

New mandate for the Government Pension Fund Global

A new mandate for the Government Pension Fund Global issued by the Ministry of Finance entered into force on 1 January 2011.¹ The new mandate has not affected the overall strategy for the investment of the fund's assets, but is more comprehensive and includes new provisions in areas such as risk management and reporting. There is still a clear division of roles and tasks between the ministry as owner and Norges Bank as operational manager. The mandate therefore contains limits and principles for the management of the fund with which the bank is to comply. The aim, as before, is to generate the highest possible return after costs, measured in international currency.

The overall strategy for the investment of the fund's assets is unchanged from before at 60 percent equities, 35-40 percent fixed income and up to 5 percent real estate. Permitted investments, benchmark indices and the rebalancing system are also largely unchanged. The new mandate specifies that the fund may not be invested in government debt issued by countries subject to large-scale international sanctions endorsed by Norway.

The mandate is now more comprehensive, as it replaces both the previous regulation and supplementary guidelines on the management of the fund and the management agreement between the ministry and the bank. The previous additional rules on responsible investment and investments in real estate have been incorporated into the mandate, with minor changes. These areas are covered by separate sections of the mandate.

The mandate introduces new general requirements for administration and reporting. The bank is to have a strategic plan and regularly evaluate performance relative to this plan. The plan is to be updated regularly and made publicly available. The new mandate contains provisions on the remuneration of employees at NBIM in line with the regulation on remuneration systems at financial institutions, securities companies and securities fund managers issued by the Ministry of Finance on 1 December 2010.

The reporting provisions form a separate section of the mandate and pave the way for a good flow of information to the ultimate owners of the fund. The provisions specify the form the fund's disclosures must take, including annual and quarterly reports. The fund's report for the first quarter of 2011, published on 13 May, complies with the provisions in the new mandate. The principles, guidelines and limits established by the bank's Executive Board in accordance with the new mandate are also being published.

¹ An English translation of the mandate can be found at: http://www.regjeringen.no/Upload/FIN/Statens_percent20pensjonsfond/mandat_spu_eng.pdf

The mandate contains a number of changes to the provisions on risk management. First, the limit for expected tracking error has been reformulated. This limit puts a ceiling on how far the fund's return can be expected to deviate from the return on the fund's benchmark indices. Previously the requirement was maximum expected tracking error of 1.5 percent, whereas the new mandate specifies that the bank is to manage the fund "with the aim of" expected tracking error not exceeding 1 percent. This offers greater flexibility to avoid unwanted adjustments in extraordinary situations. The method for calculating expected tracking error has been established by the bank and approved by the ministry.

Expected tracking error is an important measure of risk but does not capture every dimension of the fund's risk exposure. Limits in a number of new areas have therefore been added. A limit has been established for credit risk based on credit rating. All bond investments are to have a credit rating, and if no external rating is available, the bank is to produce an internal rating. The mandate also requires the bank to introduce supplementary risk limits in a number of areas, including limits for the minimum overlap between investments and the benchmark index and limits for credit risk, counterparty exposure, leverage and the reinvestment of cash collateral received. The bank's Executive Board has duly adopted limits in these areas, as set out in its letter to the ministry of 3 December 2010. As before, there is an upper limit on the size of the fund's holdings in a listed company. This is because the fund is to be a financial and not a strategic investor.

The mandate includes new provisions on the valuation of the fund's investments and the measurement of returns, as well as provisions on the management and measurement of risk. Valuations are to be prepared in accordance with Global Investment Performance Standards (GIPS). This is a form of quality assurance for return calculations that NBIM has used for a number of years. There are also a number of requirements for the measurement of risk, including relevant sources of systematic risk. Risk is to be estimated using a number of methods, including stress tests based partly on historical events and scenarios for future developments in systematic risk factors. Analyses of extreme event risk are to be an integral part of the fund's risk management. Besides market risk, there are provisions on the management of other types of risk, such as counterparty risk and operational risk.

A new regulation with accounting rules for Norges Bank also entered into force on 1 January 2011. One important change with this regulation is a switch to International Financial Reporting Standards (IFRS).