

Corporate Governance

Norges Bank Investment Management (NBIM)

AFA
29 August 2008
Runa Urheim

Agenda

- **The Government Pension Fund-Global (GPF)**
 - Size
 - Governance Structure
 - Division of Responsibility
 - Guidelines and Mandate

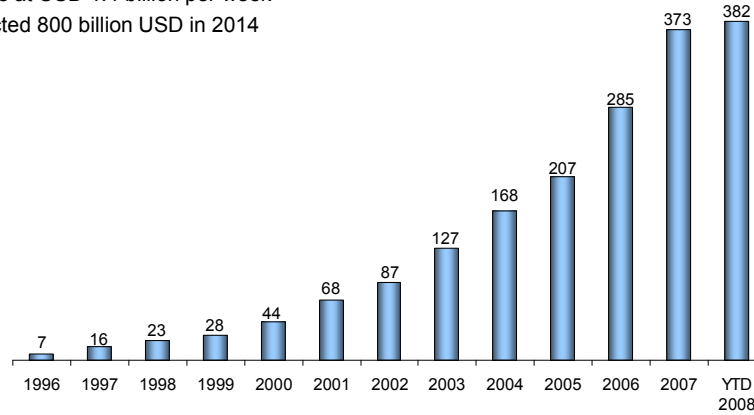
- **Norges Bank Investment Management (NBIM)**
 - Organisation
 - Investment Philosophy
 - Risk and Return

- **Corporate Governance in NBIM**
 - Mandate
 - Focus areas 2007-2010
 - Activities 2007/2008

Government Pension Fund – Global (GPF)

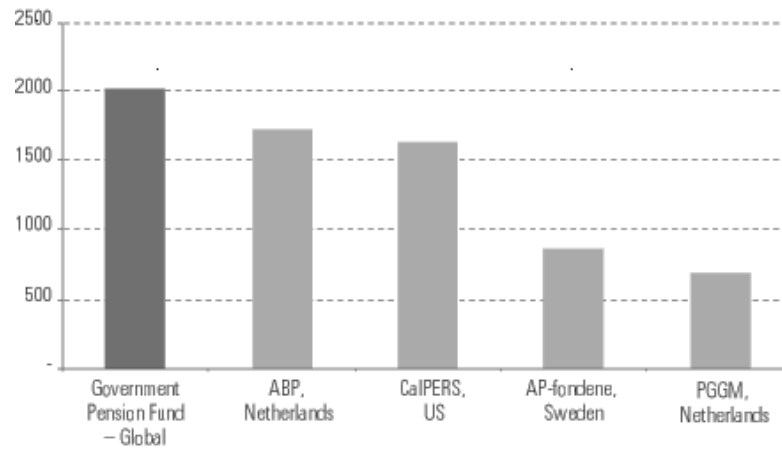
- USD 390 billion (1 992 mrd NOK), end June 2008
- Inflows at USD 1.4 billion per week
- Expected 800 billion USD in 2014

NGPF - USD billion

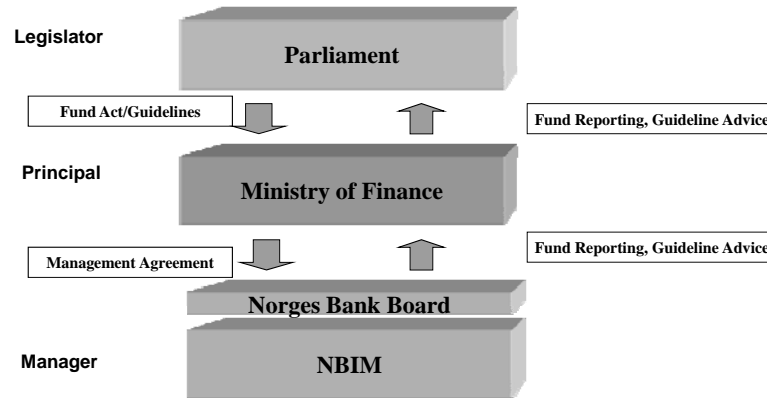


An international perspective

(End 2007, mill NOK)



GPF – Governance Structure



Properties of the governance structure

Accountability

- Main decisions on objectives, risk tolerance and ethical criteria lie with Parliament
- Clear division of responsibilities and a system of checks and balances

Transparency

- Principles, guidelines, risk and performance data are made public
- All holdings disclosed in annual reports
- Detailed reporting on corporate governance activities in annual report

