



NORWEGIAN MINISTRY OF FINANCE

Norway's Government Pension Fund:
Investing for the long run

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*Tom A. Fearnley
Asset Management Department*

Outline

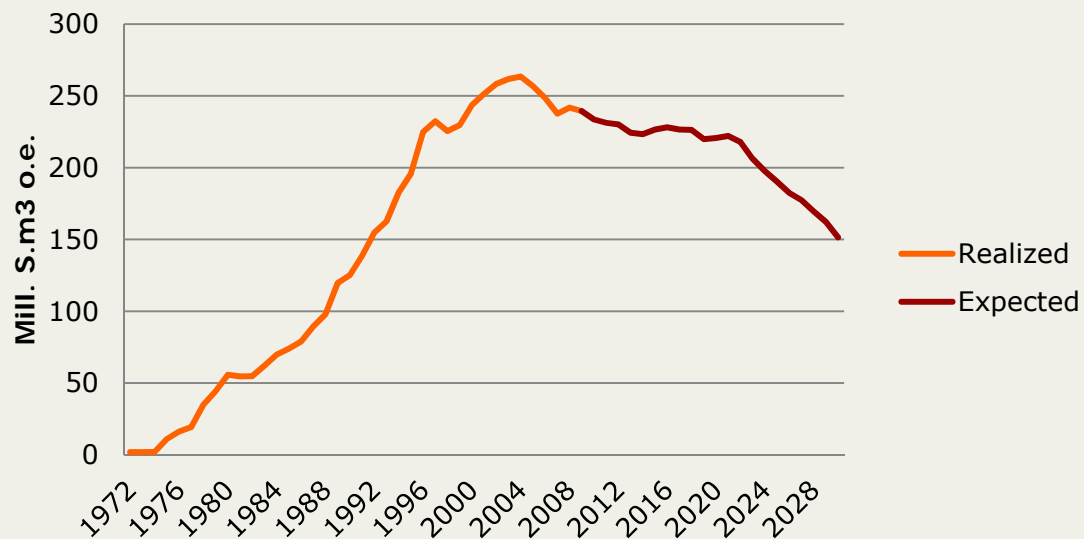
- **Norway's oil wealth**
- Norway's Government Pension Fund

Finding oil and gas

- 1963: Government proclaimed sovereignty over the Norwegian continental shelf (NCS). New regulation determined that the State owns any natural resources on the NCS.
- 1965: Agreements on dividing the continental shelf in accordance with the median line principle were reached with UK and Denmark. The first well was drilled in the summer of 1966, but it was dry.
- 1969: First discovery ! The Norwegian oil adventure began. Production from the EKOFISK field started on June 1971, and in the following years a number of major discoveries were made.

Oil and gas production

- Production peaked in 2004, but still large.
- 2nd largest natural gas exporter and 7th largest oil exporter.
- About 44 per cent of reserves have been extracted

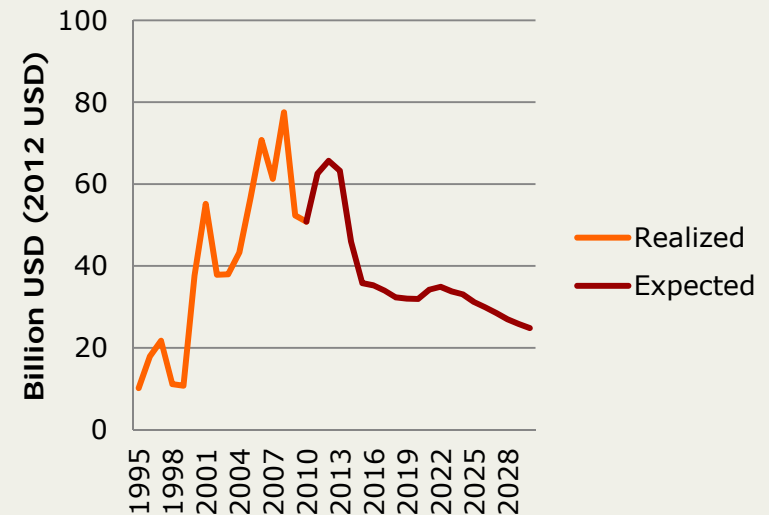
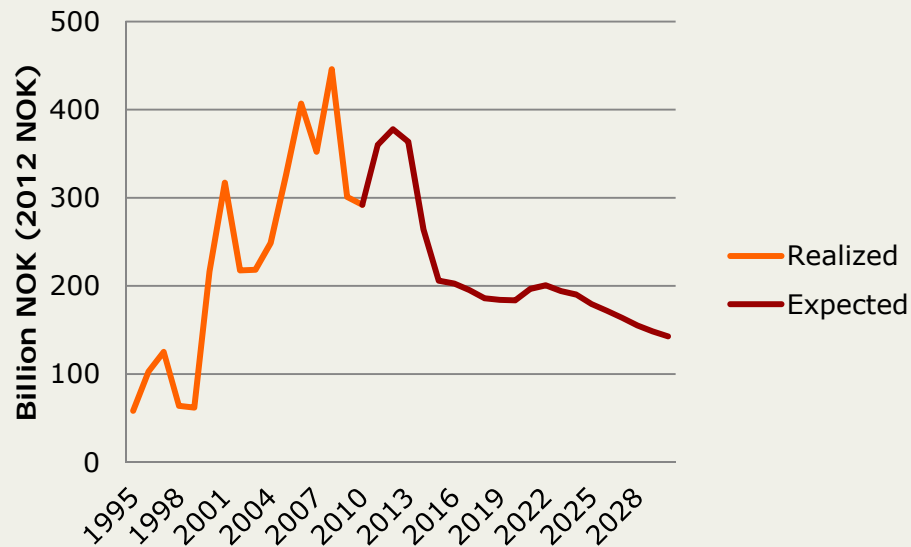


Government's oil and gas revenues: Three direct sources

- State oil and gas company STATOIL
 - Partially privatized and listed in 2001. The state maintains 67 % ownership of STATOIL (through Ministry of Petroleum and Energy).
- State's direct ownership of oil and gas fields (State's Direct Financial Interest, SDFI)
 - Ownership through the state-owned limited company PETORO (est. 2001), managing the SDFI on behalf of the State.
- Taxation of other oil and gas companies (foreign and Norwegian).

