



NORWEGIAN MINISTRY OF FINANCE

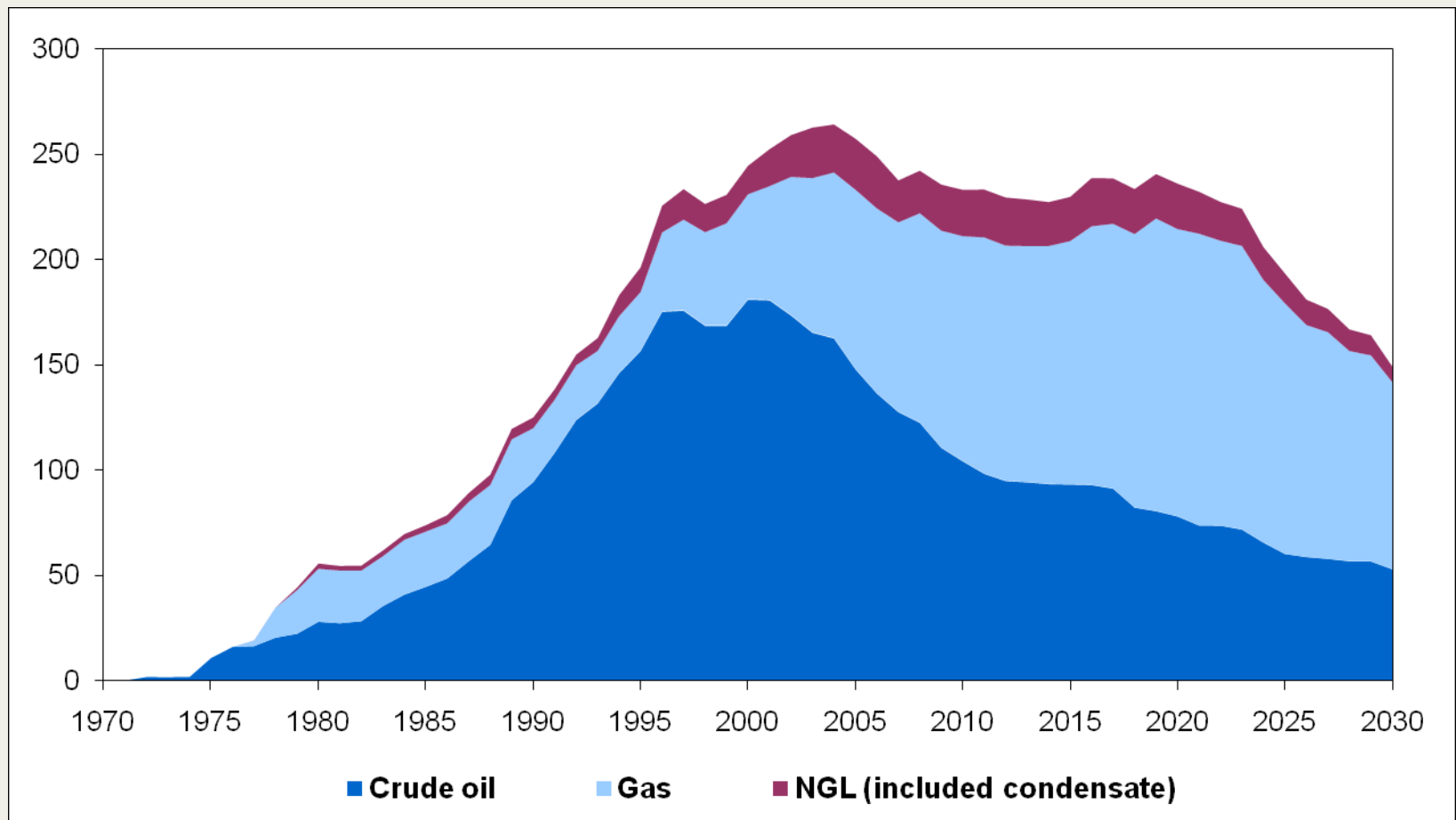
The Government Pension Fund Global *and the management of petroleum wealth*

June 2010

Director General Martin Skancke
Asset Management Department

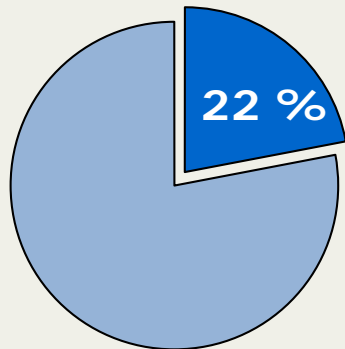
Crude oil production in Norway has peaked

-Total petroleum production in Norway, mill. Sm³ o.e.

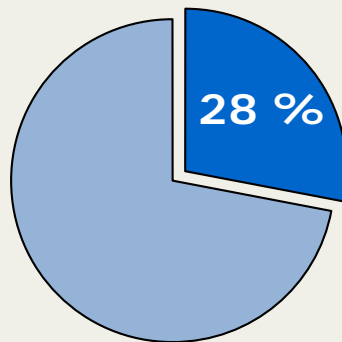


Source: Norwegian Petroleum Directorate (July 2009)

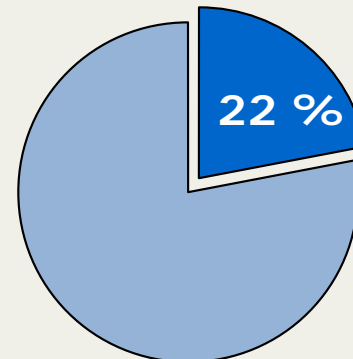
The petroleum sector in relation to the Norwegian economy. 2009



