GOVERNMENT PENSION FUND GLOBAL **ANNUAL REPORT**

2010

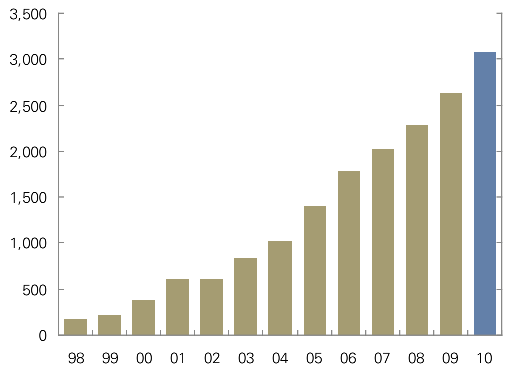
NBIM

Norges Bank Investment Management

2010 in brief

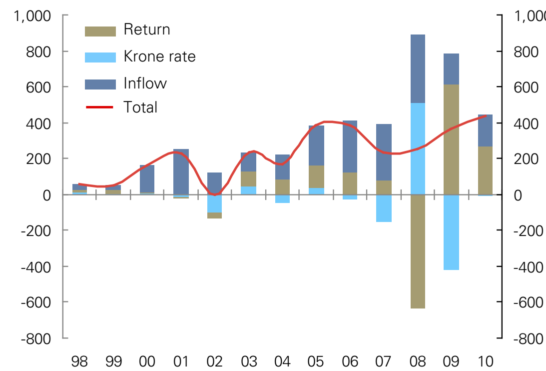
- *The Government Pension Fund Global returned 9.6 percent, or 264 billion kroner, in 2010, helped by gains in global stock and bond markets. The result exceeded the return on the fund's benchmark indices by 1.1 percentage points.*
- *Equity investments returned 13.3 percent, while fixed-income investments returned 4.1 percent, measured in the fund's international currency basket.*
- *The market value of the fund rose 437 billion kroner to 3,077 billion kroner.*
- *The fund was invested 61.5 percent in equities and 38.5 percent in fixed-income securities at the end of the year.*
- *The fund's first real estate investment was announced on 4 November 2010.*

The fund's market value. Billions of kroner



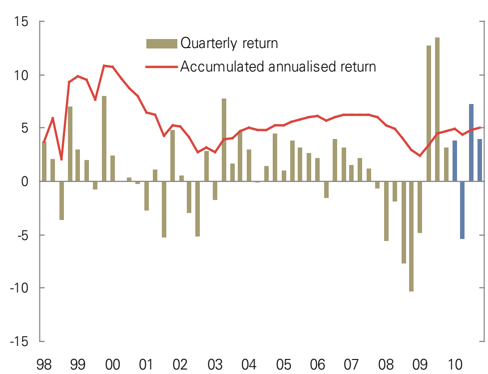
Source: NBIM

Changes to the fund's market value. Billions of kroner



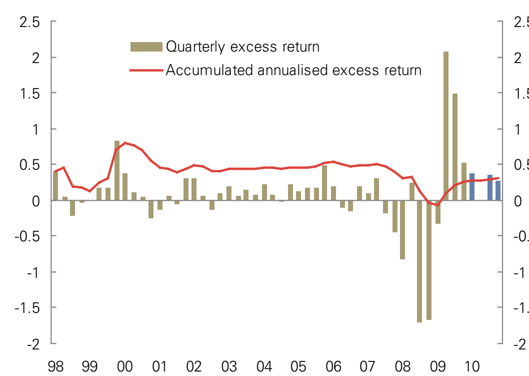
Source: NBIM

The fund's quarterly return and accumulated annualised return since 1 January 1998. Percent



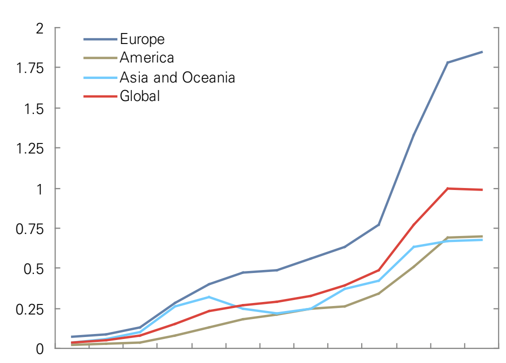
Source: NBIM

The fund's quarterly excess return and accumulated annualised excess return since 1 January 1998. Percentage points



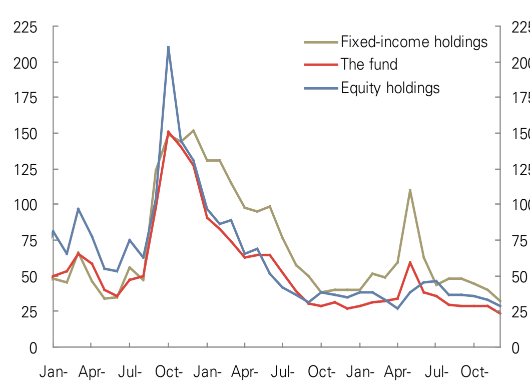
Source: NBIM

The fund's holdings in equity markets. Percentage of FTSE Global All Cap Index's market capitalisation



Source: FTSE, NBIM

Expected relative volatility for the fund. Basis points



Source: NBIM

*Our mission is to
safeguard and build financial wealth for
future generations*

Content

Published on www.nbim.no

Holdings
Voting records
Composition of benchmark indices
Methodology for the calculation of returns
GIPS report
Management mandate
Executive Board's risk management principles and investment mandate
Significant external suppliers

Translation from Norwegian. For information only.

Øystein Olsen

Enhanced fund transparency

Since its establishment, the Government Pension Fund Global has been very transparent. This year we are taking further steps by publishing our strategy plan and more detailed accounting information.

The fund is a tool for ensuring that future generations also benefit from Norway's petroleum wealth. The government only spends the expected return on the fund in its budget each year.

At the end of 2010, the fund's market value was 3,077 billion kroner. Under the government's fiscal rule, petroleum revenue spending must not exceed 4 percent of the fund's value. This corresponds to 123 billion kroner, or 13 percent of the government's total non-oil expenditure, in 2011. The fund therefore plays an important role as a source of revenue in fiscal policy.

It is easier to win support for this fiscal policy strategy when the political authorities and the public are confident that Norges Bank is managing the fund in a professional and ethical manner. Not least, such confidence depends on disclosure of key information about how the fund is managed.

The larger the fund grows, the greater the demands for transparency will be, from both Norwegian and foreign stakeholders. It is therefore natural for us to publish more and more information

The fund is entirely invested outside Norway. As a foreign investor, we are guests at another's table. When a representative of the Norwegian government becomes a major investor in another country, this can create uncertainty. It is important for the fund's investment opportunities that our capital continues to be welcome. Openness about rules and strategies will help reassure our hosts of our intentions. The perception of the fund is important for the fulfilment of our mandate in global capital markets.

The larger the fund grows, the greater the demands for transparency will be, from both Norwegian and foreign stakeholders. It is therefore natural for us to publish more and more information. Last year, we began to publish a continuously updated market value for the fund on our website, www.nbim.no.

With this annual report, we are taking further steps in the direction of increased transparency. Greater detail is being provided in the accounts, which will be prepared in accordance with International Financial Reporting Standards (IFRS) from the first quarter of 2011. There is more extensive and in-depth risk analysis than before. NBIM's strategy plan is also being published and a number of other policy documents will follow during the spring.

The fund produced good results again in 2010, with a return of 13.3 percent in global equity markets and 4.1 percent for fixed income. As in 2009, the results demonstrate the value of the fund's owners adhering to the long-term strategy even in times of financial crises and major declines in securities markets.

Oslo, 2 March 2011

Øystein Olsen

Chairman of the Executive Board

Yngve Slyngstad

Important milestones reached in 2010

The Government Pension Fund Global and NBIM reached two important milestones in 2010. In October, the fund's market value passed 3 trillion kroner for the first time, an increase of 1 trillion kroner since 2008. The following month, the fund announced its first real estate investment, a move that extends our strategy to exploit the fund's long-term outlook.

This long-term approach paid off in 2010, as large equity purchases during the financial crisis in 2008 and in the first half of 2009 yielded solid returns. The value of our fixed-income investments also continued to recover after steep price drops two years earlier. In a year marked by the European sovereign debt crisis and fears of an economic slowdown in Europe, where the fund has more than half its holdings, the fund posted its fifth-highest result ever in 2010. The return of 9.6 percent, or 264 billion kroner, was also 1.1 percentage points higher than the return on the benchmark index the fund is measured against.

We will strive to take advantage of the fund's long-term outlook. This will ensure that today's petroleum wealth also benefits future generations

Making investment decisions is the core of NBIM's business and our aim is to deliver the highest possible return within acceptable risk limits. We rely on having highly qualified employees and continued to strengthen our competency in 2010. NBIM had almost 300 employees from 25 countries at the end of the year.

The fund invests globally outside Norway and has increased its international presence in recent years. We opened an office in Singapore in June, adding to offices in Shanghai, London, New York and Oslo.

The fund's management was reviewed in 2010 and the Ministry of Finance concluded in its annual report to the Norwegian parliament that the investment strategy should be continued. Going forward, we will focus on the fund's absolute return and seek to improve the trade-off between return and risk in the fund. Not least, we will strive to take advantage of the fund's long-term outlook, investing in assets where it may take a long time for the underlying value to be realised. This will ensure that today's petroleum wealth also benefits future generations.

Oslo, 2 March 2011

Yngve Slyngstad
CEO of NBIM

Governance model

A clear division of roles and effective controls

The fund's governance model builds on a clear delegation of duties and effective systems for control and supervision.

The Government Pension Fund Global was set up to support saving for future government spending and underpin the long-term considerations in the use of Norway's petroleum revenue. Parliament has set the framework in the Government Pension Fund Act and the Ministry of Finance has formal responsibility for the fund's management.

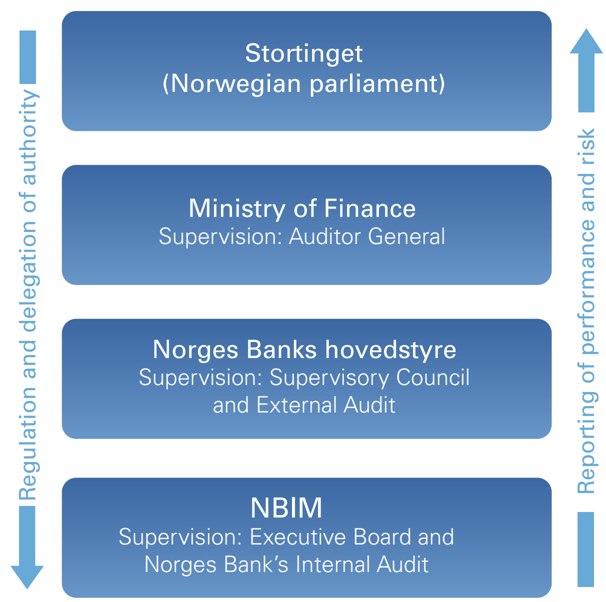
On 8 November 2010, the ministry issued a new management mandate with general guidelines for the fund's management, which is entrusted to Norges Bank. The central bank's Executive Board has in turn delegated management to Norges Bank Investment Management (NBIM). Oversight, supervision and auditing are carried out by an internal audit unit on behalf of the board.

Executive Board oversight

The Executive Board is responsible for Norges Bank's operations and consists of seven members appointed by the King in Council. The governor and deputy governor of Norges Bank are its chairman and vice-chairman, respectively.

The board sets the strategic plans and guidelines for NBIM's management. The investment manager's goal is to add value through active management of the foreign financial assets held by the government and Norges Bank and to implement the owners' strategy in a cost-effective, prudent and trustworthy way. In addition to the Government Pension Fund Global, NBIM manages Norges Bank's long-term foreign exchange reserves. NBIM also managed the Government Petroleum Insurance Fund until it was dissolved and had its assets transferred to the Government Pension Fund Global effective 31 December 2010.

NBIM's Executive Director has the responsibility and authority of CEO and reports directly to the Executive Board.



In 2010, the Executive Board updated documents governing the investment management, including NBIM's mandate. This mandate supplements the Ministry of Finance's investment limits with more detailed rules for what the fund may invest in and how much risk NBIM can take. At the same time, the Executive Board reviewed the principles for risk management at NBIM. These divide risk into four categories: market, credit, counterparty and operational. The principles within each of these categories are supplemented by more concrete risk limits for the organisation.

The Executive Board receives detailed quarterly reports on the fund management's returns, risks, compliance and internal controls, in addition to annual reports on investment performance.

The board has set up audit and remuneration subcommittees as preparatory bodies. The remuneration committee prepares recommendations for the board on the terms and pay bands for the Executive Director of NBIM and other senior managers. It also prepares recommendations for the board on the principles for performance-based pay and, annually, on the limits for performance-based pay. The audit committee deals with matters relating to the board's responsibility for risk management and control. The internal audit unit serves as the committee's secretariat.

Supervisory Council and auditing

The Supervisory Council has 15 members appointed by parliament. It supervises Norges Bank's operations and compliance with rules. This includes checking that the Executive Board has adequate oversight and control over the bank's administration and operations and whether there are appropriate procedures to ensure that operations are carried out in accordance with applicable laws, agreements, decisions and other rules. The Supervisory Council organises the bank's audit, adopts its annual financial statements and approves its budget. The council also submits an annual statement to the Norwegian parliament.

Changes to the governance model

The fund's governance model has been modified in recent years in response to the increase in the size of the fund. On 8 November 2010, the Ministry of Finance issued a management mandate for the fund to enter into force on 1 January 2011. The mandate includes requirements for the fund's investments and contributes to a clearer division of roles and responsibilities. Provisions on responsible investment and investment in real estate are included. The previous agreement between Norges Bank and the ministry was cancelled when the more detailed mandate came into effect.

Significant changes to Norges Bank's audit and supervision systems were made in 2010 in line with the revision of the Norges Bank Act from 1 January 2010. The internal audit unit was given statutory status and expanded, while the central bank audit unit was closed and replaced with the Office of the Supervisory Council and the external auditor Deloitte AS.

New accounting rules for the fund will apply from the 2011 financial year as a result of the Regulation on Norges Bank's Annual Accounts etc. of 1 January 2011.

Investment strategy

A large and long-term investor

The fund's investment strategy aims to exploit its long-term outlook, size and global presence to generate high returns and safeguard wealth for future generations.

The overall strategy is laid down by the Ministry of Finance, which decides on asset classes and regions for the fund's investments. On 1 March 2010, the ministry granted a mandate to invest in real estate, resulting in a 60 percent weighting in equities, 35–40 percent in fixed income and as much 5 percent in property investments. The asset classes have their own regional and currency weightings, all with a large emphasis on Europe.

The fund's management underwent a comprehensive review in 2010, including two external reports commissioned by the Ministry of Finance, as well as an internal study from Norges Bank. The ministry concluded in spring 2010 in its annual report on the fund's management to parliament to continue with the investment strategy and issued a new mandate in the autumn that came into effect on 1 January 2011.

Long-term investment perspective

The fund is a long-term investor. It is not dependent on short-term funding, has no clearly defined obligations and is not subject to special rules that could require costly adjustments at inopportune times. The fund can withstand periods of great volatility in capital markets and can create value by exploiting opportunities that arise when other investors are forced to safeguard capital in the short term. This can sometimes be done through investments where it may take a long time to realise the underlying value.

The goal for the fund is to generate the highest possible return within set risk limits. NBIM takes its starting point in that investment opportunities vary over time and examines how equities, bonds and properties are priced relative to their underlying value. Our focus is on keeping management costs low, identifying specific market opportunities and on improving the risk profile.

Cost-effectiveness

NBIM aims to be as cost-effective as possible when making investments. The equity and fixed-income investments are measured against benchmark indices that are updated daily to reflect changes in market value. The benchmark indices follow mechanical rules for how and when they shall be adjusted to these changes. For an investor of NBIM's size, passive adjustment to changes in the benchmarks will result in high transaction costs.

The fund's size gives us opportunities to realise economies of scale and implement new investment strategies

NBIM aims to achieve the highest possible return within acceptable risk limits

at a low marginal cost. We can establish special strategies where smaller funds may find it uninteresting or impractical to deploy resources.

Specialisation

NBIM awards mandates to managers with expertise in specific areas, such as a sector, country or region. These managers analyse equities and bonds in their areas to pick assets that are priced below their underlying values. They are bound by a particular mandate and their results are measured regularly. A high degree of specialisation, independence in decisions and concentrated investment positions shall ensure that the managers have the informational advantage to make good investments. The external managers mainly operate in markets where it is impractical or unrealistic to build internal expertise.

NBIM aims to achieve the highest possible return within acceptable risk limits. This may mean that we invest in parts of the market that fall outside the benchmark index, or that we choose not to make some investments required by mechanical adjustments to the benchmark. Decisions such as these may increase the difference between the fund's return and that of the benchmark. They may also improve the long-term trade-off between the fund's return and overall risk.

New strategic plan: Focus on return and risk

Since NBIM's start in January 1998, the fund's investments have been compared with benchmark indices for equities and bonds. There has been a particular focus on the difference between the fund's return and the return on the benchmarks, referred to as the excess return.

NBIM's strategic plan for the period 2011–2013, approved by Norges Bank's Executive Board in December 2010, places more emphasis on the fund's absolute return. The long-term investment outlook and size give more opportunity to invest in assets, such as real estate, that may be difficult to sell at short notice. By better exploiting such opportunities, NBIM can contribute more to the fund's absolute return over time.

In 2011–2013, we aim to ease the complexity of the fund, partly by reducing the number of types of bonds. On the equity side, we will strengthen our analysis of companies and increase the number of specialised mandates. We will also raise the proportion of large stock holdings. NBIM will develop credit and macroeconomic analyses and focus more on the fund's overall risk profile.

The fund's active ownership will continue to build on a principle-based and focused approach. The six focus areas will be kept during the period, and we will consider adding more.

In addition to strengthening its investment strategy during the period, NBIM will simplify its processes and standardise its systems.

The strategy plan is available on NBIM's website, www.nbim.no.

10 May: The EU and IMF launch a support package of up to 750 billion euros to stabilise European financial markets and prevent the sovereign debt crisis from spreading. The ECB announces plans to purchase government debt to normalise the markets.

23 July: The results of stress tests of EU banks show that seven out of 91 European banks need more capital.

OCTOBER 2009 **MAY 2010** **JUNE 2010** **JULY 2010** **AUGUST 2010**

19 October: The Greek government doubles its forecast for the budget deficit in 2009 to 12.5 percent. Credit rating agency Fitch downgrades Greek debt three days later.

19 June: The People's Bank of China relaxes the renminbi's two-year peg to the dollar.

27 August: Federal Reserve Chairman Ben S. Bernanke says he is open to further quantitative easing to stimulate the US economy after weaker-than-expected growth in the second quarter.

Market developments

Opportunities for a long-term investor

Global markets in 2010 were characterised by a maturing recovery following the financial crisis in 2008, tempered by new concerns over the debt burdens and deficits of some euro nations.

Globally, stocks and corporate bonds gained, helped by improving company profits, low interest rates and stimulus from the European Central Bank, the US Federal Reserve, including a second round of quantitative easing, and the Bank of Japan. By contrast, policy makers in China, South Korea and India acted to stem inflation growth caused by their economic expansion. China's economy grew 10.3 percent in 2010, the most in three years.

The fund's biggest returns, mirroring global price moves, were in Asia, followed by America and lastly Europe, where returns were held back by the sovereign debt crisis. Stocks gained on optimism for a continued expansion in the global economy, in particular for emerging economies, which the International Monetary Fund predicted in October could grow almost three times as fast as developed countries in 2011. Stock markets in emerging countries including Turkey, Israel, Columbia, Chile, Mexico, Brazil, India, Indonesia, the Philippines and Malaysia rose to all-time highs in November.

US markets rallied after Federal Reserve Chairman Ben S. Bernanke in an August speech signalled the US would enact a second round of quantitative easing, or the purchase of bonds, to ensure low long-term interest rates and stimulate the economy. US policy makers in November announced 600 billion dollars in quantitative easing through June 2011.

The VIX index, a key measure of volatility in US stock markets, fell to its lowest level in more than three years in December 2010, and averaged 22.6 percent in the year, in line with the average the last decade. It was at a record 80.7 percent after the Lehman collapse in 2008 and rose as high as 45.6 percent in May 2010.

Strong demand for raw materials, mainly from China, pushed commodities prices higher, boosting shares of metals producers, fertilizer makers and chemical companies. A second year of rising crude prices also pushed most oil companies higher. An exception was UK crude producer BP, which slumped following the blow-out and explosion at the Deepwater Horizon well in the Gulf of Mexico.

Financial stocks gained in September after central bank regulators in the Basel Committee on Banking Supervision announced new capital measures to ensure stability in the banking industry that were less severe than investors had expected. The rules increased the capital requirements for banks and mandated that banks must hold a buffer against losses and gave until 1 January 2019 to fully comply. US bank stocks gained in the year, while

19 October: The People's Bank of China raises its benchmark rate for the first time in almost three years, by 25 basis points.

3 November: The Federal Reserve announces plans for a second round of quantitative easing, involving purchases of up to 600 billion dollars of Treasury bonds through to the end of June 2011.

SEPTEMBER 2010

15 September: The Bank of Japan intervenes in the foreign exchange market for the first time since 2004 to prevent further appreciation of the yen after it hits a 15-year high against the dollar .

OCTOBER 2010

20 October: UK chancellor George Osborne presents a budget with record cuts in the country's public spending.

NOVEMBER 2010

28 November: The EU and IMF approve financial assistance of 85 billion euros to Ireland.

DECEMBER 2010

16 December: EU leaders agree on the principles for a new permanent mechanism for European debt crises from 2013.

European financial services stocks lost on the year amid concern over the region's debt crisis.

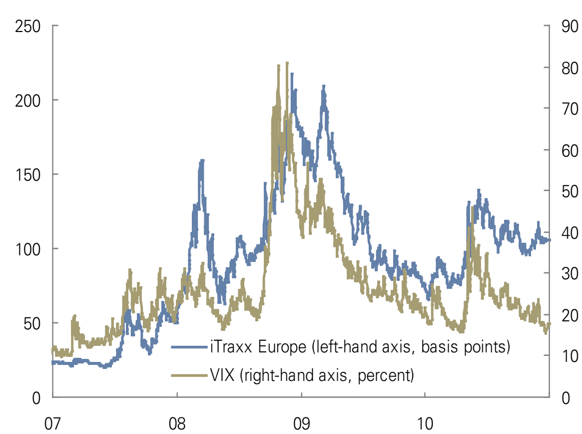
Global imbalances continued in 2010, including the US's large trade deficit against China, even after Chinese authorities in June let the renminbi strengthen against the dollar. Some countries voiced concern that the second round of US quantitative easing would weaken the dollar against their currencies. Countries such as Brazil, South Korea, Thailand and Turkey took measures to keep their currencies in check. Brazil increased the tax on foreign capital inflows earmarked for fixed-income investments to curtail foreign currency flows to the country and prevent further strengthening of the Brazilian real. The potential for further capital restrictions triggered concern among international investors.

The fund's main market, Europe, was split between a stronger-than-expected export-led economic recovery in Germany and deepening fiscal problems for mainly Greece, Ireland, Portugal and Spain. The government bond yields of these nations nearly doubled across maturities, while debt of Germany, the UK and US for most of the year benefitted from investors seeking refuge from potential losses.

Rescue packages to Greece and Ireland from the European Union and the International Monetary Fund, helped ease concerns in the second half of the year. European policy makers also agreed in December on principles for new permanent mechanisms to manage debt crises in the region.

The year in fixed-income markets was marked by a hunt for yield as policy makers kept benchmark rates near zero. Corporate bonds climbed for a second year, after record gains in 2009. The riskiest, non-investment-grade bonds led returns in 2010. Inflation-protected bonds also gained as investors bet that global stimulus measures would push up inflation in the coming years.

Chart 1-1 Risk in stock markets (VIX index) and fixed-income markets (iTraxx index)



Source: CBOE, Markit

Market value

More than 3 trillion kroner

The market value of the Government Pension Fund Global passed 3 trillion kroner in 2010, just three years after reaching 2 trillion kroner.

The fund's market value rose 437 billion kroner to 3,077 billion kroner in 2010. Equity investments accounted for 1,891 billion kroner, while fixed-income holdings amounted to 1,186 billion kroner. The fund topped 3 trillion kroner on 19 October.

The market value is affected by returns, capital inflows and exchange rates. The fund returned 264 billion kroner in 2010, compared with a record 613 billion kroner in 2009. Inflows from the government were 182 billion kroner, up from 169 billion kroner in 2009. A slightly stronger krone reduced the market value by 8 billion kroner in 2010.

The fund has extensive investments in euros, pounds and dollars. The euro and the pound fell 5.9 percent and 2.5 percent, respectively, against the krone in 2010. The dollar gained 0.6 percent. The fund also has investments in other currencies, foremost the yen, which strengthened 15.5 percent against the krone in 2010.

Most inflows to fixed income

The Ministry of Finance on 1 March 2010 issued a mandate to gradually invest as much as 5 percent of the fund in real estate through a corresponding decrease in fixed-income investments. The fund shall consist of 60 percent equities, 35–40 percent fixed-income securities and up to 5 percent real estate.

The share of equities was 61.5 percent at the end of 2010, down from 62.4 percent a year earlier. It has been above the long-term target of 60 percent since 2009 because of strong gains in stock markets. To bring the share closer to the target, 85 percent of the fund's inflows of 182 billion kroner were invested in fixed income in 2010, while the rest went to equities. The fund also received about 20 billion kroner in fixed-income assets held by the Government Petroleum Insurance Fund until it was wound down on 31 December 2010.

The fund's first real estate investment was announced in November, with completion set for spring 2011.

Chart 2-1 The fund's market value. Billions of kroner

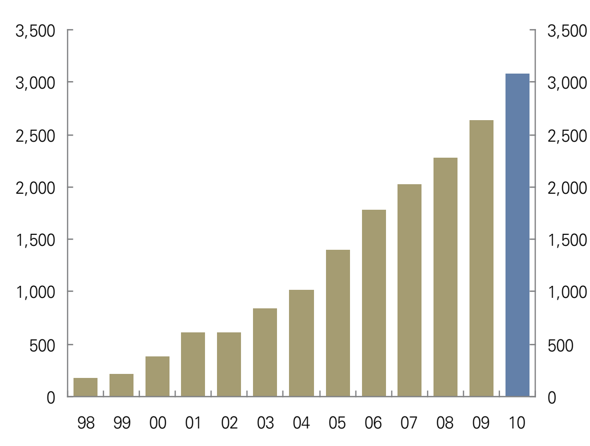


Chart 2-2 Changes in the fund's market value. Billions of kroner

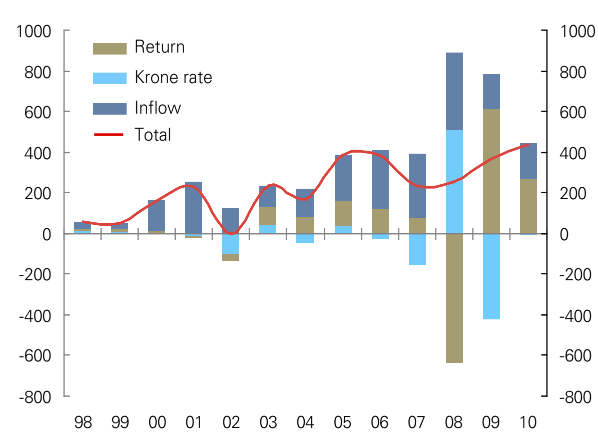
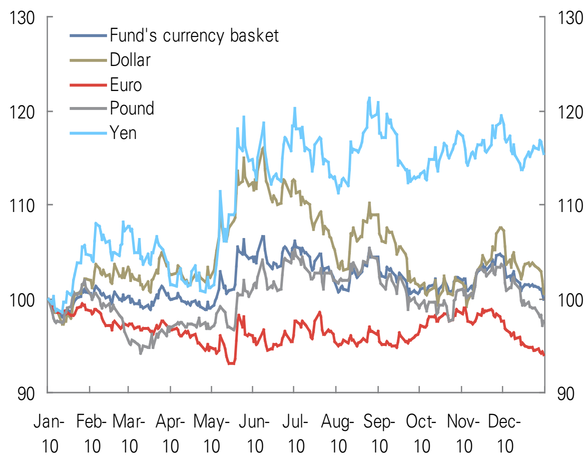


Chart 2-3 Fluctuations in currency exchange rates against the krone. Indexed



Source: WM, Reuters

Returns in international currency

The fund invests in international securities in foreign currencies. Investments are not converted into Norwegian kroner in connection with the fund's financial reporting and are not hedged against currency fluctuations. Changes in the krone exchange rate do not impact the fund's international purchasing power. Consequently, the fund's return is often given in international currency – that is a weighted combination of the 35 currencies in the fund's benchmark indices for equities and fixed income. This is known as the fund's currency basket.