Large state revenues from oil and gas

- Government's oil and gas revenues (net cash flows)



- Large inflows also compared to GDP:
 - Net cash flow 2011: 360 bn NOK
 - GDP: 2700 bn NOK (Onshore: 2100 bn NOK)

Outline

- Norway's oil wealth
- **Norway's Government Pension Fund**

Fund's history

- State's oil and gas revenues too large to be spent in the Norwegian economy.
- Instead, broad political agreement to save the revenues by investing them abroad for the future.
 - "Petroelum Fund" established by act of Parliament in June 1990.
 - First deposit of 2 bn NOK made 31 May 1996.
 - Fund renamed "Government pension fund" in 2006, to highlight future pension obligations of the state.
 - But no pension fund with liabilities. Rather, a commodity based SWF.

Fund serves four purposes

- Shields the Norwegian economy from overheating and "Dutch disease".
- Saves the revenues for future generations.
 - "Future generations fund"
- Provides fiscal buffer for "rainy days".
 - "Fiscal buffer fund"
- Gradually replaces oil and gas income as revenue source for the state.
 - Physical oil/gas asset is gradually transformed into financial asset.

Government Pension Fund: two parts

Originally established 1990. First deposit 1996.
Renamed 1 January 2006.
Managed by the Ministry of Finance

Government Pension Fund Global (former Government Petroleum Fund)

- Invested abroad
- Operational management: Norwegian Central Bank (Norges Bank)
- NOK 3 561 billion (USD 595 bn) end of Q2 2012

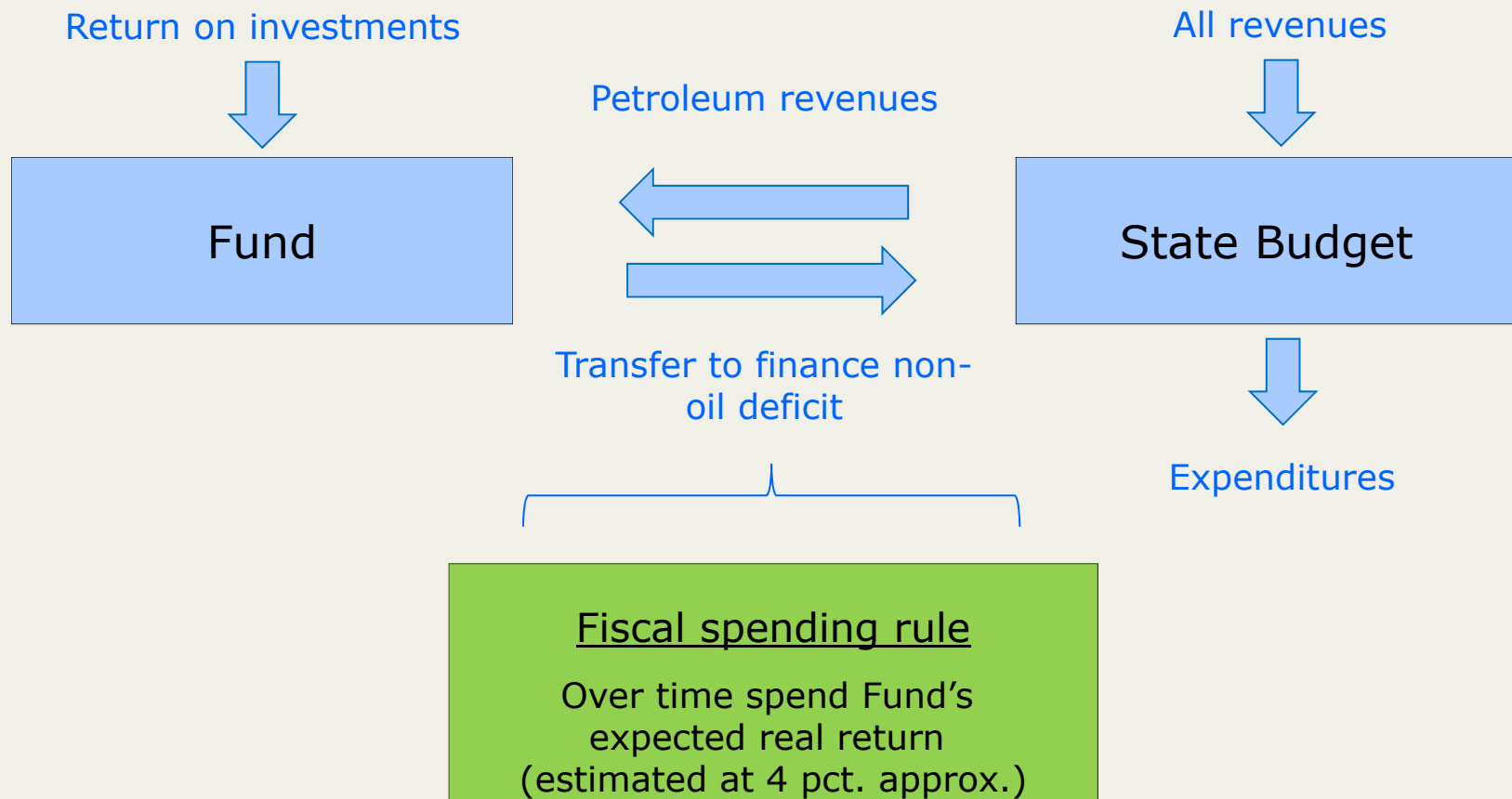
Government Pension Fund Norway (former National Insurance Scheme Fund)

- Invested in Norway (85%) / Scandinavia
- Operational management: "Folketrygdfondet"
- 136 billion NOK (USD 23 bn) end of Q2 2012