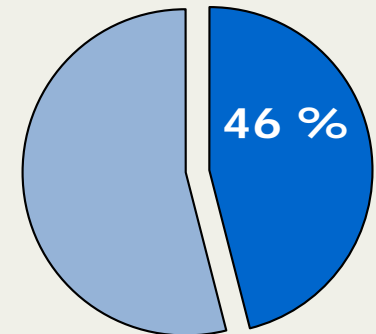
The petroleum sector's share of GDP



The petroleum sector's share of state revenues



The petroleum sector's share of total investment



The petroleum sector's share of total exports

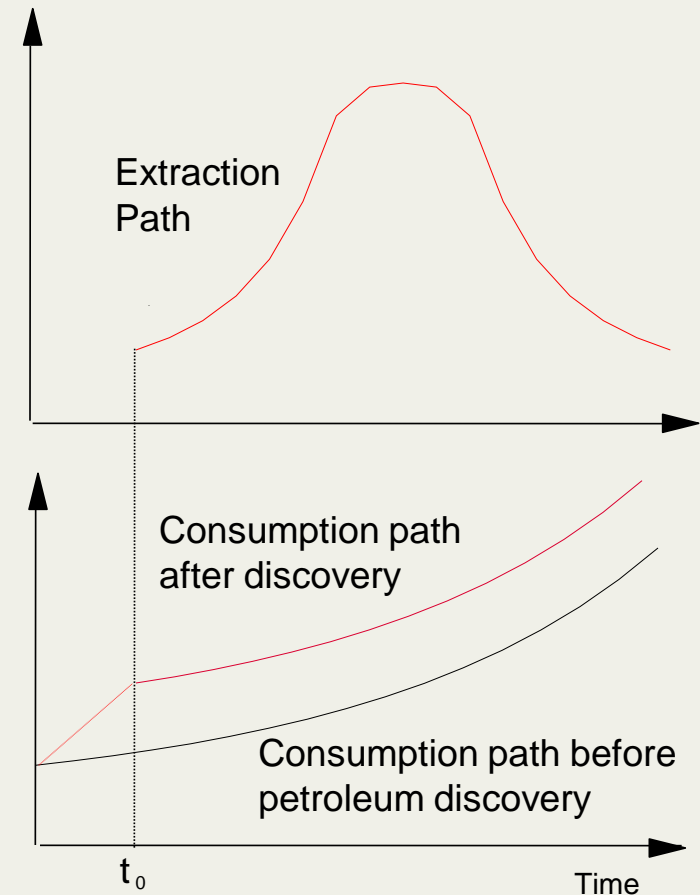
Source: Statistics Norway, Ministry of Finance

Wealth management – from theory to practice

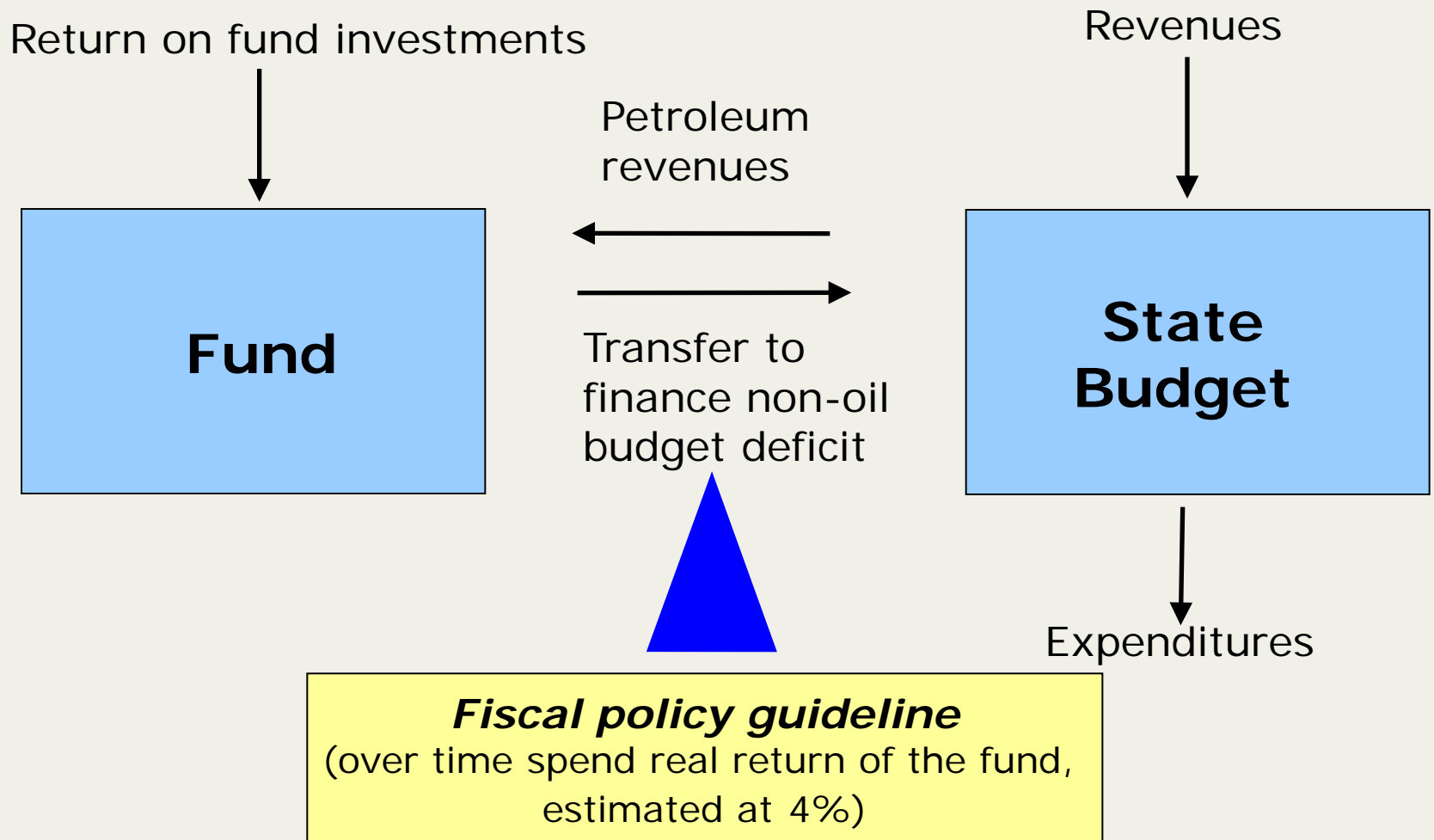
Petroleum revenues are different:

- "Free money"
 - ✓ do not reduce spending in the private sector
 - ✓ may weaken the fiscal disciplinary mechanism
 - ✓ governance challenge
- More volatile and uncertain
- Income stemming from depletion of wealth

Need to save a large part of the petroleum revenues. Necessary to separate spending from the current income from oil & gas activities.

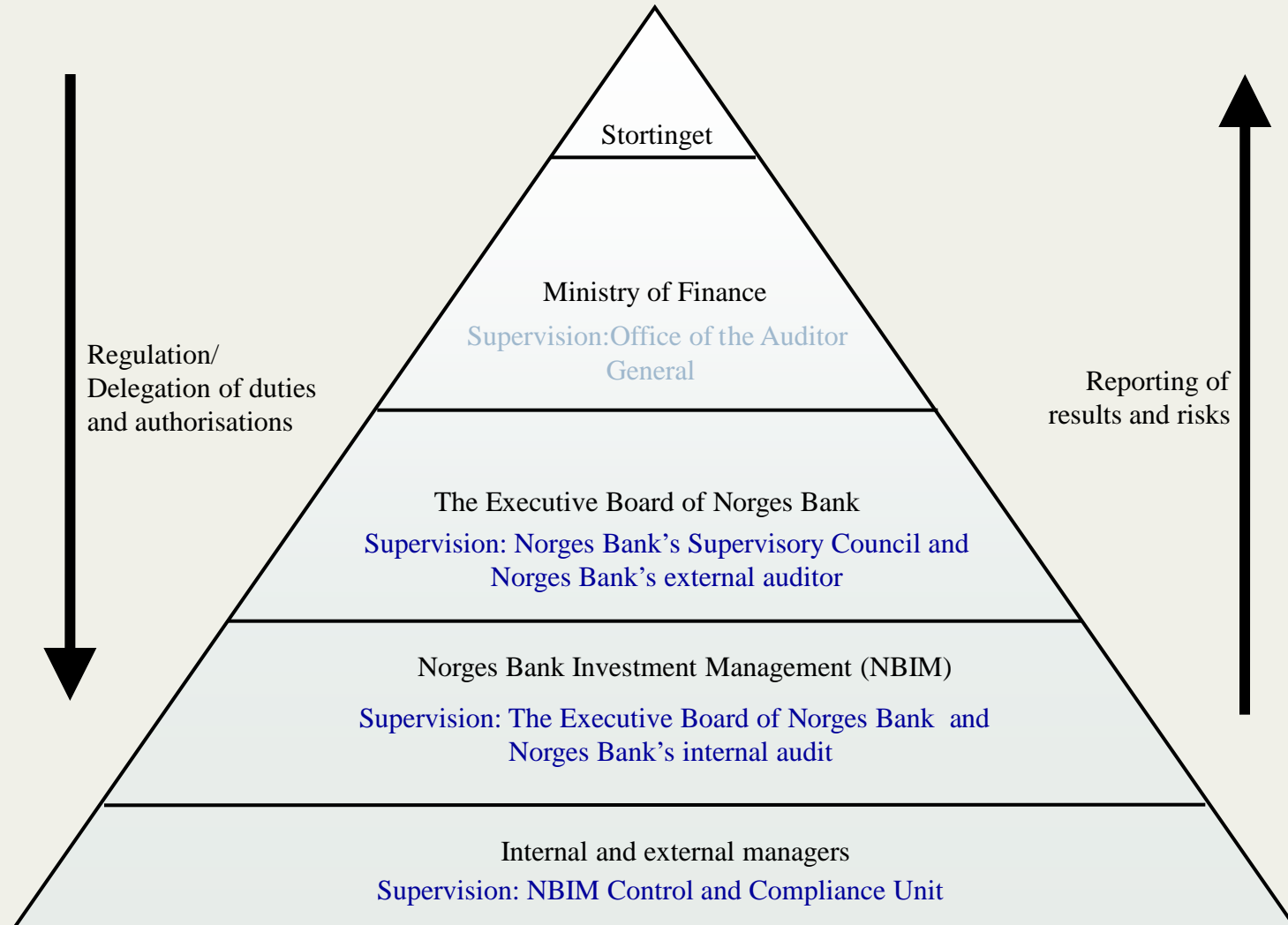


The Fund mechanism – integrated with fiscal policy



Pension Fund Global Governance Structure

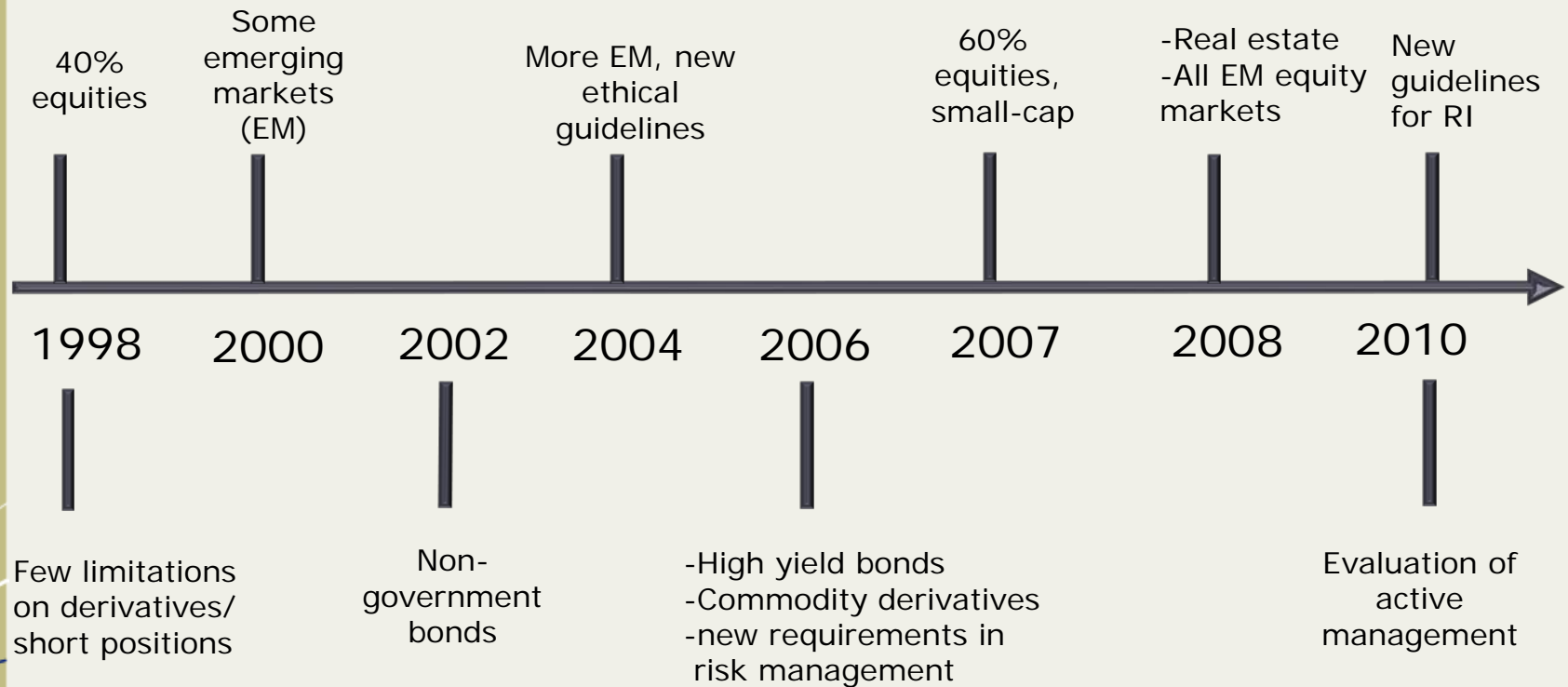
Founded on Act, regulations and separate contracts



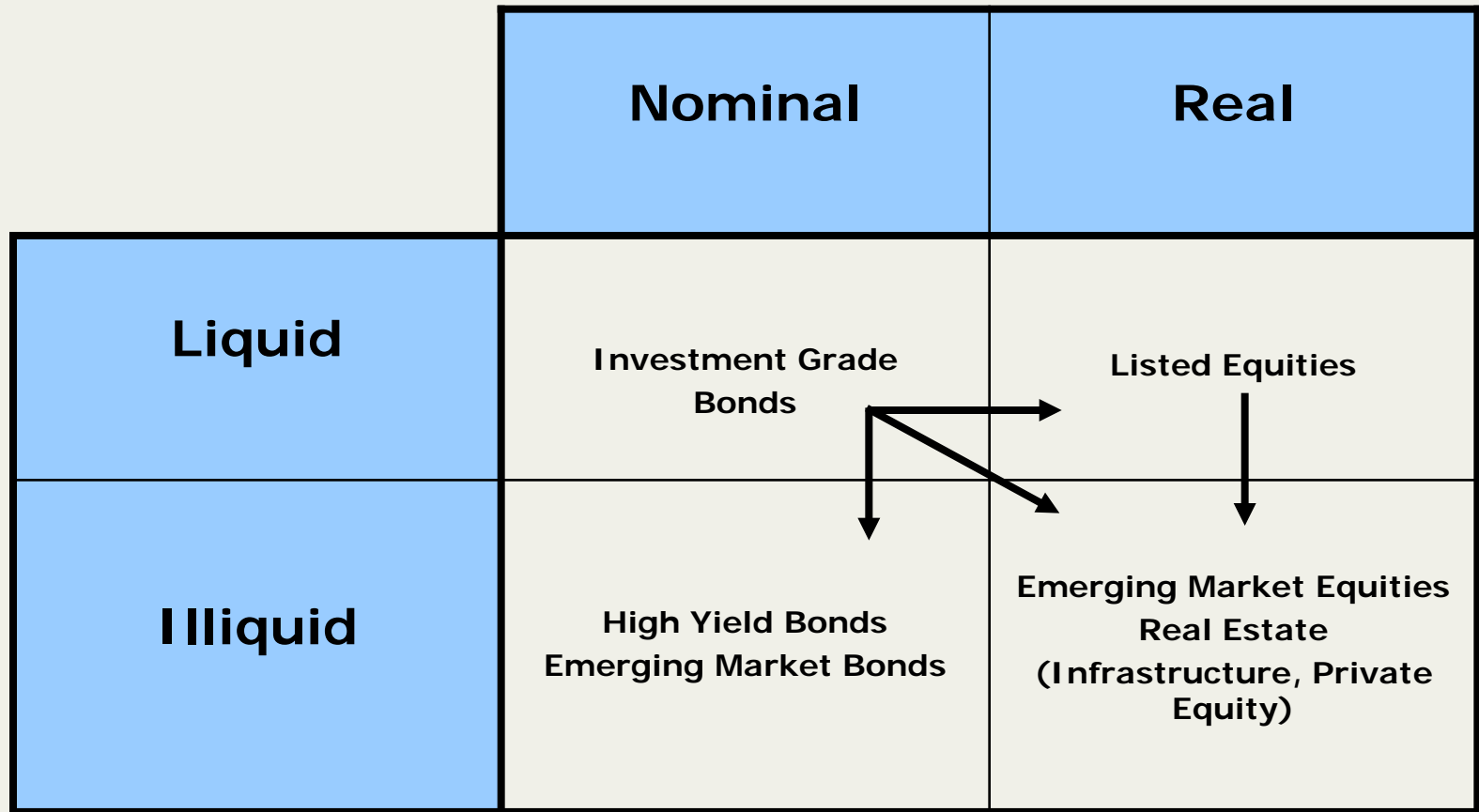
Asset management: Clear lines of responsibilities

