Statement by

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Before

The subcommittee on Domestic and International Monetary Policy, Trade and Technology and the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises

The Committee on Financial Services
U.S. House of Representatives

Hearing on

"Foreign Government Investment in the U.S. Economy and Financial Sector"

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[1] The departments of the Norwegian Ministry of Finance are each headed by a Director General. These are non-political civil servant positions.

Introduction
Thank you for the invitation to address these distinguished subcommittees on issues related to Sovereign Wealth Funds and their investments in the United States.

The Norwegian Government Pension Fund – Global (PFG) was formally established in 1990 – under the name “The Government Petroleum Fund” – as a tool to support a prudent management of petroleum revenues. Since the first net transfer in 1996, the Fund has grown rapidly in size. The Fund currently has assets of around 2,000bn NOK, which is equivalent to some 375bn USD, making it one of the largest single-owned funds in the world. One third of the portfolio, about 125 bn USD, is invested in bonds and equities in the US market. The US is by far the largest recipient country for our investments. The Fund is envisaged to grow substantially in coming years, and is estimated to reach NOK 3 500bn by the start of the year 2012, or approximately USD 600bn, see chart 1.

The Fund has a twofold purpose of smoothing out the spending of volatile oil revenues, and at the same time acting as a long-term savings vehicle allowing the Norwegian government to accumulate financial assets in order to help cope with large, future financial commitments associated with an ageing population. To effectively shield the non-oil economy from the effects of a volatile flow of foreign currency earnings from the oil sector, the Fund is only invested abroad. The allocations to and withdrawals from the Fund are fully integrated with the Fiscal Budget, see chart 2.

Accumulation of capital in the Fund reflects the depletion of a non-renewable resource, which is exchanged for financial assets through the Fund’s investments. This is true of many of the Sovereign Wealth Funds in the world today, including the SWF in the US, The Alaska Permanent Fund.

A sensible management of oil-producing countries’ petroleum wealth in well-functioning financial markets is in everyone’s interest. Well-functioning international financial markets are mutually beneficial as they give capital importers the opportunity to finance productive investments without reducing current consumption and capital exporters the chance to smooth consumption over time and achieve higher risk-adjusted returns. The experience of the 1970s, with large-scale recycling of oil revenues by oil producing countries through the international banking system, shows that a more diversified investment approach, also including equity investments, is desirable.

It can also be noted that the separation of spending of petroleum revenues from the current revenue stream through a fund mechanism allows Norway – and other oil producing countries – to extract petroleum at a higher rate than would be advisable if all the proceeds were to be allowed into the domestic economy on a continuous basis. Conversely, if investments of oil-related SWFs in international financial markets are restricted, the relative attractiveness of saving in the form of keeping oil in the ground would increase. Hence the petroleum funds do not just offer an attractive way of recycling the revenues of the oil producers in international financial markets; they can also have an indirect stabilizing effect on the oil market.

The Fund’s investments
The Fund is invested globally in a wide range of financial instruments, in order to get a broad diversification and achieve good investment returns with moderate financial risk. The Fund is a pure financial investor with small ownership shares in over 7000

individual companies worldwide. The strategic asset allocation is currently 60 pct. equities and 40 pct. fixed income. Within each asset class the Fund's investments are spread out across the world's financial markets according to the regional weights of the strategic benchmark and the weights of the various securities in the chosen market indices, see figure 3.

The investment strategy has evolved over time. As the fund has grown in size, the time horizon of the investments has also increased. A new fiscal policy rule was introduced in 2001, stipulating that the withdrawals from the Fund to cover the non-oil budget deficit over time should correspond to the estimated real return of the Fund. As long as this rule is adhered to, the capital of the Fund is preserved in real terms (but not as a share of GDP) indefinitely, making the Fund function like an endowment with an investment horizon which in principle is infinite. This has made it more appropriate to consider less liquid and somewhat more risky ways of investing the Fund's assets. The largest change recently was last year, when it was decided to increase the equity portion of the Fund from 40 pct. to 60 pct. Including real estate in the Fund's strategic benchmark is under consideration.

