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Report to the Storting (white paper)

The Government Pension Fund 2025

Recommendation of the Ministry of Finance of 10 April 2025, approved by the Council of State on the same day (Government Støre)

Unofficial translation from Norwegian. For information only.

1 Executive summary

The Government Pension Fund is owned by the State and consists of the Government Pension Fund Global (GPFG) and the Government Pension Fund Norway (GPFN). The purpose of the Fund is stipulated in the Government Pension Fund Act: The savings shall support the funding of pension expenditure under the National Insurance Scheme and facilitate long-term considerations in the spending of government petroleum revenues, thus ensuring that the petroleum wealth benefits both current and future generations. The investment objective is to achieve the highest possible return, given an acceptable level of risk. Within the scope of this financial objective, the Fund shall be managed responsibly. A financial objective and long-term management ensure that both current and future generations may benefit from the national petroleum wealth.

The GPFG is integrated into the fiscal policy framework. The net government cash flow from petroleum activities is transferred in its entirety to the GPFG, while funds are transferred annually from the Fund to cover the non-oil budget deficit. Strong growth in the Fund value over the past two decades has enabled a significant increase in the spending of Fund assets, within limits laid down in the fiscal policy guidelines.

The fiscal policy guideline links the spending of Fund assets over time to the expected real rate of return on the GPFG, which is estimated to be 3 percent. The national budgets have in recent years indicated that withdrawals should in normal years, which will be most years, be well below 3 percent. This is implied by the need for extra savings that can be drawn down in the event of major economic downturns or a large decline in Fund value.

Over time, the GPFG has become an increasingly important source of public expenditure funding, and for 2025 it is estimated that about 24 percent of the fiscal budget will be funded by transfers from the Fund. This development has granted Norway particular fiscal space. At the same time, public finances have become more exposed to international financial market developments.

By establishing the Government Pension Fund, Norwegian politicians have facilitated prudent petroleum revenue management. A succession of governments and parliaments have contributed to the design of the framework that constitutes important premises for the Fund. There has been broad support for the fund structure, the fiscal policy guideline and long-term investment strategy. Broad endorsement of the risks taken in investment management is important for the ability to remain committed to the chosen strategy over time, also during periods of market turmoil.

The choices made by the political authorities have been essential for the substantial financial wealth of Norway today. Key decisions, such as the choice of equity share, have been made by Norwegian politicians and are decisive for the overall risk and return of the Fund. Historically, more than 99 percent of the fluctuations in the fund's return can be explained by the benchmark index, which is set by the Ministry of Finance and endorsed by the Storting.¹ Concurrently, Norges Bank and Folketrygdfondet have made significant contributions in providing advice on the investment strategy and implementing the chosen strategy effectively, with low management costs. Furthermore, the managers have achieved a return on the Fund capital that is higher than implied by the overall strategic decisions.

A large national wealth entails considerable investment management responsibility. The Ministry of Finance is given formal responsibility for the management of the Government Pension Fund, and defines the investment strategy and investment framework for the Fund. Key decisions are deliberated and endorsed by the Storting prior to implementation of any changes. Norges Bank and Folketrygdfondet conduct the operational management of the GPFG and the GPFN, respectively, within management mandates stipulated by the Ministry.

The framework for the management of the Government Pension Fund is defined by the political authorities, but the Fund is not a political instrument. The objective of highest possible return, given an acceptable level of risk, underpins the Fund's ability to fund public expenditure. Political causes are funded in the ordinary budget processes, which are partly financed by the Fund. Norges Bank and Folketrygdfondet make investments and exercise ownership rights in investee companies, independently of the Ministry. Investment decisions require in-depth knowledge of the markets in which the Fund is invested. The operational management is thus acting at arm's length from political authorities regarding investments in individual companies. This clear division of roles, highlights the responsibilities of the different institutions.

¹ See Bauer, R., Christiansen, C. and Døskeland, T. (2022). *A Review of the Active Management of Norway's Government Pension Fund Global*. Norwegian Ministry of Finance.

