



NORGES BANK
INVESTMENT MANAGEMENT



STRATEGY 2017-2019

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INVESTMENT
MANAGEMENT

An aerial photograph of a mountain range with a valley and a river. The mountains are covered in green vegetation, and the valley floor is a mix of green and brown. A river flows through the valley, and there are some small settlements or villages visible. The overall scene is a natural, scenic landscape.

Our mission

is to safeguard and
build financial wealth
for future generations.

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Strategy 2017–2019

We are a large global investor and a long-term owner safeguarding our assets through efficient execution.

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Introduction

Our mission is to safeguard and build financial wealth for future generations. Long-term, sound management of the fund helps ensure that both present and future generations can benefit from this wealth.

Norges Bank Investment Management manages the fund according to the management mandate laid down by the Ministry of Finance.

The objective of the management is to ensure high long-term return after costs. We aim to achieve this goal with acceptable risk, as a responsible investor, and through an efficient organisation and transparent management.

We seek to use the fund's unique combination of characteristics to our competitive advantage. We are a large, global investor with a long investment horizon and limited liquidity needs. We hold a well-diversified portfolio across assets classes, countries and sectors, and take a systematic approach to investments. The size of the fund allows us to implement the investment strategies in a cost efficient way. Our investment strategies are grouped into three broad categories, fund allocation, asset strategies and company investments. The strategies complement each other, perform in different market environments, and reduce risk through diversification on time horizons, analytical framework and choice of securities.

The strategy for 2017-2019 continues in the direction set by the 2014-2016 strategy. In the previous strategy period, the fund grew by 2,500 billion kroner. We do not expect this growth to continue, and will adapt the strategy accordingly. We will consolidate the organisation and our investment platform.

Large global investor

ADVICE

Norges Bank is required to advise the asset owner on the need for changes to the management framework. Our advice is founded on academic and market insights, and supported by our experience as the manager of the fund. We will broaden the scope of our advisory activities, and take national wealth considerations into account.

Benchmark advice

The Ministry of Finance will review the allocation to equities in the benchmark index. A higher equity share may require a different bond portfolio. We will assess the role of corporate bonds and emerging market bonds in the fixed income index, and the implications of a higher equity share for the regional allocation in the equity index.

Currency composition

The currency basket of the fund follows from the benchmark index, and varies over time. Changes to the benchmark index thus impact the currency risk and the way fund returns are measured. We will assess adjustments to the currency composition.

Alternative risk measures

The key risk limit in the management mandate is the portfolio's relative volatility versus the benchmark index. A relative risk limit encourages investments in assets with risk characteristics similar to those included in the benchmark index and is well suited to regulate risk for securities selection strategies. It is less suited for investment decisions where the objective is to diversify to improve the overall return-risk profile of the fund. We will assess alternative risk measures suitable for the mandate of the fund.

REFERENCE PORTFOLIO

The investment mandate from the Ministry of Finance sets the owner's risk preferences through the benchmark index. The benchmark index is based on public indices designed for investors with needs and objectives that differ from that of the fund. We use the reference portfolio to manage the real estate allocation, define the investment universe, gain exposure to systematic risk factors and facilitate rebalancing. We will develop the reference portfolio further to improve the total return-risk of the fund. This is the aim for our allocation strategies.

Real estate allocation

Real estate investments are not included in the fund's benchmark index. We need to decide how much of the fund to invest in real estate, and the funding from equities and fixed income. We will decide the funding for each real estate investment considering its impact on the overall fund.

Investment universe

We include additional emerging and frontier equity markets, and selected emerging debt markets in the reference portfolio to improve diversification. We consider the investability of emerging and illiquid markets, and manage these investments actively. Companies that we have chosen not to invest in for environmental, social and governance reasons are removed from the reference portfolio's investment universe.

Risk factors

We include systematic risk factors in the reference portfolio to enhance returns. This will include the value, size and quality factors in the equity market and term and carry in the fixed income market. We will assess additional sources of priced risk.

Rebalancing

The reference portfolio is rebalanced between asset classes, bond segments and currencies. We adjust the portfolio over time to reduce turnover and transaction costs. The same applies for rebalancing of the free-float weights. We will refine the rebalancing rules for the reference portfolio.

ASSET IMPLEMENTATION

A fund of our size and reach across asset classes, regions and market capitalizations, needs to manage broad market exposures efficiently. Indices constantly change and replication of the Ministry of Finance benchmark will be costly due to the size of the fund and its thousands of single investments. We aim to generate excess return over time through systematic strategies with low transaction costs. The fund's limited need for liquidity and its global reach puts the fund in a good position to pursue asset strategies.

Asset exposure

We will continue to move away from index replication, to avoid known benchmark weaknesses and high implementation costs. We will implement carefully researched enhanced index strategies. We will expand our relative value strategies, participate in capital market activity and enhance our systematic risk factor strategies.