- Ministry of Finance – “Owner”
 - ✓ separate asset management department with overall responsibility for managing the Fund
 - ✓ strategic asset allocation (benchmark + risk limits)
 - ✓ monitoring and evaluating operational management
 - ✓ responsible investment practices
 - ✓ reports to Parliament
 - ✓ international advisor on resource funds
- Central Bank – “Operational manager”
 - ✓ separate entity within the central bank (NBIM) charged with the operational management of the Fund
 - ✓ implement investment strategy (benchmark)
 - ✓ active management to achieve excess return
 - ✓ risk control and reporting
 - ✓ exercise the Fund’s ownership rights
 - ✓ provide professional advice on investment strategy

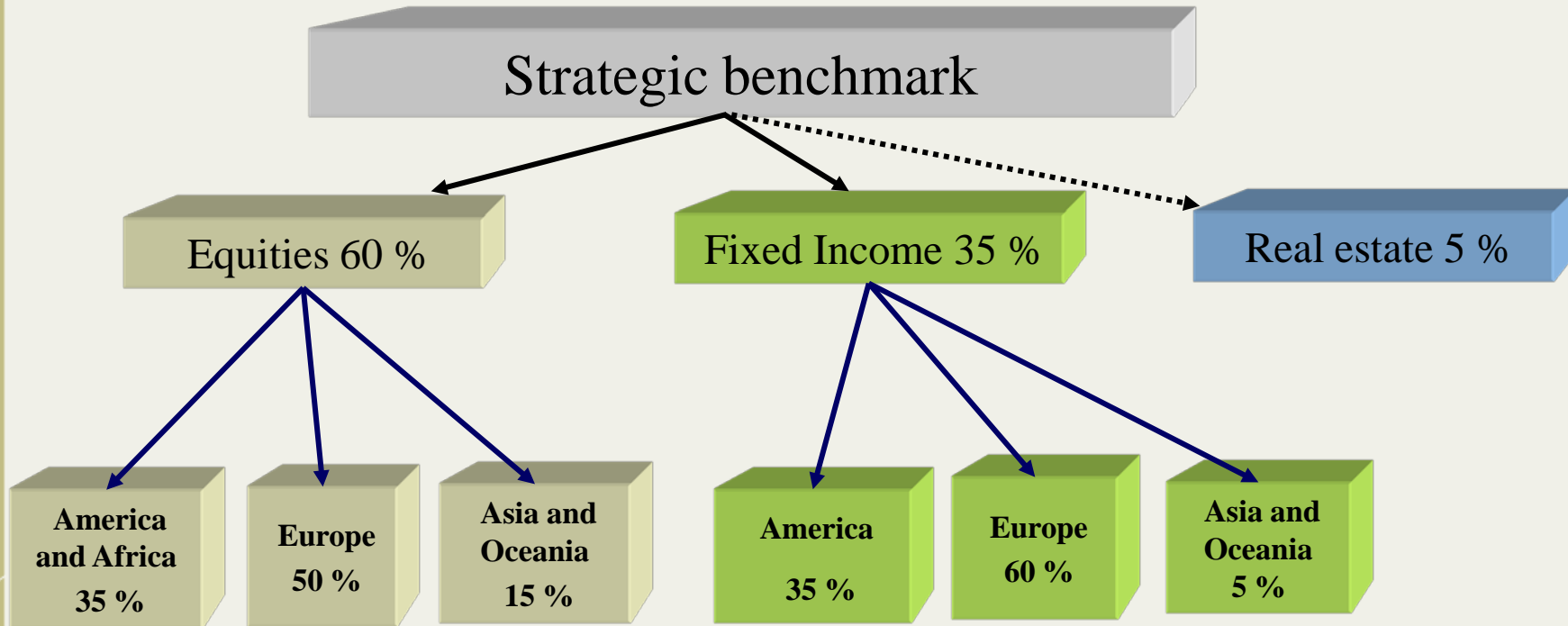
Major changes in the investment strategy



Investment strategy trend: from liquid & nominal assets towards illiquid & real assets



Benchmark for the Pension Fund Global



Equity index:

**FTSE Global All-Cap Index
More than 7 000 equities**

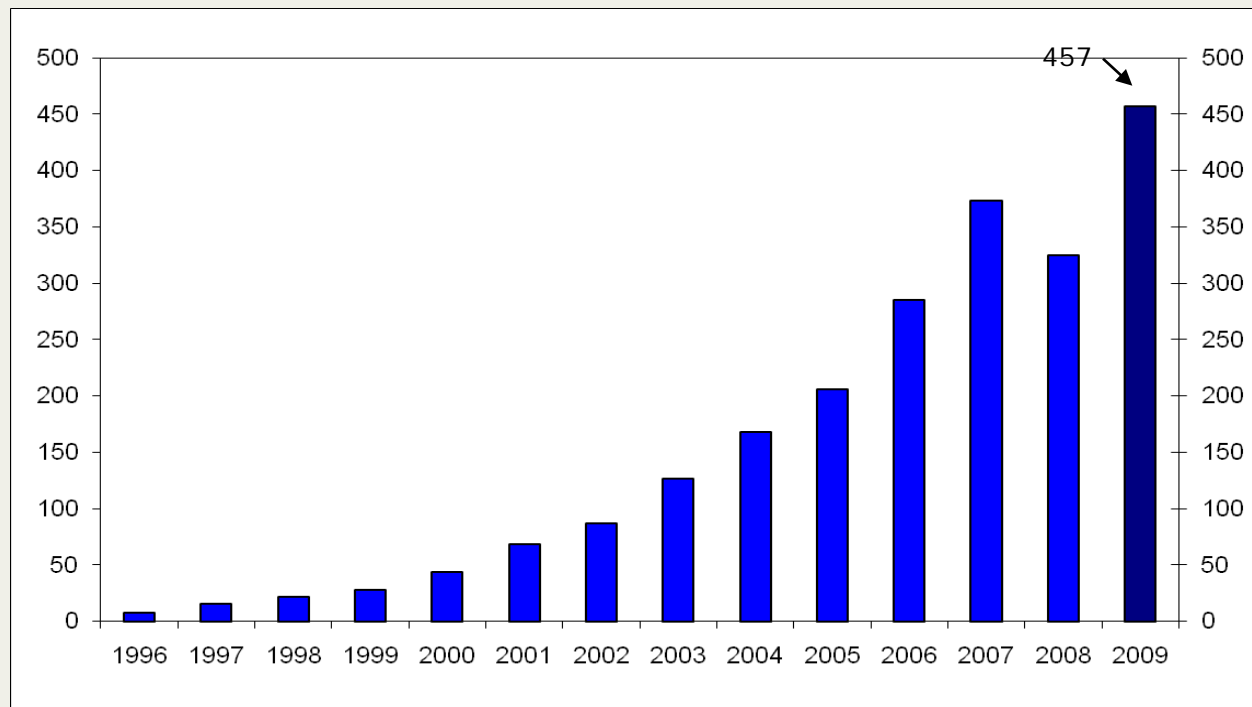
Fixed income index:

**Barclays Capital Global Aggregate/Global
Inflation Linked
(Treasury/ Gov. Related / Corporate / Securitized)
More than 10 000 bonds**

GPIF is among the largest (and fastest growing) funds in the world

- Fund by year end 2009.

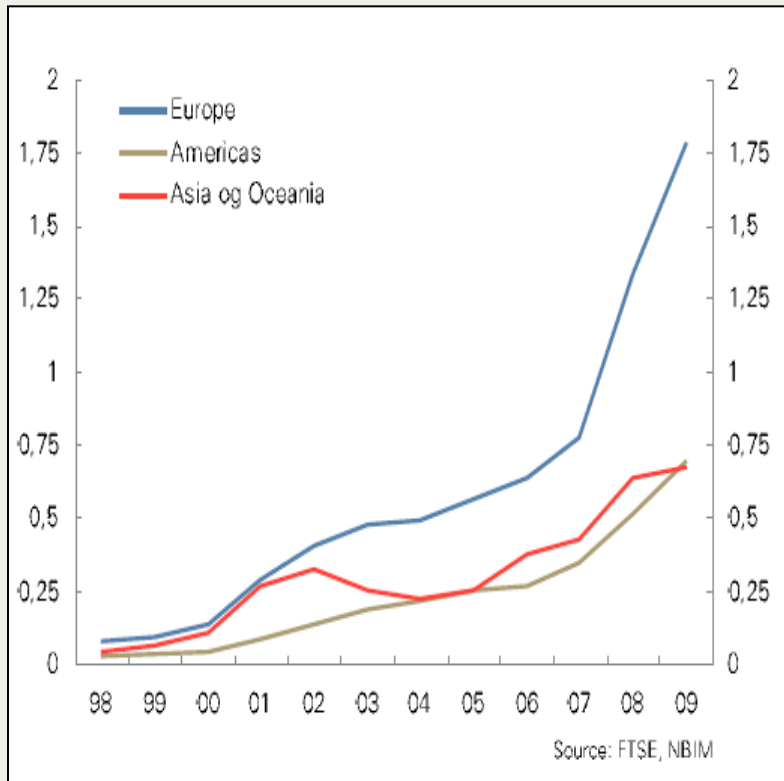
Will the trillion dollar mark be reached in 2020?