The fund was invested in 33 of the currencies in the basket at the end of 2010 and 85 percent of the fund's equities and fixed-income investments were in dollars, euros, pounds, yen and Swiss francs. About 0.2 percent of the fund was invested in Chinese renminbi, which was not included in the basket. The krone gained 0.1 percent against the currency basket in 2010.

Table 2-1 Key figures as of 31 December 2010

	2010	2009	4Q 2010	3Q 2010	2Q 2010	1Q 2010
Market value (billions of kroner)						
Market value of equity investments	1,891	1,644	1,891	1,758	1,664	1,730
Market value of fixed-income investments	1,186	996	1,186	1,150	1,128	1,033
Market value of real estate investments	0		0			
Market value of fund	3,077	2,640	3,077	2,908	2,792	2,763
Inflow of new capital*	182	169	78	49	35	19
Return	264	613	116	199	-155	103
Change due to fluctuations in krone	-8	-418	-25	-132	149	0
Total change in fund	437	365	169	116	29	123
Management costs (percent)						
Estimated transition costs	0.01	0.09	0.01	0.00	0.00	0.00
Annualised management costs	0.11	0.14	0.11	0.10	0.10	0.10
Changes in value since first capital inflow in May 1996 (billions of kroner)						
Gross inflow of new capital	2,508	2,323	2,508	2,429	2,379	2,343
Management costs	16	13	16	15	15	14
Inflow of capital after management costs	2,492	2,310	2,492	2,413	2,365	2,329
Return	746	482	746	630	430	586
Change due to fluctuations in krone	-160	-152	-160	-135	-3	-152
Market value of fund	3,077	2,640	3,077	2,908	2,792	2,763
Return after management costs	730	469	730	614	416	572

* The inflows in this table differ slightly from those in the financial accounts (see note 3) due to differences in the treatment of management fees.

Returns

Fifth best year in the fund's history

Broad gains in global stock and bond markets propelled the fund to a return of 9.6 percent in 2010, the fifth highest since its inception.

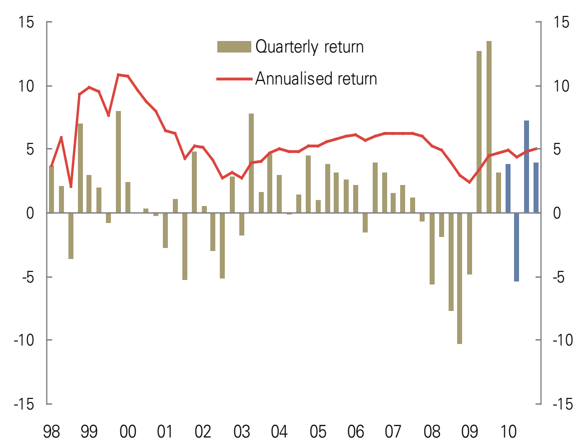
The fund's equity holdings returned 13.3 percent in 2010, driven by gains in Asian, American and European markets. Fixed-income investments returned 4.1 percent, helped by rising prices for government and corporate bonds. The returns are measured in the fund's international currency basket.

The fund's return is compared with the return on benchmark indices for stocks and bonds. The difference, referred to as the excess return, was 1.1 percentage points in 2010. The fund's equity and fixed-income investments posted excess returns of 0.7 and 1.5 percentage points, respectively.

From 1 January 1998 to 31 December 2010, the fund had an annualised gross return of 5 percent, measured in international currency. This gives an annual net real return of 3.1 percent after management costs and inflation.

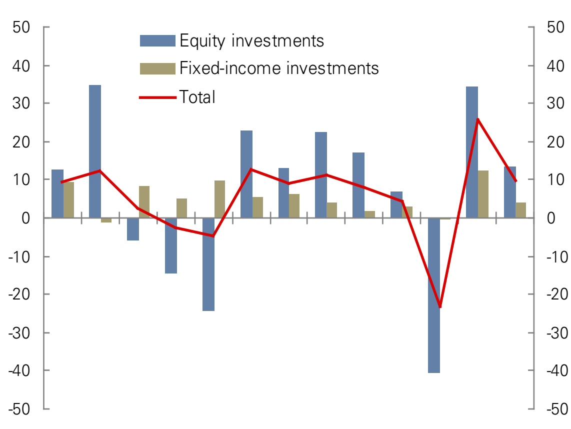
Transaction costs are incurred when capital is phased in to the fund and when the benchmark indices are rebalanced. Direct and indirect transaction costs associated with phasing in capital and rebalancing were 400 million kroner in 2010, equivalent to 0.21 percent of the 182 billion kroner transferred to the fund in 2010 and 0.01 percent of the fund's market value at the start of the year.

Chart 3-2 The fund's quarterly and annualised returns. Percent



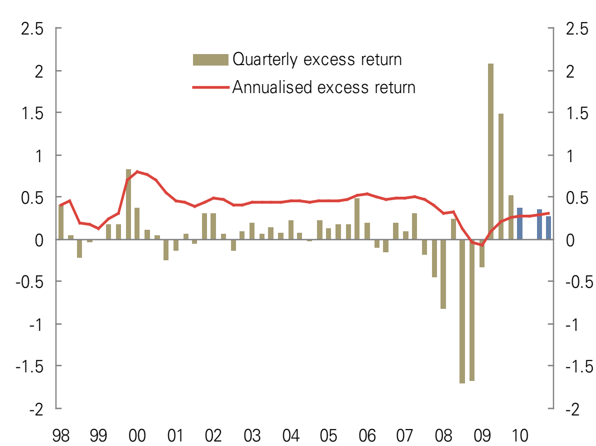
Source: NBIM

Chart 3-1 The fund's annual returns. Percent



Source: NBIM

Chart 3-3 The fund's quarterly and annualised excess returns. Percentage points



Source: NBIM

Table 3-1 Returns as of 31 December 2010

	2010	2009	4Q 2010	3Q 2010	2Q 2010	1Q 2010
Returns in international currency						
Equity holdings (percent)	13.34	34.27	8.37	9.82	-9.23	4.93
Fixed-income holdings (percent)	4.11	12.49	-2.48	3.46	1.03	2.15
Fund (percent)	9.62	25.62	3.99	7.26	-5.38	3.87
Benchmark indices (percent)	8.57	21.49	3.72	6.89	-5.38	3.49
Fund's excess return (percentage points)	1.06	4.13	0.28	0.36	0.00	0.38
Management costs (percent)	0.11	0.14	0.03	0.03	0.03	0.02
Return after management costs (percent)	9.52	25.48	3.97	7.23	-5.41	3.84
Returns in kroner (percent)						
Equity holdings	13.21	15.31	7.49	4.84	-4.29	4.96
Fixed-income holdings	3.99	-3.39	-3.28	-1.23	6.53	2.18
Fund	9.49	7.88	3.15	2.39	-0.23	3.90
Benchmark indices	8.43	4.34	2.87	2.04	-0.22	3.52

Table 3-2 Historical key figures as of 31 December 2010. Annualised data in international currency

	Last 12 months	Past 3 years	Past 5 years	Past 10 years	Since 1 Jan.1998
Return of fund (percent)	9.62	1.84	3.51	4.17	5.04
Benchmark return (percent)	8.57	1.83	3.53	3.93	4.73
Excess return of fund (percentage points)	1.06	0.00	-0.02	0.24	0.31
Standard deviation (percent)	9.63	13.30	10.48	8.31	7.77
Tracking error (percentage points)	0.36	1.53	1.23	0.89	0.82
Information ratio (IR)*	2.95	0.00	-0.02	0.27	0.38
Gross annual return of fund (percent)	9.62	1.84	3.51	4.17	5.04
Annual price inflation (percent)	1.81	1.69	2.06	1.96	1.83
Annual management costs (percent)	0.11	0.12	0.11	0.10	0.10
Annual net real return of fund (percent)	7.57	0.03	1.31	2.06	3.05

*The information ratio (IR) is a measure of risk-adjusted return. It is calculated as the ratio of excess return to the actual relative market risk that the fund has been exposed to. The IR indicates how much excess return has been achieved per unit of risk.

Table 3-3 Breakdown of the fund's 2010 excess return by type of management. Percentage points

	External management	Internal management	Total
Equity management	0.15	0.27	0,42
Fixed-income management	0.25	0.38	0.63
Total	0.40	0.65	1.06

Table 3-4 Return on the fund in 2010 in different currencies. Percent

	USD	EUR	GBP
Return on fund	8.8	16.4	12.2

Equity management

Broad gains for the fund's equities

The fund's equity investments returned 13.3 percent in 2010, driven by gains in Asian, American and European stock markets.

Nearly all of the fund's stock sectors gained in 2010, with the exception of the utilities sector. Better-than-expected earnings from a number of companies and strong growth in emerging economies such as China, India and Brazil contributed to the increase.

Equity investments in the basic materials sector, which includes metal, fertiliser and chemical producers, led gains with a return of 25.2 percent, measured in international currency. The fund's investments in the industrial and consumer goods sectors followed with returns of 22.2 percent and 20.4 percent, respectively.

Investments in the oil and gas sector returned 9.1 percent. Royal Dutch Shell, BP, Exxon Mobil and Total were among the fund's ten largest stock holdings at the end of the year and were among oil producers that reported better-than-expected earnings after an increase in oil and gas prices.

The fund's investments in financial stocks returned 4 percent, becoming the second-weakest sector in 2010. Financial stocks were somewhat held back by concern over the banking industry's ability to adapt to regulatory changes and new capital requirements set by the Basel Committee in September 2010. Uncertainty about government finances in European countries such as Spain, Greece, Portugal, Ireland and Italy, where the financial sector is the largest investor in government debt, also sparked concern that banks would have to write down the value of their government holdings. This helped increase banks' funding costs and put interest margins under pressure.

The fund's holdings of financial stocks in Europe returned -6.1 percent in 2010, measured in international currency. Investments in US and Asian financial shares returned 14.8 percent and 14 percent, respectively. Financial stocks accounted for more than 20 percent of the fund's equity investments, making it the largest of the fund's stock sectors, followed by industrials, consumer goods, oil and gas, and basic materials.

Regional performance

The fund's equity investments are distributed with about 50 percent in Europe, 35 percent in the Americas, Africa and Middle East and 15 percent in Asia and Oceania. Stock investments in Europe returned 8 percent in 2010, measured in international currency, while investments in the other two regions returned 19 percent each.

Concern over European sovereign debt and fears of slower economic growth in Europe following government spending cuts reduced investors' willingness to take risk in the region's stock market. A number of institutional investors increased investments in emerging economies such as Brazil, China, Russia, India and Mexico. The MSCI Emerging Markets Index, which tracks stock markets in about 20 emerging economies, rose 16.4 percent in 2010. By contrast, the Dow Jones Stoxx Europe 600 Index gained 8.6 percent and the S&P 500 Index in the US rose 12.8 percent in the year.

Investments in the US accounted for 30 percent of the fund's equity holdings at the end of 2010, the most in a single country, followed by the UK with 14.3 percent, France with 7 percent, Germany with 5.9 percent and Switzerland and Japan with 5.6 percent each. The fund also invests in some of the largest emerging economies and had 1.9 percent of its equity holdings in Brazil at the end of the year, followed by China with 1.7 percent, Russia with 1.6 percent and India with 1 percent.

Chart 4-1 Returns in equity markets, measured in US dollars. Indexed

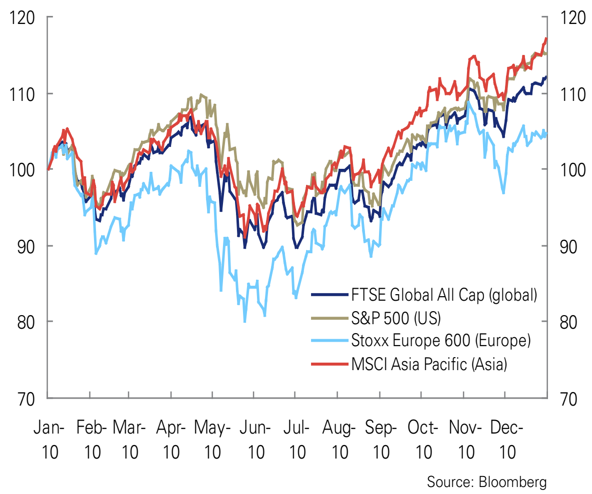


Table 4-1 Return on equity investments

	Return on fund's equity holdings (percent)	Return on benchmark (percent)	Relative return (percentage points)
1999	34.81	31.32	3.49
2000	-5.82	-6.31	0.49
2001	-14.60	-14.66	0.06
2002	-24.39	-24.47	0.07
2003	22.84	22.33	0.51
2004	13.00	12.21	0.79
2005	22.49	20.33	2.16
2006	17.04	17.13	-0.09
2007	6.82	5.67	1.15
2008	-40.71	-39.56	-1.15
2009	34.27	32.41	1.86
2010	13.34	12.61	0.73

Individual investments

The fund's best-performing stock investment, measured in krone returns, was in the food company Nestlé in 2010. This was followed by Apple and oil producer Royal Dutch Shell. The worst performers were Banco Santander of Spain, oil company BP and Banco Bilbao Vizcaya Argentaria of Spain.

Globally, listed companies raised about 600 billion dollars selling new shares in 2010, compared with about 650 billion dollars in 2009. The fund participated in the five largest share issues, which were in Brazilian oil producer Petróleo Brasileiro (Petrobras), Deutsche Bank, Agricultural Bank of China, car maker General Motors and AIA Group, a Hong Kong-listed insurer.

The purchase of 474.5 million dollars in shares of Petrobras, which issued a record 70 billion dollars in stock in September, was the fund's largest-ever investment in a share issue. The fund's biggest purchase of shares in a single company in 2010 was in US asset manager BlackRock. The fund increased its voting stock in the company from 0.3 percent at the start of the year to 7.5 percent, or 1.9 billion dollars, at the end of the year.

Excess return for equities

The fund owned shares in 8,496 listed companies in 58 countries at the end of 2010. These investments are measured against a global equity index compiled by FTSE Group and consisting of shares in 7,207 listed companies in 46 countries at the end of the year.

The return on the fund's equity investments was 0.7 percentage point higher than the benchmark index's return in 2010. About two-thirds of this excess return came from internally managed investments and the remainder from externally managed investments. The fund's investments in basic materials and financial stocks generally performed better than their respective sectors, while its holdings in technology stocks performed worse. In terms of countries, US and Spanish equities contributed most to the excess return, while equities in Hong Kong, South Africa and Australia made the greatest negative contribution.

Chart 4-3 Returns in different stock sectors, measured in US dollars. Indexed

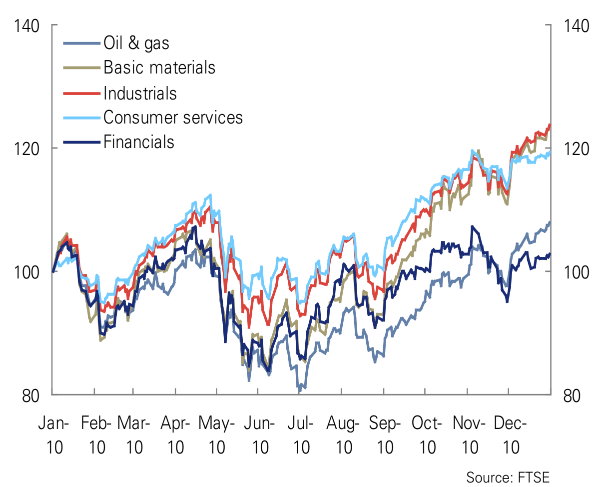


Chart 4-2 Volume of public offers, rights issues and entitlement offers at companies in the benchmark index. Billions of dollars

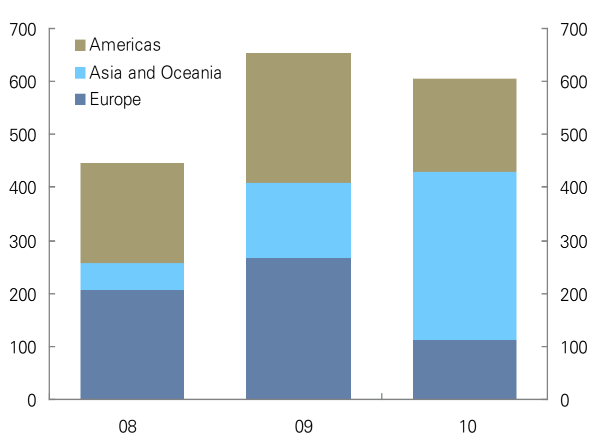


Table 4-2 Return on fund's equity holdings in 2010. By sector. Percent

Sector	Return in international currency	Percentage of equity holdings' market value
Basic materials	25.2	9.1
Industrials	22.2	13.7
Consumer goods	20.4	11.7
Consumer services	18.1	8.5
Technology	12.5	8.1
Telecommunications	10.4	4.5
Oil & gas	9.1	10.8
Healthcare	6.1	7.7
Financials	4.0	21.4
Utilities	-2.2	4.7

Our mission is to safeguard and build financial wealth for future generations

Fixed-income management

Increases in all sectors

The fund's fixed-income investments returned 4.1 percent in 2010, boosted by rising prices on government and corporate bonds.

Investments in all of the fund's fixed-income sectors gained in 2010. Central banks in the US, the UK and the euro area bought government debt and other bonds to lower interest rates, stimulate the economy and stabilise the markets. At the same time, uncertainty about government finances in some European countries and fears of an economic slowdown in Europe and the US caused substantial price fluctuations in fixed-income markets.

The yield that an investor demands for lending money through a bond will normally rise when the potential for default rises. Yields rose on government bonds from countries such as Greece, Ireland, Spain, Portugal and Italy in 2010, driven by uncertainty about these countries' ability to pay their debts. Yields climbed the most in Greece and Ireland, which both had to accept EU and IMF support packages in 2010. Ten-year Greek government bond yields rose to about 12.5 percent at the end of the year from 5.8 percent at the start of 2010, while Irish yields climbed to about 9 percent from 4.8 percent.

Concern over sovereign debt in some European countries increased demand for government bonds from nations such as Germany, the US and the UK, which were considered safer investments. Ten-year government bond yields in Germany, often used as a benchmark for European government debt, fell to about 3 percent from 3.4 percent.

Rising prices

The fund's government bond holdings returned 2.8 percent in 2010, measured in international currency, as rising prices of German, French, UK, US and Japanese bonds outweighed a drop in government bonds from some other European countries.

Investments in UK and US government debt returned 8.1 percent and 6.1 percent, respectively, measured in local currency, while euro-denominated and Japanese government bonds returned 1.8 percent and 2.7 percent, respectively. Government bonds accounted for slightly more than 40 percent of the fund's fixed-income holdings at the end of 2010.

The fund also holds bonds from government-related institutions such as the US mortgage agencies Fannie Mae and Freddie Mac, the European Investment Bank, the African Development Bank and the Export-Import Bank of China. Government-related bonds returned 1.9 percent in 2010 and accounted for about 13 percent of the fund's fixed-income investments at the end of the year.

Corporate bonds

The fund's corporate bond investments returned 6.5 percent in 2010, measured in international currency. Low yields on government bonds fuelled investors' interest in bonds with higher yields, including those sold by companies with low credit ratings. Issuance of high-yield bonds rose to about 367 billion dollars in 2010 from about 211

Chart 5-1 Price development of credit default insurance for government debt. Basis points

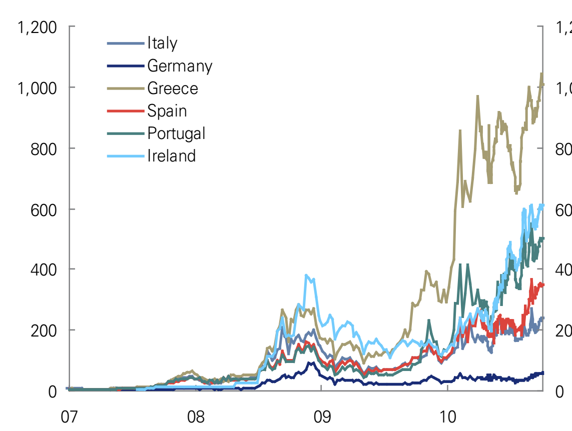


Table 5-1 Return on fixed-income investments

	Return on fund's fixed-income holdings (percent)	Return on benchmark (percent)	Relative return (percentage points)
1999	-0.99	-1.00	0.01
2000	8.41	8.34	0.07
2001	5.04	4.96	0.08
2002	9.90	9.41	0.49
2003	5.26	4.77	0.48
2004	6.10	5.73	0.37
2005	3.82	3.46	0.36
2006	1.93	1.68	0.25
2007	2.96	4.26	-1.29
2008	-0.54	6.06	-6.60
2009	12.49	5.13	7.36
2010	4.11	2.58	1.53

billion dollars in 2009, according to Bloomberg data. High-yield bonds accounted for about 12 percent of global corporate bond issuance in the year.

The fund benefitted in 2010 from rising prices for corporate debt issued by the financial sector, among others. Subordinated bank debt made a particular contribution to the return. Corporate bonds accounted for about 17 percent of the fund's fixed-income investments at the end of the year.

Securitised debt

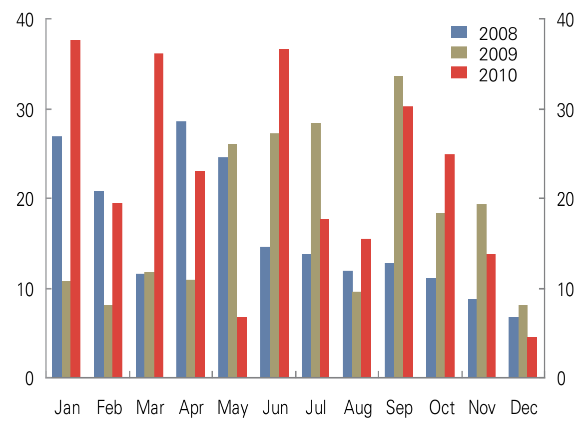
The fund's holdings of securitised debt in 2010 returned 0.6 percent, measured in international currency, making this the worst-performing fixed-income sector. These investments consisted mostly of European covered bonds, as well as US mortgage-backed securities.

Securitised debt consists of bank bonds secured against assets such as residential mortgages. Concern last year over government finances in some European countries led to uncertainty about banks' ability to raise funds in these countries. The spread, or difference in yield, between securitised debt from countries such as Spain, Portugal and Ireland and government bonds from the likes of Germany, France and the Netherlands widened significantly. By contrast, the spread to each country's own government bonds was little changed. The fund's return on securitised debt issued by countries such as Germany and France was higher than on the same type of bonds from Spain, Portugal and Ireland.

Issuance of securitised debt was high at times in 2010, as it was the only area of the fixed-income market where banks were able to issue debt for parts of the year. European covered bond issuance rose more than 20 percent to a record 266 billion euros in 2010.

The fund's covered bond holdings were worth about 197 billion kroner at the end of 2010. About 80 percent of

Chart 5-2 Issuance of European covered bonds. Billions of euros



Source: NBIM

these bonds were euro-denominated and returned 0.7 percent in the year, measured in local currency. Investments in US mortgage-backed securities were worth about 62 billion kroner and posted a return of 18.2 percent, measured in dollars. Securitised debt accounted for about 22 percent of the fund's fixed-income holdings at the end of the year.

Inflation-linked bonds

Investments in inflation-linked bonds returned 9.2 percent in international currency in 2010, making this the best-performing fixed-income sector. Monetary policy measures from central banks in the US, the UK and Europe fuelled inflation expectations and pushed up demand for the bonds, which protect investors against unexpected changes in inflation.

Yields on European and US inflation-linked bonds fell significantly in 2010. Ten-year inflation-linked bond yields declined almost 0.6 percentage point to below 0.5 percent in the UK. They fell about 0.35 percentage point to about 1 percent in Germany and slipped 0.5 percentage point to below 1 percent in the US. In an auction in October, US five-year inflation-linked bonds sold for the first time at a negative real yield, defined as the nominal yield less inflation. Inflation-linked bonds accounted for about 8 percent of the fund's fixed-income investments at the end of the year.

Chart 5-3 Returns in bond markets, measured in different currencies. Indexed

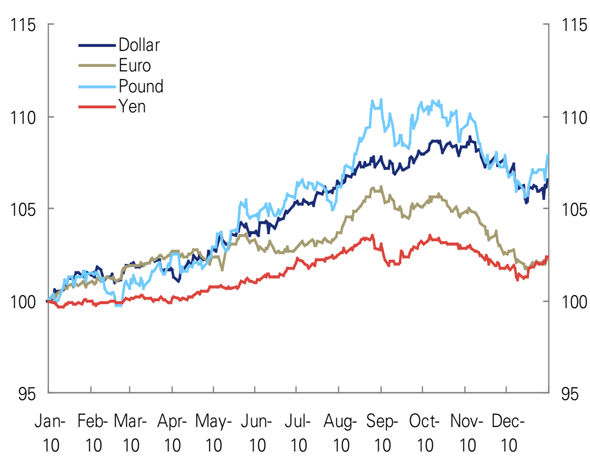
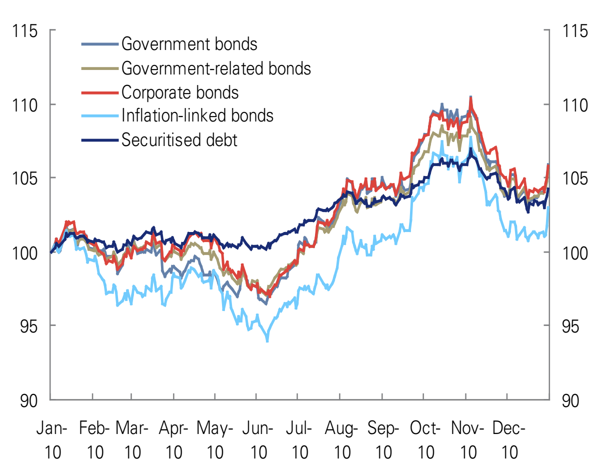


Chart 5-4 Returns in fixed-income sectors. Indexed. US dollars



Excess return for fixed income

At the end of 2010, the fund was invested in 8,659 bonds in 11 currencies. These investments are measured against a global fixed-income index from Barclays Capital, which consisted of 11,201 bonds in 11 currencies at the end of the year.

The return on the fund's fixed-income investments was 1.5 percentage points higher than the benchmark's return in 2010. About two-thirds of this excess return came from internally managed investments and the rest from external managers. The excess return was particularly helped by investments in US mortgage securities and European corporate bonds. The fund also benefitted from having smaller holdings of government debt from a number of countries in southern Europe than the benchmark index.