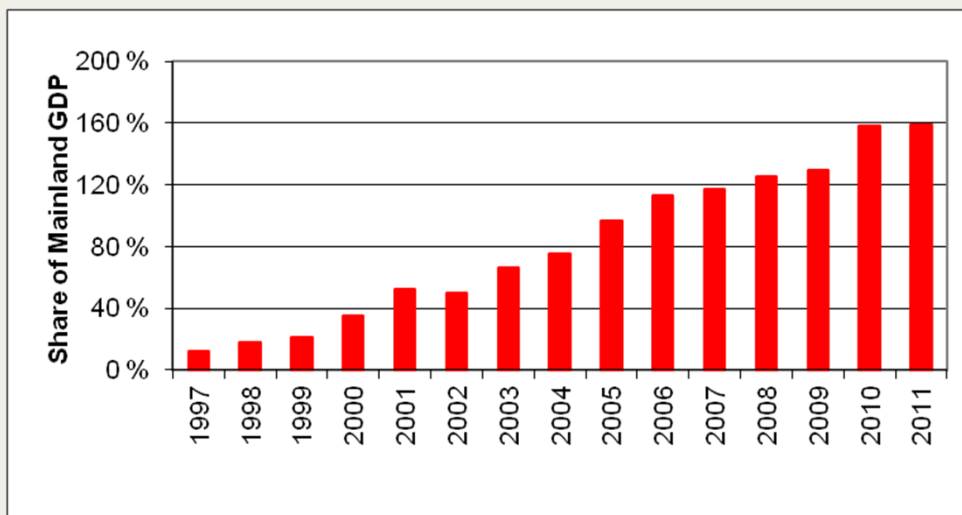
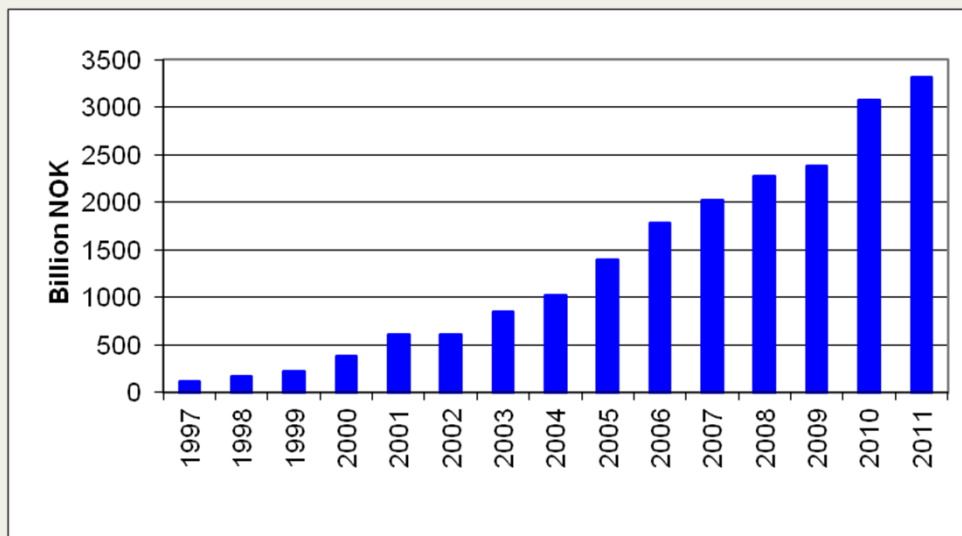
But government doesn't save *all* revenues

- Also current generations shall benefit.
- 2001: Fiscal spending rule established by Parliament:
 - Spend over the budget *the expected real return of the fund* (4 per cent of the fund value each year).
 - When economy is doing well: Spend less.
 - When economy needs fiscal stimulus: Spend more.
 - On average over time, spend 4 per cent.
 - Note: Rule preserves expected real value of fund.

The GPFG is fully integrated with fiscal policy

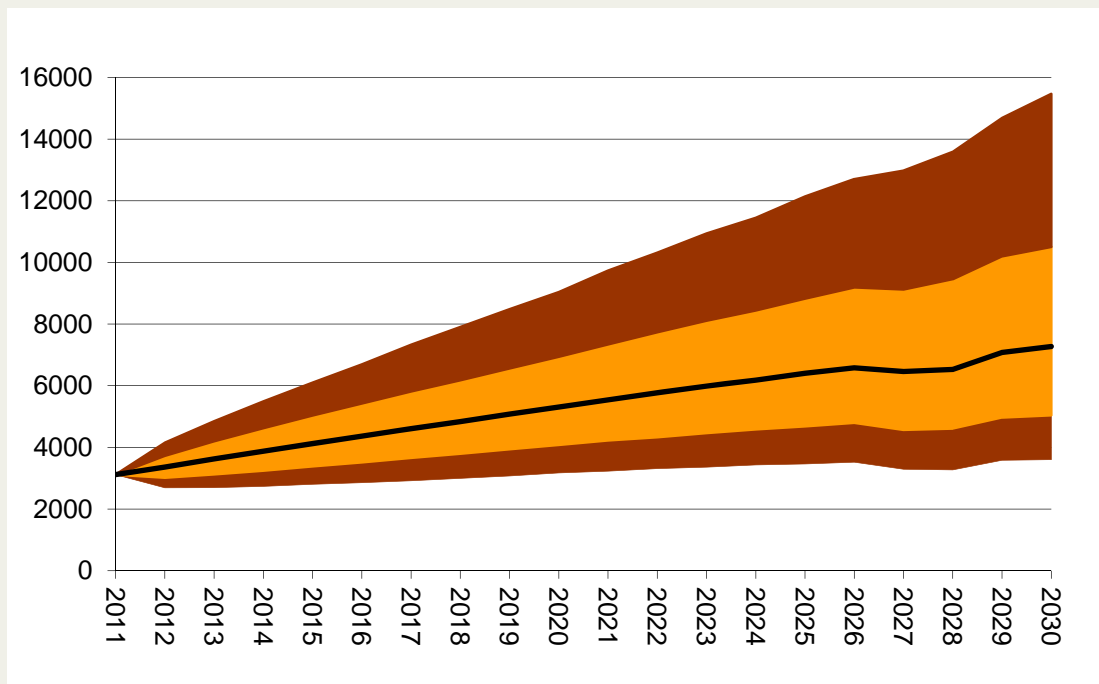


Government Pension Fund Global has grown rapidly...

