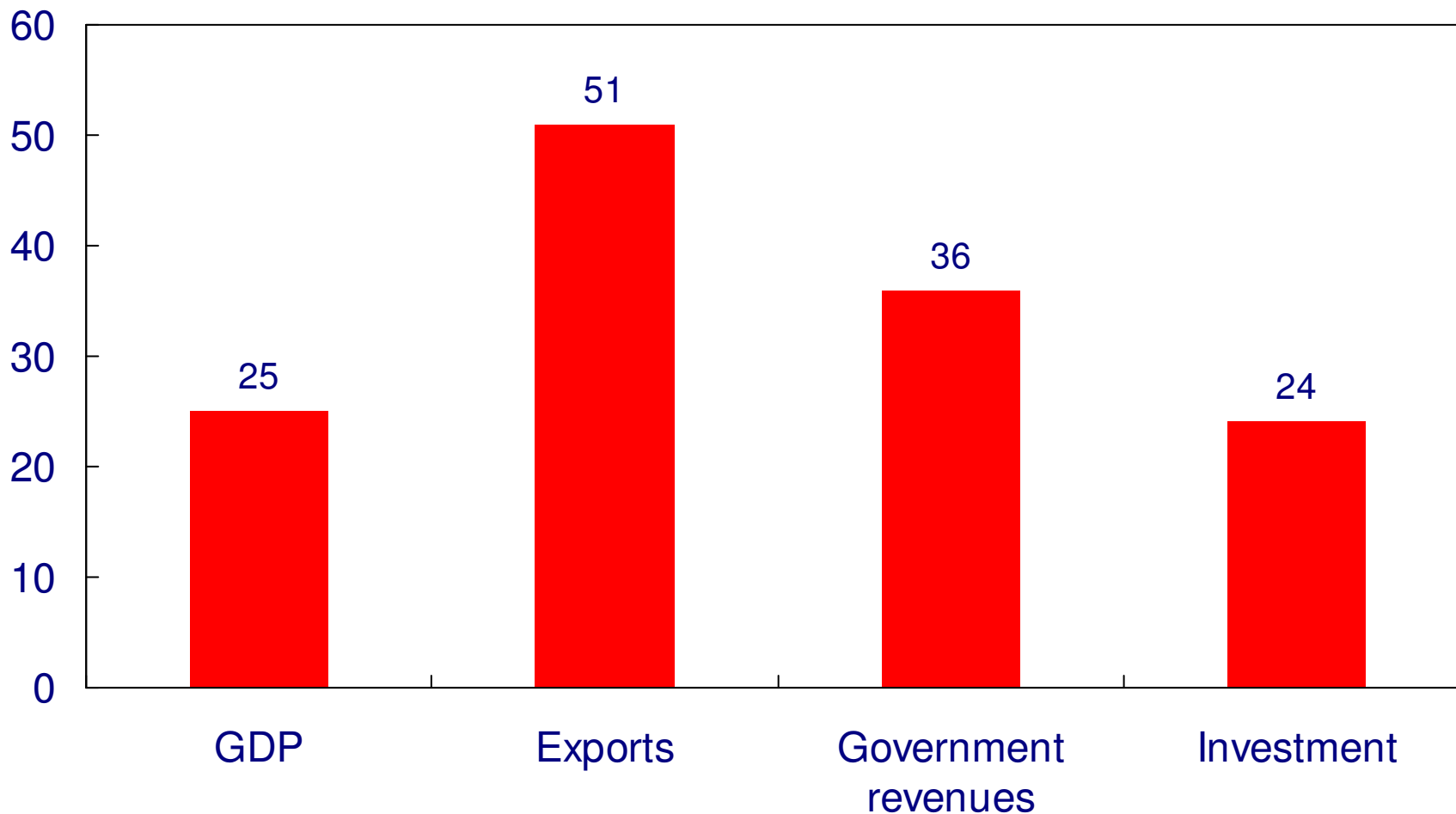


Best practice in structuring stabilization and commodity wealth funds

Deputy Governor Jarle Bergo