Table 5-2 Return on fund's fixed-income investments in 2010. By sector. Percent

Sector	Return in international currency	Percentage of fixed-income holdings' market value
Government bonds	2.8	40.5
Government-related bonds	1.9	12.9
Corporate bonds	6.5	16.5
Securitised debt	0.6	21.8
Inflation-linked bonds	9.2	8.3

The European sovereign debt crisis and the fund's holdings

Authorities around the world in 2009 countered the global financial crisis and economic slowdown with massive support packages, raising deficits and debt levels in many countries. Concern about several European countries' ability to pay their debt led to higher yields and lower prices for government bonds from these countries. The surge in yields was first seen in Greece in autumn 2009 and spread to include government bonds from Ireland, Portugal, Spain and Italy.

NBIM in 2009 more than halved the fund's holdings of government debt from these countries to 5.8 billion euros from 12.1 billion euros. The following year, NBIM increased the holdings of government debt from these countries to 10.9 billion euros at the end of 2010 after a significant drop in prices made this debt more attractive again. The fund's holdings in each country remained significantly lower than the benchmark index, with the exception of Greek debt which was removed from the benchmark in June after being downgraded by two of the three large credit rating agencies.

Chart 5-5 The fund's holdings of government debt in some European countries. Millions of euros

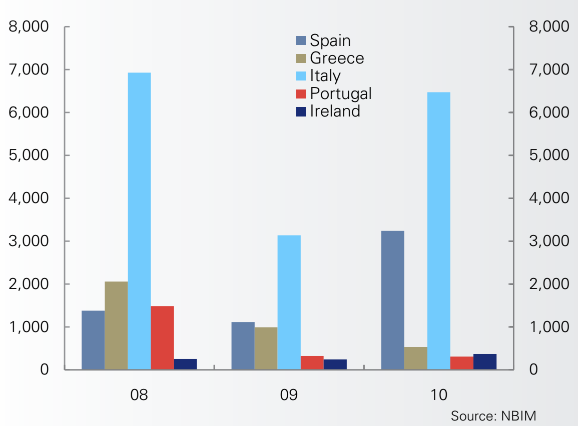
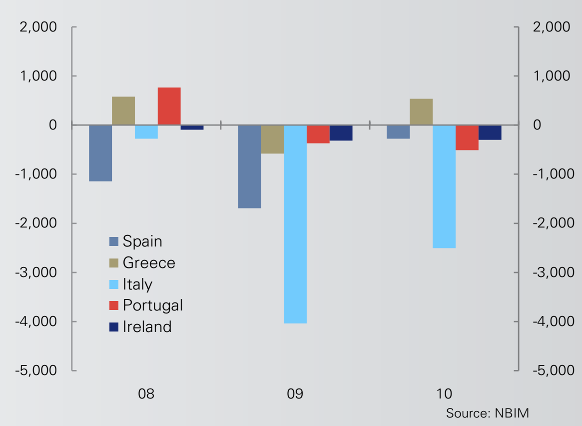


Chart 5-6 The fund's holdings of government debt in some European countries relative to the benchmark. Millions of euros



Real estate management

A new asset class

The fund announced its first investment in real estate in 2010. The move will help exploit the fund's long-term outlook and size.

The agreement to invest in The Crown Estate's portfolio of properties on Regent Street in London was announced on 4 November 2010, eight months after Norges Bank got a mandate to invest as much as 5 percent of the fund in real estate. Set to be completed in spring 2011, the 452 million-pound investment is the fund's first in this asset class.

NBIM's long-term goal is to build a portfolio of real estate investments in several countries that will yield good returns, while spreading investments and risk across new markets. We will focus on investments in well-developed markets and traditional property types, such as offices and retail premises. We will look for investments with partners that have overlapping interests and good knowledge of specific markets.

The investments will be compiled over a number of years. We will initially invest in the largest European real estate markets, such as the UK, France and Germany, before looking at other parts of the world. We will also recruit employees with real estate expertise at our offices in London, New York and Singapore.

Private real estate markets

The decision to include real estate as an investment area was an extension of the strategy to exploit the fund's long-term investment approach and considerable size. These characteristics make it possible to hold investments that may be difficult to sell at short notice but may yield good returns over time.

Investments in private real estate markets differ significantly from investments in listed stocks and bonds. Most of the properties that the fund will invest in are bought and sold in private markets with little or no publicly available information on pricing, unlike securities that trade on exchanges.

There are no standardised contracts for transactions in the real estate market. Each contract needs to be negotiated individually, resulting in higher transaction costs

The first real estate investment

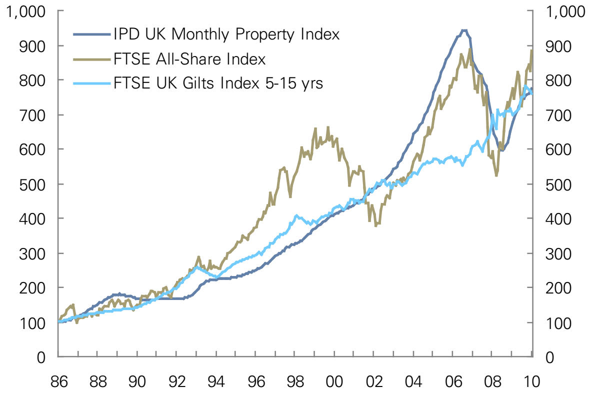
On 4 November 2010, NBIM announced an agreement to purchase a 150-year lease on 25 percent of The Crown Estate's portfolio of properties on Regent Street in London. The 452 million-pound investment (approximately 4.2 billion kroner) entitles the fund to 25 percent of the portfolio's net revenue, which stems mainly from letting retail and office premises. The Crown Estate will remain responsible for managing the portfolio, which consisted of 113 buildings across 39 blocks at the end of 2010. The properties are owned by The Crown Estate on behalf of the UK. Completion of the transaction was set for spring 2011.

than with trading of listed securities. Real estate is also less liquid than equities and fixed-income securities, which are generally traded daily. A property transaction will typically take months to complete.

Legal structures and tax

The investment risk associated with listed stocks and bonds is normally limited to the sum invested. To limit Norges Bank's potential liability, the fund's real estate investments will, as a rule, be made through subsidiaries of Norges Bank, as is standard market practice. The structure of these subsidiaries may vary from investment to investment and from country to country. NBIM will consider issues such as tax costs, complexity and operational factors before choosing a structure. We will also consider these issues before entering a new market or investment, looking at the effect they might have on the rest of the real estate portfolio and the fund's other investments.

Chart 6-1 Development over time in the UK property market (IPD), stock market (FTSE All-Share) and government-bond market (FTSE UK Gilts). Indexed



Source: IPD, FTSE

External management

An increasing number of specialist mandates

The fund awarded 14 new mandates in 2010 to external managers with expertise in a particular country or sector. Another 26 mandates were terminated, most of which were broad investment mandates.

NBIM uses external managers to handle parts of the fund's investments. We award investment mandates to organisations with expertise in clearly defined areas. These managers will seek to beat the markets they operate in and generate an excess return for the fund by using detailed and in-depth analysis of specific markets and companies. The fund's external mandates had an excess return of 2.8 percentage points in 2010, the tenth excess return in 12 years.

NBIM has over time increased the proportion of specialised country and sector mandates, particularly in small and medium-sized markets where having a local presence is an advantage. Of the 14 specialist mandates awarded in 2010, eight were in specific markets, including Greece, Spain, Italy and Sweden, and six were for specific sectors, such as environmental investments.

Nineteen of the 26 mandates ended in 2010 were held by large management organisations with broad product ranges.

The fund had 283 billion kroner in assets under external management at the end of 2010. That is equal to 9.2 percent of the fund's total market value, compared with 12 percent a year earlier. A total of 62 external mandates were managed by 45 different organisations, 59 of which were equity mandates.

External equity mandates

Externally managed equity mandates posted an excess return of 1.3 percentage points in 2010, helped largely by investments in Russia, Brazil and Japan, as well as mandates in the industrial and natural resources sectors. The external equity mandates had a market value of 258

These managers will seek to beat the markets they operate in and generate an excess return for the fund by using detailed and in-depth analysis of specific markets and companies

billion kroner at the end of 2010, equal to 13.7 percent of the fund's total equity investments.

NBIM awards external equity mandates in markets and segments where it is not expedient to build internal expertise. Many of the external mandates are in market segments where the potential to generate an excess return is considerable. This particularly applies to small and medium-sized companies and emerging markets.

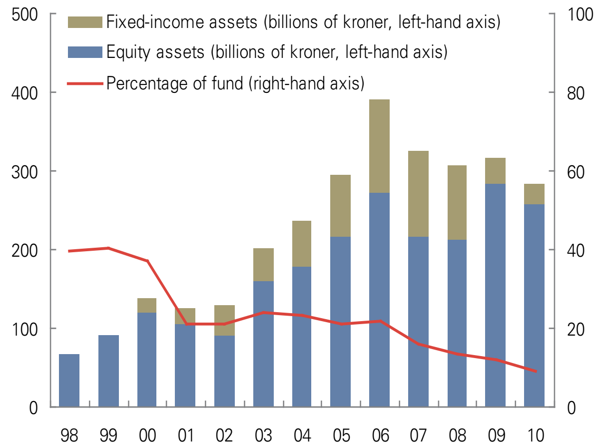
NBIM will award mandates in the geographical area where a manager is based or in an industry where a manager has particular expertise. Managers seek to generate an excess return through fundamental analysis of individual companies within a focused and concentrated investment mandate. Managers apply considerable analytical capacity to a limited number of equities in their specialist field.

External fixed-income mandates

Externally managed fixed-income mandates had a market value of 25 billion kroner at the end of 2010, equal to 2.1 percent of the fund's total fixed-income investments. External fixed-income management has been scaled back and restructured in recent years. All of the external fixed-income mandates that were awarded before the financial crisis and had losses in 2007 and 2008 were terminated by the end of 2010. NBIM had three fixed-income mandates with one external manager at the end of the year. These mandates, which were mainly for investments in US mortgage-backed securities, had an excess return of 20.1 percentage points in 2010.

More information on external management can be found in the feature on pages 54–57 of this report.

Chart 7-1 Assets under external management, measured in billions of kroner and as a percentage of the fund at year-end

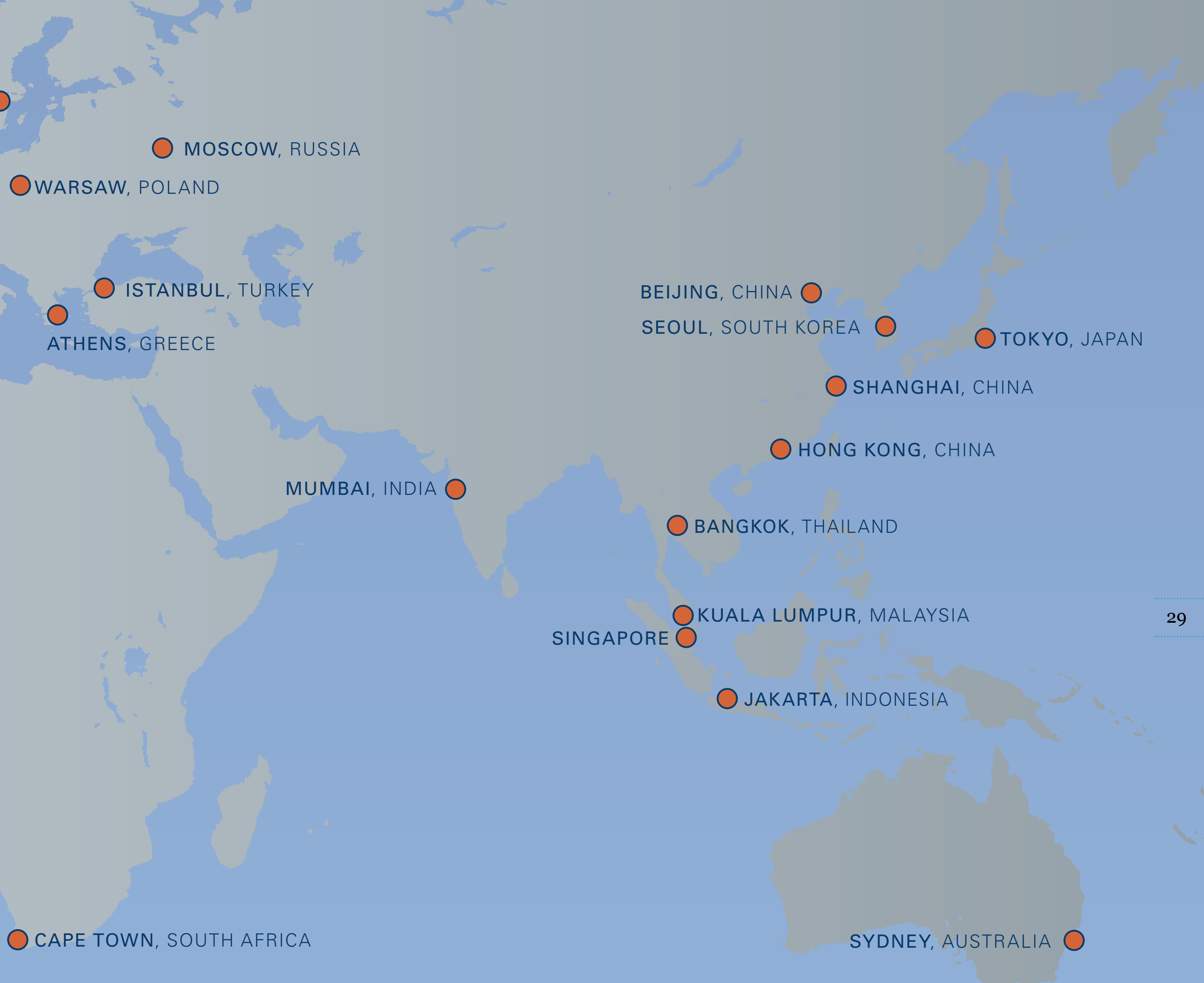


Source: NBIM

External equity managers as of 31 December 2010

Abax Investments
AEW Capital Management
Atlantis Fund Management
Ayudhya Fund Management
Bestinver Gestion
Black River Asset Management
BlackRock
BNY Mellon Asset Management
BPH TFI
Capital International Limited
Cephei Capital Management
Ecofin
Ellerston Capital
GAM International Management
HSBC (Hellas) AEDAK
Kairos Partners
Keywise Capital Management
Lannebo Fonder
Lazard Asset Management
Levin Capital Strategies
Marsico Capital Management
Martin Currie Investment Management
NWQ Investment Management
Old Mutual Investment Group
Passport Capital
Pheim Asset Management
PRIMECAP Management
Prosperity Capital Management

NBIM has over time increased the proportion of specialised country and sector mandates, particularly in small and medium-sized markets where having a local presence is an advantage.



Quantum Advisors Private Limited
RHB Investment Management
Rheos Capital Works
Savitr Capital
Scheer, Rowlett & Associates
Schroder Investment Management
Sectoral Asset Management
SPARX Asset Management
Squadra Investments
State Street Global Advisors
T Rowe Price
Templeton Asset Management
Thames River Capital
Toscafund Asset Management
Troika Dialog
Victoire Brasil Investimentos
Water Asset Management

External fixed-income managers as of 31 December 2010
BlackRock

Higher risk in the fixed-income market

Growing concern about European sovereign debt and fears of an economic downturn in Europe and the US caused substantial price swings in the markets in 2010.

The large market fluctuations in recent years have underlined the necessity of having a broad platform of measurements, procedures and systems to monitor and manage risk. NBIM focuses on three main types of investment risk: market, credit and counterparty. We have established frameworks in each category for how risk is to be measured, checked and managed.

Market risk is determined by the composition of the fund's investments and will be influenced by movements in share prices, exchange rates, interest rates and credit risk premiums. No single measure can fully capture the fund's market risk, so we use a number of different measures, including expected tracking error, factor exposure, concentration analysis and liquidity risk.

Chart 8-1 Expected absolute volatility for the fund. Percent and billions of kroner

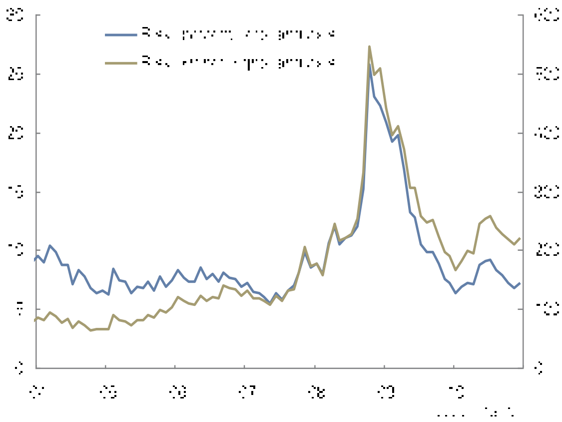
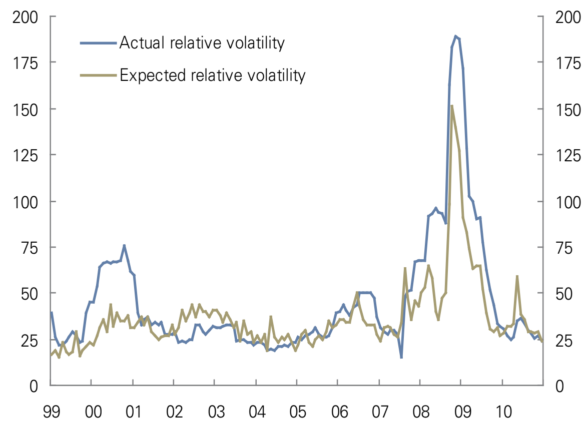


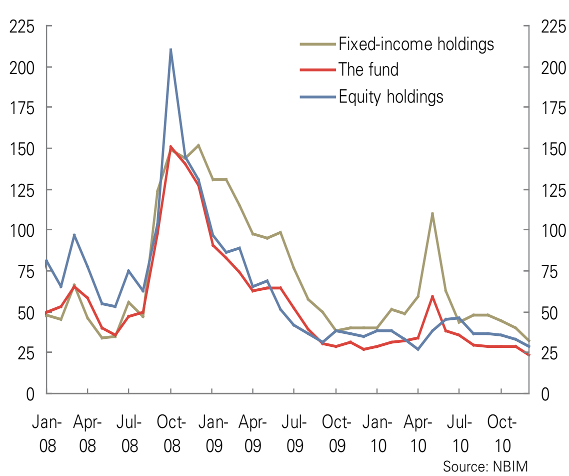
Chart 8-2 Expected and actual relative volatility for the fund. Basis points



Source: NBIM

Volatility in capital markets
Volatility in stock and bond markets increased in the first half of 2010, driven by uncertainty about European government debt, funding challenges for banks and fears of an economic slowdown, particularly in Europe. The iTraxx Europe index, which measures risk in the European fixed-income market, nearly doubled from 0.8 percent at the beginning of the year to a year-high of 1.4 percent in June. The VIX index, a measure of expected volatility in the US stock market, rose from 21.7 percent at the beginning of the year to a high of 45.6 percent in May.

Chart 8-3 Expected relative volatility for the fund. Basis points



VIX index

The VIX index measures expected volatility in stock prices in the US market over the next 30 days. The index is calculated by the Chicago Board Options Exchange using prices for a range of call and put options on the S&P 500 stock index.

The VIX index rises when volatility in the stock market is expected to increase. The index was at about 10–15 percent before the start of the financial turmoil in summer 2007 and rose to about 80 percent after the collapse of Lehman Brothers triggered large price drops and uncertainty in global stock markets in autumn 2008. The index stood at 17.8 percent at the end of 2010.

iTraxx index

The iTraxx index measures the price of insurance for investments in the European bond market. The index typically rises when investor confidence decreases and insurance needs increase. There are several iTraxx indices. One of the most widely used is iTraxx Europe, which consists of 125 European investment-grade companies (credit rating at least BBB-) and shows the average equally-weighted credit insurance premium for these companies. The index was at about 0.3 percent before the start of the financial turmoil in summer 2007 and climbed to 2.2 percent in autumn 2008. It was at 1.05 percent at the end of 2010.

The introduction in May of loan packages for euro-area countries with payment problems and better-than-expected earnings figures from many companies helped reduce volatility in stock markets in the second half of the year. The VIX index ended the year down 3.9 percentage points at 17.8 percent, while the iTraxx Europe index was at 1.05 percent, 0.3 percentage point higher than at the start of the year.

Fluctuations in fund value

The Ministry of Finance has set limits for how much the fund may deviate from its benchmark indices. One important limit is expressed as expected tracking error (relative volatility), which puts a ceiling on how much the return on the fund can be expected to deviate from the return on the benchmark indices. Expected tracking error should not have exceeded 1.5 percentage points in 2010. From 1 January 2011, the limit has been lowered to 1 percentage point.

At the end of 2010, the fund's expected tracking error was 0.24 percentage point, compared with 0.27 percentage point at the start of the year. The highest level for the year was 0.6 percentage point in May.

Expected absolute volatility, measured by the statistical concept standard deviation, uses historical price movements to estimate how much the fund's annual return may be expected to vary. The fund's expected absolute volatility fluctuated between 6 percent and 9 percent in 2010. It ended the year at about 7 percent, or approximately 200 billion kroner, the same as at the beginning of the year.

Factor exposures

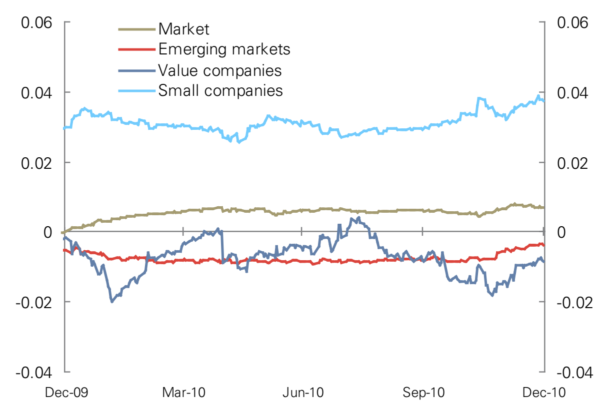
NBIM also measures the fund's exposure to systematic risk factors such as small companies, value stocks and bonds with credit premiums. These are common characteristics that most securities have to varying degrees and that contribute to both the risk and the return on different investments. The fund's exposure to these factors can be analysed by comparing the excess return on the fund with the return on these factors.

An analysis of factor exposures in 2010 indicated, among other things, that the fund's equity investments were more exposed than the benchmark to small companies and less exposed than the benchmark to companies in emerging markets. The analysis also indicated that the fund's fixed-income investments were less exposed than the benchmark to bonds with long maturity and somewhat more exposed than the benchmark to bonds with credit premiums.

The results of such statistical analyses are uncertain and the analysis does not adequately explain what drove the excess return on fixed-income investments in 2010. NBIM also uses several other approaches to analyse the fund's factor exposures.

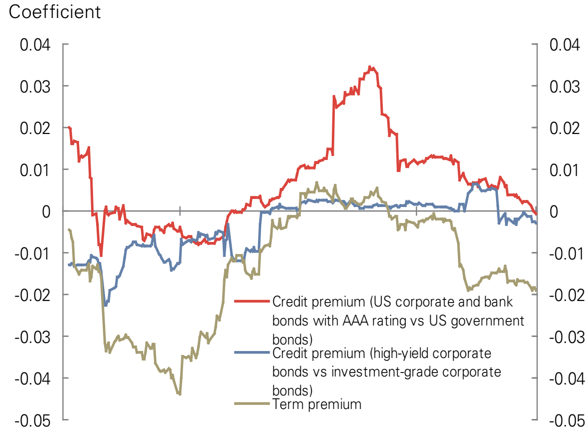
For further information on the fund's investment risk, see Note 12 on pages 79–84 in the financial reporting section.

Chart 8-4 Factor exposure for the fund's equity investments. Coefficient



Source: NBIM

Chart 8-5 Factor exposure for the fund's fixed-income investments. Coefficient



Source: NBIM

Table 8-1 Fixed-income holdings as of 31 December 2010 based on credit ratings*. Percentage of holdings

	Aaa	Aa	A	Baa	Higher risk
Government bonds	31.19	8.75	0.56	0.73	0.35
Government-related bonds	7.76	3.04	0.59	0.44	0.04
Inflation-linked bonds	4.67	3.53	0.00	0.00	0.04
Corporate bonds	0.33	3.64	6.60	5.57	0.39
Securitised debt	16.58	3.27	0.28	0.15	1.49
Total bonds and fixed-income securities	**60.53**	**22.23**	**8.03**	**6.90**	**2.31**

*Based on credit ratings from at least one of the following agencies: Moody's, Standard & Poor's and Fitch.

Table 8-2 Key figures for risk and exposure as of 31 December 2010. Percent and percentage points

Risk	Limits	Actual			
		31 Dec. 2010	30 Sep. 2010	30 Jun. 2010	31 Mar. 2010
Market risk	Tracking error max. 1.5 percentage points	0.24	0.29	0.38	0.32
Asset mix	Equities 50–70%	61.5	60.4	59.6	62.6
	Fixed income 30–50%	38.5	39.6	40.4	37.4
	Real estate 0–5%*	0.0	-	-	-
Market distribution, equities	Europe 40–60%	48.0	49.0	47.2	48.5
	Americas and Africa 25–45%	36.5	35.8	37.1	36.5
	Asia and Oceania 5–25%	15.5	15.2	15.7	15.0
Currency distribution, fixed income	Europe 50–70%	59.4	60.0	56.3	57.7
	America 25–45%	35.3	34.5	37.8	36.6
	Asia and Oceania 0–15%	5.3	5.5	6.0	5.6
Ownership	Max. 10% of a listed company	9.1	9.0	8.8	8.4

*As of 1 March 2010

Revised method for calculating expected tracking error

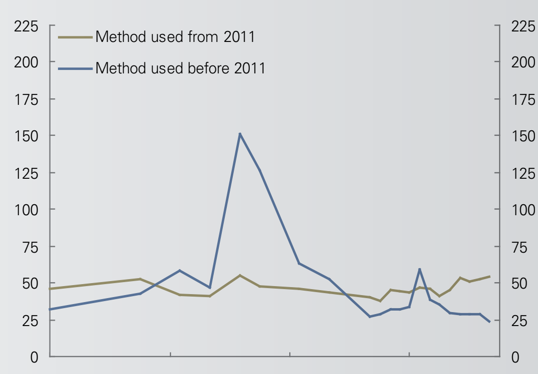
Expected fluctuations in the fund's value are measured with the help of a statistical measure called expected tracking error (relative volatility). From 1 January 2011, the method for calculating expected tracking error has been revised to make it better suited to the fund's long-term investment perspective.

Until the end of 2010, tracking error was calculated using daily historical price observations in equity and fixed-income markets, with observations over the latest days being given greater weight than observations further back in time. This meant that short-term changes in market conditions had a rapid and marked effect on the fund's expected tracking error. The new method calculates volatility using weekly prices and a three-year price history, making it less sensitive to general market turbulence. As a result, changes in expected tracking error will result more from changes in the fund's investments and less from market volatility.

Chart 8-6 shows the fund's expected tracking error with the method used until 1 January 2011 and the method used from 1 January 2011. The chart shows that short-term changes in market conditions rapidly impacted tracking error using the old method, while tracking error is more stable with the new method. The new method also generally gives higher figures for expected tracking error than the old method. This is because market fluctuations during the financial crisis are still part of the source data, while observations from the financial crisis are no longer an important part of the source data under the old method.

The change will potentially reduce the probability of unfavourable adjustments in the fund's management, such as selling assets at bad times. The new method will also better reflect the fund's long-term outlook, simplify interpretation and communication of the risk measurement and give us more knowledge about which investments impact the risk measurement.

Chart 8-6 Expected tracking error for the fund, measured with two different methods. Basis points



Source: NBIM

Our investments

Investments in 69 countries

The fund entered several new markets and announced its first real estate investment in 2010.

The fund's long-term outlook and size make it natural to spread its investments across a wide range of sectors, countries and regions. The fund owned 1 percent, on average, of the world's listed equities at the end of 2010, little changed from a year earlier.

