clear framework and mandate for the organisation pave the way for appropriate asset management. With the state as the owner and Folketrygdfondet's role in managing society's assets, there are high expectations that we operate in an efficient, responsible manner. We must ensure that the main principles for our investment activities, including the exercise of our ownership and creditor rights, are known by both the companies and our principal.

Folketrygdfondet's framework conditions mean that our investment behavior has a longer time-horizon than that of many other investors. Compared to many other investors, we have a higher ability to bear risk and less need for liquidity, and we can better tolerate major fluctuations in value. This gives us a basis for acting with a long-term view and counter-cyclically. The long-term view also means we can have more patience when it comes to seeing the results of our ownership and creditor work.

As the manager of the Government Pension Fund Norway, Folketrygdfondet is a considerable shareholder and bondholder in the Norwegian capital market. At the end of 2016, our share portfolio comprised just over 10 per cent of the market capitalization of the Oslo Stock Exchange all-share index after adjusting for free float (i.e. excluding shares that are not subject to normal trading, such as the state's direct ownership shares). Our bond portfolio equals 3.3 per cent of the Norwegian bonds registered with Nordic Trustee. This makes us the largest individual financial investor in the Norwegian financial market. We manage considerable assets that are important to Norway's industry and economy. We therefore have a particular interest in maintaining a long-term perspective for our

investment activities, and experience that we have a certain opportunity to influence the way in which companies manage their operations and the marketplace framework.

Folketrygdfondet is a relatively large shareholder in many companies in Norway. At the same time, we can have a maximum ownership stake of 15 per cent, and will therefore always be a minority shareholder. The shareholder structure of the companies we invest in varies, and this will affect how intensely — and the way in which — we exercise our ownership rights. Many of the companies have one large majority owner, such as the state, a holding company/foundation, or a family/private individuals. Folketrygdfondet may be affected by the way in which the main shareholder exercises its ownership. Other companies may have a more fragmented ownership structure. In that case, Folketrygdfondet's exercise of its ownership rights will depend on how active the other shareholders are, either together or individually. We have also experienced that ownership can be spread among several shareholders that are relatively passive, so that we in reality have greater influence than our stake would indicate.

Similarly, we are also one of the larger bondholders in the loans in which we are invested. As long as the company pays interest and redeems the loan, we are rarely involved in cases linked to our role as a creditor. However, we are often involved in preparing the wording of loan contracts and are frequently assigned a key role in renegotiation and refinancing activities.

Folketrygdfondet has managed equity investments for just over 25 years and fixed-income investments for 50 years. As an institutional investor with considerable ownership interests and a long-term perspective, we have become very familiar with the companies' strategies and historical developments. Such knowledge and institutional memory can be an advantage in our dialogue with the companies and create confidence about the way in which we will exercise our ownership and creditor rights. The way we act as an owner and creditor affects standards in general in the Norwegian capital market.

The Nordic region makes up around 15 per cent of the portfolio of Folketrygdfondet's benchmark index. In general, we have smaller ownership interests in this part of the portfolio, since our stake in a Nordic company cannot exceed five percent. For this reason, we exercise our ownership rights differently in the Nordic region than in Norway. However, we adhere to the same general principles. Folketrygdfondet's responsible investment activities are an integrated part of our investment decisions and philosophy. At the same time, consideration of environmental, social, and governance factors is one of several elements in our analysis, and the importance of individual elements can vary depending on the company. The crucial factor will be an overall assessment in order to find quality companies that support our goal of achieving the highest possible returns over time. The way in which a company handles its corporate governance and relationships with owners may affect whether, and how much, Folketrygdfondet will invest in the company and the extent to which we will contribute in the case of structural changes that require the injection of capital.

Within the risk frameworks given, Folketrygdfondet may choose to invest more or less than the benchmark indices, or choose not to invest in a company. Any deviation from the benchmark index will negatively affect our risk frameworks and must in total be within the limits set in the mandate.

