

Management of the Government Pension Fund Global (GPFG)

Introductory statement by CEO Yngve Slyngstad before the Standing Committee on Finance and Economic Affairs of the Storting (Norwegian parliament), 4 May 2015

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

I would like to thank the Chair of the Committee for the invitation to speak on the management of the Government Pension Fund Global in 2014.

Slide: Annual returns

The return on the GPFG came to 7.6 percent in 2014 measured in international currency, or the equivalent of NOK 544 billion. Since 1998, the annual return has averaged 5.8 percent. The rate of return on the first krone after inflation and costs has been 3.8 percent. The average krone has delivered a real return of 4.5 percent. In recent years, returns have been solid, but we must also be prepared for periods of value declines.

Slide: Accumulated change in market value

At the end of the first quarter of this year, the market value of the GPFG was NOK 7 012 billion. Since its inception in 1996, NOK 3 459 billion have been transferred to the GPFG. The return amounts to NOK 2 743 billion. Exchange rate movements come in addition. The return amounts to a substantially higher share of the GPFG's value today than a few years ago.

We aim to achieve value added in our management of the fund. Compared with the benchmark index for the fund, the excess return is 0.25 percentage point per year since 1998 to end 2014. In 2014, the return was in isolation 0.8 percentage point lower than the return on the benchmark index. This is primarily attributable to the fact that in the GPFG portfolio the share of European equities was higher and the duration of fixed-income investments shorter compared with the benchmark index.

Slide: Management objectives

Our goal is to achieve the high possible return in the long term at acceptable risk levels. We attach considerable importance to being a responsible investor and view that role as an integral part of our investment mission. We conduct our asset management efficiently, at low costs and the highest possible degree of

transparency. These are strategic choices that have a bearing on how we manage the GPFG.

Slide: Three pillars of responsible investment

As a step towards greater transparency, we published a separate report this year on our work on responsible investment in 2014. The work underpins the investment objective – highest possible return at acceptable risk levels. The work is guided by three main principles: We will take an active role in improving governance standards, we will exercise our ownership responsibly and we will monitor and manage the risk associated with the GPFG's investments.

International standards are of particular importance for the GPFG as a minority shareholder. If we are to have an influence, we must apply norms that other shareholders also apply. We support the development of selected international standards and give particular weight to standards established by bodies such as the UN and the OECD. We provide professional input and other type of support. For example, in 2014 we submitted a proposal for further elaboration of the OECD Principles of Corporate Governance. We also support more narrowly delimited standards. We are a member of the Carbon Disclosure Project, whose goal is to improve corporate reporting on climate risk. Moreover, we launched a new expectations document on climate change this year, which we use to explain to companies our principles and expectations.

We are a minority shareholder in more than 9 000 companies. With a rising stake in individual companies, the GPFG also faces growing expectations. We attach great importance to voting, dialogue with companies and analysis of the companies to safeguard the value of the GPFG. We must also prioritise in order to maximise the effect of our ownership work. We want closer contact with company boards and have in certain cases participated in the board appointment process.

Our voting record is available on our website alongside the list of holdings. This year the degree of transparency will increase with the disclosure of our voting intentions ahead of the general meeting of shareholders in certain cases. At the same time, we provide a published account of our motivation and the background for voting. It is our view that this strengthens our influence.

Slide: Environment-related mandates

Through the GPFG's environment-related mandates, we make extra investments in environmental technology. At the end of 2014, we had invested NOK 42 billion in environment-related equity mandates. We also invest in so-called green bonds. We

invest in companies operating in areas such as low-emission energy solutions and alternative fuels; energy efficiency and natural resource management.

The return on the environment-related mandates was 5.0 percent in 2014, which was lower than the overall annual return on the GPFG. The return on these investments must be expected to fluctuate more than the total return on the GPFG and the broad stock market. The Ministry of Finance is planning to raise the limit for environment-related mandates somewhat. The environment-related mandates are currently confined to stock market segments that are well suited to active investment management. Our investment managers have outperformed the environmental indices we use as a benchmark. The annual return on environmental mandates was nevertheless 7 percent lower than the GPFG's equity benchmark indices since we first started environmental investing in 2009.

The environment-related mandates increases the distance to the benchmark index and thereby the relative risk of the overall Fund management. The Ministry of Finance is planning to increase the tracking error limit to 1.25 percentage points, which is appropriate when the limit for environment-related mandates is also increased.

Slide: Divestments and company exclusions

In 2014, we continued our work on risk-based divestments. Some sectors are facing particular environmental and social challenges. Based on an overall financial assessment, we may divest from individual companies. Over the past three years, we have sold off our shares in 114 companies on the basis of such assessments.

Slide: Risk based divestments

So far this year, we have divested from an additional 12 companies. We have focused in particular on deforestation, water and climate emissions in recent years.

Slide: Fund holdings in coal mining

At the end of 2014, the GPFG only had small holdings in coal mining companies. At the start of this year, we sold down our position in some of these companies. We still have holdings in companies where coal is only one of several business areas, such as large mining conglomerates.

Slide: Fund holdings in selected sectors

The GPFG is also invested in electricity producers and oil and gas production companies. At the end of the first quarter of 2015, investments in oil and gas

production companies came to NOK 228 billion, while investments in electricity production and general mining amounted to NOK 109 billion and NOK 31 billion, respectively.

Slide: Electricity generation

Electricity generation companies normally derive electricity from a mix of sources. We have sent letters to our largest electricity generation companies, requesting information as to their strategy and timeline for phasing out coal from their electricity generation.

Slide: Letter to general mining companies

We have also sent letters to the largest general mining companies, where we have requested plans for transition to low-carbon energy systems. We also raised the question of spinning off coal mining.

Slide: Additional real estate investments in 2014

GPFG real estate holdings are growing rapidly. In 2014, we continued buying real estate in the US and Europe. We have never made as many real estate investments as in 2014. The proportion of the GPFG invested in real estate increased to 2.2 percent in 2014 and we will continue to increase real estate investments in the coming years. In order to reach the targets, we have established a separate management group for real estate investment that will build a separate real estate investment organisation within Norges Bank.

The strategy is to invest in large cities in the US, Europe and at a later stage in Asia. The plan is to invest about 1 percent of the GPFG in real estate every year in the coming years. The 5 percent limit should therefore be put to consideration.

Increased investments in real estate and possibly in infrastructure can contribute to improving the risk-return trade-off. Our mission as manager of the GPFG is to safeguard and build the financial wealth that belongs to the Norwegian people. We perform our task responsibly so that both today's generation and future generations will benefit from our oil wealth.

Thank you for your attention.