The fund's equity investments are divided with about 50 percent in Europe, 35 percent in the Americas, Africa and Middle East and 15 percent in Asia and Oceania. The average holding in listed European companies rose to 1.85 percent at the end 2010 from 1.78 percent a year earlier. The average stake in the other two regions was unchanged at 0.7 percent each.

The fund's fixed-income investments are split with about 60 percent in Europe, 35 percent in the Americas, Africa and Middle East and 5 percent in Asia and Oceania. The fund held an average 0.56 percent of the world's listed bonds in 2010, up from 0.51 percent in 2009. The holdings were higher in Europe than in the two other regions. The ownership figures are based on the market capitalisation of the FTSE All Cap equity index and the Barclays Global Aggregate and Barclays Global Inflation Linked bond indices.

The fund's benchmark indices

The fund is measured against benchmark indices for equities, fixed income and real estate compiled by the FTSE Group, Barclays Capital and Investment Property Databank (IPD), respectively. These indices consist of a wide range of stocks, bonds and properties in different countries and currencies.

The fund does not necessarily invest in all the countries or currencies in the benchmark indices. Operational factors such as unsatisfactory settlement systems or capital regulations may entail a risk that some investments may be insufficiently safe or impossible to sell. On the other hand, the fund is also invested in markets and securities that are not included in the benchmark indices. For example, the fund was still invested in Greek government bonds at the end of the year even though they were removed from the benchmark index in June.

At the end of 2010, the fund was invested in securities registered in 69 countries. The fund's investments shall be in recognised and regulated marketplaces. The United Arab Emirates was added to the list of countries

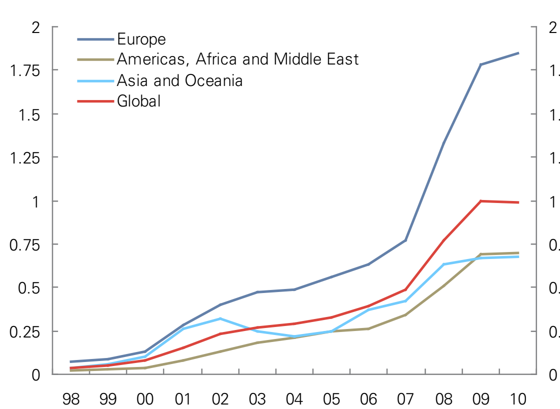
Asset class breakdown per region
Fixed income Equities

with approved marketplaces in 2010 and a total of 45 countries were on the list at the end of the year.

More equity investments

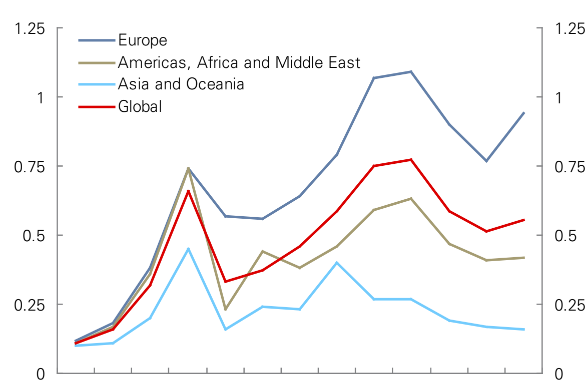
The fund was invested in 8,496 companies at the end of 2010, up from 8,335 companies a year earlier. The investments include large, medium-sized and small listed companies in developed and emerging markets. Investments in emerging markets have increased after more of these markets were added to the benchmark equity index in 2008. NBIM awarded new external equity mandates in emerging markets such as Russia and Brazil in 2010, as well as the fund's first external equity mandates in Sweden, Spain, Italy and Greece.

Chart 9-1 The fund's average holdings in equity markets. Percent of FTSE All Cap Index's market capitalisation



Source: FTSE, NBIM

Chart 9-2 The fund's average holdings in fixed-income markets. Percent of Barclays Global Inflation Linked and Barclays Global Aggregate indices



Source: Barclays Capital, NBIM

The fund's bond holdings consisted of 8,659 securities from 1,686 issuers at the end of 2010, compared with 9,163 securities from 1,954 issuers a year earlier. The investments were issued in 11 currencies and consisted of government bonds, inflation-linked bonds, corporate bonds, securitised debt and bonds issued by public institutions such as regional administrations and government corporations. A total of 95 percent of these holdings were bonds issued in euros, dollars, pounds sterling and yen.

NBIM announced the fund's first real estate investment in November, with completion set for spring 2011.

Chart 9-3 Breakdown by asset class. Percent of the fund

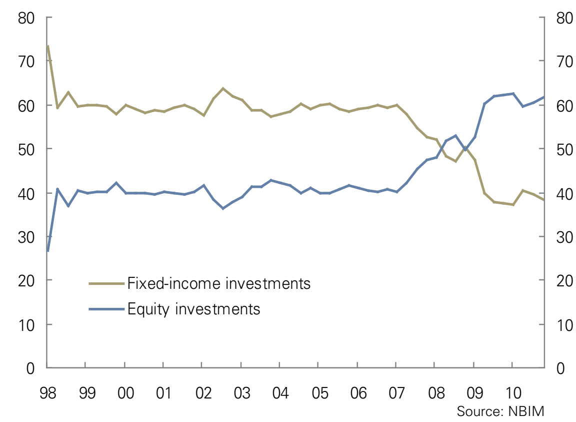


Table 9-1 The fund's largest holdings by country as of 31 December 2010. Percent

Country	Total	Equities	Fixed income
US	28.7	18.0	10.7
UK	14.7	8.6	6.0
Germany	7.7	3.5	4.2
France	7.7	4.2	3.5
Japan	5.2	3.4	1.8
Spain	4.6	1.4	3.2
Switzerland	3.8	3.4	0.4
Italy	3.5	1.2	2.3
Canada	2.8	1.9	0.9
The Netherlands	2.6	1.2	1.4

Table 9-2 The fund's largest currency holdings as of 31 December 2010. Percent.

Currency	Total	Equities	Fixed income
USD	32.8	19.6	13.2
EUR	32.1	13.8	18.3
GBP	12.8	8.2	4.6
JPY	5.1	3.4	1.8
CHF	3.5	3.3	0.2
CAD	2.6	1.7	0.9
SEK	1.8	1.4	0.4
HKD	1.6	1.6	0.0
AUD	1.3	1.2	0.2
BRL	1.0	1.0	0.0

Chart 9-4 Regional breakdown of the fund's equity investments as of 31 December 2010. Percent

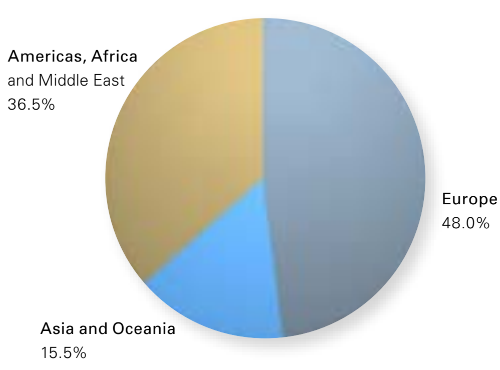
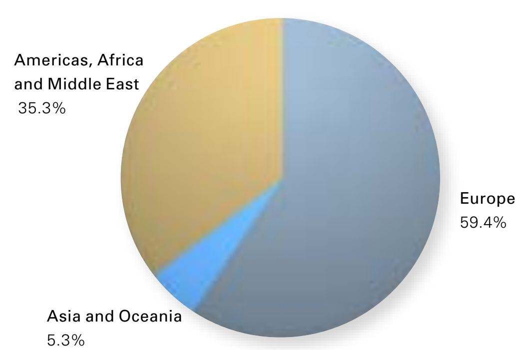
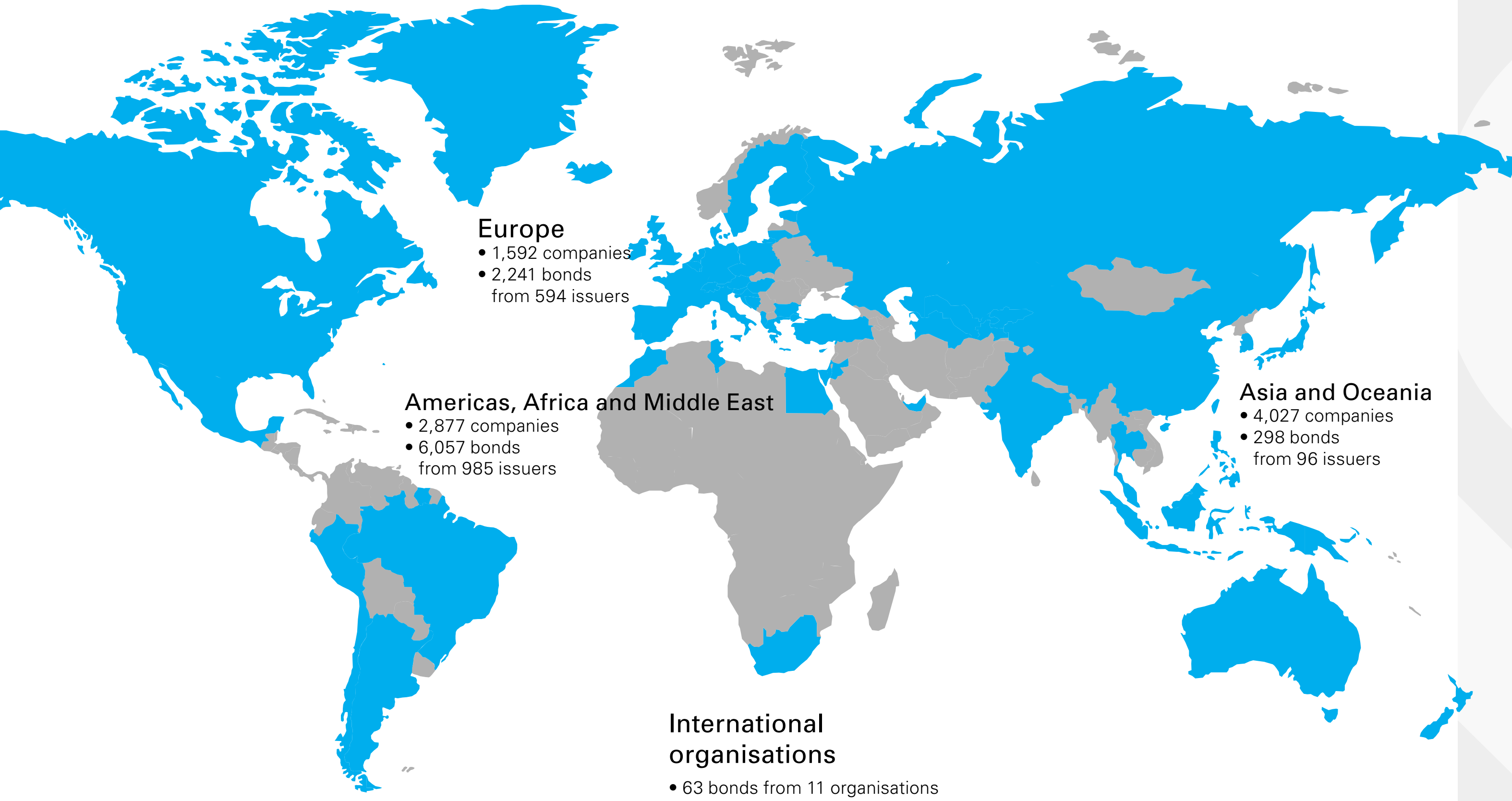


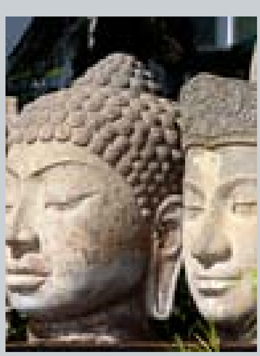
Chart 9-5 Regional breakdown of the fund's fixed-income investments as of 31 December 2010. Percent





Singapore

- Accounted for 0.4 percent of the fund's investments
- These were in 93 companies and bonds from 7 issuers
- Key industries: Electronics, chemicals, financial services, oil drilling equipment, oil refining, rubber products, ship repair, biosciences



United Arab Emirates

- Accounted for 0.05 percent of the fund's investments
- These were in 18 companies and bonds from 6 issuers
- Key industries: Oil and gas, petrochemicals, fisheries, aluminium, fertilisers, ship repair, building materials

Individual positions

Larger stakes in more companies

The number of companies where the fund's holdings exceeded 2 percent increased to 512 in 2010, more than doubling in two years.

The fund's largest shareholding in an individual company was in oil producer Royal Dutch Shell at the end of 2010. The 1.8 percent stake had a market value of 21.4 billion kroner. Four of the fund's ten largest stockholdings were in oil and gas companies.

The Ministry of Finance has decided that the fund may own as much as 10 percent of a listed company. The fund's largest percentage holding in a company was 9.1 percent of China Water Affairs Group at the end of 2010. The fund had a stake of more than 5 percent in a total of 17 companies at the end of the year, up from 6 a year earlier and 4 at the end of 2008. The number of companies where the fund's holding was higher than 2 percent rose to 512 at the end of 2010, from 342 in 2009 and 195 in 2008.

The fund is a financial investor without political or strategic motives. At the same time, holdings of 1–2 percent frequently put the fund among the top 20 shareholders in large companies where ownership is widely distributed. This gives the fund's portfolio managers and ownership department access to a company's management and board. As a minority shareholder, the fund also depends on other investors to push through demands to the board or management of a company. Equal treatment of shareholders is an important focus area.

Governments are the largest bond issuers and the fund will normally have substantial holdings of government debt. The US, the UK, Germany, Japan, France, Italy and Spain were the issuers of the fund's seven biggest bond holdings at the end of 2010, followed by Fannie Mae, the European Investment Bank and Bank of Scotland. Large public and semi-public institutions and a variety of supranational organisations are often also among the largest debt issuers. Companies generally borrow less in the bond market, particularly outside the US.

Table 10-1 The fund's largest equity holdings as of 31 December 2010

Company	Country	Holdings in millions of kroner
Royal Dutch Shell PLC	UK	21,403
Nestlé SA	Switzerland	21,285
HSBC Holdings PLC	UK	21,152
BP PLC	UK	15,938
Vodafone Group PLC	UK	15,215
Novartis AG	Switzerland	13,823
Apple Inc	US	12,282
Exxon Mobil Corp	US	11,942
Siemens AG	Germany	11,708
Total SA	France	11,582

Table 10-2 The fund's largest bond holdings as of 31 December 2010

Issuer	Country	Holdings in millions of kroner
United States of America	US	164,627
UK government	UK	98,581
Federal Republic of Germany	Germany	73,609
Italian Republic	Italy	58,461
Japanese government	Japan	54,991
French Republic	France	52,345
Spanish government	Spain	25,361
Fannie Mae	US	22,828
European Investment Bank	Supranational	22,273
Bank of Scotland PLC	UK	17,996

More environmental mandates

NBIM has since 2009 awarded mandates to internal and external managers with a particular focus on environmental investments. These mandates are subject to the same profitability requirements as the fund's other investments. They also tie in well with the fund's role as a responsible investor, which includes safeguarding long-term financial returns through sustainable economic, environmental and social development.

The number of environmental mandates increased to nine at the end of 2010 from four a year earlier. The assets under management rose to 25.7 billion kroner from 7.3 billion kroner.

Three of the mandates were for investments in water management. Such investments may be in companies that develop technology for improving water quality or infrastructure for treating and distributing water. Another three mandates were for investments in environmental technology that may help improve energy consumption or limit harmful emissions. The final three mandates were for investments in clean energy, such as companies that produce renewable energy or develop equipment for producing renewable energy.

All of the mandates awarded in 2010 went to external managers and seven of nine mandates were managed externally at the end of the year. The externally managed assets totalled 11.2 billion kroner, while internally managed assets amounted to 14.5 billion kroner.

A top ten shareholder

It is difficult to obtain precise figures for how high the fund ranks as a shareholder in all companies, partly because share registers are updated at different times and some are not official. Practices for consolidating share classes and shareholders also vary.

NBIM has looked at the fund's 1,000 largest shareholdings at the end of 2010. Subject to the above reservations, we estimate that the fund was among the top ten shareholders in about 370 of the companies and among the top 20 shareholders in about 650 companies. The highest holdings were in Europe, where more than half of the fund was invested at the end of 2010.

Table 10-3 The fund's largest ownership interests as of 31 December 2010. Percent

Company	Country	Interest
China Water Affairs Group Ltd	Hong Kong	9.1
IVRCL Infrastructures & Projects Ltd	India	7.7
BlackRock Inc	US	7.5
Telecity Group PLC	UK	7.3
UPM-Kymmene OYJ	Finland	7.3
Kloeckner & Co SE	Germany	7.0
Smurfit Kappa Group PLC	Ireland	6.7
Pioneer Corp	Japan	6.2
CSR PLC	UK	5.9
Sinclair Pharma PLC	UK	5.8

China Water Affairs Group

- Invests in, builds and operates water-related projects in China
- Listed in Hong Kong
- Revenue of 627 million Hong Kong dollars in the six months ended 30 September 2010

Siemens

- German energy, industrial and healthcare company with about 405,000 employees
- Revenue of 76 billion euros in the year ended 30 September 2010
- Presence in about 190 countries

Active ownership

Six strategic focus areas

NBIM exercises active ownership to safeguard financial wealth for future generations. We promote shareholder rights and encourage better social and environmental standards at companies.

As a long-term investor in about 8,500 companies, NBIM seeks to improve standards of corporate governance. Good corporate governance paves the way for profitable business, safeguards shareholder rights and ensures an equitable distribution of profits. We also encourage companies to take responsibility for improving social and environmental practices that may have a negative impact on their development and, consequently, the fund's long-term investments. Our ownership activities have six strategic focus areas:

- equal treatment of shareholders
- shareholder rights and board accountability
- well-functioning financial markets
- children's rights
- climate change
- water management

We use a variety of tools to promote our interests, including dialogue with companies, investors, authorities and other standard-setters in the market. We vote at general meetings, file shareholder proposals, participate in consultations and publish documents communicating our expectations. The companies we invest in are expected to comply with internationally recognised corporate governance standards.

Equal treatment of shareholders

We sought to protect our rights as a shareholder in 2010 when companies failed to meet our requirements for transparency around transactions and when NBIM and other minority shareholders were discriminated against.

In July, NBIM and some German investors together asked a court in Germany to review whether the board of Porsche had operated outside its remit and brought excessive risk to the company's minority shareholders in its attempt to take full control of Volkswagen in the period 2005–2009. A review could reveal whether the families controlling Porsche had different goals than the company's other shareholders when the takeover strategy was set. It is important to NBIM, both financially and as a matter of principle, to establish good corporate governance so that controlling shareholders cannot enrich themselves at the expense of other shareholders.

We also worked to protect our rights as a minority shareholder in companies seeking to increase their share capital. We sought to protect minority shareholders from dilution by defending their pre-emptive rights in new

share issues. We also used a shareholder's right to block new issues to prevent transactions that could be unprofitable or give particular advantages to a company's management or selected shareholders.

Board accountability

NBIM strives to prevent the same person from being both chairman and chief executive officer of a company. A company's board should help set long-term strategy and promote value creation while supervising activities and risk levels at the company. The board should also appoint and dismiss the company's management when necessary. The board must be independent of management to adequately supervise it.

NBIM in 2010 filed shareholder proposals in favour of independent chairmen at five US companies. None of the proposals won a majority of the vote at the companies' general meetings, but four garnered more support than a year earlier when we first filed such proposals.

Well-functioning markets

NBIM works with investors, authorities and other market participants to promote business practices that will contribute to well-functioning markets and safeguard the fund's long-term investments. We participated in a number of consultations in 2010 on revisions of rules and standards. Our recommendations included taking measures to strengthen shareholder rights, increase shareholder influence and ensure that companies disclose adequate information in their reporting. For example, we asked the European Commission in August to require that member states' disclosure rules encompass cash-settled derivatives. This will increase transparency around acquisitions and prevent such derivatives from being used to circumvent the disclosure obligations that apply to purchases of large shareholdings.

The Hong Kong exchange introduced new rules in June requiring companies that extract mineral resources to report on environmental, health and safety risks, as encouraged by NBIM the previous year. The Brazilian exchange set new rules in September prohibiting the same person from serving as both CEO and chairman of a company, in line with NBIM's consultation response in 2009. The UK Corporate Governance Code was revised in May to require directors to be re-elected annually rather than every three years. This was also in line with a recommendation from NBIM.

NBIM began work during the year on a document setting out our expectations for how legitimate and effective financial markets should function. Among other things, we will look at issues concerning companies' transparency and reporting. Other topics, such as openness about pricing, predictability, equal treatment and effective settlement systems, may also be considered.

How NBIM votes at companies

NBIM aims to vote at all the general shareholder meetings at the companies the fund invests in. Voting is carried out with the help of an electronic voting platform at a third party that votes on our behalf, following our instructions and guidelines.

We identify potentially important and company-specific circumstances that may call for a more detailed analysis of the agenda for a company's general meeting. Such factors may be proposals filed by other shareholders, discrepancies between the board's recommendations and our guidelines, the size of our investment in a company, the company's results, the company's ranking on various corporate governance factors and whether we have an active dialogue with the company that has increased our insight into its operations and management.

NBIM uses the electronic voting platform of Institutional Shareholder Services (ISS). ISS sends our voting instructions to our global custodian bank J.P.Morgan, which organises voting at the general meetings, often with the help of local custodian banks or other representatives. We also buy services from specialists that analyse companies and items on the general meeting agendas. Combined with internal analyses, this forms the basis for our voting.

Chart 11-1 Resolutions where NBIM voted for or against a board's recommendation in 2010. Percent

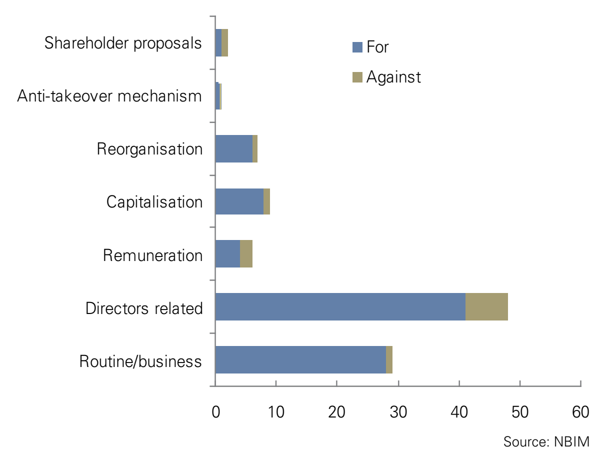


Table 11-1 Voting

	2010			2009		
Region	**Number of meetings**	**Meetings where NBIM voted**	**Share**	**Number of meetings**	**Meetings where NBIM voted**	**Share**
Americas	2,999	2,987	99.6 %	3,120	3,067	98.3 %
Europe	2,103	1,614	76.7 %	2,258	1,456	64.5 %
Asia/Oceania	6,416	6,347	98.9 %	5,843	5,572	95.4 %
Total	**11,518**	**10,948**	**95.1 %**	**11,221**	**10,095**	**90.0 %**

Responsible investment

NBIM's overall objective is to safeguard financial wealth for future generations. A good long-term return depends on sustainable economic, environmental and social development in the countries and companies that the fund invests in. As a responsible investor, NBIM seeks to deliver a good long-term return and foster the values held by the fund's owners.

The fund's management involves ethical challenges that must be addressed judiciously and ambitiously. NBIM complies with guidelines set by the Ministry of Finance as well as internationally recognised principles for responsible investment. We have signed the UN's Principles for Responsible Investment and our active ownership is based on the UN's Global Compact and the OECD's Principles of Corporate Governance and Guidelines for Multinational Enterprises.

The obligation to foster the values held by the fund's owners is fulfilled by exercising ownership rights and excluding companies from the fund's investment universe. NBIM has high hopes and expectations for what active ownership can achieve. At the same time, we see that the results seldom emerge in the short term and that active ownership is a long-term effort. Decisions to exclude companies are taken by the Ministry of Finance based on advice from the Council on Ethics, which operates independently of NBIM.

NBIM aims to promote responsible investment in the fund's management. Among other things, we analyse environmental and social risks in the companies and markets that we invest in. These analyses can reveal conditions that we will seek to change through dialogue with a company's management or voting at a shareholder meeting. Analyses of this kind are carried out and used across NBIM's departments. Analysts in the active ownership team and portfolio managers will share information, including their experiences from meetings with companies.

We have since 2009 awarded investment mandates with a special focus on environmental investments. These are held to the same profitability requirements as the fund's other investments.

Legal action as a means of safeguarding the fund's interests

NBIM has in a very few instances taken direct legal action against a company to safeguard the fund's interests. In September 2010, NBIM filed an individual claim on behalf of Norges Bank against Citigroup and selected members of its former and current management. We contend that Citigroup gave the market misleading accounting information about its investments from January 2007 to January 2009. As the company's true exposure became known, its share price fell, resulting in substantial losses for investors such as Norges Bank. A class action has also been brought against Citigroup which largely corresponds to our action, but we believe that our interests are better served by a direct action. It may be several years before the matter is resolved.

NBIM has also previously taken direct legal action as a shareholder on behalf of Norges Bank. In 2010, the bank was party to direct actions against media company Vivendi and pharmaceutical company Merck and various former members of these companies' management. The action against Vivendi was filed in 2007 and seeks damages for losses as a result of the company giving the market misleading accounting information about the company and its subsidiaries in the period 2000–2002. The action against Merck & Co was also filed in 2007 and seeks damages for losses as a result of the company withholding information about possible serious consequences of using the company's most important product, Vioxx, in the period 2001–2004.

In addition to direct legal actions, Norges Bank as a shareholder participates in various class actions in the US each year against companies in which the fund is invested. In 2010, NBIM filed claims in around 50 different cases, including one in the Netherlands, and received more than 7.7 million dollars as a result of previous claims.

Active ownership

Focusing on children, climate change and water

NBIM seeks to ensure that companies manage risks connected with children's rights, climate change and water scarcity to mitigate potential adverse affects on their businesses and, consequently, our investments.

Our NBIM Investor Expectations documents outline how we expect companies to manage these risks. Using publicly available information, we annually and systematically assess the extent to which companies meet our expectations. The results are published in annual compliance reports and are used in dialogue with companies that we have identified as exposed to high social or environmental risk. We regularly meet with Norwegian and international experts and non-governmental organisations to develop our knowledge on these issues.

Children's rights

NBIM expects companies to prevent the worst forms of child labour and promote children's rights in both their own operations and their supply chains. We have identified the agriculture (hybrid seed and cocoa), mining, apparel retail, technology hardware and equipment, steel, and toy industries as having high exposure to these risks.

Based on our 2009 compliance report we initiated dialogues with 80 companies regarding their performance on children's rights issues. In a 2010 reassessment, 29 percent of these companies had improved reporting on how they address children's rights. In particular, there was an increase in publically disclosed child labour policies and more transparency in addressing child labor in the supply chain.

We had dialogues with companies in the seed, apparel retail and mining sectors. We have seen progress in addressing child labour issues in the supply chain and in the social auditing practices by many companies, particularly apparel companies.

In 2008, NBIM and a large European investor started dialogues with some of the world's largest cocoa suppliers and chocolate producers on the risk of child labour in West Africa. In the fall of 2010, these companies were among those that launched a child labour action plan and a partnership between the industry, the US Labor Department and the governments of Ghana and the Ivory Coast.

Climate change risk management

NBIM expects companies to manage risk from the causes and impacts of climate change. In December 2010, we issued a new version of NBIM Investor Expectations on climate change risk management to reflect an increased focus on climate change in compa-

nies' business strategies, practices and risk management systems. We also placed greater emphasis on governance structures and how company boards need to integrate climate change in their broader risk mitigation. Key expectations still include improved performance reporting and the disclosure by companies of measures taken to manage the risks associated with climate change.