Transaction costs

Execution of transactions are costly for large, global investors. We will continue to develop internal trading capabilities, and be early adopters of new trading platforms that have potential to reduce transaction costs and increase transparency.

Liquidity provisioning

Providing liquidity to the market through efficient use of our holdings is a way to use our own limited liquidity needs to generate excess return. We achieve this goal through securities lending and liquidity provisioning strategies. Agency securities lending will continue to be the backbone of our lending activities. We will provide liquidity selectively, and respond to liquidity demand situations when they arise.

Well-functioning markets

The fund benefits from fair and efficient markets. We will conduct research and engage with academia, regulators and markets participants on questions related to well-functioning financial markets.

Long-term owner

COMPANY INVESTMENTS

The fund is one of the largest owners in many of the world's largest companies. The fund's significant allocation to equities requires us to have fundamental insight into the future cash flows of the companies to understand the risk of our investments. The companies that we are invested in expect an owner of our size and character to understand the company's fundamentals. This ensures our legitimacy as an appreciated owner with a common interest in long-term value creation. The ownership requires us to be a responsible owner. We will contribute to the long-term return of the fund through deep company knowledge, active ownership and responsible investment management. A thorough understanding of the companies, and the issues they face, is the basis for our company strategies.

Company knowledge

We believe that returns over time will reflect the underlying development in a company's business fundamentals, and invest based on a thorough understanding of companies. We develop our internal research capacity to attain the necessary depth of company and industry understanding. Company meetings are an essential part of our knowledge gathering. Our company research is aligned with the fund's characteristics. We will analyse our most significant holdings with a long-term and global perspective.

Sector mandates

The size of the fund gives us the competitive advantage to implement company strategies in a cost-efficient way. The long-term nature of our ownership facilitates continuous company dialogue. Long-term ownership allows us to take a long-term perspective. We will cover all sectors, with a focus on Europe and our most significant holdings.

Local managers

We use external managers in segments and markets where local knowledge is of particular relevance, and where it is infeasible to build internal capacity. Most of our emerging, and all of our frontier company investments, are managed by local external managers. In addition, we use external managers for small companies and segments of our environmental investments. We expect assets under external management to increase to 6 percent of the fund.

Responsible ownership

We aim to be a global leader in responsible investment management. We recognise that environmental, social and governance issues could have a significant impact on the fund's performance. We will be principle-based, consistent and transparent. Three pillars underpin our responsible investment efforts, namely standard setting, ownership and risk management. As a large owner with numerous investments around the world, we aim to contribute to global standards and practices that are in the fund's long-term interest. We will prioritise our most significant holdings and issues where we can achieve results beyond single company outcomes.

REAL ESTATE INVESTMENTS

The Ministry of Finance mandated the fund to invest in real estate in 2010, and we have since acquired high-quality assets in our target cities in Europe and the United States. The fund invests in real estate to improve diversification. We will take advantage of our long-term investment horizon, limited liquidity requirements and significant capital. We will invest at a steady pace, and expect the real estate investments to be 4 percent of the fund by the end of the strategy period. The investments will be evenly split between Europe and the United States.

High-quality assets

The office sector forms the backbone of our investments, largely because it presents investment opportunities of scale, and simplicity in asset management. We will target offices in prime locations that are likely to remain high-quality assets over time. We will also invest in high-street retail in our target cities and logistics assets in markets that are vital to global supply chains.

Global cities

We will target 10 to 15 global cities with favourable long-term fundamentals. The target cities share long-term economic attractiveness, and real estate markets characterised by transparency, liquidity and supply restrictions. In the United States, we will consider investments in New York, Boston, Washington, and San Francisco. In Europe, we will expand our investments in London, Paris, Berlin, and Munich. We may consider investments in two or three more European cities. In Asia, we will target Singapore and Tokyo.

Local expertise

Investing with joint venture partners is essential to our real estate strategy. We will continue to invest with high quality partners to benefit from local partners' expertise. We will pursue transactions without relying on partners in Europe. Third-party asset managers will be used when this is more efficient, and where it reduces internal resource requirements. Property management is an activity that we always will outsource. Real estate investments which involve development from the start will not be part of our core strategy.

Sustainable real estate

We manage our properties in an environmentally sustainable manner. We will incorporate measurable sustainability practices into annual business plans, constructions and renovation projects. We will increase the number of office and retail buildings with green building certifications, and improve energy ratings. We will strengthen our analytical capability for energy, water, carbon and waste management.

Safeguarding assets

RISK MANAGEMENT

Strong risk management is essential to safeguard the fund's assets. The fund characteristics determine our approach to risk management. We have a long-term perspective and pay particular attention to long-term risk drivers. Our size means that liquidity considerations have to be an integral part of the risk analysis.

