Comparative Analysis of the Functioning of the National Welfare Fund of Russia and the Pension Fund of Norway - Global

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Abstract: Sovereign wealth funds for more than half a century exist in many countries around the world. One of the problematic issues is the organization of the functioning of the fund and the development of its effective investment strategy. This article is devoted to the comparison of the basic parameters of the National Welfare Fund and the Pension Fund of Norway - Global. The both funds have the similar organization: the profits from the oil industry are invested in the fund, which are then invested in international assets. The research presents the detailed analysis of the yield and investment strategies of these funds.

1. Introduction

The largest sovereign wealth fund in the world the Pension Fund of Norway Global was created a quarter of a century ago, quickly increased, and eventually reached an incredible size. It owns about 1.3 percent of all shares in the world and also invests in bonds and real estate. The NWF of Russia is part of the country's budget. It is an integral part of a complete system of timely pension payments to citizens of the country. The National Welfare Fund provides an increase in pensions to future retirees, formed from personal savings. In addition, one of the main goals of the National Welfare Fund is to replenish the budget of the Pension Fund in the event of a sudden deficit. NWF invests in a range of the authorized financial assets. The investment strategy is an important question for the both funds and both of them search for the more efficient one. The research presents the detailed comparative analysis of the main characteristics yield and investment strategies of these funds.

The National Welfare Fund of Russia and the Pension Fund of Norway - Global were created with similar goals, but their volumes and profitability differ significantly. For the detailed analysis we consider the main characteristics of the funds presented in Table 1.
<table>
<thead>
<tr>
<th>Characteristics</th>
<th>National Welfare Fund of Russia</th>
<th>Pension Fund of Norway – Global</th>
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</thead>
<tbody>
<tr>
<td>The essence / purpose of the fund</td>
<td>The National Welfare Fund is part of the federal budget. The fund is intended to be part of a sustainable long-term pension insurance mechanism for citizens of the Russian Federation.</td>
<td>Pension benefits. The fund is intended to form state savings to finance future expenses of the National Insurance System. No political decision was made as to when the fund could be used to cover future retirement expenses, and the likelihood of large withdrawals from the fund was limited. This makes it a really long-term fund.</td>
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<td>Goals</td>
<td>The objectives of the National Wealth Fund are to ensure the co-financing of voluntary pension savings of citizens of the Russian Federation and to ensure balance (deficit coverage) of the budget of the Pension Fund of the Russian Federation.</td>
<td>The main goal of the fund management is to obtain the highest possible level of real profitability in the long term, taking into account the moderate level of risk. The purpose of the oil fund is to ensure responsible and long-term management of revenues from Norwegian oil and gas resources in the North Sea, so that this wealth benefits both the current and future generations.</td>
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<tr>
<td>The role of “oil money” in the economy</td>
<td>natural rent - the basis of the budget</td>
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</tr>
<tr>
<td>Filling rules</td>
<td>are based on budget rule 1) all oil and gas revenues from the sale of oil at a price exceeding the budgeted $ 40 per barrel 2) income from fund management</td>
<td>are based on budget rule 1) strive to achieve the highest possible return in the currency basket of the investment portfolio (2) The Fund shall not invest in companies excluded from the list (3) The Bank integrates its management efforts, the long-term return on investment depends on sustainable development in economic, environmental and social terms, as well as on the market situation.</td>
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<tr>
<td>Management objectives</td>
<td>The objectives of managing the funds of the National Wealth Fund are to ensure the safety of the Fund’s assets and a stable level of income from its placement in the long term. The management of the Fund’s assets for the indicated purposes allows for the possibility of obtaining negative financial results in the short term.</td>
<td>1) strive to achieve the highest possible return in the currency basket of the investment portfolio (2) The Fund shall not invest in companies excluded from the list (3) The Bank integrates its management efforts, the long-term return on investment depends on sustainable development in economic, environmental and social terms, as well as on the market situation.</td>
</tr>
<tr>
<td>Governing body</td>
<td>Ministry of Finance Central Bank of the Russian Federation (separate powers)</td>
<td>Bank of Norway (Norges Bank Investment Management manages the fund on behalf of the Ministry of Finance)</td>
</tr>
<tr>
<td>Methods and features of investing</td>
<td>Investment is executed in the following ways (both individually and simultaneously): 1) by purchasing foreign currency funds from the Fund and placing it on accounts to record funds of the National Wealth Fund in foreign currency (US dollars, euros, pounds sterling) at the Central Bank of the Russian Federation. For the use of funds in these accounts, the Central Bank of the Russian Federation pays interest established by the bank account agreement; 2) by placing the Fund’s assets in foreign currency and financial assets denominated in Russian</td>
<td>Investment is executed in the following ways: - investments in shares (66.3%) of investments, bonds - (30.7%), real estate - (3%). - exclusion of companies with high carbon emissions, defense, telecommunications sectors and weapons manufacturers</td>
</tr>
</tbody>
</table>
Investment Strategy | Conservative
---|---
| Growth strategy and maximum income
Investment tools | Authorized financial assets determined by the Budget Code of the Russian Federation:
- foreign debt
- debt obligations of foreign government agencies and central banks
- debt obligations of international financial organizations, including securities issued
- deposits and bank balances in banks and credit institutions
- deposits in the state corporation Bank for Development and Foreign Economic Affairs (Vnesheconombank)
- deposits and bank balances with the Central Bank of the Russian Federation
- debt obligations of legal entities
- shares of legal entities and shares (participation shares) of investment funds
| - stocks
- debt securities (bonds)
- property
Equity investments are distributed among 9,000 companies to capture global value creation and diversify risks as best as possible. Up to 70 percent of the fund can be invested in stocks.
In 2017, the fund changed the regulatory structure of investments, increasing the proportion of shares from 62% to 70%. At the end of 2018, shares accounted for 66.3% of investments, bonds - 30.7%, real estate - 3%.
Investment directions | sovereign bonds of a very limited number of countries with a high credit rating (not lower than AA-)
| investments by region and industry according to the approved list, which is adjusted every year
Yield | 0.64 (2016)
-0.1 (2017)
-0.63 (2018)
Yield on foreign currency accounts expressed in a basket of allowed foreign currencies%
| 6.92 (2016)
13.7% (2017)
-6.12 (2018)