Based on the findings in the assessment for 2009, we corresponded with 40 companies on climate change risk. In a follow up in 2010, we found indications that 18 companies slightly improved their compliance with NBIM's expectations, while the disclosure of 10 worsened.

Water management
Water scarcity is a growing risk for many companies. In our first assessment of compliance with NBIM Investor Expectations on water management, we in 2010 examined 431 companies in the mining and industrial metals, forestry and paper, food and beverage, electricity and multi-utilities, water utilities and pharmaceuticals industries. We found that 44 percent reported on their water management, use of water and associated risks, indicating that such issues are of concern to companies. Only 9 percent of the companies reported on how they manage water in their supply chain.

NBIM became lead sponsor of the CDP Water Disclosure in 2009, an initiative aimed at increasing the availability and quality of information on how companies manage water. The first report, CDP Water Disclosure 2010 Global Report, was issued last year based on water-related data from the world's largest corporations. The key finding from this report is that respondents have a good overall awareness of water risks and water usage within their own operations, but much less knowledge of their supply chain This concurs with the findings from our assessment. The information collected by CDP Water Disclosure is one source of information we use for assessing companies.

NBIM

278

25

278 employees from 25 nations

NBIM

Developing global expertise

NBIM opened an office in Singapore in 2010 and recruited 29 employees from 11 countries. The fund's growth in recent years has increased the need for a global presence and specialist expertise.

Being present in the markets the fund invests in gives NBIM better access to investment opportunities and a broader recruitment base. It also ensures that we have employees looking after the fund's investments around the clock. The opening of the Singapore office in June 2010 brought us closer to important growth markets in Asia and supplemented our offices in Shanghai, London, New York and Oslo.

The number of permanent employees at NBIM increased to 278 during the year, 32 percent of whom were non-Norwegian nationals. An ever broader investment mandate has boosted the need for resources in recent years, not least international expertise and specialisation. Some 22 percent of our workforce was employed abroad in 2010.

Our employees must have a global perspective to manage the fund's investments. For example, a portfolio manager with expertise in a particular sector must look for global investments in that sector. We move employees between our offices to foster this experience.

NBIM's goal is to deliver the highest possible return within the bounds of our mandate. We rely on dedicated and highly qualified employees and seek to strengthen competency in the organisation by giving specialists, experts and managers good development opportunities. We last year set up the NBIM Academy, which offers training to our employees. We also started a four-year trainee programme for graduates seeking to pursue a career in international investment management.

Remuneration system in 2010

Pay and personnel policy is a means for NBIM to achieve its strategic goals. The Executive Board sets limits for the remuneration system, which is based on a fixed salary and a performance-based component. We carefully monitor market developments in remuneration and

Table 12-1 Compensation to senior management at NBIM in 2010

Position	Name	Paid salary	Value of other benefits	Accumulated pension benefits	Employee loan
Chief Executive Officer	Yngve Slyngstad	4,181,678	27,929	345,792	905,944
Deputy CEO (until 1 Oct. 2010)	Stephen Hirsch	5,306,396	145,181	769,502	0
Chief Risk Officer	Trond Grande	2,681,654	26,723	241,591	0
Chief Operating Officer	Age Bakker	2,384,688	20,192	299,660	0
Chief Compliance Officer	Jan Thomsen	2,766,665	66,594	259,640	0
Chief Strategic Relations Officer	Dag Dyrdal	2,165,563	35,746	302,746	0
Chief Treasurer	Jessica Irschick	4,903,500	13,319	490,350	0
Chief Administrative Officer	Mark Clemens	2,237,125	29,609	239,701	260,000
Chief Investment Officer	Bengt Ove Enge	4,526,286	20,690	202,939	81,336

More information on pension and loan arrangements is available in Norges Bank's annual report for 2010, note 10.

remuneration systems to stay competitive.

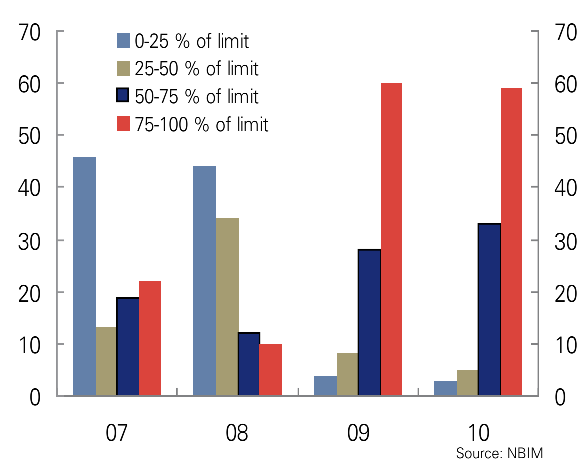
Performance-based pay is calculated by looking at results achieved relative to set targets. Employees who make investment decisions are assessed quantitatively based on returns. The performance-based pay component was a substantial part of their salaries in 2010. Members of NBIM's senior management receive a fixed salary with no performance-based component.

NBIM's investment departments had 96 employees with performance-based pay in 2010. Their fixed salaries totalled 91.5 million kroner. The total upper limit for their performance-based pay was 155.2 million kroner. On average, these employees received 64 percent of the upper limit in 2010.

The other departments had 146 employees with performance-based pay in 2010. Their fixed salaries totalled 100.6 million kroner. Their total upper limit for performance-based pay was 35.4 million kroner. On average, these employees received 78 percent of the upper limit in 2010.

NBIM's total performance-based pay was 67 percent of the upper limit for 2010. This limit was 6.4 percent lower compared with 2009. The average payment per employee was 25 percent lower than in 2009.

Chart 12-1 Performance-based pay relative to upper limit. Percentage of workforce



Hege works with internal strategic development. She joined NBIM in 2004.

«NBIM has given me development opportunities and many challenging assignments. It's an exciting and international environment with skilled and likeable colleagues.»

Emil is a trader. He has been with NBIM since 2005.

«As a trader at NBIM, I get to go beyond financial theory and make decisions that have an impact. We participate in most of the world's stock markets, so every day I am challenged, stimulated and inspired by working in this international environment.»

Gavin is part of the active ownership team and joined NBIM in 2009.

«I chose NBIM because of its clear mandate to integrate corporate governance, environmental and social issues with investment activities. Combined with the fund's size and long-term outlook, this makes it the world's preeminent fund for effective active ownership.»

Birgitte started as a trainee at NBIM in autumn 2010.

«I joined NBIM because I wanted to learn about global asset management in an organisation that emphasises professionalism and being a responsible investor. The trainee programme offers great exposure to different areas of NBIM, as well as the opportunity to work and study abroad.»

Operational risk management

Reduced risk in many areas

NBIM continuously strives to improve processes to prevent unwanted events. Few of the unwanted events in 2010 had financial consequences and we lowered risk in many areas of the organisation.

NBIM identifies unwanted events systematically and strives to improve processes to prevent such events from occurring. We define potential unwanted events as risk factors and take steps to lower the risk after assessing the cost of an event relative to the benefit of taking action. We also register unwanted events that have occurred and take action to prevent them from reoccurring. Reporting and following up on these incidents is an important part of our continuous efforts to improve NBIM's processes and risk management.

The Executive Board sets principles for operational risk management and internal control at NBIM. In 2010, the board decided that there should be less than 20 percent probability that operational risk factors would result in gains and losses totalling 500 million kroner or more for NBIM over a 12-month period. This limit is referred to as the board's tolerance for operational risk at NBIM.

Unwanted events in 2010

NBIM registered 320 unwanted events in 2010. Most of these had no financial consequences, either because they were discovered early enough to prevent gains or losses, or because they only had potential consequences for NBIM's reputation. The estimated total financial impact of these incidents was 38 million kroner, breaking down into losses of 24 million kroner and gains of 14 million kroner. This level is well within the Executive Board's risk tolerance limit.

Technical faults accounted for 38 percent of unwanted events at NBIM in 2010. Some of the most important processes at NBIM, such as the allocation of funds, the purchase and sale of assets and the reporting and control of investment results, depend on complex technological systems. Several of the most important systems were affected by temporary outages in 2010. These mainly led to brief operational disruptions and to a lesser extent caused financial losses. We worked on reducing the complexity and increasing the standardisation of NBIM's IT solutions in 2010.

A total of 30 percent of unwanted events in 2010 were due to errors in our processes, routines and procedures. Few of the events in this category were related to our core investment management activities.

Shortcomings on the part of our suppliers and in our relations with suppliers caused 16 percent of unwanted events in 2010. NBIM outsources services in areas such as IT operations, custody, settlement, equity and fixed-income management, as well as voting administration. In 2010, our suppliers of voting services voted incorrectly on NBIM's behalf at 228 out of a total of 10,948 general meetings, and an incorrect vote was cast on 502 out of a total of 93,011 resolutions. To prevent such errors from being repeated, we reviewed the processes, systems and contracts at both NBIM and our suppliers and made changes.

Mistakes by NBIM's employees caused 13 percent of unwanted events in 2010. For example, fewer than one in a thousand trades in the investment operation were executed on the basis of incorrect instructions in 2010. Most cases were quickly picked up by controls in NBIM's systems and few of these events led to losses.

NBIM also takes account of risks associated with external factors such as natural disasters and terrorism. Risks in this category are generally unlikely to materialise but may have serious consequences if they do. Events of this kind are covered by NBIM's contingency plans and risk levels in this area were considered moderate in 2010.

Breaches of guidelines

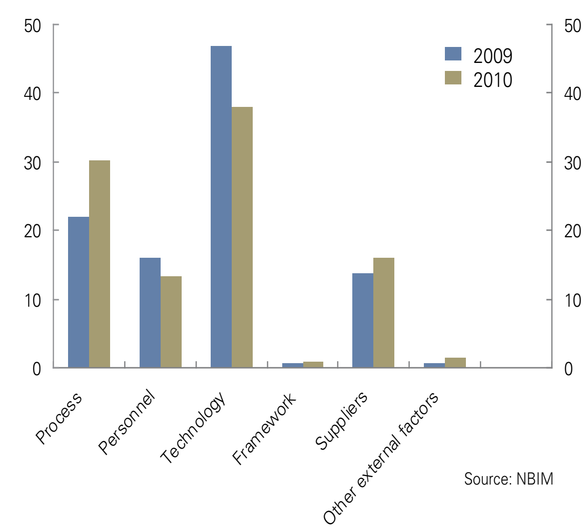
The Ministry of Finance has set extensive guidelines for the fund's management. There were five minor breaches of these guidelines in 2010. All of the breaches occurred when NBIM by mistake came to possess securities from companies excluded from the fund's investment universe. In three cases, NBIM accepted such securities as collateral for other securities lent out. In the other two cases, purchases were made of such securities. All of these errors were quickly detected and corrected.

More information on NBIM's operational risk management can be found in the feature on pages 58–61.

Chart 13-1 Unwanted events at NBIM in 2010. Thousands of kroner and number of incidents

Source: NBIM

Chart 13-2 Unwanted events at NBIM, sorted by cause. Percent



Source: NBIM

External management of the fund

About 10 percent of the Government Pension Fund Global was managed externally at the end of 2010. External mandates were mainly in specific industrial sectors or geographical markets requiring levels of expertise and local knowledge that currently is not practical for NBIM to develop in-house. Experience of this type of external management has been positive to date.

Many of today's specialised mandates are in individual emerging markets. NBIM's experience is that managers who are based where a company is established and listed have a better understanding of, and better access to, information about the company. Local managers have greater opportunities to visit the company and meet its management. At the same time, the fund has an upper limit on ownership of a company of 10 percent and will always be a minority shareholder. This role is a particular challenge in emerging markets, which have a shorter history of well-functioning capital markets. NBIM has therefore identified local managers in these markets who we consider to be skilled investors with high ethical standards. Locally based managers are well placed to look after our interests and will help reduce the risk in our investments.

Among the equity mandates specialising in specific industrial sectors, healthcare is the most important area. Here, managers look for companies at the cutting edge of developments and many of the investments are in small companies in biotechnology or technical equipment. Our external healthcare managers are currently heavily invested in companies developing new medicines for cancer, which requires considerable expertise in medical research. Another area is new technology for renewable energy and water management. Although we are building internal expertise in this area, we also need the skills of external managers. We need to know what we are investing in and we need insight and expertise to find the right companies.

Fundamental requirements for external managers

NBIM has a number of requirements that a management company must meet to be awarded a mandate on behalf of the fund. These requirements are set out in our guidelines for external management.

Ethical and legal footing

The manager must be licensed to operate in a country with adequate regulation and supervision of the financial sector. The manager must have satisfactory ethical rules for its operations, good delegation of responsibilities between departments and an appropriate internal organisation.

All of those applying for a mandate must undergo extensive vetting by NBIM personnel. This includes multiple site visits to the company's offices before and after signing the agreement, a review of large volumes of documentation and the retrieval of information from public sources. In addition, NBIM has hired a global accountancy firm to perform independent evaluations of managers' background, reputation and integrity.

If we find that an external manager's affairs are not in accordance with the mandate or NBIM's expectations, action is taken. In serious cases the mandate will be terminated. NBIM's standard external management agreement forms the basis for all agreements with external managers. In any situation where NBIM deems it necessary, the agreement can be terminated the same day and the entire portfolio transferred immediately to our internal management.

Operational framework

NBIM's close monitoring of external managers requires them to be well organised with a good operational framework. External managers have to invest in Norges Bank's name. They are authorised only to make use of securities and bank accounts administered by Norges Bank's own custodian. All trades must be registered and all holdings are verified daily.

This monitoring gives NBIM a complete picture of all positions at all times. We can continuously analyse transactions and exposure to specific stocks, sectors and risk factors. The data are also used to analyse the factors behind returns and to check whether managers have remained within their allotted mandate and investment universe.

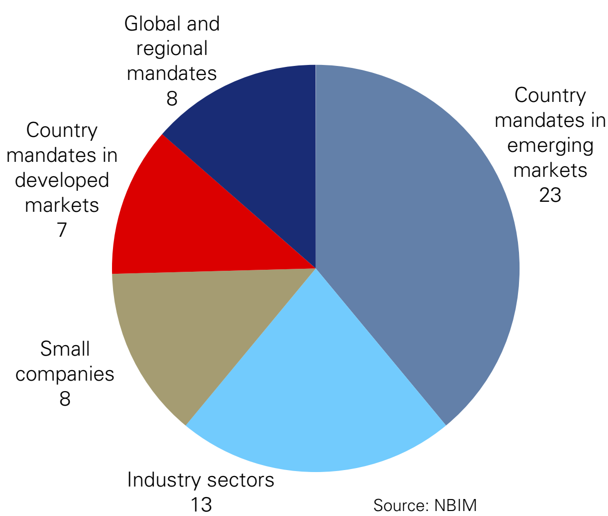
Specialist managers

NBIM believes that an in-depth understanding of companies' underlying operations is required to create real value through active investment decisions.

NBIM applies a number of criteria when choosing external managers for specialised mandates. First and foremost, we look for organisations that specialise in the specific segments where we need managers. It is essential that the organisation has both analysts and portfolio managers whose main focus is on the strategy in question. It is through thorough and independent collection and analysis of information that managers can create an informational advantage.

Much of the information about a company can only be understood by a manager based in the local market in which the company is established and listed. Local managers have greater opportunities to visit the company and meet its management, which can help build a deeper understanding of the company.

Chart 14-1 External equity mandates per strategy in 2010



The process of choosing an external manager

Choosing a manager is a process that consists of information-gathering, analysis, meetings and assessments. The process normally takes six to eight months from the first meeting between NBIM and the manager to the decision to award a mandate.

Before NBIM embarks on this process, information about the relevant market is analysed. NBIM uses a number of independent sources, such as market participants, observers and databases, to identify relevant candidates for the mandate.

To be considered, a manager must complete a questionnaire with information on ownership structure, assets under management, investment process, personnel and portfolio composition. It is normally NBIM that initiates contact with the manager and invites it to apply. The initial investigations form the basis for deciding which managers NBIM meets. We usually meet 20 to 30 different managers in these initial phases. All of the meetings are held on the management company's premises, as this provides information about local conditions and makes it possible to meet everyone who influences investment decisions portfolio managers, analysts, risk managers, employees in operational functions and executives.

A limited number of managers are then selected for a more detailed process where we ask for further information about their organisation and obtain detailed historical data on their portfolios and performance. Through repeated meetings with the manager, we aim to build a fuller picture of its portfolio managers' and the organisation's competence.

The final decision on the choice of manager is based on an expectation of its ability to create value over time. Key elements in this assessment are the depth of the manager's knowledge of the companies in its portfolio, the information sources used and how its company analyses and opinions differ from those of its competitors. Analyses of the portfolio's performance over time and discussions with the manager's employees about individual companies are the most important factors in the final decision.

Experience with external management
NBIM's experience with having external managers manage parts of the equity portfolio has been very positive. The excess return from external managers has made a stable, positive contribution to the fund's overall excess return. Through to 2010, the total contribution from external equity management to the fund's overall excess return was 22.4 billion kroner, while fees to these managers over the same period came to 6.9 billion kroner.

A detailed understanding of equity investments' underlying operations is very important for the fund. It is therefore important to have external specialists in the geographical areas, market segments and industrial sectors where it is not currently practical for NBIM to build in-house expertise.

The strategy adopted for external fixed-income management has differed from that for equity management. The negative excess return on external fixed-income mandates has been due primarily to exposure to market segments, while the positive excess return on equity mandates has been due to investments in selected companies. Experience with external fixed-income mandates has been much less positive than on the equity side and the fund's external fixed-income management has now been largely phased out. External fixed-income management was discussed in detail in the 2008 and 2009 annual reports.

The fund scaled back its externally managed fixed-income mandates from 128 billion kroner in 2007 to 25 billion kroner in 2010. The remaining fixed-income mandates were retained and contributed a return of 5.8 billion kroner in 2010. In addition, the fund has retained a substantial proportion of the positions originally purchased by external managers. These contributed to the fund's strong performance in 2009 and 2010.

Chart 14-2 External equity management. Exess return and fees. Millions of kroner

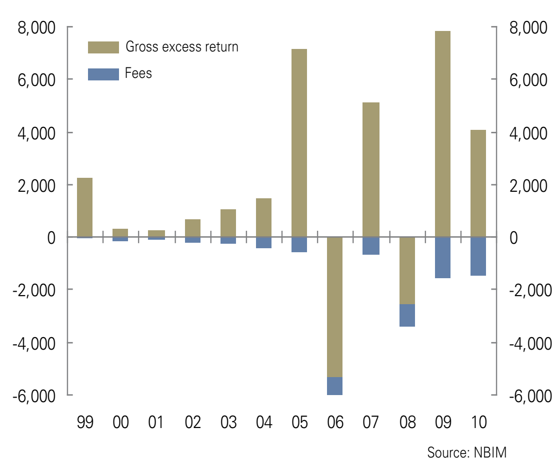


Chart 14-3 External fixed-income management. Excess return and fees. Millions of kroner

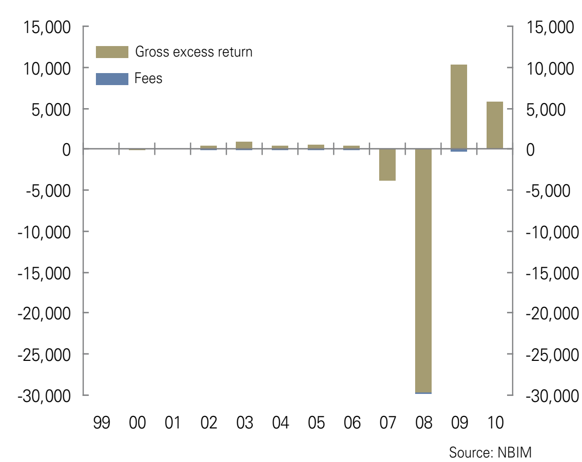


Table 14-1 Excess return and fees for external equity managers. Millions of kroner

External equity management	Gross excess return	Fees
2010	4,103	1,432
Since inception	22,438	6,864

Table 14-2 Excess return and fees for external fixed-income managers. Millions of kroner

External fixed-income management	Gross excess return	Feesr
2010	5,824	6
Since inception	-14,728	1,011

Fees

Over the past two years, NBIM has introduced a new fee structure to further impress its long-term investment approach upon external managers. Fees to external managers consist primarily of two components: a base fee and a performance-based fee. All mandates awarded since the end of 2009 employ the new structure.

In principle, the base fee is intended to cover the costs associated with the specific mandate and is generally well below the market standard for the mandate.

To achieve its long-term goal for the management of the fund, NBIM makes extensive use of performance-based fees for external management. These fees are calculated on the basis of the difference between the return on the mandate on the one hand and the return on a comparable index plus a set percentage and the base fee on the other hand.

Under the new structure, managers will be paid only a certain percentage of the fees accrued during the first five years. The longer the mandate has been active, the higher the percentage paid out. This system of retaining parts of the fee helps align managers' incentives with the fund's objective, which is to achieve a long-term real return by taking moderate risk.

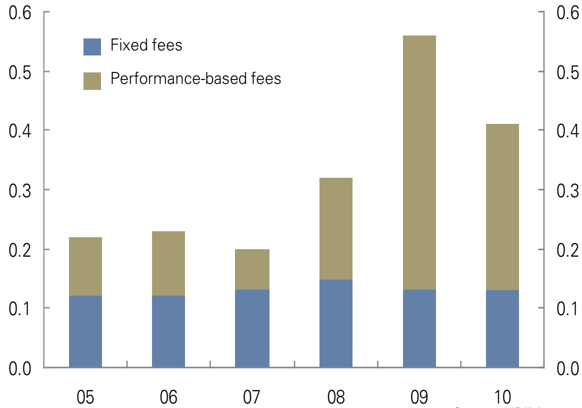
The new structure also means that the performance-based fee is linked to the whole history of the mandate. If a manager has a period with returns lower than the benchmark, it must earn back all of this underperformance before performance-based fees begin to accrue again. Even over many years, the total fees paid for a mandate will therefore not normally be higher than a fixed percentage of the excess return generated by that mandate.

In some cases, the fees paid out in a single year have been substantial. The two highest annual fees ever paid to an external management company both came in 2009, at 530 million kroner and 170 million kroner, respectively. During the course of 2009, a ceiling was introduced for annual fees in all external management agreements. Any fee accrued above this ceiling may be paid out at a later date, but only if the mandate retains a positive excess return since inception. In this way, the agreement furthers the mandate's long-term incentives even after the return reaches the ceiling. Following these changes, fees in a single year will in future not hit the record levels of 2009.

Management agreements are entered into with the aim of keeping total fees as low as possible, given the objective of an excess return. How far NBIM is willing to stretch when negotiating fees depends on an assessment of the manager's ability to generate excess return over time. As a large, recognised long-term investor, NBIM normally has a strong hand when negotiating with external managers. Competition for many managers' capacity is fierce, however, and not all managers are willing to accept NBIM's terms.

As a large proportion of external management fees depend on excess return generated, total management costs will normally be higher in years of good performance. Specialised management mandates will also require more resources and somewhat higher fees. In recent years, NBIM has increased the proportion of specialised mandates and has also reported good results. Costs for external active equity management are nevertheless low compared with the market for equivalent mandates.

Chart 14-4 Fees to external managers as a proportion of externally managed funds. Percent



Source: NBIM

Operational risk management at NBIM

Operational risk management at NBIM is about systematically identifying what may go wrong, assessing how wrong it may go, working to reduce the likelihood of it going wrong and minimising the consequences if it does.

In 2010, Norges Bank's Executive Board set a tolerance level for operational risk at NBIM: there must be less than 20 percent probability that unwanted events will have financial consequences of 500 million kroner or more over the course of a year.

Operational risk is defined as the risk of financial or reputational losses due to failures in internal processes, human error or system error, or other losses due to external factors that are not a consequence of the fund's market risk. Operational risk management is about identifying risk factors that may result in losses and estimating the probability and consequences of potential unwanted events.

Norges Bank's Executive Board sets principles for risk management at NBIM based on the requirements and expectations of the Norwegian parliament and the Ministry of Finance. The size of the fund means that even seemingly small and insignificant events can have major financial consequences. In line with good business practice and applicable legislation, NBIM has established a framework for operational risk management and internal control. This framework includes mechanisms for management and control, processes, skills and awareness, as well as effective tools.

What is operational risk management?
Operational risk management encompasses everything NBIM does. In every part of the organisation, we look systematically at what may go wrong (risk) and how wrong it may go (risk level), trying to lower the risk as far as practically possible (risk reduction). If something does go wrong (unwanted incident), as it will from time to time, we try to limit the consequences as far as we can (impact reduction). We view risk management as an integral part of general operational management, where risks and the associated risk levels are taken into account when decisions are made.

Take the execution of equity trades as an example. A portfolio manager decides what we should invest in. A trader ensures that the trade is executed in the best way possible. Support functions make sure that the transaction is completed correctly and at the right time, ensuring that we get what we have paid for and that our holding data are updated to reflect the trade. This process is repeated several thousand times a month at NBIM.

These are well-defined processes with a generally low level of risk, but there is still a lot that may go wrong. Are we sure that the portfolio manager is trading within his or her mandate? What happens if the trader misunderstands the message from the portfolio manager? What if someone accidentally enters the wrong values into the systems? What if someone internally or externally tries to defraud us? What if the systems fail to work as they should? What kind of internal control do we need in place to ensure that this chain of activities is carried out as robustly as possible? We can never achieve zero risk, so what level is acceptable?

The challenge for operational risk management is to answer these and similar questions and to establish a systematic approach to identifying what may go wrong and finding the right countermeasures throughout the organisation. At the same time, risk needs to be considered in light of the cost of risk-reducing measures.
The tolerance level set by the Executive Board means that the total financial impact of all unwanted events at NBIM in a normal year should be well below 500 million kroner. This is a gross limit that includes gains and losses. An example of a gain following an unwanted event might be when a portfolio manager buys an equity outside his or her mandate and its price subsequently rises. When the position is reversed, this will result in a gain for the fund. While profitable, this is nonetheless an unwanted event.

The total financial consequences of unwanted events are expected to average 200–300 million kroner a year, equal to about 0.01 percent of assets under management at the end of 2010.

Identification of risk
Our efforts to identify, assess and reduce operational risk is the core of operational risk management and internal control at NBIM. We look at operational risk related to strategies and action plans as well as ongoing processes.

Strategies and action plans lead to change that impacts risk levels positively or negatively. We consider our overall goals and identify what may prevent us from achieving these. We also consider how associated measures may affect the existing risk picture. Some plans may have an unacceptable impact on the operational risk picture.

At the same time, defined working processes form the basis for ongoing identification and follow-up of risk throughout the organisation. These processes say something about how we work internally across the various departments. They also show how we deal with external suppliers, how we use systems and tools and how the outcomes of one process contribute to another. Based on these processes, we attempt to systematically identify risk factors – that is, individual, unwanted events that may occur.

Assessment of risk level
For each of the unwanted events identified, we first estimate the level of risk before internal control measures are implemented (inherent risk level). In equity management, inherent risk varies between the markets we invest in, partly because some marketplaces are better regulated and more mature than others. Inherent risk also varies between asset classes. It is higher for real estate investments than for equity investments from an operational standpoint, because the processes are more manual and susceptible to human error.

We then look at the risk reduction measures already in place for the various risk factors. These will normally include good processes and control procedures, and together these control measures make up our internal control environment.

Finally, we consider the risk level for each individual risk factor once these established control measures are taken into account (current risk level).

Mitigation of risk

If a particular risk factor or the aggregated current risk level falls outside the Executive Board's risk tolerance level, further action needs to be taken to mitigate the risk. This can be done either by reducing the probability of a potential unwanted event or by reducing the consequences if it does occur. In general, we could say that we aim to lower risk as far as practically possible. This normally involves an assessment of costs versus benefits. We would not want the cost of reducing a risk to exceed the potential loss unless other factors are more important, such as possible reputational consequences.