The governance structure ensures that the decisions of crucial importance to Fund risk and return, as well as the responsible investment framework, are endorsed by the Storting. However, it is emphasised that there must be sufficient delegation of duties to ensure that operational investment decisions are made close to the markets in which the Funds are invested.

Investment management shall be as transparent as possible, within limits defined by sound implementation of the management mandate. Transparency is important to preserve the legitimacy of the Fund, and the confidence of the Storting and the wider public. The management of the GPFG is highly rated in international transparency rankings. The degree of transparency will however in some instances be subject to limitations, out of consideration for the financial interests of the Fund, for example when implementing strategy changes or divesting from companies excluded under the Guidelines for Observation and Exclusion. If information on such changes was to become known in the market, it could be exploited by other market participants and impose unnecessary costs on the Fund.

International trade and economic integration have been important to global economic growth and high financial market returns in recent decades. Internationally, tensions are currently rising, and the investment conditions faced by the Fund may be impacted by great power rivalry and geopolitical uncertainty going forwards. These developments increase the risk of a more fragmented world order and weakened international economic integration. Tendencies towards democratic erosion, protectionism, and economic decoupling could weaken global economic growth, and thereby depress the return on the Fund and its ability to fund public expenditure.

Against this background, it needs to be acknowledged that management of the Fund may become more demanding. Geopolitical developments may also weaken the scope of responsible investment activities. Developments that challenge democracy, transparency and a free press may make it more challenging to deliver on responsible investment expectations and ambitions. A high profile in this regard entails a risk that the Fund may be perceived as a Norwegian foreign policy tool. Transparency and clear communication of what the Fund is, and what it is not, will therefore continue to be important to support its financial purpose and legitimacy.

In the face of an uncertain future, broad risk diversification, which is a key pillar of the investment strategy for the Fund, remains the best approach. Abrupt strategy shifts or ill-considered decisions should be avoided.

Investment strategy

The Ministry of Finance is committed to an investment strategy for the GPFG and the GPFN which is professionally sound and tailored to the distinctive characteristics and purpose of

the Fund. While the GPFN is a major investor in the Norwegian capital market, the GPFG is in relative terms a smaller investor in large, international financial markets. Investment objective, fund size, ownership and other distinctive characteristics may give rise to a broad range of investment opportunities, but may also entail certain limitations. The investment strategy has been developed over time, based on professional recommendations, thorough assessments and practical experience.

The strategy is defined in the management mandates for the GPFG and the GPFN and is reflected in, inter alia, the composition of the benchmark indices. The strategic benchmark indices define a fixed capital allocation between equities and fixed-income securities, and reflect the asset owner's investment preferences and risk tolerance. The choice of equity share is the decision with the most impact on expected risk and return. The equity share for the GPFG is 70 percent, while it is 60 percent for the GPFN. In general, investments that offer scope for higher returns also entail more return volatility and a higher risk of loss. In other words, there is a trade-off between return and risk. In endorsing the choice of equity share, the Storting has expressed what is considered an acceptable level of risk in the management of the Fund.

Equity and fixed-income market developments are not perfectly aligned. This means that the equity and fixed-income benchmarks generally do not move in tandem. To ensure that risk over time is in line with the expressed risk tolerance, the Ministry has stipulated rules on the rebalancing of the equity share, when deviations from the fixed strategic share of 70 percent exceed certain predetermined limits.

A key premise underpinning the investment strategy is that risk can be reduced by diversifying investments broadly. Diversification across different asset classes and, as far as the GPFG is concerned, companies globally, reduces vulnerability to developments in individual companies, industries, countries and regions. Over time, a broadly diversified portfolio entails lower risk than a concentrated portfolio. Less risk diversification and more stringent restrictions on the Fund's investment opportunities may on the other hand result in higher risk, without a commensurate increase in the expected return.

The benchmarks have been designed with a view to ensuring broad investment diversification and close replication at a low cost. The benchmarks are also used to measure the investment management performance of Norges Bank and Folketrygdfondet. Within defined risk limits, the investment managers may deviate somewhat from the benchmark indices. This is intended both to facilitate cost-effective investment management and to utilise distinctive characteristics of the Funds, such as size and a long investment horizon, to achieve excess return. The GPFG may also be invested in unlisted real estate and unlisted renewable energy infrastructure, within the scope for deviations from the benchmark index.

