

State secretary Tore Vamraak. Norwegian Ministry of Finance, Speech at the public hearing on Sovereign Wealth Funds at The European Parliament

Thank you for inviting me to speak on this panel.

Sovereign Wealth Funds are defined as special purpose investment vehicles owned by the general government. According to the Sovereign Wealth Fund Institute, there are currently close to 80 such funds worldwide with combined assets under management of about 7.400 billion US dollars. This represents roughly 10 per cent of the global market for listed equities and investment grade bonds. More than half (57 per cent) of the capital base of these funds stems from the extraction and export of oil and gas.

One may therefore argue that Sovereign Wealth Funds are a significant segment of global investors – bearing in mind that these state owned funds encompass a broad and diverse group of investors. The largest funds are located in Norway, China, Abu Dhabi, Saudi Arabia, Kuwait, Singapore and Qatar – countries that are heterogeneous with respect to both historical and political context – as well as varying institutional arrangements and traditions for transparency. For this very reason, a generic approach to the topic at hand may prove challenging given the diverse characteristics of such funds as a group of investors. I will therefore focus my presentation on the key issues that apply to Norway and our sovereign wealth fund called the Government Pension Fund Global.

Norway contributed actively to the drafting of the Santiago principles in 2008. These principles encompass 24 generally accepted principles and practices for Sovereign Wealth Funds covering transparency, good governance, accountability and prudent investment practices. Although Norway is not a member of the International Forum of Sovereign Wealth Funds, we strongly support the work of the Forum on promoting the Santiago Principles. However, we regard the principles as minimum standards with which every sovereign wealth fund should comply.

In the European debate on Sovereign Wealth Funds the main concerns seem to relate to issues of transparency and uncertainty surrounding the purpose of the investment activity – whether there are political or strategic ambitions versus financial objective. Let me therefore start by providing a brief backdrop as to why Norway manages such a large Sovereign Wealth Fund.

Our Fund was originally named the Norwegian Petroleum Fund – reflecting the natural resource wealth the Fund is funded from. As a tool to separate the volatile net petroleum revenues from current spending over the state budget, the Fund was established in 1990, two decades after the Norwegian oil production started. Government petroleum revenues are deposited in the Fund and an annual amount is transferred back to the state budget to cover the non-oil budget deficit. The capital of the Fund is invested abroad only in order to shelter the Norwegian economy from large and fluctuating petroleum revenues.

It is therefore fair to say that fiscal and monetary policy considerations led to the establishment of the Petroleum Fund, rather than an ambition on part of the Norwegian state to become a large international investor.

Now, let me turn to the investment strategy of our Sovereign Fund.

First, I would like to highlight that at the core of the investment strategy is the fact that in order to generate a satisfactory long term financial return, one must accept a certain level of risk. Furthermore, to be able to assume this risk, one must anchor the overall risk profile of the investment strategy with key stakeholders. This is imperative to the ability to stay firmly on course through challenging market environments. In our case, the key stakeholder is the Norwegian Parliament, and the ultimate asset owners are the citizens of Norway.

The governance framework for the Fund 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). The Ministry sets the benchmark index and associated limit for deviations from the index for our fund manager. Within such risk limits, the manager (Norges Bank) makes investment decisions independently of the Ministry. Actual investments in countries and individual companies are kept at arm's length from political authorities.

The investment strategy aims for maximising financial returns over time, within a level of risk deemed acceptable to the asset owners. Within this overarching financial objective, the Fund shall be responsibly managed. The responsible investment guidelines for the Fund are not be viewed as undue political interference, but rather as a prerequisite for the legitimacy of the Fund. To maintain broad parliamentary and public support for the management of the Fund, it is vital that our ownership in the various companies worldwide is acceptable to the Norwegian

citizens. On that note, I would like to stress that the Fund is not an environmental policy or foreign policy instrument.

The investments of the Fund are spread across listed equities, fixed income instruments and unlisted real estate – and broadly diversified across geographical regions, countries, sectors and individual companies and issuers in order to reduce risk. The Fund is thus a financial investor with small ownership stakes in close to 9,000 companies and in bonds from more than 1,200 individual issuers.

The strategic asset allocation reflects that our Fund is a long term government savings instrument. The investment strategy stipulates a fixed weight of currently 62.5 per cent of the benchmark index to listed equities and the remaining share of 37.5 per cent in investment grade bonds. Unlisted real estate forms part of the active management of Norges Bank, with an upper cap for unlisted real estate investments of 7 per cent of the capital of the Fund.