Sovereign Funds Roundtable
8 May 2007

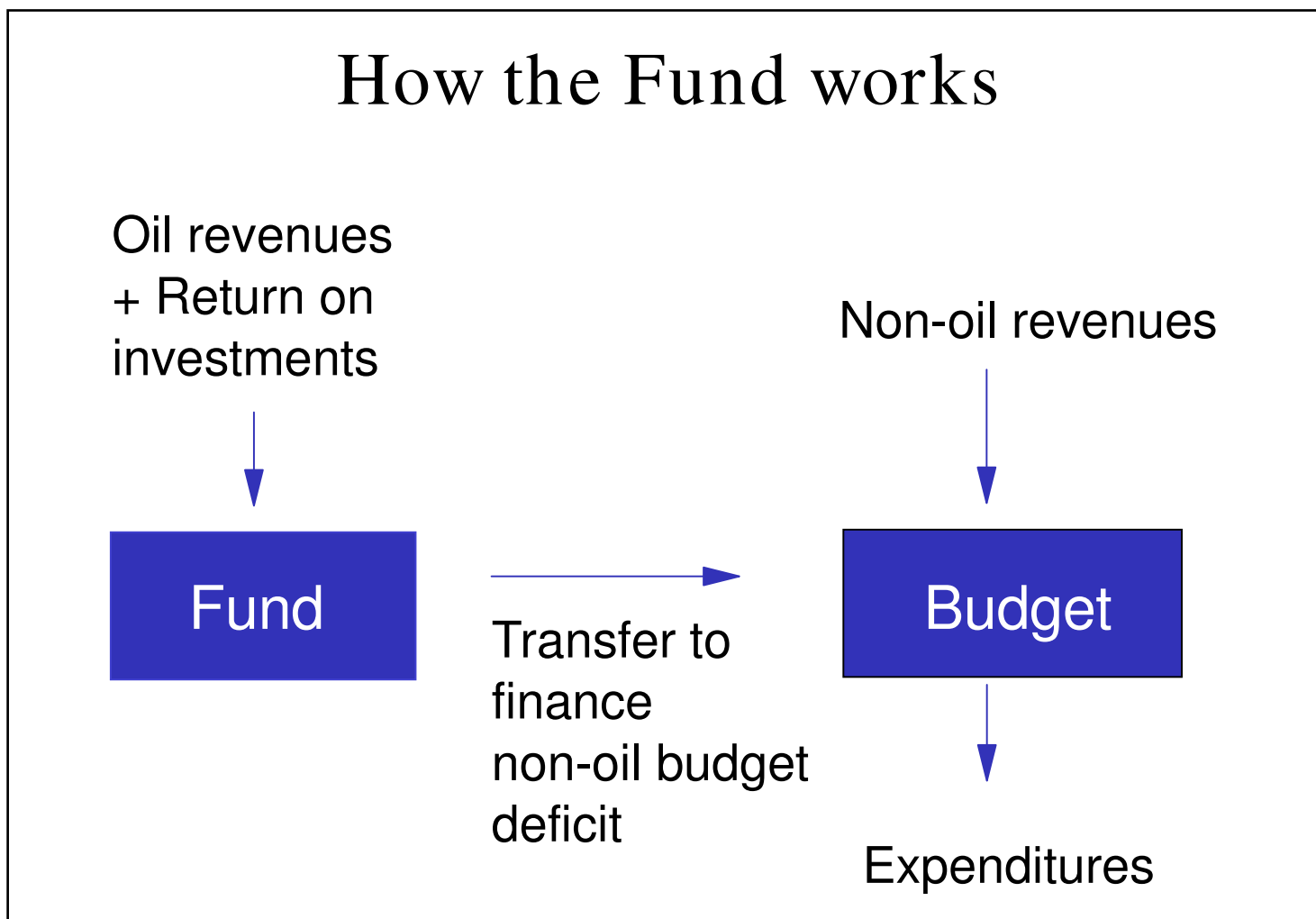
The size of the Norwegian petroleum sector

