

Asset Management in Norway: Who are we and who can we become?

by

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BI Norwegian Business School

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About the study

The project “Asset Management in Norway: Who are we and who can we become?” is a further development of Professor Torger Reve’s nation-wide research project “Knowledge-based Norway” (2012). The common denominator for the two projects is the cluster perspective on industry development, as opposed to the traditional industry-neutral view.

The main purpose of this project is to offer a cluster perspective on the development of an asset management industry in Norway. The key question addressed in this project is the viability of supporting the emergence of a financial hub in Oslo that is strong enough to larger extent compete with well-established financial European clusters such as London or Stockholm.

The project is undertaken by BI Norwegian Business School on behalf of the Finance Sector Union of Norway (Finansforbundet), with Professor Torger Reve as Head of Research, Marius Nordkvelde as Project Leader and Researcher and Anton Diachenko as Researcher

We would like to make a special thanks to research associate Robert Alexandru who has made a significant and excellent contribution in the process of writing the report. Thank you!

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Definitions and abbreviations

CAGR: Compounded Annual Growth Rate

AuM: The market value of assets that an investment company manages on behalf of investors. Assets under management (AUM) is considered to be a measure of success against the competition and consists of growth/decline due to both capital appreciation/losses and new money inflow/outflow (Investopedia, 2013).

Value Creation: This is the economic resource created by an operating firm for distribution among its employees (salaries), capital owners (capital yield net of taxes) and the government (Taxes on labor and capital). It is calculated simply as a company's turnover less cost of goods/services. This is the same as payroll costs plus earnings before depreciation and amortization (EBITDA).

Asset Management (AM): The management of a client's investments by a financial services company, usually an investment bank. The company will invest on behalf of its clients and give them access to a wide range of traditional and alternative product offerings that would not be offered to the average investor.

Collective investment fund (Verdipapirfond): A fund that is operated by a trust company or a bank and handles a pooled group of trust accounts. Collective investment funds combine the assets of various individuals and organizations to create a larger, well-diversified portfolio.

Introduction

Although small in international terms, the financial sector in Norway has shown strong growth during the last decade, in spite of the severe financial crisis during 2008 and 2009. In comparison to the financial industry sectors in other countries as well as the overall private sector in Norway, the financial sector in Norway has achieved a rather remarkable performance. Accordingly, wages, earnings and tax revenues in the sector have surged.

Following the global trend, the Norwegian financial sector has undergone a significant process of internationalization over the past decade. As a result, not only has the Norwegian activity abroad increased, but more importantly, the foreign presence on the Norwegian market has greatly intensified. The latter may indicate that Norway has become an attractive location for financial activity, serving as a platform for international operations within specific niches of financial services.

The companies operating in the asset management industry provide services for the collection and management of capital. Customers range from large and medium-sized businesses in the private and public sectors to pension funds, foundations and high net worth individuals. According to the “A knowledge based Norway” report from 2010, the ten largest asset management companies account for approximately 75% of the total corporate value created in the industry. Of these companies, the largest player is Statoil Pensjon which accounts for 17% of the value created. The Norwegian government has a substantial stake in the three largest asset management companies in term of value creation, Statoil Pensjon, DnB NOR Kapitalforvaltning and Argentum Fondsinvesteringer.

The following sections of the report refer to data collected from the asset management companies classified as collective investment funds (verdipapirfond). This will exclude players like Statoil Pensjon and Argentum Fondsinvesteringer. In addition, The Government Pension Fund Global is also not included in the discussion. NBIM manages the fund on behalf of the Ministry of Finance, which owns the fund on behalf of the Norwegian people. The fund was set up to give the government room for maneuvering in fiscal policy, should oil prices drop or the mainland economy contract. It also served as a tool to manage the financial challenges of an ageing population and an expected drop in petroleum revenue. The fund was designed to be invested for the long term, but in a way that made it possible to draw on it when required. The capital is invested abroad, to avoid overheating the Norwegian economy and to shield it from the effects of oil price fluctuations. The fund invests in international equity and fixed-income markets and real estate.

NBIM awards investment mandates to external equity managers with expertise in specific markets. The mandates are in markets and segments where it is not expedient to build internal expertise and the potential for excess returns is considerable. The mandates typically cover investments in emerging markets and small-capitalization companies in developed markets. According to NBIM’s 2012 annual report, the fund had 146 billion kroner, or 3.8 percent of its capital, under external management at the end of 2012, compared with 140 billion kroner at the start of the year. NBIM has 336 employees, with a third of the new recruits working at

the offices in London, New York, Singapore and Shanghai. Proximity to international markets improves the access to investment opportunities and ensures the fund's investments can be followed up around the clock.

Lastly, Folketrygdfondet manages the NOK 150 billion Government Pension Fund – Norway, the former National Insurance Scheme Fund. Unlike the Global division, it is instructed to invest in domestic companies on the stock market, predominantly on Oslo Stock Exchange. Due to this, the Government Pension Fund – Norway is a key stock owner in many large Norwegian companies.

Industry Overview

After four years of stalled growth the global asset management industry has returned to a growth path. Not only the total assets under management (AuM) but also the profits, measured as a percentage of revenues) nearly returned to pre-crisis levels.

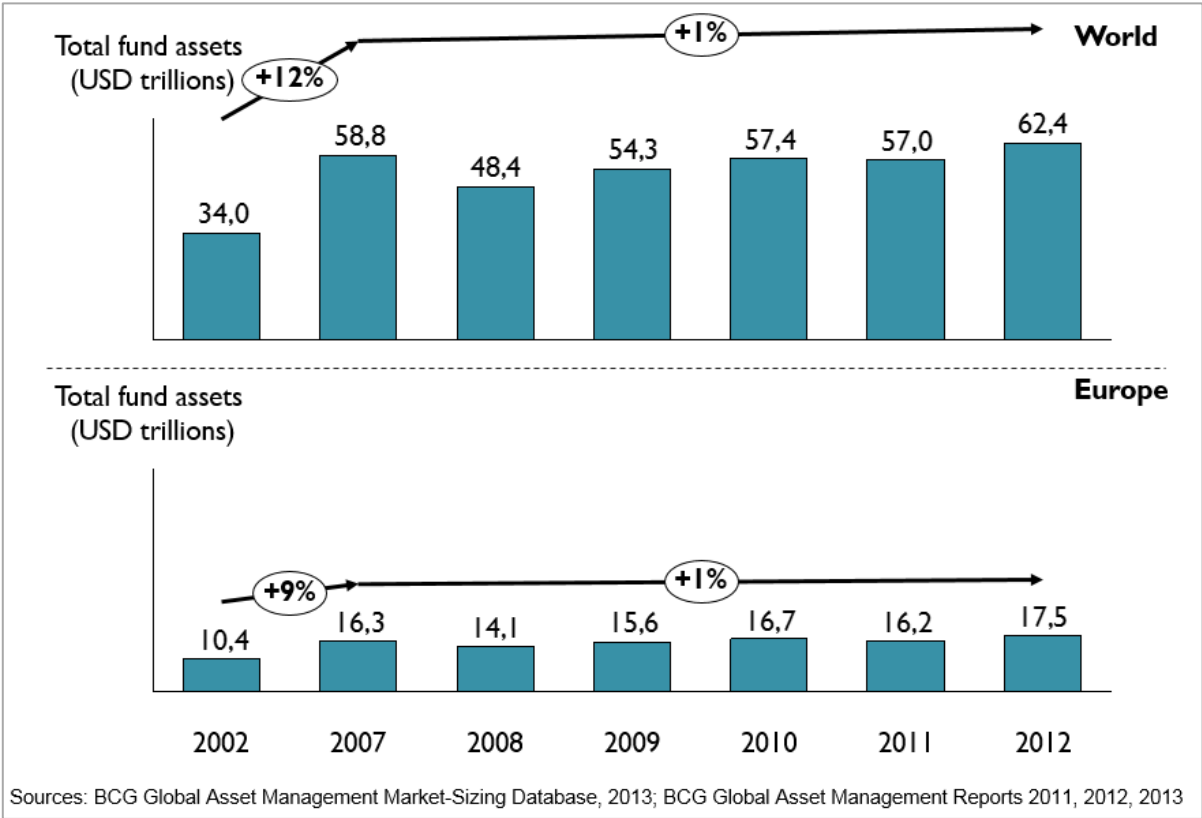


Figure 1 Assets under management, 2002 - 2012 (\$ trillions).

According to the latest Global Asset Management report published by BCG, the global value of AuM reached a record high level in 2012, surpassing for the first time the levels reached in 2007. AuM has increased by 9% percent to \$62.4 trillion as compared to the \$57 trillion in 2011, and \$58.8 trillion in 2007.

On the world stage, Europe ranks as the second largest market (behind the United States) in the global asset management industry, managing around 28% of the global AuM funds at the end of 2012. The European asset management industry has retained a fairly steady share amounting to approximately one-third of the global industry.

Analyzing the global growth, one will notice that asset managers continue to live in a two-speed world in which the smaller, emerging markets have grown at a faster pace than the developed markets, with higher net flows. At the same time, AuM growth in the developed

markets was significantly larger in absolute terms, since these markets represent roughly 90 percent of global AuM.

As depicted in Figure 2, there has been a wide variation in growth if examined by geographic region. The largest contribution to global growth in AuM has been made by Asia and Latin America, given that countries like China and Brazil have enjoyed robust growth over the last few years.