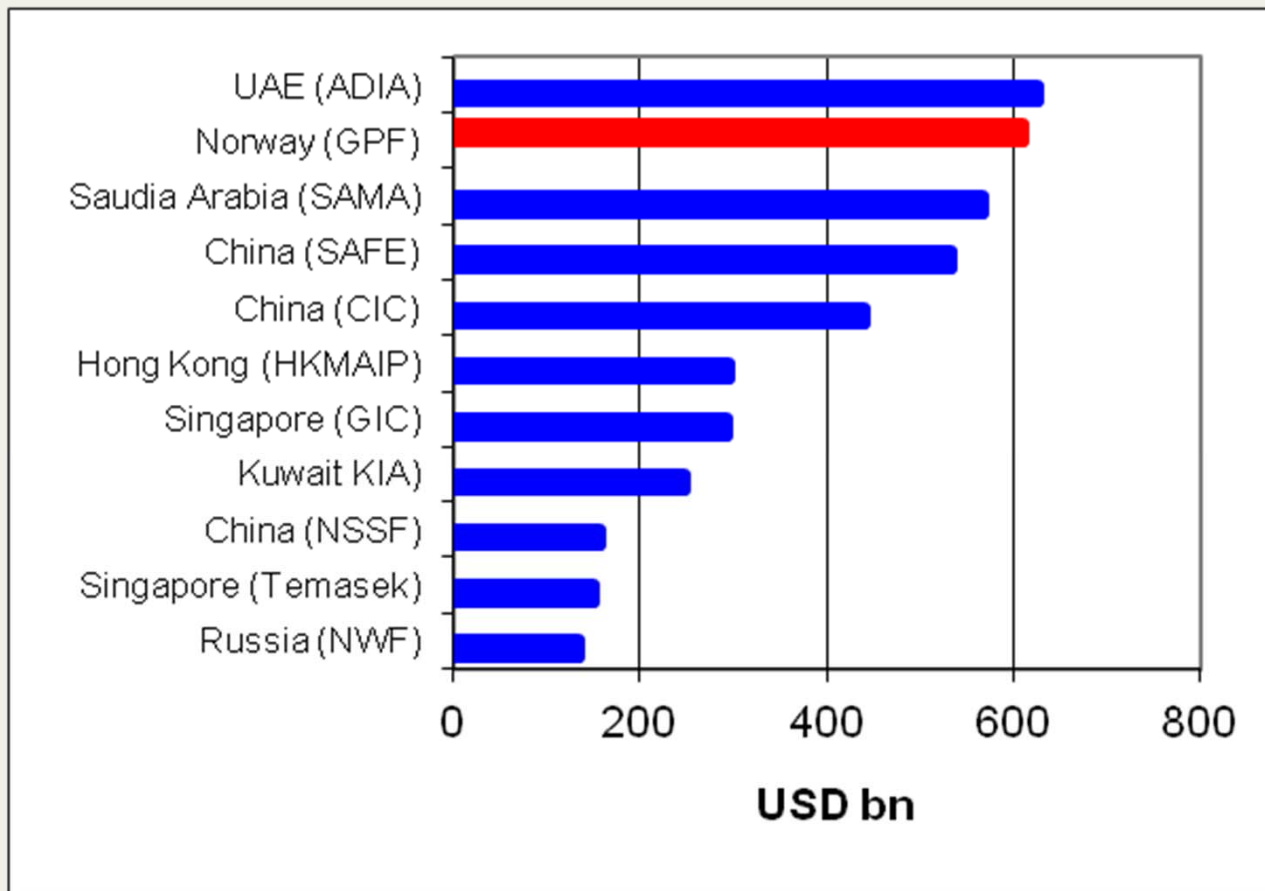


and is expected to grow further...

- Expected growth and uncertainty (68 % and 95 % confidence bands), in billion NOK:



Fund is 2nd largest Sovereign Wealth Fund (Source: SWF Institute 2012)



The Fund holds significant ownership shares in global financial markets

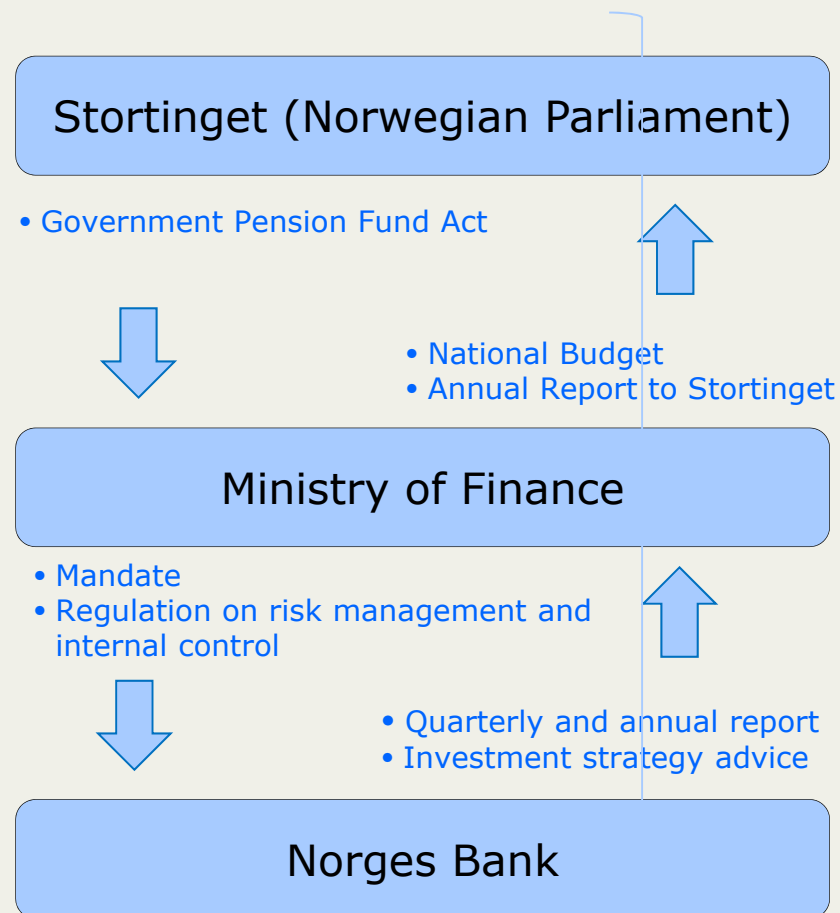
- 1 per cent of world listed stock market.
 - (2 per cent of European).
- 0.6 per cent of world investment grade bond market.
 - (1 per cent of European).