The design of the investment strategy is premised on a long-time horizon. The GPFG and the GPFN have a greater ability to withstand risk, in terms of return volatility from one year to the next, than an investor with major payment obligations and a shorter investment horizon. The two funds can weather stock market drawdowns without having to divest at an unfavourable time.

The investment strategies for the GPFG and the GPFN are discussed in chapters 2.2 and 4.2, respectively (in Norwegian only).

Investment performance in 2024

During 2024, the value of the GPFG increased by NOK 3,985 billion, to reach NOK 19,742 billion. Favourable financial market developments led to a return of 13.1 percent measured in the currency basket of the Fund and before the deduction of investment management costs. This is equivalent to NOK 2,511 billion. Net transfers to the Fund totalled NOK 409 billion, as a result of the net government cash flow from petroleum activities being significantly higher than the non-oil budget deficit. When considered in isolation, Norwegian krone depreciation relative to the currency basket of the Fund increased the Fund value in NOK terms by 1,072 billion. However, NOK exchange rate changes do not affect the international purchasing power of the Fund.

The market value of the GPFN increased by about NOK 27 billion last year, to reach NOK 381 billion. The return was 7.6 percent, measured in NOK and before the deduction of investment management costs.

Norges Bank and Folketrygdfondet seek to achieve the highest possible return, net of costs and given an acceptable level of risk, within the limits laid down in the mandates from the Ministry of Finance. In 2024, Norges Bank achieved a return that was 0.45 percentage points lower than the return on the benchmark index, while Folketrygdfondet achieved a return that was 1.15 percentage points higher than the return on the benchmark index.

The Ministry assesses the overall performance achieved in the GPFG and the GPFN over time. The average annual excess return on the GPFG has been 0.19 percentage points over the last 20 years, while the average excess return on the GPFN has been 1.00 percentage point per year since 2007. The Ministry is satisfied with this performance, given the level of risk assumed. Measured as a share of assets under management, investment management costs last year were 4.1 basis points (0.041 percent) in the management of the GPFG and 6.5 basis points (0.065 percent) in the management of the GPFN. The Ministry emphasises cost-effective investment management, and comparisons with other funds show that investment management costs in both the GPFG and the GPFN are very low.

The performance in the management of the GPFG and the GPFN is discussed in more detail in chapters 2.4 and 4.4, respectively (in Norwegian only).

Responsible investment

The Government Pension Fund is to be managed responsibly. The mandates for the management of the GPFG and the GPFN are based on the premise that favourable long-term returns depend on sustainable development in economic, environmental and social terms, as well as on well-functioning, legitimate and efficient markets. Environmental, social and corporate governance considerations therefore form an integral part of investment management.

The mandates from the Ministry of Finance require Norges Bank and Folketrygdfondet to adopt responsible investment principles in accordance with internationally recognised standards from, inter alia, the UN and the OECD. The responsible investment practices for the Government Pension Fund are held to further the overarching financial objective of achieving the highest possible return, given an acceptable level of risk, by advocating long-term value added and responsible business conduct.

The responsible investment framework comprises, inter alia, advocating sound corporate governance principles, communicating responsible business conduct expectations, contributing to the development of international standards and best practices, supporting academic research in the field, engaging in dialogue with companies and voting in annual general meetings. Norges Bank has, as part of these efforts, prepared expectation documents on various issues, including, children's rights, human rights, the climate, biodiversity and human capital. Correspondingly, Folketrygdfondet has outlined what it expects from companies on various topics. Such documents are directed at the boards of directors of the investee companies and are used as, inter alia, a starting point for ownership dialogue and engagement with standard setters.