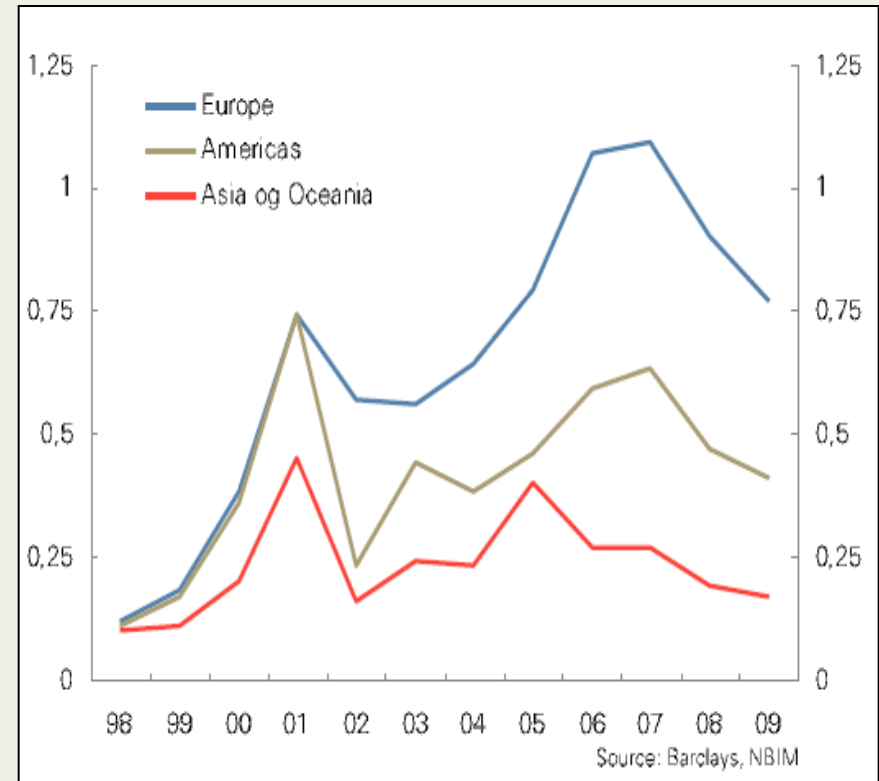
Source: Ministry of Finance

Ownership of equity and fixed income markets

Ownership of equity markets. Percentage of FTSE All-World Index's market capitalization.



Ownership of fixed income markets. Percentage of Barclays index's market capitalization.



Responsible investment – overarching goals

- Ensure sound financial returns so that future generations will benefit from the petroleum wealth.
- Sound financial return over time is considered to be contingent on sustainable development economically, environmentally and socially, along with well-functioning, legitimate and efficient markets
- The tools shall be used with a view to (i.a.):
 - ✓ promote good corporate governance and sustainable development
 - ✓ contribute to the portfolio companies respecting fundamental ethical norms
 - ✓ promote organization of financial markets which safeguard the Fund's financial interests
 - ✓ preclude investments which is in conflict with international law
 - ✓ avoid investments in companies involved in grossly unethical activities

Responsible investments for diversified investor

- The Fund has a very long investment horizon. The nature of the Fund's diversified portfolio has been referred to as universal ownership.
- When most economic activity impacts your portfolio (negatively or positively) on the margin, there is no rationale to support exploitive behaviour in any one portfolio company.
- This is the essential difference between the Fund and the average investor.



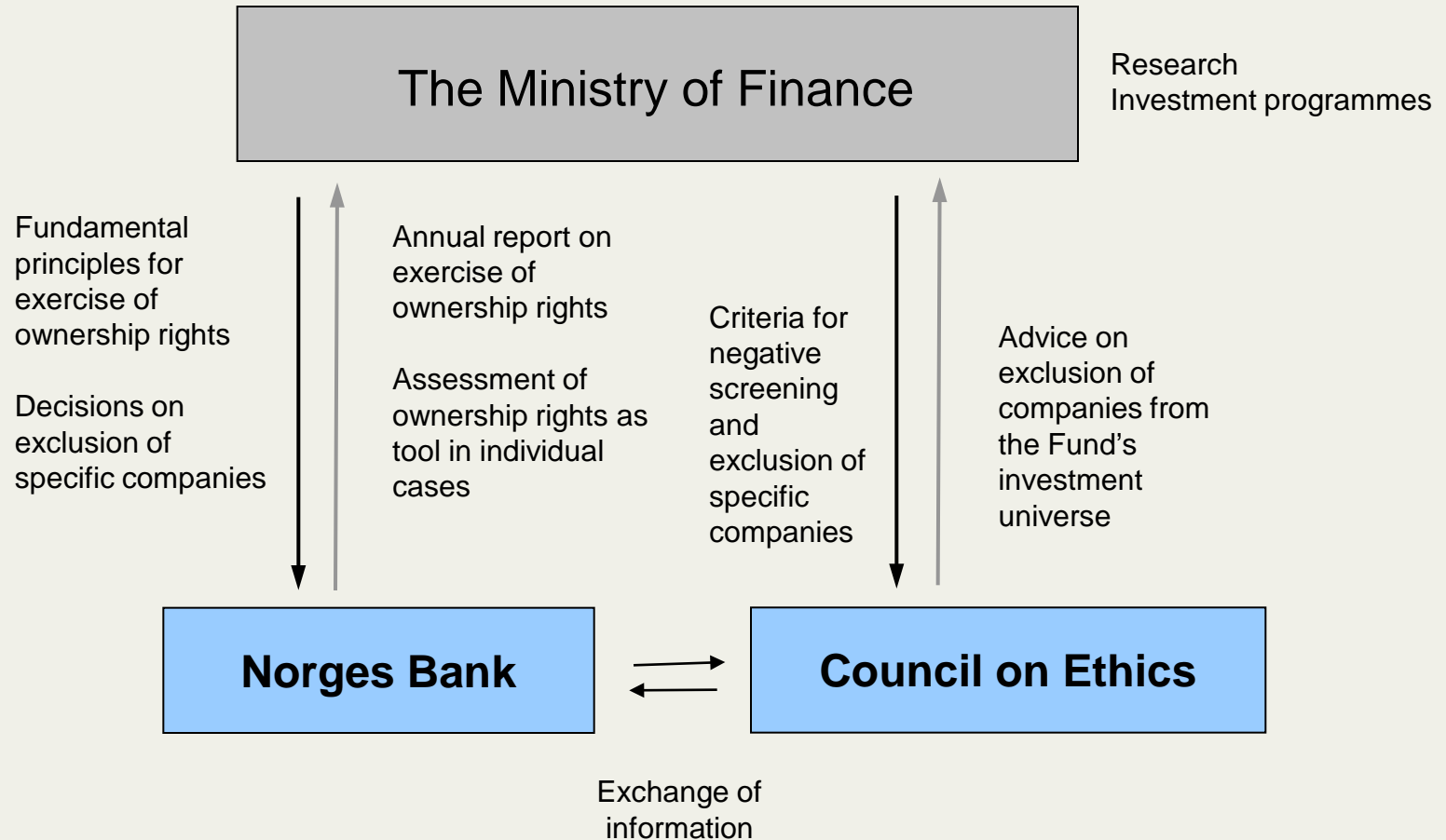
The principal-agent problem and responsible investment