Governance structure: Division of responsibilities

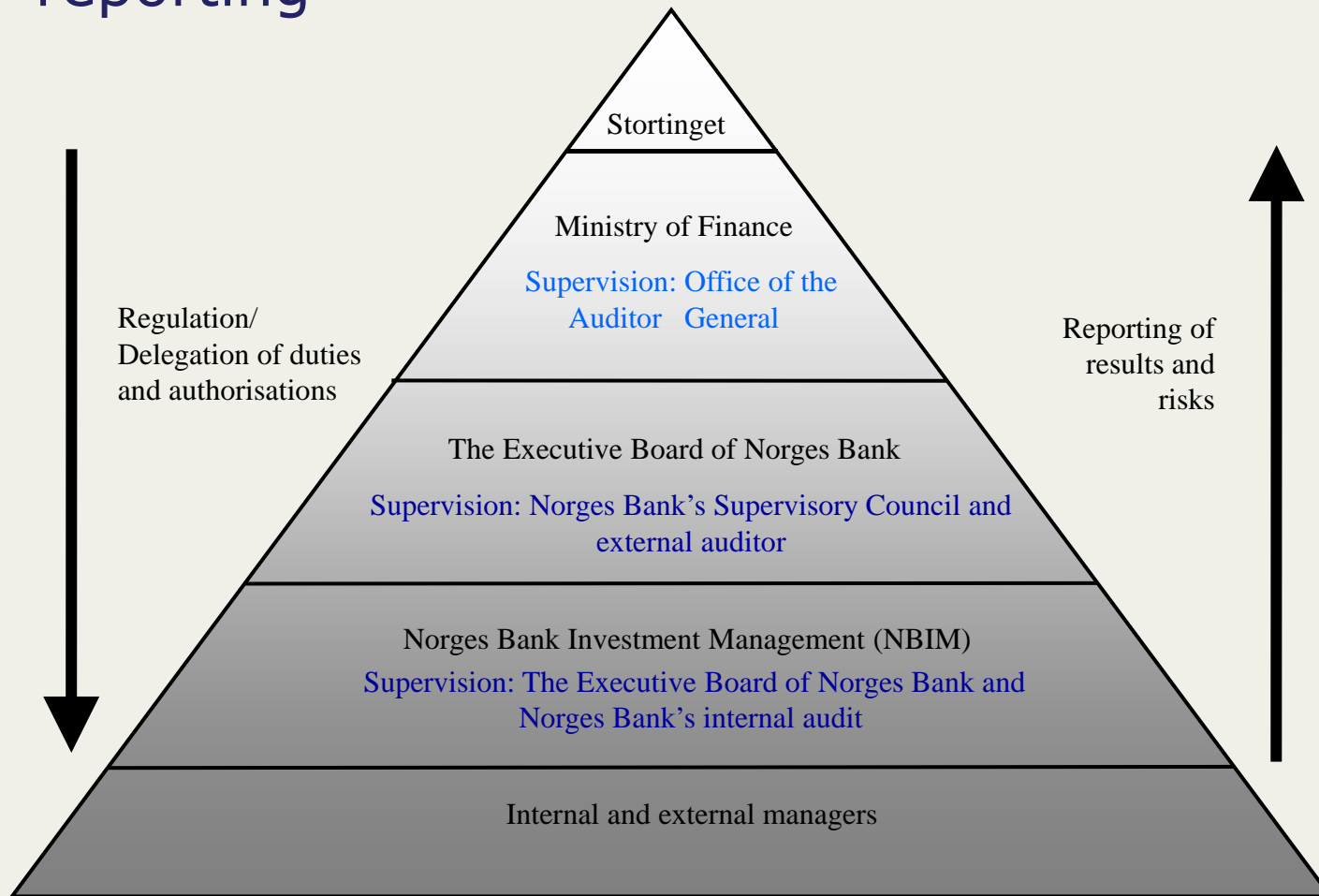
- *Owner (Ministry of Finance)*
 - Decides investment strategy (strategic benchmark, rebalancing scheme, scope of active management, investment universe).
 - Monitors operational manager.
 - Develops ethical guidelines.
 - Reports to Parliament.

- *Operational manager (Norges Bank, the Central Bank)*
 - Implements investment strategy.
 - Invests monthly inflows.
 - Runs active management program.
 - Exercises fund's ownership rights.
 - Reports to Ministry of Finance

Governance structure...