An example of a probability reducing measure may be to build error detection into trading systems so that data entry errors are blocked before anything goes wrong. If events are of a type where their probability cannot be reduced, such as natural disasters, risk mitigation will primarily take the form of contingency plans.

Other times, an unacceptable level of risk might mean that we decide against a particular course of action. This may occur when deciding whether to use external managers. We consider the risk too high in some markets and cases, choosing instead to keep the mandates in-house at NBIM.

Following up and reporting on events

Risk management and internal control at NBIM build on three lines of defence. The first is the operational units themselves, which own the risks, events and actions. The second is the compliance department, which ensures that the first line carries out processes and control procedures within set governing structures and boundaries. The third is Norges Bank's internal audit unit, which continuously evaluates risk management and control procedures in the first two lines.

However good our internal controls, and however many risk reduction measures we introduce, unforeseen events will occur from time to time. NBIM reports and follows up such events on a continuous basis, both those that actually occur and "near misses." These include both internal and external events with potential financial or reputational consequences for NBIM. All such events are followed up and investigations are immediately initiated if the events are serious. We estimate the actual loss from each individual event and compare the total losses from all events with the Executive Board's risk tolerance level.

Reporting to the Executive Board

Operational risk and events are reported regularly as part of NBIM's internal management reporting. In addition, a report on operational risk and internal control is submitted to the Executive Board each quarter. This report covers events that have occurred, an assessment of the status of internal control in the organisation and a risk outlook with planned risk-reducing measures. NBIM also estimates and reports expected losses for the various risk factors.

Attitudes and culture

The attitudes and approach of NBIM's employees are crucial for good operational risk management. NBIM aims to build a culture which promotes awareness of operational risk. This is a culture where all errors are reported, where errors are tolerated but where we try to learn from them. We aim for the highest possible level of openness, both internally and externally. We want a culture where the individual employee can notify his or her superior of a suspected problem and be taken seriously, and where we strive continuously to improve working processes with an awareness of the associated operational risks.

Operating costs in the fund's management

The Government Pension Fund Global's assets under management have grown considerably in a short space of time. The investment universe has been expanded and other aspects of the regulatory framework have been revised. NBIM has built a global organisation in response to these changes. Costs have risen, but there are also indications that we are realising economies of scale in a number of areas. The fund's management costs are low relative to other funds.

Introduction

In just a few years, the Government Pension Fund Global has grown into one of the world's largest funds. In line with this growth NBIM has, as the fund's manager, built an organisation with about 300 employees at offices in Europe, the US and Asia. The fund's investment universe has expanded considerably since NBIM's start in 1998, increasing the demands on infrastructure and control processes in every part of the organisation. NBIM has chosen to outsource some support functions to streamline its operations and focus on its core investment management role.

The expansion of the organisation, strong growth in assets under management and changes in the mandate have increased costs substantially. Even so, we are now seeing signs of economies of scale as costs grow at a lower rate than assets under management.

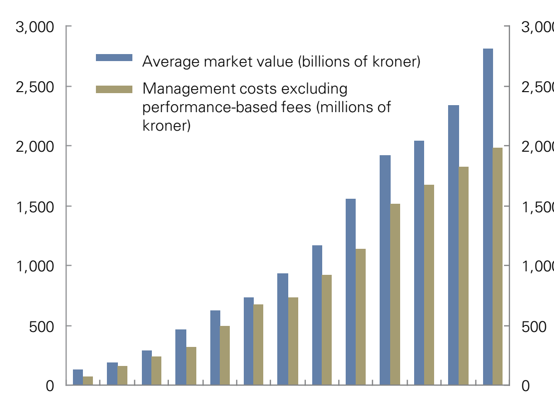
A focus on costs alone will not give a full picture of NBIM's management. Higher costs may result in higher revenue or better quality in the work carried out. The fund's performance is readily measurable and increased use of resources can lead to substantial additional revenue in the form of a higher return on the fund. One important aim in the fund's management is to maximise the long-term return after costs.

Operating costs for the management of the fund totalled 2,959 million kroner or 0.105 percent of average assets under management in 2010, including performance-based fees to external managers of 986 million kroner for excess return generated. Excluding these fees, costs came to 0.07 percent of average assets under management.[1]

NBIM uses external managers for parts of the fund's investments. Common to most of these managers is that they must aim to beat the markets they operate in and deliver an excess return for the fund. The fees paid to these managers are largely determined by the excess return they generate, which means that a high fee reflects an even higher amount of revenue for the fund. As this type of cost is very distinct from NBIM's other operating costs, we have chosen to exclude these fees in the rest of this cost review.

The chart below shows developments in costs and assets under management over time. Over the entire period from 1998 to 2010, operating costs totalled 16.1 billion kroner, including performance-related fees to external managers of 4.4 billion kroner.

Chart 16-1 Development of market value and management costs, 1998-2010.

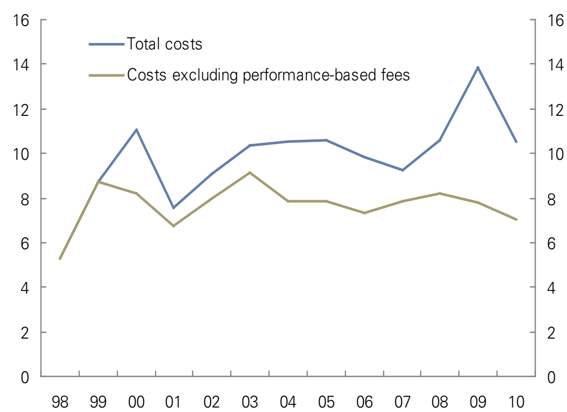


Source: NBIM

[1] In addition to the Government Pension Fund Global, NBIM manages Norges Bank's long-term foreign exchange reserves and, until the end of 2010, managed the Government Petroleum Insurance Fund on behalf of the Ministry of Petroleum and Energy. Fees to external managers and to settlement and custodian institutions are invoiced and paid separately for each fund. Other operating costs are allocated between the funds using a distribution key based largely on market values and asset allocations.

The chart below shows developments in costs relative to assets under management, measured in basis points. The lower line shows costs excluding performance-based fees to external managers. From 2003 to 2010, these costs fell to 7.0 from 9.1 basis points of assets under management.

Chart 16-2 Management costs compared with assets under management, 1998-2010. Basis points



Source: NBIM

Factors that affect cost levels

To obtain a complete picture of the cost development over time, it is necessary to take account of the major changes in the investment universe and other aspects of the mandate since 1998, some of which have had a substantial impact on cost levels. There have been several such changes since capital was first transferred to the fund in 1996.

In 1998, a 40 percent allocation to equities was introduced. In 2007, it was decided to increase this allocation to 60 percent and small and medium-sized companies were included in the fund's equity benchmark. A year later, a number of emerging markets were added to the equity benchmark. In 2002, bonds from private issuers were included in the fixed-income benchmark, which previously contained only bonds issued by governments and supranational organisations. In 2010, real estate was added as a new asset class.

Asset mix

NBIM estimates that internal equity management has cost around twice as much as internal fixed-income management over time. Settlement and custody costs are higher for equities than for bonds, and a more complex infrastructure is needed to trade in equity markets and to follow up specific corporate events and tax matters and to exercise ownership rights. All things being equal, the increase in the allocation to equities from 40 percent to 60 percent is estimated to have raised unit costs by 1 basis point, or just under 300 million kroner.

Expansion of the investment universe

The expansion of the investment universe since 1998 has led to considerable growth in the number of securities included in the fund's benchmark indices. More complex benchmark indices and a larger investment universe require more resources in every part of the organisation and result in higher costs.

The inclusion of small and medium-sized companies in the equity benchmark index has increased the number of companies in the index to 7,200 from around 2,400. The inclusion of private bonds in the fixed-income benchmark index also led to a substantial increase in the number of instruments: 11,200 were included in the fixed-income benchmark in 2010, compared with fewer than 1,000 in 1998.

Exchange rates

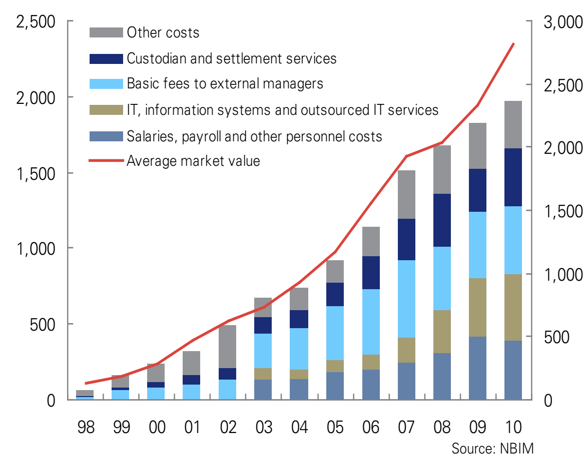
About 75 percent of NBIM's operating costs are billed and paid in foreign currency. As the accounts are kept in Norwegian kroner, movements in exchange rates can have a substantial accounting impact even if the actual cost in foreign currency is unchanged.

Operating costs in 2010

Note 2 in the financial accounts gives an overview of operating costs charged to the fund in 2009 and 2010. The main components are personnel-related costs, IT costs, fees to external managers, settlement and custody costs and other external services.

The chart below shows movements in these cost categories from 1998 to 2010. The data available for 1998 to 2002 is slightly less detailed and fewer components are shown in the early years.

Chart 16-3 Development of individual cost components since 1998. Costs (millions of kroner, left-hand axis) and market value (billions of kroner, right-hand axis)



NBIM had employees at five offices at the end of 2010. Salaries, employer's contributions and other personnel-related costs have increased over time in line with the increase in staff numbers. Performance-based pay, which depends partly on the excess return generated by each portfolio manager, forms part of the salary figure. This cost component can therefore vary considerably from year to year due to variations in performance-based pay. From the end of 2003 to the end of 2010, the number of permanent employees at NBIM climbed from 118 to about 300, an increase of 156 percent. During the same period, assets under management grew by 255 percent. More assets under management per employee mean that NBIM is realising economies of scale in terms of staffing.

Costs for IT, information and decision-support systems consist of the purchase and replacement of hardware and software, as well as costs for lines and communication equipment. This item also includes a number of information and decision-support systems used in many of NBIM's departments. Within this category, costs for information systems have grown fastest, due partly to the increase in staff numbers, but also to NBIM investing in new asset classes, instruments and markets. This cost component has grown at roughly the same rate as assets under management, even though changes in the investment universe and mandate would indicate a higher rate of growth. In particular, NBIM realises economies of scale over costs of hardware, software, lines and communication equipment.

Since 2007, NBIM has entered into various agreements for the outsourcing of IT services. These relate primarily to the operation, maintenance and development of IT infrastructure with global 24-hour support. Agreements have also been entered for the operation and development of IT applications. The costs associated with these agreements relate to the globalisation of NBIM's operations and buying these services externally is more cost-effective than building up internal capabilities. Most of the work on outsourcing IT was performed in 2007–2009, and costs grew rapidly during this period before levelling off. At the same time, the use of internal IT staff was scaled back sharply, which substantially reduced this cost component. The decision to outsource many IT services has paved the way for economies of scale in the years ahead.

The fee structure agreed with external managers normally includes a fixed component which is paid out whether the manager generates an excess return or not. These base fees have grown much more slowly than the amount of externally managed capital.

Services related to the settlement of transactions and custody of securities are provided by international banks and financial institutions. The costs associated with these services depend partly on the number of transactions performed and partly on the size of the holdings kept in custody. Our agreements with these suppliers set prices for settlement and custody in each market. Prices vary from market to market, so a change in the market mix will impact overall costs. Settlement and custody costs are generally much lower in developed markets than in emerging markets. Consequently, the inclusion of a number of emerging markets and of small and medium-sized companies in the investment universe has led to higher costs in this area.

NBIM has entered into agreements regarding settlement and custody which bring lower unit costs as the number of transactions and the size of the fund increase. A typical agreement will give a percentage discount once the value of assets in custody passes a certain level. There are also agreements where the price per transaction falls once the number of transactions passes a certain volume. We have therefore made substantial savings as a result of the growth in assets under management. All in all, settlement and custody costs have grown slightly faster than assets under management in recent years. This is due to the changes in the investment universe. Allowing for this, we have realised economies of scale in this area too.

NBIM is charged for some of the costs of control and support functions performed by other parts of Norges Bank. These include costs for internal and external auditing, administrative functions and pensions.

Other costs include the operation of NBIM's offices outside Norway. NBIM has opened two offices in Asia, in 2007 and 2010, and has expanded its offices in London and New York. This has contributed to an increase in costs in this category.

Comparison with other funds

CEM Benchmarking Inc. (CEM) produces a detailed report for the Ministry of Finance each year comparing the fund's management costs with other large funds. Differences in the funds' cost levels may be due to differences in cost effectiveness, but may also be related to differences in size, asset mix and investment style.

Norges Bank's total management costs for the Government Pension Fund Global amounted to 0.14 percentage points (or about 14 basis points) of average assets under management in 2009. Direct comparison of these costs with costs at other large funds does not, however, tell the full story of whether Norges Bank's management is cost effective. CEM has therefore developed a cost benchmark based on the fund's asset mix which indicates the costs the peer group would have had with the same asset mix as the fund.

The peer group consists of the largest funds in the CEM survey (seven US, three Canadian, two European and one Asian pension fund). The fund's average market value in 2009 was substantially higher than in the peer group.

CEM's analysis shows that the fund's actual management costs were 0.015 percentage point lower than the cost benchmark in 2009, equivalent to almost 310 million kroner. These lower costs are due primarily to Norges Bank making less use of external managers than the peer group. The cost of internal management is substantially lower than the cost of external management. In addition, the analysis shows that Norges Bank's internal management has cost less than at comparable funds. Table 16-1 shows that the fund's management costs have been lower than in the peer group every year since 2003.

Table 16-1 Cost development for the Government Pension Fund Global and comparison peer group in the period 2003–2009. Basis points

	2003	2004	2005	2006	2007	2008	2009
Government Pension Fund Global	10.3	10.5	10.6	9.8	9.4	10.6	14.0
Comparison peer group (median)	13.1	12.0	13.4	10.8	11.3	13.6	15.5

Financial Reporting

Norges Bank's annual financial statements, which include the Government Pension Fund Global, were approved by Norges Bank's Supervisory Council on 17 March 2011. These financial statements include a set of accounts and additional information for the Government Pension Fund Global presented in a separate note. These accounts and an excerpt from Norges Bank's accounting policies are reproduced below.

Profit and loss account

Figures in NOK million, for the year ended 31 December	Note	2010	2009
Profit/loss on financial assets excluding exchange rate adjustments			
Interest income on deposits in foreign banks		377	462
Interest income, lending associated with reverse repurchase agreements		350	696
Net income/expenses and gains/losses from:			
- Equities and units		207,070	488,082
- Bonds and other fixed income instruments		60,316	118,971
- Financial derivatives		-3,552	7,398
Interest expense repurchase agreements		-574	-2,571
Other interest expense		-105	-60
Other expenses		-9	-193
Profit/loss before exchange rate adjustments	1	**263,873**	**612,785**
Exchange rate adjustments		-8,498	-417,607
Profit/loss before management fee		**255,375**	**195,178**
Management fee	2	-2,959	-3,228
Profit/loss for the year		**252,416**	**191,950**

Balance sheet

Figures in NOK million, 31 December	Note	2010	2009
ASSETS			
FINANCIAL ASSETS			
Foreign bank deposits		6,303	4,644
Lending associated with reverse repurchase agreements	3,4	255,501	191,473
Cash collateral paid	3	0	140
Equities and units	5	1,733,378	1,496,759
Equities lent	4,5	162,483	150,847
Bonds and other fixed income instruments	3,4,5	1,038,793	918,500
Bonds lent	4,5	215,090	161,990
Financial derivatives	6	3,068	2,263
Unsettled trades		4,864	17,572
Other assets	7	1,358	251
TOTAL FINANCIAL ASSETS	9,11, 12	**3,420,838**	**2,944,439**
LIABILITIES AND CAPITAL			
FINANCIAL LIABILITIES			
Short-term borrowing		2,939	6,238
Borrowing associated with repurchase agreements	3	132,992	109,536
Cash collateral received	4	172,309	154,676
Bonds and other fixed income instruments	5	809	10,278
Financial derivatives	6	9,372	8,118
Unsettled trades		20,358	11,925
Other liabilities	7	4,639	3,625
Management fee payable	2	2,959	3,228
TOTAL FINANCIAL LIABILITIES	9,11, 12	**346,377**	**307,624**
Owner’s capital	8	3,074,461	2,636,815
TOTAL LIABILITIES AND CAPITAL		**3,420,838**	**2,944,439**

The Government Pension Fund Global is presented in the following way in the balance sheet of Norges Bank:

Figures in NOK million, 31 December	2010	2009
Assets		
Investments for the Government Pension Fund Global	3,074,461	2,636,815
Liabilities		
Deposits in krone account Government Pension Fund Global	3,074,461	2,636,815

Notes to the financial reporting

Accounting policies

The accounting policies at Norges Bank are adopted by the Supervisory Council. Pursuant to an agreement with the Ministry of Finance, Norges Bank's accounting policies are also applied to the Government Pension Fund Global. An extract from the Norges Bank accounting policies follows.

1 General

1.1 Basis for preparing the annual financial statements

Norges Bank is subject to the Act of 24 May 1985 relating to Norges Bank and the Monetary System and is not required to comply with the Norwegain Accounting Act. The annual financial statements are, nevertheless, with only a few exceptions prepared in accordance with the Norwegian Accounting Act of 1998 and generally accepted accounting principles in Norway. The few reporting exceptions are due primarily to special conditions specific to a central bank and are listed below:

The reporting exceptions from the Norwegian Accounting Act primarily are:
- The profit and loss account and balance sheet are presented in a manner more appropriate to the Bank's activities.
- A cash flow statement has not been prepared.
- The information in the notes is presented in a manner appropriate to Norges Bank's activities.
- All equities, bonds and other fixed income securities as well as financial derivatives are measured at fair value.

1.2 New financial reporting framework for Norges Bank beginning in 2011

Pursuant to an amendment to the Norges Bank Act, Norges Bank is required to comply with the Norwegian Accounting Act as from 1 January 2011. At the same time, the Ministry of Finance has issued a separate regulation relating to annual financial reporting for Norges Bank. The regulation applies as from the 2011 accounting year and requires Norges Bank to prepare its financial statements in accordance with the International Financial Reporting Standards (IFRSs) that have been endorsed by the EU. The regulation requires Norges Bank's financial statements to include the financial reporting of the Global Pension Fund Global, which shall also be prepared in accordance with IFRS. Norges Bank's interim financial statements from Q1 2011, which will only consist of quarterly financial reporting of the investment portfolio of the Government Pension Fund Global, will be presented in accordance with IAS 34 Interim Financial Reporting. Comparative amounts for the corresponding period will be restated in accordance with IFRS. For the financial reporting of the Government Pension Fund Global 's investment portfolio, the transition to IFRS will not entail changes to Owner's capital as at the opening IFRS balance sheet

1.3 Presentation of the Government Pension Fund Global

The Ministry of Finance has a krone account in Norges Bank relating to The Government Pension Fund Global. The corresponding value of the krone account is managed by Norges Bank and invested in foreign currency securities in a separatly identified portfolio. The entire return on the portfolio is transferred to the krone account. Norges Bank bears no financial risk in connection with changes in the value of the Government Pension Fund Global. The performance of the Government Pension Fund Global does not affect Norges Bank's profit and loss account or Norges Bank's capital. The Government Pension Fund Global's net investments are recognised as an asset on a separate line in the Norges Bank balance sheet. The krone account is recognised as a liability in the same amount to the Ministry of Finance. Separate financial reporting is prepared for the Government Pension Fund Global and included as a separate note in Norges Bank's annual financial statements.

2 Use of estimates when preparing the annual financial statements

The preparation of the financial statements for Norges Bank involves the use of estimates and judgement that can affect assets, liabilities, income and expenses. Estimates and discretionary valuations are updated regularly and are based on historical experience and expectations of future events that are considered probable at the time the financial statements are presented. Even though the estimates are based on best judgement actual results may differ from the estimates. In the cases where estimates are used these are covered in the respective notes.

3 Currency

Norges Bank's functional currency is the Norwegian kroner (NOK). Transactions in foreign currency are recognised in the financial statements at the exchange rate prevailing on the transaction date. Assets and liabilities in foreign currencies are translated into Norwegian kroner at the exchange rate prevailing on the balance sheet date.

In the profit and loss account, the foreign exchange element linked to realised and unrealised gains and losses on financial instruments is disaggregated and presented on a separate line. Foreign exchange adjustments for the period are estimated based on the cost price in foreign currency and changes in exchange rates between the time of purchase, or the previous balance sheet date for financial instruments purchased in earlier periods, and the balance sheet date. At realisation the exchange rate at the transaction date is used.

4 Financial instruments

4.1 Recognition and derecognition

Financial assets or liabilities are recognised on the balance sheet when Norges Bank becomes a party to the contractual terms of the instrument. The transactions are recognised on the trade date.

Financial assets are derecognised from the balance sheet when the contractual rights to the cash flows expire or when the financial asset and significant risks and returns relating to ownership of the asset are transferred. At derecognition average cost price is used.

Financial liabilities are derecognised from the balance sheet when the liability has been settled or no longer exists.

4.2 Fair value measurement

Initial measurement
A financial asset or liability is recognised at the purchase price including direct transaction costs. Direct transaction costs include commissions, stamp duties and commissions paid in connection with commission sharing agreements (CSA).

Subsequent measurement
All equities, bonds and other fixed income securities as well as financial derivatives are recognised at fair value as of the balance sheet date. Fair value is the estimated realisable value of an asset or the estimated cost of settling a liability in an arm's length transaction between well-informed and willing parties.

The price quoted by a stock exchange, broker or price provider is used for securities that are traded in an active market.

Valuation methods are used to estimate the fair value for securities that are not traded in an active market. Valuation methods include the use of recent arm's length market transactions between well-informed and willing parties (if such information is available), reference to the current fair value of other similar and comparable instruments (if practicable), discounted cash flow calculations and option pricing models. If there is a valuation method that is commonly used by market participants to price the instrument, and this technique has provided reliable for estimates of prices achieved in actual market transactions, this valuation method is used. Market information is used in the valuation estimation methods to the extent possible.

Changes in fair value are recognised in the profit and loss account. Direct transaction costs relating to financial instruments measured at fair value are presented in the profit and loss account on the same line as the instruments to which the respective costs relate.

Receivables and current liabilities other than derivatives, are carried at amortised cost, and the effective interest is recognized in the profit and loss account.

4.3 Securities lending

Securities lending transactions consist of a transfer of securities, either equities or bonds, from Norges Bank to a borrower against collateral in the form of cash or securities. When the loan is terminated, the identical securities are returned to Norges Bank. The borrower is obligated to compensate the lender for various events relating to the securities, such as subscription rights or dividends. In addition the borrower pays a fee to the lender. The borrower holds the voting rights attached to the securities during the lending period.

Securities lent are not derecognised from Norges Bank's balance sheet. During the lending period the securities are accounted for in the same way as other securities holdings. Lending fees are accrued as interest income, and are presented net in the profit and loss statement.

Cash collateral received is recognised on the balance sheet together with a corresponding liability measured at amortised cost. Collateral received in the form of securities is not recognised in the balance sheet unless reinvested. Unrealised and realised gains and losses on reinvestments measured at fair value are recognised in the profit and loss account.

4.4 Repurchase/reverse repurchase agreements

In connection with repurchase agreements, the security is not derecognised from the balance sheet when the agreement is entered into. During the contract period, the accounting for the underlying securities is in accordance with the accounting policies for securities. Cash received is recognised as a financial asset and the corresponding short-term financial liability is recognised at amortised cost.

In connection with reverse repurchase agreements, the underlying security is not reinvested and therefore is not recognised on the balance sheet. The cash paid is derecognised from the balance sheet, and a corresponding receivable reflecting the cash amount that will be received in return is recognised.

4.5. Accrued interest income and expenses

Accrued interest income and expenses are recognised in the balance sheet on the same line as the related financial asset or liability.

5 Taxation

Norges Bank's activities in Norway are not subject to tax.

6 Management fee

Norges Bank's costs related to the management of the Government Pension Fund Global are covered by the Ministry of Finance up to a set limit. The management fee is accrued in the current year financial statements, with payment received by Norges Bank in the year following.

Note 1 Profit/loss before exchange rate adjustments

Table 1.1: Specification of profit/loss before exchange rate adjustments

Figures in NOK million, 2010	Interest income/ expense	Dividends	Net income/ expense*	Realised gains/ losses	Unrealised gains/ losses	Total
Interest income on deposits in foreign banks	377	.	.	.	.	377
Interest income, lending associated with reverse repurchase agreements	350	.	.	.	.	350
Net income/expense and gains/losses from:						
- Equities and units	.	42,775	1,446	30,494	132,355	207,070
- Bonds and other fixed income instruments	47,077	.	274	5,273	7,692	60,316
- Financial derivatives	-2,519	.	.	-538	-495	-3,552
Interest expense repurchase agreements	-574	.	.	.	.	-574
Other interest expense	-105	.	.	.	.	-105
Other expenses	.	.	-9	.	.	-9
Profit/loss before exchange rate adjustments	**44,606**	**42,775**	**1,711**	**35,229**	**139,552**	**263,873**

*See also note 4 Securities lending.

Note 2 Management fee

*Table 2.1: Specification managment fee**

	2010		2009	
	NOK thousands	Percent	NOK thousands	Percent
Apportionment of salary, social security and other personnel related costs	389,260	.	416,360	.
IT, information and decision support systems	223,335	.	203,604	.
Base fees to external managers	452,151	.	431,931	.
Performance-based fees to external managers	986,143	.	1,401,762	.
Custody and settlement costs	382,255	.	289,279	.
Outsourced IT and analysis costs	213,488	.	186,699	.
Consulting and legal fees	116,304	.	124,960	.
Allocated common costs Norges Bank	115,258	.	105,463	.
Other costs	81,300	.	67,921	.
Total management fee	**2,959,494**	**0.11**	**3,227,979**	**0.14**
Total management fee excluding performance-based fees	**1,973,351**	**0.07**	**1,826,217**	**0.08**

*The table shows total costs incurred by Norges Bank that are reimbursed by the Ministry of FInance as the principal for the management of the Government Pension Fund Global. Fees to external managers and custody and settlement fees are invoiced directly to and paid individually by each of the portfolios managed by Norges Bank. All other costs included in the total management fee are costs that are common for the management of all portfolios, and are allocated to the individual portfolio using a cost allocation model based primarily on market values and asset class composition.

Note 3 Repurchase and reverse repurchase agreements

Norges Bank uses the markets for repurchase and reverse repurchase agreements directly and through securities lending programs (see note 4 Securities lending) as part of liquidity management and to generate additional income through investments. At any time the bank will have lent or transferred parts of its holdings in bonds through repurchase agreements (repos and sell buy backs), against receiving a corresponding amount in cash. This may be in the form of financing of the asset management (borrowing of cash), or lending of securities with the aim of reinvesting received cash at higher interest and thus creating additional income/return. In addition the bank has positions in reverse repurchase agreements where the counterparty has transferred bonds or equities to the bank (reverse repo, buy sell backs and triparties), and where the bank has transferred cash to the counterparty. Such positions are used in connection with placing liquidity and also through the securities lending agents as reinvestments of received cash collateral related to lent securities. Under repurchase agreements, the lent security is not derecognised from the balance sheet of the Government Pension Fund Global. Received cash is recognised as Foreign bank deposits, with a corresponding liability to pay back the cash included in Borrowing associated with repurchase agreements. For reverse repurchase agreements the borrowed security is not recognised in the balance sheet, while transferred cash is derecognised from Foreign bank deposits and a corresponding receivable is recognised as an asset, Lending associated with reverse repurchase agreements.