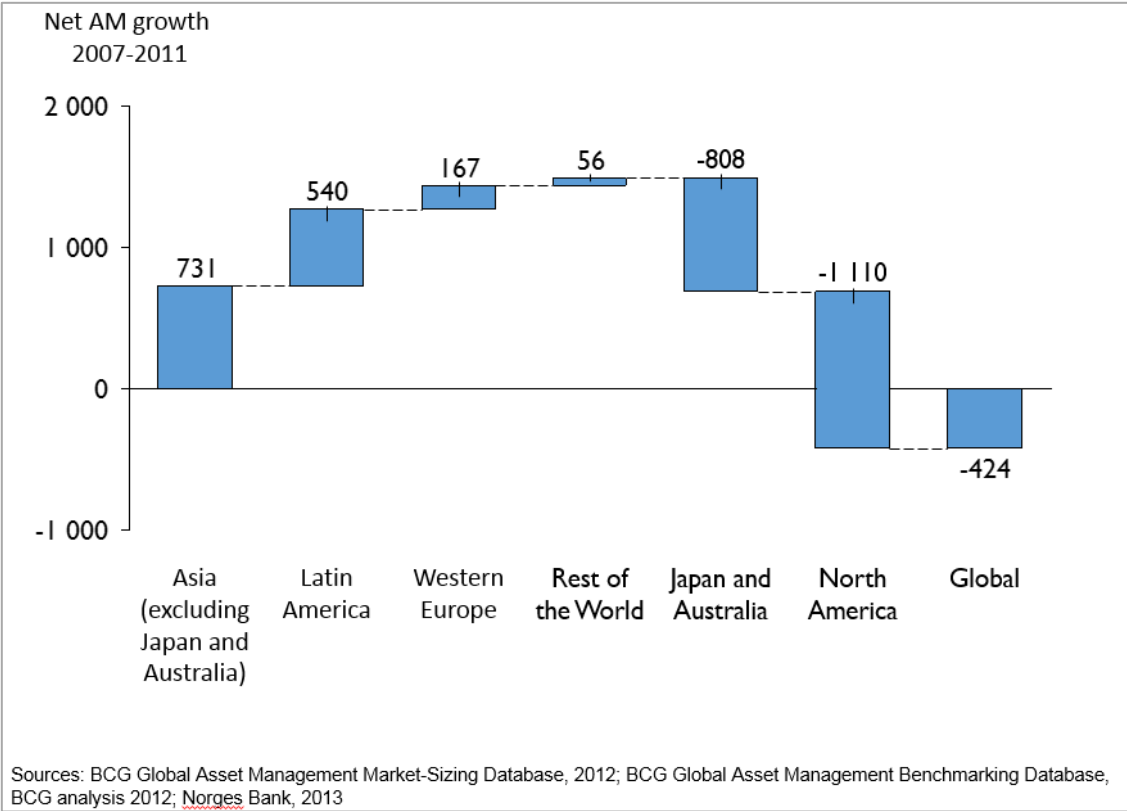


Figure 2 Growth in AuM varies widely by region

Overall, European AuM increased 8 percent to \$17.5 trillion in 2012, with almost no net contribution of new flows. France and Southern Europe shrank almost 7 percent and experienced net outflows while Northern Europe, including Germany, the Netherlands and Nordic countries grew 11 percent. In Norway, AuM increased 15 percent to NOK 558 billion, while in Sweden AuM increased almost 12 percent to NOK 1814 billion. On average, the market has grown at a CAGR of 6 percent in Norway and 5 percent in Sweden since 2007.

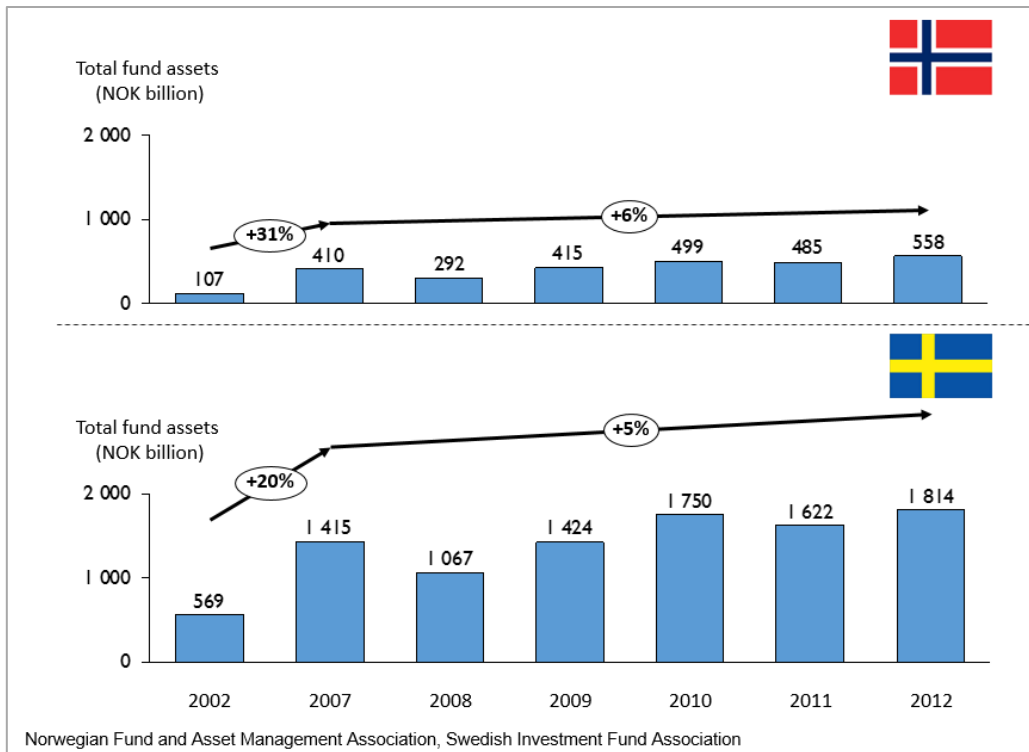


Figure 3 AuM growth in Norway and Sweden

Figure 4 shows that in comparison with global trends, the net inflows are significantly higher in Scandinavia.

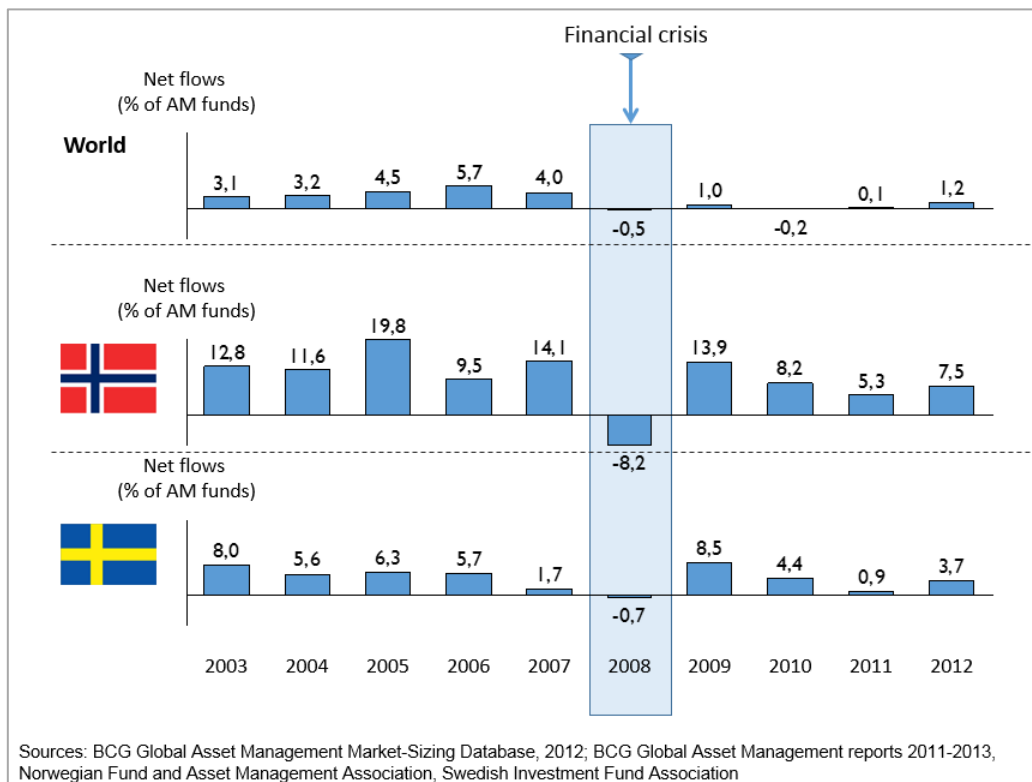


Figure 4 Net inflows: Scandinavia vs. world

Product portfolio has been constantly changing for the last decade. Due to persistently lower interest rates and shifting investor preferences, there has been a growing demand for specialization and multi-asset capabilities. As a consequence, passive, alternative and specialty products such as emerging-market asset classes, as well as solutions, continue to grow. Investors have continued to divest developed-market equities and money market assets, while net flows into passive strategies, fixed-income specialties, and high-yield and emerging-market corporate debt have been strong.

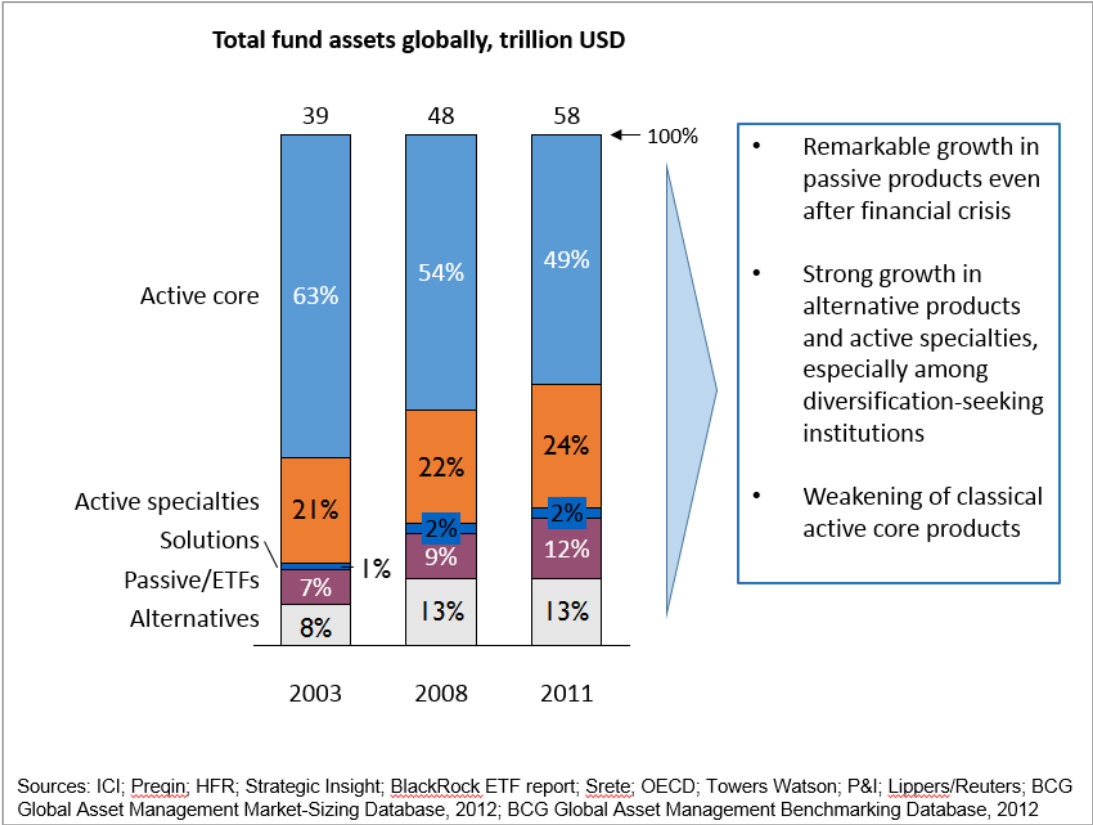
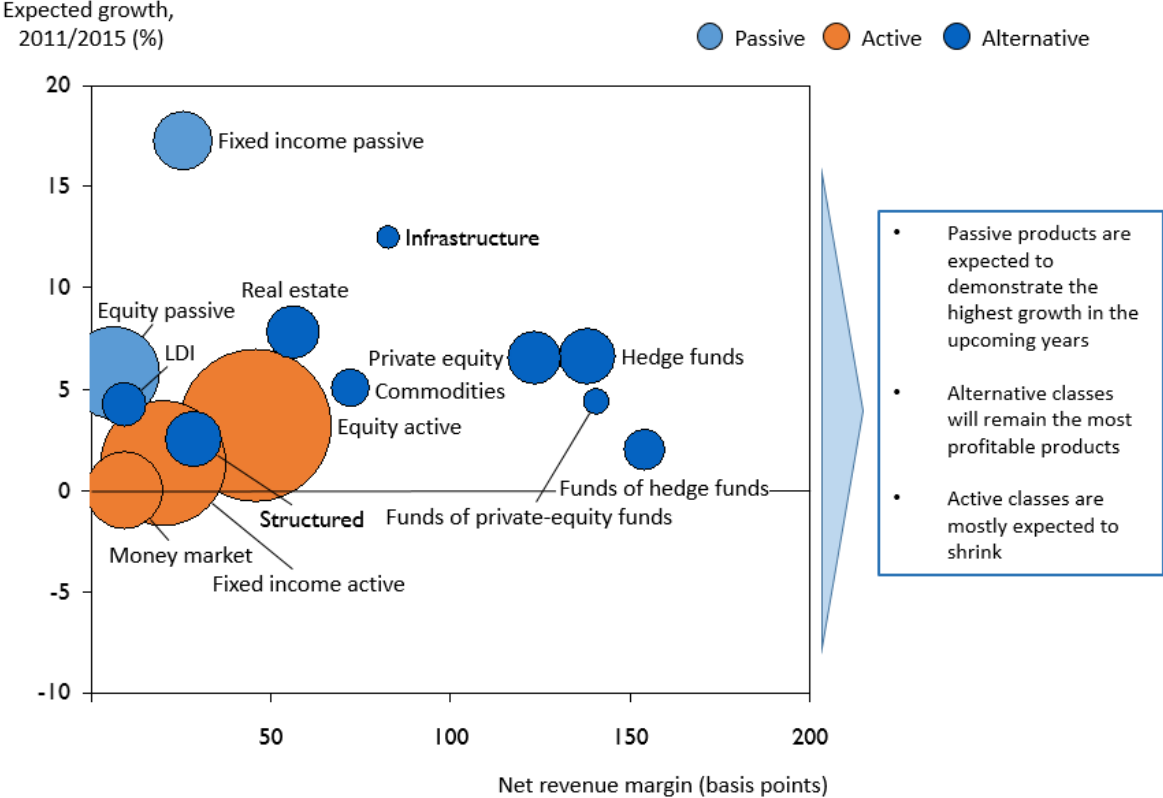