We believe the Fund has a positive influence on international financial markets through enhancing market liquidity and financial resource allocation. The Fund has a long investment horizon, no leverage and no claims for the imminent withdrawal of funds. The portfolio is rebalanced regularly, to bring actual portfolio weights in line with the stipulated strategic weights. The Fund will therefore generally be buying equities when equity prices are in relative decline, and vice versa. This also constitutes a stabilizing factor in financial markets.

Governance structure

The governance structure of the Fund is marked by a clear division of responsibilities between the political authorities and the operational management, see figure 4. Under the Pension Fund Act, the Ministry of Finance is the formal owner of the Fund. However, all significant changes to the Fund's investment strategy are in practice presented to Parliament before implementation as a way of ensuring broad political support for important strategic choices.

The Fund is formally an account the Ministry of Finance has in Norges Bank (The Norwegian Central Bank). Norges Bank has invested the corresponding value of the account in international financial markets in its own name through the fund management division of the Bank, Norges Bank Investment Management (NBIM). Norges Bank is thus the formal owner of the foreign assets of the Fund. The value of the Ministry's account in the Bank is set equal to the market value of the corresponding pool of foreign assets held by the Bank. The Ministry therefore bears the risk of changes in the market value of the assets.

The Ministry has formulated the investment strategy for the Fund by setting a clearly defined and transparent benchmark with risk limits. Within these limits, there is full delegation of operational management to Norges Bank. The Bank manages parts of the funds internally, while parts are managed by external managers appointed by the Bank on a commercial basis. Norges Bank is as formal owner of the assets also charged with exercising the Fund's ownership rights.

The Ministry of Finance established Ethical Guidelines for the Fund in 2004 based on a broad political consensus. The Ethical Guidelines' paramount objectives are sound financial returns, along with the obligation to respect fundamental rights of those who are affected by the companies in which the Fund invests. The Ethical Guidelines are transparent and predictable, and are based on internationally recognized standards, such as the UN Global Compact and the OECD Guidelines for Multinational Enterprises.

Two policy instruments – the exercise of ownership rights and exclusion of companies – are prescribed as tools to promote the ethical commitments of the Fund. It is emphasized that ownership interests in the companies in which the Fund invests are exercised with a view to safeguard the long-term financial interests of the Fund. The guidelines are based on the view that there is a link between sustainable economic development and sustainable social and environmental development, so that the Fund in the long run as a very diversified investor with a long time horizon will benefit from companies respecting fundamental ethical norms.

Institutional funds in general, and funds owned by governments in particular, face specific challenges. While individual shareholders may sell their holdings of individual assets or funds they do not find ethically acceptable, the citizens of Norway have to accept to be the ultimate owners of the companies that the Fund invests in. To preserve the legitimacy of the Fund, it is important that the ownership in the various companies is acceptable for most citizens. Hence, the Fund avoids investments in companies whose practices constitute an unacceptable risk that the Fund is or will be complicit in what is deemed as grossly unethical activities. The decision to exclude a company from the Fund's investment universe ultimately rests with the Ministry of Finance, but are based on publicly available recommendations from an independent Council on Ethics for the Fund, see figure 5. This should not be misrepresented as undue political interference with the Fund's investments. It is a necessary measure – based on principles of transparency and fairness – to ensure support and legitimacy for a fund which is a cornerstone of macroeconomic policy, and which presently is accumulating assets at a rate corresponding to 15-20 pct. of Norwegian GDP per year. As of February 2008, the Ministry has excluded a total 27 companies from the investment universe of the Fund, primarily as a consequence of the exclusion of some forms of weapons production, i.a. cluster bombs, land mines and nuclear weapons.

Transparency and the international work on SWFs

Key factors in the management of the Norwegian Fund include a high degree of transparency in all aspects of its purpose and operation, the Fund's role as a financial investor with non-strategic holdings, an explicit aim to maximise financial returns, and clear lines of responsibility between political authorities and the operational management. Norges Bank presents financial reports for the fund every quarter. The Bank has also published its priorities in the field of corporate governance. A full list of every single asset held by the Fund is published annually, and with effect from 2007, a full list is also published of how the Bank has voted on every issue in every company where it has exercised this right, comprising almost 40 000 issues in more than 4 000 companies. The Ministry of Finance presents an annual report to the Norwegian Parliament, giving detailed information on returns and a broad discussion of issues related to investment strategy and the implementation of the ethical guidelines. Most of the information is given both in Norwegian and English.