For repurchase agreements the transferred security may be viewed as collateral given by Norges Bank to borrow cash, see "Bonds given as collateral (asset)" in table 3.1. This item also includes lending of securities, where received cash is collateral held by Norges Bank. All positions within the instrument type repurchase agreements are shown in the table as borrowing of cash against given collateral in the form of securities.

Similarly received securities in relation to reverse repurchase agreements may be viewed as received collateral related to lent/placed cash, see "Bonds received as collateral" in table 3.1. In some cases these will be borrowed securities where transferred cash is collateral given by Norges Bank. All positions within the instrument type reverse repurchase agreements are shown in the table as placements of cash where received securities are collateral. Rules are laid down on which types of securities may be received as collateral. Bonds shall have a credit rating of at least A or similar from at least one of the rating agencies Fitch, Moody's and Standard & Poor's to be accepted as collateral.

In addition to collateral related to each transaction the bank has established a process for monitoring the net market value the positions by comparing the collateral value against the transaction value per counterparty, where additional collateral in the form of either securities or cash is given or received if the exposure is above a threshold value. Within the Government Pension Fund Global the bank has not received or given such cash collateral at year-end. Given and received additional collateral in the form of securities is shown separately in table 3.1, and is treated in the financial statements similarly to other security collateral.

Table 3.1 shows total positions in repurchase and reverse repurchase agreements in the Government Pension Fund Global as at year end 2010, with comparative figures for 2009, and corresponding collateral in the form of securities. The items Borrowing associated with repurchase agreements and Lending associated with reverse repurchase agreements shows the balance sheet value of these positions (amortised cost / cash amount transferred). This includes unsettled trades based on the transactions being recognised on trade date. The collateral in the form of securities is shown at fair value. For repurchase agreements this is the value the securities holdings are measured at in the balance sheet (see note 5 Equities and units / Bonds and other fixed income securities). As for reverse repurchase agreements, the received securities are not recognised in the balance sheet. In order to show the total exposure of the positions, unsettled trades have been shown separately under received and given collateral. This securities collateral has not yet been transferred and therefore is not included in the lines Bonds given as collateral (asset) and Bonds/equities received as collateral in table 3.1, while the corresponding cash amount to be transferred is included in Borrowing associated with repurchase agreements and Lending associated with reverse repurchase agreements.

Table 3.1: Specification repurchase and reverse repurchase agreements

	31.12.2010		31.12.2009	
Figures in NOK million	**Book value**	**Fair value**	**Book value**	**Fair value**
Borrowing associated with repurchase agreements (cash borrowed)	132,992	132,992	109,536	109,536
Bonds given as collateral (asset)	130,198	130,198	107,265	107,265
Unsettled trades (asset), collateral not yet transferred	205	205	0	0
Net over collateralisation (under collateralisation) repurchase agreements	**2,589**	**2,589**	**2,271**	**2,271**
Cash lent outside of securities lending programs	101,990	101,990	65,824	65,824
Cash lent through the securities lending programs (reinvesting)	153,511	153,511	125,649	125,649
Lending associated with reverse repurchase agreements (total cash lent)	**255,501**	**255,501**	**191,473**	**191,473**
Bonds received as collateral	-	243,481	-	185,774
Equities received as collateral	-	5,813	-	4,378
Total received collateral	**-**	**249,294**	**-**	**190,152**
Unsettled trades (liability), collateral not yet received	7,820	7,820	2,058	2,058
Net over collateralisation (under collateralisation) reverse repurchase agreements	**-**	**1,613**	**-**	**737**
Additional collateral				
Cash collateral paid (additional collateral)	-	-	140	140
Collateral given in the form of bonds	505	505	-	-
Received collateral in the form of bonds	-	384	-	-
Total additional collateral	**-**	**121**		**140**
Net over collateralisation (under collateralisation) repurchase and reverse repurchase agreements	**-**	**4,081**	**-**	**2,868**

Table 3.1 shows that Norges Bank within the Government Pension Fund Global is over collateralised related to repurchase agreements in the amount of NOK 2,589 million at the end of 2010. This means that the bank has an excess of the mentioned amount of cash received compared to collateral given. Similarly Norges Bank is over collateralised also for reverse repurchase agreements, in the amount of NOK 1,613 million, as the bank has an excess of received securities collateral compared to placed cash of this amount. Total over collateralisation across these instrument types, including additional collateral, is NOK 4,081 million as at 31 December 2010.

Outside of securities lending programs Norges Bank had borrowed a net amount of NOK 31 billion kroner at the end of the year. This consists of the net effect of borrowed cash of NOK 132,992 million and lent cash of NOK 101,990 million. See also further descriptions of leverage in note 12 Risk, and in note 4 Securities lending which describes the leverage effect of the securities lending programs.

Note 4 Securities lending

Norges Bank has entered into agreements with external agents regarding securities lending. These agents have access to the securities holdings of the portfolio, and may lend these to other market participants with borrowing needs. Both equities and bonds are lent through the securities lending programs. The purpose of the lending activities is both to provide the market with better access to securities and thereby to increase efficiency, and to create additional returns for the Government Pension Fund Global based on its securities holdings. When a security is lent out, the borrower transfers collateral to the agent in the form of cash or securities. The collateral is held on the behalf of Norges bank. The agreements with the agents have provisions ensuring the bank's and the portfolio's interests in the event of the counterparty not being able to deliver the borrowed securities back, and in the event that the collateral that has been received for the loan is not sufficient to cover losses that may occur. The cash collateral is reinvested primarily in fixed income instruments at a higher interest rate than what is paid on received cash. The reinvestments are done by the agent both in the form of positions in the repo market (reverse repurchase agreements: reverse repos, buy sell backs and triparties, see note 3 Repurchase and reverse repurchase agreements) and in the form of bonds. At year end 70 percent of these bond investments within the Government Pension Fund Global were rated at Aaa from Moody's. Bonds as a share of reinvestments have decreased from 36 to 10 percent during the last two years.

Lent securities are presented on separate lines in the balance sheet. Received cash collateral is recognised in the balance sheet as "Foreign bank deposits" with a corresponding liability "Cash collateral received" based on the fact that the bank has the right to dispose of this cash. Received collateral in the form of securities is not recognised in the balance sheet, because these are not reused (rehypothecated), but are left in custody. Reinvestments in the form of reverse repurchase agreements and bonds are recognised in the balance sheet in the same way as other such investments.

Norges Bank earns a net fee income based on these securities lending programs. The net income consists of the pure lending fee, costs related to received cash collateral, as well as interest income and realised returns from reinvestments. The agent's share as a fee for carrying out the transactions is included in this net income. Net income from securities lending is presented on the profit and loss account lines Net income/expenses and gains/losses from equities and units and Net income/expenses and gains/losses from bonds and other fixed income instruments. The income related to equities lending within the Government Pension Fund Global amounted to NOK 1,446 million in 2010, while the corresponding income from bond lending amounted to NOK 274 million in 2010 (see also note 1 Profit/loss before exchange rate adjustments). In addition to the mentioned profit and loss items come unrealised gains and losses related to reinvestments in the form of bonds measured at fair value. This element is not included in the fee income, but is also included in the profit and loss line Net income/expenses and gains/losses from bonds and other fixed income instruments. NOK 1,010 million has been recorded as income in 2010 based on a change in unrealised loss for these holdings.

Table 4.1 and 4.2 shows an overview of positions within securities lending programs at the end of 2010 and 2009.

Table 4.1: Securities lending

	31.12.2010		31.12.2009	
Figures in NOK million	Book value	Fair value	Book value	Fair value
Securities lent				
Equities lent	162,483	162,483	150,847	150,847
Bonds lent	215,090	215,090	161,990	161,990
Total securities lent	**377,573**	**377,573**	**312,837**	**312,837**
Collateral received				
Cash collateral received	172,309	172,309	154,676	154,676
Equities received as collateral	-	123,995	-	92,191
Bonds received as collateral	-	98,962	-	79,896
Total collateral related to securities lending	**172,309**	**395,266**	**154,676**	**326,763**
Net over collateralisation	**-**	**17,693**	**-**	**13,926**

Table 4.2: Reinvestment of cash collateral connected to securities lending

Figures in NOK million	31.12.2010 Book value	31.12.2009 Book value
Reinvestment connected to securities lending		
Reverse repurchase agreements	153,511	125,649
Asset-backed securities	13,541	22,030
Other fixed income instruments	3,831	4,600
Total reinvestment in the form of bonds and other fixed income instruments	17,372	26,630
Total reinvestments of cash collateral	**170,883**	**152,279**
Unrealised loss bonds and other fixed income instruments	**1,341**	**2,351**

Table 4.2 shows that Norges Bank within the Government Pension Fund Global at the end of 2010 has investments in bonds at a market value of NOK 17 billion that have been made by using received cash collateral as financing. This may be seen as leverage of the portfolio, and is included in the measure of net leverage that is described in note 12 Risk. Reinvestments in addition to this are done with the purpose of covering interest costs on received cash collateral through the use of low risk instruments (reverse repurchase agreements), and are not viewed as creating leverage. The purpose of the securities lending programs is primarily to earn extra returns in the form of securities lending fees, as opposed to getting access to additional capital for investment.

Note 5 Equities and units/bonds and other fixed income instruments

Tabel 5.1: Specification of equities and units / bonds and other fixed income instruments

Figures in NOK million, 31 December 2010	Cost price	Fair value	Accrued interest/ dividends	Total fair value
Equities and units:				
Listed equities	1,746,534	1,893,714	2,147	1,895,861
Total equities and units	**1,764,534**	**1,893,714**	**2,147**	**1,895,861**
Hereof Equities lent				162,483
Government bonds:				
Government bonds	537,015	514,337	6,658	520,995
Total government bonds	**537,015**	**514,337**	**6,658**	**520,995**
Government related bonds:				
Bonds issued by local authorities	33,977	33,142	667	33,809
Bonds issued by supranational bodies	26,899	27,565	441	28,006
Bonds issues by federal agencies	89,286	85,615	1,345	86,960
Total government related bonds	**150,162**	**146,322**	**2,453**	**148,775**
Inflation-linked bonds:				
Inflation-linked bonds issued by government authorities	92,062	102,835	502	103,337
Total inflation-linked bonds	**92,062**	**102,835**	**502**	**103,337**
Corporate bonds:				
Bonds issued by utilities	21,592	21,013	384	21,397
Bonds issued by financial institutions	122,414	108,892	2,060	110,952
Bonds issued by industrial companies	74,963	73,468	1,363	74,831
Total corporate bonds	**218,969**	**203,373**	**3,807**	**207,180**
Securitised bonds:				
Covered bonds	201,887	192,780	4,210	196,990
Mortgage-backed securities	61,201	55,356	246	55,602
Asset-backed securities	18,031	14,117	19	14,136
Commercial mortgage-backed securities	6,487	6,026	33	6,059
Total securitised bonds	**287,606**	**268,279**	**4,508**	**272,787**
Total bonds and other fixed income instruments*	**1,285,814**	**1,235,146**	**17,928**	**1,253,074**
Hereof Bonds lent				*215,090*

*Total bonds and other fixed income instruments of NOK 1,253,074 million in the table includes a liability amount of NOK 809 million, which is short positions in bonds. From the annual financial statements for 2010 short sales of bonds are no longer netted against the asset line Bonds and other fixed income securities. Short sales of bonds are presented on a separate line under liabilities in the balance sheet as Bonds and other fixed income securities. Comparative figures for 2009 have been restated.

Note 6 Financial derivatives

Table 6.1 shows the nominal values of positions in financial derivatives for purchased (long) and sold (short) positions as exposure. Nominal value is the basis for the calculation of any cash flow and gains/losses for the contracts. In addition, assets (positive market values) and liabilities (negative market values) are shown at market value.

Table 6.1: Exposure – financial derivatives

	Exposure				Fair value 31.12.2010		
	31.12.2010		Average 2010				
Figures in NOK million	Purchased	Sold	Purchased	Sold	Asset	Liability	Net
Foreign exchange contracts	**29,849**	**0**	**27,468**	**0**	**402**	**316**	**86**
Stock exchange listed futures contracts	**16,791**	**17,056**	**20,557**	**16,267**	**43**	**22**	**21**
Interest rate swaps	25,002	74,689	14,035	70,908	1,847	7,300	-5,453
Credit default swaps	37,092	2,246	30,926	2,434	41	749	-708
Equity swaps	39	128	823	85	21	77	-56
Total swaps	**62,133**	**77,063**	**45,784**	**73,427**	**1,909**	**8,126**	**-6,217**
Options	**33,845**	**15,217**	**24,829**	**15,840**	**714**	**908**	**-194**
Total financial derivatives	**142,618**	**109,336**	**118,638**	**105,534**	**3,068**	**9,372**	**-6,304**

Foreign currency exchange contracts

This item consists of foreign currency exchange contracts with normal settlement for future delivery. Contract exposure is the sum of the nominal value of the contracts at any given point in time.

Stock-listed futures contracts

Exposure is the nominal value of the contracts.

Non-stock listed financial derivatives (OTC)

Interest rate swaps

This item includes both interest rate swaps and combined interest rate and currency swaps.

Exposure is the nominal value of the contract and indicates whether Norges Bank receives (has purchased) or pays (has sold) a fixed rate of interest.

Credit default swaps

In a credit default swap, the seller receives a periodic premium or lump sum from the purchaser as compensation for assuming the credit risk. The purchaser receives payment from the seller only if the credit protection of the underlying loan is triggered (a credit event). A credit event might, for example, be a default on the underlying credit or bond loan. The protection normally expires after the first credit event.

The underlying assets for credit default swaps are corporate bonds, securities issued by sovereign states, corporate bond indices, asset-backed securities (ABS) indices and commercial mortgage-backed securities (CMBS) indices.

Exposure indicates whether Norges Bank has purchased or sold protection for all or part of the credit risk associated with the various types of underlying assets.

Equity swaps

Equity swaps are agreements between two counterparties to swap cash flows based on changes in the underlying securities, which can be shares, an equity portfolio or an index. In addition to the periodic cash flow, payments are received in connection with dividends and corporate events.

Exposure corresponds to the market value of the underlying equities or equity indices.

Options

Exposure is the market value of the underlying assets. Options written by the fund are reported as Sold. Options where Norges Bank pays a premium are reported under purchased contracts.

Table 6.2 shows received and given collateral in connection with financial derivative positions.

Table 6.2: Collateral connected to financial derivatives

Figures in NOK million	31.12.2010	31.12.2009
OTC financial derivatives		
Net fair value OTC financial derivatives (book value)	-6 355	-5 887
Cash collateral received in relation to OTC positions	-1	0
Futures contracts and equity swaps		
Fair value futures contracts	21	-289
Fair value equity swaps	-56	172
Deposits with clearing brokers (collateral given)	331	639
Bonds given as collateral to clearing brokers	620	560

Norges Bank gives or receives cash collateral in connection with positions in OTC financial derivatives (interest rate swaps, credit rate swaps and options). Follow-up against collateral thresholds is done per counterparty, and if the net market value of positions held by the counterparty exceed the given limits, the party with the negative market value is required to give collateral to the other party. The bank had as of year-end received collateral of NOK 1 million from counterparties, because few of the Government Pension Fund Global's positions had postive market values. There is a preponderance of negative market values as of year-end but the bank had not given any collateral on behalf of the Government Pension Fund Global as the limit is set quite high due to the bank's high credit worthiness.

Other received cash collateral, included in the line Cash collateral received as of the end of 2010 is connected to securities lending. See note 4 Securities lending for additional information.

Futures contracts and equity swaps (CFD – Contracts for Difference) are transacted via clearing brokers, and for these positions collateral is delivered to the clearing brokers. This can be given in the form of cash (margin calls) and/or securities. The market value of cash deposits is included in the balance shown in the line Foreign bank deposits. Transferred securiteis is not deducted.

Note 7 Other assets / Other liabilities

Table 7.1: Other assets

Figures in NOK million	31.12.2010	31.12.2009
Withholding tax	1,239	176
Accrued interest securities lent	119	75
Total other assets	**1,358**	**251**

Table 7.2: Other liabilities

Figures in NOK million	31.12.2010	31.12.2009
Capital gains tax payable abroad	88	256
Other foreign liabilities	229	176
Liabilities to other portfolios under common management*	4,322	3,193
Total other liabilities	**4,639**	**3,625**

*Liabilities to other portfolios under common management comprises the net value of bank deposits, security lending, repurchase agreements and reverse repurchase agreements vis-a-vis other portfolios managed by Norges Bank. These related party transactions have been conducted using the same principles as for transactions conducted with unrelated parties.

Note 8 Owner's Capital

Table 8.1: Specification owner's capital

Figures in NOK million	31.12.2010	31.12.2009
Balance in the Norwegian krone account on 1 January	2,636,815	2,273,289
Inflows during the year*	185,230	171,577
Management fee payable to Norges Bank	-2,959	-3,228
Profit/loss transferred to/from Norwegian krone account	255,375	195,178
Owner's capital – krone account balance	**3,074,461**	**2,636,815**

*The Government Petroleum Insurance Fund was discontinued as of 31 December 2010, and net assets of NOK 19,838 million transferred to the Government Pension Fund Global. This cash inflow is shown as part of Inflows during the year. Out of the total inflows to the Government Pension Fund Global in 2010, NOK 3.2 billion were used during the first quarter to pay the 2009 accrued management fee to Norges Bank. The remainder of NOK 182 billion was transferred into the investment portfolio.

Note 9 Currency distribution

Table 9.1 Specification of the balance sheet by currency

	31.12.2010							
Figures in NOK million	**USD**	**CAD**	**EUR**	**GBP**	**CHF**	**JPY**	**Other**	**Total**
Foreign bank deposits	422	41	681	170	-11	50	4,950	6,303
Lending associated with reverse repurchase agreements	67,503	277	168,506	7,365	0	7,231	4,619	255,501
Equities and units	592,971	53,984	394,203	236,938	98,658	84,194	272,430	1,733,378
Equities lent	25,418	917	38,477	22,662	6,115	21,370	47,524	162,483
Bonds and other fixed income instruments	357,578	24,941	459,350	113,462	5,125	55,429	22,908	1,038,793
Bonds lent	57,586	2,085	116,823	30,340	45	0	8,211	215,090
Financial derivatives	-7,660	-32	-1,061	-2,312	-2	-162	14,297	3,068
Unsettled trades	1,487	33	2,523	31	60	288	442	4,864
Other assets	122	0	291	12	932	0	1	1,358
Total financial assets	**1,095,427**	**82,246**	**1,179,793**	**408,668**	**110,922**	**168,400**	**375,382**	**3,420,838**
Short-term borrowing	2	0	0	0	1,706	359	872	2,939
Borrowing associated with repurchase agreements	34,392	462	66,482	19,521	0	7,831	4,304	132,992
Cash collateral received	54,398	0	116,713	1,198	0	0	0	172,309
Bonds and other fixed income instruments	809	0	0	0	0	0	0	809
Financial derivatives	201	63	3,877	2,540	-192	7,508	-4,625	9,372
Unsettled trades	11,374	479	7,383	198	36	270	618	20,358
Other liabilities	207	-48	1,547	2,571	-50	358	54	4,639
Management fee payable	.	.	.	.	.	.	2,959	2,959
Total financial liabilities	**101,383**	**956**	**196,002**	**26,028**	**1,500**	**16,326**	**4,182**	**346,377**

Note 10 Real Estate Investments

13 January 2011 Norges Bank signed the agreements for the first real estate investment of the Global Pension Fund Global. The transaction is expected to be completed 1 April 2011. The investment gives rights to a 25 percent share in the net operating income generated by a portfolio of properties that are located in and around the prime retail location of Regent Street, London, United Kingdom. This real estate portfolio is currently managed on behalf of the United Kingdom by The Crown Estate, who will continue to manage this portfolio following the completion of this transaction. The agreed purchase price is GBP 452 million (NOK 4.2 billion). A deposit of GBP 22.4 million (NOK 204 million) was paid to The Crown Estate on 13 January 2011, with the remainder due and payable on 1 April 2011.

Note 11 Fair value measurement of financial instruments

Control environment

The control environment for measuring the fair value of financial instruments is organised around a formalised and documented valuation policy and guidelines which are supported by work and control procedures. The policy document for valuation refers to pricing hierarchies which are established for each of the different asset classes.

The valuation environment is established, and adjusted, in accordance with leading best market practices for valuation. The operational implementation of the best market practise principles is done in a manner to ensure a transparent, scalable and comparable valuation of all holdings on a daily basis through the use of sophisticated processes using both internal and external data solutions.

In principle all holdings in securities and other instruments are valued by independent valuation specialists. These pricing providers were chosen based on thorough analyses by the internal department in Norges Bank that is operationally responsible for valuations. This department on a routine and ongoing basis follows-up with these price providers through dialogue, controls and inquiries connected to the prices of individual securities. The financial instruments prices from these independent price providers are based on observable prices and/or models that use observable and in some cases unobservable input factors.

On a daily basis the valuation process is subject to numerous controls by the internal valuation department as well as by the fund accountant focusing on defined thresholds and sensitivities. The levels of these thresholds and sensitivities are monitored and adjusted in accordance with prevailing market conditions. At each month end additional extensive controls are performed to ensure that established pricing procedures and fair value measurement principles following from the valuation policy have been followed. This includes verifying that the external fund accountant uses external prices as required by the price hierarchy in force at the relevant time, as well as verifying that the resulting values reflect fair value as of the actual date, i.e. that the value of the current holdings reflects the amount that can be realised in an arm's length transaction between two well informed and willing parties. Throughout this process, particular attention is paid to illiquid financial instruments, structured products and special instruments in the portfolio that have additional valuation challenges. Illiquid instruments are identified with the help of sector and currency classifications, price differences between different external price providers, coverage of the instrument by external price vendors, credit rating indicators, bid/ask spreads, and activity in the market.

A valuation memo and report are prepared at the end of each quarter documenting the results of the controls performed, status of the valuation, the largest sources of price uncertainties and associated valuation risk, as well as other relevant information for the valuation.

This documentation is reviewed by a valuation committee which acts as a forum for the consideration of significant pricing issues and formally approves the valuation. The committee meets at least once a quarter prior to the publication of the financial reporting. The committee consists of the NBIM leader group.

Valuation methods

Norges Bank has defined hierarchies for the independent price sources that are used for valuation. Holdings that are included in the benchmark portfolio are normally priced in accordance with the index providers' prices, while the remaining holdings of equities and bonds are priced almost exclusively by reputable independent external price providers. Prices are verified based on a comparative analysis of the applicable prices in the established hierarchies with prices from available alternative price sources. When alternative price sources are considered to be more representative of fair value, prices are adjusted to bring the valuation closer to expected fair value.

Equities are valued almost exclusively based on official closing prices from stock exchanges or last traded exchange prices, and are thus observable market prices. The same applies to more than half of the holdings in bonds. Over 80 percent of the investments for the Government Pension Fund Global as of the end of 2010 were holdings of high liquidity and therefore associated with low valuation risk.

For both part of the bond portfolio and the majority of the interest rate derivatives valuation is performed using valuation models as opposed to direct pricing as observable prices are not available to a sufficient extent due to varying degrees of illiquidity and limited market activity. These valuation techniques are both models that use observable market data and models that to a large extent make use of unobservable market data. Valuation methodologies used by the independent valuers for bonds and derivatives are generally a combination of market standard and proprietary models but based off standard valuation principles. The models are combined with extensive daily research and analysis by the evaluations teams in order to generate high quality valuations. Methodologies vary according to the asset class or sub class under review. For bonds these will include, but are not limited to, credit spreads based on observable prices for comparable instruments, non-adjusted and option adjusted discounted cash flow models for bonds containing embedded options, and models with discount margins for bonds with floating interest rates. In the OTC derivative market established option pricing models as well as implied interest rate curves and credit spreads are the most commonly used valuation methods.

The data, both observable and unobservable, used in the different valuation models includes the following elements:

- Bond prices – prices based on price quotes and relevant market activity in new issues and from secondary market transactions.
- Credit spreads – these are sourced from the credit derivative market as well as trades of more liquid bonds.
- Interest rate curves – benchmark interest rate curves are often the foundation of the valuation matrix and are sourced from various market sources including government bond markets, interest rate swap markets, future markets as well as interbank markets.
- Currency rates – obtained from various stock exchanges and trading markets for use in the valuation of spot, forward and future contracts.
- Equity prices.
- Prepayment rates – early prepayment of principal. Estimates based on both historical and expected levels can have a material effect on the valuation of individual types of bonds where early prepayment of principal is possible. This information is collected by the external price providers from various market sources, for example reports from market participants and data sources such as Bloomberg/Reuters.
- Default and recovery estimates – assumptions regarding expected default and loss given default are important input factors in the models that price structured instruments and which estimate the relative size and timing of cash flows for the different tranches. Data sources are the same as for prepayment rates.
- Structuring and cash flow details per tranche – analysis of structured bonds produces estimated cash flows which are used as input in the valuation models. Data sources are the same as for prepayment rates.
- Volatility – this is the extent to which the price of a security fluctuates. Volatility is one of the key input factors in the valuation of option derivatives. Data sources are the same as for prepayment rates.
- Correlation – this is the extent to which changes in one variable are interdependent with changes in another variable. Positive correlation indicates that the variables move in the same direction while negative correlation means the variables change in opposite direction. Data sources are the same as for prepayment rates.
- Counterparty risk – prices are based on an assumption of risk-free counterparties. This is a reasonable assumption based on the existence of netting agreements and the use of collateral.

Pricing uncertainty

All equities, bonds and financial derivatives have been allocated to categories for assessed pricing uncertainty. Level 1 consists of investments that are valued based on observable market prices in active markets and are considered to have very limited pricing risk. Investments allocated to level 2 are valued using models with observable market data. These holdings have some pricing uncertainty with regards to establishing fair value, but overall this valuation risk is considered to be limited. Holdings allocated to category 3 are priced using models with considerable use of unobservable input factors, which implies substantial uncertainty surrounding the establishment of fair value. Nevertheless, it should be noted that the majority of these investments are valued by external professional price providers who are regarded as giving the best estimate of fair value and where the total valuation from different price providers varies only to a limited extent. Uncertainty connected with valuation gives a risk for both too high and too low values. Extensive controls are employed to mitigate this risk.

Table 11.1 groups the investments into categories of assessed pricing uncertainty as at 31 December 2010.

Table 11.1: Specification of investments by level of price uncertainty

	Level 1		Level 2		Level 3		Total	
Figures in NOK million	31.12.2010	31.12.2009	31.12.2010	31.12.2009	31.12.2010	31.12.2009	31.12.2010	31.12.2009
Equities	**1,894,319**	**1,646,147**	**1,454**	**1,453**	**88**	**5**	**1,895,861**	**1,647,606**
Total bonds	**726,521**	**514,290**	**501,291**	**522,404**	**25,262**	**33,518**	**1,253,074**	**1,070,212**
Government bonds	496,468	307,416	24,527	5,010	0	0	520,995	312,426
Government related bonds	72,362	71,964	76,149	82,090	264	0	148,775	154,054
Inflation-linked bonds	75,182	32,293	28,155	56,321	0	0	103,337	88,615
Corporate bonds	1,389	0	204,077	225,232	1,714	3,092	207,180	228,324
Securitised bonds	81,120	102,616	168,383	153,750	23,284	30,427	272,787	286,793
Total financial derivatives	**21**	**-289**	**-6,325**	**-5,566**	**0**	**0**	**-6,304**	**-5,855**
Assets	43	105	3,025	2,158	0	0	3,068	2,263
Liabilities	-22	-394	-9,350	-7,724	0	0	-9,372	-8,118
Total	**2,620,861**	**2,160,148**	**496,421**	**518,291**	**25,350**	**33,523**	**3,142,631**	**2,711,963**

Table 11.2 shows a furter specification of level 3 holdings.