Figure 5 Product portfolio

Overall, the growth in exchange-traded funds (ETFs) has been notable, rising from \$0.8 trillion at the end of 2007 to \$1.3 trillion in 2011 in spite of the crisis. This is consistent with a CAGR of 14 percent. The growth of alternatives has also been strong, driven especially by the institutions seeking greater diversification.

Fixed-income products, the traditional products of active managers and a source of recent solid growth, are now under threat. To begin with, passive fixed-income investing has nowadays grown in importance, pushing net sales of fixed-income ETFs above \$38 billion in 2010 and \$50 billion in 2011. Secondly, the persistently low rates that are unlikely to fall further, reduce both the returns and the attractiveness of fixed-income assets. Lastly, investors have lost much of their confidence in the perceived risk-free, liquid character of government

bonds. This drives diversification and encourages a shift towards specialized products such as credit, high yield or emerging-market debt.



Sources: ICI; Preqin; HFR; Strategic Insight; BlackRock ETF Report; IMA; Arete; OECD; Towers Watson; P&I; Lipppers/Reuters; BCG Global Asset Management Market-Sizing Database, 2012; BCG Global Asset Management Benchmarking Database, 2012

Figure 6 Future trend in product portfolio

According to the latest BCG Asset Management report, passive, alternative and specialty products will continue to grow over the next years. This will further shrink and squeeze the traditional-product share, which now represents 50 percent of total AuM and 33 percent of global revenues. The estimate is that by 2016, traditional products will represent 44 percent of AuM and 30 percent of revenues.

The asset management industry has improved its profitability, nearly rebounding to pre-2008 levels. In absolute terms, profits climbed 7 percent, rising to \$80 billion – 15 percent less than the historical peak of \$94 billion in 2007.

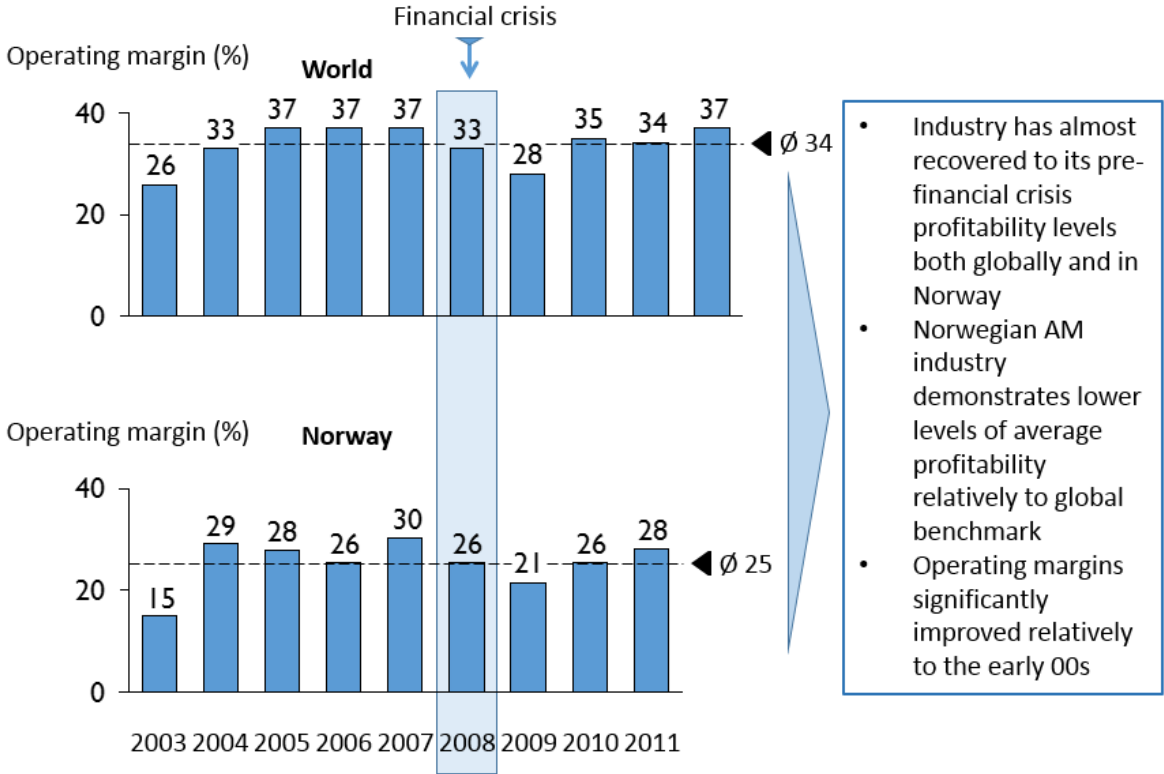
According to BCG analysis, the 2011 increase was driven by a 6 percent growth in average AuM. Net revenues improved by 4 percent while costs increased by 3 percent. As a result, the operating margins rose to 37 percent of net revenues (see Figure 7).

In the aftermath of the financial crisis of 2008, managers have changed the way that they achieve profit improvement. Before 2008, the main drivers of profitability were average AuM growth and high margins. Nowadays, given the overall flat revenues margins, CEOs are becoming increasingly concerned with cost discipline. And even if the decline of costs was

largely driven by asset growth from 2007 to 2011, costs in 2011 in absolute terms were also 4 percent below the 2007 level. During 2011, despite the AuM recovery and the fact that 66 percent of providers managed to increase their profitability, only 38 percent managed to cut their costs in absolute terms.

In Norway, the main players have succeeded in increasing their profitability over the past few years, but their operating margins are still below pre-crisis levels. Moreover, the Norwegian AM industry demonstrates a lower average profitability relative to the global benchmark.

Overall, European players were unable to improve their profitability. In spite of a strong growth in the market, there was increased competition from US managers. On average, US players have achieved a 10 percentage point higher operating margin. According to the BCG 2013 Global Asset Management report, the main driver of this disparity is that US players have managed to adapt faster in developing specialist capabilities that allow them to expand both domestically and internationally, especially in Europe.



Sources: BCG Global Asset Management Report 2012, ProffForvalt, Norwegian Fund and Asset Management Association

Figure 7 Profitability in the asset management industry

Cluster logic and the scope of the study

Industry clusters are defined as “geographic concentrations of interconnected companies and institutions in a particular field. Clusters encompass an array of linked industries and other entities important to competition. They include, for example, suppliers of specialized inputs such as components, machinery, and services and providers of specialized infrastructure”¹.

Competitors within a single industry benefit from being in a cluster as it “allows each member to benefit *as if* it had greater scale or *as if* it had joined with others formally – without requiring it to sacrifice its flexibility or independence.”²

Boston, London and New York are currently the largest clusters in asset management (based on the value of funds under management) and are likely to remain important in the future. However, the 2008/09 financial crisis has changed the environment in which western asset management operates and has created unique opportunities for other clusters.

In the present report we discuss the possibility and viability of the emergence of a financial center in Oslo. We try to assess whether Oslo can become a global asset management hub and compete with the current clusters in London, New York or Singapore.

The sustainability of the financial cluster is supported by the emergence of numerous specialized asset management funds in Oslo that stimulate this industry’s growth in Norway. The availability of vast amounts of capital not only spurred the entrance of many international players on the Norwegian market, but also encouraged the local funds to improve their business model. The potential effect of an asset management cluster in Oslo is expected to be rather qualitative. The main outcome would not necessarily be the number of new jobs, but rather positive knowledge externalities. The financial cluster would attract talent and create knowledge and expertise that would feed into the other industries in Norway.

However, the threat of stricter regulation in some western financial markets (European Union’s Alternative Investment Fund Manager Directive) has also created opportunities for Asian and South East Asian markets, which are campaigning to attract funds to the region. Perhaps even more important is the potential for organic growth in Asia – driven by strong economic performance and large stocks of private and public capital.

When asked for their professional opinion, most of the industry experts operating in Norway doubt the feasibility of the Oslo cluster³. However, should this strategy ultimately be followed, the consensus is that Oslo should focus to a larger extent on Northern Europe and the Baltics. Here, the main potential competitor would be Stockholm, Sweden’s capital city and the strongest financial hub in the region.

