

GOVERNMENT PENSION FUND GLOBAL **ANNUAL REPORT**



2011

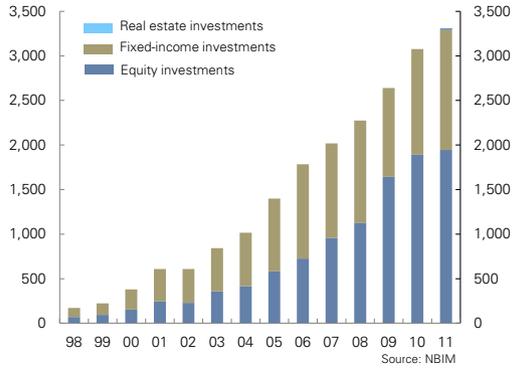
**NBIM**

Norges Bank Investment Management

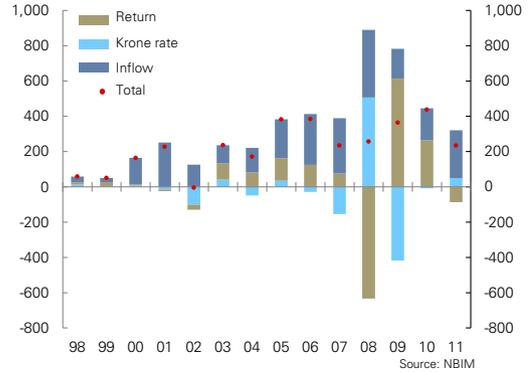
# 2011 in brief

- *The Government Pension Fund Global returned -2.5 percent, or -86 billion kroner, in 2011 as global stock markets declined.*
- *Equity holdings returned -8.8 percent and fixed-income investments returned 7 percent. The overall return was 0.1 percentage point lower than the return on the benchmark indices.*
- *The fund's market value rose 234 billion kroner to 3,312 billion kroner in 2011. Capital inflows to the fund amounted to 271 billion kroner, the largest since 2008.*
- *The fund made its first real estate investments in 2011 and held interests in 114 buildings in London and Paris at the end of the year.*
- *Assets under external management were reduced during the year to 145 billion kroner, or 4.4 percent of the fund, from 283 billion kroner.*
- *The fund held 58.7 percent in equities, 41 percent in fixed income and 0.3 percent in real estate at the end of the year.*

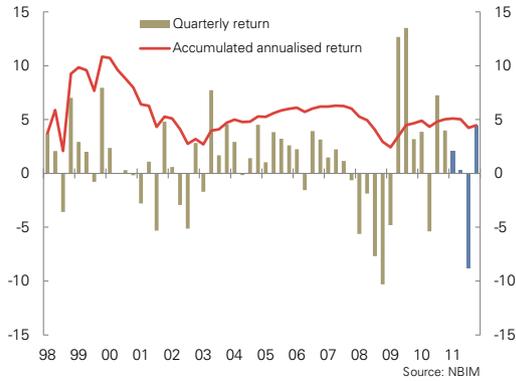
The fund's market value. Billions of kroner



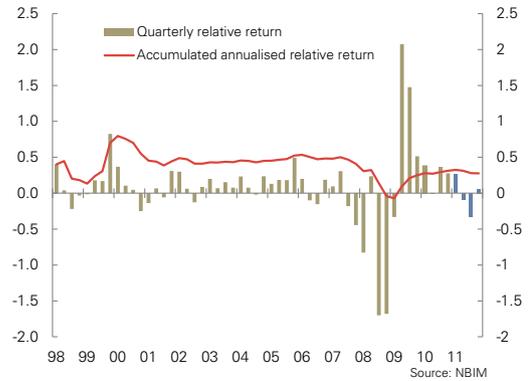
Changes in the fund's market value. Billions of kroner



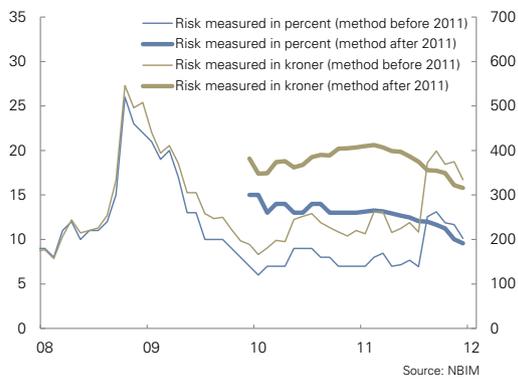
The fund's quarterly return and accumulated annualised return. Percent



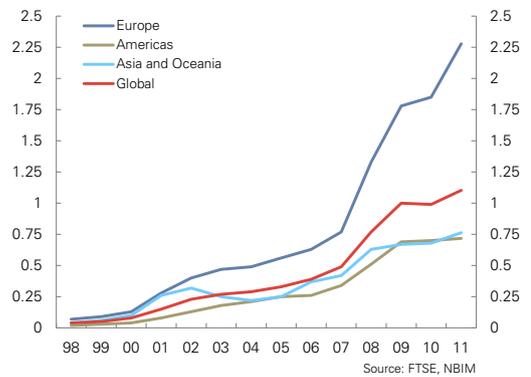
Quarterly relative return and accumulated annualised relative return on the fund, excluding real estate investments. Percentage points



Expected absolute volatility of the fund, excluding real estate. Percent (left-hand axis) and billions of kroner (right-hand axis)



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



A young child is captured in motion, hula hooping on a paved surface. The child is wearing a black helmet, a blue t-shirt, patterned shorts, and protective gear including elbow pads, knee pads, and wrist guards. A pink hula hoop is around their waist. In the background, there is a white wall and some greenery. To the left, a structure with lights is visible. A dark teardrop-shaped graphic is overlaid on the right side of the image, containing the text.

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

# Content

<b>Management</b>	Øystein Olsen	An efficient and transparent fund management	2
	Yngve Slyngstad	Another turbulent year	4
<b>Strategy</b>	Governance model	Effective systems for control and supervision	6
	Investment strategy	Investing for future generations	8
<b>Main developments in 2011</b>	Market developments	Increased turbulence in global markets	10
	Market value	Rise in market value	14
	Returns	Stock slump weighs on returns	16
<b>Fund management</b>	Equity management	Share prices drop on European turmoil	18
	Fixed-income management	Gains on bond investments	22
	Real estate management	Investments in London and Paris	26
	External management	Fewer external mandates	28
	Investment risk	Large fluctuations in the fund's value	32
<b>Investments</b>	Our investments	Larger shareholdings in Europe	38
	Individual investments	Increasing company stakes	42
<b>Active ownership</b>	Strategic focus areas	Safeguarding long-term interests	46
		Highlighting children, climate and water	48
<b>Organisation</b>	NBIM	Strengthening the organisation for future growth	52
	Operational risk management	Unwanted events fall by a third	56
<b>Feature articles</b>	Real estate	Real estate investments	58
	Benchmark indices	Use of benchmarks in the fund management	66
<b>Accounting</b>	Financial Reporting		70
	Notes to the Financial Reporting		75
	Auditor's Report		110

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- [Holdings](#)
- [Voting records](#)
- [Composition of benchmark indices](#)
- [Methodology for the calculation of returns](#)
- [GPS report](#)
- [Significant external suppliers](#)
- [Monthly returns](#)

The governance model and supplementary governing documents are also available on our website.

Translation from Norwegian. For information only.



Øystein Olsen

## An efficient and transparent fund management

The Government Pension Fund Global is growing. Both its management and reporting are adjusting to changes in the landscape and the framework of the fund. 2011 marked the fund's first investments in real estate. It was also the first year the fund's financial reporting followed International Financial Reporting Standards (IFRS).

Norway invests a large proportion of its petroleum revenues in international equity, bond and real estate markets through the Government Pension Fund Global. Norway's welfare must continue to build on the value created within its own borders. The fund's investments provide us with a share of the value created outside our borders.

The government and parliament have set limits for the risks the fund can take. The fund's management aims to achieve the highest possible return within these limits. Norges Bank's Executive Board sets more detailed guidelines for NBIM's management of the fund. The bank's objective is to create value while safeguarding the owners' long-term financial interests through active

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*We are in a position to manage the fund  
with a long-term perspective and ride out periods  
of great uncertainty*

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ownership and efficient implementation of management strategies.

Norges Bank has realised economies of scale in the fund management in recent years. Management costs as a share of the fund have dropped, even though the fund is increasing investments in equities and emerging markets.

Further steps were taken in 2011 to increase transparency of the fund's management. The Executive Board's mandate for NBIM's CEO was revised and published. So were documents presenting principles for risk management, active ownership, organisation, management and remuneration at NBIM. The financial reporting for 2011 is the first to be presented in accordance with IFRS, making it easier to compare our reporting with that of large international companies. This harmonisation also extends to the notes, which have been expanded to include important information in areas such as repurchase agreements, valuations and collateral.

The fund is different from most investors. It does not need to borrow to invest and has no short-term liquidity requirements. We are in a position to manage the fund with a long-term perspective and ride out periods of great uncertainty. The fund's size also means that we can exploit investment opportunities globally and in many different asset classes. Investments in real assets are

in a start-up phase and we are mandated to invest as much as 5 percent of the fund in real estate. Investments in real assets will over time provide good protection against inflation and the direct yield may be expected to be relatively stable. At the same time, this type of investment presents new challenges in limiting Norges Bank's risks and liabilities.

One of Norges Bank's tasks is to advise the Ministry of Finance on strategic issues in the management of the fund. In the past year, the bank gave advice on key aspects of investment strategy, including allocations to different asset classes and regions and the division of responsibilities between manager and owner. The aim is to strike the best possible balance between risk and expected return.

*Oslo, 29 February 2012*



*Øystein Olsen*  
*Chairman of the Executive Board*



Yngve Slyngstad

## Another turbulent year

It was another turbulent year in global capital markets. The third quarter was the second weakest in the fund's history as debt market concerns deepened and stocks declined. A recovery in the fourth quarter left the fund with an annual return of -2.5 percent, or -86 billion kroner. We are prepared for significant fluctuations in the fund's value from year to year.

The euro-area debt crisis escalated during the year as government bond yields in southern Europe climbed. In contrast, ten-year government bond yields in large economies such as the US, Germany and the UK fell to record lows. Nominal yields on government bonds from these

countries declined to below 2 percent at the end of the year, while real yields were negative.

We bought more than 150 billion kroner in European equities from the summer through the end of the year.

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*We continued developing our fund management in 2011 to take greater advantage of our long-term approach as we invest for future generations*

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This was in line with the long-term strategy of investing in assets that have fallen in price and that we think will over time generate a high return. Because more than half of the fund is invested in Europe, it is of great importance to us that authorities are successful in solving the considerable structural and monetary challenges faced by the euro countries.

We continued developing our fund management in 2011 to take greater advantage of our long-term approach as we invest for future generations. We created a team to allocate funds to areas based on their long-term development and risk characteristics. We strengthened analytical capacities in equities, real estate, credit and macro-economics. We also formed a group to enhance the financial theoretical foundations for areas of the fund and established the Norwegian Finance Initiative.

The fund received 271 billion kroner in government petroleum revenue and grew to a market value of 3.31 trillion kroner in 2011. We are focused on safeguarding these substantial assets for future generations as we build our investment strategy and organisation.

*Oslo, 29 February 2012*



*Yngve Slyngstad*  
CEO of NBIM

## Governance model

# Effective systems for control and supervision

With effective controls and supervision, the fund's governance model provides a sound foundation for daily investment management.

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

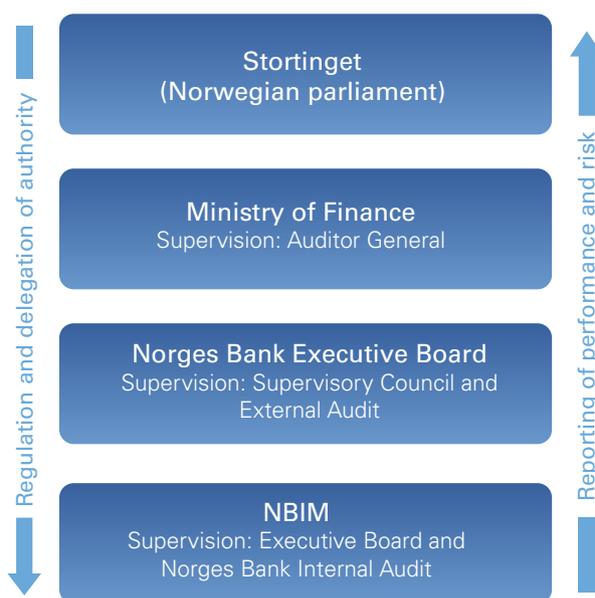
The Ministry of Finance has formal responsibility for the fund's management and has laid down general guidelines in the Mandate for the Management of the Government Pension Fund Global. The fund's management is entrusted to Norway's central bank (Norges Bank), which has delegated the task to Norges Bank Investment Management (NBIM). The central bank's internal audit unit carries out oversight and supervision on behalf of the bank's Executive Board.

### Executive Board

The Executive Board is responsible for Norges Bank's operations and has 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 strategies and guidelines for NBIM's fund management. NBIM seeks to add value, safeguard the owners' long-term financial interests through active ownership and implement the owners' investment 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's chief executive officer is responsible for the fund's daily management and reports directly to the Executive Board. The CEO is advised on different aspects of the fund's management by several committees.

The Executive Board receives reports on the fund's returns and risks, in addition to reports on operational risk management, internal controls and regulatory



compliance. The board also approves the public quarterly and annual reports on the fund's management.

The Executive Board has set up audit and remuneration subcommittees as preparatory bodies. The remuneration committee prepares recommendations for the board on the salaries of NBIM's CEO and other senior managers who report directly to the CEO. The committee also makes recommendations on principles for performance-based pay and, annually, on the framework for performance-based pay. The audit committee handles matters related to risk management and control, as well as the financial statements. The bank's internal audit unit serves as the committee's secretariat.

### Supervisory Council

The Supervisory Council has 15 members appointed by parliament. It supervises Norges Bank's operations and



compliance with applicable rules. This includes checking that the Executive Board has adequate oversight and control over the bank's operations and whether there are appropriate procedures to ensure that operations are carried out in accordance with applicable laws, agree-

ments, decisions and other rules. The council appoints the bank's external auditor, approves the auditor's fees, approves the bank's budget and adopts its annual financial statements. The council also submits an annual statement to parliament on its work.

### Governing documents for investment management

The Executive Board revised the structure and content of the governing documents for NBIM's investment management in 2011. The documents set out principles for risk management, active ownership, organisation, management and remuneration. They also describe the delegation of responsibility and authority for the fund's management to NBIM's CEO. The documents are available on NBIM's website.

*Principles for Risk Management at NBIM* outlines guidelines for identifying, measuring, managing and reporting on risk in the fund's management. It also sets guidelines for the organisation of risk management and divides risk into four areas – market risk, credit risk, counterparty risk and operational risk. NBIM has to fulfil specific requirements within each area.

*Principles for Ownership Management at NBIM* describes a general position on the roles and responsibilities of companies and their directors, as well as the focus areas and tools for NBIM's active ownership work.

*Principles for Organisation and Management at NBIM* contains rules for managing investment activities, including reporting requirements. The document also sets out general requirements for NBIM's internal organisation.

*Principles for Compensation of Employees at NBIM* presents the structure and key requirements of NBIM's remuneration system.

*Job Description for the CEO of NBIM* outlines the delegation of responsibility for all NBIM's activities to its chief executive officer.

*Investment Mandate for the Government Pension Fund Global* describes the delegation of investment responsibilities to NBIM's CEO. The mandate builds on the fund's strategy and the management mandate from the Ministry of Finance. It includes supplementary limits for managing investment risk.

## Investment strategy

# Investing for future generations



NBIM seeks to exploit the fund's long-term outlook and size to generate high returns and safeguard wealth for future generations.

The overall strategy is set by the Ministry of Finance, which decides on asset classes and regions for the fund's investments. The fund shall hold 60 percent in equities, 35-40 percent in fixed income and as much as 5 percent in real estate. The asset classes have their own regional and currency weightings, all with a large emphasis on Europe.

The goal is to achieve a high long-term return with moderate risk. NBIM's strategy plan for 2011-2013 emphasises the trade-off between return and risk and seeks to take greater advantage of the investment opportunities derived from the fund's size and long-term perspective.

### **Long-term investments**

The fund invests for future generations. It has no clearly

defined obligations, does not depend on short-term funding and is not subject to rules that could require costly adjustments at inopportune times. The fund can withstand periods of great volatility in capital markets and is able to exploit opportunities that arise when other investors are forced into short-term decisions. This took place during the financial crisis in 2007-2009 and again in the autumn of 2011, when the fund bought substantial amounts of stocks as the markets slumped.

NBIM in 2011 developed its investment management to take greater advantage of the fund's long-term perspective and size. We set up a team to allocate funds to different markets and assets based on their long-term prospects. We also increased the number of companies where we have large, long-term investments. We made the fund's first real estate investments and developed

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*Our investment decisions are based on in-depth analysis. In 2011, we boosted our analytical capacities in equities, real estate, fixed income and macroeconomics*

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our management in this area. In addition, we introduced a new operational bond benchmark portfolio and reduced the number of fixed-income holdings.

A good long-term return depends on sustainable economic, environmental and social developments. We consider social, environmental and governance risks when making large investments and as part of our active ownership. We established a database in 2011 with information on such risks at about 4,000 of the largest companies the fund held shares in at the end of the year.

**Strengthened analysis**

Our investment decisions are based on in-depth analysis. In 2011, we boosted our analytical capacities in equities, real estate, fixed income and macroeconomics. We set up a group to analyse credit markets and a team to analyse economic developments. We also established a unit focusing on the theoretical foundation of different parts of the fund's management. As part of this, we introduced the Norwegian Finance Initiative (NFI) to promote financial research and education in areas relevant to the fund's long-term management. These may include asset pricing and portfolio theory, corporate finance, active ownership, corporate governance and market microstructure.

Our portfolio managers analyse stocks, bonds and properties to find investments with the potential for good long-term returns. Each manager has a clearly defined mandate and the results are measured regularly. Our

portfolio managers and analysts have regular contact with the board and management of companies we invest in to increase their knowledge of relevant industries. We had more than 2,200 meetings with about 1,300 companies in 2011.

**Operational benchmark portfolio**

NBIM has constructed internal operational benchmark portfolios for equity and bond investments. These reflect the types of securities that we believe represent a neutral and appropriate strategy. The benchmark portfolios are designed to avoid undesirable risk in parts of the capital market that do not fit with the fund's size, long-term outlook and objective. The portfolios are based on groups of securities picked because of their return and risk characteristics.

The internal operational benchmark portfolio for bond investments was modified in 2011. This included reducing the number of bonds in the portfolio to about 5,000 from approximately 11,000. We also moved to a gross domestic product weighting from a market weighting on euro-denominated government debt, leading to a reduction in investments in government bonds from some of the most heavily indebted European countries. In addition, we increased the number of currencies and countries in the benchmark portfolio and included bonds from countries such as China, India and Indonesia.

**14 January:** Tunisia's government is ousted after popular uprisings across North Africa that also lead to regime change in countries including Egypt and Libya.

**17 March:** The G7 countries agree on coordinated currency intervention to help Japan avoid further appreciation of the yen.

**7 April:** The ECB raises its benchmark interest rate by 25 basis points to 1.25 percent.

**4 May:** The EU and IMF agree with Portugal on a 75 billion-euro rescue package.

JANUARY 2011

MARCH 2011

APRIL 2011

MAY 2011

**11 March:** Japan is hit by a major earthquake and tsunami, causing a serious nuclear accident.

**8 April:** North Sea oil surpasses 125 dollars per barrel.

## Market developments

# Increased turbulence in global markets

Europe's debt crisis and weaker global economic growth weighed on stock markets in 2011, particularly on shares in the financial industry and emerging markets. A flight to safer investments fuelled an increase in the price of bonds, which were the best-performing asset class.

The two-year-old sovereign debt crisis entered a new phase in 2011. In May, Portugal became the third euro country after Greece and Ireland to receive financial support from the European Union and the International Monetary Fund. Concern that debt difficulties would also spread to some of the region's larger economies, such as Italy and Spain, led to considerable volatility in stock and bond markets in the year.

In September, the IMF warned of serious consequences if European authorities failed to prevent contagion of the debt crisis and cut its forecasts for global growth in 2011 and 2012 to 4 percent from 4.3 percent and 4.5 percent, respectively. The Organization for Economic Cooperation and Development in November raised concern about the euro's survival and lowered growth projections for its 34 member countries to 1.9 percent from 2.3 percent in 2011 and to 1.6 percent from 2.8 percent in 2012.