A high degree of transparency is essential to be able to build and maintain support for the Government's management of the petroleum wealth, which entails running large budget surpluses and building up substantial and very visible financial assets. Openness about the fund management may also contribute to stable international financial markets. Other market participants will then be familiar with our investment strategy and circumstances, thereby facilitating well-functioning financial markets. Furthermore, transparency provides a disciplinary effect on the fund management. As fund performance is subjected to public scrutiny, managers of sovereign wealth are met with pressures to deliver sound financial returns.

Thus we are of the opinion that a high degree of transparency does not compromise the return of our Fund. However, our investment strategy has focused on well diversified financial investments in highly liquid markets. Costs of transparency can be higher for a strategic investor in less liquid markets.

In the international debate on Sovereign Wealth Funds, transparency has become a central issue. Transparency is an abstract concept, and we perhaps need a more granular approach to the subject of increased transparency if we are to make progress in this area. Hence there is a need to better define the concept of transparency and which elements of disclosure that will be necessary to best serve well-functioning markets.

It may in this regard prove useful to distinguish between three different areas of transparency.

- Governance structure: Who are the ultimate owners of a fund, who makes investment decisions, what are the arrangements for audit, supervision and control?
- Investment objectives: What is the purpose of the fund, the time horizon for investments, the rules governing allocations to and withdrawals from a fund?
- Investment strategy and implementation: What is the size of the fund, the asset composition, risk limits and returns?

Transparency about governance structure and investment objectives would be helpful steps to alleviate concerns about Sovereign Wealth Fund investments.

Transparency on investment strategy and implementation would probably need to reflect the characteristics of the investor. Claims for increased transparency have to be balanced against legitimate business interests of investors. Whilst the Norwegian Fund is characterized by a high degree of transparency, there are certain aspects in the management of the Fund that, based on pure business considerations, are not made public. There are risks associated with deploying considerable amounts of capital into the financial markets. The disclosure of the exact timing and procedure of fund allocations in advance of the relevant actions could have adverse pricing effects in the markets. There is a need to strike a balance – also for us – between the need for transparency and on the other hand to use business sense and not be put at a disadvantage in the market.

Transparency also has to run both ways. If recipient countries set up screening processes to address legitimate national security concerns, there must be transparency with respect to how such screening decisions are made, by whom and under which criteria. Lack of transparency in this area can lead to suspicions of financial protectionism, introduce an element of uncertainty to the investment process, reduce investor confidence, and may ultimately reduce the relative attractiveness of non-transparent recipient countries.

Even a transparent process may reduce the relative attractiveness of a market if foreign sovereign investors have to undergo a lengthy formal process that puts them at a disadvantage compared with domestic investors or other foreign investors.

We support the ongoing work in the IMF and the OECD in studying the effects of Sovereign Wealth Funds (SWF). Any work on developing a set of best practices should be carried out by the IMF, with the collaboration of relevant partners. In this respect, we welcome the constructive approach of the EU commission as presented in their paper of February 27th. However, we see no cause for regulations that would restrict the present investment activities of our Fund, or any regulation imposing restrictions on SWF over and above those applying to non-SWF investors.

Apart from restrictions applying to very limited cases concerning national security, we must respect freedom of investment and equal treatment of shareholders as a fundamental principle. The declaration from the G8-summit on 7 June 2007 in Heiligendamm expressed what would seem to be a sound principle: "...we remain committed to minimize any national restrictions on foreign investment. Such restrictions should apply to very limited cases which primarily concern national security."