- The principal-agent concern the problem of aligning an agent's (for example a manager) interests and actions with that of a principal (for example a shareholder).
- In the management of the Fund, the question of different strategic horizons is key.
 - ✓one example is water management. Water might become very scarce in 15 years, but this will not necessarily affect company decisions today
- There are numerous examples of principal-agent problems facing a large, diversified, essentially passive investor
 - ✓"Moral hazard" (for example in the financial sector)
 - ✓waste management (for example illegal deposits in economically important rivers)
- The existence of principal-agent problems creates a clear rationale for investors to engage in active ownership

Actions that may improve the long term performance of the Fund

- Integrate ESG considerations more broadly in the management of the fund (PRI)
 - ✓ tentative steps taken. New guidelines for responsible investment.
- Active ownership, exclusion mechanism, observation list
- New targeted investment programmes
 - ✓ environmental investments
- International collaboration and contribution to the development of best practice
 - ✓ UN Global Compact project on guidelines for responsible business practice in areas with war or conflict.
 - ✓ UN PRI membership, projects and reporting
- Participate in research and investigation
 - ✓ a broad study of the possible effects of climate change on financial markets and strategic asset allocation

Division of roles – RI concerns both the owner and manager

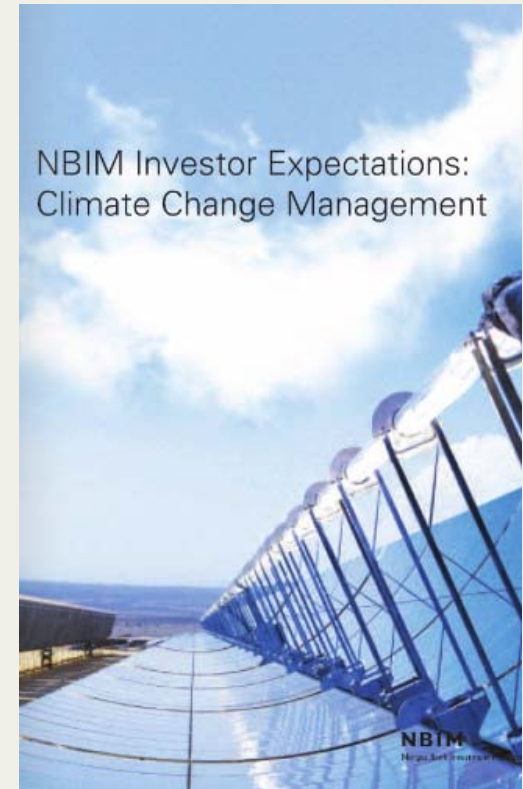


Ownership strategies – objective and priorities

- The overall objective of the ownership effort is to safeguard the (long-term) financial interests of the Pension Fund
- The principles governing the exercise of ownership rights:
 - ✓ **the UN Global Compact**
 - ✓ the OECD Principles of Corporate Governance and the OECD principles for Multinational Enterprises
- Focus areas
 - ✓ equal treatment of shareholders
 - ✓ shareholder influence and board accountability
 - ✓ well-functioning, legitimate and efficient financial markets
 - ✓ children's rights
 - ✓ climate change
 - ✓ water management
- Expectations documents to clearly identify the Fund's expectations of portfolio companies in some focus areas

Ownership strategies (continued) - tools

- Tools for exercising ownership rights
 - ✓ voting
 - ✓ engagement
 - ✓ working toward standard setters
 - ✓ peer networks
 - ✓ shareholder resolutions
 - ✓ litigation
 - ✓ communication



Negative screening and exclusion - The Fund's ethical basis is shared Norwegian social values

- Negative screening (products)
 - ✓ weapons that through their normal use may violate fundamental humanitarian principles (e.g. cluster munitions and nuclear arms)
 - ✓ tobacco
 - ✓ sales of weapons or military material to Burma
- Exclusion (production methods and conduct)
 - ✓ serious violations of fundamental ethical norms (human rights incl. child labour, corruption, severe environmental damage)
 - ✓ forward-looking assessment
 - ✓ exclusion should always be a measure of last resort
- Gross unethical conduct might negatively influence a portfolio, but the rationale for exclusion will always be partly value driven.
 - ✓ the Ministry of Finance has excluded 48 companies as of March 2010

Contact details

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Links

Ministry of Finance

- www.government.no/en/dep/fin

Government Pension Fund

- www.government.no/gpf

Norges Bank Investment Management

- www.nbim.no

Council on Ethics

- www.etikkradet.no