Standard & Poor's in August reduced its credit rating for the US to AA+ from AAA amid concern over how the nation's debt was managed. The downgrade came three

days after President Barack Obama and Congress agreed, after weeks of talks, to raise the US debt ceiling from 14.3 trillion dollars as well as lower public spending by 2.4 trillion dollars over the next decade.

The VIX index, a key measure of expected volatility in the US stock market, on 8 August had its biggest one-day gain since February 2007. It jumped 16 percentage points to 48 percent, the highest level since March 2009. The index ended the year at 23 percent, up from 18 percent a year earlier. The equivalent European VStoxx Index climbed 8 percentage points during the year to 32 percent.

In emerging economies such as China, the world's second-largest economy, authorities shifted from a focus on curbing inflation with higher interest rates to stimulating the economy with rate cuts and other measures. The People's Bank of China raised its policy rate three times as inflation accelerated to a three-year high in July, before in November lowering its reserve requirements for the country's banks for the first time in three years in response to weakening growth toward the end of year.

**11 July:** Finance ministers from the 17 euro countries sign a treaty establishing the 500 billion-euro European Stability Mechanism (ESM) to provide financial assistance to euro countries from 2013.

**2 August:** A new debt ceiling is agreed on in the US after political disagreement had fuelled market turmoil.

**5 August:** Credit rating agency S&P downgrades the US for the first time ever.

**7 August:** The ECB says it will resume purchases of debt to support markets.

**8 August:** The VIX index surges to 48 percent, the highest since March 2009.

**31 August:** Brazil's central bank cuts its benchmark interest rate just six weeks after raising it.

JULY 2011

AUGUST 2011

**7 July:** The ECB raises its benchmark rate by 25 basis points.

**31 July:** China's inflation reaches 6.5 percent. The country's central bank in 2011 raises its bank reserve requirement six times and its benchmark rate three times to ease inflationary pressure.

**11 August:** Ten-year Italian government bond yields rise to more than 7 percent for the first time since the euro's inception.

Expectations for slower growth and waning demand pushed prices for metals such as copper, aluminium and nickel lower during the year. China accounted for about 40 percent of world copper consumption in 2011 and the euro area for approximately 20 percent. Meanwhile, benchmark oil prices climbed for a third consecutive year, gaining 9 percent in London and 17 percent in New York, as political turmoil in the Middle East and North Africa stoked concerns that oil supplies would be reduced.

**Stock markets decline**

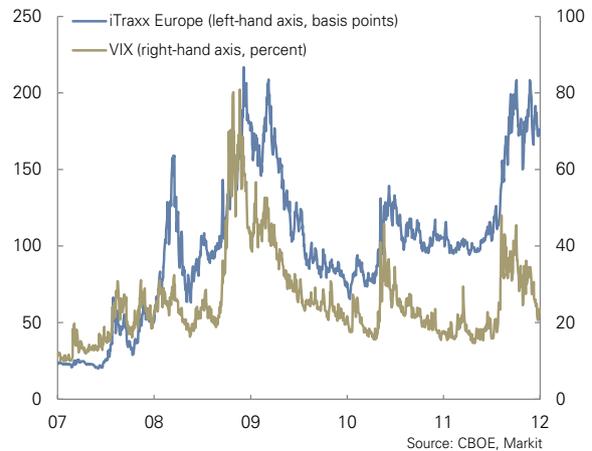
The MSCI All-Country World Index of shares fell 9 percent in 2011, after gaining 10 percent in 2010 and 32 percent in 2009.

Concern the debt crisis would cause losses at European banks made the region's lenders less willing to lend to each other. The Euribor-OIS spread – the difference between the rate banks quote each other for unsecured euro-denominated loans and the expected deposit rate at the ECB – more than doubled to 97 basis points at the end of the year from 41 basis points a year earlier. Inter-bank rates for dollar-denominated loans climbed in December to their highest levels since July 2009.

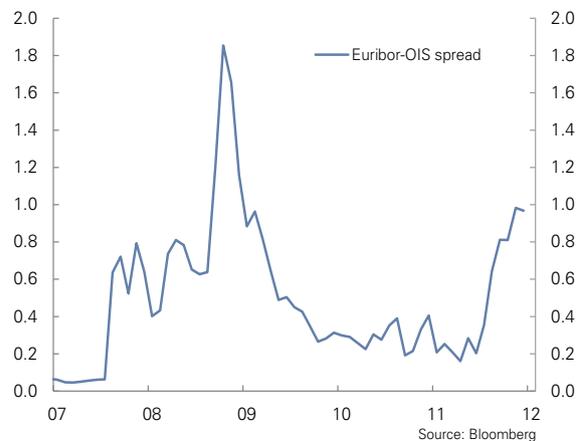
The STOXX Europe 600 index fell 11 percent in 2011, led by a decline in bank shares. Growing concern over some euro countries' ability to service their debt and fears of bank losses in the event of sovereign default triggered a 32 percent decline in European bank stocks in the year.

European stocks retraced some losses after reaching a low in September. Euro-area leaders agreed in the second

**Chart 1-1** Expected risk in stock markets (VIX index) and fixed-income markets (iTraxx index)



**Chart 1-2** Difference between three-month euro interbank rate (Euribor) and overnight indexed swaps (OIS). Percentage points



**5 September:** Nigeria's central bank says it will hold part of its currency reserves in renminbi to reduce its exposure to the dollar.

**21 September:** The Federal Reserve launches Operation Twist to swap 400 billion dollars of short-term debt for bonds with longer maturities between October 2011 and June 2012.

**6 October:** The Bank of England announces further quantitative easing, increasing planned purchases of government bonds by 75 billion pounds to 275 billion pounds.

SEPTEMBER 2011

**6 September:** The Swiss National Bank announces that it will intervene to keep the franc below 1.20 against the euro after the two currencies approached parity in August amid concern of a euro collapse.

OCTOBER 2011

**22 September:** Ten-year US treasury yields fall to their lowest level since at least 1953.

half of the year to increase financial support to countries with payment problems. The European Central Bank cut its benchmark rate in November and December by a total of 50 basis points to 1 percent to stimulate economic growth. Six central banks, including the ECB and the Federal Reserve, in November together offered banks cheaper emergency dollar loans to improve their funding options and prevent a credit squeeze. In December, the ECB also said it would issue a record 489 billion euros in three-year loans to more than 500 banks.

In the US, the S&P 500 stock index ended the year unchanged, after gaining in 2010 and 2009. Falling stock prices for financial and commodities companies were offset by rising health care and consumer goods stocks. The index was down as much as 14 percent through October after several institutions cut their growth forecasts for the US and concern mounted that the European debt crisis would worsen. Stocks erased losses toward the end of the year, buoyed by signs of improvements in the US economy and the ECB's unprecedented liquidity injection in December.

In Asia, stock markets fell for the first year since 2008, weighed down by concern that the European debt crisis would weaken global growth and after an earthquake and tsunami struck Japan on 11 March. The natural disaster halted output at many factories and caused the most serious nuclear accident since the 1986 Chernobyl explosion at the Fukushima Daiichi atomic power plant. Shares of Tokyo Electric Power Company, the owner of the plant, plummeted 91 percent in 2011. The MSCI Asia Pacific stock index fell 17 percent in the period.

Chart 1-3 Price developments for credit default insurance for government debt. Basis points

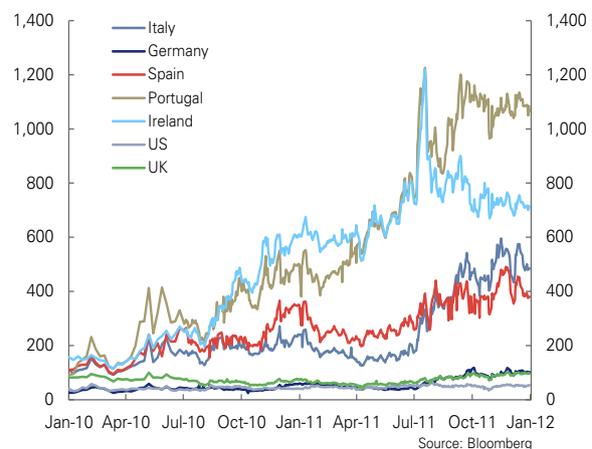
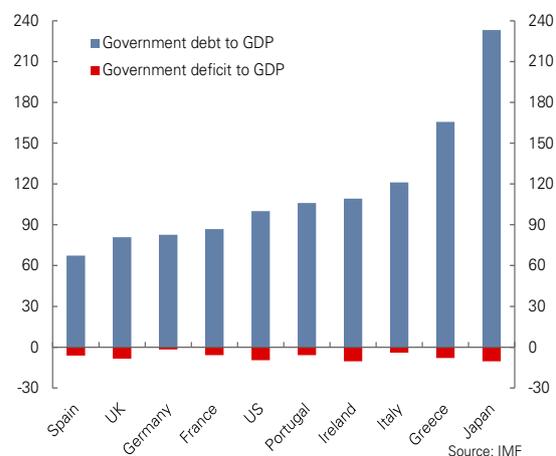


Chart 1-4 Estimated government gross debt and budget deficits in some countries in 2011 as a percentage of gross domestic product. Percent



**1 November:** Mario Draghi takes over from Jean-Claude Trichet as president of the ECB. Two days later the bank cuts its benchmark rate by 25 basis points.

**6 November:** Greek Prime Minister George Papandreou steps down. Five days later a coalition government is formed under former ECB vice president Lucas Papademos.

**30 November:** Six central banks take coordinated action to improve liquidity in interbank markets and avoid a credit squeeze.

**30 November:** The People's Bank of China cuts its bank reserve requirement for the first time in almost three years.

**5 December:** Credit rating agency S&P warns of possible downgrades of Germany, France and 13 other euro-area countries.

## NOVEMBER 2011

**16 November:** Italian Prime Minister Silvio Berlusconi resigns and a technocratic government is formed shortly afterwards by Mario Monti.

**28 November:** The Bank of Israel, the first to raise interest rates in 2009, cuts its benchmark rate by 25 basis points.

**8 December:** The ECB cuts its benchmark rate by another 25 basis points and offers banks unlimited three-year loans.

## DECEMBER 2011

The Shanghai Composite index, which tracks developments in listed Chinese companies, fell 22 percent in 2011. China's economic growth was 8.9 percent in the fourth quarter, the slowest in ten quarters, as authorities took measures to curb inflation.

### Strong year for bonds

Bonds were the best-performing asset class in 2011 because investors flocked to government bonds from countries such as the US, the UK and Germany as a safe haven from the debt crisis. Yields on these bonds fell to record lows during the year. That contrasts with yields on government bonds from Italy and Spain, the third- and fourth-largest euro economies, which in the second half of the year climbed to euro-era records amid growing speculation of potential debt defaults.

Bonds gained as the ECB bought government debt from euro countries including Italy and Spain to ease the turmoil and lower borrowing costs. Spain's ten-year yield fell to 5.1 percent at the end of the year, down from as high as 6.7 percent in November and 5.4 percent at the start of the year. The equivalent Italian yield rose to 7.1 percent from 4.8 percent at the beginning of the year. By the end of 2011, the ECB had bought about 215 billion euros of government debt since it started purchases in May 2010, including about 140 billion euros in 2011.

UK gilts were the best-performing government bonds in Europe, with an average return of 17 percent in 2011. This was about 7 percentage points higher than the return on benchmark German bunds, which were held back by concern that the euro would fall apart. Standard & Poor's

warned in December of a possible credit rating downgrade on Germany, France and 13 other euro countries.

US government bonds returned about 10 percent, the most since 2008. The Federal Reserve said in August it would keep its policy rate low until mid-2013 to stimulate economic growth. The following month, the bank announced it would swap 400 billion dollars of short-term debt in its investments for longer-maturity bonds to bring down long-term yields. This followed two rounds of quantitative easing, or purchases of bonds, for 2.3 trillion dollars between March 2009 and June 2011.

In the foreign exchange market, the euro fell 3.3 percent against the dollar in 2011 and in December traded below 100 yen for the first time since 2001. The yen climbed 5.4 percent against the dollar, while the renminbi gained 4.7 percent against the US currency.

## Market value

# Rise in market value

The fund's market value increased 234 billion kroner to 3,312 billion kroner in 2011 after the largest inflows of new capital in three years.

The market value of equity investments rose 54 billion kroner to 1,945 billion kroner during the year and fixed-income investments climbed 170 billion kroner to 1,356 billion kroner. The fund's first real estate investments were made in 2011 and had a market value of 11 billion kroner at the end of the year.

The market value is affected by investment returns, capital inflows and exchange rates. The fund returned -86 billion kroner in 2011, while capital inflows from the government were 271 billion kroner, the most since 2008. A weakening of the krone against several major currencies increased the market value by 49 billion kroner.

The fund had 83 percent of its investments in pounds, dollars, yen and euros at the end of 2011. The krone fell 1.9 percent against the pound, 2.7 percent to the dollar

and 8.2 percent versus the yen during the year. It gained 0.7 percent against the euro.

The fund, which is in a start-up phase in real estate investing, is mandated to hold 60 percent in equities, 35 percent in fixed income and 5 percent in real estate. Actual investments at the end of 2011 were 58.7 percent in equities, 41 percent in fixed income and 0.3 percent in real estate.

The share of equities fell below the long-term target of 60 percent after a slump in global stock markets reduced the value of the holdings. The fund's capital inflows are primarily invested in the worst-performing asset class. In 2011, 69 percent of the fund's inflows of 271 billion kroner were invested in equities, 27 percent in fixed income and 4 percent in real estate.

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

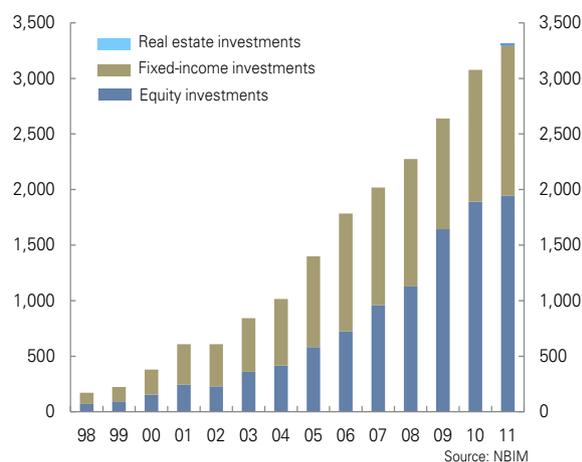


Chart 2-2 Changes in the fund's market value. Billions of kroner

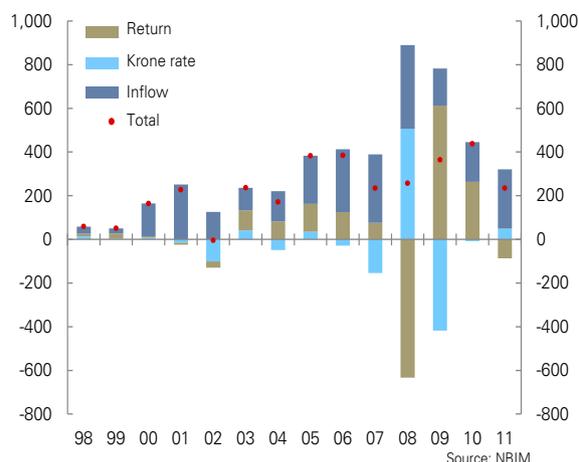
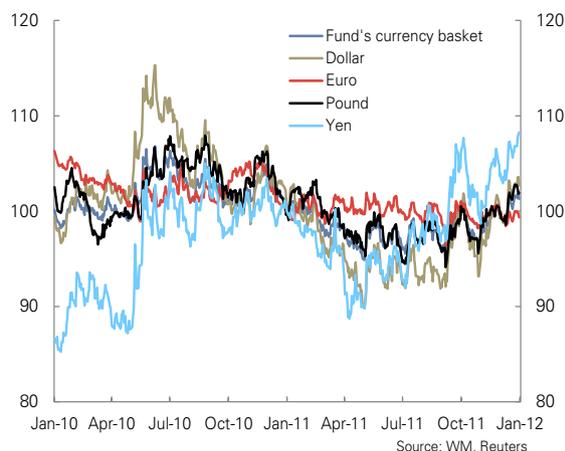


Table 2-1 Accumulated return since 1996. Billions of kroner

	2011	2010	4Q 2011	3Q 2011	2Q 2011	1Q 2011
Return on equity investments	226.0	394.8	226.0	103.6	432.2	446.9
Return on fixed-income investments	434.2	351.4	434.2	421.3	376.8	357.8
Return on real estate investments	-0.2	-	-0.2	-0.4	-0.2	-
Total return	659.9	746.2	659.9	524.6	808.8	804.7

**Chart 2-3** Movements in currency exchange rates against the krone. Indexed. 31 Dec 2010 = 100



## Returns in international currency

The fund's investments in international securities are not converted into kroner in connection with financial reporting and are not hedged against moves in the krone. Changes in the krone exchange rate do not affect the fund's international purchasing power. Consequently, the return is generally measured in international currency – a weighted combination of the currencies in the fund's benchmark indices for equities and fixed income. This basket consisted of 35 currencies at the end of 2011. The krone weakened 1.2 percent against the group of currencies in the year.

The returns in table 2-1 and table 2-2 were calculated in the international currency basket before being converted into kroner.

**Table 2-2** Key figures as of 31 December 2011

	2011	2010	4Q 2011	3Q 2011	2Q 2011	1Q 2011
<b>Market value (billions of kroner)*</b>						
Market value of equity investments	1 945	1 891	1 945	1 699	1 881	1 900
Market value of fixed-income investments	1 356	1 186	1 356	1 346	1 226	1 197
Market value of real estate investments	11	-	11	10	4	4
Market value of fund	3 312	3 077	3 312	3 055	3 111	3 102
Inflow of new capital*	271	182	102	78	53	38
Return on fund	-86	264	135	-284	4	59
Change due to fluctuations in krone	49	-8	19	150	-48	-73
Total change in fund	234	437	257	-56	9	24
<b>Management costs (percent)</b>						
Estimated transition costs	0.02	0.01	0.01	0.01	0.01	0.01
Annualised management costs	0.08	0.11	0.08	0.08	0.08	0.08
<b>Changes in value since first capital inflow in 1996 (billions of kroner)</b>						
Gross inflow of new capital	2 782	2 508	2 782	2 679	2 601	2 547
Management costs	19	16	19	18	17	17
Inflow of capital after management costs	2 763	2 492	2 763	2 661	2 583	2 530
Return on fund	660	746	660	525	809	805
Change due to fluctuations in krone	-111	-160	-111	-131	-281	-233
Market value of fund	3 312	3 077	3 312	3 055	3 111	3 102
Return after management costs	641	730	641	507	791	788

\* The fund market value presented in this table does not take into account the management fee to NBIM from the Ministry of Finance. The market value will therefore differ slightly from the Statement of cash flows and the Statement of changes in owner's capital in the financial accounts. The inflows in this table differ slightly from those in the financial accounts (see Statement of cash flows and Statement of changes in owner's capital) due to differences in the treatment of management fees.

# Returns

## Stock slump weighs on returns

The fund returned -2.5 percent in 2011 as global stock markets declined. It was the third-weakest year in the fund's history.

The fund's equity holdings returned -8.8 percent, measured in international currency, after a decline in share prices in Asia, the US and, particularly, Europe. Fixed-income investments returned 7 percent as bond prices rose, while one-off transaction costs led to a return of -4.4 percent on the fund's real estate investments. The annual result was the third weakest since the fund's inception.

Returns on the fund's equity and fixed-income investments are compared to returns on global benchmark indices for stocks from FTSE Group and bonds from Barclays Capital. The return on the equity and fixed-income investments was 0.1 percentage point lower than the return on the benchmark indices in 2011.

The equity investments lagged behind the benchmark by 0.48 percentage point, while fixed-income investments outperformed the benchmark by 0.52 percentage point. NBIM does not report a relative return for real estate investments as these were in a start-up phase in 2011.

From 1 January 1998 to 31 December 2011, the fund generated an annual gross return of 4.5 percent, measured in international currency. It had an annual net real return of 2.4 percent after management costs and inflation.