As a share of selected macroeconomic variables. 2006. Per cent

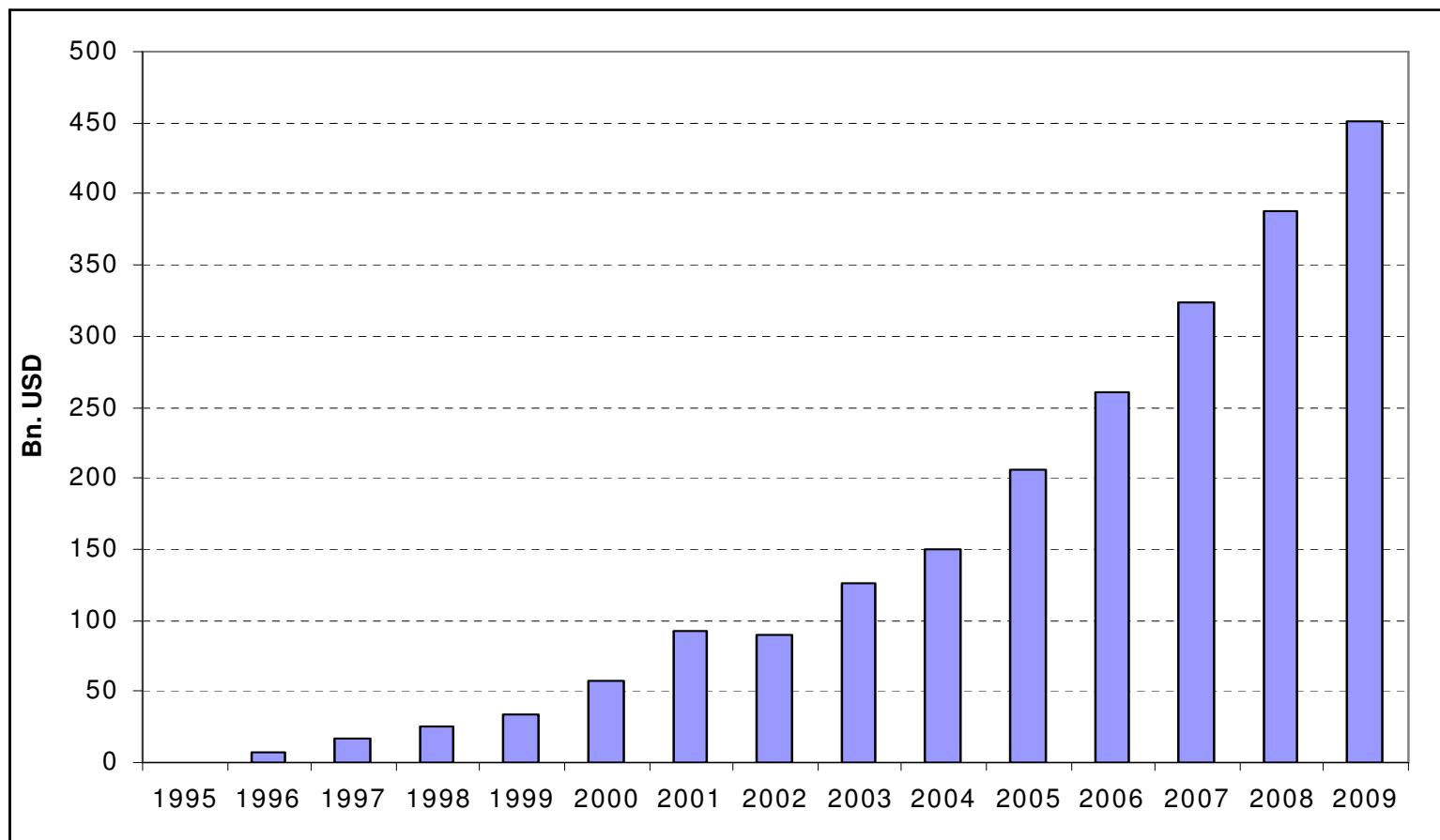


The National Challenges

- Ensure a fair distribution of oil wealth across generations
 - as oil wealth is transformed into financial wealth; do not spend the principal, only the expected real return
- Avoid pronounced cyclical fluctuations in the mainland economy due to variations in oil revenues
 - invest in financial assets abroad only