^{1 2} Porter (1998) Clusters and the new economics of competition

³ BI Survey, 2013

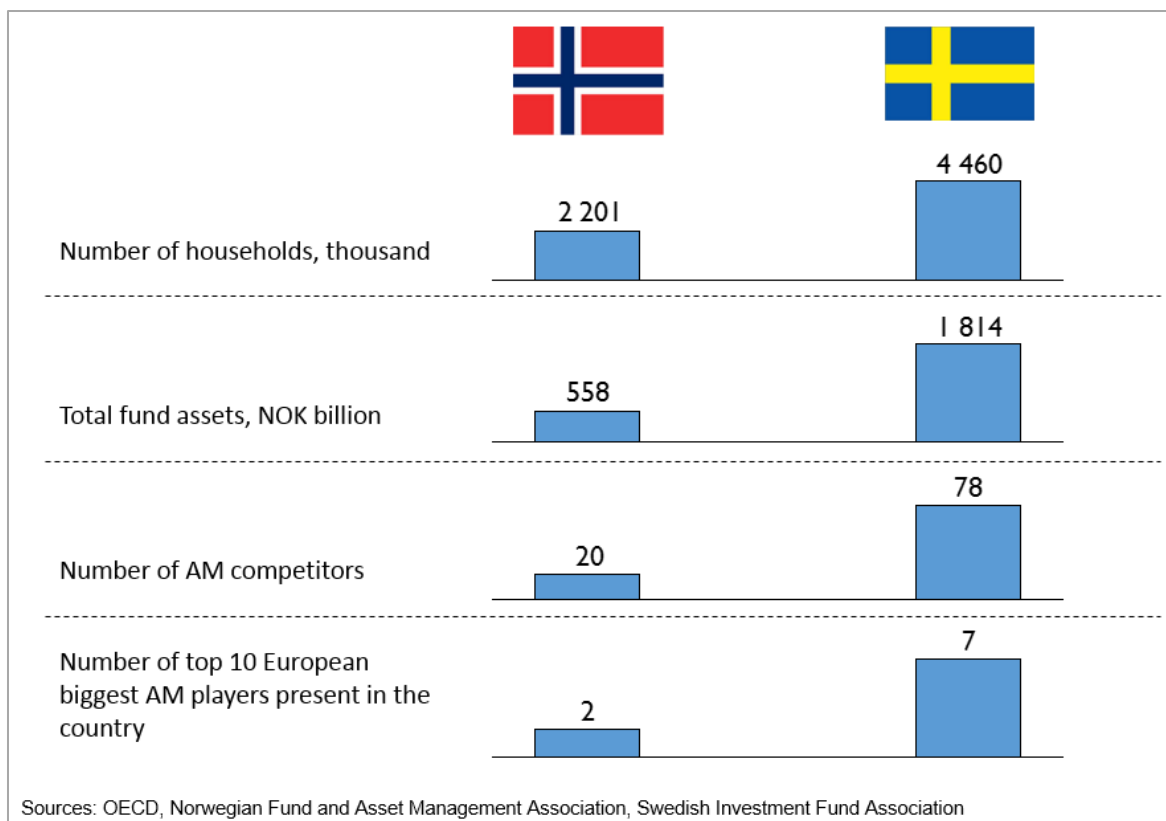


Figure 8 Norway vs. Sweden

Stockholm is considered the financial center of Northern Europe. Not only does it boast a mature and advanced financial market, incorporating the latest innovations in transaction technologies and Internet-enabled applications; Stockholm is also the home of NASDAQ OMX, a strong and efficient stock market, it and has a world-leading private equity industry. In addition, Sweden is widely recognized for its political stability, sound economic management and strong, transparent and independent legal and regulatory systems. The Swedish economy is open, competitive and resilient.

Stockholm is the business hub of Scandinavia. More financial decision makers and headquarters can be found here than in any other city in Scandinavia. Almost fifty percent of Forbes 2000 companies with operations in Scandinavia are located in Stockholm.

Four of the six largest Scandinavian financial groups and many international banks and insurance companies already use Stockholm as the base for their customer contacts in Scandinavia and northern Europe. The high density of key financial decision makers, an efficient legal and regulatory system and a competitive and resilient economy make Stockholm an unparalleled place to do business.

Continued deregulation and increased internet penetration have contributed to the development of the financial market. The deregulation of the Swedish national pension schemes has seen a high number of private citizens own and trade securities, and there is a tech savvy retail market.

Asset management industry potential in Norway

Even if Oslo is a rather small city in a peripheral country, it has managed to become an important international financial center of expertise with core competence in energy (oil and gas), shipping and seafood. The importance of Oslo city is reflected by the Oslo Stock Exchange being the second largest financial marketplace for shipping and the world’s largest for seafood. Additionally, about half of the value on the Oslo Stock Exchange is related to the energy sector.

As a capital abundant nation, Norway has a great potential for developing a very strong asset management industry. According to a small survey conducted by BI Norwegian Business School (asking some of the major asset management players in Norway), the key drivers of the growth of the asset management industry are the increasing size of the industry and the linkages created with the other industries and different asset classes. This is also in line with the value network logic described by Stabell and Fjeldstad (1998). For an asset management firm (value network), size (fund size) and different form of linkages are the most important value drivers.

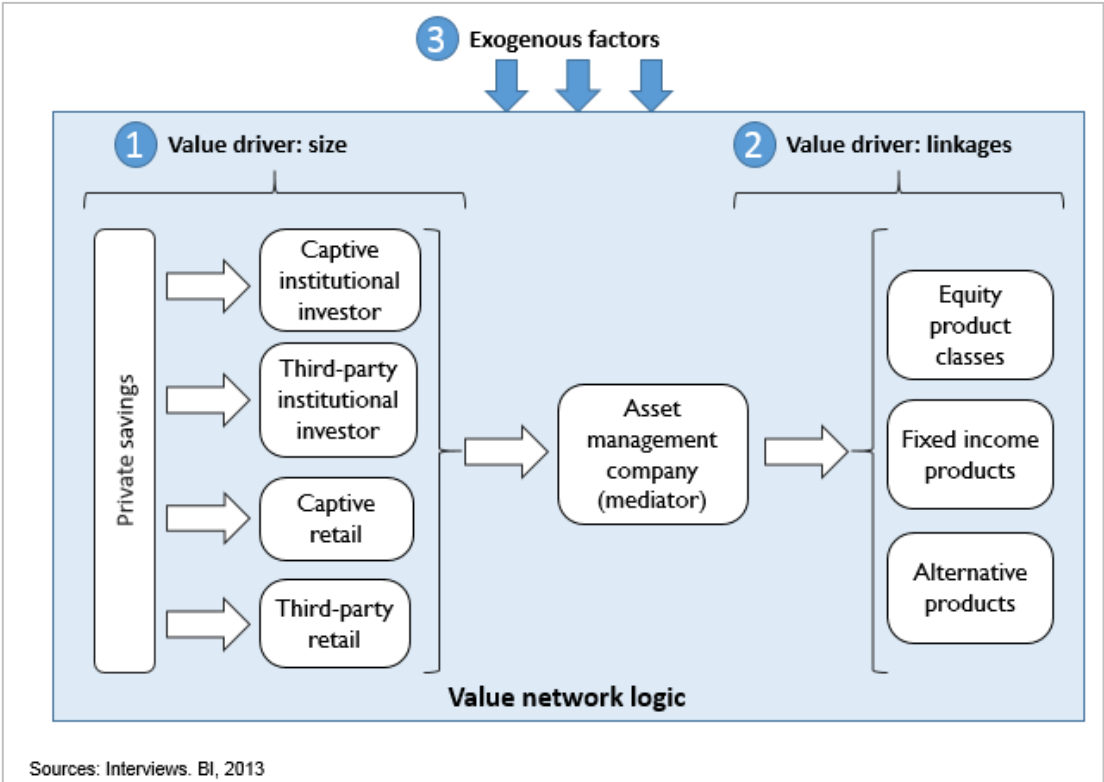


Figure 9 Key drivers of the AM industry in Norway

The rest of this chapter will present the main drivers of the asset management industry in Norway and the external factors that affect this industry. The industry in Norway is portrayed relative to its major competitor in Northern Europe, Sweden.

Size

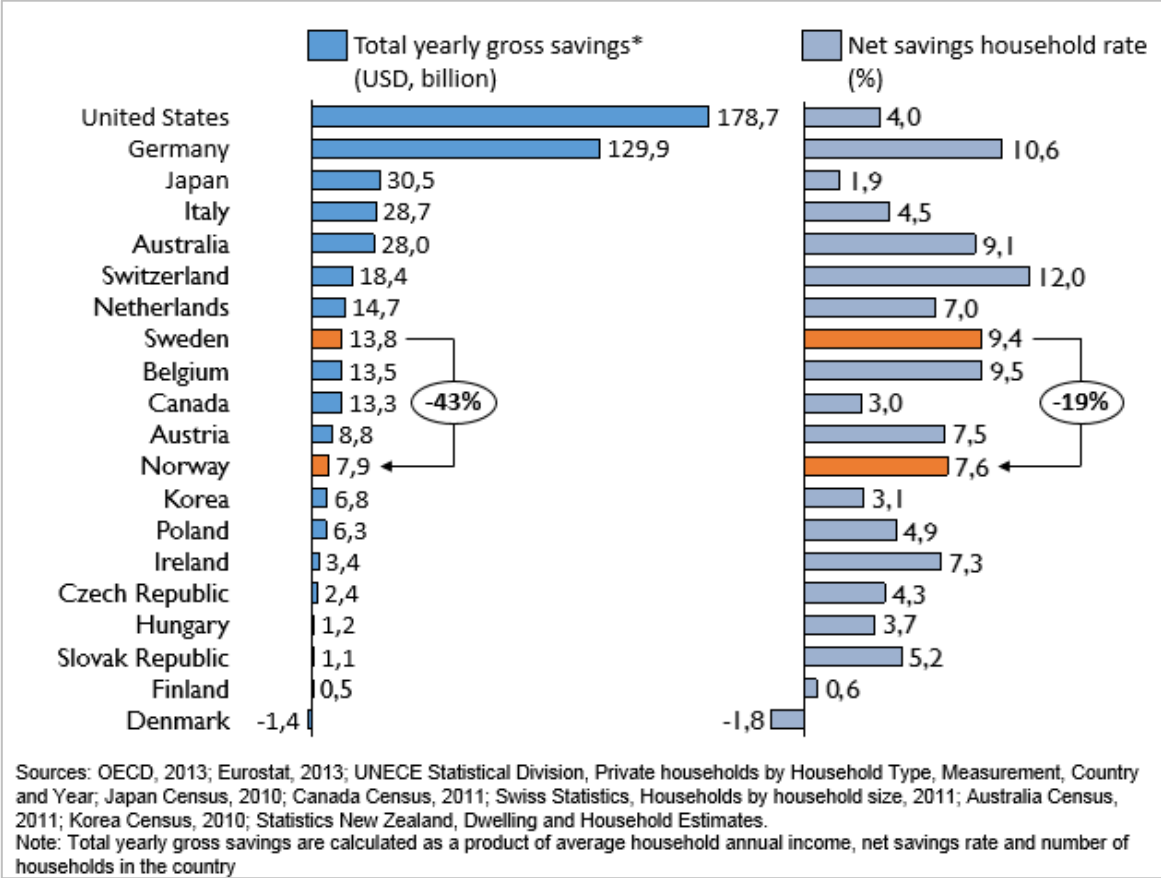
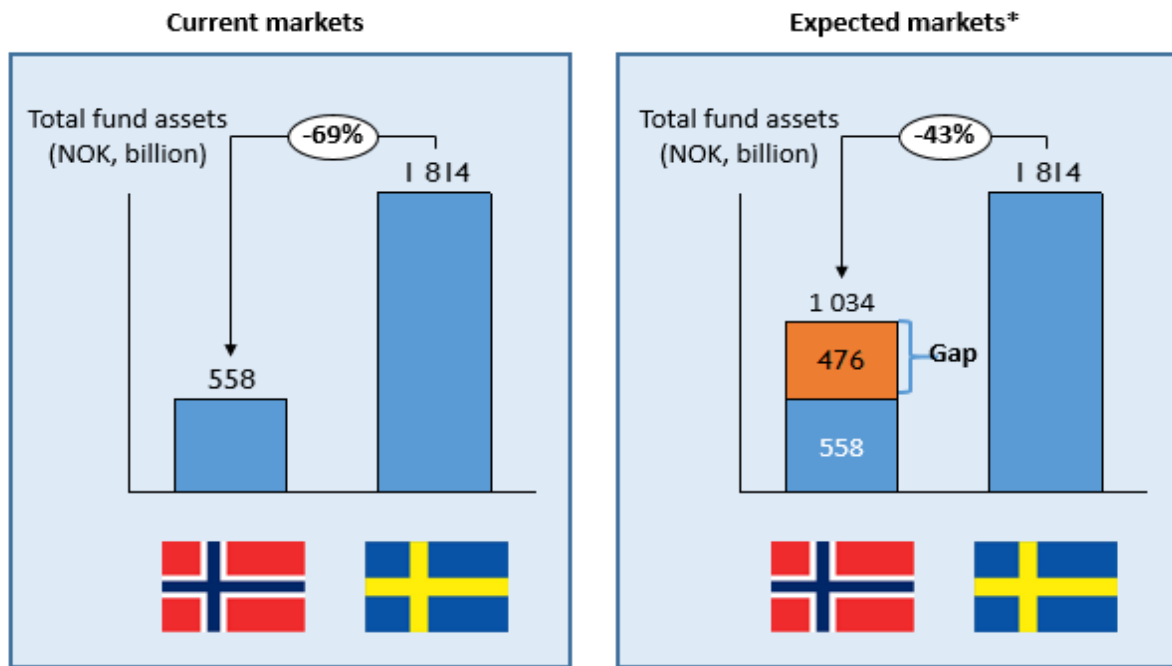