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

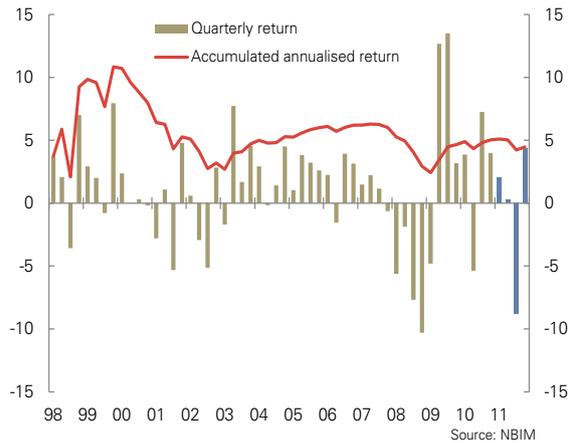


Chart 3-1 The fund's annual returns. Percent

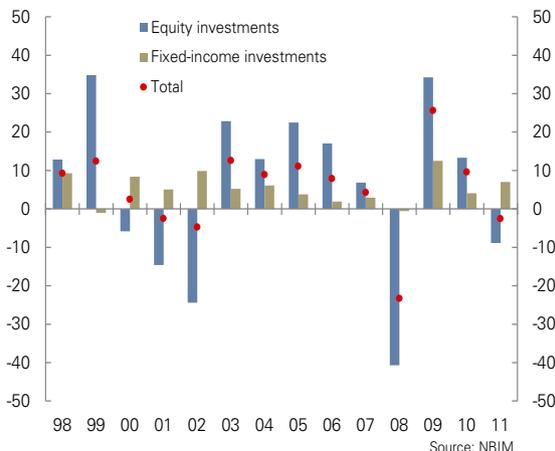
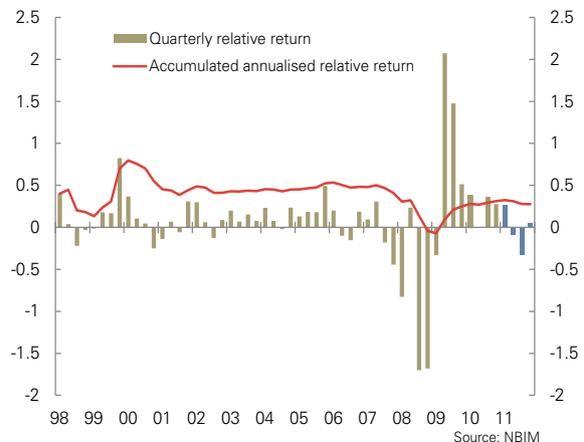


Chart 3-3 Quarterly relative return and accumulated annualised relative return on the fund, excluding real estate investments. Percentage points



**Table 3-1** Returns as of 31 December 2011

	2011	2010	4Q 2011	3Q 2011	2Q 2011	1Q 2011
<b>Returns in international currency</b>						
Equity investments (percent)	-8.84	13.34	7.36	-16.95	-0.65	2.91
Fixed-income investments (percent)	7.03	4.11	0.74	3.65	1.78	0.72
Real estate investments (percent)	-4.37	-	0.44	-0.10	-4.70	-
Fund (percent)	-2.54	9.62	4.39	-8.80	0.29	2.06
Fund, excluding real estate (percent)	-2.55	9.62	4.41	-8.82	0.30	2.06
Benchmark indices, excluding real estate (percent)	-2.42	8.57	4.35	-8.49	0.39	1.80
Relative return of fund, excluding real estate (percentage points)	-0.13	1.06	0.06	-0.33	-0.09	0.27
Relative return of equity investments (percentage points)	-0.48	0.73	0.12	-0.50	-0.16	0.13
Relative return of fixed-income investments (percentage points)	0.52	1.53	-0.01	-0.00	0.03	0.48
Management costs (percentage points)	0.08	0.11	0.02	0.02	0.02	0.02
Return after management costs (percent)	-2.63	9.52	4.37	-8.82	0.27	2.04
<b>Returns in kroner (percent)</b>						
Equity investments	-7.77	13.21	7.94	-12.85	-2.32	0.37
Fixed-income investments	8.30	3.99	1.28	8.76	0.07	-1.76
Real estate investments	-0.79	-	0.99	4.83	-6.30	-
Fund	-1.39	9.49	4.96	-4.30	-1.39	-0.45
Fund, excluding real estate	-1.39	9.49	4.97	-4.32	-1.38	-0.45

**Table 3-2** Historical key figures as of 31 December 2011. Annualised data in international currency

	Last 12 months	Last 3 years	Last 5 years	Last 10 years	Since 1 Jan 1998
Return on fund (percent)	-2.54	10.30	1.42	4.16	4.48
Return on fund, excluding real estate (percent)	-2.55	10.30	1.42	4.16	4.48
Return on benchmark indices, excluding real estate (percent)	-2.42	8.78	1.49	3.95	4.20
Relative return on fund, excluding real estate (percentage points)	-0.13	1.52	-0.07	0.21	0.28
Standard deviation (percent)	8.42	10.53	11.01	8.45	7.82
Tracking error, excluding real estate (percentage points)	0.44	0.83	1.23	0.90	0.79
Information ratio (IR), excluding real estate*	-0.30	1.83	-0.06	0.24	0.35
Gross annual return on fund (percent)	-2.54	10.30	1.42	4.16	4.48
Annual price inflation (percent)	2.77	2.19	2.22	2.14	1.91
Annual management costs (percent)	0.08	0.11	0.10	0.10	0.10
Annual net real return on fund (percent)	-5.25	7.83	-0.89	1.87	2.42

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

**Table 3-3** Contributions from equity and fixed-income management to the fund's relative return in 2011. Percentage points

	External management	Internal management	Total*
Equity investment	-0.02	-0.33	-0.34
Fixed-income investment	-0.02	0.24	0.21
Total	-0.04	-0.09	-0.13

\* The figures in the table do not always add up to the sub totals and total due to rounding of decimals.

**Table 3-4** Return on the fund in 2011 in different currencies. Percent

	USD	EUR	GBP
Return on fund	-3.96	-0.75	-3.25

## Equity management

# Share prices drop on European turmoil



The fund's equity investments returned -8.8 percent in 2011, weighed down by declines in Europe, where the fund had half its shareholdings at the end of the year.

Concern that the European debt crisis would deepen and signs of weaker global economic growth damped investors' risk appetite in 2011, triggering declines in most of the fund's stock sectors.

Investments in the basic materials and industrial sectors, which are particularly sensitive to economic cycles, returned -22.2 percent and -13.8 percent, respectively, measured in international currency. Several institutions, including the Organisation for Economic Cooperation and Development, cut their forecasts for global economic growth after weaker-than-expected performance in Europe and the US. In November, the OECD warned of the danger of a global slowdown unless authorities took steps to stimulate growth and contain the debt crisis.

The fund's financial stocks returned -19.2 percent in 2011, the second-weakest sector after basic materials. Shares of financial institutions declined the most in Europe, where forecasts for bank earnings were lowered because of the risk of slower economic growth and potential losses from sovereign defaults. The fund's European financial stocks returned -24.8 percent, measured in international currency, while US and Asian financial shares returned -11.1 percent and -17.7 percent, respectively. Financials were the fund's largest equity sector, accounting for 19.8 percent of the holdings at the end of the year.

Investments in oil and gas shares returned -2.4 percent and comprised 11.6 percent of the equity holdings. Benchmark crude oil prices rose 8.6 percent in London



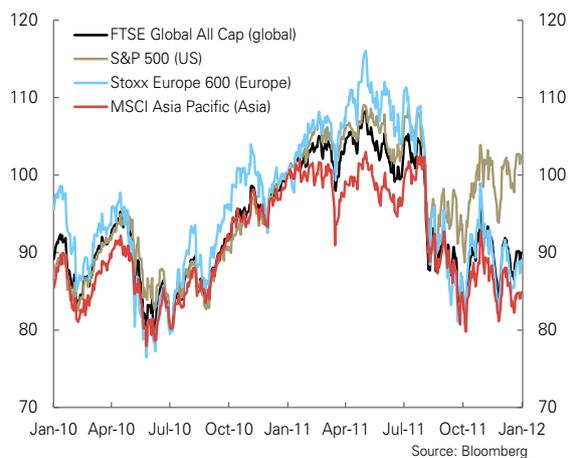
and 17 percent in New York on concern political unrest in the Middle East and North Africa would reduce the supply of oil. Shares of Royal Dutch Shell and Exxon Mobil, among the fund's ten largest equity holdings at the end of the year, gained 13.8 percent and 15.9 percent, respectively.

Investments in healthcare shares returned 10.2 percent in 2011, the only stock sector with a positive return. Healthcare shares are often considered a safer investment in turbulent markets and the sector accounted for 9.5 percent of the fund's equity holdings at the end of the year.

**Regional performance**

About 50 percent of the fund's equity investments were in Europe, 35 percent in the Americas, Africa and the

**Chart 4-1** Price developments in regional and global equity markets, measured in US dollars. Indexed. 31 Dec 2010 = 100



Middle East and 15 percent in Asia and Oceania. Equity investments in these regions returned -12.1 percent, -2.4 percent and -15.5 percent, respectively, in 2011, measured in international currency.

The fund had 30.3 percent of its shareholdings in the US at the end of 2011, making it the largest equity market. The UK was the second-largest market with 16.3 percent of the holdings, followed by France with 6.9 percent, Switzerland with 6.3 percent, Germany with 5.8 percent and Japan with 5.6 percent.

Japanese stocks made up 40 percent of the fund's equity investments in Asia and Oceania and returned -18.7 percent in 2011, measured in local currency. The earthquake and tsunami that hit Japan on 11 March halted production at factories owned by companies including Toyota, Honda, Fujitsu and Sony, and triggered a serious accident at the Fukushima Daiichi nuclear power plant, north of Tokyo. Shares of Tokyo Electric Power Company (Tepco), the owner of the plant, slumped 91 percent. The company was the fund's worst-performing investment in Japan in 2011.

Equity investments in the four largest emerging economies – Brazil, Russia, India and China – declined as investors' risk appetite waned. Investments in emerging markets tend to fluctuate in value more than those in developed markets. The MSCI Emerging Markets index, which tracks stock markets in 21 emerging economies, fell 20.4 percent in 2011 after gaining 16.4 percent in 2010. By contrast, the Stoxx Europe 600 index fell 11.3 percent in 2011, while the S&P 500 index in the US ended the year unchanged. The fund's equity investments returned -10.1 percent in Brazil, -19.5 percent in Russia, -34.4 percent in India and -21.8 percent in China, measured in local currency. Investments in these countries constituted 5 percent of the fund's shareholdings at the end of the year.

Stock markets in the Middle East and North Africa fell after popular uprisings that began in Tunisia at the start of the year spread to countries including Algeria, Egypt, Bahrain, Libya and Syria. This led to regime changes in several countries, including Egypt, which closed its exchange for almost two months. Equity investments in the Middle East and North Africa made up 0.2 percent

**Table 4-1** Return on the fund's equity investments

	Return (percent)	Relative return (percentage points)
1999	34.81	3.49
2000	-5.82	0.49
2001	-14.60	0.06
2002	-24.39	0.07
2003	22.84	0.51
2004	13.00	0.79
2005	22.49	2.16
2006	17.04	-0.09
2007	6.82	1.15
2008	-40.71	-1.15
2009	34.27	1.86
2010	13.34	0.73
2011	-8.84	-0.48

**Table 4-2** Return on the fund's equity investments in 2011.  
By sector. Percent

Sector	Return in international currency	Share of equity investments
Financials	-19.17	19.76
Industrials	-13.77	13.13
Consumer goods	-3.61	12.72
Oil and gas	-2.37	11.56
Healthcare	10.23	9.52
Consumer services	-2.92	8.98
Technology	-5.32	7.87
Basic materials	-22.24	7.82
Telecommunications	-2.32	4.40
Utilities	-9.75	4.25

of the fund's stocks at the end of the year and returned -28.5 percent, measured in international currency.

### Individual investments

The investment that contributed the most to the fund's return in 2011 was Apple, maker of the iPad and the iPhone, followed by UK drugmaker GlaxoSmithKline and US oil company Exxon. The worst-performing investment was French bank Société Générale, followed by German carmaker Daimler and UK bank HSBC Holdings.

Globally, about 162 billion dollars was raised through initial public offerings in 2011, down 42 percent from 2010, according to Bloomberg. Initial public offerings for about 48 billion dollars were cancelled or postponed in 2011, the most since 2008, as investor demand waned. These included IPOs of Spanish lottery operator Sociedad Estatal Loterías y Apuestas del Estado, Siemens' lighting unit Osram and Chinese aluminium producer China Hongqiao. In total, listed companies raised about 560 billion dollars from selling new and existing shares in 2011, down from 804 billion dollars in 2010.

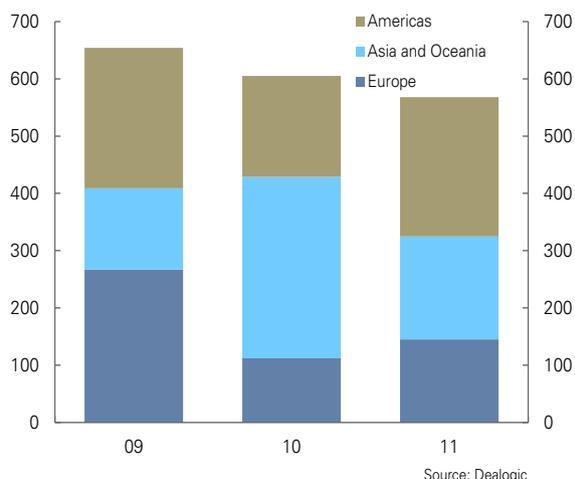
The largest capital raising the fund bought shares in was Swiss commodities company Glencore International's May issue of shares for 6 billion pounds, or 54 billion kroner. This was followed by US insurer American International Group and Germany's Commerzbank, which sold shares for 8.7 billion dollars and 5.3 billion euros, respectively.

### Relative return of equities

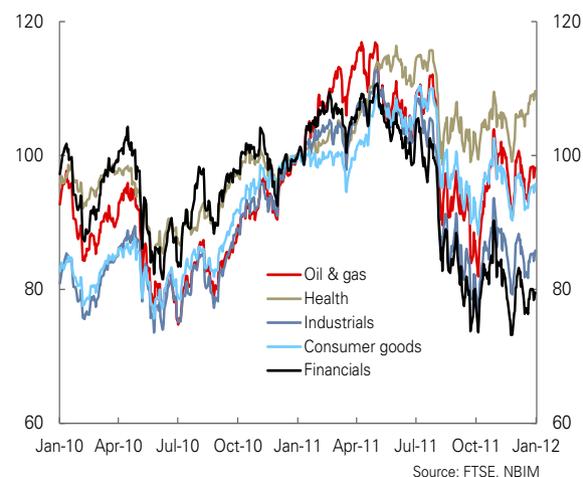
The fund held shares in 8,005 listed companies at the end of 2011. These investments are measured against an index from FTSE Group consisting of 7,265 listed companies.

The return on the fund's equity investments was 0.48 percentage point lower than the benchmark index's return in 2011, the second-weakest relative return since the fund's inception. Among the fund's stock sectors, investments in basic materials and oil and gas performed the worst relative to the benchmark index, while investments in technology and financial stocks performed the best. In terms of countries, US and Hong Kong stocks performed the worst relative to the benchmark index, while investments in Spain and France performed the best.

**Chart 4-2** Volume of public offers, rights issues and entitlement offers in global equity markets. Billions of dollars



**Chart 4-3** Price moves in stock sectors in the FTSE Global All Cap Index. Measured in US dollars. Indexed. 31 Dec 2010=100



## Fixed-income management

# Gains on bond investments

The fund's fixed-income investments returned 7 percent in 2011, helped by gains for government bonds that were deemed the safest.

Yields on government bonds from countries such as the US, Germany and the UK fell to record lows during the year as investors sought the safest investments. By contrast, Greek, Portuguese, Italian, Spanish and Irish government bond yields reached euro-era highs on concern the countries would be unable to meet their debt obligations. Investors normally demand more in yield to lend money through a bond when the perceived risk of default increases, pushing down the bond's price.

Ten-year Italian government bond yields climbed to 7.1 percent at the end of 2011 from 4.8 percent a year earlier, while the equivalent Portuguese yields rose to 13.4 percent from 6.6 percent. The ECB's purchases of government debt from a number of European countries in the second half of the year helped curb the rise in yields. Ten-year Spanish government bond yields fell to 5.1 percent at the end of the year from a peak of 6.7 percent in November.

Ten-year German government bond yields, a benchmark for European sovereign debt, fell to 1.8 percent from 3 percent during the year.

### Government bond prices rise

The fund's government bond holdings returned 10.5 percent in 2011, measured in international currency. Rising prices of German, French, US, UK and Japanese government bonds outweighed a drop in prices of bonds from some European countries. Investments in euro-denominated bonds returned 4.1 percent, while UK, US and Japanese government debt returned 21.4 percent, 16.6 percent and 1.7 percent, respectively, measured in their local currencies. Government bonds accounted for 46.1 percent of the fund's fixed-income investments at the end of the year.

The fund also invests in bonds from government-related institutions such as the European Investment Bank, Kreditanstalt für Wiederaufbau and Caisse d'Amortissement de la Dette Sociale. These accounted for 13.4 percent of the fund's fixed-income investments at the end of the year and returned 5.9 percent, measured in international currency.

Chart 5-1 10-year government bond yields. Percent

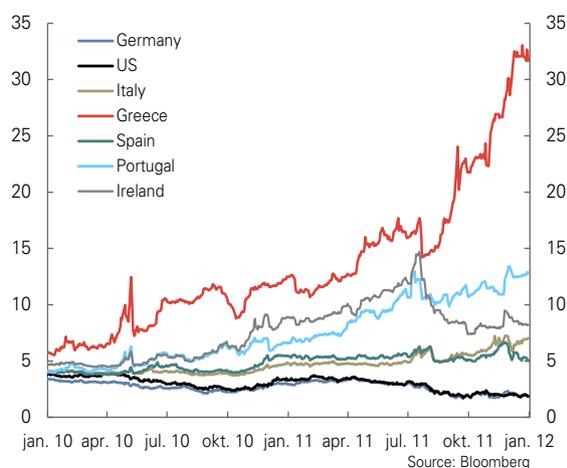


Table 5-1 Return on the fund's fixed-income investments

	Return (percent)	Relative return (percentage points)
1999	-0.99	0.01
2000	8.41	0.07
2001	5.04	0.08
2002	9.90	0.49
2003	5.26	0.48
2004	6.10	0.37
2005	3.82	0.36
2006	1.93	0.25
2007	2.96	-1.29
2008	-0.54	-6.60
2009	12.49	7.36
2010	4.11	1.53
2011	7.03	0.52

**Table 5-2** Return on the fund's fixed-income investments in 2011. By sector. Percent

Sector	Return in international currency	Share of fixed-income investments
Government bonds	10.52	46.14
Government-related bonds	5.87	13.35
Inflation-linked bonds	10.95	7.96
Corporate bonds	5.52	14.19
Securitised debt	3.48	18.36

### Inflation-linked bonds strongest

Inflation-linked bonds, issued almost exclusively by sovereign states, were the fund's best-performing fixed-income sector and returned 11 percent in 2011, measured in international currency. Increased demand for safer investments pushed up prices of US, UK and German inflation-linked bonds, which constituted 60 percent of the fund's investments in the sector. Toward the end of the year, expectations of slower inflation in these countries damped the price increase on these bonds, which are designed to protect investors against inflation.

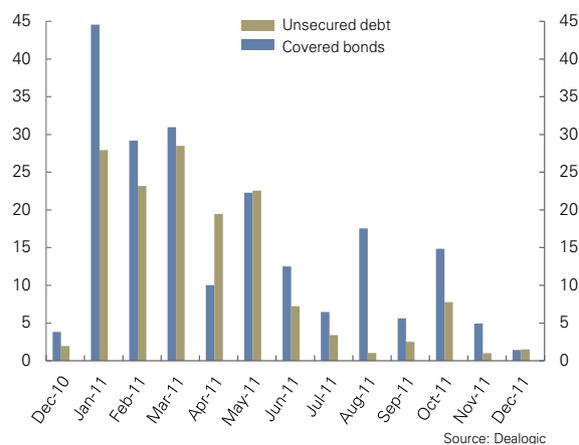
The yield an investor gets on an inflation-linked bond is a real, or inflation-adjusted, yield. Real yields on ten-year inflation-linked bonds in the US fell to -0.11 percent at the end of 2011 from 0.97 percent a year earlier. Ten-year real yields in the UK decreased to -0.58 percent from 0.59 percent, while the equivalent yields in Germany slid to -0.13 percent from 1.04 percent. Inflation-linked bonds accounted for 8 percent of the fund's fixed-income investments at the end of the year.