### 3 CRITERIA FOR THE EXERCISE OF OUR OWNERSHIP AND CREDITOR RIGHTS

The way in which we carry out our roles as an owner and creditor influences the way in which Folketrygdfondet is perceived. Folketrygdfondet is concerned with ensuring that the way we carry out these roles derives from the following criteria:

- **Responsible**

As an owner and creditor, we act in an orderly, business-like manner, and with a long-term perspective.

- **Predictable**

Our conduct is predictable based on defined values and principles.

- **Careful**

We handle ownership and creditor issues in a careful, well-thought-out manner in which we also take consequences for the company into consideration.

- **Independent**

The exercise of our ownership and creditor rights is based on independent, objective assessments and views.

- **Openness**

There is full transparency about the principles we follow and our way of working when exercising our ownership and creditor rights.

## 4 IMPORTANT OWNER AND CREDITOR ISSUES

Folketrygdfondet is a financial investor with stakes in individual companies of up to 15 percent in Norway and 5 percent in the Nordic region. As a demanding and professional owner, we have expectations regarding the companies' management, corporate governance and relationships with owners. We want to have a clear division of roles and responsibilities between the shareholders and creditors on the one hand, and the company's governing bodies on the other. For Folketrygdfondet, equal treatment of shareholders is a fundamental principle that we emphasize when exercising our ownership rights.

The general meeting is the company's supreme body. Folketrygdfondet will take part, directly or via proxy, and vote on the issues put before the shareholders. Similarly, we will attend bond-holder meetings, either directly or via proxy. Folketrygdfondet is not represented on company boards. The issues stated below are issues that we regard as important and in which we become involved and express our views.

- *Strategy and capital structure*

It is the board's responsibility to determine the company's strategy, capital structure, and risk level. Folketrygdfondet will normally have questions relating to the company's strategic priorities, risk level, capital yield targets, dividend policy, and capital structure in relation to the company's goals. We will discuss these topics with the company when necessary.

The company's board must justify the company's need for equity and financing using borrowed capital. If the company's board requests authorisation to issue shares, both the size and objective of the authorisation must be assessed thoroughly. We will on an independent basis consider each case separately, based on both the characteristics of the case and ongoing processes in the company, but we will not normally vote for general share-issue authorisations that exceed 10 per cent. This limit also includes authorisations in connection with any convertible loan unless a specific loan approval has been granted and/or there is a justified need.

- *Composition of the Board of Directors*

Folketrygdfondet is concerned with whether the company's governing bodies have broad shareholder representation that can safeguard the company's and community of

shareholders' interests. The nomination committee's is responsible for ensuring sound processes for finding skilled candidates for governing bodies. The nominations of the nomination committee should be supported by the largest shareholders.

The board has an important function as the supreme supervisory and management body, and Folketrygdfondet shall contribute to making the composition of the board as optimal as possible. Recommendations for board member candidates must be prepared thoroughly, related to defined competence requirements and meet the independence requirements in the Norwegian Code of Practice for Corporate Governance (NUES). Where we find this correct and expedient, we will propose candidates and/or qualifications necessary for board members to nomination committees.

- *Management salaries*

Folketrygdfondet will base its voting related to management-salary declarations on its guidelines for management-salary schemes. Management-salary declarations will be reviewed and we will assess the scheme's criteria and conditions, whether the costs of the scheme are predictable, and whether the scope of the scheme is unreasonable or determined by external factors that the management cannot influence. The goal is to ensure the creation of compensation models that are targeted and provide motivation for long-term value creation.

Notices of general meetings must give a clear account of share and option programmes. Share and option programmes should be dealt with as separate items, so that it is clearly stated which parts of the management-salary declaration are to be approved by the general meeting. This assumes that there already exists, or that there is a separate proposal to grant a share-issue authorisation that specifically deals with the share issue to fulfil the programme.

- *Good corporate governance*

The companies' boards shall establish satisfactory management principles and values for the organisation. The board is responsible for implementation of the company's strategy and for establishing a good corporate culture. Folketrygdfondet expects the companies to identify, understand, and address business-critical factors relating to the environment and society. The types of material challenges will vary across sectors, companies and time-horizons. The companies must map important factors relating to the environment and society based on their own business model, strategy, and value chain. The financial consequences and sufficient handling of important aspects will vary from company to company.