Figure 10 Private savings

Norway is a capital abundant nation with significant total private savings accompanied by a solid savings rate (Figure 10). However, as shown by the figures for 2012, Norway still lags behind Sweden. The Norwegian total gross savings of USD 7.9 billion are 43 percent less than the USD 13.8 billion which the Swedes managed to save. Also, the 7.6 percent net household savings rate in Norway is almost 20 percent smaller than the 9.4 percent rate in Sweden. The current Norwegian AM market is 70 percent smaller than in Sweden. However, the expected value of this market is twice as high as the current total fund assets.



Sources: Norwegian Fund and Asset Management Association, Swedish Investment Fund Association
 Note: Expected markets value is calculated based on the assumption that both countries have the same ratio between net savings and saving into fund assets going forward

Figure 11 Total fund assets

There are three potential strategies that can be employed to increase the AuM in Norway. To begin with, an increase in the households' savings rate will translate into more capital available for investment. Since the early-to-mid-1990s, savings rates have been stable in some countries but have declined in others - in some cases sharply, including in Australia, Canada, Japan, Hungary, South Korea, the United Kingdom and the United States. A combination of factors fueled an increase in household borrowing and, concurrently, a decrease in household savings. These factors included low interest rates, lax lending standards, availability of exotic mortgage products and growth of a global market for securitized loans.

The great recession of 2007-2008 reversed that trend, and household savings rates increased in 2009 in many countries. However, in 2010 they started declining once again in a number of places and are projected to continue to do so through 2013. The savings rate in Norway since 2009 has been relatively low compared to many OECD countries, especially when one takes into consideration that Norway is amongst the wealthiest countries on earth. Based on statistics from OECD, the average household savings rate in Norway, 7.4% for the period 2009 to 2012, was only 1.4 percentage points higher than the average for OECD countries.

Secondly, the Norwegian asset management companies can increase their market shares abroad, attracting more of the foreign capital. For example, Pareto Securities is an independent full service investment bank with a leading position in the Nordic capital markets and a strong international presence in certain sectors such as oil services, E&P and shipping. Pareto Securities is headquartered in Norway, with some 300 employees located in offices in

Norway, Sweden, Denmark, United Kingdom, Finland, US, Singapore and Brazil. Pareto Securities offers access to Nordic high yield bonds, both in the primary and the secondary markets.

Lastly, the Norwegian authorities could actively look to improve the performance of Statens pensjonsfond – utland. In recent days, there has been a heated debate within the Norwegian government regarding the restructure of the fund. The main reason for this is the enormous size of the fund and the apparent little return achieved on average over the last decade. The government is currently considering two options: splitting the fund and/or allowing for investment in different classes of assets.

In 2010, NBIM was allowed to invest the fund's money in property, a good asset for such a long-term investor, since returns tend to be earned over an extended timeframe. However, there is another obvious asset class that the government has been reluctant to consider so far, that is infrastructure. Investing in big power, rail and road projects has the benefits of being long-term investments and of generating decent returns.

The other option being considered is to split the fund into smaller funds, concentrating on different aspects or assets on the market. Sweden, for instance, has five separate pension funds, although the prevailing sentiment in Stockholm is to combine them like in Norway, as competition has not really helped returns. One alternative would be to establish some smaller funds to build up more specialized competence in areas where Norway has strong interests. That could include a fund dedicated to investments within energy and environmental technology, for example, and one that would be actively managed by brokers outside of Norway's financial center in Oslo. Another view is to invest more heavily in developing countries by setting up two funds, one for investments in poor countries and one for environmental technology.

According to the BCG analysis, there is a clear correlation between the percentage of AM penetration (measured in terms of AuM as a share of total financial assets) and the country's GDP per capita. The results are shown in Figure 12. According to this relationship, Norway stands out as an example of a country where the AM market penetration is smaller than one might expect. In contrast, Sweden enjoys much higher AM penetration, standing at 12 percent relative to Norway at just 8 percent.

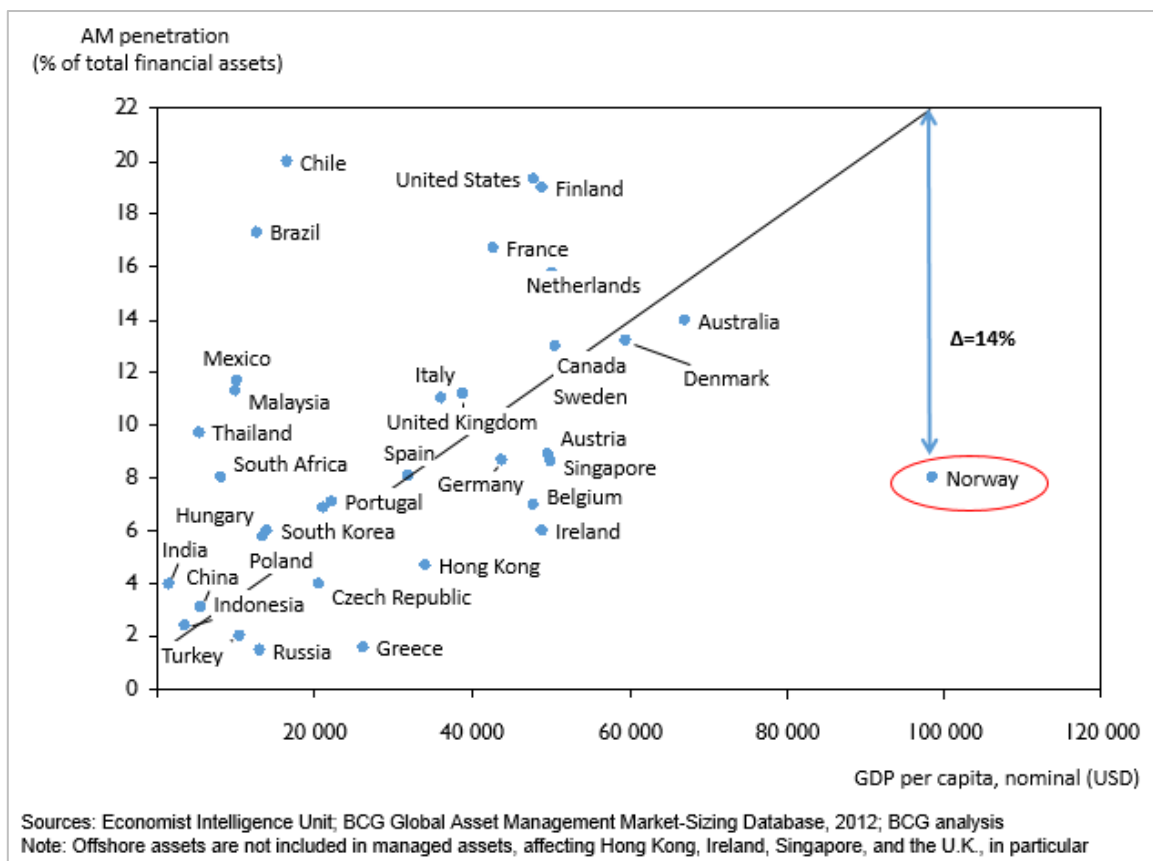


Figure 12 AM penetration

One possible explanation for the low penetration of the AM market in Norway can be related to the Norwegians' over-optimism regarding return on investment in real property. In a survey conducted by the Norwegian Fund and Asset Management Association, Norwegians still expect the highest return from their investment in residential property. Investing in residential property is perceived to bear the same risk as deposit accounts. Their confidence is fueled by the fact that house prices are still growing from record high levels, and the price growth over the past years has been very high both by historic and international comparison. On the other hand, equity is generally considered to be both low return and high risk.

In contrast, people in Sweden tend to invest most of their savings in asset management funds. According to the Swedish Investment Fund Association, in 2012 the entire population had savings invested in funds. If one excludes the pension savers, 77 percent of Swedes were investing in funds at the end of 2012.