The Ministry of Finance has adopted Guidelines for Observation and Exclusion of Companies from the GPFG (the ethically motivated guidelines). For the GPFN, the mandate also stipulates that the Fund shall not invest in companies that are excluded pursuant to the ethically motivated guidelines for the GPFG. The guidelines feature both product-based and conduct-based exclusion criteria. The product-based exclusion criteria encompass the production of tobacco, cannabis for recreational purposes, coal and several weapon types. The conduct-based exclusion criteria encompass, inter alia, serious violations of the rights of individuals in situations of war or conflict, severe environmental damage, unacceptable greenhouse gas emissions and serious or systematic human rights violations, including violations of fundamental labour rights. An independent Council on Ethics appointed by the Ministry of Finance makes observation or exclusion recommendations to the Executive Board of Norges Bank, which makes decisions in these cases. Before deciding whether exclusion is appropriate, the Executive Board shall consider whether other measures may be suited for reducing the risk of continued norm violations. Such a measure may be for the Fund to

remain invested and seek to influence the company to change its conduct through special ownership dialogue.

The investments of the GPFG attract considerable attention. The investment strategy implies that the Fund is invested in a large number of companies, including in countries and regions with different norms and values. Even with a robust framework for risk management, responsible investment and ethically motivated guidelines, unwanted situations may arise in markets and companies in which the Fund is invested. It is not possible to organise the management of the Fund in such a way that it cannot be exposed to unwanted situations. The Ministry nevertheless emphasises that the responsible investment practices need to evolve to match the size and complexity of the Fund, based on the premise that it is a long-term financial investor.

The GPFG investments in companies that operate in areas of war and conflict have attracted considerable attention. Several of the criteria in the ethically motivated guidelines pertain to companies operating in such areas and to companies' production or sale of weapons.

In 2024, an important part of the Council on Ethics' work consisted of assessing companies with activities linked to the Israeli settlements and occupation on the West Bank, but the Council also considered cases concerning companies with activities in Myanmar. There is a broad international consensus that the settlements in the occupied territory of the West Bank are in violation of international law. The Council's assessments are made on the basis that the Israeli settlements and occupation on the West Bank are unlawful under international law. A total of ten companies have so far been excluded from investment by the GPFG at the Council's recommendation on the basis of their business activities linked to such settlements. The Council infers that the guidelines are not intended to result in the exclusion from the GPFG of companies with any or all forms of business activities linked to violations of international law, either in the West Bank or in other conflict areas. An important factor in the Council's assessment is whether the activities of a given company are a prerequisite for the international law violation to occur. Furthermore, it must be likely that the companies' activities or links to activities which may constitute grounds for exclusion, will continue into the future. The Council also attributes weight to the nature of a company's contribution, e.g. whether it is sporadic or resulting from a permanent presence in the occupied territory. Moreover, the Council will assess whether a company manufactures and sells purely generic products or products and services especially adapted for use in the area. It has also been important for the Council to establish a practice that is consistent with the assessment of companies' contributions to similar norm violations in other areas of occupation or armed conflict.

In 2024, the Council on Ethics also considered whether the criterion on the sale of weapons to states engaged in armed conflict that use the weapons in ways that constitute serious and

systematic violations of the international rules on the conduct of hostilities may be applied to companies with a connection to the war in Gaza. The Council on Ethics' review showed that the companies involved in ongoing deliveries of weapon types that may notably impact civilians have already been excluded from the GPFG under the product-based weapons criterion.

The responsible investment practices of the GPFG and the GPFN are discussed in chapters 2.3 and 4.3, respectively (in Norwegian only).

Small-cap companies in the equity benchmark (GPFG)

In the white paper on the Government Pension Fund published in the spring of 2021, the Ministry of Finance proposed a reduction in the number of companies in the equity benchmark. The Ministry noted that the number of companies in the benchmark had increased significantly over time. It also noted that the smallest companies of the small-cap segment represent a negligible share of the total market value of the benchmark. Consequently, the diversification gain from including such companies in the benchmark is limited. In addition, it was highlighted that a large number of small-cap companies in the benchmark may increase the complexity of investment management, as well as the management- and transaction costs. It was also noted that there is generally less information available on small-cap companies.