### Securitised and corporate debt weakest

Securitized debt, consisting of bonds issued by banks and secured by assets such as home mortgages, was the fund's worst-performing fixed-income sector, followed by corporate bonds. Bonds in both sectors gained in price in 2011 but not as much as the highest-rated government bonds.

Euro-denominated covered bonds accounted for about 70 percent of the fund's investments in securitized debt

**Chart 5-2** Issuance of euro-denominated covered bonds and senior unsecured debt. Billions of euros



at the end of the year. Spanish covered bonds were the single largest country holding, comprising 23 percent of investments in the segment. Growing concern about losses at banks in the event of default on Spanish government debt led investors to demand higher yields on bonds issued by Spanish banks. The spread, or difference in yield, between Spanish covered bonds and German government debt widened by about 1.6 percentage points during the year.

The concerns of defaults on government debt also reduced investors' demand for unsecured debt issued by financial institutions, which accounted for 43 percent of the fund's corporate bond investments at the end of the year. Issuance of euro-denominated bank debt fell to 146 billion euros in 2011 from 242 billion euros in 2010, while issuance of euro-denominated covered bonds totalled 200 billion euros, compared with 194 billion euros in 2010, according to Dealogic.

Securitized debt returned 3.5 percent in 2011, measured in international currency, and accounted for 18.4 percent of the fund's fixed-income investments at the end of the year. Corporate bonds returned 5.5 percent and constituted 14.2 percent of bond investments.

### Decline in issuance

Global bond issuance fell to 10.79 trillion dollars in 2011 from 11.13 trillion dollars in 2010, according to Dealogic. Government issues totalled 5.75 trillion dollars, down from 6.18 trillion dollars in 2010. Bond issuance in the financial sector was 3.48 trillion dollars, compared with 3.47 trillion dollars a year earlier.

The fund's three largest investments in new bond issues other than government debt were in covered bonds from Canadian Imperial Bank, Swedbank and Bank of Nova Scotia.

The fund reduced its holdings of Italian and Spanish government bonds in 2011 and increased its investments in US and UK government debt. It also sold most of its holdings of bonds issued by US mortgage agencies Fannie Mae and Freddie Mac.

### Relative return of bonds

The fund was invested in 5,215 bonds from 1,404 issuers at the end of 2011. These investments are measured against an index from Barclays Capital that consisted of 11,430 bonds from 2,315 issuers.

The return on the fund's fixed-income investments was 0.52 percentage point higher than the benchmark's return

in 2011, the third-highest relative return since the fund's inception. Investments in unsecured bonds issued by financial institutions and investments in Japanese inflation-linked bonds made particularly positive contributions to the relative return, while European government bonds and European covered bonds contributed negatively.

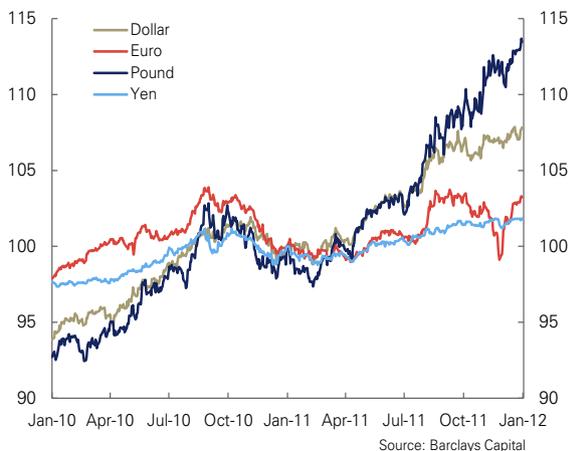
### Operational benchmark portfolio

NBIM's internal operational benchmark portfolio for bond investments reflects the bonds we believe are natural for the fund to hold over time. We reduced the number of bonds in the operational benchmark portfolio in 2011, partly by excluding US asset-backed securities backed by home and auto loans. We also switched to a GDP-weighting from a market-weighting on euro-denominated government debt in the portfolio to reduce investments in bonds from some of the most heavily indebted European countries. These changes were made from mid-April.

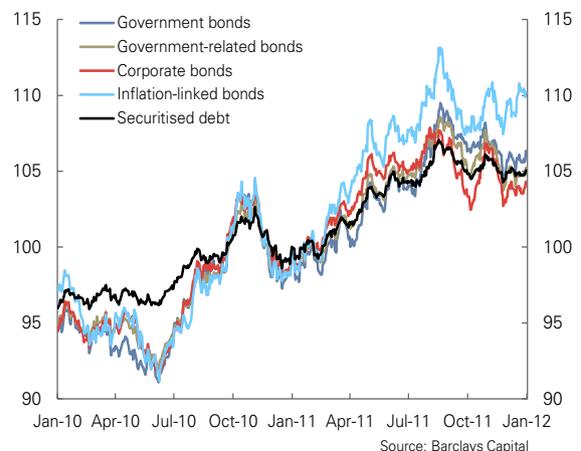
The operational benchmark portfolio had 4,916 bonds at the end of 2011. It returned 6.2 percent from mid-April to the end of the year, 0.19 percentage point more than the benchmark index set by the Ministry of Finance.

For more information on the operational benchmark portfolio, see the feature article on page 66.

**Chart 5-3** Price developments for bonds issued in dollars, euros, pounds and yen in the Barclays Global Aggregate Index, measured in local currencies. Indexed. 31 Dec 2010 = 100

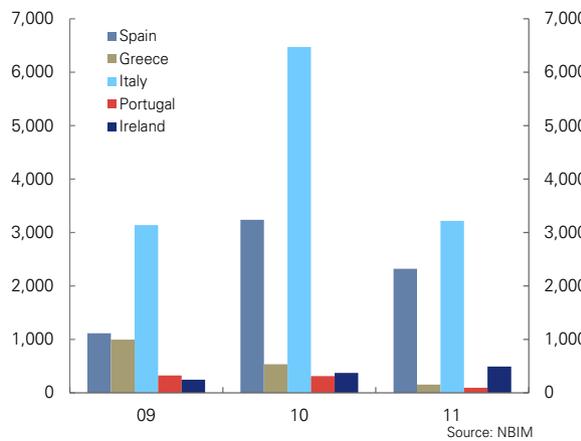


**Chart 5-4** Price developments in fixed-income sectors in the Barclays Global Aggregate Index, measured in US dollars. Indexed 31 Dec 2010 = 100

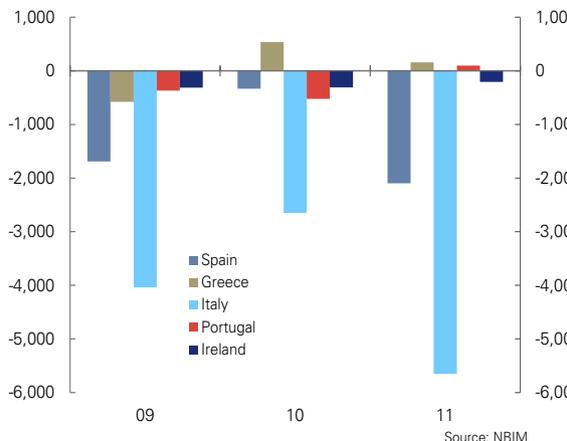




**Chart 5-5** The fund's holdings of government debt in some European countries. Millions of euros



**Chart 5-6** The fund's holdings of government debt in some European countries compared with the fixed-income benchmark index. Millions of euros



## Real estate management

# Investments in London and Paris



After making its first real estate investments in 2011, the fund held interests in 114 buildings in London and Paris at the end of the year.

Real estate investments amounted to about 0.3 percent of the fund at the end of the year. This will over time increase to as much as 5 percent through a corresponding reduction in bond holdings. The fund will focus on investments in well-developed markets and properties such as offices and retail premises. It will initially seek to invest with partners that have good knowledge of specific markets.

The first real estate investment, a 25 percent stake in The Crown Estate's Regent Street portfolio in London, was completed in April. This was followed in July by the purchase of a 50 percent stake in seven properties in and around Paris from AXA Group. The addition during the year of two more buildings in Regent Street and three properties in Paris gave the fund a stake in 114 buildings

at the end of 2011. Most of these were office and retail premises.

The move into real estate will help spread the fund's investments and risk across more markets. Property investments can also protect against inflation as rents are often linked to price indices.

### **European property market**

The return on real estate in Europe was generally lower in 2011 than in the previous year. Properties of a high standard and in prime locations performed best, returning about 9 percent in 2011, compared with 15 percent in 2010, according to the advisors AXA Real Estate Research and DTZ.

## Properties in London and Paris

The fund's first real estate investment was completed in April 2011 with the purchase of a 25 percent stake in The Crown Estate's Regent Street portfolio in London for 452 million pounds, or about 4.2 billion kroner. This was followed in July by the acquisition of a 50 percent stake in seven properties in and around Paris from AXA Group for 702.5 million euros, or about 5.5 billion kroner. In both cases, NBIM and the seller entered into a partnership that made additional investments before the year ended. The Regent Street partnership, which divides its proceeds and expenses with 25 percent to the fund and 75 percent to The Crown Estate, bought two buildings off Regent Street in the third quarter for 28 million pounds. The partnership with AXA bought three buildings in Paris in December for 290 million euros. The fund and AXA each held 50 percent of the investments.

Prices for office buildings in London and Paris rose in 2011 as rents increased. Office rents in London's West End, where Regent Street is located, rose 5.7 percent in the year, while Paris office rents gained 3.8 percent, according to the advisor CBRE. Prices for retail premises rose in London's West End as rents climbed 5.6 percent. They were unchanged in Paris.

### Annual valuations

The book value of the fund's real estate investments should reflect their estimated market value, which will be assessed externally at least once a year. The purchase price will normally be the best estimate of value on a new investment for a period after a transaction, unless market developments or other circumstances indicate a significant change in value.

The purchase price was considered the best estimate of the value of the fund's property investments in France at the end of 2011. The value of the UK investments was increased by 3.2 percent from the purchase price because of higher rents in the Regent Street area.

While the returns on real estate are largely determined by rental income and changes in property values, other revenue and costs are also factors. The fund's real estate investments returned -4.4 percent in 2011, measured in international currency. The negative result was due

primarily to one-off transaction costs. The investments in London returned 1.8 percent, measured in local currency, after the portfolio's revaluation. The Paris investments returned -3.1 percent, measured in local currency, because of the transaction costs.

### Limiting risk

The fund's real estate investments will generally be made through Norges Bank subsidiaries to limit liability to a subsidiary's capital. This is standard market practice and supports the bank's goal of safeguarding the fund's assets through prudent risk management.

Norges Bank set up the subsidiary NBIM S.à r.l. in Luxembourg in May 2011. Many of the fund's real estate investments in mainland Europe will be channelled through the subsidiary, which will hold stakes in entities investing directly or indirectly in properties. The subsidiary's responsibilities also include accounting, book-keeping and transferring of rental income to Norges Bank.

For more information on the fund's real estate investments, see the feature article on page 58 and note 10 in the financial-reporting section.

## External management

# Fewer external mandates



The fund more than halved the share of assets under external management to 4.4 percent in 2011 after ending 18 investment mandates.

NBIM awards investment mandates to external managers with expertise in clearly defined areas. We ended 18 external equity and fixed-income mandates in 2011 and awarded eight equity mandates targeting specific sectors or countries. A total of 52 external mandates were managed by 45 organisations at the end of the year, down from 62 mandates and 45 organisations a year earlier.

The fund had 145.5 billion kroner, or 4.4 percent, under external management at the end of 2011, down from 283.5 billion kroner, or 9.2 percent, a year earlier. The share of externally managed assets is expected to remain low in the future.

### **External equity mandates**

NBIM awards external equity mandates in markets and segments where it is not expedient to build internal

expertise. These mandates are in segments where we see considerable potential for excess returns. This particularly applies to small and medium-sized companies and emerging markets. A total of 51 external equity mandates were managed from 31 cities at the end of 2011, down from 59 mandates a year earlier.

We awarded three new equity mandates in emerging markets in 2011. A total of 59 billion kroner was under external management in emerging markets such as Brazil, Russia, India, China, South Africa, Malaysia, Indonesia, Thailand, Turkey and Poland at the end of the year.

Four mandates were awarded to focus on small companies in developed markets, including France, Germany and Belgium. A total of 54 billion kroner was under external management in this category at the end of 2011.

## Fees to external managers

Fees to external managers have two components: a fixed fee and a performance-based fee. The performance-based fee is based on the difference between the return on a mandate and the return on a comparable index.

NBIM introduced a ceiling in 2009 for the fees paid each year under agreements with external managers. This ceiling was in 2011 set at 25 million dollars per mandate per year. Any fees accrued above this ceiling are held back and paid out at a later date if the manager's excess return since the start of the mandate is larger than when the fees were retained. Holding back part of the fee will promote a long-term management approach.

A total of 917 million kroner was booked in the fund's income statement for 2011 as paid and accrued management fees to the 45 external organisations managing assets for the fund. The single highest fee was 108 million kroner (19 million dollars), reflecting a strong return over the past three years.

We also awarded a mandate for environmental investments and had 9.1 billion kroner under external management in renewable energy and water management by year-end.

The return on the fund's externally managed equity investments was 0.6 percentage point below the return on the benchmark indices the external managers were measured against in 2011. Investments in small companies in developed markets contributed most to the shortfall.

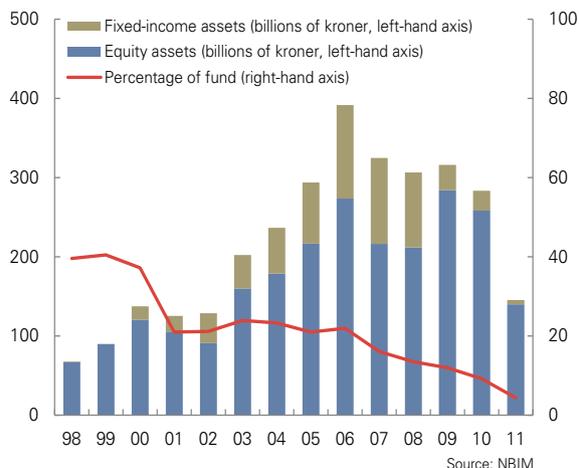
### External fixed-income mandates

The external fixed-income mandates were reduced to one at the end of 2011 from three a year earlier. The remaining mandate was for investments in US mortgage-backed securities and accounted for 0.1 percent of the fund.

The return on the fund's externally managed fixed-income investments was 4.7 percentage points lower than the

return on the benchmark indices the external managers were measured against in 2011.

Chart 7-1 Assets under external management at year-end. Billions of kroner and percentage of the fund





**External managers  
as of 31 December 2011**

Abax Investments  
 Atlantis Fund Management  
 Bestinvest Gestion  
 Black River Asset Management  
 BlackRock  
 BNY Mellon Asset Management  
 BPH TFI  
 Capital International Limited  
 Cephei Capital Management  
 DNB Asset Management

Ecofin  
 Ellerston Capital  
 Financiere de l'Echiquier  
 FPM Frankfurt Performance Management  
 GAM International Management  
 Kairos Partners  
 Kenanga Investors  
 Keywise Capital Management  
 Krungsri Asset Management  
 Landmark Asset Management

Lannebo Fonder  
 Lazard Asset Management  
 Levin Capital Strategies  
 Marsico Capital Management  
 Neuberger Berman Asia  
 NWQ Investment Management  
 Old Mutual Investment Group  
 Passport Capital  
 Primecap Management  
 Prosperity Capital Management

*External mandates are in segments where we see considerable potential for excess returns*

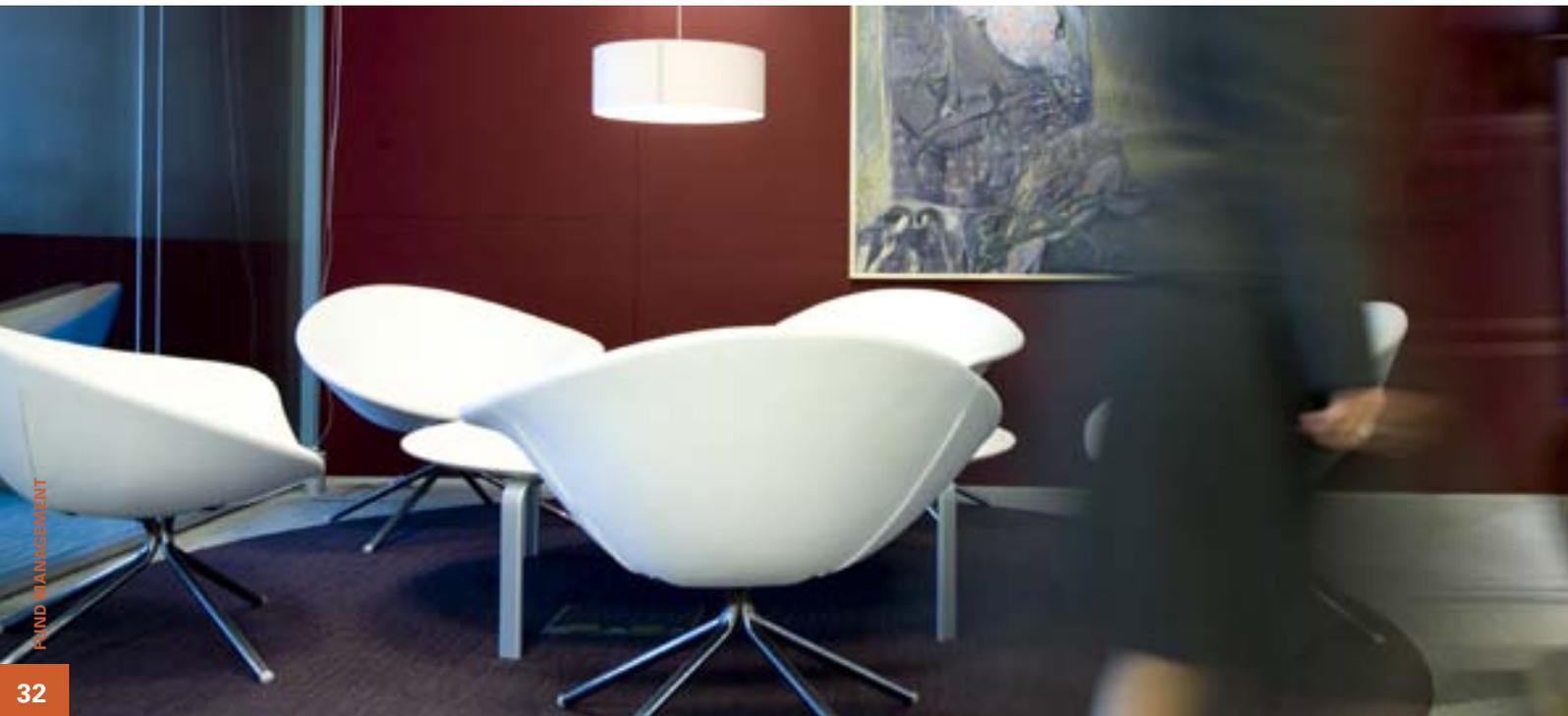


Quantum Advisors Private Limited  
Rheos Capital Works  
Savitr Capital  
Schroder Investment Management  
Sectoral Asset Management  
Selectum Vermogensbeheer  
Sparx Asset Management  
Squadra Investments

T Rowe Price  
Templeton Asset Management  
Thames River Capital  
Toscafund Asset Management  
Troika Dialog  
Victoire Brasil Investimentos  
Water Asset Management

## Investment risk

# Large fluctuations in the fund's value



Uncertainty about government finances in some European countries and weaker global growth prospects increased volatility in stock and bond markets in 2011.

NBIM focuses on three main types of investment risk: market, credit and counterparty. We have set up frameworks in each category for how risk is 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. As no single measure or analysis can fully capture the fund's market risk, we use a variety of measures and analyses, including expected tracking error, factor exposures, concentration analysis and liquidity risk.

### **Increased market volatility**

Volatility in stock and bond markets increased in 2011, driven by uncertainty about European government debt, weaker global growth prospects and funding problems

at banks, especially in Europe. The VIX index, a measure of expected volatility in the US stock market, climbed as high as 48 percent in August from 17.8 percent at the start of the year, after credit rating agency Standard & Poor's downgraded US government debt to AA+ from AAA. At the same time, yields on Spanish and Italian government debt rose on increased fears of default. The iTraxx Europe index, which measures credit insurance premiums for 125 European companies with an investment-grade credit rating, peaked at 2.1 percent in October and November, up from 1.1 percent at the start of the year. The index typically gains when investor confidence decreases and the need for insurance increases.