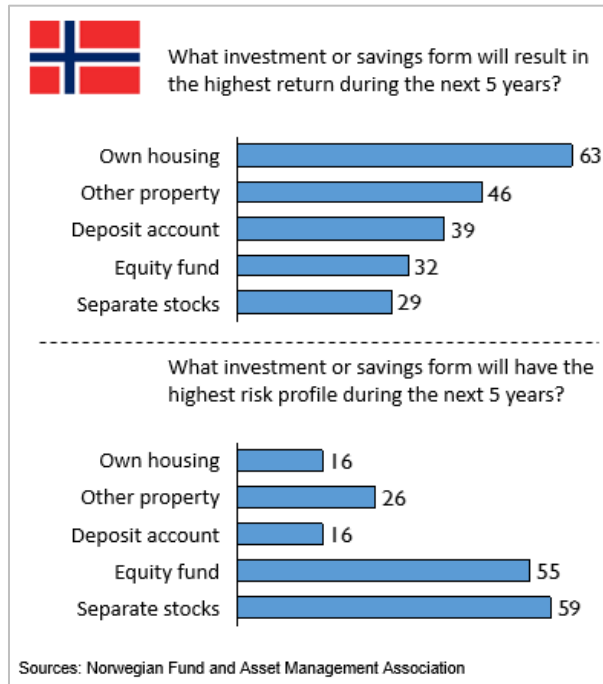


Figure 13 Real property ROI

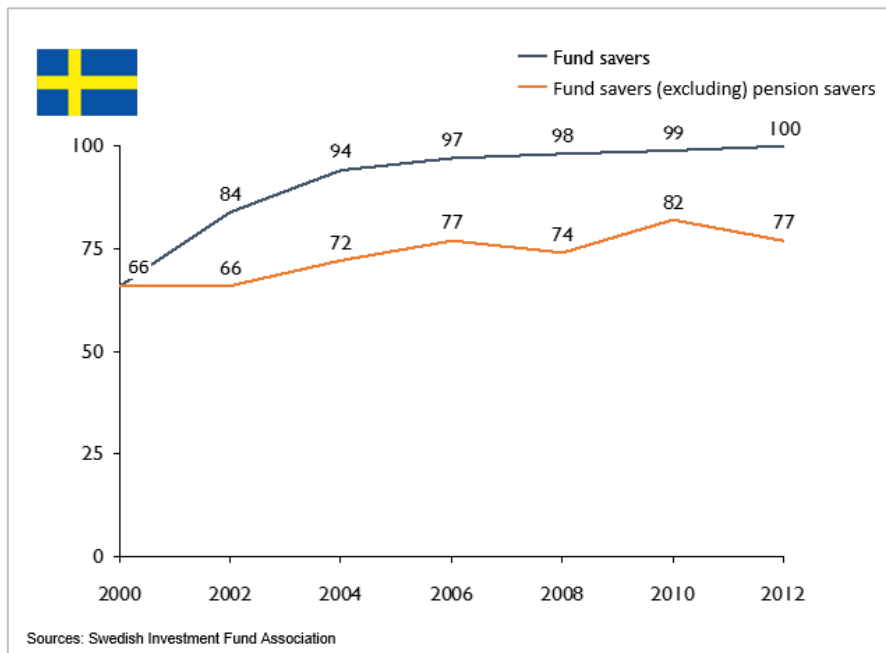


Figure 14 Fund savers in Sweden

There appears to be an inverse relationship between the AM market penetration and the national housing prices. Countries with rather modest growth in housing prices, such as Germany or Switzerland, tend to invest more in funds, while countries with high growth in housing prices have a lower AM penetration.

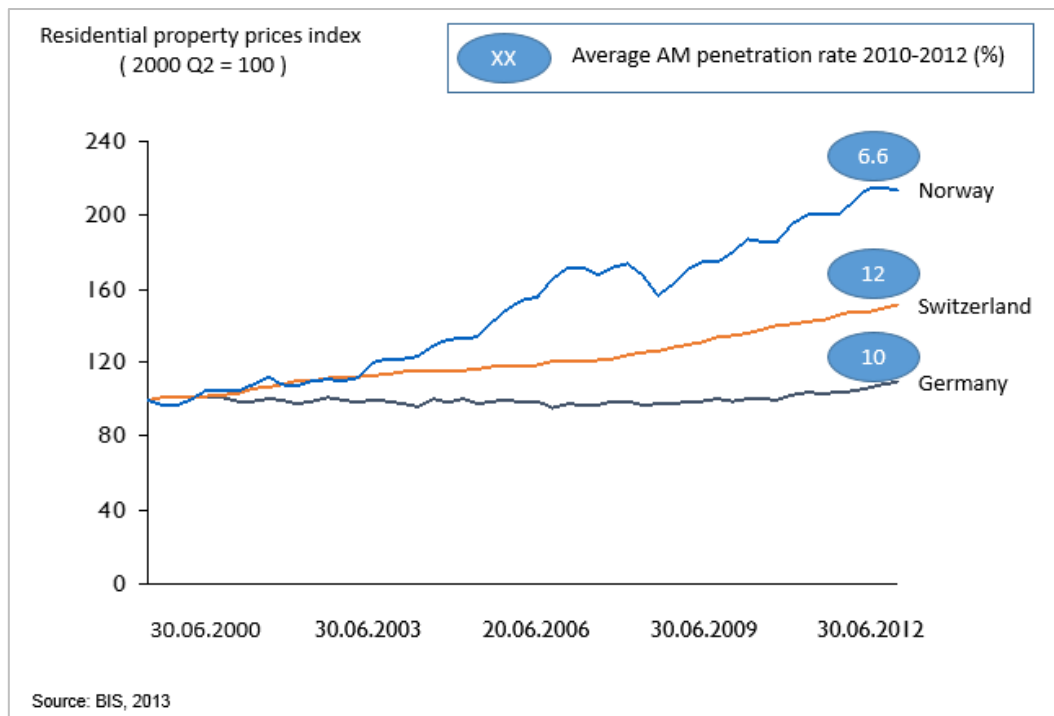


Figure 15 Housing prices and AM penetration

According to OECD, “The tax system in Norway is generally well structured with some innovative characteristics, but the taxation of capital still imposes distortions on savings. This is due to low taxation of residential property and uneven treatment of assets in the wealth tax, as theoretical calculations appear to show very high tax rates on some capital income, while maintaining overall progressivity.”

As mentioned in the OECD report, the Norwegian tax system provides strong incentives for investing in residential property. By far the lowest tax rate is paid on investments in housing.

The level of the subsidy is approximately equal across Scandinavia. However, Norway is the only country which allows an unlimited amount of tax subsidy on property. On the other hand, Denmark has already approved legislation on a gradual decrease of the subsidy.

Linkages

The interviews conducted by Norwegian Business School reveal the major linkage factors that affect the AM industry. The access to adjacent markets and competence together with the business environment are perceived to be critical factors in the success of the AM industry in a particular country. Figure 18 presents a comparison between Sweden and Norway in regard to these linkage factors. It can be noticed that currently, Sweden clearly outperforms Norway on all the critical aspects.

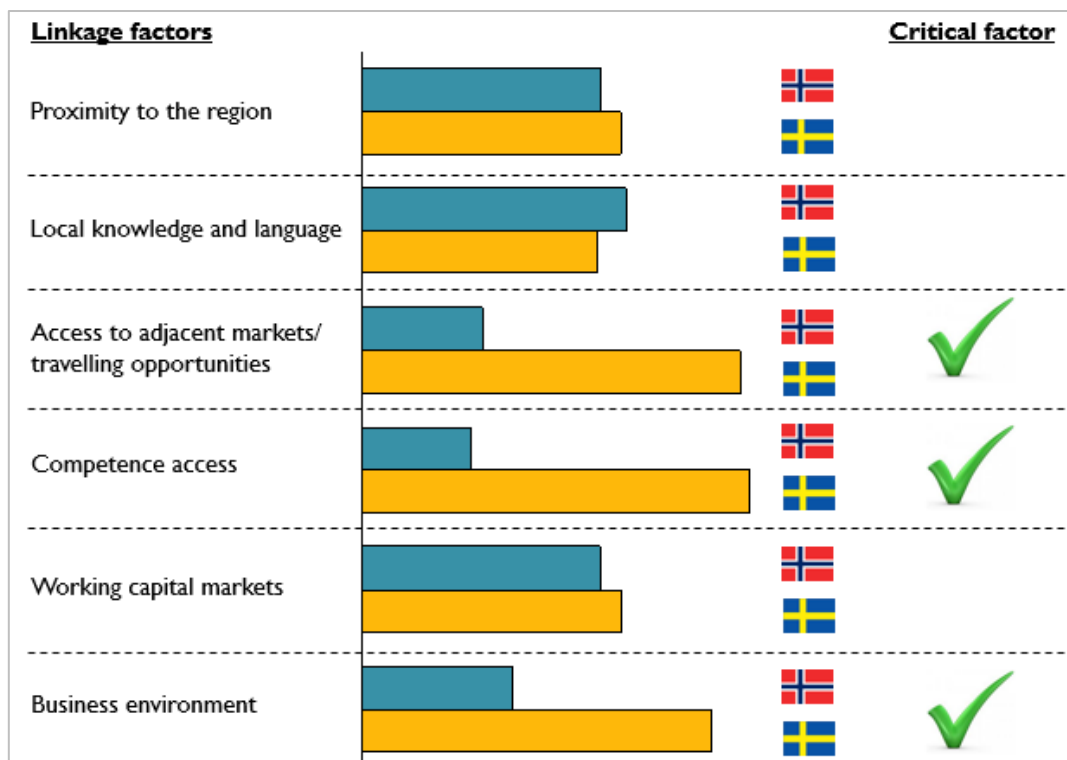


Figure 16 Linkage Factors. Source: BI Interviews, 2013.

Global financial hubs have excellent transportation, both within the city and connections to other cities. Good transportation system allows business to be done in the city, as people can easily come in and out of the city. Oslo and Stockholm are at par in term of flight connections, but in the latter city, the flight frequency is higher. One recommendation would be to add flights to other destinations and to perhaps increase the frequency of the existing routes in order to make Oslo more accessible.

In order to ensure competence access, a global financial hub must provide an education of good quality and ensure a great cultural experience. Norway has very good education, but it still does not compete on a global standard, and lacks behind the likes of Sweden for example both in terms of quality of management schools and quality of math and science education. Norway should aim not only to increase the quality of its higher education, but also to create a world class elementary and secondary school with an international program, with the aim to send students to international universities upon graduation. In addition, Sweden has much closer linkages between academia and the finance sector. This is of huge importance.