Accountability - Division of responsibilities

Ministry of Finance

- Strategic asset allocation
- Benchmark portfolio
- Exchange listed equities
- No investments in Norway
- Max ownership of 10%
- Active Risk (deviations from the benchmark 150 bp)
- Negative screening/Exclusion of companies
- Reports to the Parliament



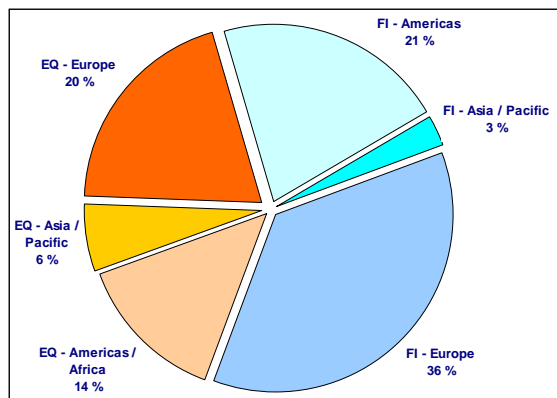
Advisors

- Council of Ethics
- Strategy Council
- Mercer
- Norges Bank

GPF's investment objectives

- Maximise the long-term international purchasing power, assuming acceptable risk
- Long-term investment horizon
- Highly diversified
- Short-term variations in return are less important

Benchmark for GPF



Strategic benchmark:

60 → 40 % Fixed Income
 40 → 60 % Equities

"Smart" rebalancing:

- Monthly inflows
- Asset class / region with largest negative deviation from benchmark

Equity Index:

FTSE All World Index
 31.12.2007: 6 954 companies

Fixed Income Index:

Lehman Brothers Global Aggregate
 Government / Agency / Corporate / Securitized
 31.12.2007: 9 819 bonds

The Role of Norges Bank / NBIM

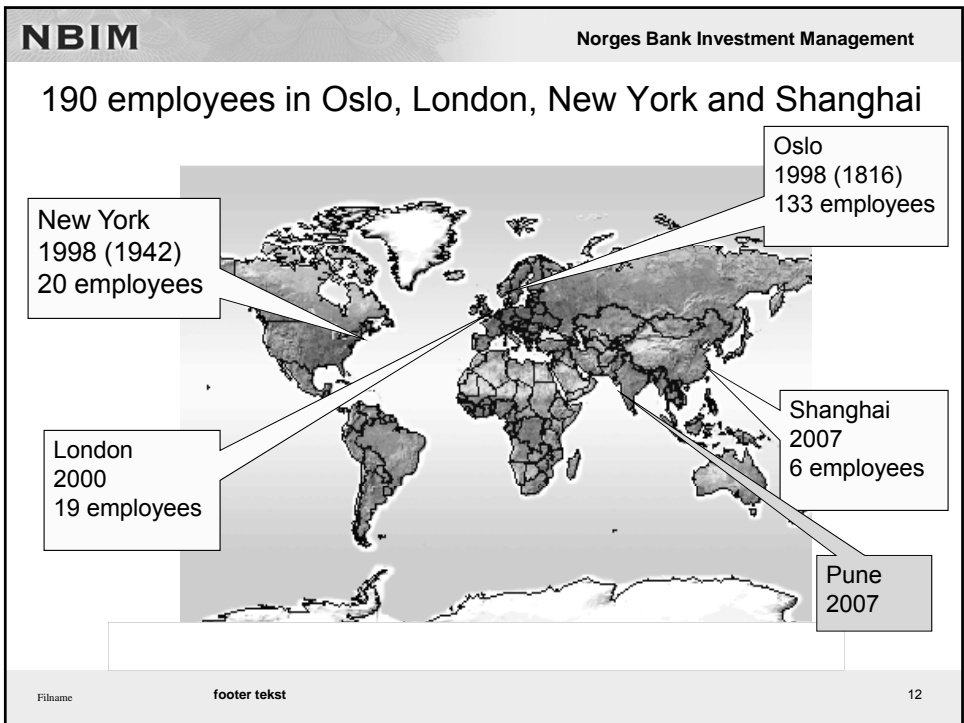
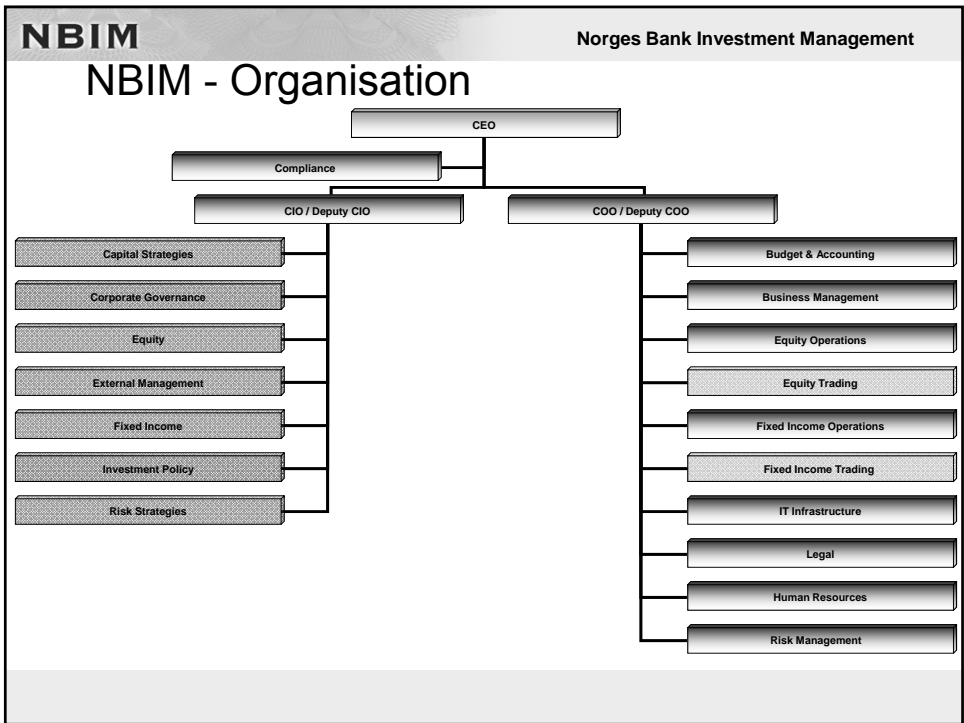
Operational manager of the fund:

- Cost-effective transitions and market exposure
- Individual investment decisions based on the mandate
- Active management to achieve excess return
- Risk control
- Exercising ownership rights / Corporate governance
- Advice on investment strategy
- Reporting

Transparency

- Performance, risk and costs are reported by NBIM every quarter and published on web-site
- Press conference on a quarterly basis
- Annual report listing all investments, both equities and fixed income
- Annual report listing all voting
- Corporate Governance and voting guidelines published on web-page





NBIM – focus on core activities and competences

- Manages 3 portfolios – USD 450 billion (GPF 390 billion USD)
- Inflows at USD 1.4 billion per week
- Expected 800 billion USD in 2014

- Diversified
 - 5 investment groups with diverse strategies in areas of competitive advantage
 - Specialist mandates with defined investment strategies and universe
 - 158 portfolios, 92 external (with 16 % of assets and 60% of risk)

- Position focus
 - Individual investment mandates with individual incentive structures
 - Delegation of investment process and tools, own all processes

- Outsourcing
 - Outsource all non-core activities, offshore to cover globe and clock
 - Extend outsourcing to investment and mid office activities

NBIM – Investment Philosophy

- Active management only where there may be inefficiencies in the market
- Where we find/develop managers with unique expertise
- Specialization
- 158 sub-portfolios → 30 000 individual positions
- Extensive delegation
- No committee structure
- Remuneration linked to performance



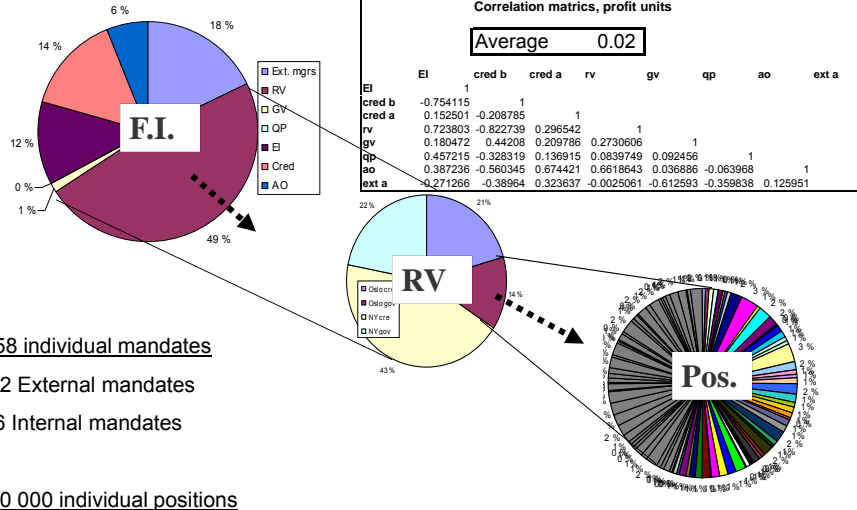
The Fundamental Law of Active Management

$$IR = IC \cdot \sqrt{BR}$$

Challenge:
 Improve IC (hit ratio) and/or
 Increase breadth many independent positions and trade frequency