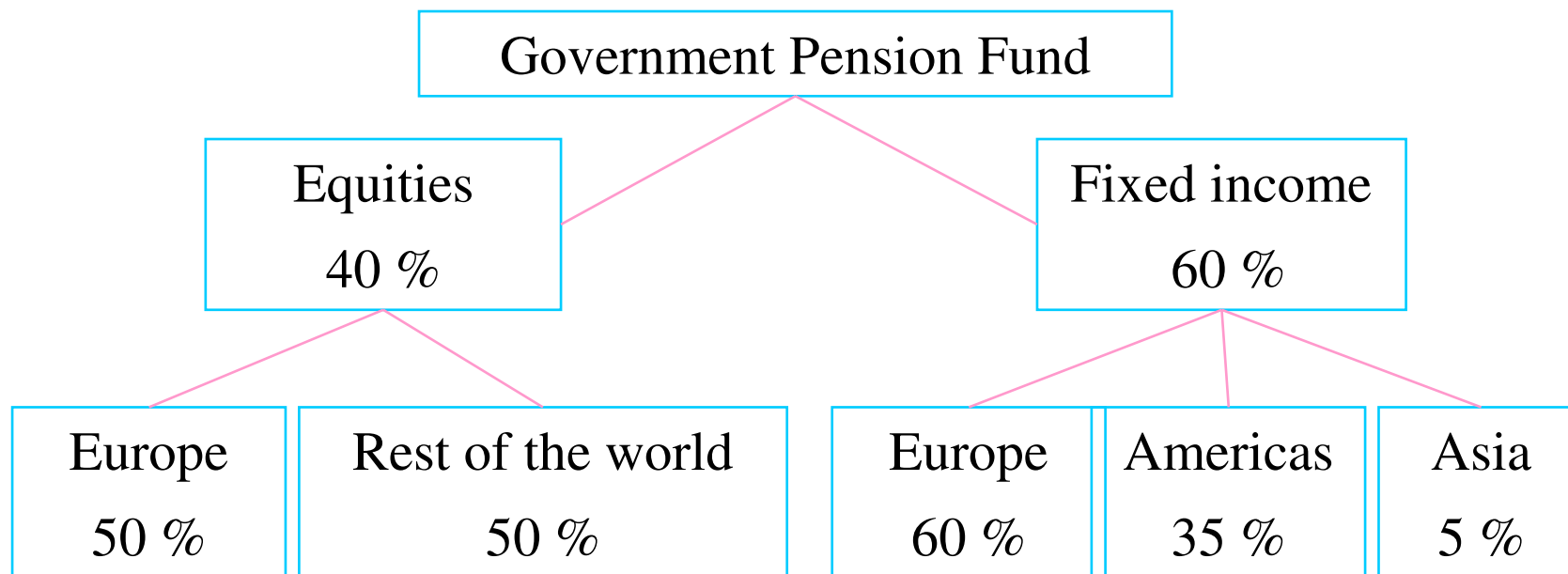
Size of the Government Pension Fund – Global Billion USD



Division of responsibilities

- Ministry of Finance
 - decides on the strategic asset allocation
 - defines the benchmark portfolio
 - sets limit for deviations from the benchmark portfolio (scope for active management)
 - reports to the Norwegian parliament
- Norges Bank
 - cost-effective transitions and market exposure
 - active management to achieve excess return
 - risk control and reporting
 - provides professional advice on investment strategy