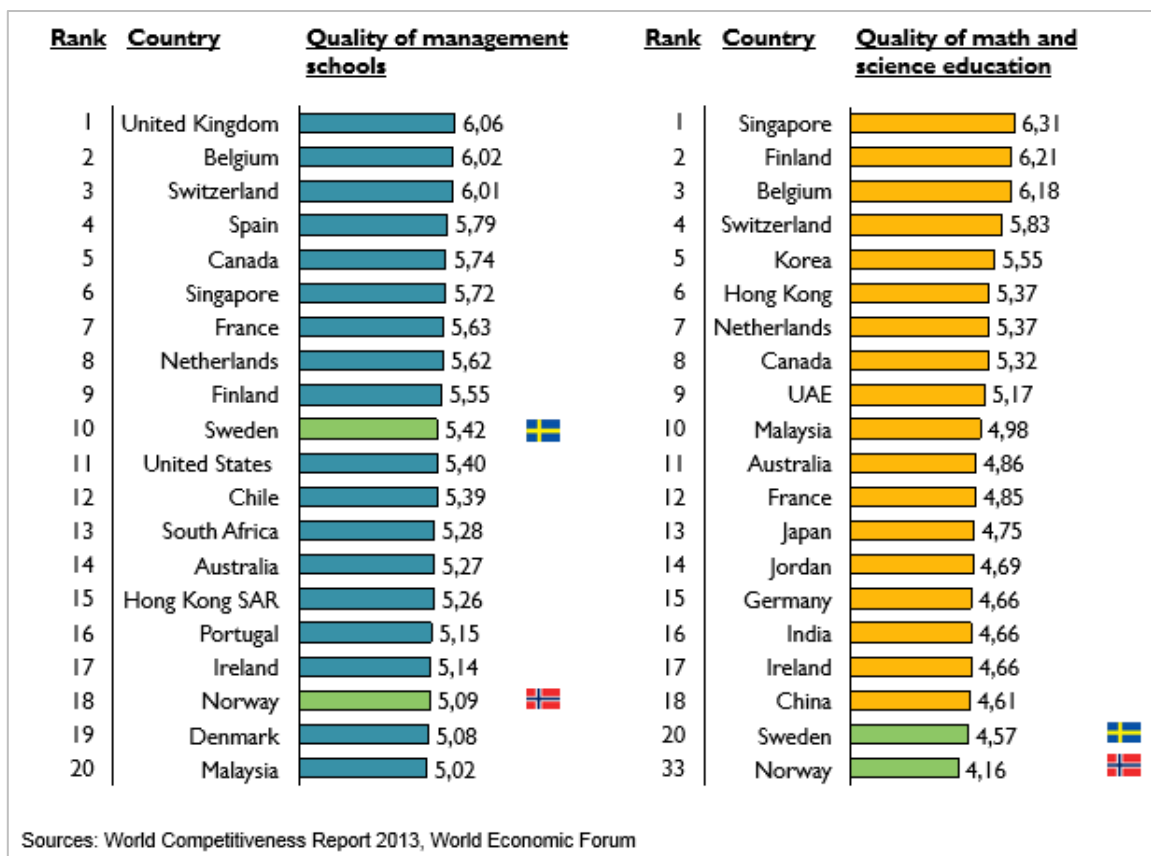


Figure 17 Quality of education

The Prospera survey from 2006 tried to identify the major directions that have to be followed by Stockholm to become an important financial center. One of the main findings was the need to attract highly skilled personnel, including not only recent graduates, but also specialized international experts. In this context, the Norwegian authorities have considerable potential for improving the conditions on the labor market and thus increase the industry's attractiveness.

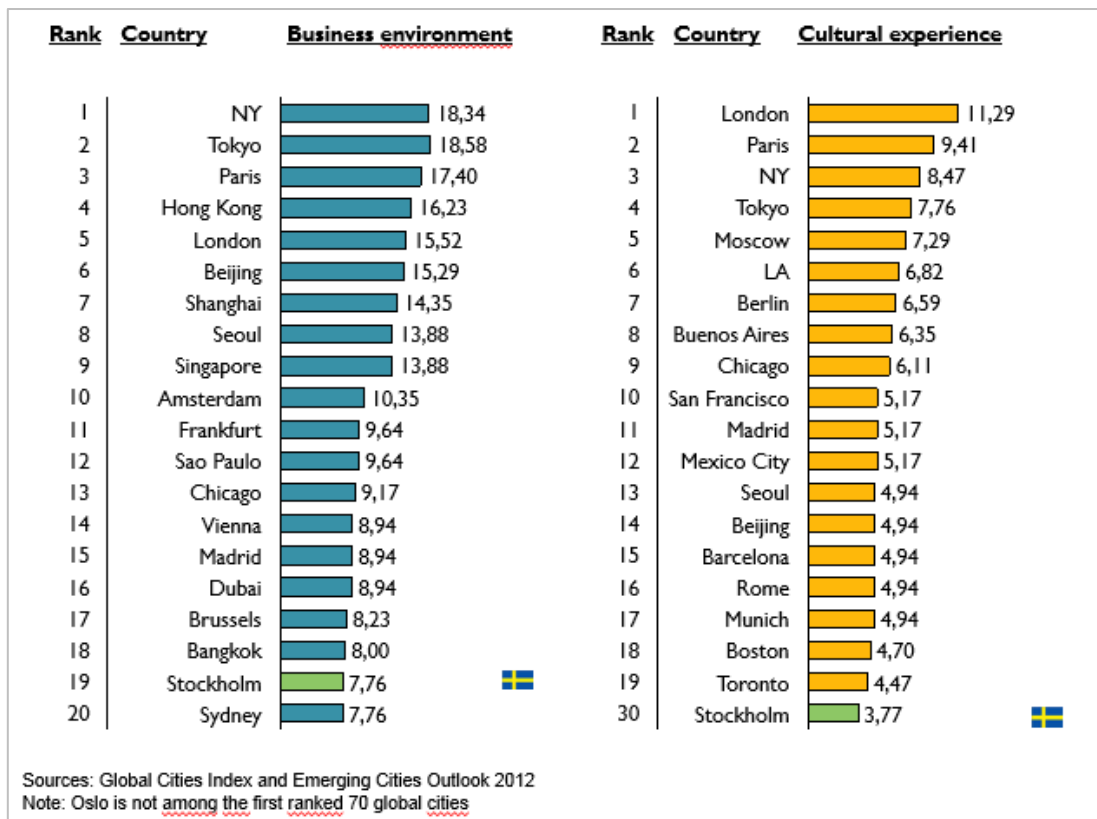


Figure 18 Business Environment and Cultural Experience rankings

Norway is known for being a very fair society, and thus will not pay fund managers the market price. As a result, top fund managers and specialized experts will stay in locations where they are paid well (New York, London or Hong Kong). To catch up, Norway will have to pay close to global salaries or at least try to provide other unique benefits.

Oslo also lags behind Stockholm when it comes to cultural experiences and the quality of business environment. Oslo may have to rebrand itself, and spend time and money marketing in an effort to raise awareness to visit Norway. Once more people arrive, a city naturally becomes more interesting.

External factors

There are also factors external to the asset management industry itself that will influence the success of the Oslo Financial Cluster. The most important external factors identified are the culture and history of the country, country branding or the regulatory environment. In addition to these factors, there has to be a common view that the asset management industry is the number one priority.

Figure 21 presents a comparison between Sweden and Norway in regard to the external factors affecting the asset management industry. Again, Sweden appears to be a more attractive host for a financial cluster.

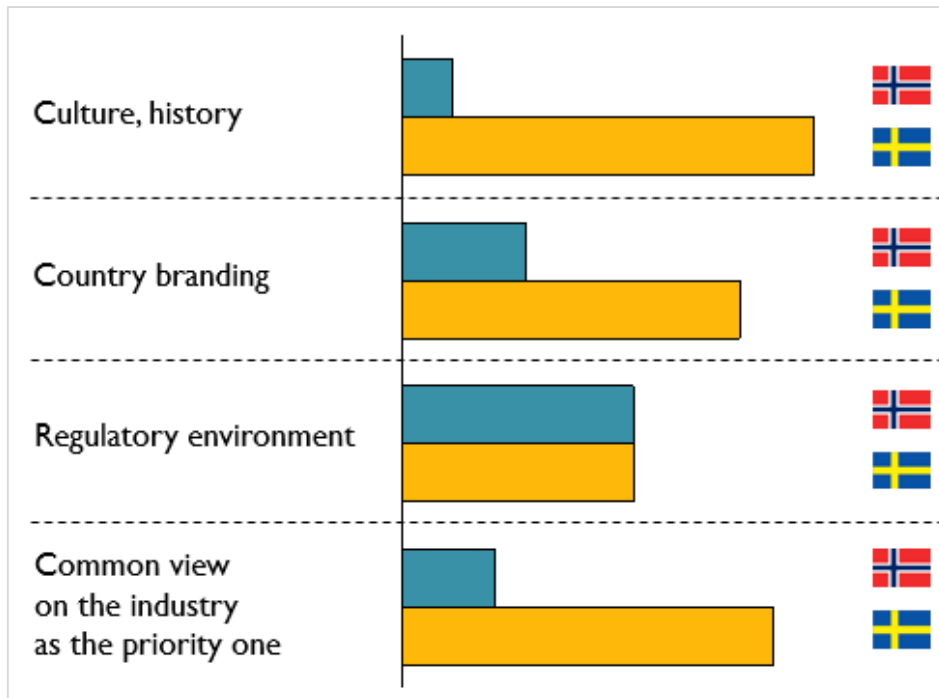


Figure 19 External factors Sweden vs. Norway

Nation branding aims to measure, build and manage the reputation of countries. Nations Brands Index is a concept meant to measure global perceptions of countries across several dimensions (culture, governance, people, exports, tourism, investment and immigration). Monocle compiles its Soft Power Survey ranking nations according to their soft power, that is, the amount of attractiveness and thus influence a country has in the world. Ranking nations according to their standard of government, diplomatic infrastructure, cultural output, capacity for education and appeal to business.

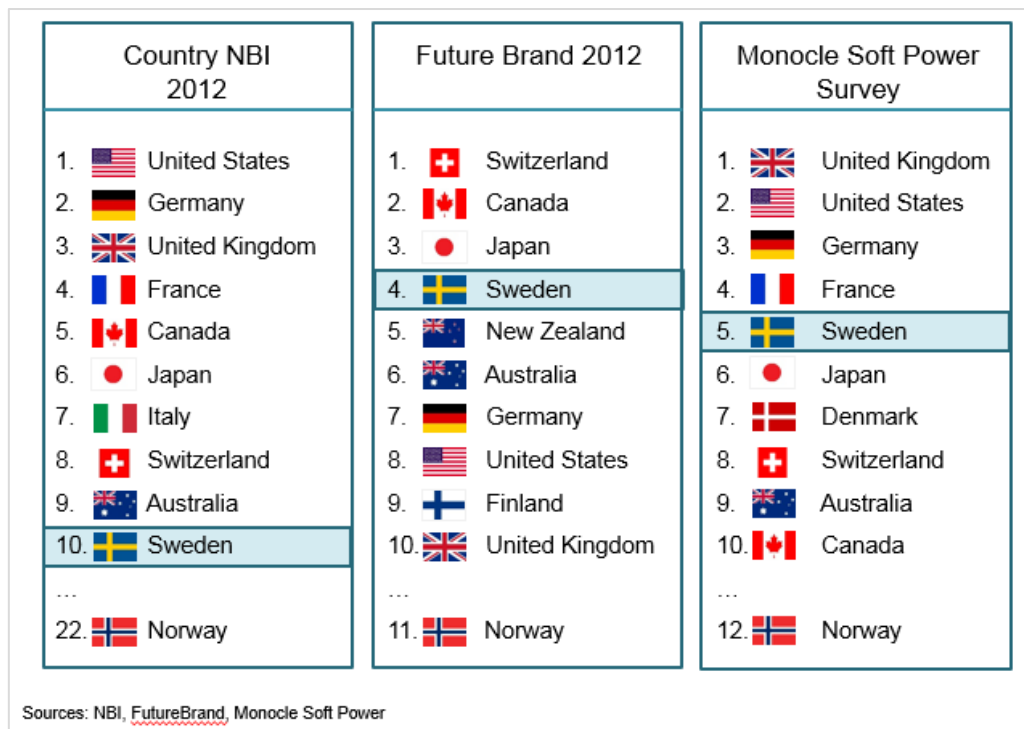


Figure 20 Nation Branding Indices

FutureBrand compiles its Country Brand Index in an attempt to measure and rank global perceptions around the world's nations – from their cultures to their industries, to their economic vitality and public policy initiatives. Sweden outranks Norway in all the rankings, making it the better branded nation worldwide.