Corporate governance in the US
I note that there are some questions related to regulatory framework and corporate governance in the invitation to this hearing. While these are very timely and important questions, they primarily fall under the responsibility of Norges Bank as investor and formal owner of the Fund's assets. In keeping with our strict adherence to proper separation of responsibilities, let me just make some general remarks on this issue and refer you to the views of Norges Bank as published in their annual report yesterday.

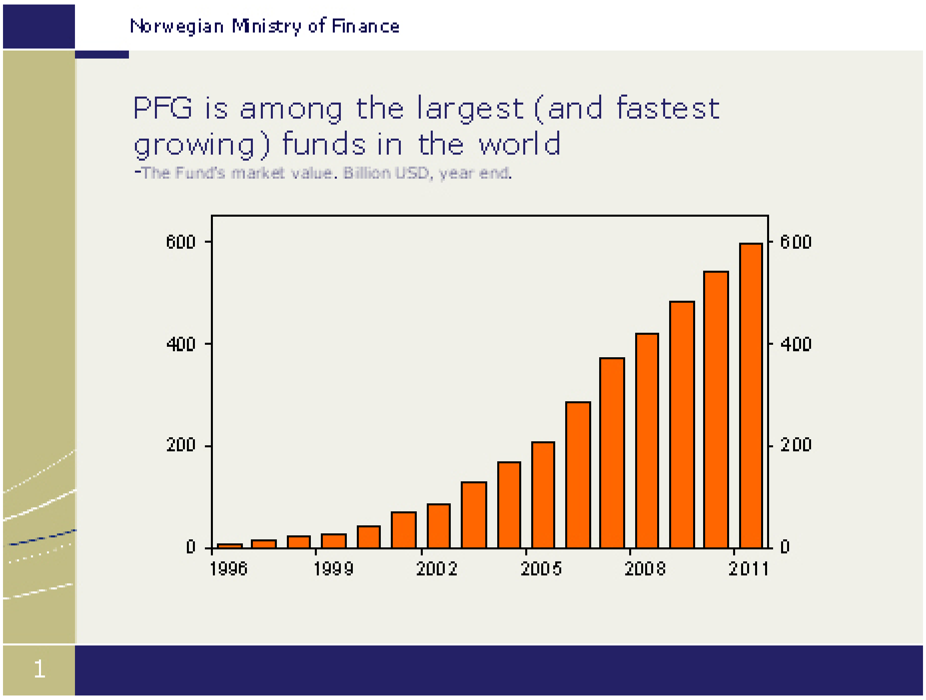
The Norwegian Pension Fund has a very long time horizon, and will in principle be permanently invested in global capital markets. It is in the Fund's financial interest that the companies it invests in are well-run, profitable and operate in well-functioning markets. A sound regulatory framework and good corporate governance arrangements are important preconditions for this.

