Publication of the decision following a due diligence assessment of companies in the Gulf States

KLP and the KLP Mutual Funds
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1. Summary

With effect from December 2023, KLP and the KLP Mutual Funds (KLP) have decided to exclude 12 companies from investment universe on the basis of a due diligence assessment of companies listed on stock exchanges in Saudi Arabia, Qatar, the United Arab Emirates and Kuwait (the Gulf States). KLP has excluded 11 of these companies because it considers that there is an unacceptable, sector-specific risk of contributing to human rights abuses. The excluded companies operate in the building and construction, property and telecommunications sectors. In addition, one company has been excluded on the basis of its close ties to a dominant state owner, combined with an active position in violation of KLP's expectations with respect to climate change mitigation and energy transition plans.

The exclusions follow from a due diligence analysis of KLP's investments in the Gulf States, as these are represented in MSCI's Emerging Markets Index. Qatar and the United Arab Emirates (UAE) have been included in MSCI's Emerging Markets Index since 2014. Kuwait joined the index in 2020. Although Saudi Arabia was included in the index in 2019, KLP has not invested in the country since we wanted to perform a comprehensive due diligence assessment of all the Gulf States before making any investments in Saudi Arabia. This assessment has now been completed. Companies in the Gulf States may now be included in KLP's portfolios, with the exception of the excluded companies listed in Table 1.

Table 1: List of excluded companies

SecName	Country	Industry Group
SAUDI ARAMCO	Saudi Arabia	Energy
EMIRATES TELECOM GROUP CO	United Arab Emirates	Telecommunication Services
SAUDI TELECOM CO	Saudi Arabia	Telecommunication Services
EMAAR PROPERTIES PJSC	United Arab Emirates	Real Estate
ALDAR PROPERTIES PJSC	United Arab Emirates	Real Estate
ETIHAD ETISALAT CO	Saudi Arabia	Telecommunication Services
MOBILE TELECOMMUNICATIONS CO	Kuwait	Telecommunication Services
DAR AL ARKAN REAL ESTATE DEV	Saudi Arabia	Real Estate
OOREDOO QPSC	Qatar	Telecommunication Services
MOBILE TELECOMMUNICATIONS CO	Saudi Arabia	Telecommunication Services
MABANEE CO KPSC	Kuwait	Real Estate
BARWA REAL ESTATE CO	Qatar	Real Estate

2. Framework for due diligence assessments

The UN's Guiding Principles on Business and Human Rights and the OECD's Guidelines for Multinational Enterprises guide KLP's decisions and actions. A key point in this respect is the requirement that due diligence assessments covering human rights, among other considerations, be performed prior to and as long as KLP has links with a company's business through the investments. The Norwegian Transparency Act, which came into force on 1 July 2022, requires Norwegian businesses to perform due diligence assessments on their supply chains. For KLP, this means that due diligence assessments must be performed ahead of particularly high-risk investments and that risk-related factors in existing investments must be clarified. Investments in the Gulf States are deemed to be of such nature.

According to KLP's guidelines for responsible investment, we must perform due diligence assessments on investments and may decide to divest from companies on due diligence-related grounds if a combination of country, sector and company risks means that there is an unacceptable risk of contributing to a violation of the guidelines.[1] At the same time, KLP is a broad, index-based investor that must balance due diligence assessments against a strategy that, to the greatest extent possible, reflects relevant market segments through representative indexes. Therefore, KLP aims to limit the number of excluded companies and instead focus on exercising active ownership to encourage improvement. The objective is not to eliminate sustainability risk, but to be aware of the portfolio's latent risk and use resources systematically to keep this at an acceptable level.

3. Risk associated with investing in the Gulf States

The Gulf States are all independent countries located on the Arabian Peninsula in the Middle East, and share a number of cultural, religious and political attributes. All the states have some form of monarchy, with the powers of the monarch ranging from substantial political influence to sole and absolute authority. The Gulf States are rich in natural resources, particularly oil and gas. In 2020, it was estimated that 48.3 per cent of the world's oil reserves are to be found in the Middle East.[2] In recent years, the Gulf States have invested heavily in development and infrastructure, and have increasingly opened up for outside investments. Across the entire region, part of the economy unrelated to oil and gas extraction is growing annually by 4.8 per cent.[3] The need for expertise and labour has resulted in a large proportion of the workforce in these countries being migrant workers.