Hierarchy of regulation, supervision and reporting



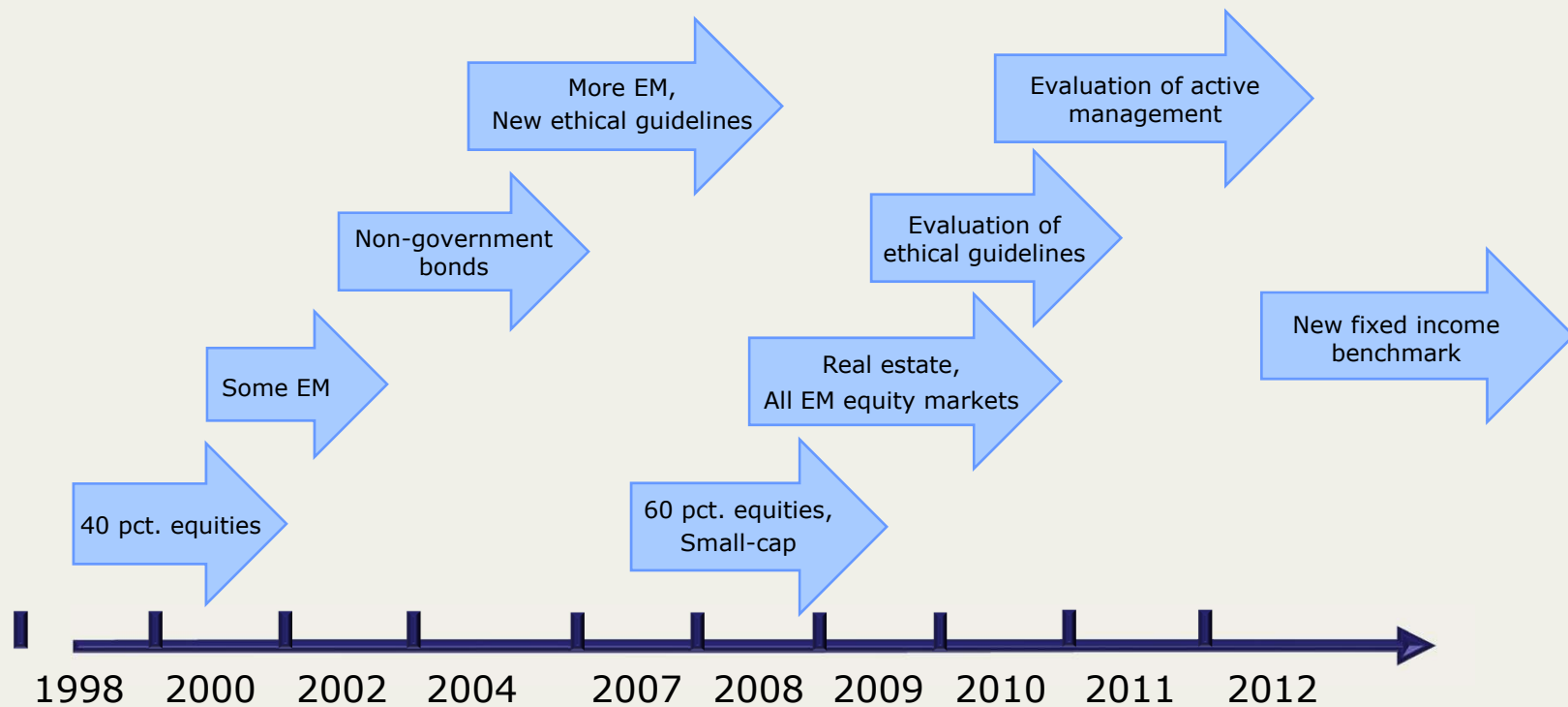
Our circumstances

- No clearly defined liabilities (not a pension fund).
- **Indefinite investment horizon.**
- Therefore, strong risk bearing capacity
 - Year to year volatility of less concern.
- However, spending rule based on long run expectation of 4 % real return annualized.
- Is this the Fund's liability ?
 - Not quite. Stated objective is to "maximize international purchasing power given moderate risk".
 - Reflects fact that fund will ultimately be used to finance imports.

Investment strategy

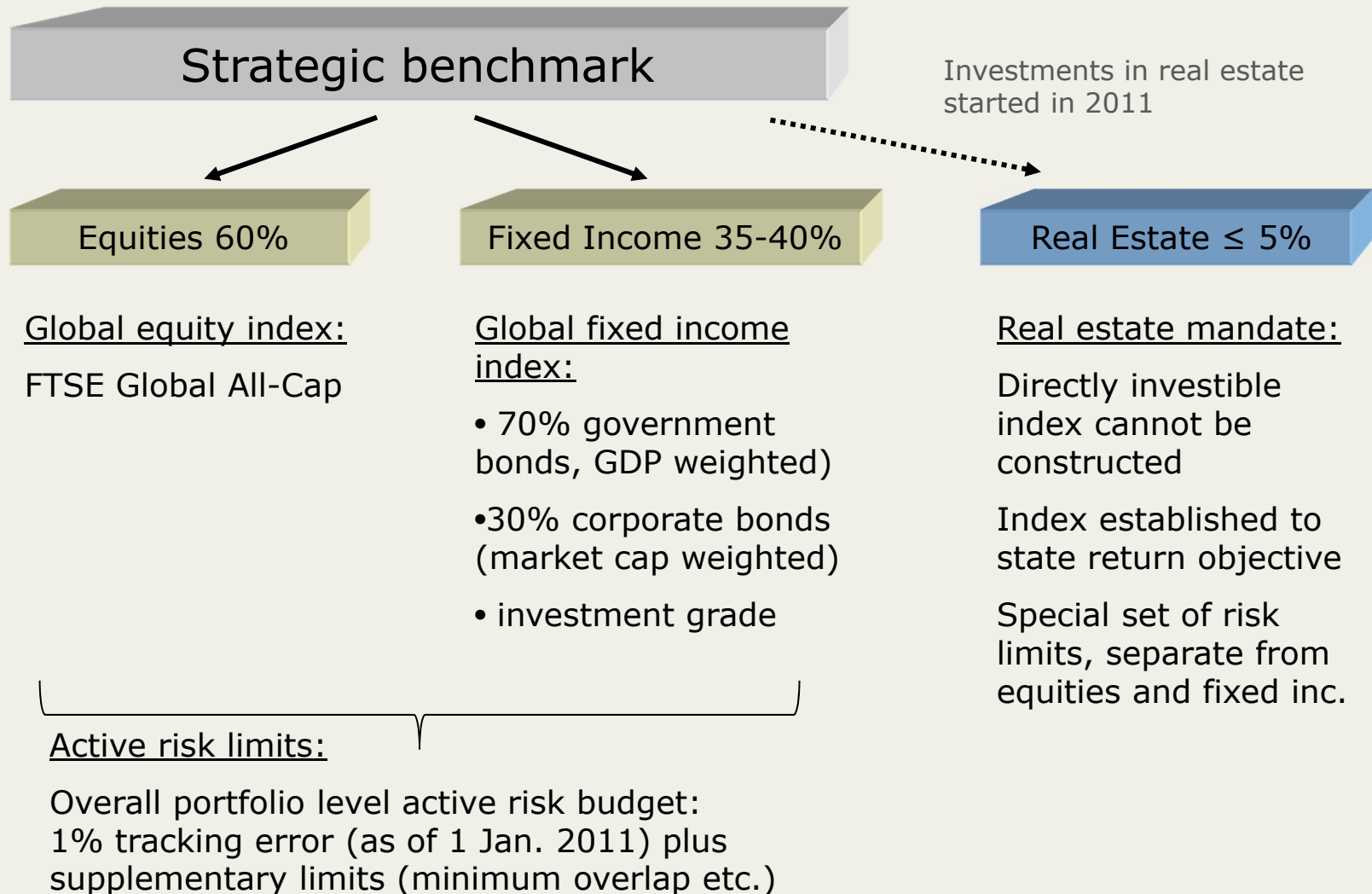
- Build on clear governance structure.
- Harvest risk premia over **very long investment horizon**. Heavy reliance on equity risk premium.
- Reduce risk through diversification. Max. ownership share of companies is 10 % (“financial investor”).
- Rebalance portfolio according to mechanical (non-discretionary) rebalancing rule.
- Emphasise cost efficiency.
- Seek excess return through limited active management program.
- Emphasise role as a responsible long term investor / universal owner: Exercise ownership rights and integrate ESG into investment process.
- Be transparent.