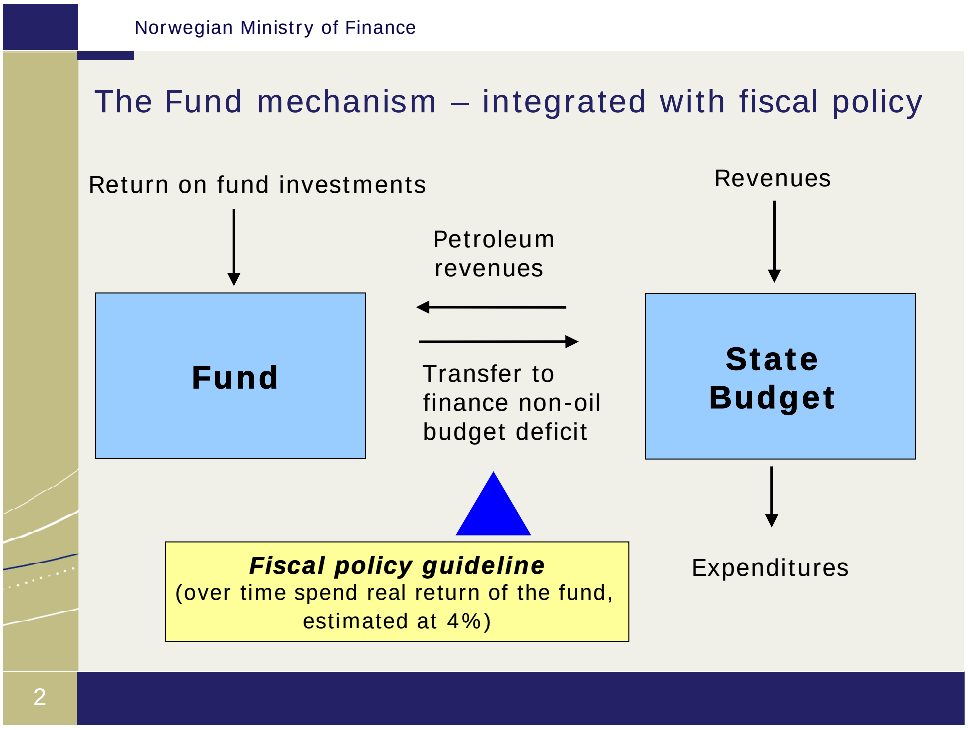
Norges Bank has chosen to concentrate its corporate governance work on a small number of priority areas which are of particular importance for the long-term returns of the Fund. The Bank has, in collaboration with other large institutional European investors (Hermes, ABP and PGGM), entered into a dialogue with US authorities on the subject of shareholder rights in US listed companies. Norges Bank observes that a lack of accountability, still faced in many corporations, constitutes a source of risk. Further, it notes that shareholder influence in the composition of boards helps to build a proper system of checks and balances between managers (agents) and the board representing the principal. In this regard, further progress on the accountability of corporate boards will yield a positive effect on the attraction of the US market for international investors. In its annual report for 2007, Norges Bank notes progress on some corporate governance issues it has raised with US authorities, but simultaneously expresses concern about lack of progress in other areas.

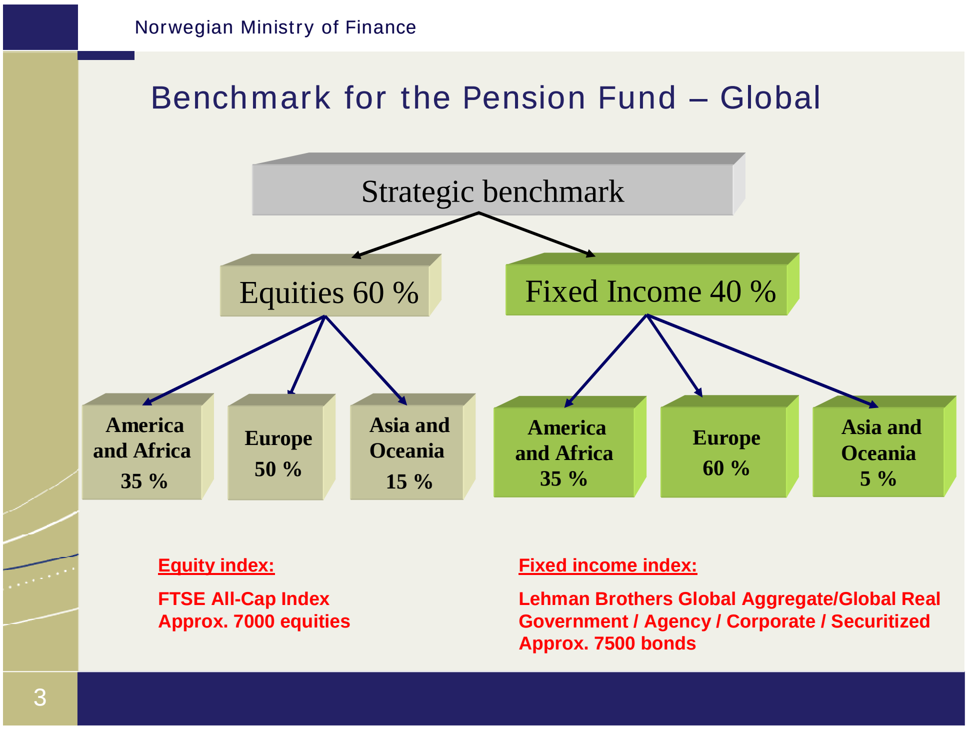
I trust that you will interpret this as a gentle encouragement of further strengthening the already high standing of US financial markets.