Current strategic asset allocation

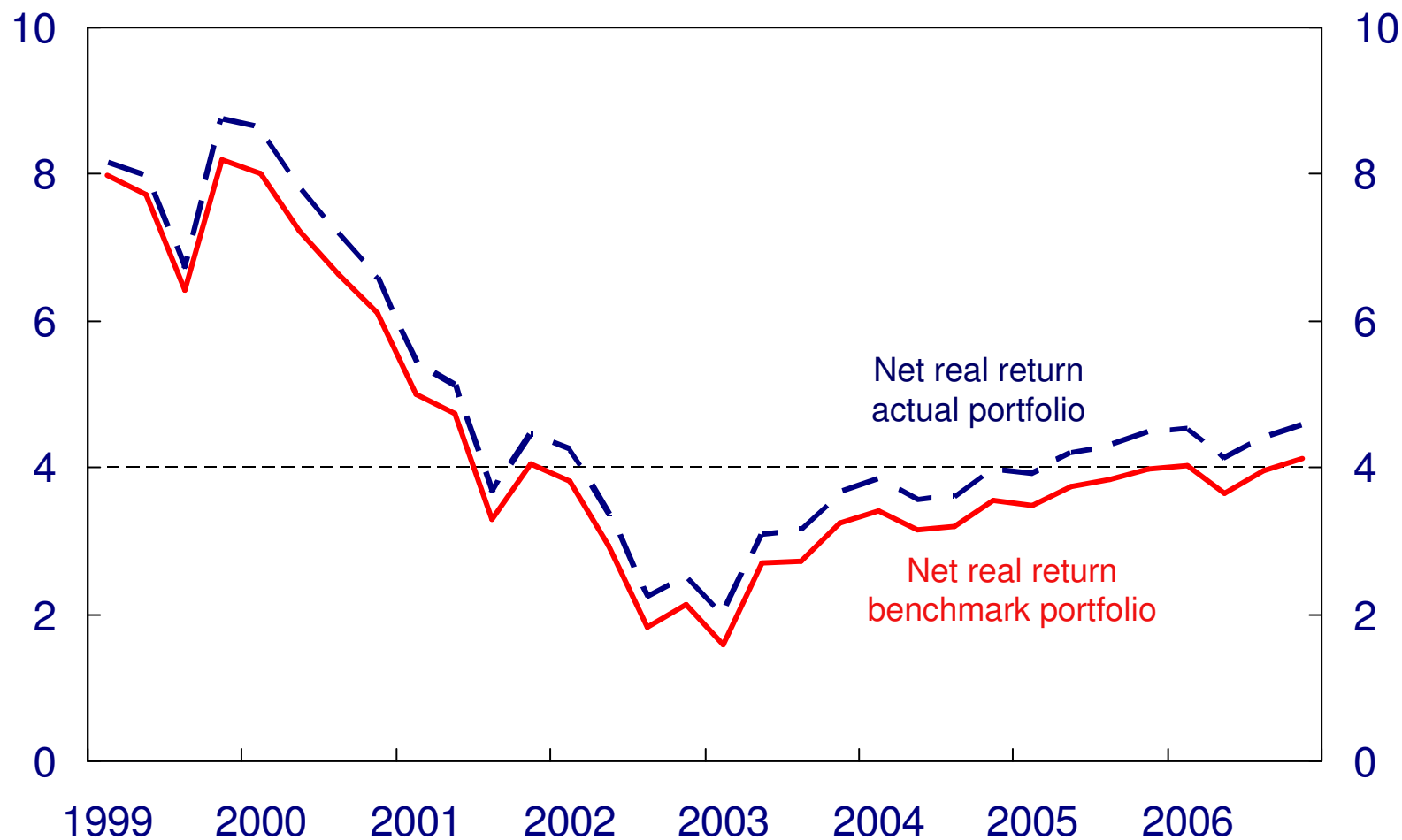


FTSE all-world country indices in 27 countries

Lehman Global Aggregate broad fixed income index and Lehman Global Real in 18 European and North American countries, and LGA Treasury and LGR indices in 4 Asian countries