2. The Volume of the Fund

Starting from February 1, 2018, Russia has only one sovereign National Welfare Fund (NWF) of the Russian Federation. The reserve fund of the Russian Federation officially ceased to exist, and the balances (6.71 billion euros, 7.62 billion dollars and 1.10 billion pounds sterling) were sold by the Bank of Russia for 1 trillion. rub. and credited to the federal budget. Over the year, the volume of the National Welfare Fund in ruble terms increased by 7.5% and as of January 1, 2019 amounted to 4 trillion. 36 billion rubles.
Since 1998 the volume of the Pension Fund-Global has increased from 172 billion to 8478 billion Norwegian kroner (Figure 1). The largest growth was due to equity investments (from NOK 70 to 5732 billion). As a large portfolio investor, the fund chose a strategy for obtaining the highest return. The Fund adheres to the policy of investing in highly liquid assets in order to be able to use savings to support the economy during the recession. At the end of 2018 the fund has amounted to 8256 billion Norwegian crowns.
3. **Essence / Purpose and Objectives of the Fund**

Both funds have similar goals of creation and purpose. Initially, the Reserve Fund and the National Wealth Fund had different tasks: the first was used to cover the budget deficit, and the second was to prevent the Pension Fund deficit. Now the combined NWF will solve both of these tasks at once, although it will be filled as before - at the expense of super-profits from oil exports and the revenues received from managing the assets of the fund.

Established in 1990, the Norwegian-Global Pension Fund was also originally conceived as a kind of shock absorber with sharp jumps in oil prices. The Norwegian Pension Fund - Global assumed savings for posterity, on that black day, when oil still runs out.

4. **Investment Strategy**

The NWF follows a conservative policy of investing its funds. The dynamics of the yield of the NWF, expressed in the basket of allowed foreign currencies, since 2009, did not exceed 3% per year (Figure 1). In 2017 the yield expressed in the basket of allowed foreign currencies was -0.10% per annum. This is due to the negative dynamics of foreign government bond quotes, which make up indices for calculating interest on accounts in euros and to a lesser extent in pounds sterling, together with low coupon rates on these bonds. This is also due to the reorientation of investors to more risky markets, but also more profitable than sovereign bonds in euros and pounds sterling, instruments (including stocks) against the backdrop of a booming global economy.
In the period from December 2017 to May 2018, the investments of NWF funds in foreign assets caused losses in the amount of 340 million dollars (approximately 20 billion rubles). This may be due to Russia's withdrawal from US treasury bonds (their yield is about 3% per year) and the transfer of this money to other, less profitable instruments with lower returns. Economically, this is inexpedient, but is a reflection of the current geopolitical situation and is justified by the desire to insure against the consequences of possible anti-Russian sanctions as part of the trend for dedollarization. In 2018, the total return on the placement of funds of the National Welfare Fund on accounts in foreign currency at the Bank of Russia was as follows: the yield expressed in the basket of allowed foreign currencies is 0.63% per annum (1.26% per annum since the foundation of the fund); yield, expressed in rubles - 18.33% per annum (16.25% per annum since the foundation of the fund).