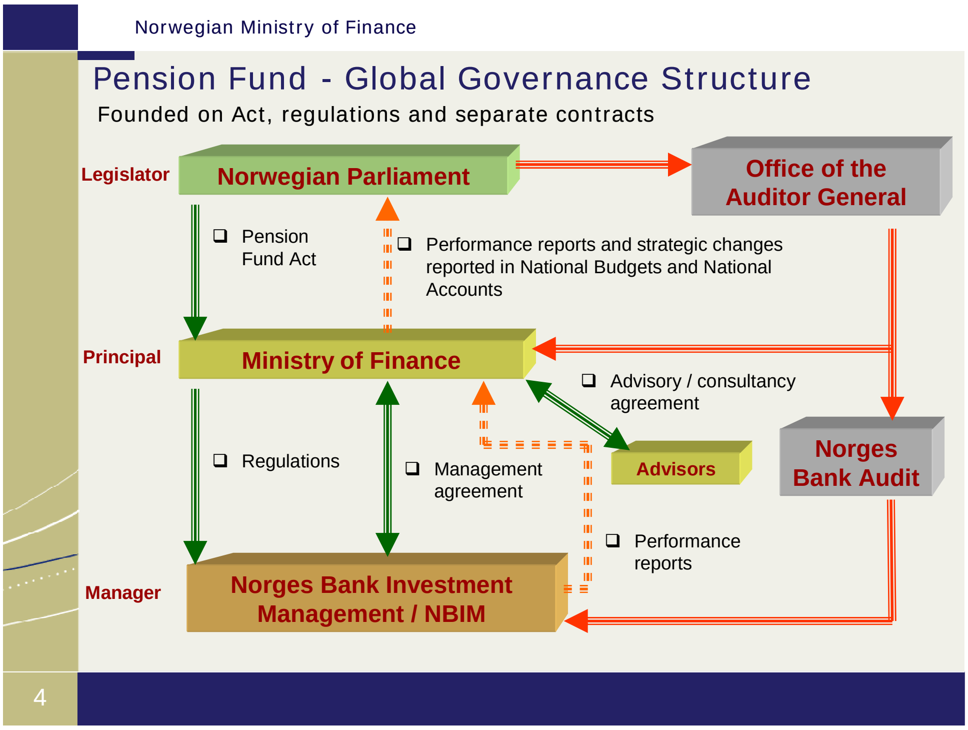
I will be more than willing to answer any questions you might have. Thank you.