Gradual changes to the investment strategy

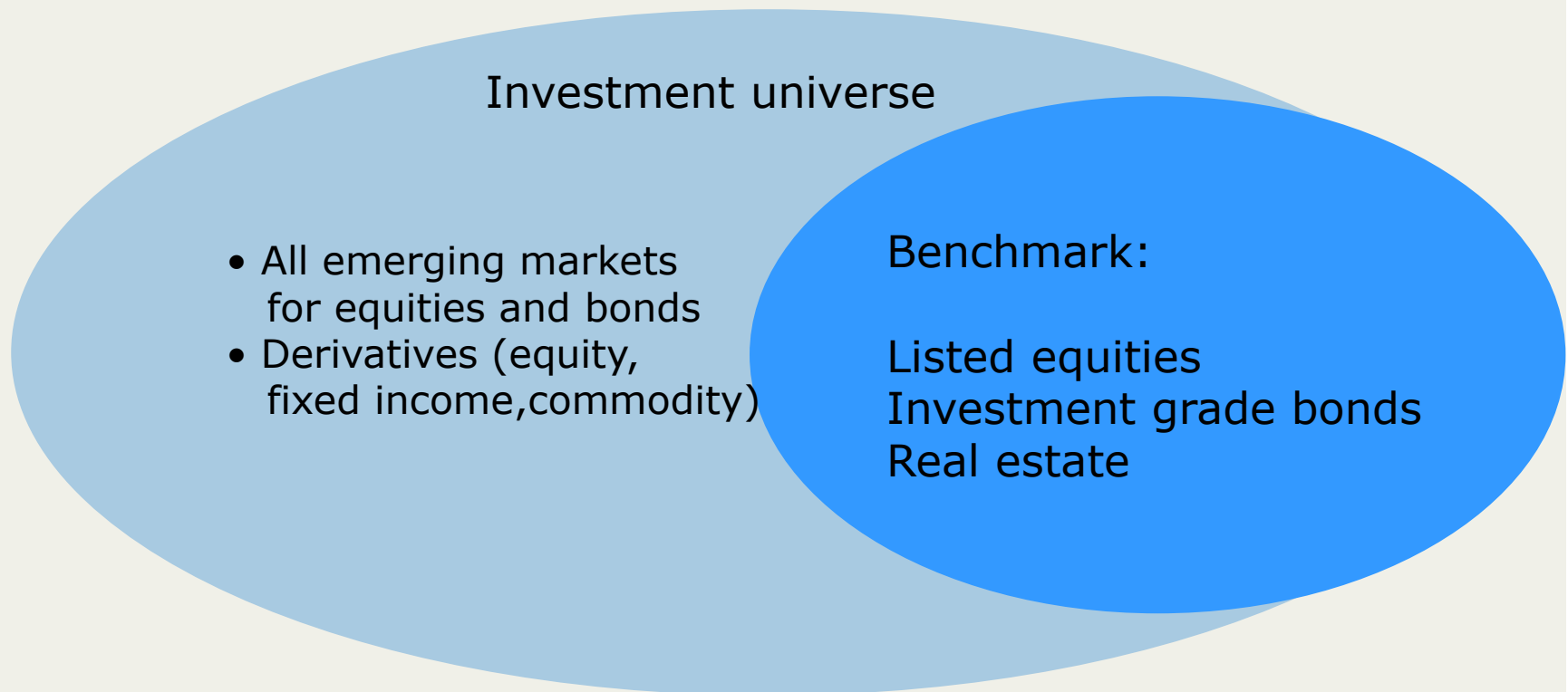


1996-1997: 100 % government bonds

Strategic Asset Allocation for the Fund



The investment universe gives significant degree of freedom for Norges Bank's active management



Market risk budget:
100 bp tracking error on total portfolio

Corporate governance and ESG integration

Two complementary goals:

- 1) To ensure sound financial returns so that future generations will benefit from the petroleum wealth.
 - ❑ One of many tools:
Exercise ownership rights (corporate governance).