Information Coefficient (IC) = corr[α, θ]
 α = expected (ex ante) return
 θ = actual (ex post) return
 corr[α, θ] = correlation between α and θ
 Breadth (BR) = number of independent positions

Many independent positions



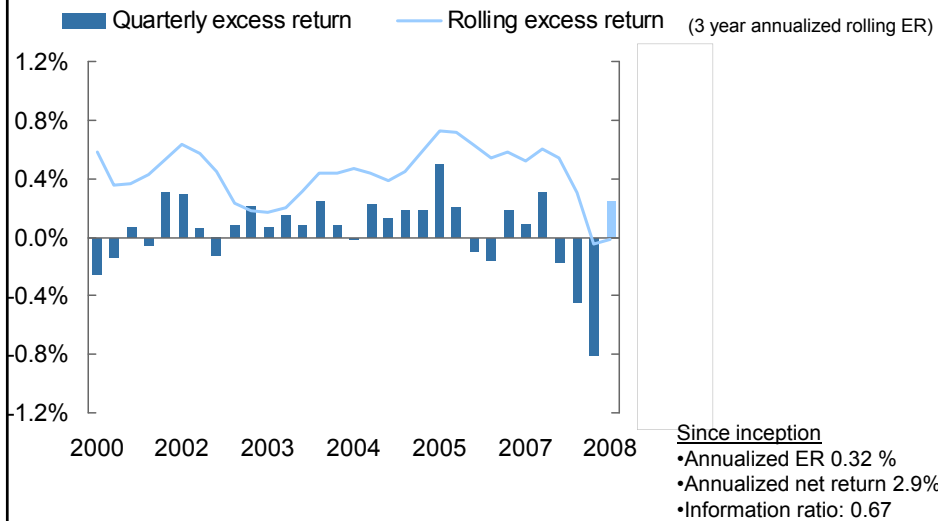
>158 individual mandates

> 92 External mandates

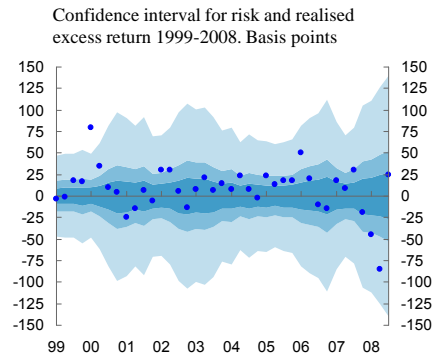
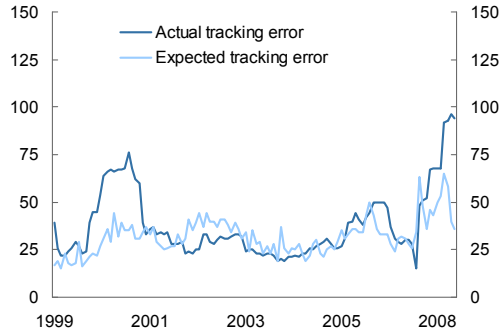
>66 Internal mandates

> 30 000 individual positions

Quarterly excess return against the benchmark

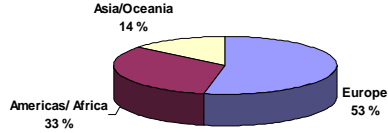


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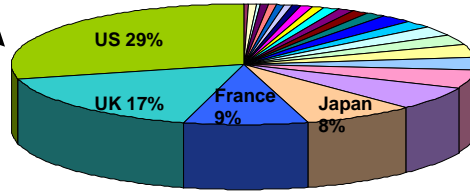