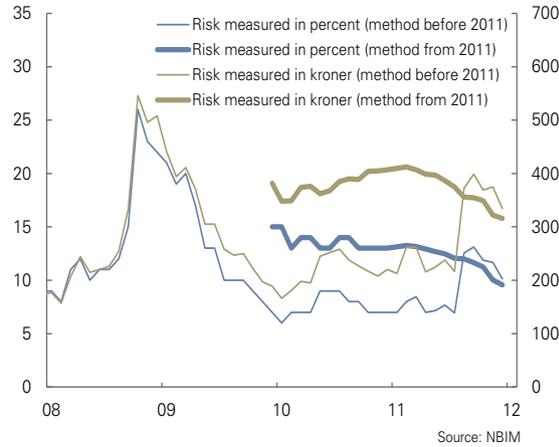
Volatility in the stock markets subsided toward the end of the year after central banks, including the European and the US, announced a series of measures to prevent



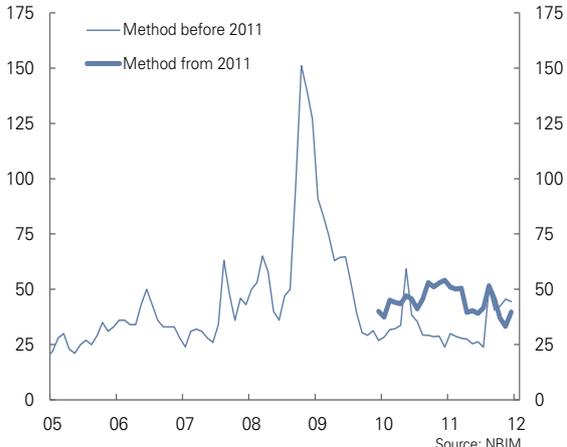
contagion of the debt crisis, avert a credit squeeze at banks and stimulate economic growth. The US economy also showed signs of improvement. The VIX index ended

the year at 23.4 percent and the iTraxx index was at 1.7 percent.

**Chart 8-1** Expected absolute volatility of the fund, excluding real estate. Percent (left-hand axis) and billions of kroner (right-hand axis)



**Chart 8-2** Expected relative volatility of the fund, excluding real estate. Basis points



Source: NBIM

Source: NBIM

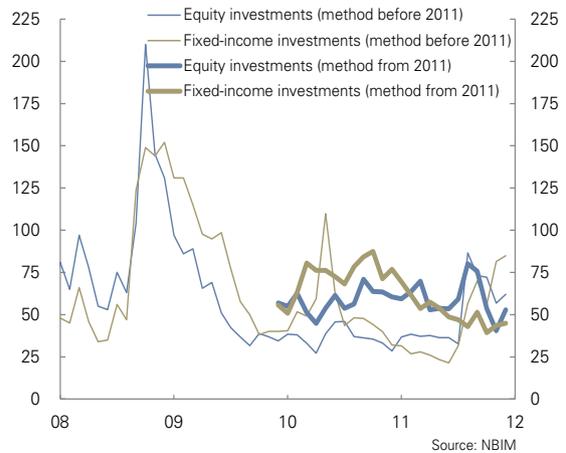
### Fluctuations in fund value

The VIX index uses the latest prices on put and call options on the S&P 500 stock index to signal expected volatility in the US stock market. The fund's expected absolute volatility, calculated using the statistical measure standard deviation, uses a three-year price history to estimate how much the return on the fund's equity and fixed-income investments will fluctuate, making it less sensitive to short-term market turbulence than the VIX index. The fund's expected absolute volatility was 9.6 percent, or about 300 billion kroner, at the end of 2011, compared with 13.2 percent a year earlier.

The Ministry of Finance has set limits for how much NBIM may deviate from the benchmark indices in managing the fund's equity and fixed-income investments. Expected relative volatility (tracking error) is one of these limits and caps how much the return on the fund's equity and fixed-income investments may be expected to deviate from the return on the benchmark indices. NBIM should aim for expected tracking error of no more than 1 percentage point. The actual figure was 0.4 percentage

point at the end of 2011, down from 0.5 percentage point a year earlier and a peak of 0.7 percentage point in September.

Chart 8-3 Expected relative volatility of the fund's equity and fixed-income investments. Basis points



### Calculation of expected volatility

Expected fluctuations in the value of the fund's equity and fixed-income investments are measured with the help of the statistical measure expected volatility. From 1 January 2011, the method for calculating this measure was revised to better fit the fund's long-term investment perspective. Expected volatility had been calculated using daily price observations in equity and fixed-income markets, with data over the most recent days given greater weight than observations further back. This meant that short-term changes in market conditions had a rapid and marked effect on the expected volatility of the fund's investments. The new method calculates volatility using weekly prices and a three-year price history, making it less sensitive to short-term market turbulence. As a result, movements in expected volatility will result more from changes in the fund's investments and less from general market volatility.

Table 8-1 Key figures for the fund's risk and exposure

Risk	Limits set by the Ministry of Finance and Norges Bank's Executive Board	Actual		
		31 Dec 2011	30 Sep 2011	30 Jun 2011
Net market value*	Equities 50-70% of fund's market value*	58.7	55.6	60.5
	Bonds 30-50% of fund's market value	41.0	44.1	39.4
	Real estate 0-5% of fund's market value	0.3	0.3	0.1
Exposure	Equities 50-70% of fund's market value**	58.6	56.0	60.5
	Bonds 30-50% of fund's market value	39.5	44.1	39.4
	Real estate 0-5% of fund's market value***	0.3	0.3	0.1
Counterparty risk	Any one counterparty maximum 0.75% of fund's market value	0.2	0.2	0.1

\* The net market value is the value of all securities, financial instruments and cash within each asset class.

\*\* The calculation of exposure includes the full underlying value of derivatives. As a result, the actual share of equities may vary from the net market value.

\*\*\* The exposure limit for real estate includes leverage.

**Table 8-2** Risk and exposure of equity and fixed-income investments

Risk	Limit	Actual		
		31 Dec 2011	30 Sep 2011	30 Jun 2011
<b>Limits set by the Ministry of Finance</b>				
Market risk	1 percentage point expected tracking error for equity and fixed-income investments	0.4	0.5	0.4
Credit risk	Maximum 3% of fixed-income investments may be rated below Baa3/BBB-	1.1	1.2	1.2
Maximum ownership	Maximum 10% of voting shares in a listed company	9.6	9.5	9.5
<b>Limits set by Norges Bank's Executive Board</b>				
Credit risk	Maximum 1% of fixed-income investments from any one issuer may be rated below Baa3/BBB-	0.1	0.2	0.3
Overlap between actual holdings and benchmark indices	Equities minimum 60%	84.2	84.5	83.0
	Bond issuers minimum 60%	76.4	76.9	79.3
Liquidity	Minimum 10% of shall be in government bonds from US, UK, Germany, France, Italy, Netherlands and Japan	15.3	16.5	13.9
Leverage	Maximum 5% of equity and fixed-income investments	0.0	0.0	0.0
Securities lending	Maximum 35% of equity and fixed-income investments	4.2	13.8	16.3
Issuance of options	Maximum 2.5% of equity and fixed-income investments	0.0	0.5	0.5
Securities borrowing through borrowing programmes	Maximum 5% of equity and fixed-income investments	0.0	0.0	0.0
Investment in any one company	Maximum 1% of equity and fixed-income investments	0.9	0.8	0.7
Assets managed by any one external manager	Maximum 1% of equity and fixed-income investments	0.4	0.6	0.7

**Table 8-3** Risk and exposure of real estate investments

Risk	Limit	Actual		
		31 Dec 2011	30 Sep 2011	30 Jun 2011
<b>Limits set by the Ministry of Finance*</b>				
Country allocation	France, Germany, United Kingdom: no limit	100.0	100.0	100.0
	Other countries: maximum 25% of real estate investments	0.0	0.0	0.0
Sector allocation	Office space: 0-100% of real estate investments	63.2	51.8	37.0
	Retail space: 0-100% of real estate investments	35.4	46.7	61.0
	Residential space: 0-25% of real estate investments	0.4	0.7	1.0
	Industrial space: 0-25% of real estate investments	0.0	0.0	0.0
	Other property: 0-25% of real estate investments	1.0	0.8	1.0
<b>Limits set by Norges Bank's Executive Board**</b>				
Investments in real estate under development	Maximum 20% of real estate investments	0.9	1.6	3.7
Investments in real estate that is not leased	Maximum 25% of real estate investments	8.1	4.2	4.0
Investments in interest-bearing securities	Maximum 20% of real estate investments, but no more than 5 billion kroner	0.0	0.0	0.0
Investments in listed real estate shares	Maximum 20% of real estate investments, but no more than 5 billion kroner	0.0	0.0	0.0
Debt ratio	Maximum 50% of real estate investments	0.0	0.0	0.0
	Maximum 70% for each investment	0.0	0.0	0.0
Assets managed by any one external manager	Maximum 15% of real estate investments, but no more than 5 billion kroner	0.0	0.0	0.0

\* The country and sector allocations will apply until the net value of real estate investments comprises 1 percent of the fund's market value.

\*\*The Executive Board has also limited new real estate investments to as much as 2 percent of the fund per year.

**Table 8-4** The fund's fixed-income investments as of 31 December 2011 based on credit ratings\*. Percentage of holdings

	Aaa	Aa	A	Baa	Higher risk	Total
Government bonds	37.3	6.0	2.1	0.5	0.3	46.1
Government-related bonds	8.3	3.0	1.0	0.9	0.2	13.3
Inflation-linked bonds	5.8	1.6	0.5	0.0	0.0	8.0
Corporate bonds	0.0	1.9	7.1	4.9	0.2	14.2
Securitised debt	13.9	2.7	0.9	0.5	0.4	18.4
<b>Total bonds and fixed-income securities</b>	<b>65.3</b>	<b>15.2</b>	<b>11.7</b>	<b>6.8</b>	<b>1.1</b>	<b>100.0</b>

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

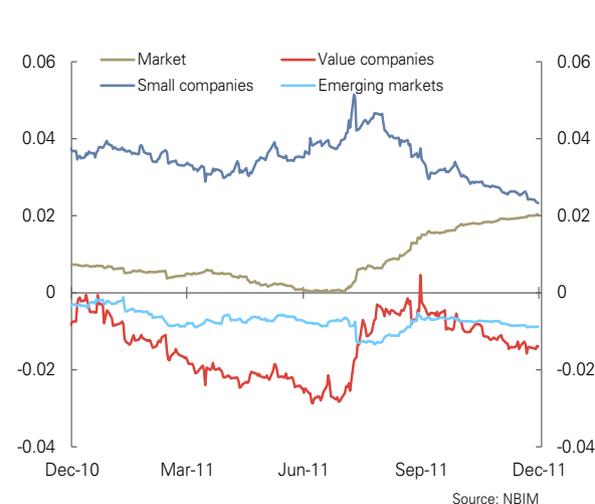
### Factor exposures

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 securities have to varying degrees over time and that contribute to both the risk and the return on different investments. The fund's relative exposure to these factors can be estimated by comparing the relative return of the fund with the return on these factors.

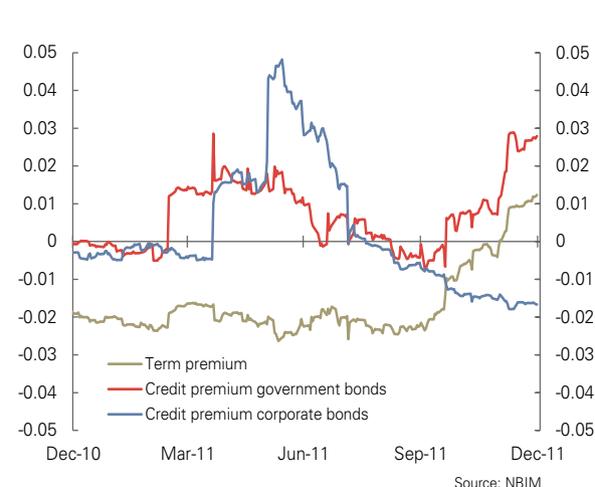
An analysis of factor exposures in 2011 indicates, among other things, that the fund's equity investments were more exposed than the benchmark to small companies during the year and somewhat more exposed than the benchmark to general stock market developments in the second half of the year. The analysis also shows that the relative return of the fund's equity investments was increasingly explained by four risk factors – the market, value stocks, small companies and emerging markets. More than 70 percent of fluctuations in the relative return could be explained by these risk factors at the end of the year, compared with about 35 percent a year earlier, according to the analysis. An equivalent analysis of the relative return for fixed-income investments in 2011 has very little explanatory power and gives few indications that the relative return on these investments was driven by systematic factor exposures during the year. The results of such statistical analyses are uncertain and NBIM also uses several other approaches to analyse the fund's factor exposures.

For more information on the fund's investment risk, see note 14 in the financial-reporting section.

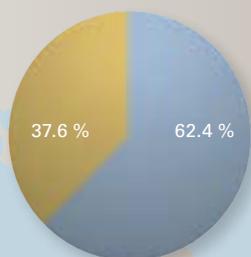
**Chart 8-4** Factor exposure of the fund's equity investments. Coefficients



**Chart 8-5** Factor exposure of the fund's fixed-income investments. Coefficients







Americas, Africa and Middle East

Europe

## Our investments

# Larger shareholdings in Europe

The fund's holdings in listed European companies rose to 2.3 percent in 2011 after the first large-scale equity purchases in two years.

The fund bought stocks for 185 billion kroner from June through November, following a strategy of investing capital inflows in the worst-performing asset class. Most of the purchases were in Europe, where stock markets fell as much as 26 percent in the period. It was the first time the fund made major equity purchases since the financial crisis in 2007 to 2009.

The average holding in listed European companies rose to 2.3 percent at the end of 2011 from 1.9 percent a year earlier. The average in the Americas, Africa and the Middle East was unchanged at 0.7 percent, while holdings in Asia and Oceania increased to 0.8 percent from 0.7 percent. On average, the fund held 1.1 percent of the world's listed equities at the end of 2011, compared with 1 percent a year earlier. About 50 percent of the stock investments were in Europe, 35 percent in the Americas, Africa and the Middle East and 15 percent in Asia and Oceania.

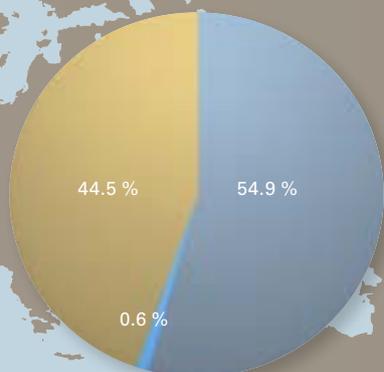
The fund's share of global bond markets was little changed in 2011. On average, the fund held 0.6 percent

of the world's bonds at the end of the year. The holdings figures for stocks and bonds are based on the market capitalisation of the FTSE Global All Cap equity index and the Barclays Global Aggregate and Barclays Global Inflation Linked bond indices.

### Investments in 68 countries

The fund invests in a broad range of sectors, countries and regions. At the end of 2011, it owned shares, bonds and real estate registered in 68 countries.

The fund's equity investments shall be in recognised and regulated marketplaces. A total of 47 countries had approved marketplaces at the end of 2011 after Colombia was added to the list. The US was the single largest market with 30 percent of the fund's equity investments, followed by the UK with 16 percent and France with 7 percent. The fund has increased its investments in emerging markets in recent years and awarded new investment mandates to external equity managers in China and Malaysia in 2011. The fund was invested in



## Asia and Oceania



Asset class breakdown per region  
 ● Fixed income ● Equities ● Real estate

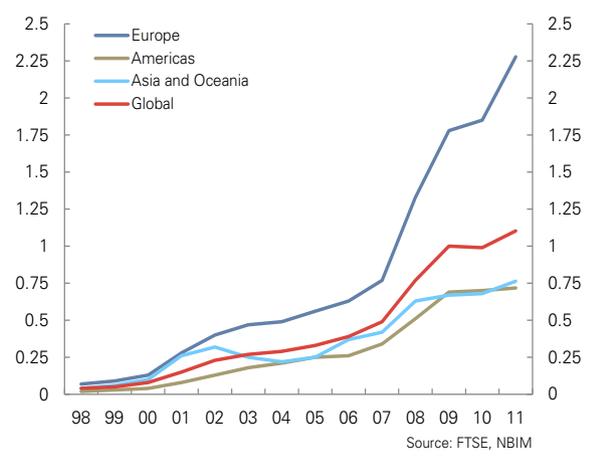
8,005 companies at the end of 2011, down from 8,496 a year earlier.

The fund's fixed-income investments consisted of government bonds, inflation-linked bonds, corporate bonds, securitised debt and bonds issued by public institutions such as regional administrations and government corporations. Government bonds accounted for 46 per cent of fixed-income investments, followed by securitised

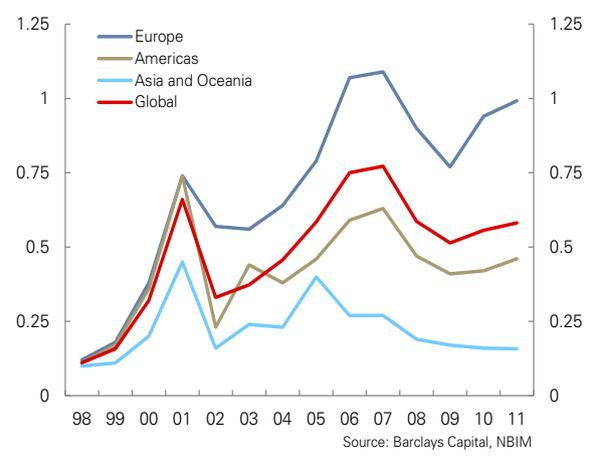
debt with 18 percent and corporate bonds with 14 percent. The fund was invested in 5,215 bonds from 1,404 issuers at the end of 2011, down from 8,659 bonds from 1,686 issuers a year earlier. A total of 94 percent of the bonds were issued in euros, dollars, pounds and yen.

The fund's first real estate investments were made during the year in London and Paris.

