Management of the Government Pension Fund Global

Norges Bank Investment Management CEO Nicolai Tangen's introduction to the hearing of the Storting's Standing Committee on Finance and Economic Affairs on the management of the Government Pension Fund Global.

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

My thanks to the chair of the committee and for the opportunity to talk about the management of the fund. It is a pleasure to be here.

I will speak today about the fund's performance, our revised strategy and how we will be taking our work on responsible investment to the next level.

Our objective for the management of the fund is, of course, the highest possible return. In 2020, we delivered a return of 10.9 percent, or 1,070 billion kroner, and that was in a year when the world was turned on its head. The main contributor was a 12.1 percent return on the fund's equity investments, while fixed-income investments returned 7.5 percent.

The fund has generated a return of almost 7 trillion kroner since inception, and more than 4 trillion of this has come in the past five years. We cannot expect such strong performance in the future. A high percentage of the fund is invested in the equity market. This will boost the return to the Norwegian people in the long term, but we need to be prepared for periods of sharp decline in the short term. With interest rates so low, we expect bond investments to produce limited returns.

Last year showed how much the value of the fund can swing from quarter to quarter. We need to be able to navigate effectively through market movements of this kind. We need to make good decisions and perform well when the going gets tough. In doing so, we will build on the good results and solid work of our employees over many years.

A few weeks ago, the Executive Board approved a revised strategy plan for our management of the fund. The strategy is the result of input from every level of the organisation. It is built around three priorities: performance, people and communication. These priorities provide the foundations for how we will work on investments, technology, responsible investment, employee development and transparency on the management of the fund.

We have a single objective: the highest possible return after costs. The first priority in our strategy is therefore how we can improve our *performance*. We will continue to develop our investment strategies and to focus on cost efficiency. We will also improve and fine-tune our most important processes. This will be done within the risk limits of our management mandate.

One key initiative is to look at the investment process and at which human factors constrain or improve our decision making. We are drawing inspiration partly from top-level sport and how elite athletes perform under pressure. We want to provide headroom for mistakes and look at how we can learn from them. We also want to improve how we take risks and how we can increase our mental strength. It is not easy to be an investor in stormy waters. We need to be well drilled and fully prepared the next time markets take a tumble.

We have begun to build an investment simulator. This is one of our most important IT projects this year. We are compiling millions of historical data points for each portfolio manager. We are analysing why they made the decisions they did, and how they can improve them. It is about learning from mistakes and about having a systematic approach to decision making.

Our second priority is *people*. The fund is managed by 520 talented individuals. They are our most important asset. To get the best from them, I am a believer in flexibility and lifelong learning.

The world is changing fast. Innovation and a breadth of perspectives are therefore crucial. As an asset manager, we need to think differently, and for this we need diversity. We are looking for diversity of gender, mindset, ethnicity, age, academic background and life experience. The more diverse we are, the broader our perspectives will be, the more creative we will become, and the better the decisions we will make.

Our final priority is *communication*, both internal and external. Public confidence in our management of the fund is dependent on transparency. The more that people know about the fund, the more faith they will have in us.

2020 was a challenging year for many companies. The pandemic has stress-tested businesses around the globe. We worked hard on ownership activities during the year. We published five new position papers, three asset manager perspectives and more detailed voting guidelines. We began to publish all of our votes five days before the shareholder meeting. When we vote against a company, we now explain why publicly. In this way, we are open about how we think as an owner, and companies will understand why we want them to change. We held meetings with 2,877 companies during the year. We also had dialogues with companies on a number of new topics.

The Ministry of Finance has launched an extensive programme of work to learn more about how climate change could affect the fund. This is an important task. We have been working on climate change for more than a decade. We want to see more climate information from companies, not least on their short- and medium-term targets. In 2020, we raised climate issues in our dialogue with companies accounting for 26 percent of the value of the equity portfolio. Our expectations of companies make it clear that their plans and targets must reflect the Paris Agreement.

Our default position is that we want to be invested. Ownership dialogue is therefore our preferred approach, but in some cases we may choose to divest from companies. As Øystein mentioned, we make risk-based divestments on financial grounds. These are companies with a business model that we do not believe to be sustainable. These divestments differ from ethical exclusions in that the rationale is purely financial, even if there is an ethical aspect to the underlying problems in these companies. We divested from 32 companies in 2020 following risk assessments of this kind. Altogether, we have divested from 314 companies since 2012. We looked at some new areas for risk-based divestments during the year: we divested from companies with elevated tax risks for the first time, and we also exited companies with consumer lending practices that we consider irresponsible.

As the incoming CEO, I have been impressed by the work on ownership. We work systematically and for the long term. But we are far from done. In our revised strategy, we state that we wish to be a global leader in responsible investment, and I would now like to talk to you about something we have been working hard on recently.

In the strategy, we write that "we will further reduce our exposure to companies with unsustainable business models and re-allocate capital to more sustainable companies". There has long been debate about whether sufficient consideration is given to companies entering the fund. The Mestad Committee looked at the possibility of automatic *ex ante* ethical screening of new companies. They found that mechanical advance screening is not appropriate: the uncertainty is too high and the accuracy too low. But they also noted that we could use our judgement to exercise due diligence in our investments – and this is what we now plan to do to an even greater extent.

We already engage in extensive risk monitoring of companies that are already in the fund – both on an ongoing basis and in annual thematic reviews. We assess the financial risk to the fund and consider companies' activities in the light of relevant guidelines and principles from the UN and the OECD. Where companies seem to be exposed to particularly great social or environmental risks, we consider whether risk-based divestment or active ownership would be the best approach. We also exchange information with the Council on Ethics when the ethical criteria could come into play.

There are currently two main things we do *before* we invest in a company. One is that we approve markets. The other is that our portfolio managers perform detailed analyses of large companies before we invest in them. Small companies, on the other hand, are automatically added to our portfolio once they are included in the index.

This is where we are going to make a change: we will now be doing *more* in advance. We are currently extending our system for reviewing sustainability risks at all new companies added to the index we follow. This will enable us to consider environmental and social issues at these companies at an earlier stage. This means that we will choose not to invest in some companies even if they are included in our benchmark index. We may also decide to invest in companies but engage in active ownership from day one.

We view this as the logical next step in our work. It is a question of enhanced due diligence. This is related to, but different from, the mechanical advance screening that some have advocated. In the past five years in particular, we have built up an extensive database of information on sustainability and social matters. The data cover everything from emissions to water consumption. Previously, ESG data were often referred to as non-financial data. Given that they can impact on companies' long-term profitability, however, they are most certainly financially relevant. These data enable us to carry out good risk assessments. Due diligence of new companies included in our index is both in keeping with the revised strategy and a natural extension of our existing risk assessments, divestments and ownership work.

It is important to stress that we still want to see even better data from companies. There is still much that is not reported on. There is often little information available on companies before they are added to the index. Not everything can therefore be discovered before we invest. In this context, it is also worth mentioning the proposal to reduce the number of companies in the fund's index. Generally speaking, less information is available on small companies than on larger companies. Fewer small companies of this kind would simplify our ownership work. We will continue to monitor the companies included in the fund, look at new data and increase the number of risk-based divestments. We will also make use of information from NGOs and other parts of civil society. Through their local networks, they often have information – including on company-specific issues – that we would not be able to capture on our own.

Taken together, we believe that this provides an excellent starting point for our future work. We are learning all the time and look forward to improving further.

Thank you for your time.