Corporate Governance

Own on average 0.8% in each company

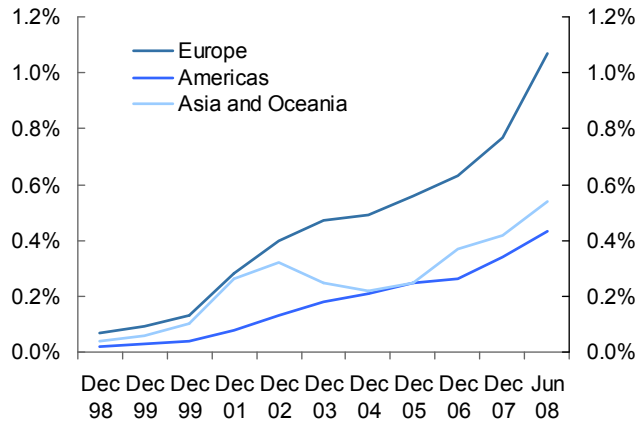


- No investments in Norway
- 200 billion USD in equities
- About 7 500 companies
- About 50 countries



■ New Zealand	■ Portugal	□ Austria	□ Singapore	■ Greece	■ Mexico
■ Ireland	□ Denmark	■ South Africa	■ Belgium	■ Brazil	■ Finland
■ Taiwan	■ Hong Kong	■ South Korea	■ Canada	■ Sweden	□ Australia
□ Netherlands	□ Italy	□ Spain	■ Switzerland	□ Germany	□ Japan
■ France	■ UK	■ US			

Own on average 0.8% in each company



Corporate Governance guidelines

- Government Regulation on GPF:
 - NBIM shall exercise voting rights for the Fund*
 - The overall goal is to safeguard the financial interests*

- Norges Bank Executive Board has established principles for corporate governance

- Ethical Guidelines issued by the Government, based on two premises:
 - A reasonable portion of the country's petroleum wealth should benefit future generations
 - Not make investments which constitute an unacceptable risk that the Fund may contribute to unethical acts or omissions

Ethical Guidelines:

- Promoted through three mechanisms
- Division of responsibilities and roles

Responsibility	Task	Means
Ministry of Finance	Avoid complicity to servere unethical behaviour	Withdrawals Negative screening
NBIM	Influence	Excercise of ownership rights

NBIM		Norges Bank Investment Management	
Reason	Date	Company	
Anti-personnel landmines	26.apr.02	Singapore Technologies Engineering Ltd,	
Cluster munitions	31.aug.05	Alliant Techsystems Inc, USA	
		General Dynamics Corporation, US	
		L-3 Communications Holdings Inc, US	
		Lockheed Martin Corporation, US	
		Raytheon Company, US	
		Thales SA, France	
	30.nov.06	Poongsan Corporation, South Korea	
	31.dec.07	Hanwha Corporation, South Korea	
Nuclear weapons	31.dec.05	BAE Systems plc, UK	
		Boeing Company, US	
		Finmeccanica SpA, Italy	
		Honeywell International Inc, US	
		Northrop Grumman Corp, US	
		Safran SA, France	
		United Technologies Corp, US	
	10.may.06	EADS Co, Netherlands**	
	31.dec.07	GenCorp Inc, US	
		Serco Group plc, UK	
Breaches of human rights	31.may.06	Wal-Mart Stores Inc, US	
		Wal-Mart de Mexico SA, Mexico	
Environmental damage	31.may.06	Freeport McMoRan Copper and Gold Inc, US	
	31.mar.07	DRDGOLD Ltd, South Africa	
Environmental damage and breaches of human rights	31.oct.07	Vedanta Resources plc, UK	
		Sterlite Industries Ltd, India	
		Madras Aluminium Company, India	

NBIM		Norges Bank Investment Management	
<h2>NBIM Exercise of ownership rights</h2>			
	<ul style="list-style-type: none"> • The principles are based on internationally recognized guidelines, such as <ul style="list-style-type: none"> • OECD Corporate Governance Guidelines • OECD Guidelines for Multinational Enterprises • UN Global Compact 		
	<p>Norges Bank's principles approved by the Executive Board December 2004</p>		

Primary objective:

Safeguard the Fund's long-term financial interests for future generations

- Broad investment diversification → own a piece of the world and can not avoid bad governance by selling stocks
- Time horizon nearly infinite → return depends on sustainable development in economic, environmental and social sense, as much on market level as on individual company level
- *We have to influence the companies*
- *We have to work on market regulation and standard setting*

NBIM Objectives & Tools

- To obtain board room influence in order to secure financial interests and a sustainable market in the long run
- The set of tools available will differ from the set of tools available to other parties, such as NGOs, national GOs and international GOs
- NBIM is a financial investor, not a foreign policy tool
- Being an owner brings along shareholder responsibilities as well as shareholder rights
 - Active ownership – not passive
 - Focus on social and environmental issues

How to get influence while owning only 0.8 %?