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



**Chart 9-2** The fund's holdings in fixed-income markets. Percentage of the market capitalisation of the Barclays Global Aggregate and Barclays Global Inflation Linked indices



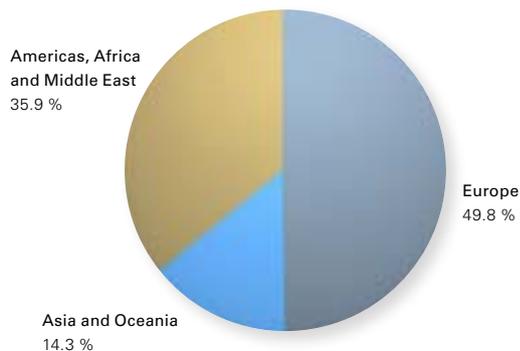
**Table 9-1** The fund's ten largest country holdings as of 31 December 2011. Percent of the fund

Country	Total	Equity	Fixed income
US	29.2	18.0	11.2
UK	15.5	9.7	5.8
France	8.6	4.2	4.4
Germany	7.0	3.5	3.5
Japan	5.5	3.4	2.1
Switzerland	4.1	3.7	0.4
Spain	4.1	1.4	2.7
Canada	2.8	1.6	1.2
The Netherlands	2.8	1.2	1.6
Sweden	2.6	1.5	1.1

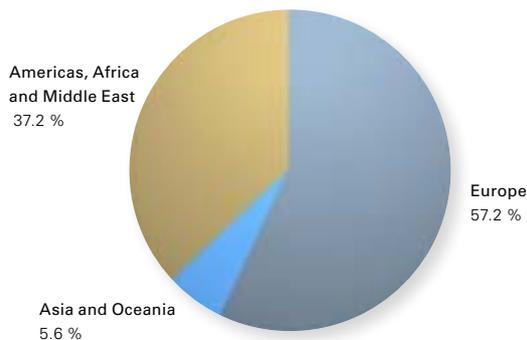
**Table 9-2** The fund's ten largest currency holdings as of 31 December 2011. Percent of the fund

Currency	Total	Equity	Fixed income
USD	33.5	19.3	14.2
EUR	30.5	13.3	17.2
GBP	13.7	9.1	4.6
JPY	5.5	3.4	2.1
CHF	3.8	3.7	0.1
CAD	2.4	1.5	0.9
SEK	2.3	1.5	0.8
HKD	1.4	1.4	0
AUD	1.1	1.0	0.1
DKK	1.0	0.6	0.4

**Chart 9-3** The fund's equity investments sorted by region as of 31 Dec 2011. Percent



**Chart 9-4** The fund's fixed-income investments sorted by currencies in different regions as of 31 Dec 2011. Percent



## Japan

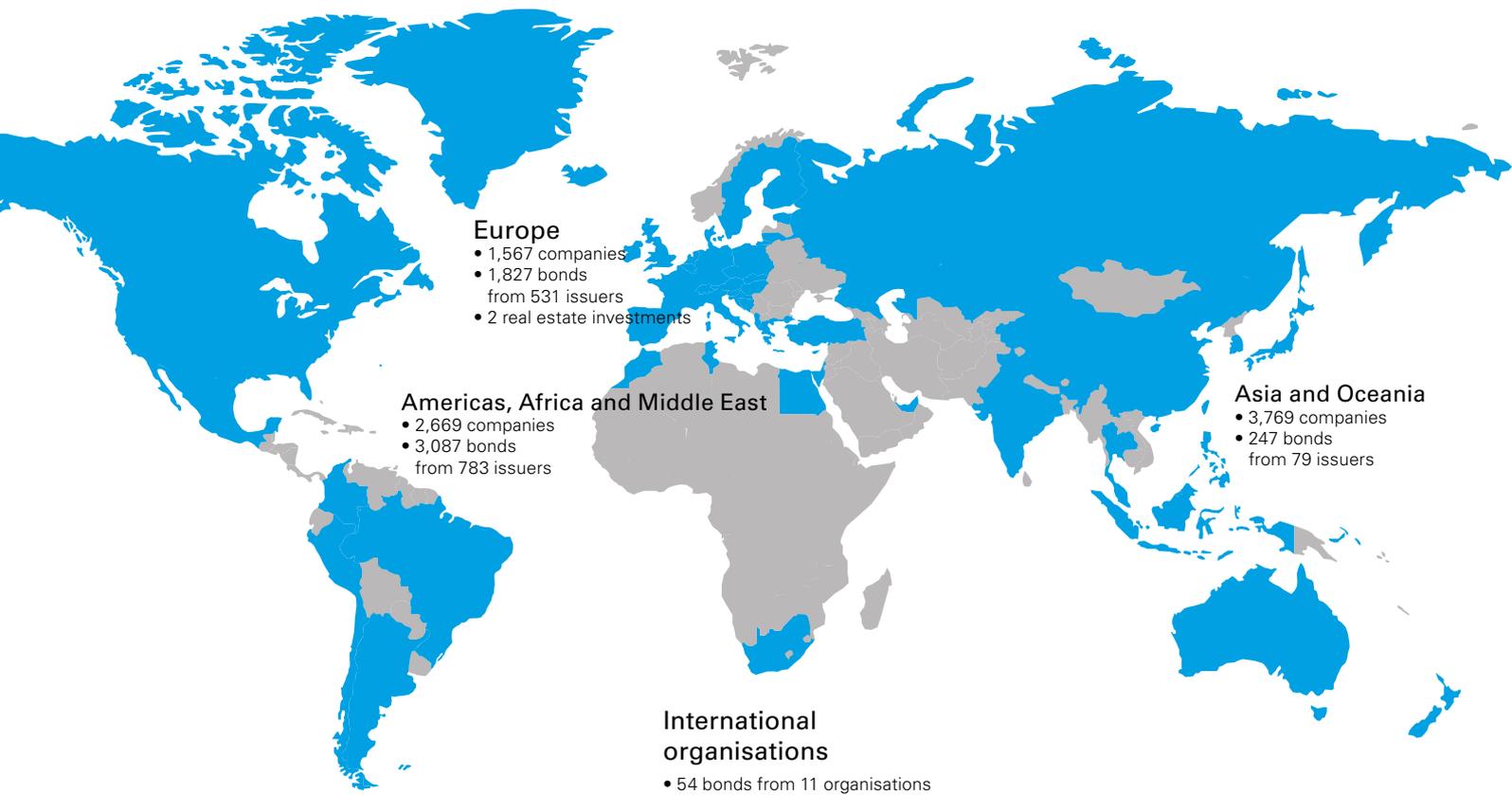
- Accounted for 5.5 percent of the fund's investments at the end of 2011
- These were in 1,267 companies and bonds from eight issuers



## Colombia

- Accounted for 0.01 percent of the fund's investments at the end of 2011
- These were in eight companies





## USA

- Accounted for 29.2 percent of the fund's investments at the end of 2011
- These were in 2,041 companies and bonds from 656 issuers



## United Kingdom

- Accounted for 15.5 percent of the fund's investments at the end of 2011
- These were in 397 companies, bonds from 101 issuers and one real estate portfolio



Individual investments

# Increasing company stakes



The number of companies where the fund owned a stake larger than 5 percent more than tripled to 53 in 2011.

Svenska Cellulosa Aktiebolaget, Land Securities Group and British Land were the three largest companies in which the fund increased its stake to more than 5 percent in 2011. The market value of the companies ranged from 35 billion kroner to 65 billion kroner each. The fund held stakes of more than 5 percent in a total of 53 companies at the end of 2011, up from 17 a year earlier.

The fund's investment strategy for 2011-2013 aims to increase holdings in more large listed companies. Portfolio managers shall analyse fewer companies more in depth to identify good long-term investments. The fund may hold as much as 10 percent of a listed company.

### Single largest investments

The largest single company investment at the end of 2011 was in oil producer Royal Dutch Shell. The fund

owned a 2.2 percent stake with a market value of 31 billion kroner. The largest percentage holding was a 9.6 percent stake in Irish packaging company Smurfit Kappa Group, which was valued at 773 million kroner.

The fund has gradually increased its holdings in a number of companies because of its growth in recent years. It exceeded 2 percent ownership in 872 companies at the end of 2011, up from 512 companies in 2010 and 342 companies in 2009. Holdings of 1-2 percent frequently put the fund among the top 20 investors in large businesses with many shareholders. This gives the fund's portfolio managers and ownership department good access to a company's management and board. Companies also increasingly contact NBIM for views on issues.

With the exception of securities issued by the European



Investment Bank and Kreditanstalt für Wiederaufbau, the fund's ten largest bond holdings at the end of 2011 were

of government debt. US, UK, French, Japanese and German government bonds were the five largest holdings.

Table 10-1 The fund's largest equity holdings as of 31 December 2011

Company	Country	Holdings in millions of kroner
Royal Dutch Shell Plc	UK	30,983
Nestlé SA	Switzerland	25,346
HSBC Holdings Plc	UK	19,583
Novartis AG	Switzerland	19,281
Vodafone Group Plc	UK	18,858
BP Plc	UK	17,277
Exxon Mobil Corp	US	16,901
Roche Holding AG	Switzerland	16,279
Apple Inc	US	16,027
GlaxoSmithKline Plc	UK	15,775

Table 10-2 The fund's largest bond holdings as of 31 December 2011

Issuer	Country	Holdings in millions of kroner
United States of America	US	249,072
UK government	UK	109,813
French Republic	France	79,790
Japanese government	Japan	67,036
Federal Republic of Germany	Germany	51,294
Italian Republic	Italy	32,914
European Investment Bank	Supranational	24,099
Kreditanstalt für Wiederaufbau	Germany	22,703
Government of the Netherlands	The Netherlands	20,218
Kingdom of Spain	Spain	17,975

*The fund has gradually increased its holdings in a number of companies because of its growth in recent years*

### 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 also vary for consolidating share classes and shareholders. NBIM has looked at the fund's 1,000 largest shareholdings at the end of 2011. Subject to the above reservations, we estimate that the fund was among the top ten shareholders in about 500 of the companies at the end of 2011. We were also among the top 20 owners in about 760 companies. The highest rankings were generally in Europe, where the fund had half its equity investments at the end of 2011.

**Table 10-3** The fund's largest company holdings by percent as of 31 December 2011

Company	Country	Interest
Smurfit Kappa Group Plc	Ireland	9.6
IVRCL Ltd	India	9.5
Lanco Infratech Ltd	India	8.7
Telecity Group Plc	UK	8.6
China Water Affairs Group Ltd	Hong Kong	8.5
NCC Ltd	India	8.3
Kloeckner & Co SE	Germany	8.1
Monitise Plc	UK	8.1
Stora Enso OYJ	Finland	7.8
CNinsure Inc	China	7.8

### Environmental investments

NBIM has since 2009 awarded mandates with a particular focus on environmental investments to internal and external managers. These mandates are subject to the same profitability requirements as the fund's other investments. They also support sustainable economic, environmental and social developments.

The number of environmental mandates increased to ten at the end of 2011 from nine a year earlier. Seven of the mandates were for investments in renewable energy and technology that can help increase energy efficiency. This includes companies that produce or distribute renewable energy or develop the equipment needed for this. It also comprises businesses that use waste to produce energy or companies that develop more efficient power supply systems.

The largest investment in this area at the end of 2011 was in Johnson Controls, a producer of technical solutions for optimising the energy efficiency of buildings and batteries for hybrid and electric vehicles. This was followed by investments in Novozymes, Pall, EDF and Wacker Chemie.

Three more mandates were for investments in water management. This includes companies that develop technology for improving water quality or infrastructure for treating and distributing water, often in emerging markets. The five largest investments in this area at the end of 2011 were in Pentair, Progressive Waste Solutions, Suez Environnement, Republic Services and Danaher.

The value of the fund's environmental investments fell to 21.1 billion kroner at the end of 2011 from 25.7 billion kroner a year earlier, dragged down by slumping share prices of solar and wind power producers. Public spending cuts in a number of European countries threatened subsidies for renewable energy, while competition from government-backed Chinese companies increased. The fund's environmental mandates returned -22.8 percent in 2011, measured in international currency.

Eight of the environmental mandates were managed externally at the end of the year and two were managed internally. The external mandates totalled 9.1 billion kroner and the internal mandates were worth 12 billion kroner.



## Land Securities Group

Land Securities Group is a British property company.

It owns shopping centres, offices and other retail units across the UK.

The company generated revenue of 702 million pounds in the year ended 31 March 2011.

The fund owned 5.2 percent of the company at the end of 2011.



## Svenska Cellulosa Aktiebolaget

Svenska Cellulosa is a Swedish paper producer with about 45,000 employees in 60 countries.

The company's products include packaging, toilet paper, diapers and newsprint, as well as timber for buildings, furniture and biofuels.

The company's revenue was 109 billion kronor in 2010.

The fund owned 7.1 percent of Svenska Cellulosa at the end of 2011.



Active ownership

## Safeguarding long-term interests



We use our rights as a shareholder to safeguard the fund for the long term. We strive to promote good corporate governance and to encourage sustainable social and environmental standards.

As a long-term investor in about 8,000 companies, NBIM seeks to improve corporate governance standards. We encourage companies to take responsibility for improving social and environmental practices that may impact their profitability and, consequently, the fund's long-term returns. Our focus is on six strategic areas:

- equal treatment of shareholders
- roles and responsibilities of the board
- 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 financial markets. We vote at general meetings and file shareholder proposals. We also publish documents outlining our expectations for how companies should manage social and environmental risks in their operations and supply chains.

Our ownership activities are based on the UN's Global Compact, the OECD's Principles of Corporate Governance and the OECD's Guidelines for Multinational Enterprises. We signed an investor statement in 2011 supporting the Guiding Principles for Business and Human Rights endorsed by the United Nations Human Rights Council.

### **Voting and shareholder proposals**

NBIM in 2011 voted at 11,300 annual and extraordinary general shareholder meetings. Our voting was based on

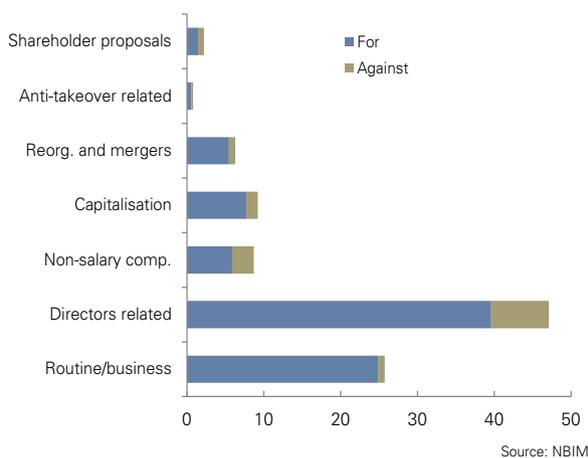
Table 11-1 Voting at shareholder meetings

Region	2011			2010		
	Number of meetings	Meetings where NBIM voted	Share	Number of meetings	Meetings where NBIM voted	Share
Americas	3,017	3,003	99.5%	2,999	2,987	99.6%
Europe	2,168	1,887	87.0%	2,103	1,614	76.7%
Asia/Oceania	6,481	6,410	98.9%	6,416	6,347	98.9%
Total	11,666	11,300	96.9%	11,518	10,948	95.1%

the principles of our ownership activities. We voted for proposals that would promote the long-term interests of companies and we voted against proposals that would undermine our shareholder rights. This included voting against proposals for corporate transactions that would give particular advantages to a company's management or specific shareholders.

NBIM has increasingly filed shareholder proposals aimed at making the board more accountable to shareholders. We filed shareholder proposals in 2011 at four US companies requesting a separation of the CEO and chairman roles. An independent chairman is a prerequisite for satisfactory oversight of a company. We also in November filed proposals at six US companies to give shareholders proxy access, or the right to nominate candidates for board elections on company ballots.

Chart 11-1 Resolutions where NBIM voted for or against a board's recommendation in 2011. Percent



## Legal action as a way to safeguard the fund's interests

NBIM will on occasion take legal action to safeguard the fund's interests. This may include action against an issuer of shares or bonds when the fund has suffered a financial loss due to the conduct of the company or its management. NBIM may also request a declaratory judgment to determine whether a company or its management has acted in accordance with applicable rules.

In the second quarter of 2011, NBIM withdrew a request for a review of Porsche SE. NBIM and certain German investors had in 2010 requested that a German court review whether the board of Porsche had operated outside its remit and exposed the company to excessive risk in its attempt to gain control of Volkswagen in the period 2005-2009. The request ceased to be relevant after the German investors negotiated a solution in May 2011 where Porsche paid preference shareholders an extraordinary dividend and made a commitment to improve corporate governance.

In the third quarter of 2011, Norges Bank and 14 other institutional investors jointly filed a lawsuit against Countrywide Financial Corporation, three of its former directors and its auditor KPMG in a US federal court. The lawsuit claimed that Countrywide, formerly the largest mortgage lender in the

US, publicly promoted itself as a company that primarily underwrote and guaranteed high-quality home mortgages and adhered to best lending practices, while in reality engaging in irresponsible lending practices that lacked prudent standards for the provision of loans and guarantees. The company also concealed the true level of credit risk it took. As a result of this misrepresentation, Countrywide's stock traded at artificially high prices between March 2004 and March 2008. Norges Bank and the other investors involved in the lawsuit sought compensation for losses incurred from buying Countrywide shares during this period. The lawsuit was withdrawn in the fourth quarter after the investors and Countrywide reached a settlement.

NBIM has also previously taken direct legal actions as a shareholder. Three such cases, against Vivendi, Merck and Citigroup, are still being processed in court.

In addition, Norges Bank files claims in relation to settlements or judgments in class actions against companies where the bank holds shares on behalf of the fund. In 2011, NBIM filed claims in new class actions involving 43 listed companies and received approximately 16 million dollars as a result of previous claims.

# Highlighting children, climate and water

NBIM expects companies to manage social and environmental risks that may hurt their profits and the fund's investments.

We have published documents outlining our expectations for how the businesses we invest in should manage risks related to children's rights, climate change and water scarcity. We annually evaluate the extent to which companies in industries with high exposure to these risks meet our expectations and publish the results. Our assessments are based on publicly available information from the companies and cover about 500 businesses in each risk area.

## Children's rights

For the fourth consecutive year, NBIM in 2011 evaluated how companies reported on risks related to child labour and children's rights in their operations and supply chains. We looked at 452 companies in the hybrid seed, cocoa, food and beverage, apparel retail, steel, mining, toy and technology hardware and equipment sectors. The overall results showed companies' reporting on these issues improved slightly in 2011 compared with a year earlier. A total of 48 percent of the companies had a policy against child labour in 2011, up from 43 percent in 2010, and 35 percent reported that they had systems to monitor child labour in the supply chain.

We had dialogues in 2011 on child labour with a number of companies in the seed, cocoa, apparel retail and technology sectors. Cotton seed companies Monsanto, Bayer, DuPont and Syngenta, which NBIM initiated talks with in 2007, showed progress in reducing child labour at seed farms in India. In December, NBIM and Dutch pension fund APG ended three years of joint dialogue with five cocoa and chocolate companies after the industry took steps demonstrating a clear commitment to combating child labour.

## Climate change

For a third year in a row, NBIM in 2011 evaluated how companies reported on climate change risks. We assessed 453 companies in the basic resources, building materials, chemicals, oil and gas, power generation, transport and real estate sectors. The results showed a general improvement in how companies managed and

reported on climate change risks, compared with 2010. More companies said they included climate change risks in their business strategies and action plans. The power sector had the highest proportion of companies reporting on climate change risk, at 59 percent. The transport sector had the lowest proportion of companies, at 40 percent. Only 38 percent of the companies disclosed their greenhouse gas emissions levels and targets to reduce these emissions.

In the US, NBIM and financial-services organisation TIAA-CREF had joint dialogues with companies in the aviation and real estate industries on their management of new regulatory requirements to limit carbon emissions from aircraft and from energy used in buildings. We were also among investors that signed the 2011 Global Investor Statement on Climate Change.

## Water management

For the second consecutive year, NBIM in 2011 assessed how companies reported on risks related to water resources in their operations and supply chains. Our evaluation covered 447 companies in the mining and industrial metals, electricity and multi-utilities, water utilities, pharmaceutical, food and beverage and forestry and paper industries. The results showed that 58 percent of the companies in 2011 reported on water-related risks in their operations, compared with 57 percent a year earlier. A total of 53 percent of the businesses implemented action plans to manage these risks, against 52 percent a year earlier. Less than a fifth of the companies reported on water management in the supply chain in 2011.

NBIM and the Dutch pension fund PGGM in 2011 started a project aimed at improving companies' reporting on water-related risks in China and India, where scarce and polluted water resources are a growing problem. We also renewed our support of CDP Water Disclosure, an initiative aimed at increasing the availability and quality of information on how companies manage water resources.

*For the fourth consecutive year, NBIM in 2011  
evaluated how companies reported on risks related to  
child labour and children's rights*



NBIM

315





26

51

315 employees from 26 nations

NBIM

# Strengthening the organisation for future growth



NBIM in 2011 recruited new employees and reorganised its senior management team to further strengthen the fund's management.

The fund's growth and new investment tasks have triggered an increase in NBIM's workforce in recent years. We continued hiring new staff in 2011, particularly in real estate management and equity, credit and macro-economic analyses.

NBIM had 315 permanent employees at the end of 2011, an increase from 278 a year earlier. More than 40 percent of the new recruits were located at our offices in London, New York, Singapore and Shanghai, while the rest were based at the main office in Oslo. Proximity to international markets gives us better access to investment opportunities and ensures we can follow up the fund's investments around the clock.

The senior management team was reorganised to strengthen oversight in each investment area after real estate was added as an area in 2010. The chief investment officer role was split into three separate positions responsible for equities, real estate and allocation, respectively. The CIO for allocation is responsible for fixed-income investments as well as allocation of capital to different asset classes.

NBIM depends on dedicated and highly skilled employees to ensure the best possible management of the fund. We organised numerous courses for employees in 2011 through the NBIM Academy to boost competency in the organisation and give our employees good development opportunities.