It is not Folketrygdfondet's task to instruct companies on how to handle their important challenges, however. The board has the responsibility to ensure that these risk factors are addressed in a sufficient and expedient manner.

- *Reporting and openness*

We expect the companies to communicate financial information to the market and to give an account of their values, management principles, and significant environmental, social, and governance (ESG) factors. Correct, relevant and timely information is a prerequisite for conducting investment analyses of the companies. Reporting in accordance with the Norwegian Code of Practice for Corporate Governance (NUES) or a correspondingly relevant foreign code of practice is a minimum. Each company must itself consider which factors are important for the organisation, and explain and report on how it handles relevant issues that pose a material risk to the company. Follow-up and compliance with the company's own principles should form part of such a report. The companies must be conscious of their communication with shareholders and bondholders, and ensure that relevant information reaches the market quickly.

## 5 OPERATIONALISATION OF OUR EXERCISE OF OWNERSHIP RIGHTS

### 5.1 The equity portfolio

In companies in which we are shareholders, we exercise our ownership rights primarily through the following activities and arenas:

- *Dialogue*

Being a large shareholder carries certain responsibilities. As a large and long-term investor, an active and constructive dialogue with companies is one of our most important ownership activities. We must be available to companies and we expect companies to be available to us. Through meetings and other contact with the chair of the board and management, the companies get to know us and we get to know them. We have meetings with the administration to learn about the company's operations. In cases that are the board's responsibility, we communicate with the board verbally and in writing. Both Folketrygdfondet and the companies are aware that we must not receive inside information in our dialogue.

Our size means that we often have, and try to have, a dialogue with management and, if necessary, with the chair of the board, in order to discuss the company's development, strategy, goals and specific ownership issues. It is the board's task to ensure that strategy and risk are handled within the framework of good corporate governance. Folketrygdfondet's work with companies on issues and improvement processes can take place over several years.

The dialogue with companies is both proactive and reactive. A proactive dialogue is the ongoing dialogue in which we are updated on the company's operations and challenges. A reactive dialogue is linked to a specific event that requires the company to implement measures and actively relate to what has happened.

- *Attendance at general meetings*

The general meeting is the shareholders' most important arena for exercising ownership rights. Folketrygdfondet places emphasis on a good process leading up to the general meeting with regard to the issues to be dealt with. We contribute to ensuring the company presents issues on which there is broad agreement, and we are positive to dialogue with the company prior to the general meeting.

Folketrygdfondet votes at general meetings of the companies in which it owns shares. For companies listed on the Oslo Stock Exchange, we attend the meeting in person if practicable. If we vote via a proxy, we always provide voting instructions. In the Nordic companies, we normally vote via proxy due to capacity constraints.

Prior to a general meeting, we thoroughly review the items on the agenda. We vote in accordance with our principles, guidelines, and assessments. Our point of departure is to vote in accordance with the board's proposals. In the Norwegian companies, we explain our views to the company's management before the general meeting if we disagree with the board's proposal. Afterwards, we normally publish an explanation of our vote on our website if we vote against the board's proposal.

- *Participation in, and the proposal of candidates to, the nomination committee and governing bodies*

Folketrygdfondet expects companies in which it has invested to have a nomination committee that safeguards the community of shareholders' interests and ensures good processes so that the board as a whole has the right and relevant expertise. It is important to have well-functioning nomination committees and Folketrygdfondet tries to suggest candidates to them to the greatest extent possible.

Folketrygdfondet can participate in nomination committees of companies where it is a significant shareholder or where particular considerations merit in favour of becoming a member. By suggesting candidates to the nomination committee, we contribute to the board having the right and relevant expertise for the company's operations. We may also be represented on other corporate bodies, but may not accept board appointments.