- Promote NBIM's principles for Corporate Governance
 - Long term perspective, highly diversified
 - Contribute to the understanding of long-term consequences of company actions or no-actions
 - Get acknowledgment of ethical, legal and environmental obligations
- Exercise our right to vote and speak at AGMs
- Engage with companies
- Contact with regulators and standard setters
- Build alliances and networks with other investors and participate in initiatives
- Promote good Corporate Governance through written documents
- Participation in Class Actions and private actions

Can only mobilize other investors if we succeed in arguing for long-term financial benefits and act as a serious investor (and not as politicians)

The financial investor's toolbox is different from the government's

Focus areas 2007-2010

- The right to vote
- The right to participate in board elections
- The right to sell
- The right to information
- Children's rights/ child labour
- Climate Change

} Often one complex of governance issues

The right to vote

- National voting rules not adjusted to international ownership and cross border (proxy) voting
 - Participating in a research project with Tuck School of Business in order to map relevant regulation and practice in the major markets
 - Engage with companies, regulators and the custody chain to make voting possible, more efficient and less costly
- Contact with regulators
 - EU hearing regarding shareholders rights
 - Joined investor initiative towards the Swedish security committee regarding the difference in treatment of shares in connection with takeovers
 - German regulation on acting in concert
 - SEC engagement on proxy access
- Focus on "one share – one vote" through voting and engagement.

The right to participate in board elections

- This is still a major issue in North America where this right is limited
- Main focus in US has been the right for investors to propose their own board members - proxy access
 - Dialogue with SEC together with other investors. So far not achieved what we want
- Further focus on right to elect board members and annual election of board members through voting (Global)
- Board composition, independence and diversification/competences

The right to sell our shares

- This right is often challenged by the company establishing various measures to protect them from (hostile) takeovers (e.g. "poison pills)
- NBIM has through company engagements been critical regarding takeover protections and voiced this through engagement and voting

The right to information

- Timely and relevant information, especially in connection with an upcoming annual meeting, is a main issue for NBIM
 - This has been worked on through voting and company engagement
 - Also an important issue in processes regarding engagement on social and environmental engagement

Children's rights/child labour

- Corporate engagement/dialogue
- Proxy voting
- Engagement/initiatives together with other investors
- Factors:
 - child labour/human rights policy and risk management
 - performance reporting
 - governance structures
 - UN Global Compact participation
- Three high risk markets: Asia, Brazil and Africa
- Sectors: cotton seed industry, textiles, iron & steel/mining, cocoa, and toys

Why are children's rights an issue for investors?

Ethical, but also **financial** reasons:

- boards must as part of their fiduciary responsibility to their shareholders, consider the economic impact of social issues, including child labour
- child labour and poor education affects future production and employment in a negative way
- the legitimacy of individual companies, markets and the global market economy
- unwillingness to assume corporate responsibility re the exploitation of children may be an indication of weak corporate management in dealing with externalities and risk

What do we expect as an investor?

- Proper and transparent risk assessment
- Systems/routines for risk minimisation
- Signing of the UN Global Compact
- Systems/routines for dealing with violations
- Adequate and transparent reporting on action taken

In order to clarify our expectations for corporate performance with regards to the prevention of child labour and promotion of children's rights we developed:

"NBIM Investor Expectations on Children's Rights"

NBIM Investor Expectations on Children's Rights



Children's rights – child labour

NBIM Expectations on Children's Rights

- Specifies our expectations for corporate performance with regard to preventing child labour and promoting children's rights
- Targets portfolio companies
- Objective: create a standard for preventive corporate action in regard to the worst forms of child labour, sustaining of the minimum age for labour, and promotion of children's welfare

4 Expectations

- Prevention of the worst forms of child labour
- Sustaining the minimum age standard
- Promotion of children's welfare
- Governance structures

Accompanying Requirements

- Child labour policy
- Continuous risk analysis
- Preventive and corrective action plans
- Supply chain risk management
- Performance reporting

Climate Change

- NBIM highly diversified, long term investor
- Externalities and sustainability of the markets
- Climate change being a problem for investors such as NBIM is stated in Stern reviews, IPCC reports etc
- Early action is less costly is also mounting
- NBIM focus on US legislation
 - An effective global solution remains limited without the US
 - Possible legislation 1-3 years from now, US companies will impact legislation through lobbying
- NBIM dialogue with approx 20 companies
 - Energy and transport sector
 - Predominantly met with Chairman/ CEO to discuss strategy.
 - The issue is top priority for these companies → mutually strategic issue
 - NBIM emphasises that we do not have any opinions on how in practice different states should regulate this
 - During 2007/2008 many companies have clarified their public stance on climate change