Chart 12-1 Number of employees by area as of 31 Dec 2011

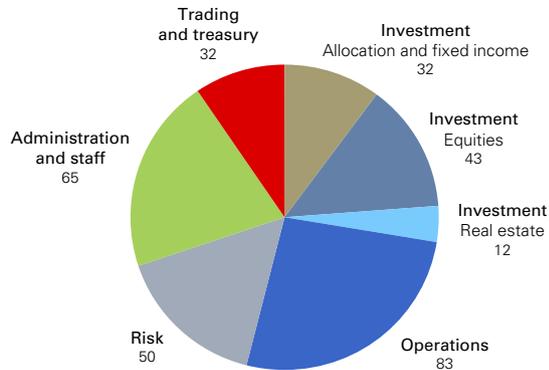
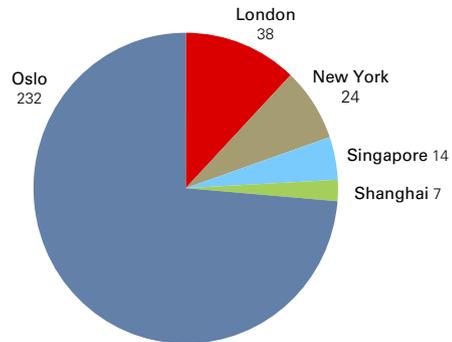


Chart 12-2 Number of employees by location as of 31 Dec 2011



### Lower management costs

NBIM aims to maximise the fund's long-term return after costs. We seek to maintain a high level of cost awareness and realise economies of scale. We also attach importance to using resources to keep a high level of quality in the fund's management and ensure good risk management and control.

NBIM receives an annual fee from the Ministry of Finance to cover costs of managing the fund. These costs fell to 2.54 billion kroner in 2011 from 2.96 billion kroner in 2010,

mainly because of a reduction in fixed and performance-based fees to external managers. By contrast, the growth in our workforce led to higher salary and staff expenses, while the increasing size of the fund boosted transaction and settlement costs. Management costs fell to 8.1 basis points of assets under management in 2011 from 10.5 basis points in 2010. Excluding performance-based fees to external managers, costs fell to 6.4 basis points from 7 basis points.

Chart 12-3 Management costs as a share of assets under management, 1998-2011. Basis points

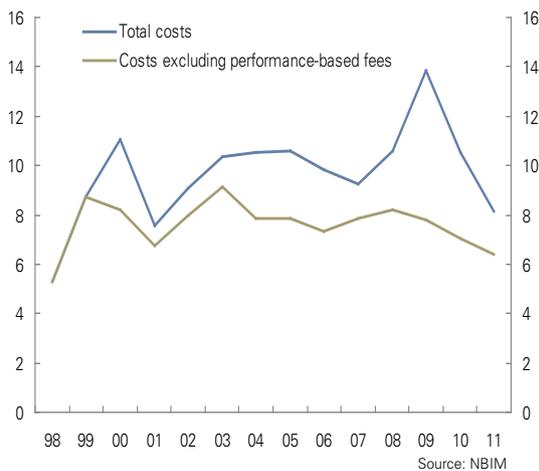
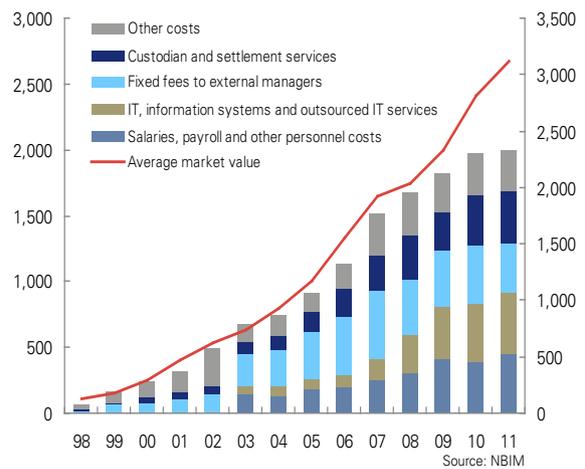


Chart 12-4 Development of individual cost components, 1998-2011. Costs (millions of kroner, left-hand axis) and market value (billions of kroner, right-hand axis)



### New remuneration system in 2011

With effect from 1 January 2011, new rules on remuneration in the Norwegian financial sector were incorporated into the mandate for the fund and new guidelines were introduced for remuneration at NBIM. The implementation of the guidelines entailed that employees working in risk management, control, operations and support switched from a system with both fixed and performance-based components to only a fixed salary. Employees working directly with investment decisions continued to receive performance-based pay, though with revised terms for accrual and payment. Performance-based pay is calculated on the basis of the performance of the fund, group and individual measured against set targets over a period of at least two years. Half of the accrued performance-based pay shall be paid the year after it was accrued, while half shall be held back and paid over the following three years. The held back amount is adjusted for the return on the fund.

NBIM's investment departments had 121 employees with performance-based pay in 2011. Their fixed salaries totalled 113 million kroner, while the upper limit for performance-based pay was 148 million kroner. The limit for performance-based pay fell 22 percent from 2010 to 2011 because of the reduction in the number of eligible employees.

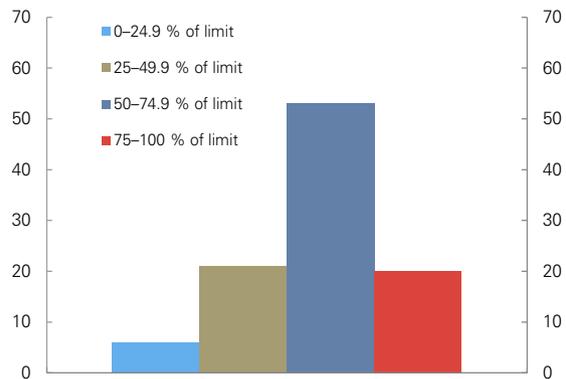
On average, employees eligible for performance-based pay accrued 56 percent of the limit for 2011 based on multi-year performance. For 2011 in isolation, the average amount accrued was 36 percent of the upper limit. Half

of the amount accrued on the basis of multi-year performance will be paid in 2012 and the remainder held back for payment over the following three years.

NBIM's senior management team receive only a fixed salary. The CEO's salary and pay bands for other senior managers are set annually by Norges Bank's Executive Board. The CEO's salary was 5.75 million kroner in 2011.

Other than senior management and employees in receipt of performance-based pay, NBIM had 187 permanent employees working in risk management, control, operations and support at the end of 2011. Their fixed salaries totalled 156 million kroner.

Chart 12-5 Performance-based pay relative to upper limit in 2011. Percentage of workforce



Source: NBIM



Mikko joined NBIM in 2007 and works as a trader in New York.

*“At NBIM I’m part of an international team that trades the entire fixed-income universe across the global time zones, which is much more challenging and rewarding than trading a narrow band of a single asset class on ‘the street.’ But most importantly, I appreciate the fantastic team of colleagues I’m privileged to share my working days with.”*

The Executive Board sets a pay band for NBIM’s CEO. The chairman of the board determines the annual salary within this band. Salaries for other members of the NBIM leader group are determined by the CEO in consultation with the board and following annual assessments.

Table 12-1 Compensation to senior management at NBIM in 2011\*

Position	Name	Paid salary	Value of other benefits	Pension benefits earned	Employee loan
Chief Executive Officer	Yngve Slyngstad	5,751,162	25,620	382,809	805,328
Deputy CEO and Chief of Staff	Trond Grande <sup>1</sup>	3,609,575	23,676	292,331	-
Chief Investment Officer, Equities	Petter Johnsen <sup>2</sup>	3,228,750	50,587	322,875	-
Chief Investment Officer, Real Estate	Karsten Kallevig <sup>3</sup>	2,812,500	23,965	214,821	-
Chief Treasurer	Jessica Irschick	4,520,250	38,789	452,025	-
Chief Risk Officer	Jan Thomsen <sup>4</sup>	3,296,924	17,656	303,120	-
Chief Operating Officer	Age Bakker	2,760,630	16,382	345,161	-

\*The compensation is for the period the employee was a member of the leader group.

- 1) Trond Grande became Deputy CEO on 1 February 2011 and Chief of Staff on 1 April 2011. Before that, Grande was Chief Risk Officer.
- 2) Petter Johnsen became CIO Equities on 1 April 2011.
- 3) Karsten Kallevig became CIO Real Estate on 1 April 2011.
- 4) Jan Thomsen became Chief Risk Officer on 1 April 2011. Before that, Thomsen was Chief Compliance Officer.

Table 12-1 covers leader group members at NBIM as of 31 December 2011. Dag Dyrdal was part of the leader group as Chief Strategic Relations Officer until 1 April 2011. Dyrdal’s benefits in this position in 2011 amounted to 569,709 kroner in paid salary, 6,977 kroner in other benefits and 86,452 kroner in earned pension. Mark Clemens was part of the leader group as Chief Administrative Officer until 1 April 2011. Clemens’ benefits in this position in 2011 amounted to 582,900 kroner in paid salary, 4,642 kroner in other benefits and 76,542 kroner in earned pension. Mark Clemens also had an employee loan of 766,668 kroner. Bengt Ove Enge was part of the leader group as Chief Investment Officer until 30 June 2011. Enge’s benefits in this position in 2011 amounted to 2,202,763 kroner in paid salary, 6,459 kroner in other benefits and 234,027 kroner in earned pension.



Michaela has been with NBIM since 2009. She works with the fund’s external managers as a portfolio manager in New York.

*“Working at NBIM gives me the opportunity to engage with some of the brightest external managers all over the world. I travel extensively to all corners of the world to find local asset managers whose dedicated fundamental company research will translate into excess return on our investments.”*



Giovanni is an analyst on the real estate team in London. He joined NBIM in 2007.

*“What’s keeping me at NBIM is our mission: preserving wealth for future generations and investing responsibly with an unlimited time horizon. It is much more rewarding than maximising quarterly profits.”*



## Operational risk management

# Unwanted events fall by a third

NBIM improved processes and reduced complexity in its operations in 2011, leading to fewer unwanted events.

NBIM works systematically to identify unwanted events and improve processes to prevent such incidents. Reporting and following up on these incidents is an important part of efforts to improve operations and internal controls. We use cost-benefit analyses in our work to reduce risk levels.

Norges Bank's Executive Board sets limits for operational risk management and internal controls at NBIM. The board has decided that there should be less than 20 per cent probability that operational risk factors will result in gains and losses totalling 500 million kroner or more over

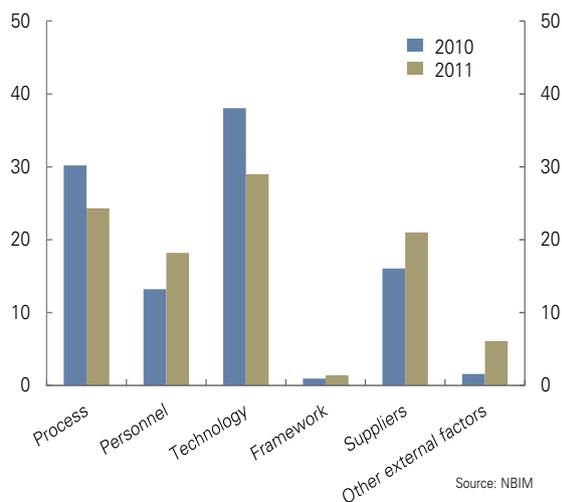
a 12-month period. This limit is referred to as the board's risk tolerance.

Our internal control system is designed to minimise risks and provide reasonable assurance against material errors or losses. Internal controls are put in place based on an ongoing risk assessment and their effectiveness is reviewed at least once a year.

### **Unwanted events in 2011**

NBIM registered 216 unwanted events in 2011, down from 320 in 2010. Most of these had no financial conse-

Chart 13-1 Unwanted events at NBIM sorted by cause. Percent



quences, either because they were discovered early enough or because they only had potential reputational consequences. The estimated total financial impact of these incidents was 13.5 million kroner, breaking down into losses of 13.45 million kroner and gains of 50,000 kroner.

Technical errors caused 29 percent of unwanted events in 2011, down from 38 percent in 2010, helped by a reduction in the complexity of our information-technology systems. Some of the most important processes at NBIM, such as the allocation of funds, the buying and selling of assets and the reporting and control of investment results, depend on complex systems. Technical faults caused one of the fund's most important equity trading systems to shut down for 155 minutes in the fourth quarter of 2011. The incident had no financial consequences as it happened at a time when trading activity was low. Unwanted events caused by technical errors in 2011 mainly led to brief operational disruptions and caused limited financial losses.

A total of 24 percent of unwanted events in 2011 were due to errors in our processes, routines and procedures, down from 30 percent in 2010. Some of these incidents were related to changes in investment processes. While the purpose of such change is to reduce operational risk in the long term, it can increase risk levels in the transition period.

Shortcomings on the part of our suppliers and in our relations with suppliers caused 21 percent of unwanted

events in 2011, up from 16 percent in 2010. NBIM out-sources services in areas such as IT operations, custody, settlement, legal affairs and equity and fixed-income management. An operational error at one supplier in the first half of 2011 resulted in incomplete claims being filed in 13 class action lawsuits against companies NBIM invests in. NBIM discovered and rectified the error, which could have caused the fund to miss out on as much as 10 million kroner in payouts under these actions. While several unwanted events in this category had a financial impact in 2011, the losses were in most cases covered by the suppliers under the terms of their contracts.

Mistakes by NBIM's employees caused 18 percent of unwanted events in 2011, up from 13 percent in 2010. Most cases were quickly picked up by controls in NBIM's systems and few led to losses. Human error is difficult to avoid but can be minimised through well-developed systems supported by appropriate controls, fail-safe functions and good information management.

NBIM also takes into account risks associated with external factors such as natural disasters, terrorism and war. The 2011 popular uprisings in the Middle East caused the Cairo stock exchange to shut down for almost two months starting in late January. NBIM was unable to trade in Egyptian shares during this period and the cost of the closure is unclear. While the fund's holdings of Egyptian shares were kept in safe custody by our global custodian banks during the closure, prices on the exchange fell almost 50 percent in the year. Although events of this kind are rare, the potential consequences are serious. This category accounted for 6 percent of unwanted events in 2011, including the 22 July terrorism act in Oslo, which triggered our business continuity procedures. None of these events had severe consequences for NBIM.

#### Breaches of guidelines

The Ministry of Finance has set extensive guidelines for the fund's management. There were no significant breaches of these guidelines registered in 2011. NBIM was also not notified by external supervisory authorities of any significant breaches of market rules or general legislation.

## Feature article

# Real estate investments

The fund made its first investments in real estate in 2011, taking it into an unlisted asset class quite unlike bonds and listed equities. Real estate investments have different requirements when it comes to the execution of investment decisions, the management framework, oversight and control.

The Ministry of Finance decided in 2010 that up to 5 percent of the Government Pension Fund Global should be invested in real estate.<sup>1</sup> Equities and bonds are the two largest asset classes used by financial investors, and real estate the third. Based on the fund's current value and the projections used by the ministry,<sup>2</sup> the 5 percent target means investing in the region of 250-300 billion kroner in properties outside Norway by 2020, making the fund one of the world's largest investors in real estate. Norges Bank will take some time phasing in this asset class. The bank is building expertise and processes for investment decisions and is attaching importance to oversight and control functions.

### Real estate as an asset class in the fund

The distribution of the fund between different asset classes is a trade-off between expected return and risk in the long term. The size of the allocation to equities is the single most important decision. A high allocation to equities can produce a favourable return in the long run, but also requires a relatively high tolerance to short-term variations in return.

Bond investments of high credit quality – first and foremost government debt issued in local currency – offer a relatively safe return and reduce fluctuations in the fund's overall nominal return. However, nominal bond investments provide no protection against an unexpected rise in inflation and so do not fully protect the fund's long-term international purchasing power.

Real estate investments may be one of several possible ways of protecting the fund against inflation. Investments in real estate confer direct ownership of real assets and an expected return in the form of stable, inflation-adjusted cash flows. This inflation adjustment is due to rental income from these investments often being linked to inflation.

Norges Bank has recommended increasing the share of real estate and other types of real asset, in the fund.<sup>3</sup>

A larger share of real assets in the portfolio should be matched by a smaller share of nominal fixed-income investments. Investments in many real assets will be relatively illiquid. The fund has no short-term liquidity needs and can therefore reap the rewards of this characteristic of these investments.

### Strategy for real estate investments

The long-term goal is to build a portfolio of real estate investments that delivers a good long-term return. This will be achieved by diversifying investments and risk across multiple markets. NBIM will invest primarily in well-developed markets and traditional property types, such as offices and retail premises.

The portfolio will be built up over a number of years. NBIM will initially invest in the largest European real estate markets before looking at other parts of the world. We will assess potential investments together with local partners with aligned interests and a good knowledge of specific markets.

Investments in real estate also confer ownership of land or buildings. The asset class spans a wide range of properties, including offices, shopping centres, industrial buildings and residential complexes. Direct investments mean that we own a property without an intermediary, while indirect investments are where we buy units in a fund or shares in a property company which, in turn, invests directly in one or more properties.

The management of the property, including maintenance and rent collection, is often separate from the investment. Many investors set up separate companies to handle property management or outsource it. For now, NBIM has decided that property management should be handled directly or indirectly by the bank's partners.

### Investing in real estate through subsidiaries

Real estate investments require a different implementation

<sup>1</sup> See section 4 of the Mandate for the Management of the Government Pension Fund Global and the discussion in Report to the Storting No. 16 (2007-2008) on the management of the fund in 2007 and Report to the Storting No. 10 (2009-2010) on the management of the fund in 2009.

<sup>2</sup> See Report to the Storting No. 1 (2011-2012) on the national budget for 2012.

<sup>3</sup> See Norges Bank's letter to the Ministry of Finance of 6 July 2010 on the development of the investment strategy for the Government Pension Fund Global.

than financial investments in equities and bonds. A property transaction will often take months to complete. Each contract needs to be negotiated individually, and transaction costs are higher than for trading in listed securities.

The Ministry of Finance has laid down rules for real estate investments in the fund's mandate. These rules allow the portfolio to be invested directly in real estate or in equities and bonds issued by listed and unlisted companies, fund structures and other real estate investment vehicles. In time, real estate investments are to be broadly distributed both geographically and between property types, such as offices, retail, industrial and residential.

The rules allow Norges Bank to invest in real estate through Norwegian or foreign entities. Unlisted companies and fund structures must be registered in OECD countries, countries with which Norway has tax treaties or countries from which Norway is entitled to demand tax information under other international agreements. In line with the rules for equities and bonds, the fund may not invest in real estate in Norway.

The investment risk associated with listed stocks and bonds is normally limited to the sum invested, but this is not the case with real estate. In line with the mandate from the ministry, Norges Bank has assessed suitable operational platforms for the implementation of real estate investments. Key criteria in considering the choice

of platform have been:

- i. Limitation of liability and protection of the central bank's assets against claims arising as a consequence of investments in real estate
- ii. An appropriate and robust oversight and control structure
- iii. Cost effectiveness, including limiting administration and tax costs
- iv. Efficient operational management

To limit liability and protect the central bank's assets, it will be necessary to invest through subsidiaries, as is standard practice in the real estate market. The corporate structures used may vary from investment to investment and from country to country. We will attach importance to oversight and control, tax costs, complexity and operational factors when choosing a structure. Property investments will thus normally be done through a subsidiary, and capitalized in this company. Between the different units in a company structure, intercompany loans can generally be used.

Some countries tax real estate investments heavily, and some have tax rules that could affect the tax status of the fund's other investments. This latter issue is particularly relevant when it comes to investing in the US, the world's largest real estate market. US tax law is highly complex, and it has proved both difficult and time-consuming to establish what our tax position might be.<sup>4</sup>

## Low taxes

The Ministry of Finance's mandate for the Government Pension Fund Global states that the bank shall seek to achieve the highest possible return after expenses. An important cost element can be taxes on the fund's investments in all markets and countries where we have assets. Norges Bank's and the fund's tax positions are specified by local regulations and the tax treaties Norway has signed with that country. It is important for Norges Bank that investments are taxed properly according to local laws and regulations, but also that the fund is not charged for more tax costs than necessary.

In real estate investments the tax position of Norges Bank and the fund can depend on the tax position of the counterparty in the transaction. Therefore, Norges Bank may need to establish companies in countries with low taxes. Low taxes are not the same as lack of transparency or money laundering. These two conditions are often mixed in the discussion of so-called "tax havens." The bank's agreements and corporate documents ensures the necessary transparency for the bank's internal audit, the Executive Board's regulatory body, for the bank's external auditor and the supervisory board, which is the Parliament's supervisory body for Norges Bank.

<sup>4</sup> See discussion in Norges Bank's consultation response to the Ministry of Finance of 21 October 2009 on new rules for the Government Pension Fund Global.

**Investment in London**

The fund’s first real estate investment was made in London. NBIM has entered into an agreement with *The Crown Estate*<sup>5</sup> which entitles the fund to 25 percent of the rental income from a number of properties on Regent Street for a period of 150 years. In practice, the fund will have full ownership during the period of agreement. Further information on the investment can be found in the main body of this report and in the 2010 annual report.

