

Management of the Government Pension Fund Global

Yngve Slyngstad's introduction to the Storting's hearing on the Government Pension Fund Global.

Please note that the text below may differ from the actual presentation.

I would like to thank the chair and members of the Committee for this opportunity to present the management of the Government Pension Fund Global to the Storting.

Chart: The GPFG's market value

2008 was a challenging year. The GPFG lost NOK 633 billion in international currency. Since then, there has been a return of NOK 716 billion. It appears that the GPFG has made it through the greatest financial crisis for many decades without loss. At the end of the first quarter, the market value of the GPFG was NOK 2,763 billion.

When our grandchildren come to benefit from the return on the GPFG sometime in the future, the swings in market value in NOK terms over the past two years will not stand out in particular.

Chart: Key figures 2008-2010

The most important strategic choice made by the GPFG's owner is the degree to which the GPFG is to be an owner or a lender in global financial markets. Historical experience suggests that it is more profitable to be an owner than a lender. As a shareholder, however, we have to be prepared for fluctuations of the kind seen over the past two years. Indeed it is this variation in return that leads us to expect a higher return on equities than bonds in the long term.

The closest the GPFG can get to risk-free investment is not to put its money in the bank but to buy short-term government debt, or Treasury bills. During the 12 years since the GPFG began to invest in equities, the total return has been NOK 586 billion. This corresponds to a real annual return of 2.9 per cent. The real return on Treasury bills during the same period was around 2 percentage points lower.

There have been a number of sharp downturns in equity prices over the years. These periods have been followed by periods of strong gains and high returns. For better or for worse, the GPFG is exposed to developments in the global economy. Broad ownership of global equity markets means that we hold a stake in the global market economy's production capacity.

Chart: Equity purchases and equity index

In June 2007, the Storting approved an increase in the GPFG's allocation to equities from 40 to 60 per cent, and a corresponding decrease in its allocation to bonds. Over the next two years, we invested a total of NOK 1,010 billion in equities.

Chart: The GPFG's ownership of equity markets

These extensive equity purchases have meant that the GPFG now has a substantial ownership interest in very many companies. For future generations, the most important consequence of the financial crisis for the GPFG may well be that we doubled our holdings in global equity markets in two years.

Chart: Active market risk in the management of the GPFG

The issue of active versus passive management of the GPFG has its origins in the theoretical question of whether financial markets are efficient – whether all available information is reflected in prices at all times. The practical question that NBIM encounters daily is whether we should build up knowledge and understanding of what we are investing in.

One common misconception is that active management means high levels of risk. To date, active management has accounted for only a small part of the GPFG's overall market risk. Properly implemented, active management will serve to decrease rather than increase total risk. Knowledge of the companies in which the GPFG invests and the countries to which it lends puts us in a position to evaluate the underlying risk associated with our investments.

As one of the world's largest shareholders, the GPFG has a duty to allocate capital to the most profitable companies and projects. Financial markets will not function if the largest shareholders do not take a position on the underlying value of companies through analysis and insight.

The GPFG's long-term horizon means that we can weather periods of considerable market turmoil without being forced to realise losses.

Experience from 12 years of managing the GPFG suggests that active management could make an important contribution to the return on the GPFG in the long term. Active management has produced an annual excess return of 0.28 percentage point to date. Based on the current size of the GPFG, that is equivalent to NOK 8 billion a year.

NBIM implements its management mandate at relatively low cost. Studies have shown that, over time, our costs have been somewhat below the average for other large funds. Active management does increase some cost components. Fees to external managers depend on the excess return they deliver: when this excess return is high, these fees will also be high.

The expertise we amass through active management also means that NBIM can give the Ministry of Finance more expert advice on investment strategy and obtain better results in our active ownership work.

Chart: Active ownership

The GPFG's extensive ownership of global industry means that it has a responsibility as owner. To achieve the best possible results, our ownership work is principle-based and long-term. We believe that companies need long-term and active owners who continuously monitor their investments.

NBIM has identified six focus areas for active ownership in order to be able to concentrate its efforts. Three of these areas are child labour, water management and climate change.

The other three relate to traditional corporate governance. These include equal treatment of shareholders and the board's accountability to shareholders. We are also working on promoting well-functioning and efficient markets. During the financial crisis, important parts of the world's capital markets ceased to function for long periods. A passive management strategy for one of the world's largest funds will not improve the functioning of financial markets. There are considerable practical problems with being a passive investor reliant on efficient markets when markets cease to function.

Chart: Tools of active ownership

In all of the focus areas, NBIM plays the role of a long-term and rational investor concerned with the financial return on its investments. This characterises our work in both the ethical and governance-related focus areas.

Active ownership at NBIM is a long-term process and requires understanding of and insight into our investments.

Chart: Building a global organisation for the future

NBIM is very much a global organisation. We now have around 250 employees from just over 20 countries. Besides the head office in Oslo, we have offices in London, New York and Shanghai, and we will be opening a new office in Singapore in June. We buy in specialist services from external suppliers in a wide range of areas, and we have delegated parts of the management of the GPFG to specialist external managers. The GPFG holds equities in more than 8,300 companies in more than 50 countries on six continents.

We attach great importance to building a global, skilled and forward-looking organisation. NBIM is a knowledge-based organisation, and it is very important to recruit and retain skilled employees in a global labour market. The expected future strategy for the GPFG, with investments in real estate and, further ahead, perhaps also private equity and infrastructure, will mean higher management costs and more employees than today.

Chart: Our mission

Our mission is to safeguard and build financial wealth for future generations. An active and knowledge-based investor with deep insight into the long-term value of our investments is essential for safeguarding and building the wealth in the GPFG.