Activities 2007

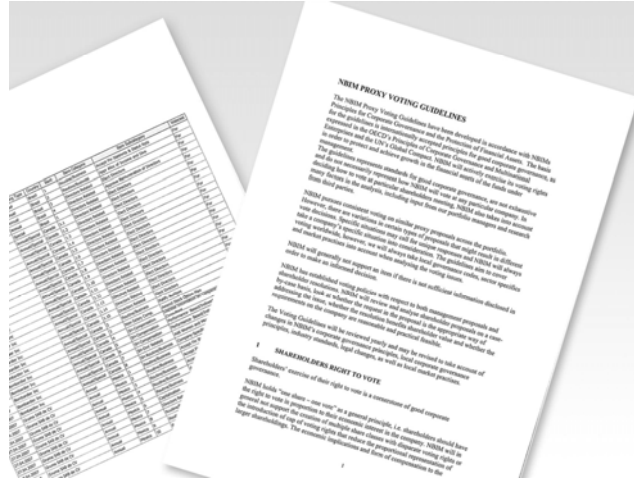
Company engagement

- Initiated dialogue with 90 companies in 2007, of which 30 are in depth engagements
- Continued these (some are closed), as well as starting up new in 2008

Networks

- Member of International Corporate Governance Network (ICGN)
 - Investor network with global and regional meetings with a focus on various general corporate governance issues
- Participated in Council of Institutional Investors (CII)
 - Forum of US institutional investors aiming to improve dialogue with regulators and improve market practice
- Participated in more informal networks with the Dutch funds ABP and PGGM, and the British fund Hermes with initiatives towards SEC and the EU commission
- Co-arranger of roundtable discussions for a selected group of investors at Tuck School of Business

Voting

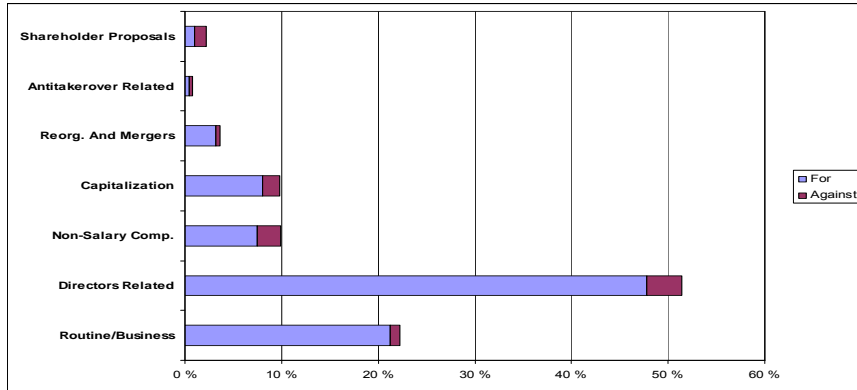


Proxy Voting - Meetings in 2007

Meeting/Region	Voting % per Region	2007			2006	2005	1 half 2008
		Total	Voted	Voted%	Voted%	Voted%	Voted %
America	35.4 %	1647	1489	98 %	94 %	92 %	96%
Europe	21.3 %	1257	852	88 %	60 %	60 %	65%
Pacific	44.3 %	1927	1881	97 %	88 %	86 %	97%
Total		4731	4202	89 %	79 %	78 %	88% (6 143)

- Voted on 89% of the meetings held
- Voted on more than 98% of the meetings in the US, the UK and Japan
- Voted on 51% of the meetings in Europe ex UK, an increase from only 24% in 2006 due to several countries have abolished the practise of share blocking
- From 2007 all votes are published on NBIMs web site (incl. Voting guidelines)

Votes Cast



- Voted on 38 862 resolutions in the 4 202 meetings
- 98% of the resolutions were put forward by management
- 2% of the resolutions were shareholder proposals

Votes against Management

Type	Against Management				Per Region		
	#Votes	#Votes against	% of total	% within category	Americas	Europe	Pacific
Routine/Business	8627	358	10 %	4 %	106	119	133
Directors Related	19992	1410	38 %	7 %	585	340	485
Non-Salary Comp.	3842	949	26 %	25 %	99	160	690
Capitalization	3822	693	19 %	18 %	54	201	438
Reorg. And Mergers	1418	163	4 %	11 %	29	10	124
Antitakeover Related	300	122	3 %	41 %	19	22	81
Total	38001	3695	100 %	10 %	892	852	1951
					24 %	23 %	53 %
					8 %	9 %	11 %