Subsequent to the Ministry of Finance's adoption of a new equity benchmark with fewer small-cap companies, the number of companies included in this modified benchmark has nevertheless increased considerably. The Ministry finds that the intention behind the decision in 2021 of, inter alia, reducing the complexity of investment management can best be served by removing emerging market small-cap companies from the equity benchmark.² This change means that the number of companies in the benchmark is reduced by about 22 percent. The adjustment represents less than 1 percent of the market value of the benchmark. The impact on expected risk and return, including diversification across regions, is therefore limited. This conclusion is supported by historical risk and return analyses from Norges Bank.

In consultation with Norges Bank, the Ministry will prepare a plan for phasing in the equity benchmark changes. The Ministry will report to the Storting on the transition after it has been completed.

Reference is made to chapter 3.1 for further details (in Norwegian only).

² This means that the emerging market sub-benchmark will be based on the standard FTSE Emerging Index, which includes large- and mid-cap companies.

Expert council (GPFG)

It was announced in last year's white paper on the Government Pension Fund³ that the Ministry was working on establishing an external expert council charged with examining relevant issues affecting the management of the GPFG. The expert council shall be comprised of individuals with a high level of expertise in relevant fields, as well as knowledge of the Fund's role in the Norwegian economy and public administration.⁴

Reference is made to chapter 3.2 for further details (in Norwegian only).

Investments in Russia – lifting of freeze (GPFG)

On 28 February 2022, the Ministry of Finance decided that the GPFG investments in financial instruments issued by Russian enterprises, the Russian state or entities affiliated with the Russian state should be frozen with immediate effect and until further notice. It was also decided that the investment universe of the Fund would no longer include Russia, including financial instruments, real estate, infrastructure and cash holdings. At the same time, the Ministry asked Norges Bank to prepare a plan for implementing the divestment of Russian securities in the Fund.

In a letter of 24 November 2023, Norges Bank noted that an ever-expanding sanctions regime against Russia, as well as countermeasures implemented by the Russian authorities, meant that the Bank was still unable to propose a divestment plan. Norges Bank did, however, request permission to divest a small number of securities the Bank considered possible to sell within the applicable sanctions regime. The Bank further reported that it would monitor market conditions and the equity portfolio, and revert to the Ministry if conditions were to change in such a way as to enable a prepared plan for complete divestment.

In a letter of 25 August 2024, Norges Bank stated that individual sales are the only way for the Bank to sell equities in the Russian portfolio, although such sales opportunities are considered very limited. The Bank therefore requested a general permission to sell the Russian equity holdings in the GPFG, within the applicable sanctions provisions, should any sales opportunities arise.

On 3 December 2024, the Ministry of Finance lifted the freeze on the Fund's investments in Russia, provided that any sales are made within the applicable sanctions regime. Norges Bank is to inform the Ministry of any divestments in the Russian portfolio, as well as if market

³ Meld. St. 22 (2023-2024); *The Government Pension Fund 2024*.

⁴ This is in line with the recommendation in NOU 2022: 12; *The Fund in a changing world* (Sverdrup Commission).

conditions change in such a way as to enable the Bank to consider a more general divestment plan.

The decision to no longer include Russia in the investment universe of the Fund remains unchanged, and has also been implemented in the management mandate for the GPFG. Russian securities that were included in the portfolio as of 28 February 2022, as well as cash proceeds from corporate events or the sale of such equities, will remain part of the investment universe until divestments have been completed.

Climate risk (GPFN)

In 2022, the mandate for the Government Pension Fund Global (GPFG) was amended to strengthen climate risk management. The Ministry of Finance has now included corresponding provisions in the mandate for the management of the Government Pension Fund Norway (GPFN).

It is intended for the new mandate provisions to contribute to an integrated approach to the management and reporting of climate risk, based on the GPFN's financial objective of the highest possible return, given an acceptable level of risk. The Fund's purpose, distinctive characteristics and investment strategy, as well as Folketrygdfondet's investment management organisational structure, are also important factors in determining what will constitute an appropriate implementation of the new provisions.

Reference is made to chapter 5.1 for further details (in Norwegian only).