Yield dynamics of the world's largest sovereign fund of the Pension Fund -Global (Norway) since 1998. fluctuated in the range from about -24 to 26% per year (which is associated with the fund's investments in stocks, for which both the yield and the risk level are greater), but on the whole exceeded the yield of the NWF. Even the return on investments of the Pension Fund-Global in fixed income instruments (bonds) as a whole was higher than the return on investment of the NWF of the Russian Federation expressed in the basket of allowed foreign currencies. In 2017 the yield of the Norwegian fund is 13.7% (figure 2). In 2018, the fund received its first net loss in seven years. For the year, he lost 485 billion Norwegian krones ($ 57 billion), or 6.1%. From the inception of the fund in 1998 to 2017, the average annual profit was 5.9%, and after accounting for management costs and inflation - 4%.

![Dynamics of the yield of the Pension Fund Global and NWF](image)

Figure 2: Dynamics of yield of the Pension Fund-Global and the National Wealth Fund

The filling of the Norwegian Fund and the National Wealth Fund occurs on the basis of the budget rule, the latest edition of which in Russia assumes that all oil and gas revenues from oil sales at a price above the budgeted $ 40 per barrel will go to the National Wealth Fund. Under the budget rule, the Ministry of Finance sends additional oil and gas revenues to the NWF when the market price of oil exceeds the cut-off price in the budget. In 2018, the cut-off price was $ 40 per barrel. Every year the cut-off price in the budget is increased by 2%. In 2019, revenues received from the price of Urals oil over $ 41.6 per barrel are considered additional; in the budget law of 2019, such
revenues will amount to 3.369 trillion rubles. The forecast for 2020 is 2.777 trillion rubles (42.4 per barrel), by 2021 - 2.632 trillion rubles (43.3 dollars per barrel).

In Norway, all oil money goes to the fund in general. At the same time, no more than three percent of the total fund size can be used for budget expenses.

It turns out that oil and gas revenues regularly replenish the fund in any case, and at the same time it consumes mainly only investment income, but not the main fund volume.

There are differences in the management of these funds. The approach to the management of the NWF is very conservative and is aimed at saving resources, while the Norwegian fund is focused on income. The only class of financial assets in which the funds of Russian sovereign funds can be invested (their liquid part, not aimed at financing infrastructure projects), is sovereign bonds of a very limited number of countries with high credit ratings (not lower than AA-). The Norwegian fund, on the other hand, is not afraid to invest in riskier assets on a large scale, that is, in the same stocks - in its portfolio, in particular, there are papers of Google, Apple, Alibaba Group, Mitsubishi.

Using this strategy, the Norwegian sovereign fund, of course, could not avoid negative results. In particular, in 2008 its yield was -23.31%, in 2018 - (-6.12%), however, for a long period of time until 2018, it fluctuated around 6.79%, which is significantly higher than the NWF: over the entire period of its existence, the NWF showed an average yield of about 1.32% per annum.

The Pension Fund of Norway Global also invests in debt securities - the fund’s benchmark for investment in bonds is the Bloomberg Barclays Global-Aggregate Bond Index, which includes investment-grade assets. After S & P has returned Russia's investment rating, the Norwegian fund can increase its investments in Russian instruments.

The issue of ineffective management of the National Welfare Fund is a matter of constant concern. In early 2017, the Accounts Chamber has already reported about the inefficient use of funds of the National Wealth Fund - then the experts of the supervisory authority noted "systemic flaws and problems in the implementation of infrastructure projects."

The Ministry of Finance does not disclose the total return for 2017 on the NWF, but it cannot be significant, because most of the funds simply lie in the accounts either in currency or in rubles, and the banks - holders of NWF deposits themselves invest in certain infrastructure projects. In addition, the National Welfare Fund owns packages of preferred shares of VTB, RSHB and Gazprombank - the fund acquired these packages in 2014. In addition, the Ministry of Finance has not yet fixed the loss on Ukraine’s already irrecoverable debt of three billion dollars. In general, the investments of the funds of the National Welfare Fund are not systematic and are definitely not aimed at a serious increment of the fund itself.

In the first half of the year, the NWF brought the federal budget only 27.8 billion rubles, which is less than half the target figure for the year. In Russia, there is no mechanism for monitoring the fund’s investments in infrastructure projects. The volume of the National Welfare Fund is almost 4.5 trillion rubles, of which most are in liquid form - in the accounts of the Federal Treasury at the Central Bank, and about 1 trillion rubles constitute the investment part, about 500 billion rubles are on deposits in VEB, and about 1 trillion rubles - invested in non-returnable projects, for example, the Olympic construction of Sochi. The disadvantages of the National Welfare Fund include insufficient transparency, no control over investments.

5. Conclusions

To conclude, the analysis of the main parameters of the National Welfare Fund of Russia and the Pension Fund of Norway - Global showed that an active investment strategy of the Pension Fund of Norway - Global is more risky: the fund can receive both high returns (13.66% in 2017) and incur large losses (-23.31 % in 2008, -6.12% in 2018). The conservative investment strategy of the NWF,
based on the principles of liquidity and security, does not bring such a high yield, but does not tolerate large losses.

References