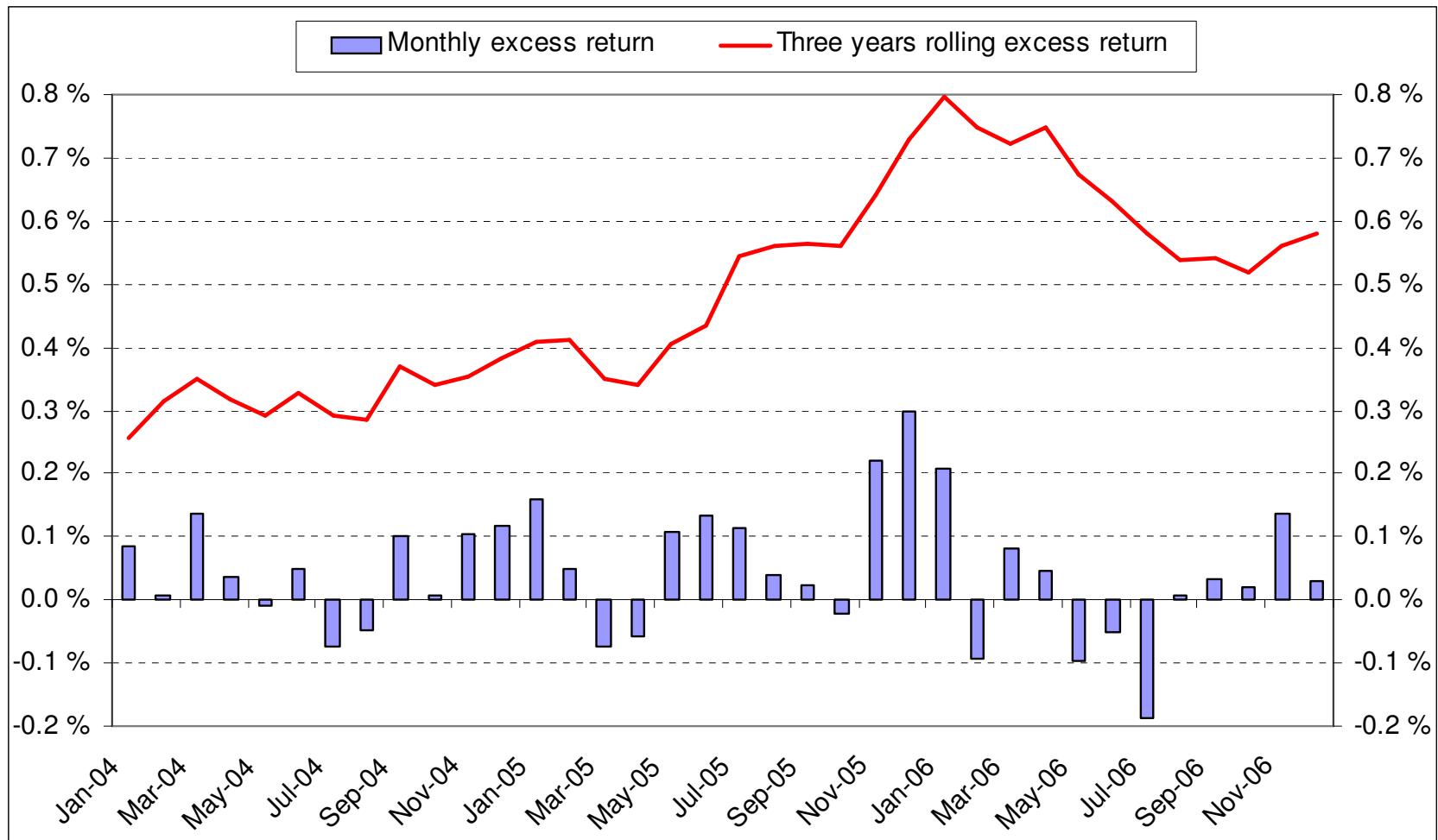
Average annual net real return since 1997