Cash flow risk

The standard approach to manage market risks is to use market price dynamics as a basis for risk modelling. As a long-term investor, we believe that there is value in modelling cash flows from our investments to formulate investment risk scenarios. We will address the risks of cash flows received from our investments falling short of expectations.

Tail risk

Volatile historical market events contain valuable information about potential losses. We will perform tail risk calculations based on previously stressed periods, and run scenario analysis to shed light on potential losses in rare events.

Model risk

We recognize that there is a limit to how much we can rely on models to describe how financial markets work. We do not rely on a single risk measure and will make use of a broad set of complementary and overlapping risk analytics. A deep understanding of data, its quality, usefulness and limitations improves the value of our risk models. We will selectively apply technologies to improve our risk analyses and increase operational efficiency.

Environmental, social and governance risk

We strive to manage all relevant risks in the investment portfolio. We specifically identify, analyse, monitor and manage environmental, social and governance risks in the investment portfolio. We recognize that non-financial data may be of relevance for the value of our investments, and we will seek to integrate these data into our risk assessments.

CONTROL AND OVERSIGHT

Changing market regulations, technological advances, and evolving threats set high requirements for how we operate. A robust governance structure with defined roles, responsibilities, policies and guidelines is critical for a well-controlled and efficient organisation. Risk-based and efficient monitoring and control, and specialist competency in high-risk areas, is essential to safeguard the fund's assets.

Risk based

We systematically identify risk and capture incidents through operational risk management. We realise that it is infeasible to prevent all unwanted events, and prioritise safeguarding our most critical assets. Unlikely events may still affect us, and we will learn from and strengthen our ability to manage such events through business continuity planning. We will address operational risk and uncertainty as an integrated part of decision-making when we implement strategies, processes and services.

Efficient control

We will ensure that comprehensive control and oversight is in place to monitor activity across the organisation, and conduct awareness training for our employees. Taking advantage of technology improves efficiency and reduces operational risk. We aim to automate control and monitoring to identify and correct potential issues before they materialise.

Specialist competence

Specialist expertise in identified high-risk areas is required to safeguard the fund's assets. Our information and IT systems face a changing threat environment. The fund's global investments involve significant challenges within trading and regulatory compliance. We will develop specialist risk and compliance expertise to cover IT and information security, trading and regulatory compliance.



Efficient execution

INVESTMENT ORGANISATION

We operate with a high level of specialist expertise, and a desire to improve. We are an investment organisation with a strong investment culture, characterised by trust and collaboration.

Cost efficient

We will continue to improve the organisation's effectiveness and efficiency. We have realised economies of scale through consolidation and standardisation of our investment platform, and insourcing and automation of services. We expect total internal management costs to be kept below 0.05 percent of assets under management, even with expected changes in asset allocation.

Lean organisation

We will remain a small and flexible organisation. We expect the organisation to be around 600 employees, including 120 in the real estate organisation. This will however be dependent on the asset allocation and the degree of outsourcing. We expect that more than half of our employees will work at our international offices.

Knowledge based

We are a knowledge-based organisation that operates in a global, highly competitive and constantly evolving market. We will attract and retain the right expertise and capabilities at the right location, and recruit for potential more than experience. We believe that diversity and a global mindset is a strength. We work to increase the number of women at all levels in the organisation. We will strengthen our employee development programme.

INVESTMENT PLATFORM

Asset management is a highly information intensive business. The management assignment requires a robust, efficient and secure investment platform for global portfolio management and transaction processing.

Efficient solutions

We will consolidate and simplify our investment platform, and aim for efficiency, quality and improved security. We will develop our own applications in areas where our requirements are unique.

Global operations

With portfolio management and trading activities in all time zones, our operational coverage needs to be global and operate on a continuous basis. We will continue to strengthen our global process coverage. We do not foresee a significant change in our global custody model.

Efficient sourcing

We have reduced our dependency on third party administrators and insourced our back- and mid-office processes. We have established an investment platform with a high level of automation to maintain scalability and efficiency. We will improve our technology services and increase use of cloud-based solutions.



COMMUNICATION

We manage the fund on behalf of current and future generations. We need to be reliable and transparent to earn trust and legitimacy. We build trust through increasing knowledge of the management of the fund.

Comprehensive information

We will publish timely, correct, comprehensive and understandable information about the management assignment. Our main information-sharing platform is www.nbim.no, and all relevant information including reports, voting, holdings, policies and publications will be accessible through this site.

Increased knowledge

We work to increase general knowledge about the fund in Norway and internationally. We will use multiple communication channels to increase knowledge about the fund. We aim to be regarded as a professional investor, sharing a common interest in long-term, sustainable value creation. The recognition and legitimacy of our investment management will be safeguarded and built over time and for the long term.





We safeguard the fund
for future generations
as prudently, efficiently
and transparently
as possible.



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