The existence of a common belief that the industry should be considered a priority, is also essential in the emergence of the financial. A recent example to support this view is the Australian Government's commitment to work with the industry in an attempt to position Australia as a regional and global financial center. Since the introduction of the Australian mandatory retirement income system in 1992, the investment management industry with assets under management has grown by a CAGR of 11.9 percent. After acknowledging the strategic importance of financial services, the government engaged in an ambitious program of reforms. These include tax reforms and legislation changes, such as the introduction of an Investment Manager Regime, and the development of an Asia Region Funds Passport. Supervision of the sector is organized along functional rather than institutional lines, with oversight effected by statutory bodies with operational independence from government.

Australia's ambition of becoming a leading global financial player also relies on a series of existing factors. Its A\$1.7 trillion investment fund asset pool has attracted some of the world's largest investment managers, primarily from the United States and Europe. Australia is a growing and sizable economy (the fourth largest in the Asia Pacific region) with a sophisticated and diverse finance and insurance industry. Australia has access not only to a highly skilled and multilingual workforce, but also to advance business and IT infrastructure, sound regulation and an enviable lifestyle.

Australia’s funds managers have an increasingly diverse asset allocation that reflects product innovation and the increasing sophistication of the investor base in Australia.

The chart below demonstrates that as at December quarter of 2009, Australian equities, fixed interest and cash accounted for just under 55 per cent of assets, while overseas equity and fixed interest accounted for more than 22 per cent (or A\$240 billion). An indication of the sophisticated investment strategies being deployed is the 5.2 per cent allocation of funds to alternative investments and 7.1 per cent to currency/tactical assets.

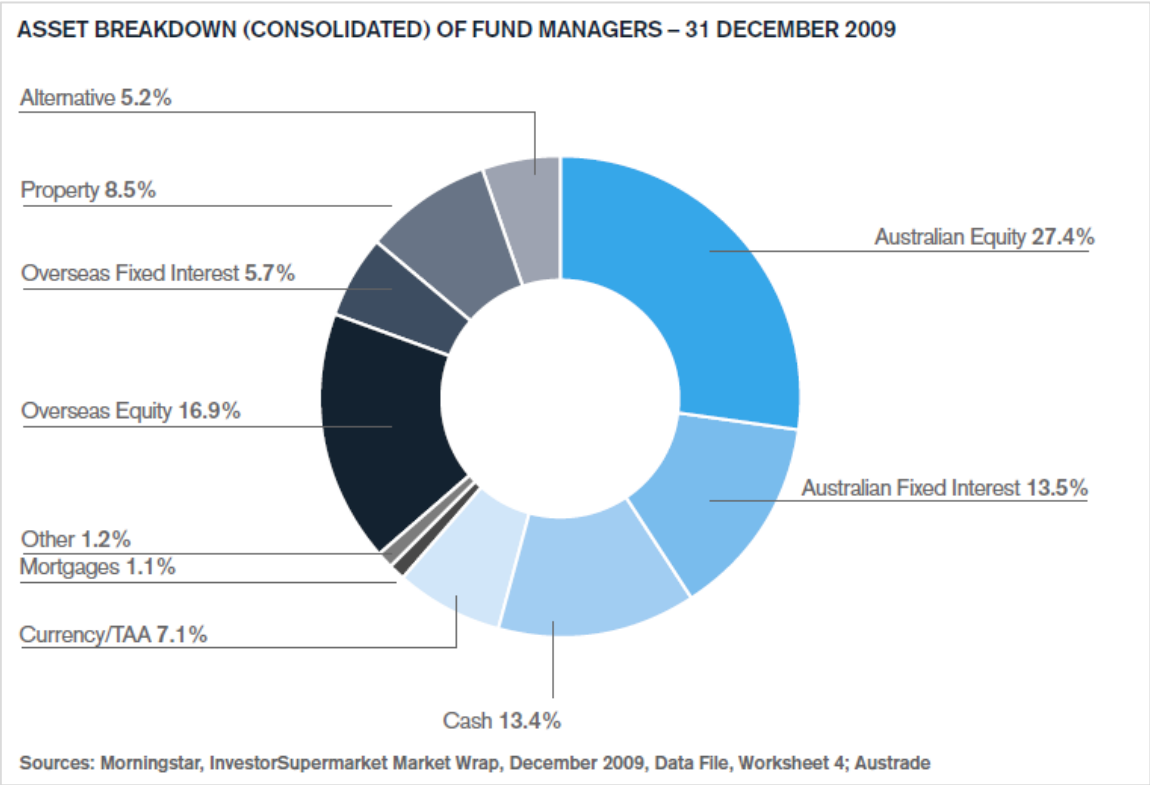


Figure 21 Australia's Asset Pool Allocation

An analysis of investment manager asset allocations over the recent financial crisis shows that Australian managers maintained relatively unchanged portfolios. Alternative investments were broadly stable, having remained relatively unchanged through 2008. Similarly, overseas equity and fixed interest remained constant, although they dipped in mid-2009. Australian equities have seen the most significant downward fluctuation, which appears to be matched by increased allocations to Australian fixed interest and cash.

Allocations to global markets are significant. A total of 22.6 per cent of fund manager assets are allocated to global markets, comprising 16.9 per cent to international shares and 5.7 per cent to international fixed interest. (See chart above).

These allocations have attracted a number of offshore investment managers to establish local sales operations to capture business opportunities. Other offshore managers have used the services of locally based third party marketing firms as sales representatives.

Conclusions

The study presents the asset management industry in Norway and tries to assess the extent to which Oslo can become an attractive location for financial services with a focus on international markets. Not only size and linkages, the main drivers of the AM industry, but also the external factors that affect this industry are analyzed in comparison to Sweden, the current financial headquarters of Northern Europe.

The findings clearly point out that Stockholm is currently far better positioned within the AM industry. However, Oslo has the resources and capabilities to become a world class city and a leading financial hub that can attract top talent from all around the world. The Norwegian financial industry has shown impressive growth over the past decade. Despite the financial crisis in 2008 and 2009, the industry has achieved significant value creation, and the employees, shareholders and the government have enjoyed the benefits through higher wages, profits and tax revenues.

In addition to this, the Norwegian Government Pension Fund Global has grown rapidly in the last few years on the back of rising oil revenues and is expected to reach \$1trillion by the end of the decade, making it by far the largest sovereign wealth fund in the world. The oil fund now amounts to around NOK 4,450 billion, and it has thus become a major player in international stock markets and, more recently, in real estate. Norway has gained clout as an international investor, and the fund is managed through a unit of the country's central bank, with investments subject to ethical guidelines set by the Ministry of Finance. The current government wants a debate on whether it makes sense to split the oil fund into smaller parts. This could potentially increase returns on the oil fortune, strengthen Norwegian interests and contribute to competition among various fund managers.

Recently, pension fund investors have started looking at other avenues for high yielding and diversifying investments. The extension of the alternative asset class has included investment in hedge funds, commodities and infrastructure. Infrastructure investment, which includes investment in bridges, toll roads, airports, pipelines, utility towers, and educational and healthcare facilities, is the most recent addition to this category and potentially the most attractive to pension fund investors. Investment in these real infrastructure assets is becoming a more popular investment choice because of the diversification benefits and the predictable and reliable long-term cash flow streams.

Pension funds have made various attempts to minimize funded ratio risk - for example, by matching assets more closely with liabilities. Infrastructure investments provide an opportunity to link the asset cash flows more closely to liability cash flows. Investment in infrastructure such as toll roads or bridges may have high upfront costs, but provides many benefits to the long-term investor.

Moreover, the Norwegian financial sector has experienced a strong internationalization over the last years. Foreign owners (especially from Nordic countries) have secured a substantial grip, partly through acquisitions and partly through new entrants into the market. Within each

segment, the foreign players achieved significant market shares and contributed to lifting the competition. At the same time, a number of Norwegian companies have extensively established themselves abroad. Companies like DnB NOR, Storebrand or Pareto Securities have established offices abroad and now derive a substantial portion of their revenues from customers and acquisitions outside Norway.

It is vital that all the players involved in the AM market are aware of the importance of financial services for Norway. As shown by the Australian example, Oslo can only become an important hub if asset management is regarded as the first priority, and both the local authorities and local institutions support the emergence of this cluster.

To conclude, it is our belief that size (fund size managed from Oslo) is the most important factor that will contribute to the success of the financial cluster in Oslo. We identify three major ways in which to achieve this goal. To begin with, Norwegians are still reluctant to place their savings in asset management funds. Supported by tax reliefs and the general perception that housing prices will continue to increase in the future, in addition to cultural factors, Norwegians consider residential property to be provide the best risk return trade-off and as a result they only invest a relative small portion of their savings in managed funds. New tax reforms together with the imminent pension reform could provide a boost to the growth in the AuM of the industry in Norway.

Secondly, Norway manages one of the largest sovereign wealth funds in the world. NBIM, the institution responsible with its management, often awards investment mandates to equity managers in developed and emerging markets. They focus on specialist mandates for a specific country or sector. The mandates are for investments in listed equity and are long-only products. From an industry perspective, one should make a structure were, equity managers will increase their chances of being awarded a mandate if they establish local offices in Oslo. Also, once established, it is reasonable to assume that they will take advantage of their location and they will get accustomed to the local industry they are now becoming a part of. This would allow them not only to perhaps sell their services to the Norwegian public, but also to provide their clients around the world with products from the Norwegian stock exchange etc.. The latter would stimulate the competition with the Norwegian players that are now operating globally, DnB NOR or Pareto Securities, for example.

Lastly, splitting the Government Pension Fund Global into smaller funds would create healthy competition between the new emerging domestic public funds investing in foreign markets. Norwegian funds could to a larger extent utilize some of its core industry competence (niche focus), investing abroad. In fact, many countries have more than one sovereign wealth fund or major public pension investor, examples including China, Singapore or the Gulf countries. On the other hand, splitting the fund to increase competition would also lead to not only increased risk taking that would focus on short-term results but also to an increase in administrative costs in the aggregate.