Per cent



Excess return past three years

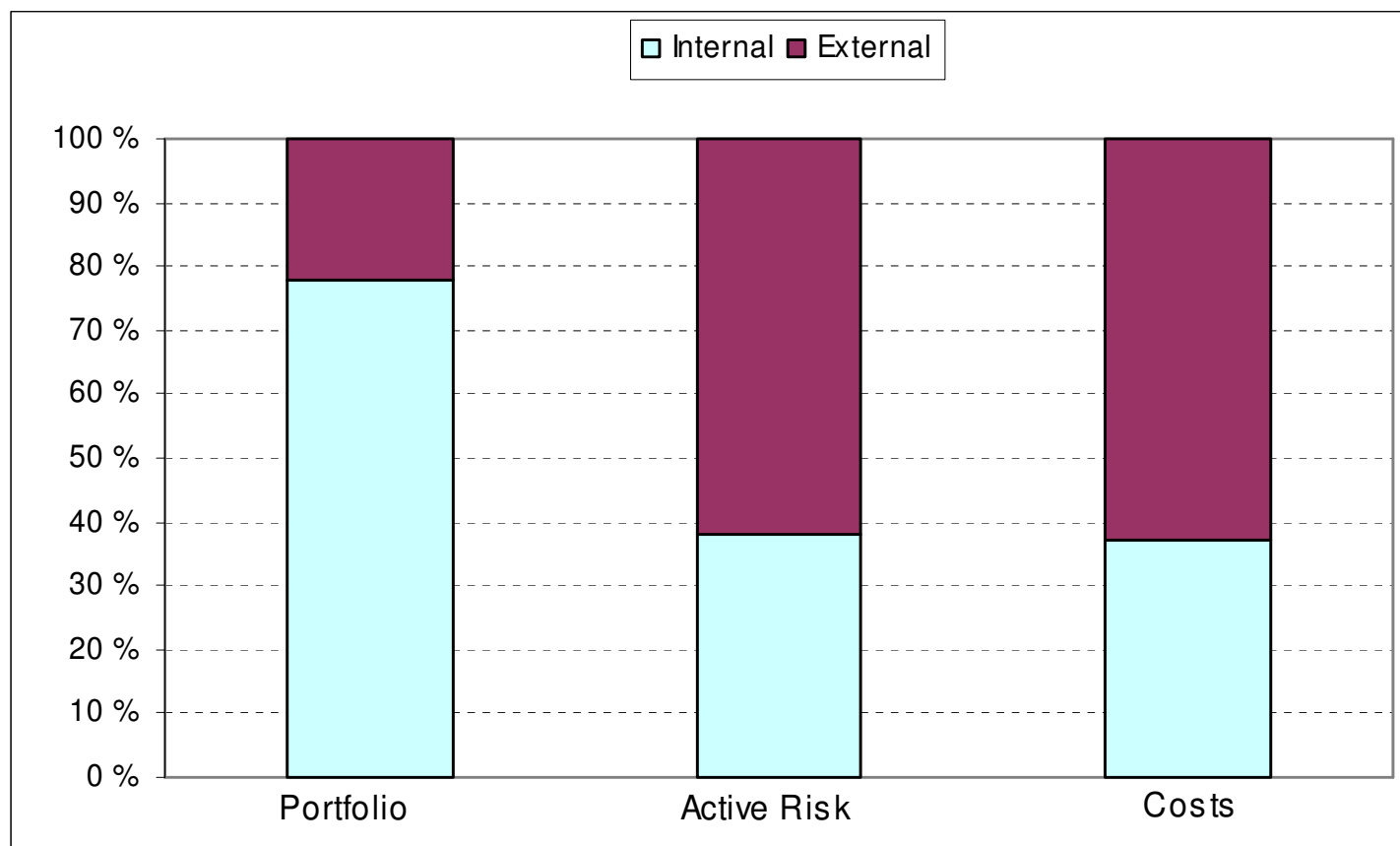
Per cent



Beta, alpha and total net return

- Total net return
 - Beta: The strategic portfolio return
 - Alpha: The active management return
 - Cost: Transition and management cost
- The bulk of the expected return and risk is provided by the strategic portfolio return
 - Responsibility of the Ministry of Finance (fund owner)

Distribution of portfolio, active risk and management costs between internal and external management