Table 11.2: Additional specification of level 3

Figures in NOK million	31.12.2010	31.12.2009
Equities	**88**	**5**
Total bonds	**25,262**	**33,518**
Government related bonds	264	0
Bonds issued by federal agencies	*200*	*0*
Bonds issued by local authorities	*64*	*0*
Corporate bonds	1,714	3,092
Bonds issued by financial institutions	*1,651*	*3,091*
Bonds issued by industrial companies	*63*	*1*
Securitised bonds	23,284	30,427
Asset-backed securities (ABS)	*3,878*	*6,673*
Commercial mortgage-backed securities (CMBS)	*465*	*2,442*
Mortgage-backed securities (CMO)	*18,941*	*21,311*
Total level 3	**25,350**	**33,523**

Almost all of the equity holdings are classified as level 1 with a low valuation risk as there is normally available an official closing price from active trading on a listed stock exchange, thus correctly reflecting the fair value. Equity holdings classified as level 2 consist mainly of relatively illiquid shares where the price estimate is based on more liquid shares issued by the same company. The valuation risk in this instance is also generally low as the model is straightforward and the input factors observable. Equities classified as level 3 consist of a few holdings where the valuation is particularly uncertain due to a lack of observable transactions markets and also of equities that have been suspended over a longer time period due to special circumstances such as bankruptcy, nationalisation, or liquidation.

The pricing uncertainty situation for bonds is much more varied. Norges Bank carries out analyses for each reporting period to identify the extent to which there have been actual transactions and to identify the price transparency that is associated with market liquidity for different types of bonds as well as for a number of individual securities. The pricing of most government bonds is based on observable market prices in an active market with quoted prices and frequent transactions, i.e. level 1. Government-related and inflation-linked bonds are allocated to level 1 and 2 based on the bank's analyses of liquidity and the degree of trading and price transparency in the markets. The analysis shows a relatively high degree of observed liquidity for these bonds. Most corporate bonds are assessed as priced by models with observable input factors, while certain particularly illiquid corporate bonds are allocated to level 3 and some highly liquid bonds belong to level 1. Securitised bonds are allocated to all three categories based on the complexity of the input factors and the degree of liquidity, actual transactions and price transparency in the markets. Covered bonds are categorised in the observable levels 1 and 2 based on the degree of liquidity and price transparency in the markets. Some very liquid guaranteed mortgage-backed securities belong to level 1 with observable market prices in active markets. Other guaranteed mortgage-backed securities that are not tranched have been classified as priced by models using observable data inputs, i.e. level 2. Securitised bonds that are deemed to be tranched such that they have a particularly high exposure to unobservable input factors have been allocated to level 3. Other securitised bonds are allocated to categories 2 and 3 based on the observed degree of price consensus between the available price providers.

Norges Bank's analyses indicate that the valuation risk has been somewhat reduced over the course of 2010, as well as during only the fourth quarter. Total exposure that is regarded as being particularly uncertain as related to correct pricing estimates was 25.3 billion kroner as of year-end

2010, versus 33.5 billion kroner at the end of 2009. This consisted mainly of securitised bonds (23.3 billion kroner) of which 23.1 billion kroner is United States' securitised bonds. It is in particular the securitised bonds not guaranteed by a federal agency that are associated with a high degree of pricing uncertainty (16.4 billion kroner). The remaining 6.7 billion kroner consisted of structured securitised bonds where the underlying debt is guaranteed, but where there is particularly greater sensitivity towards other estimated assumptions in the pricing models, primarily related to the principal repayments. The reduction in level 3 holdings throughout 2010 is primarily due to the reclassification of certain securitised bonds to level 2 as a result of improved pricing data quality and pricing consensus between alternative price sources. Maturity and repayment of principal also contributed in some degree to the reduced exposure of holding in level 3.

The size of the price uncertainty for level 3 holdings is difficult to estimate exactly. While the average price uncertainty for individual securities in this category is expected to be approximately +/- 10 percent, the group as a whole is expected to have somewhat lower price uncertainty due to diversification effects. Estimated valuation uncertainty was therefore determined to be +/- 1.5 to 2 billion kroner in this category as compared to 2 to 3 billion kroner as of the end of 2009.

The result of the valuation based on ordinary pricing sources in comparison to the established external price provider hierarchy as of 31 December 2010 is viewed as providing an appropriate reflection of market values in accordance with the fair value principle. It was therefore not necessary to make any accounting provisions related to price uncertainty during the year.

Note 12 Risk

Government Pension Fund Global investment mandate

The Ministry of Finance has delegated the investment responsibility related to the Government Pension Fund Global to the Executive Board of Norges Bank. Norges Bank shall seek to obtain the highest possible return after expenses measured in the currency basket of the benchmark.

The Ministry of Finance has placed the Government Pension Fund Global as a Norwegian kroner deposit in Norges Bank. Norges Bank in its own name invests the Norwegian kroner deposit in a portfolio consisting of equities, fixed income securities, real estate and cash. The asset class level benchmarks are tailored with strategic allocations to regions, rule-based adjustments to certain fixed income sectors, exclusion of selected companies from the investment universe, and the real estate benchmark is adjusted for actual real estate asset class leverage and expected investment management expenses and taxes. Securities issued in Norwegian kroner or issued by Norwegian entities are excluded from the investment portfolio and benchmark. Positions in financial derivatives are part of the relevant asset classes, but are shown separately in the portfolio's profit and loss account and balance sheet.

Norges Bank's governance structure

The Executive Board of Norges Bank has delegated the responsibility for implementation of the investment mandate to the Chief Executive Officer (CEO) of Norges Bank Investment Management (NBIM) which is an organisational unit within Norges Bank.

The CEO of NBIM is empowered by a job description, by an investment mandate, and by the Executive Board's principles for risk management at NBIM which cover operational and investment risk management. In addition to this specific delegation, NBIM must also adhere to internationally recognised standards within performance measurement, valuation and industry best practise.

Reporting requirements from the Executive Board of Norges Bank to NBIM are outlined in the CEO's job description. The Executive Board receives monthly reports, with more extensive reporting on a quarterly basis. The Governor of Norges Bank is notified immediately for special issues or serious breaches to the investment mandate.

NBIM governance structure

Within NBIM investment responsibilities are further delegated through investment mandates. Responsibility for processes and personnel is delegated through job descriptions, while process requirements are detailed through policies and guidelines. The construction of the NBIM leader group and delegation reflects a desire and requirement to ensure segregation of duties between investment management, treasury and trading, risk management, compliance and operations.

The market risk committee, credit and counterparty risk committee, and the instrument universe committee complement the delegation to advice on investment risk management, as well as on the instrument universe.

Internal risk reporting requirements are issued by the CEO through job descriptions to personnel in the risk area. The CEO receives daily, weekly and monthly reports. The CEO is notified immediately for special issues or serious breaches to the investment mandate.

NBIM investment processes

Segregation of roles and responsibilities is a corner stone of process design at NBIM. Processes such as the management of investment mandates, portfolio hierarchy and counterparties are delegated to the Chief Risk Officer (CRO). Changes or additions to existing investment mandates in NBIM, the portfolio hierarchy or new counterparties require approval by the CRO.

NBIM investment mandates

In the investment mandate as given to Norges Bank for the Government Pension Fund Global, there are several guidelines and restrictions for the combined equity and bond asset classes, as well as for the individual asset classes. These restrictions regulate to what degree Norges Bank can engage in active investment management while remaining within the rule based capital allocations.

NBIM's framework for investment risk

The Executive Board's risk management principles are detailed further in NBIM through policies and guidelines. The responsibility for an effective organisation and process related to risk management is delegated to the CRO to ensure a robust risk management process within NBIM.

Risk management process

NBIM implements measurements, processes and systems to mitigate the risk of overreliance on any one given method of measurement, process or system to control investment risk. NBIM complements robust best of breed risk management systems and processes with internally developed measurements and processes to ensure an overlap between industry solutions with flexible alternative solutions and risk management processes.

Risk management at NBIM is defined as:

- Market risk management
- Credit risk management
- Counterparty risk management, and
- Operational risk management

The first three items listed are defined by NBIM as investment risk. In NBIM the investment area has responsibility for investing, and for taking and managing the portfolio risk and individual mandate risk, while the risk management area independently measures, manages and reports investment risk across the portfolio, asset classes and other levels within the portfolio that reflect the investment process. Operational risk is managed separately from investment risk.

Investment risk – market risk

NBIM defines market risk as the risk of a loss or a change in the market value of the portfolio or in a part of the portfolio as a result of changes in financial market variables. This includes movements in credit spreads. Market risk is measured by NBIM on the following dimensions: absolute and relative exposure as compared to the benchmark, volatility and correlation risk which estimates the economic risk to the entire portfolio or to parts of the portfolio, systematic factor risk and liquidity risk. Market risk is actively taken to generate investment returns in line with the objective of the investment mandates.

Investment risk – credit risk

NBIM defines credit risk as the risk of loss due to an issuer being unable to meet its payment obligations. Within credit risk NBIM measures risk as: single issuer credit risk where the probability of default and loss given default are taken into account, as well as portfolio credit risk where credit risk takes into account the correlation in credit losses between the instruments and the issuers. Credit risk is actively taken to generate investment returns in line with the investment mandates' objectives.

Investment risk – counterparty risk

NBIM defines counterparty risk as the risk of loss related to the possible bankruptcy of a counterparty or other similar event leading to counterparty default. Counterparty risk can be divided into credit risk associated with the bankruptcy of a counterparty, default risk and custodian risk. Counterparty risk is controlled and mitigated to the largest extent possible, given the investment strategy.

Market risk measurement

Market risk is the risk of changes in the value of the portfolio due to movements in interest rates, equity prices, foreign currency exchange rates and credit spreads. Norges Bank measures risk in both absolute terms for the actual portfolio, and the relative market risk for holdings of the Government Pension Fund Global.

Measurement and assessment of market risk in NBIM is performed along multiple risk dimensions, employing several methodologies and approaches. Combining different and complementary risk measures gives increased insight into the risk profile related to the holdings of the Government Pension Fund Global.

Asset class per region

The portfolio is invested across several asset classes and regions as shown in table 12.1.

Table 12.1: Allocation by asset class and region

	Region	Market value* in percent	Owner's capital before management fee
Equities	Americas and Africa	36.7%	
	Europe	48.0%	
	Asia and Oceania	15.2%	
Total equities		60.2%	1,891,250
Bonds	Americas and Africa	35.2%	
	Europe	59.8%	
	Asia and Oceania	5.0%	
Total bonds		39.8%	1,186,170

* Includes only holdings in equities and bonds.

Concentration risk

Within the holdings of the Government Pension Fund Global a large percentage of the investments are in government issued bonds. It is also normal for private companies to issue both bonds and equities. The following tables show the concentration of investment in the largest issuers of government bonds and other issuers.

Table 12.2 shows the largest exposures in bonds issued by governments, including government bonds issued in local currency, foreign currencies and inflation-linked bonds issued in local currency.

Table 12.2: Largest positions within the category government and inflation-linked bonds by issuing country

	Market value in NOK million
USA	164,627
United Kingdom	98,581
Germany	73,609
Italy	58,461
Japan	54,991
France	52,345
Spain	25,361
Belgium	14,229
The Netherlands	12,940
Austria	11,224

Table 12.3 shows the portfolio's largest holdings of non-government issues, for both bonds and equities. Covered bonds issued by financial institutions are included in the bonds column.

Table 12.3: Largest total positions excluding governments, for both bonds and equities

Figures in NOK million	Sector	Bonds	Equities	Total
HSBC Holdings PLC	Financial institution	2,780	21,152	23,932
Fannie Mae	Government related	22,828	-	22,828
European Investment Bank	Government related	22,273	-	22,273
Royal Dutch Shell PLC	Energy	-	21,403	21,403
Nestle SA	Consumer/non-cyclical	-	21,285	21,285
Bank of Scotland PLC	Financial institution	17,996	-	17,996
Kreditanstalt fuer Wiederaufbau	Government related	17,108	-	17,108
Vodafone Group PLC	Communication	1,346	15,215	16,561
BP PLC	Energy	499	15,938	16,437
Banco Santander SA	Financial institution	5,854	8,794	14,648

Volatility and correlation risk

NBIM uses risk modelling to quantify the economic risk, connected to the entire portfolio or parts of a portfolio. Examples of risk measures used are Value at Risk and tracking error. Value at risk and tracking error are standard risk measurements based on statistical methodologies such as standard deviation. The risk measures give an estimate of how much one can expect the portfolio's value to change assuming normal markets conditions. Expected volatility can be expressed in terms of the portfolio's risk or active risk. Tables 12.4 and 12.5 present risk both in terms of the portfolio's absolute risk and the relative/active risk.

Table 12.4: Portfolio risk in terms of expected standard deviation through 2010 (in percent)

		Expected volatility – responsive					Expected volatility – long-term				
	Risk measure	31.12. 2010	Min 2010	Max 2010	Average 2010	31.12. 2009	31.12. 2010	Min 2010	Max 2010	Average 2010	31.12. 2009
Portfolio	Standard deviation	7.2%	6.2%	9.8%	7.7%	7.2%	13.2%	13.1%	15.8%	13.6%	14.5%
Equities	Standard deviation	9.7%	9.2%	15.9%	11.9%	10.0%	21.1%	21.0%	25.2%	21.7%	22.4%
Bonds	Standard deviation	8.3%	6.3%	13.9%	9.6%	10.0%	12.3%	11.2%	13.4%	12.2%	11.8%

Table 12.5: Active risk in terms of expected tracking error through 2010 (in basis points)

		Expected volatility – responsive					Expected volatility – long-term				
	Risk measure	31.12. 2010	Min 2010	Max 2010	Average 2010	31.12. 2009	31.12. 2010	Min 2010	Max 2010	Average 2010	31.12. 2009
Portfolio	Tracking error	23.86	23.86	59.19	34.10	26.88	54.06	37.41	58.47	47.72	40.01
Equities	Tracking error	28.49	27.18	46.84	37.95	34.50	60.51	44.79	70.93	58.11	56.98
Bonds	Tracking error	32.00	30.75	114.44	55.12	40.10	76.80	50.74	90.41	76.43	55.71

At the end of 2010 the total risk for the Government Pension Fund Global's holdings and the risk for the equity asset class were at the same level as at the end of 2009, while the fixed income asset class risk was reduced from 10 to 9 percent. During 2010 risk levels varied and peaked in the second quarter as the standard deviation for the entire portfolio, for equities and for fixed income was 9.8 percent, 15.9 percent and 13.9 percent, respectively. Volatility in both the equity and fixed income markets increased due to the uncertainties in the European government debt markets, funding challenges for banks and fears of an economic downturn. In the second half of 2010 the expectation of a new recession lessened and fluctuations in equity markets declined.

In the responsive modelling shown in the table above, Norges Bank has used a parametric calculation methodology based on daily returns with a decay factor of 0.97 which implies that newer data is given more weight than older data. This measurement approach has been employed in 2010 and prior years for measurement against the 150 basis points expected tracking error restriction given by the Ministry of Finance. The mandate for the Government Pension Fund Global in force from 2011 has a limit of 100 basis points expected tracking error. Controls to ensure compliance with this restriction will be based on a new long-term model which uses equally distributed weekly return data over the last three years and a parametric calculation methodology. This long-term model is a better match when compared to the long-term investment horizon of the Government Pension Fund Global's holdings. The same methodologies are used for both portfolio risk and tracking error. Tracking error based on both a responsive return series and on the long-term model has been within the current and the new restrictions in 2010.

Strengths and weaknesses

A strength of these types of risk models is that one can estimate the risk of a portfolio across different asset classes, markets, currencies, securities and derivatives and express the risk through one single figure which takes into account the correlation between different asset classes, securities and risk factors.

Model-based risk estimates are based on historical relationships in the market place. Models that use recent historical data have good forecasting capabilities in normal markets. Alternatively, in periods with significant changes in volatility and correlation the estimates will be less reliable. Additionally the models estimate risk over a specified period of time based on the assumptions that the exposures are liquid and can be closed within the period. Calculated volatility gives a point estimate of risk, and gives little information about the total risk profile (the tail ends of the risk distribution). Annualisation assumes that volatility and the portfolio in its entirety are constant over time. To compensate for these weaknesses in the model, NBIM uses complementary models, methods and various stress tests.

Follow-up testing of models (back testing)

Follow-up testing of the models (back testing) is performed to validate the model's ability to estimate risk. One of the methods used is to compare the predicted risk estimated by the models to the actual risk observed in the portfolio's actual return.

The table below summarizes the total observations where actual loss exceeds the expected risk, the expected frequency and the ratio between them. Only downside risk has been taken into account. The closer the observed/expected ratio is to 1, the better the model has estimated risk. Three different confidence levels are considered. A ratio above one indicates that the risk has been underestimated.

Table 12.6: Comparison between portefolio's expected loss frequency and actual loss frequency

Risk measure	Period	Expected	Actual	Actual/Expected
Standard deviation	2 years	83	65	0.78
Value at Risk 95%	2 years	26	19	0.73
Value at Risk 99%	2 years	5	4	0.77

Table 12.7: Comparison between expected and actual loss frequency on relative return

Risk measure	Period	Expected	Actual	Actual/Expected
Standard deviation	2 years	83	42	0.50
Value at Risk 95%	2 years	26	13	0.50
Value at Risk 99%	2 years	5	4	0.77

The Government Pension Fund Global investment mandate allows for the opportunity to be exposed to several systematic risk factors. Risk factors are common security characteristics that most securities are to some extent exposed to, and that contribute to both the risk and to the return of a security. This type of factor analysis is based on the observed return on the portfolio and attempts to explain the observed return based on a number of factors, such as the market portfolio, emerging economies, value stocks and small-cap companies over a long time series.

Credit risk

Credit risk is the risk of losses from issuers of fixed income instruments defaulting on their payment obligations. Fixed income instruments in the portfolio's benchmark portfolio are all rated as investment grade by one of the major credit rating agencies, Standard & Poor's (S&P), Moody's or Fitch. The credit rating reflects the issuer's expected creditworthiness. Bonds in the fixed income asset class benchmark portfolio are investment grade and therefore deemed to represent low credit risk. In Table 12.8, 2.3 percent of the actual portfolio is categorised non-investment grade (Higher risk) as of 31 December, 2010.

Table 12.8 specifies the actual fixed income portfolio based on the different credit rating categories as of 31 December 2010.

Table 12.8: The bond portfolio specified by credit rating

Figures in NOK millions	Aaa	Aa	A	Baa	Higher risk	Total
Government bonds	390,840	109,658	6,989	9,106	4,402	520,995
Government related bonds	97,246	38,097	7,410	5,576	446	148,775
Inflation linked bonds	58,558	44,260	-	-	519	103,337
Corporate bonds	4,139	45,576	82,693	69,837	4,935	207,180
Securitised bonds	207,742	40,997	3,549	1,880	18,619	272,787
Total bonds and other fixed income securities	**758,525**	**278,588**	**100,641**	**86,399**	**28,921**	**1,253,074**

Following the financial crisis of 2007 and 2008 bankruptcy and default rates increased. As of the end of 2010 the portfolio of the Government Pension Fund Global held defaulted bonds with a market value of NOK 2.9 billion, or 0.2 % of the holdings in the fixed income portfolio. The nominal size of defaulted bonds was NOK 13.3 billion. Norges Bank uses a credit default definition in line with the definition used by the credit rating agencies for securitised debt. Defaulted bonds are grouped under "Higher risk" in the table above.

Table 12.9 below shows the fixed income asset class aggregated by credit rating and currency. In line with the ruled-based capital allocation European currencies are a larger percentage of the fixed income asset class than the market value in the benchmark portfolio would indicate.

Table 12.9: The bond portfolio specified by credit rating and currency

	Aaa	Aa	A	Baa	Higher risk	Total
EUR	26.0 %	14.1 %	3.3 %	2.1 %	0.5 %	46.0 %
USD	21.3 %	2.5 %	3.6 %	4.0 %	1.7 %	33.1 %
GBP	9.2 %	0.6 %	1.0 %	0.6 %	0.0 %	11.4 %
JPY	0.0 %	4.4 %	0.0 %	0.0 %	0.0 %	4.4 %
CAD	1.4 %	0.6 %	0.1 %	0.1 %	0.0 %	2.2 %
Other currencies	2.8 %	0.0 %	0.0 %	0.1 %	0.0 %	2.9 %
Total	**60.7 %**	**22.2 %**	**8.0 %**	**6.9 %**	**2.3 %**	**100.0 %**

The credit risk of the portfolio can be managed through the use of credit derivatives. The credit risk in the bond portfolio is reduced through the use of this type of derivative. See note 6 Financial derivatives for additional information.

In addition to the credit rating based approach Norges Bank has started using two other methods to measure credit risk. These model-based approaches complement the credit rating method and are used to monitor credit risk in the fixed income asset class independently of credit rating. These methods are comparable to Value at Risk and tracking error in the manner in which credit risk is quantified into one number and is a function of observable credit spreads and equity prices. Norges Bank will continue to develop the use of these methods.

Counterparty risk

Norges Bank is exposed to risk vis-à-vis counterparties in the international settlement and custody systems where trades are settled. Additionally, counterparties are necessary to ensure efficient cash management, and effective trading and hedging of market and/or credit risk. Repurchase and reverse repurchase agreements and securities lending via external agents also give rise to counterparty risk.

Norges Bank reduces counterparty risk concentration by using many counterparties and by setting strict credit rating requirements. Rating requirements for counterparties with unsecured bank deposits on the behalf of Norges Bank are higher than in situations when collateral is given. Netting agreements are used to further mitigate counterparty exposure when trading in OTC derivatives and foreign exchange contracts. An additional reduction in counterparty risk is ensured through a collateral requirement for counterparty net positions with a positive market value. The concentration of counterparty risk is reduced through the implementation of low exposure limits per counterparty.

The method used to calculate counterparty exposure, gross and net, is in accordance with the recommendations of the UK Financial Services Authority. Two methods are used. An internal counterparty risk model was implemented during 2010 for OTC derivatives, time deposits, bank deposits, and foreign exchange contracts. The model prices these positions using different assumptions to take into account possible future market movements. The model gives a measurement of expected future exposure. Netting agreements and collateral is taken into account in determining the net exposure.

An expanded financial collateral method is used for repurchase agreements and securities lending transactions executed via external agents. This method entails calculating the market value and adding an additional internal charge that reflects the position's volatility. These positions are also adjusted for netting and actual received and given collateral when determining the net exposure. In table 12.10 the exposure is specified by type of activity/instrument that is categorised as having counterparty risk. In addition to the figures from the internal risk model, the counterparty risk according to the balance sheet figures is given, adjusted for both recognised and not recognised collateral.

Table 12.10: Counterparty risk by type of position

	Balance sheet value adjusted for collateral	Gross exposure	Netting effects	Collateral and guarantees	Net exposure
Time deposits	2,796	2,708	-	-	2,708
Unsecured bank deposits	3,279	3,281	-	-	3,281
OTC derivatives including foreign exchange contracts	-6,098	8,523	5,462	1,581	1,480
Repurchase and reverse repurchase agreements*	-4,081	5,756	579	-	5,177
Securities lending transactions**	-16,352	30,965	-	17,597	13,368
Total		**51,233**	**6,041**	**19,178**	**26,014**

*The column Balance sheet value adjusted for collateral takes into account all positions in the repurchase market, including the reinvestment of cash collateral, see also note 3 Repurchase and reverse repurchase agreements. The internal measurement and controls of counterparty risk for these types of instruments does not include these reinvestments as of year-end.
**The column Balance sheet value adjusted for collateral includes securities lent and received collateral, see also note 4 Lending of securities, and is also adjusted for unrealised losses connected to reinvestments in the form of bonds.

In table 12.10 the balance sheet line Deposits in foreign banks (NOK 6,303 million as of 31 December 2010) is divided into time deposits of NOK 2,796 million, unsecured bank deposits (nostro bank deposits and futures margin) of NOK 3,279 million and NOK 227 million of equity swap margin. The latter is included in the line OTC derivatives including foreign exchange contracts in the table. This line consists of, in addition to the NOK 227 of margin deposits on equity swaps, net market value of foreign exchange contracts (NOK 86 million), swap agreements (NOK -6,217 million) and options (NOK -194 million). See also note 6 Financial derivatives. Counterparty risk for derivative positions is followed-up on a net basis in Norges Bank.

Norges Bank counterparties have a credit rating from an independent credit rating agency. Only in instances when the counterparty risk is considered very low can an internal credit evaluation be used as the basis for counterparty approval. Credit ratings of the bank's counterparties are monitored and complemented by alternative credit risk indicators. Table 12.11 shows Norges Bank's counterparties classified according to credit rating category.

Table 12.11: Counterparties categorised by credit rating

	Norges Bank's counterparties (excluding brokers)	Brokers
Aaa	3	3
Aa	55	57
A	23	36
Baa	-	21
Ba	-	6
B	-	3
Total	**81**	**126**

Leverage

Leverage is used primarily to ensure effective management of the investments. The use of leverage is regulated in the investment mandate issued by the Norges Bank governing board to NBIM. Leverage is measured net as a percent of the net market value of the portfolio of the Government Pension Fund Global. The definition takes into account the net value of cash, cash equivalents as well as derivatives converted to the underlying security and cash position. When the net value of these items is negative, this is defined as leverage. Cash equivalents include bank deposits and bank loans, receivables and short-term liabilities, as well as repurchase and reverse repurchase agreements. The net cash effect is measured as a percentage of the portfolio's net market value. See also note 3 Repurchase and reverse repurchase agreements and note 4 Securities lending for additional information on the activities that principally create leverage. These accounted for close to 80 percent of the leverage effect as of year-end. The remainder is primarily due to short-term liabilities, for example unsettled trades and money market loans that normally contribute to leverage. Leverage in the portfolio of the Government Pension Fund Global is reduced somewhat in 2010 and has been constantly low in the period.

Table 12.12: Net leverage

	2009	1. quarter 2010	2. quarter 2010	3. quarter 2010	2010
Net leverage as a percent of market value as of the end of the period	3.1%	3.0%	2.7%	1.9%	2.1%

Sale of securities Norges Bank does not own

Sale of securities not owned by Norges Bank (short sales) can only be done if the bank has established borrowing agreements to cover a negative position. Such transactions are used to a very low degree.

The annual report 2010 was submitted by Norges Bank's Executive Board on 2 March 2011

Translation from the original Norwegian version.

To the Supervisory Council of Norges Bank

INDEPENDENT AUDITOR'S REPORT

We have audited the financial reporting of the Government Pension Fund Global for 2010 included in Norges Bank's annual financial statements. The financial reporting comprise the balance sheet as at December 31, 2010, and the profit and loss account, showing a profit of NOK 252 416 million, for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial reporting
Management is responsible for the preparation and fair presentation of the financial reporting in accordance with the Norwegian Accounting Act and accounting standards and practices generally accepted in Norway with the reporting exceptions set out in the accounting policies, and for such internal control as management determines is necessary to enable the preparation of financial reporting that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on the financial reporting based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial reporting is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial reporting. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial reporting, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial reporting in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, if any, made by management, as well as evaluating the overall presentation of the financial reporting.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the financial reporting presents fairly, in all material respects, the financial position of the Government Pension Fund Global as at December 31, 2010 and the profit and loss account for the year then ended in accordance with the Norwegian Accounting Act and accounting standards and practices generally accepted in Norway with the reporting exceptions set out in the accounting policies.

Oslo, March 2, 2011

Deloitte AS

Aase Aa. Lundgaard
State Authorised Public Accountant (Norway)

ISSN 1891-1323

Design: Burson-Marsteller by Erik Sand
Photo: NBIM, The Crown Estate (Regent Street) and iStockphoto.
Illustrations: Erik Sand

Paper: Galerie Art Matt 250/150
Production: 07 Gruppen AS
Printed ex.: 1100

Norges Bank Investment Management (NBIM)
Bankplassen 2
P.O. BOX 1179 Sentrum
0107 Oslo
Norway

Phone: +47 24 07 30 00
www.nbim.no