- *Company analyses*

Thorough macro, sector, and company analyses comprise an important foundation for our investment activity. The goal is to map trends in development, risks, and potential that may affect sector and market conditions, as well as to identify quality companies. In the analyses of individual companies, assessments linked to financial factors, corporate governance, and environmental and social factors form an integrated whole. We will always try to have up-to-date information in order to have an overview of the portfolio's financial risk.

By investing widely in Norway and the Nordic region, we gain insight into the management of companies in the same and adjacent sectors, and into pricing and changes in value. We utilise our knowledge of sectors across national boundaries. Company analyses and sector-related issues in Nordic companies are often useful when investing in Norwegian companies.

- *Sector-related or systematic sustainability risk*

Some challenges are common to several companies in the portfolio. At all times, we focus on developments that we consider may comprise a specific risk to our portfolio. Climate risk is one such example. We follow up such developments both directly, through meetings and joint initiatives, and through surveys, lectures, and other involvement.

- *Cooperation with other shareholders*

Folketrygdfondet will cooperate with other shareholders on individual issues if we believe this is expedient for safeguarding our financial interests. Such cooperation may also give us more weight in the issues we raise with companies.

## 5.2 The fixed income portfolio

Within the management of fixed income securities, we do not have ownership rights. For this reason, there is also not the same regular contact between bondholders and issuers, as long as interest is paid and repayments are made in accordance with the loan agreement.

We focus on analysing how important factors linked to corporate governance, environmental, and social issues are safeguarded in the companies. The way in which an issuer deals with such factors speaks to the credit risk. We therefore integrate such analyses into our regular credit assessments. We believe that if more investors do the same, this may over time affect the companies' financing costs.

If a credit event occurs, such as a default on payment or breach of other clauses in the loan agreement, the bondholders must be involved. Folketrygdfondet will attend and vote at bondholder meetings. Normally, a representative will be appointed to represent the bondholders, but the representative's authority to make decisions is limited.

Folketrygdfondet is often one of the major bondholders and is thus responsible for arriving at a solution that all parties can accept. We therefore often play an active role in renegotiation and default situations. Good loan agreements are important, and Folketrygdfondet will make efforts to ensure that loans are issued with expedient loan clauses that are adapted to the

credit risk we believe the loan represents. We will not invest in a loan unless a representative is appointed.

### 5.3 Development of good practice

Folketrygdfondet takes part in several collaborative projects and initiatives linked to responsible investment activities in both a Norwegian and international context. We do so to exchange information and experiences with other investors, to remain up-to-date on new regulations and standards relating to corporate social responsibility and responsible business activity, and to contribute to the development of international best practices in this area. Through our participation in the UNPRI, we are obliged to report on our implementation of responsible investment activities.

Apart from such initiatives, Folketrygdfondet supports various measures and organisations with professional and sector-related interests and objectives that we believe are useful to the financial market. In addition to financial support, we can contribute our expertise by accepting positions on committees within relevant professional organisations. This applies to organisations such as the Norwegian Society of Financial Analysts and Norsif, as well as other initiatives linked to the capital markets, such as the Norwegian Institute of Directors (*Styreinstituttet*).

### 5.4 Company monitoring

Folketrygdfondet subscribes to a service that carries out an automatic online search for all the companies in its portfolios. These searches are systematised and based on global norms and standards, such as the UN Global Compact and OECD Guidelines for Multinational Companies, as well as environmental and human rights conventions. If a company in our portfolio is linked to a breach of these norms, our service provider will notify us. In this way, we can follow up how the companies comply with their own guidelines and whether their operations are in accordance with international conventions and recognised standards for responsible investment.

### 5.5 Exclusion from the Government Pension Fund Global's investment universe

If a company is excluded from the portfolio of the Government Pension Fund Global, Folketrygdfondet is obliged to do the same. For us, this only applies to companies listed in Sweden, Denmark or Finland, and has not been very relevant.

