

Management of the Government Pension Fund Global (GPFG)

Introductory statement by CEO of NBIM Yngve Slyngstad, before the Storting's Standing Committee on Finance and Economic Affairs.

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

I would like to thank the Chairman and for this opportunity to make some introductory remarks on the management of the GPFG in 2012.

Chart: Performance

The return on the GPFG was 13.4 percent in 2012. This was the second-best performance in its history. The return was primarily driven by equity investments, reflecting the broad upswing in global stock markets.

The favourable performance continued into 2013, primarily as a result of a continued advance in equity markets which made the main contribution to the overall return of 5.4 percent in the first quarter. The annual nominal return since 1998 has been slightly higher than 5 percent.

The current market value of the GPFG is about NOK 4 250 billion. Since the previous hearing on 17 April 2012, its value has increased by NOK 800 billion.

Since 1998, the GPFG has generated an annual real return after costs of 3.25 percent.

Even though returns on the GPFG have been high in recent years, we must be prepared for the possibility of periods of large value losses. With the current value of the GPFG and its asset composition, annual performance on a par with the worst year recorded in the past 100 years would have resulted in a loss of just below 30 percent or a good NOK 1 200 billion.

Chart: Yield of inflation-linked bonds

As I pointed out at the Committee's hearing on the report Long-term Perspectives on the Norwegian Economy 2013 a few weeks ago, we are facing a number of considerable challenges. Bond market returns are low and are likely to remain so for some time ahead. Real yields on the safest investments, as shown by yields on US and UK inflation-linked government bonds, are now negative in all major markets.

The safest investment alternative will provide a return after inflation below zero. Many countries are heavily indebted and monetary policy implies low, and in some cases negative, real interest rates ahead. Moreover, today's favourable stock market conditions may be based on expectations that do not materialise.

Chart: Changing the regional allocation

Last year's report announced three changes to the investment strategy; rebalancing rules, a new regional distribution with a lower allocation to Europe and increased investment in emerging markets, and a new allocation of fixed-income investment with more currencies and a revision of their weights.

As proposed by Norges Bank, an official rule has now been established for rebalancing the allocation to equities when it moves away from 60 percent by a defined margin. The Ministry of Finance adopted a rule providing for rebalancing if the deviation is 4 percentage points at month's end.

On the Bank's recommendation, the Ministry approved a new geographical distribution to apply from July, which provides a broader and more diversified investment portfolio and is one of the most significant changes in the history of the GPFG and we are implementing this change gradually.

Although the proportion of investments in Europe is reduced, actual overall investments in this region will not decline. We are using inflows of new capital to the GPFG to invest in other regions. The proportion of European equity holdings will continue to be higher than for other regions for many years ahead.

Chart:: New fixed income markets in 2012 and 2013

In recent years, we have changed the currency composition of the bond portfolio. This reduces the impact of movements in an individual currency and provides a distribution that better matches each country's share of world GDP. The new distribution should over time better safeguard the long-term international purchasing power of the GPFG than the previous currency composition. However, this may also lead to larger short-term fluctuations.

At the end of 2010, close to 95 percent of these investments were concentrated in four currencies; the US dollar, euro, Japanese yen and pound sterling. This share has now been brought down to below 80 percent. The share of bonds issued in emerging market currencies has increased markedly and is now around 11 percent.

Investments in emerging markets increased by about NOK 200 billion in 2012, with bonds accounting for two-thirds and equities for a third of the increase.

Chart: New equity markets in 2012 and 2013

The GPFG was invested in 7 400 companies at the end of 2012. The list has been expanded by including Bulgaria, Jordan, Kenya, Croatia, Kuwait, Oman, Qatar and Romania in our investment portfolio. At year-end, total equity holdings in Africa came to NOK 17 billion and NOK 1 billion in the Middle East.

This year's report calls for few changes in the investment strategy. The Ministry of Finance will maintain the market-weighted benchmark index for equities in line with Norges Bank's

recommendation, and will allow the Bank's operational management to exploit systematic risk factor. The Ministry will continue to use a benchmark index for fixed-income investments that includes both nominal bonds and inflation-linked bonds. Inflation-linked bonds are a type of bond we invest in, but are not a part of the Bank's own operational benchmark portfolio.

Charts: Real estate investments

The report refers to investments in real estate outside Europe, including Real Estate Investment Trusts (REITs). From the turn of the year, the real estate mandate became global and the first real estate investments have now been made in the US. In 2012, we made new investments in France, the UK, Switzerland and Germany. The allocation to real estate is now close to 1 percent.

The main strategy for real estate investing remains firm. We are gradually building capacity and competence in real estate investing, but it will take a few years to reach the targeted 5 percent allocation to real estate. The bulk of investments will be in commercial buildings and office premises, primarily in the major urban centres of the world. .

Chart: Responsible investor

A sound long-term return depends on sustainable economic, environmental and social developments. We use our rights as a major shareholder to promote developments that secure favourable returns in line with the mandate issued by the Ministry of Finance. We are a financial investor and we give weight to long-term value creation for shareholders, equal treatment of shareholders and the responsibility of company boards as elected representatives of shareholders.

Chart: Environmental and social risks

As a minority shareholder, we apply a long-term investment horizon and take a principle-based approach. If we are to have an impact as a minority shareholder, we must apply standards that other shareholders also recognise. Our ownership must be exercised based on internationally recognised principles for investors. Norges Bank operates under a mandate that clearly precludes the GPF from being a foreign policy instrument.

We vote at the shareholder meetings of virtually all the 7 400 companies in which we have a stake. In 2012, we voted at more than 10 000 shareholder meetings. We have developed a database that includes information relating to environmental, social and corporate governance developments in about 4 000 of the companies in our portfolio. This database gives our analysts and equity managers a broader basis for making investment decisions. We also engage in dialogue with a large number of companies and had 2 300 meetings with 1 300 companies last year.

Chart: Industry initiatives

In 2012, we added tropical deforestation to our climate focus area. In the focus area child labour, we have achieved results in the cottonseed industry, the cocoa supplier sector and

chocolate production. We have started work to address the issue of tropical deforestation in the palm oil industry. This work involves a long-term effort where results are achieved over time.

Our guidelines and principles apply to all the companies in our portfolio. But our most active ownership activities are concentrated in the companies where we have the largest shareholdings. The GPF's average ownership share in listed companies worldwide has now been increased to about 1.3 percent. Our estimates show that we are among the 10 largest shareholders in about 550 companies.

The work on responsible investment is important for the GPF. The work involves a long-term effort and the results must be assessed over time. We attach great importance to voting, engaging in dialogue with the companies and analysing their development with a view to safeguarding the value of the GPF to the benefit of future generations.

Thank you for your attention.