Compared to the global market portfolio, our Fund has a higher exposure to listed equities and less exposure to investment grade bonds in line with our long-term investment horizon. We rebalance our investment portfolio back to the target weight whenever the equity allocation deviates by more than four percentage points from our strategic allocation. In practice, this means that whenever stock markets drop significantly, our Fund provides market liquidity by buying listed equities. Our contrarian investment behaviour may contribute to stabilising equity markets and – when taken in isolation – reduce market volatility. However, increasing exposure to risky assets during market turmoil is not a risk free strategy and any rebalancing regime must be within the risk tolerance of the asset owner.

Our Fund invests globally and there is an overweight to European equity markets of approximately 10 percentage points compared to market weights. The Fund is thus a significant provider of funding for listed private sector firms in the European Union – and as such, I would argue, a contributor to the funding of private sector employment within the region. The Fund is also a significant investor in the European fixed income market – also in bonds issued by multilateral development banks such as the European Investment bank. The investment opportunities for the Fund do not include private equity or unlisted infrastructure – due to risk management complexity and other considerations.

Within the Norwegian political context, a high degree of transparency is vital in achieving the necessary support for the main features of the fund management. In turn, this will contribute

to securing the short-term risk bearing capacity that is characteristic of long-term investors. We therefore believe that compliance with the transparency requirements of the Santiago-principles are in the self-interest of long-term sovereign investors. The investment mandate issued by the Ministry of Finance states that there shall be the greatest possible degree of transparency within the limits defined by a sound execution of the management assignment. For instance – all Fund holdings of equities, fixed income and unlisted real estate are published annually. Transparency provides for a broad anchoring and thus support for and understanding of the Fund management.

In order to be transparent also towards the recipient countries of Fund investments, all key documents on investment strategy and reporting are published in English on the websites of the Ministry of Finance and the Central Bank of Norway.

Thank you.

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#### Concluding remarks

Let me start by reemphasizing that for an oil exporting country there is a need to separate the accrual of volatile government petroleum revenues from the spending of such cash flows in the government budgets. Additionally, if these revenues are large compared to the size of the national economy, there is a need to shelter the national exchange rate from these fluctuating foreign currency revenues. A sovereign wealth fund with a cross-border investment strategy can be a good policy response to the fiscal and monetary policy challenges that an oil exporting country faces.

In the Norwegian case, capital in our Fund has been accumulated over the last 20 years. Today the Fund accounts for nearly three times the non-oil economy and our fiscal spending rule and monetary policy considerations imply that we truly are a long term cross-border investor. In order to be able to stay the course also in turbulent financial markets it is essential to anchor the risk profile of the investment strategy with our asset owners (represented by the Norwegian Parliament). Transparency about Fund objectives, governance structure and our investment strategy is a prerequisite to obtain national political and public support for our policy of managing the government petroleum revenues.

I would further like to repeat that Norway contributed actively to the drafting of the Santiago principles (for Sovereign Wealth Funds) in 2008. [These principles encompass 24 generally accepted principles and practices for Sovereign Wealth Funds covering transparency, good governance, accountability and prudent investment practices.] Norway strongly supports the work of the International Forum of Sovereign Wealth Funds on promoting these Principles. However, we regard the principles as minimum standards with which every sovereign wealth fund should comply. We see no need for recipient countries to regulate funds that adhere to the Santiago Principles.

The investments strategy of our Fund has been developed gradually by (among other factors) expanding the global scope and increasing the exposure to equity markets. Our Fund invests globally but there is an overweight to European equity markets of approximately 10 percentage points compared to market weights. The Fund is therefore a significant provider of funding for listed private sector firms in the European Union – and as such, I would argue, a contributor to the funding of private sector employment within the region. In addition, the Fund is a significant investor in the European fixed income market – also in bonds issued by multilateral development banks such as the European Investment bank.

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On the website of the Central Bank of Norway, you may find English translations of all quarterly and annual reports, annual fund holdings lists and a record of all voting at General Assemblies of close to 9000 companies.

I am pleased to confirm that our sovereign wealth fund will continue to be a long term investor in European financial markets for the next centuries to come. This is in the mutual benefit of both Norway and the European Union.