### 5.6 Expectation documents

Folketrygdfondet expects the companies' management and operations to comply with established corporate governance and corporate social responsibility standards. Different companies face different challenges, also in relation to corporate social responsibility. To make our expectations clear, Folketrygdfondet has prepared guides based on the UN Global Compact's 10 principles and the Norwegian Code of Practice for Corporate Governance. These expectation documents will be used in our dialogue with the companies and cover the following issues:

- Strategy, capital structure and financial targets
- Human rights
- Labor rights
- Environment
- Climate
- Anti-corruption
- Executive remuneration

### 5.7 Our reporting

Folketrygdfondet reports annually on the exercise of its ownership and creditor rights and

normally publishes an ownership report as part of its annual report. The ownership report gives an account of the activities that Folketrygdfondet has carried out to safeguard its ownership and creditor interests, and includes special issues discussed at general meetings, relevant issues that Folketrygdfondet has raised with companies, and the number and type of positions that Folketrygdfondet employees hold.

## 6 CHALLENGES LINKED TO OUR ROLE AS AN OWNER AND CREDITOR

Folketrygdfondet continuously strives to improve the way it exercises its ownership and creditor rights, in order to achieve better results and increased compliance with its principles and guidelines. Responsible investment activities can be challenging, not least because questions relating to corporate governance, social and environmental factors are rarely black or white. We face many dilemmas in our work with these types of questions.

The processes required to implement change are often long-lasting, and it can take time to reach solutions in accordance with our principles. If we do not feel that a company is implementing measures or working to improve, an alternative may be to reduce our shareholding or sell all our shares in the company.

Folketrygdfondet primarily seeks a trusting dialogue with portfolio companies. In our experience, this has produced the best results over time. Public criticism of, or disagreement with the companies is therefore not a goal in itself. However, if we are unable to reach agreement with the company, we will make our standpoint clear, publicly as well. We respect the fact that other shareholders and bondholders take a different approach in order to bring about public focus and awareness. The community of shareholders and bondholders contributes in different ways to putting important issues on the agenda.

We will always assess our work as an owner and creditor in relation to the results we can expect to achieve. At the same time, consideration of environmental, social, and corporate governance issues is one of several elements in an overall investment decision. There may be some parts of a company's corporate governance that are not in accordance with our principles, while we nevertheless are able to maintain a good, constructive dialogue with the company and confidence in the company's management. We must prioritise our resources based on the most important owner questions and/or those that may entail a financial risk. There will at all times be an overall assessment that takes into consideration the importance of the issue, the risk involved, and the probability that our views will be accepted, given that we are a minority shareholder.

Folketrygdfondet is a large owner and creditor, and that entails responsibilities. In difficult cases, we therefore want to contribute to a solution that forms the basis for further work in the right direction. It is important that not only Folketrygdfondet's but all parties' interests are safeguarded in these processes. That necessarily means we may support solutions which are not ideal based on our principles, but where our views have in part been accommodated.

We have experienced that, in some cases, our interests as a shareholder may conflict with our interests as a lender to the same company. It is essential to be aware that this type of conflict may arise. We have internal processes to ensure that our and the company's overall interests are safeguarded.

We place emphasis on dialogue and on the companies initiating change processes. The long-term nature of this work can make it difficult for the public to see immediate, measurable results from our responsible investment activities. Over time, however, we experience that companies become more aware of, and improve their compliance with recognised corporate governance principles. Folketrygdfondet attempts to a great extent to make portfolio

companies aware of the risks and challenges we believe they face, without stipulating measures or tools. The companies are best placed to determine how to handle these challenges.

It is important to have a clear division of roles between the community of shareholders and the board. We do not believe the general meeting should discuss or decide on general social issues, choose strategies or carry out assessments. We are concerned with maintaining the normal division of work between the board and the general meeting. As a shareholder, it is our task to elect a board that has the expertise to determine, implement, and follow up the company's strategy and to ensure that this takes place within the frameworks and values in place. The board is elected precisely for its ability to understand the company's challenges and issues and conduct the necessary evaluations before making a decision. However, as a shareholder, Folketrygdfondet will always ensure it is well informed about the company's strategy and operations in order to be able to assess whether the company's operations, developments, and growth are satisfactory and create value over the long term.