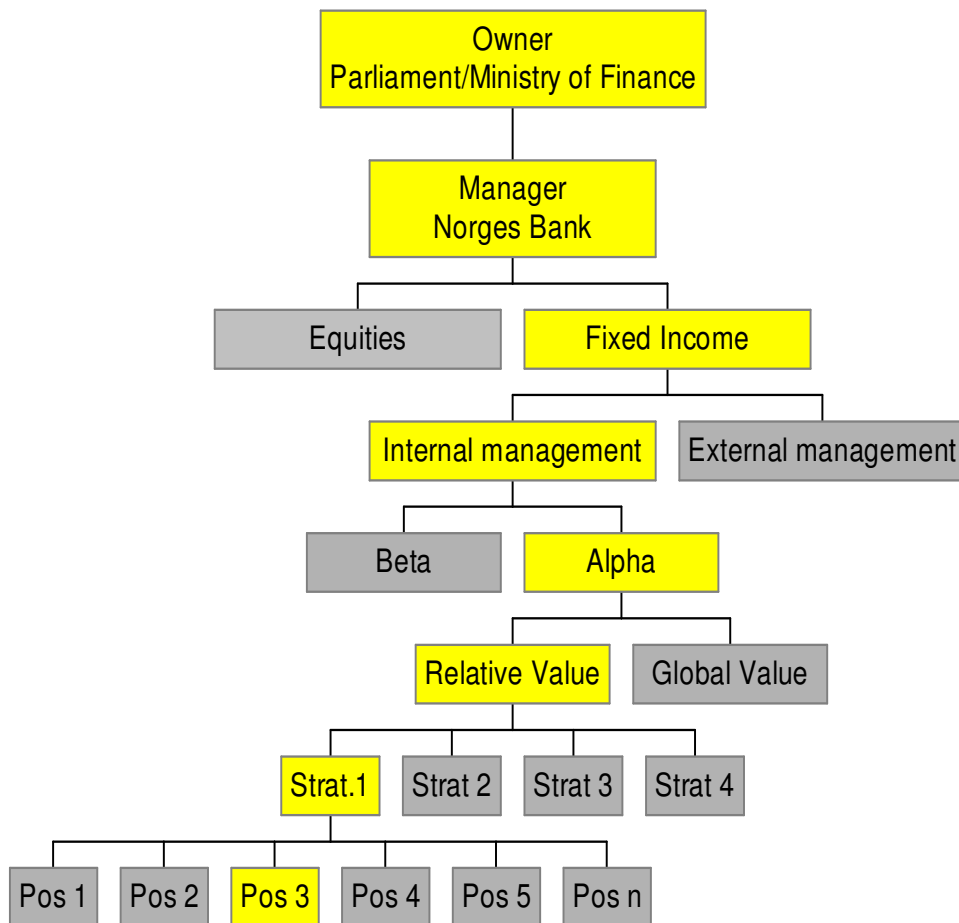


50 external fund managers are responsible for close to 60 percent of the active risk (80 different mandates)

Principles supporting active management

- Clear separation between beta and alpha exposure
- Very high respect for the market. Applying financial theory. Humility and discipline
- Active management only where there may be somewhat lower market efficiency and where we find/develop managers with unique expertise
- Specialization. More than 100 sub-portfolios
- Extensive delegation. No committee structure
- Incentives linked to performance

Delegation, line management, measurement, control



- Clear division of responsibilities
- Trading within defined risk limits
- Periodic assessment of performance and investment guideline compliance
- Portfolio trading is strictly delegated
 - to more than 80 external mandates
 - to 15 – 20 internal teams

Empowerment and ownership

- Individual investment mandates
- Individual incentive structure
 - clearly defined and measured
 - ‘managing own money’
- Ownership in all other processes
 - operations included in the business units
 - division of responsibilities, defined work task
- Independence in team structure
 - optimal size for flexibility and communication
 - accountability and visibility without ‘atomization’
 - blending competition and support
 - avoiding ‘group think’

Transparency

- Performance, risk and costs are reported by NBIM every quarter. Focus on contribution to value added in operational management
- Quarterly reports published on website
- Press conference on a quarterly basis
- Annual report listing all investments, both equities and fixed income



Key insights

- The owner must set clear objectives:
 - The strategic asset allocation, i.e. the total risk return trade-off
 - The tracking error and the required value added from active management
- The risk return trade-off must be taken by the political authorities to ensure time-consistency in adverse market environments
- The operational management must be carried out by investment professionals
 - To avoid a mixture of politics with investments, investment mandates must be defined very clearly
- A commercially vigilant performance culture can be fostered within a public sector institution
 - Empowerment and compensation system are key ingredients