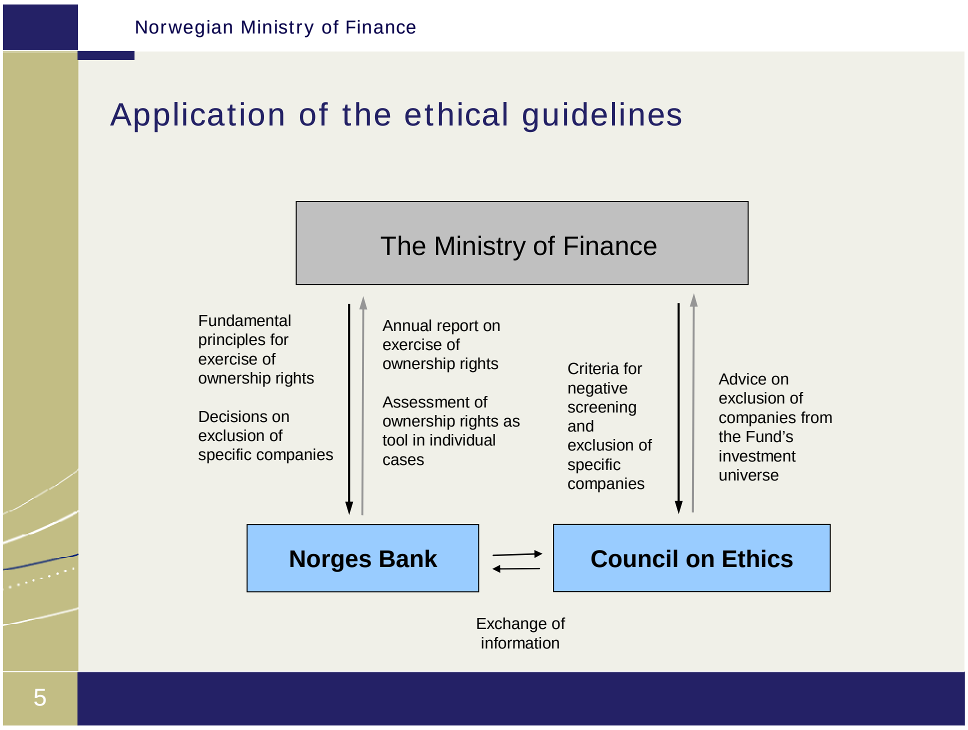
Charts


Norwegian Ministry of Finance
PFG is among the largest (and fastest growing) funds in the world
-The Fund's market value. Billion USD, year end.
600
400
200
0
1996
1999
2002
2005
2008
2011
1


Norwegian Ministry of Finance
The Fund mechanism – integrated with fiscal policy
Return on fund investments
Revenues
Petroleum revenues
Fund
State Budget
Transfer to finance non-oil budget deficit
Fiscal policy guideline
(over time spend real return of the fund, estimated at 4%)
Expenditures
2


Norwegian Ministry of Finance
Benchmark for the Pension Fund – Global
Strategic benchmark
Equities 60 %
Fixed Income 40 %
America and Africa 35 %
Europe 50 %
Asia and Oceania 15 %
America and Africa 35 %
Europe 60 %
Asia and Oceania 5 %
Equity index:
FTSE All-Cap Index
Approx. 7000 equities
Fixed income index:
Lehman Brothers Global Aggregate/Global Real Government / Agency / Corporate / Securitized
Approx. 7500 bonds
3


Norwegian Ministry of Finance
Pension Fund - Global Governance Structure
Founded on Act, regulations and separate contracts
Legislator
Norwegian Parliament
Office of the Auditor General
Pension Fund Act
Performance reports and strategic changes reported in National Budgets and National Accounts
Principal
Ministry of Finance
Advisory / consultancy agreement
Regulations
Management agreement
Advisors
Norges Bank Audit
Performance reports
Manager
Norges Bank Investment Management / NBIM
4


Norwegian Ministry of Finance
Application of the ethical guidelines
The Ministry of Finance
Fundamental principles for exercise of ownership rights
Decisions on exclusion of specific companies
Annual report on exercise of ownership rights
Assessment of ownership rights as tool in individual cases
Criteria for negative screening and exclusion of specific companies
Advice on exclusion of companies from the Fund's investment universe
Norges Bank
Council on Ethics
Exchange of information
5

Appendix:

Fact-sheet on the Government Pension Fund – Global
(Formerly known as the Government Petroleum Fund)

History
1969: Petroleum discovered in the North Sea (Ekofisk), production start in 1971.
1990: Parliament passed the Government Petroleum Fund law.
1996: First net transfer to the Fund. Invested like Central Bank currency reserves.
1998: Investment in equities introduced in the benchmark (40% allocation).
2000: Five emerging market countries added to the equity benchmark.
2002: Non-government bonds added to the fixed income benchmark.
2004: New ethical guidelines.
2006: The Government Petroleum Fund renamed the Government Pension Fund – Global.
2007: Strategic equity allocation increased to 60%, small-cap stocks included in benchmark.

Purpose
The Petroleum Fund was established in 1990 as a fiscal policy tool to support a long-term management of the petroleum revenues. Renaming the Fund to the Pension Fund - Global in 2006 was part of a broader pension reform, highlighting also the Fund's role in facilitating government savings necessary to meet the rapid rise in public pension expenditures in the coming years. The Fund is not earmarked for pension expenditures.

