

# Mandate for the expert group assessing Norges Bank's management of the GPFG

## Background

The Government Pension Fund Global (GPFG) stems from accumulated revenues from the extraction of oil and gas on the Norwegian continental shelf. The Fund serves as a tool to support long-term considerations in the spending of oil and gas revenues, as well as a long-term savings vehicle. The market value of the Fund was 7,867 billion kroner (approximately 917 billion USD) at the end of March 2017.

The governance framework of the GPFG is marked by a clear division of roles and responsibilities. The Ministry of Finance holds the formal responsibility for the management of the Fund, whereas the operational management is carried out by Norges Bank (the central bank of Norway). All significant changes to the GPFG's investment strategy are presented to Parliament before implementation.

Norges Bank manages the GPFG in accordance with a management mandate issued by the Ministry of Finance. The mandate sets out the general principles and regulations for Norges Bank's management of the Fund. The mandate expresses the Fund's investment strategy, including provisions on the composition of the benchmark index, risk limits, reporting and responsible management.

The GPFG is invested in listed equity, fixed income and unlisted real estate outside of Norway. The Fund's investment objective is to achieve the highest possible return, given an acceptable level of risk. The Fund's investment strategy has been developed gradually over time based on assessments of expected risk and return, the Fund's purpose and distinctive characteristics, and views on the functioning of international capital markets.

Over time the risk-taking and investment universe of the GPFG has been expanded, both with regards to the size of the equity share, the number of countries the Fund is invested in, and more asset classes and financial instruments. The Fund's current benchmark consists of 62.5 per cent equities and 37.5 per cent fixed income, and is based on broad, global indices from leading index providers.<sup>1</sup> Recently it has been decided to increase the equity allocation to 70 per cent. This increase will be implemented gradually over time.

Within specified risk limits set out in the management mandate, Norges Bank can deviate from the Fund's benchmark.<sup>2</sup> The principal risk limit is a tracking error limit of 1.25 percentage points. The regulation of real estate was changed as of January 1, 2017. There is no longer an allocation to real estate, but such investments are rather included in the tracking error limit. The new regulation of unlisted real estate investments means that the scope and composition of such investments are decided by Norges Bank, within the risk limits set by the Ministry of Finance. The regulation of unlisted real estate includes an upper limit of such

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<sup>1</sup> The benchmark is based on indices from FTSE (equities) and Bloomberg Barclays (fixed income). The benchmark's geographical composition is based on market weights for equities and corporate bonds, and GDP weights for government bonds.

<sup>2</sup> The management mandate is available on the Ministry's website: [www.regjeringen.no/spf](http://www.regjeringen.no/spf).

investments of 7 per cent of the GPFG. At the end of March 2017, about 2.5 per cent of the Fund was invested in unlisted real estate.

The Ministry of Finance evaluates Norges Bank's management of the GPFG every four years at the start of each parliamentary term. In accordance with this, the Ministry aims at presenting an evaluation in the spring of 2018.

As part of the evaluation, the Ministry of Finance appoints an expert group to assess Norges Bank's active investment strategies for the GPFG, the possibility to obtain excess returns, as well as the historical performance in the active management of the Fund. The group is also asked to assess the historical result in the real estate portfolio. Based on the review of Norges Bank's management of the GPFG, including historical results, strategies and possibilities going forward, the group is asked to assess if the current tracking error limit should be adjusted.

### **Mandate for the expert group assessing Norges Bank's active management of the GPFG**

The group shall prepare a public report reviewing Norges Bank's management of the Government Pension Fund Global (GPFG), by December 15, 2017. The report shall include the following:

1. **An assessment of Norges Banks's current main investment activities in the management of the GPFG, and the most significant investment strategies within each activity for the equity and fixed income portfolios, respectively.** Significance should be proportional to the share of relative risk, shortfall risk and cost budgets allocated to the strategy. The assessment shall include discussions of the activities' and strategies'
  - theoretical and empirical foundations,
  - known risk and return characteristics,
  - suitable evaluation horizons,
  - scalability.
2. **An assessment of Norges Bank's active management results for the GPFG since 1998.** Emphasis should be put on the most recent years. The assessment shall include quantitative analyses in accordance with leading academic standards using data on, i.a., return, risk and costs, and as a minimum present:
  - Analysis of results for the GPFG ex. real estate, and for the equity and fixed income portfolios separately, relative to the respective benchmarks given in the management mandate from the Ministry of Finance.
  - Analysis of results from each of Norges Bank's main investment activities and most significant investment strategies within each activity for the equity and fixed income portfolios, respectively.
  - A cost-benefit analysis of Norges Bank's main investment activities and significant investment strategies within each activity for the equity and fixed income portfolios, respectively.
3. **An assessment of Norges Banks management of the real estate portfolio since 2011.** Emphasis should be put on the most recent years. The assessment shall include a discussion of the chosen strategy, and a quantitative analysis where the real estate

investment results within selected major markets such as the US, UK, Germany and France are evaluated against relevant benchmarks.

4. **An assessment of Norges Bank's possibilities to obtain excess returns in the management of the GPFG relative to the current strategic benchmark.**
5. **Recommendations.** Based on the review of Norges Bank's management of the GPFG, including historical results, strategies and possibilities going forward, should the size of the relative risk budget – or “expected tracking error limit” – be adjusted?