Management of the Government Pension Fund Global

Governor Øystein Olsen. Introductory statement at the hearing before the Storting's Standing Committee of Finance and Economic Affairs 20 May 2011.

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

I thank the Chairman and would also like to express my gratitude for giving Norges Bank the opportunity again this year to report on its management of the Government Pension Fund Global (GPFG) in connection with the Storting's (Norwegian parliament) deliberations on the report to the Storting on the management of the GPFG.

In 2010 Norges Bank was given a new investment mandate from the Ministry of Finance. The new mandate replaced the previous regulations, supplementary guidelines and management agreement. The rules have now been simplified and are more easily accessible. This in itself enhances the transparency surrounding the framework for investment management that is so important.

Under the investment mandate, Norges Bank shall seek to obtain the highest possible return after costs measured in international currency.

Chart 1: Performance

The return on the GPFG was almost 10 per cent in 2010. In the first quarter of this year the return was 2.1 per cent. The annual net real return on the Fund has averaged 3.0 per cent since 1998.

Transparency regarding the investment framework is of decisive importance for the necessary confidence of the Fund's owners in Norges Bank's investment management. The Fund also relies on a favourable reputation, among supervisory authorities and among countries and companies we invest in.

As part of this greater transparency, the Executive Board's risk policies and other policy documents have now been published. This includes the Bank's strategy plan for 2011-2013, which the Executive Board adopted in autumn 2010. This strategy plan is based in part on the Bank's letter to the Ministry of Finance of July 2010 regarding the Fund's investment strategy. In the letter Norges Bank stated that in future the Bank will assume greater responsibility for the balance between absolute return and risk than it has done so far.

Chart 2: Costs

Management costs were 0.07 per cent of the Fund's capital in 2010, before the calculation of performance-based fees. Including these fees, management costs were 0.11 per cent. Costs in NOK terms have risen in recent years, partly reflecting an expanded investment universe and a larger share of equities in the asset mix. Nevertheless, there are clear signs of economies of scale in the Fund's management. This includes IT expenses, transaction costs and custodial expenses for securities. Cost data from the GPFG and other large funds show that ever since 2003, costs have generally been lower than in comparable funds.

Although cost developments are a matter of considerable importance to the Fund, focusing solely on costs would be insufficient. Higher costs may reflect the higher level of quality of the work performed. The Fund's performance can be measured, and an increased use of resources can produce substantial additional income in the form of higher returns on the Fund. An important management objective is to achieve the highest possible long-term return after costs.

One reason for the GPFG's relatively low costs is the modest use of external managers. At the end of the first quarter of 2011, external organisations managed 7.2 per cent of the Fund, a share that has been declining since 1998. This is a consequence of the strategy of developing in-house investment expertise in an increasing number of areas at Norges Bank.

The Government Pension Fund Global has a single specific purpose: to facilitate central government saving so as to enable coming generations, too, to benefit from Norway's petroleum wealth. The Fund shall be managed to generate the highest possible return within the risk tolerances set by the owners' representatives, an objective laid down in Norges Bank's mandate from the Ministry of Finance. The same objective is stated in the Executive Board's mandate to the CEO of NBIM and in the investment mandates he has delegated to his investment personnel. Earmarking investment funds for special purposes will entail setting a different return requirement for these investments from the requirement for other investments in the Fund.

By the end of the first quarter of this year, Norges Bank had established nine investment mandates in the area of environment-related investments, seven of which are external. These investments are subject to the same return requirement as the Fund's other investments.

The Fund emerged stronger from the financial crisis, despite substantial losses in 2008. Over the past few years, this value has been more than restored. The primary reason is that the Fund held on to its equity holdings, even after prices had fallen. By maintaining this strategy during the crisis, substantial value has been preserved for the Fund's owners.

This past year Norges Bank has refined its investment strategy. The Bank believes that the new strategy will result in higher quality and lower risk in investment management in the coming years. Expanded insight into what the Bank is actually investing in will result in a better balance between risk and return.

I will now give the floor to Yngve Slyngstad, CEO of NBIM.