- Voted against 10% of the management recommendations
- 53% of the votes in the Pacific region
- 38% of the votes has been directors related
- Voted against 41% of the anti-takeover related issues

Votes against Management

- **Director Elections**
 - Independence issues (Global)
 - Lack of information on candidates (Europe and Latin America)
 - Not supporting re-election due to failure to act on majority approved shareholder proposals previous years (Poison pills, poor payment policies, etc.) (US)
 - Tenure longer than best practise (Europe)
- **Compensation Issues**
 - Long term incentive programs: pay not linked to performance, high discount, high dilution, immediate vesting and lack of disclosure on programme (Globally)
 - Excessive retirement bonuses
 - Remuneration reports (advisory vote in the UK, Sweden, Netherlands and Australia)
 - Retirement bonuses in Japan to non-executive directors and auditors, or their families

Votes against Management

- **Capitalization Issues**
 - Lack of disclosure, excessive discount and excessive dilution.
 - Allocation of dividend in Japanese companies due to allocation been low over many years while company showing positive and increasing results
- **Anti-takeover Mechanisms**
 - Poison pills in France and Japan
 - Amendments of articles of association in Japanese companies to give the board more powers without having to ask the AGM

Shareholder Resolutions

Resolution	Voted 2007			Voted 2006		
	Total	For	%	Total	For	%
Directors Related	253	129	51 %	211	161	76 %
Routine/Business	240	77	32 %	181	77	43 %
Compensation	190	119	63 %	95	41	43 %
Corp Governance	50	34	68 %	45	37	82 %
Social/Human Rights	11	6	55 %	25	11	44 %
Health/Environment	67	26	39 %	61	10	16 %
Social Proposal	50	9	18 %	44	5	11 %
Total	861	400	46 %	662	342	52 %

- Supported 46% of the shareholder proposals (52 % in 2006)
- Increasing globally (Canada, Japan, France and Germany) – America 71%
- 85% related to Core Governance issues
- More shareholder proposals filed than earlier
- But also more proposals withdrawn before the GM (35%)

Do we have an influence?

- Investors increasingly using their rights to vote
 - Vote participation increasing in most countries:
 - US 80%, UK 60%
 - Continental Europe 30-50%
 - Japan: high among domestic investors, but increasing among foreign investors
- Changes in regulations and guidelines
 - SEC disclosure rules on exec compensation
 - Advisory vote on remuneration (Say on Pay) in the UK, Australia, Sweden, Netherlands, in the US bill proposal pending
 - Proxy Access in the US (?)
 - EU new directive on shareholder rights

NBIM participated to changes at individual companies:

- Voting down a LTIP at major Swedish company → Company had to change the plan
- Voting against introduction of loyalty dividend in a Dutch company → court ruled against implementation
- Shareholder proposals to abolish voting cap/double voting rights at French companies → gained majority support → companies to abolish practice
- Vote of no confidence in board in a Dutch company due to not listening to majority supported proposal on strategy and putting up anti-takeover mechanisms → court ruled against company actions and appointed investigation
- Companies we have engaged with have started reporting on the steps it has taken to detect and prevent child labour among its suppliers, and presenting quantitatively the incidence of child labour over a number of years.
- Companies we have engaged with have signed up to UN Global Compact

Shareholder proposals have lead to changes

- Director Elections in the US
 - Majority voting; 200 companies changed
 - Changes in Delaware and other state laws
 - Annual elections (majority of S&P 500)
 - Declassified boards
- Executive remuneration in the US
 - “Pay for performance”
 - “Say on pay” proposals
- Shareholder proposals
 - Increased support, also on social and environmental issues
 - 30% withdrawn, due to company communication and changes

Pension ownership

- Pension fund ownership is major and growing
 - Hold 40% of US equities
 - Hold 30-50% of the European equities
 - Total global pension fund assets estimated to 15 trillion USD
 - Have doubled in size during the past ten years
- Global ownership is major and growing
 - 30% in the US held by foreign investors
 - 30-40% in Europe held by foreign investors
- Large pension funds becomes more and more engaged
- GPF to take a leading role in corporate governance

www.nbim.no

rur@nbim.no