[1] https://www.klp.no/en/english-pdf/Guidelines%20for%20KLP%20as%20a%20responsible%20investor.pdf
[2] https://snl.no/energikilder
[3] https://www.arabnews.com/node/2391626/business-economy. GCC includes all the countries in this analysis, in addition to Bahrain and Oman.

For many years, human rights organisations like Human Rights Watch and Amnesty International have highlighted migrant workers' poor employment conditions.[4] The Kafala (sponsorship) system, under which each migrant worker needs a sponsor to get a job, has been widespread throughout the region. The arrangement has also been used to restrict many workers' freedom to move freely in and out of the country. In the past few years, the Kafala system has been somewhat modified in all the Gulf States, with workers being given greater rights. For example, in some places, they are now entitled to change jobs without their existing employer's approval.[5]

Human rights organisations continue to express concern about the level of human rights compliance in the Gulf States. For KLP as an investor in listed companies, the treatment of migrant workers is a particularly relevant risk. While welcoming the reforms made to the Kafala system, human rights organisations point to challenges associated with monitoring and ensuring compliance with the new laws. Apart from the risk associated with the rights of migrant workers, restrictions on political freedoms also constitute a significant challenge.

In order to perform risk assessments, KLP has obtained data and information from a number of different sources, including:

- Conversations with public officials familiar with the countries in the region
- Conversations with human rights organisations
- International indexes showing where the Gulf States are ranked with respect to civil and political rights and working conditions. The indexes used are:
    a. **Global Rights Index 2023**,[6] which assesses countries on the basis of their compliance with collective labour rights and documented violations of internationally recognised rights by public authorities and employers.
    b. **Freedom House: Freedom in the World Index 2023**,[7] which measures the degree of political rights and civic freedoms in countries worldwide.
- Articles and reports describing the Gulf States' development of human rights, corporate governance[8] , the private business sector,[9] and reporting from the companies.

[4] https://www.hrw.org/news/2023/06/16/qatar-six-months-post-world-cup-migrant-workers-suffer
[5] https://www.theguardian.com/global-development/2020/sep/01/new-employment-law-effectively-ends-qatars-exploitative-kafala-system
[6] https://www.globalrightsindex.org/en/2023
[7] https://freedomhouse.org/report/freedom-world
[8] https://www.ecgi.global/code/corporate-governance-regulations-kingdom-saudi-arabia-1
[9] https://www.norway.no/no/saudi-arabia/for-nordmenn/muligheter-for-norsk-naringsliv-i-saudi-arabia3/

On the basis of an analysis and review of these sources, KLP has identified two sectors in the Gulf States where we consider that there is a generally unacceptable risk that KLP may contribute to human rights abuses. These sectors are telecommunications and building, construction and property.

3.1. Telecommunications

Numerous important issues must be addressed when investing in the telecommunications sector in the Gulf States. The states are characterised by an authoritarian system of government that restricts freedom of expression and political rights.[10] Several companies have been accused of engaging in the widespread and systematic surveillance of the population, both on social media and through other communication channels.[11] Surveillance of this kind violates key human rights. The development of advanced technology, including artificial intelligence (AI), reinforces the risk of systematic surveillance and censorship.[12] Telecoms companies depend on the authorities for licences, and their equipment and customer data could be misused to persecute critical voices and opposition figures in those countries. Critics and human rights activists have been arrested, with many convicted as terrorists and sentenced to lengthy terms of imprisonment.[13] The authorities' lack of respect for human rights therefore constitutes a significant risk that companies in the telecommunications sector could contribute indirectly to the violation of fundamental human rights. The authorities' key role makes it difficult for KLP to influence these companies. It has therefore been decided that companies associated with telecommunications in the Gulf States shall be excluded from KLP's investments.