"The Norwegian petroleum fund model" in a nutshell
- The Fund is fully integrated into the state budget. It functions as a tool to strengthen the budget process and builds on existing institutions.
- The Fund is only invested abroad in financial assets. This ensures risk diversification and good financial returns, and helps to protect the non-oil economy.
- There is a high degree of transparency and disclosure of information. This helps build public support for a wise management of petroleum revenues, and reduces the risk of bad governance.

Key Design Features
- The Fund's inflow consists of all state petroleum revenues, net financial transactions related to petroleum activities, as well as the return on the Fund's investments.
- The outflow from the Fund is the sum needed to cover the non-oil budget deficit.

This means that the Fund is fully integrated into the state budget and that net allocations to the Fund reflect the total budget surplus (including petroleum revenues). Fiscal policy, which regulates the outflow from the Fund, is anchored in the guideline that over time the structural, non-oil budget deficit shall correspond to the real return on the Fund, estimated at 4%.

Governance
- The Ministry of Finance is responsible for the management of the Fund.
- The operational management is carried out by Norges Bank (the Central Bank), which invests the Fund in accordance with guidelines issued by the Ministry.
- Key changes to investment guidelines are presented to Parliament before implemented.
- The Ministry receives advice on the investment guidelines from Norges Bank, the Ministry's advisory council on investment strategy and external consultants.
- The Ministry uses external consultants for independent performance measurement and benchmarking of performance and costs.

Investment Guidelines
- The investment strategy is to achieve high financial returns subject to moderate risk.
- The Fund is only invested abroad in financial instruments. The fund is a financial investor with a diversified portfolio of non-strategic holdings in a range of companies.

- The Fund’s financial results are primarily assessed in international currency terms, in order to gauge the development in the Fund’s international purchasing power.
- Equities account for 60% of the Fund's strategic benchmark portfolio, consisting of equities listed on exchanges in Europe (50%), America/Africa (35%) and Asia/Oceania (15%).
- Fixed income instruments account for 40% of the strategic benchmark portfolio, consisting of fixed income instruments issued in currencies from Europe (60%), America/Africa (35%) and Asia/Oceania (5%).

Ethical Guidelines
The ethical guidelines for the Fund are based on the recommendations of the Graver Commission (NOU 2003:22). The guidelines have two main elements:

- The Fund is an instrument for ensuring that a reasonable portion of the country’s petroleum wealth benefits future generations, and it is an ethical obligation for present generations to manage it so as to generate a sound return.
- The Fund should not make investments which constitute an unacceptable risk that the Fund may contribute to unethical acts or omissions, such as violations of fundamental humanitarian principles, serious violations of human rights, gross corruption or severe environmental damages.

To implement the ethical guidelines, the following mechanisms are employed:

- Manage the Fund well so as to achieve high returns subject to moderate risk.
- Exercise the ownership rights associated with the equity holdings (done by Norges Bank).
- Exclude some companies from the Fund’s investment universe (decided by the Ministry based on advice from a Council on Ethics). Exclude some government bonds from the investment universe (decided by the Ministry).

Transparency
The management of petroleum revenues in general and the Fund in particular is characterised by a high degree of transparency and disclosure of information.

- The Ministry reports to Parliament on all important matters relating to the Fund, such as the size of petroleum revenues and the Fund; the outlook for fiscal sustainability; changes to the investment strategy; the Fund’s performance, risk and costs.
- The Ministry publishes advice and reports received from Norges Bank, the Strategy Council and external consultants.
- Norges Bank publishes quarterly reports on the management of the Fund, as well as an annual report and an annual listing of all investments.

Key numbers

	2005	2006	2007	1998-2007
Size in NOK bn	1 399	1 784	2 019	
Size in USD bn	207	285	380	
Total return in % (in FX basket)	11.1	7.9	4.3	6.0
…of which manager excess return	1.1	0.2	-0.2	0.4
Net real return in %	8.5	5.6	1.1	4.3

For more information on the Fund please see the following links:

Ministry of Finance:
www.regjeringen.no/en/dep/fin

Government Pension Fund:
www.government.no/gpf

Norges Bank Investment Management:
www.nbim.no

Council on Ethics:
www.etikkradet.no