Ministry of Finance
Asset Management Department
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Date: 18 August 2011
Your ref.: 11/1852 EEr
Our ref.:

Report No. 15 (2010-2011) to the Storting on the Management of the Government Pension Fund in 2010

Reference is made to the Ministry's letter of 28 June 2011 on the follow-up of Report No. 15 (2010-2011) to the Storting on the Management of the Government Pension Fund in 2010.

Norges Bank notes that the Ministry will come back to the question of evaluating the criteria used for the composition of the environmental investment mandates once more experience with these investments has been gathered. We refer to the provisions on public reporting in chapter 7 of the mandate, including the description in our annual report for 2010.

In the letter, the Ministry refers to the discussion in the report to the Storting of work on an expectations document in one of the bank's six focus areas for active ownership: well-functioning, legitimate and efficient markets. Issues relating to companies' transparency and reporting will be one of a number of themes covered by the key documents for ownership work at Norges Bank. This autumn and early next year the Bank aims to publish expectations documents for the following three focus areas: equal treatment of shareholders; shareholder rights and board accountability; and well-functioning, legitimate and efficient markets.

Norges Bank attaches importance to cost-effective operation. The annual report on the Government Pension Fund Global for 2010 included a broad review of costs at NBIM in a feature article. We also expanded the notes to the financial statements so that they now provide more information than before on operating costs in the management of the fund. We note that the Ministry plans to extend its analysis of costs in next year's report to the Storting on the fund. It will be natural to have a broad review of costs in the annual remuneration letter to the Ministry and in NBIM's annual report on the management of the fund in 2011.

In its letter of 28 June, the Ministry proposes an amendment to the fourth paragraph of section 1-4 of the management mandate for the Government Pension Fund Global, namely inserting a requirement that agreements with external managers on performance-based fees contain provisions imposing a ceiling for these fees.

Norges Bank has no objections to the proposed amendment of this paragraph. As reported before, NBIM introduced a ceiling for the fees paid each year under all new agreements with external managers back in 2009. Any fees accrued beyond this ceiling may be paid out at a later date, but only if the excess return from inception continues to be at least as positive. The practice now established for the payment of fees to external managers is reflected in the Executive Board's investment mandate for NBIM's CEO. Last amended on 10 August this year, the investment mandate requires agreements with external managers to contain an upper limit for the payment of fees in the form of a specific maximum amount. This amount must not exceed 25 million US dollars per year per investment mandate. Our implementation of the new requirement in the fourth paragraph of section 1-4 would therefore mean that agreements with external managers will contain an absolute limit for the payment of annual fees for each particular mandate.

The fees recognised in the financial statements in any one year may be higher than the fees actually paid out. Under applicable accounting rules, the recognised amount must include not only actual payments but also provisions for liabilities arising during the financial year in the form of accrued but unpaid fees. In the event of high excess returns and the ceiling for payments being exceeded in a particular year, the management agreements are designed in such a way that the recognised liability will never exceed the ceiling for the following year.

In its letter of 28 June, the Ministry asks for the Bank's views on what kind of changes to the geographical distribution of the fund it might be appropriate to make during the current year.

The fund's geographical distribution has been covered several times in Norges Bank's letters to the Ministry over the past year. In our letter of 6 July 2010 on the development of the investment strategy, we show that the relationship between the goal of safeguarding the fund's long-term international purchasing power and the current regime with strategic regional weights is unclear. There needs to be a review of whether it is appropriate to retain the current structure with regional weights.

In our letter of 18 March 2011 on the investment strategy for the fund's nominal bonds, we argued that the goal of achieving the greatest possible long-term international purchasing power will best be attained through broad ownership of the production of goods and services of which the fund is to finance the purchase. The biggest change in the currency mix resulting from our specific recommendations is significantly lower representation of European currencies. We therefore recommended assigning these currencies a special adjustment factor during a transition period.

The changes in the benchmark index proposed by Norges Bank will better serve the fund's strategic goals. The mandate for the management of the fund makes it possible to adjust the portfolio to changes in the strategic benchmark index in an efficient manner. There are no operational factors that would prevent us from quickly commencing the implementation of the strategic advice we have submitted.

Yours faithfully

Øystein Olsen Yngve Slyngstad