3.2. Building, construction and property

Building, construction and property is a labour-intensive sector, where the high proportion of migrant workers poses a risk. Most of the workers come from Africa or Asia. All migrant workers in the Gulf States have been subject to the Kafala system, which has been heavily criticised, and there have been multiple well-documented cases of migrants' rights being abused, particularly in the run-up to the 2022 FIFA World Cup in Qatar.[14]

The fact that there may be differences in how conservative, discriminatory and widespread the Kafala system has been in the different countries should nevertheless be taken into account. Several of the states have also introduced labour reforms which will formally ease

[10] https://rsf.org/en/region/middle-east-north-africa
[11] https://rankingdigitalrights.org/2019/06/12/arab-regions-telecommunications-companies-fail-to-respect-users-digital-rights/
[12] https://freedomhouse.org/report/freedom-net/2023/repressive-power-artificial-intelligence#regulating-ai-to-protect-internet-freedom
[13] https://www.amnesty.org/en/latest/campaigns/2022/10/silence-is-king-the-persecution-of-activists-in-the-gulf/
[14] https://amnesty.no/sportsvasking-vm-i-qatar; https://www.business-humanrights.org/en/latest-news/qatars-world-cup-has-highlighted-abuse-of-migrant-workers-that-is-rife-across-the-region/

restrictions and discrimination, although it is unclear what effect this will have in the short term. It is important to underline that the low level of press freedom and freedom of expression in each country makes it difficult to obtain a full overview. Furthermore, Human Rights Watch reports that although the new reforms have brought improvements, they do not go far enough in abolishing the discriminatory system.[15] The probability that KLP, through its shareholdings in the sector, is contributing to the abuse of human rights is therefore deemed to be high. For this reason, it has been decided to exclude companies in the building, construction and property sector in the Gulf States from KLP's investments.

3.3. Dominant state ownership and weak plans for transition: Saudi Aramco

The combination of an authoritarian system of government and a lack of human rights compliance, as described above for the Gulf States in general, entails a specific risk relating to companies with close ties to the public authorities. Since the Saudi state owns 90 per cent of the shares in Saudi Aramco, it is, in practice, difficult for other shareholders to influence the company through the exercise of active ownership. As such, the company appears to be associated with a particularly high level of risk.

At the same time, Saudi Aramco is the world's largest oil company and is therefore also assessed considering KLP's goal of reducing greenhouse gas emissions to net zero in 2050, in line with the Paris Agreement and the goal of limiting global warming to 1.5°C. A rapid transition in the petroleum sector is critical to reach these targets and is a priority topic for the exercise of KLP's ownership.

In a ranking of the largest oil and gas companies' climate-related goals and transition plans, performed by the Carbon Tracker organisation, Saudi Aramco comes last of the 25 companies ranked.[16] Climate Action 100+ performs a detailed annual review of 40 oil and gas companies. The companies are not ranked, but Saudi Aramco scores "red" on majority of the indicators associated with climate goals, climate policy and transition plans.[17] The company's climate policy and lobbying efforts reflect the dominant owner's active opposition to the phasing out of oil and gas as a climate mitigation measure. Close links between the state and the company result in a significant overall ability to leverage power and influence in favour of a climate and energy transition policy that runs counter to KLP's goals.

[15] https://www.hrw.org/world-report/2020/country-chapters/qatar
[16] https://carbontracker.org/aramco-worlds-biggest-oil-giant-ranks-last-on-climate-targets/
[17] Saudi Arabian Oil Company (Aramco) | Climate Action 100+

Based on an overall assessment of the company's close ties to an authoritarian state and an active position in opposition to KLP's expectations regarding oil and gas companies' climate change and energy transition plans, it has been decided to exclude Saudi Aramco from KLP's investments.

3.4. Other investments in the Gulf States and active ownership

As a broad, index-based investor, KLP strives to as far as possible reflect relevant market segments through representative indexes. Investments in countries and companies that entail risk of human rights abuses may be justified where we believe we can achieve improvements through the exercise of active ownership and dialogue. However, this presumes the existence of the necessary conditions for such a dialogue and the exercise of shareholder influence. Despite the risk picture discussed above, and the exclusion of companies in several sectors, there are opportunities for KLP to have a positive impact in the Gulf States. The desire to attract international companies and investors has led to the professionalisation of business, especially in listed companies, including accessibility and opportunities for dialogue with the management of the companies.

KLP has found engaging in dialogue with companies based in the Gulf States to be fruitful. Going forward, KLP will continue to prioritise the exercise of shareholder influence relating to issues that are particularly challenging in the Gulf States, including migrant workers' rights, equality and diversity at management level. KLP further expects companies to work systematically to promote equality and diversity in their operations. An equal gender balance and increased diversity should be the goal in all parts and at all levels of the business. The exercise of shareholder influence with respect to other sustainability issues that are relevant for companies in this region is assessed on an ongoing basis.