- 2) To respect the environment and the fundamental rights of those who are affected by the companies in which the Fund invests. Two main tools:
 - ❑ Exercise ownership rights / integrate ESG in investment decisions.
 - ❑ Follow guidelines for the *observation* and *exclusion* of companies that fail to satisfy our *product-based* or *conduct-based* standards.

Observation and exclusion of companies

Product-based exclusion

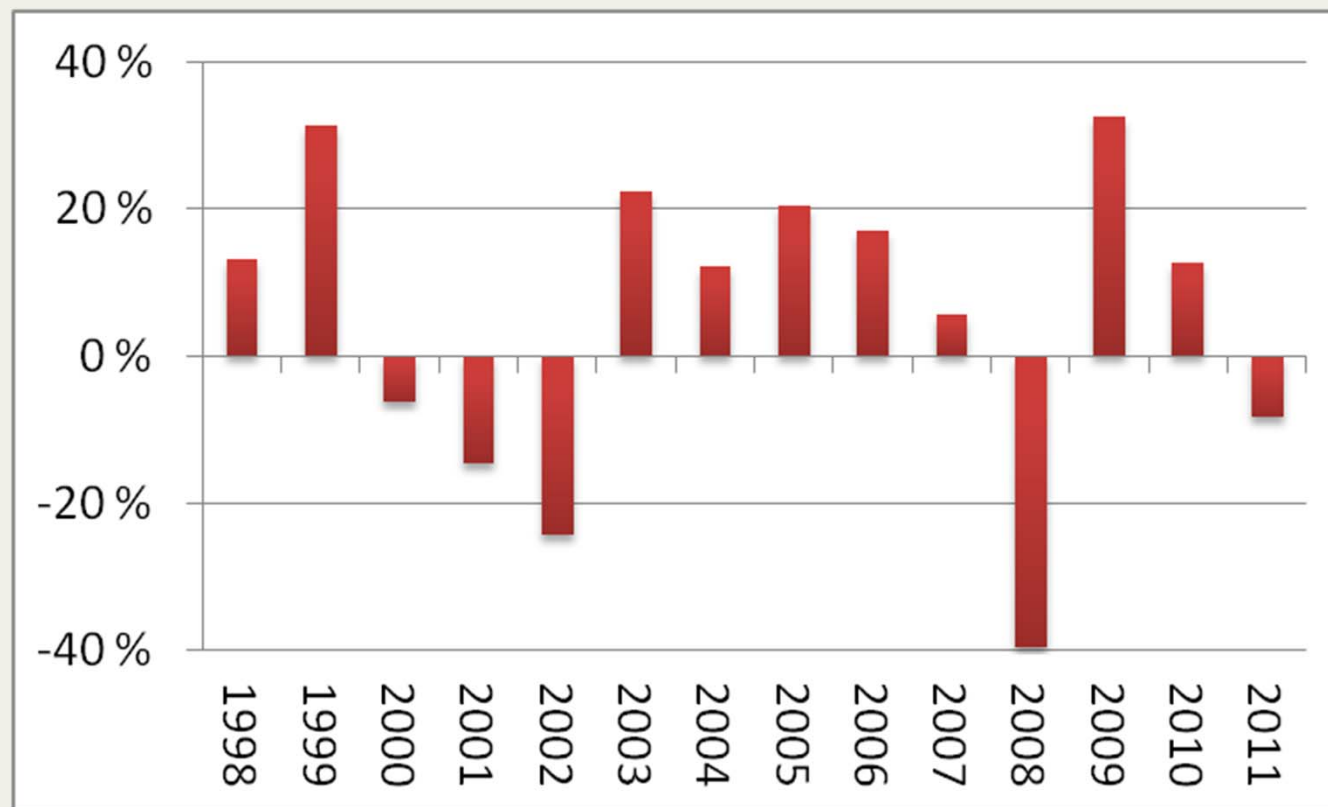
- Companies producing
 - specific weapons
 - tobacco

Conduct-based exclusion

- Companies responsible for serious or systematic violations of fundamental ethical norms, among them:
 - ✓ human rights / labor rights
 - ✓ corruption
 - ✓ environmental damage
 - ✓ other violations of fundamental ethical norms

The Ministry of Finance has excluded 55 companies, and placed two under observation as of end-2011.

The fund has experienced volatile equity markets



In 2008, the entire inflow of new money, almost 70 bn USD, was invested in the stock market.

Moderate long term real return expectations

- Over very long investment horizon we expect:

	Global government bonds	Global real estate	Global stocks
Expected real return, geometric	2.5 %	3.5 %	5.0 %
Expected volatility	6 %	12 %	16 %

Resulting expected long term real return

- Expected long term real return: approx. 4 %
- Expected volatility: approx. 10 %
- But realized real return 1998 – Q2 2012 only 2.57 %
- Well below the long term expectation !
- Should the long term expectation be revised ?
Currently hotly debated in Norway !

Summary: Main characteristics of Fund

- Very large and growing SWF
 - Owns roughly 1 % of world's stock market
- Very long investment horizon
 - In practice unlimited
- Purely financial investor
 - Max ownership share in listed markets: 10 %
- No clearly defined liabilities
 - But is funding a structural non-oil budget deficit through a fiscal spending rule.
- Highly transparent. Emphasises role as a responsible long term investor / universal owner.

Contact details

Norwegian Ministry of Finance
Asset Management Department
P.O.Box 8008 Dep.
NO-0030 Oslo, Norway

Visiting Address: Akersgt. 40
Telephone: +47 22 24 45 10
E-mail: postmottak@fin.dep.no

Links

Ministry of Finance

- www.regjeringen.no/en/dep/fin

Government Pension Fund

- www.government.no/gpf

Norges Bank Investment Management

- www.nbim.no