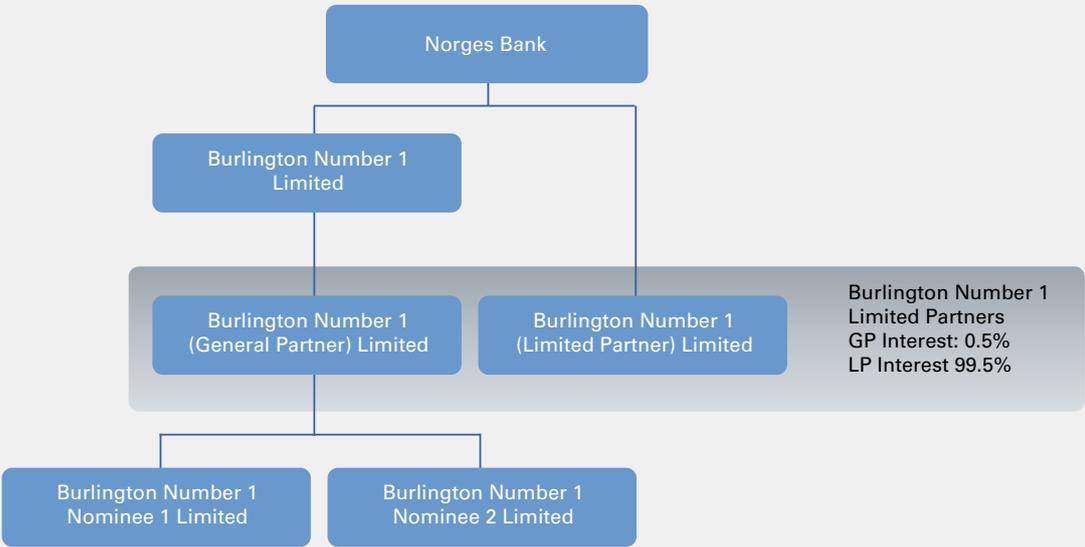
*The Crown Estate* manages the portfolio of properties on Regent Street in which the fund has this 25 percent

leasehold interest. Further investments may be made within this partnership

Norges Bank has set up five UK companies under the Companies Act 2006 to accommodate the partnership. A structure of this kind is often used for real estate investments. It protects the bank’s interests and limits its liability, while taking advantage of its favourable tax status: Norges Bank and the fund are exempt from UK income tax, corporation tax and capital gains tax on property sales if investments are made through tax-transparent entities.

**Regent Street – Norges Bank’s corporate structure**

The rights to rental income under the agreement with *The Crown Estate* are managed through the registered companies *Burlington Number 1 Nominee 1 Ltd* and *Burlington Number 1 Nominee 2 Ltd* on behalf of the registered partner companies *Burlington Number 1 (General Partner) Ltd*, which holds 0.5 percent of the investment, and *Burlington Number 1 (Limited Partner) Ltd*, which holds 99.5 percent of the investment and is tax-exempt. The companies’ directors are appointed by Norges Bank.



<sup>5</sup> The Crown Estate is owned by the reigning British sovereign but is not the private property of the monarch, nor of the British government. It is managed by a special-purpose statutory corporation.



## Investment in Paris

The fund's second real estate investment was in Paris, where the bank has entered into a partnership with units of the listed French insurance company AXA Group SA. Through this partnership, the fund owns 50 percent of various properties and property companies in and around Paris. Further investments may be made within this partnership. The investment is presented in more detail in the main body of the report.

For investments in mainland Europe, Norges Bank has concluded that a structure with a holding company in Luxembourg best meets the key criteria for the choice of corporate platform as discussed above. Many real estate investors set up subsidiaries in Luxembourg, and the use of this country meets the Ministry of Finance's requirement in the mandate for the fund that unlisted companies and fund structures are registered in OECD countries or countries with which Norway has tax treaties.<sup>6</sup>

Against this background NBIM S.à r.l.<sup>7</sup> was set up on 4 May 2011 with an office in Luxembourg. It is a wholly-owned subsidiary of Norges Bank and a holding company for the ownership and administration of real estate investments in mainland Europe.

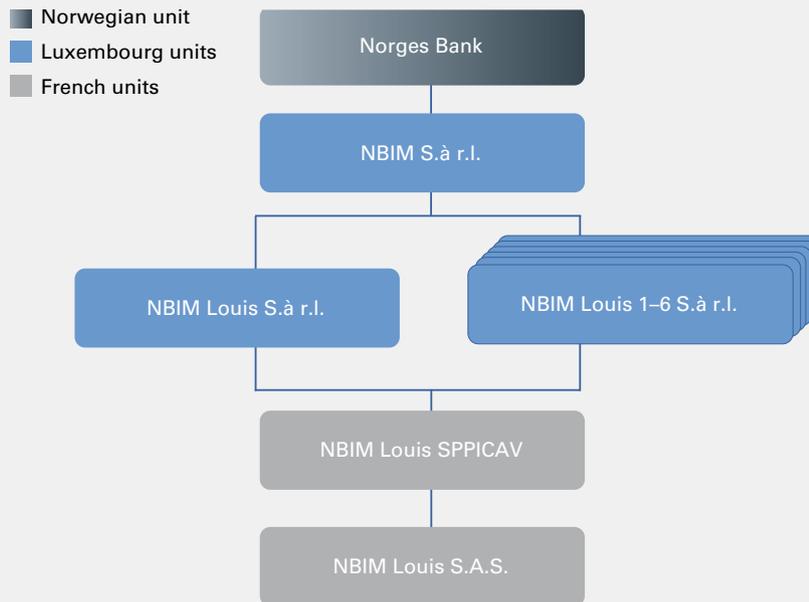
NBIM S.à r.l. performs tasks such as the administration of the office and investments, compliance with local laws and rules, financial reporting and the follow-up of cash flows from transactions. Real estate investments outside the AXA partnership or outside France that are to be channelled through Luxembourg will be held through separate entities owned by NBIM S.à r.l.

A number of companies have been set up in Luxembourg and France through the partnership with AXA.



<sup>6</sup> See Bill 55 S (2009-2010): Consent to implement the protocol signed in Brussels on 7 July 2009 amending the tax treaty between Norway and Luxembourg signed in Oslo on 6 May 1983.  
<sup>7</sup> Société à Responsabilité Limitée (S.à r.l.) is a corporate form very common in France, Switzerland and Luxembourg which limits the owners' liability to the capital they have contributed. The Norwegian corporate form that comes closest to this is the aksjeselskap (AS).

## Paris – Norges Bank's corporate structure



### Role of the individual companies in the structure:

- **NBIM S.à r.l.** is the master holding company and is wholly owned by Norges Bank. The company protects the fund's other assets against claims arising as a consequence of real estate investments. The intention is for future investments channelled through Luxembourg to be subsidiaries of NBIM S.à r.l.

The company's four directors are appointed by Norges Bank. Two are external, while the two internal members are NBIM's CIO Real Estate and the CEO of NBIM S.à r.l. Under the company's articles of association, board decisions must be unanimous, Norges Bank must approve key decisions affecting the company, and the bank has the right to appoint and dismiss directors with immediate effect.

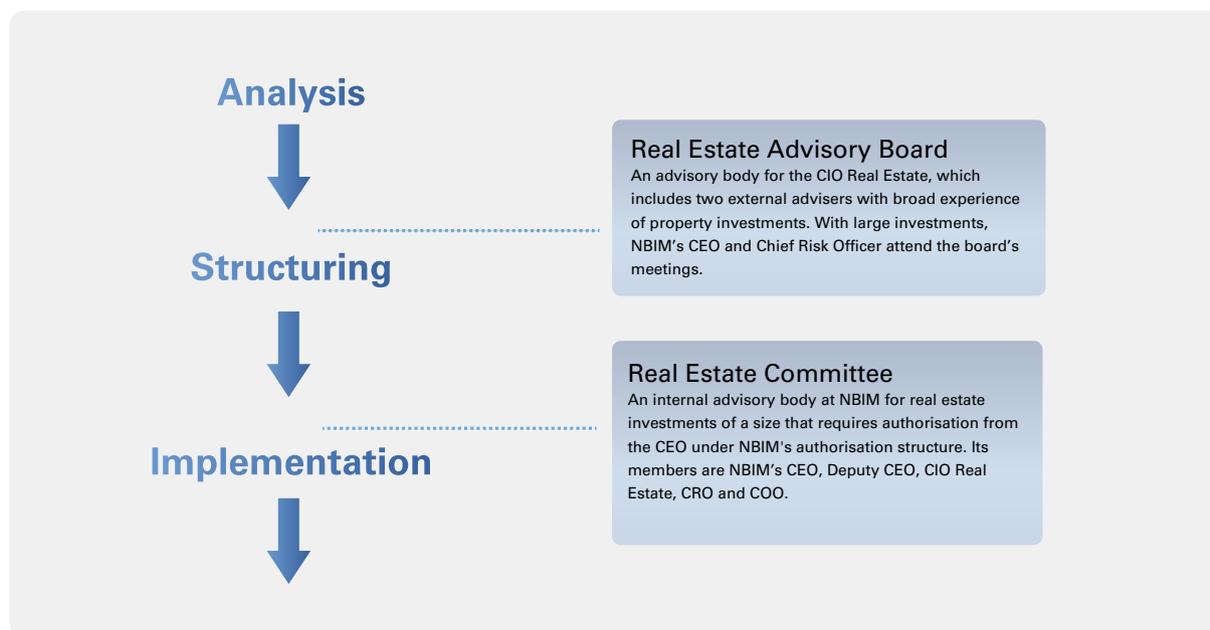
- **NBIM Louis S.à r.l.** The AXA investment is held through this company, which is wholly owned by NBIM S.à r.l. This company shields NBIM S.à r.l. from financial liability beyond its equity capital.
- **NBIM Louis 1-6 S.à r.l.** The role of these Luxembourg-registered companies is to own the French-registered company NBIM Louis SPPICAV.<sup>a</sup>
- **NBIM Louis SPPICAV.** A SPPICAV is a regulated investment vehicle which enjoys favourable tax treatment under French law.
- **NBIM Louis S.A.S.**<sup>b</sup> The French corporate form S.A.S. is often used for joint ventures between French and foreign companies. NBIM Louis S.A.S. is party to the agreement with AXA and has lawful title to 50 percent of the underlying assets in the form of properties and property companies.

a) Société de Placement À Prépondérance Immobilière À Capital Variable.

b) Société par Actions Simplifiée.



## Management and oversight of real estate investments



NBIM is gradually building up a management organisation for real estate investments. The real estate department had 12 employees in Oslo and London at the end of 2011. The department is responsible for analysing investment opportunities and for executing, following up, monitoring and managing investments.

When assessing prospective investments, consideration is given to the property itself, the counterparty, the corporate structure for the transaction, the contractual framework and tax matters. Environmental issues will also be addressed as set out in the regulations governing the fund.

Investment decisions are taken under a delegated authorisation structure. The subsidiaries discussed above have purely operational roles.

The oversight and control structure for real estate investments has multiple elements. Investments in real estate are covered by NBIM's governance structure in the same way as investments in stocks and bonds. The oversight model is based on governing documents issued by the Executive Board. Building on these, we have drawn up internal guidelines for our activities,

including investment mandates and a job description for the CIO Real Estate, as well as operational guidelines. The key elements are delegation of authority, control and reporting.

NBIM has worked systematically on operational risk management and internal control. In the same way, control and follow-up of risk have been established for real estate activities, and operational risk management has been extended to included real estate subsidiaries through governing documents and reporting requirements.

The bank's internal audit unit and external auditors and the Office of the Supervisory Council oversee the activities of NBIM and its subsidiaries. The Supervisory Council issued guidelines in 2011 for the supervision of subsidiaries. With wholly-owned subsidiaries, an auditor will be appointed as for Norges Bank. With partly-owned subsidiaries, we will endeavour to appoint an auditor similarly. In cases where the bank does not have the final decision on the choice of auditor, the auditor will be chosen in consultation with the Office of the Supervisory Council.

<sup>8</sup> See further discussion on [www.nbim.no](http://www.nbim.no).

<sup>9</sup> See discussion in the feature article in the 2010 annual report.

Feature article

## Use of benchmarks in the fund management

Benchmark indices are widely used in international investment management and serve a variety of purposes. As it may be useful to operate with benchmarks at multiple levels in the management of the Government Pension Fund Global, NBIM has developed an operational benchmark portfolio.

### The use of benchmark indices

A strategic benchmark index is an expression of the owner's investment preferences. It is rooted in the fund's objectives and should reflect the strategic role of the individual asset classes in the fund. Above all, the strategic benchmark index defines an investment direction and a risk tolerance.

The strategic benchmark index for a large public fund should be chosen from leading and readily available indices to maximise transparency. Most commonly used indices aim to cover the investable universe in an asset class and weight the different securities included in the index on the basis of their market value. These market indices are designed to serve as a yardstick for a manager's implementation of a management mandate and are not tailored to an individual fund's specific objectives and characteristics.

An operational benchmark portfolio allows these commonly used indices to be tailored more closely to a fund's objectives and characteristics. The benchmark portfolio will move away from leading market indices towards a higher degree of customisation. This customisation requires proximity to the markets invested in, and decisions must take account of fundamental and structural factors in these markets.

The aim of the operational benchmark portfolio is to achieve a better trade-off between expected return and

risk after costs. The limits set in the management mandate can still be linked to the strategic benchmark index. Deviations between the benchmark index and the benchmark portfolio will then draw on the risk limits in the investment mandate in the same way as other investment decisions, but may differ in size, nature and timeframe from what would normally come under the heading of active management.

### The strategic benchmark index set by the Ministry of Finance

In its Mandate for the Management of the Government Pension Fund Global, the Ministry of Finance has defined a strategic benchmark index consisting of two asset class indices – an equity index and a bond index – in set proportions. No good market indices are available for the fund's third asset class, real estate, and so it is not discussed further in this article.

The benchmark indices set by the ministry are based on market indices from leading index suppliers, which helps ensure transparency and verifiability. The index defines an investment direction and reflects the owner's risk tolerance. The equity benchmark is the FTSE Global Equity Index Series All Cap index, while the benchmark for bond investments is composed of indices from Barclays Capital.

The composition of the index will move away from the fixed weights in the strategic benchmark index over time

due to different movements in value between regions and asset classes. The ministry therefore calculates an actual benchmark index, which can be very different to the strategic index at times. The difference between the strategic and actual benchmark indices from the ministry will also be affected by how inflows of new capital and the rebalancing of the fund are handled. The actual benchmark index is the one used to calculate excess return and risk. The investment decisions as part of the procedures for inflows and rebalancing are not measured in this structure.

#### **The operational benchmark portfolio used by NBIM**

NBIM's operational benchmark portfolio aims to further adapt the strategic benchmark index to the fund's objectives – safeguarding wealth and long-term purchasing power – and distinguishing characteristics – primarily its size, long-term outlook and absence of short-term liabilities. It addresses the methodological weaknesses and unnecessary complexity of the strategic benchmark index, reflects adjustments to the fund's investment universe, and aims to take account of structural changes in the markets, alternatives to market-weighting, and time-varying risk premiums.

Commonly used benchmark indices have a number of methodological weaknesses in terms of the different asset classes' strategic role in the fund. Two examples on the fixed-income side are the automatic exclusion from the index of bonds whose credit rating drops below a certain level and bonds that have less than a year to maturity. An example on the equity side is the adjustment of a company's index weight to allow for shares that are not freely tradeable (free-float adjustment).

The diversification gain from holding all stocks and bonds

included in broad benchmark indices is limited. The key risk characteristics of the strategic benchmark index can be recreated with a much smaller number of securities, which helps reduce the complexity of the portfolio and the cost of management. In the operational benchmark portfolio, we have removed some types of structured bonds, such as US mortgage-backed securities, and we have set a higher threshold for the inclusion of new bond issues, reflecting the size of the fund.

Leading market indices represent the investment universe of a typical investor. In some cases, however, a large sovereign investor such as the fund will have different investment options. The operational benchmark portfolio adjusts the investment universe on the basis of risk assessments relating to operational risk and legal protection as well as various forms of regulation. NBIM has set up a committee to decide which markets and securities the fund may be invested in, and this is reflected in the operational benchmark portfolio. Pakistan, for example, is not approved for equity investments as it is considered to provide inadequate protection for shareholders, even though this market is included in the strategic benchmark index. Similarly, investments in the Mexican financial sector have been excluded from the operational benchmark portfolio because foreign sovereign funds are not permitted to hold shares in Mexican financial institutions. An equivalent example on the bond side is the capital restrictions on government bonds in Taiwan, only in this case the operational benchmark portfolio is broader than leading market indices as these restrictions are not a limiting factor for the fund.

Commonly used market indices will reflect structural changes in the issuance of new securities. Through

adjustments to the operational benchmark portfolio, we can make more appropriate allowance for such changes. One example is changes in bond issuance in various parts of banks' capital structure as a result of new regulation in the financial sector, which should not necessarily be part of the fund's investment strategy. Another example is increased issuance of government bonds in countries where public finances are under pressure, which can impact on the currency, credit and liquidity characteristics of market indices without necessarily being in line with the fund's long-term aims.

Market indices weight securities on the basis of their market value. This market-weighting is not necessarily the best option for the fund given its particular characteristics. Other weighting methods may help improve the long-term trade-off between risk and return in the fund, especially when it comes to equities. On the fixed-income side the principle of market-weighting means that borrowers issuing large volumes of bonds have a greater weight in the benchmark index. In a GDP-

weighted portfolio, each country's share is based on its economic output rather than its borrowings. The portfolio's currency mix will be affected partly by which currencies are included and partly by the weights they are given. Government bonds in emerging markets have been assigned a larger weight in the operational benchmark portfolio to reflect the fund's objective of safeguarding long-term international purchasing power.

Investment opportunities and risk premiums vary over time and along different dimensions. In some cases, the fund may be particularly well-placed to exploit these variations. It may therefore be natural to include time variations in some risk premiums in an operational benchmark portfolio, such as exposure to small companies or variations in credit premiums. This could be a way of taking advantage of the fund's long-term outlook and absence of short-term payment obligations.

# Management

Chart 15-1 Benchmark bond index set by the Ministry of Finance as of 31 Dec 2011. Asset type. Percent

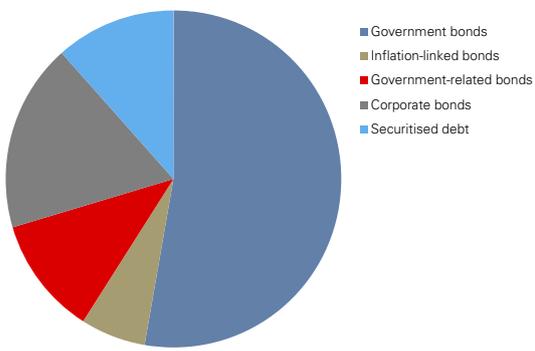
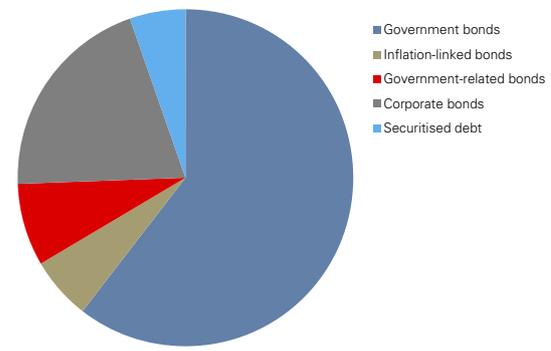


Chart 15-2 NBIM's operational benchmark portfolio for bonds as of 31 Dec 2011. Asset type. Percent



# Financial Reporting

Norges Bank's annual financial statements, which include the financial reporting for the investment portfolio of the Government Pension Fund Global, were approved by the Executive Board 29 February 2012 and adopted by Norges Bank's Supervisory Council on 15 March 2012. This financial reporting and an excerpt from Norges Bank's accounting policies and significant estimates and critical judgements are presented below.

Income statement	71
Statement of comprehensive income	71
Balance sheet	72
Statement of cash flows	73
Statement of changes in owner's capital	74
<b>Notes to Financial Reporting</b>	
<b>Note 1</b> Transition to International Financial Reporting Standards (IFRS) and accounting policies	75
<b>Note 2</b> Significant estimates and critical accounting judgements	82
<b>Note 3</b> Profit/loss on the portfolio before foreign exchange gains and losses	83
<b>Note 4</b> Other expenses	84
<b>Note 5</b> Management fee	85
<b>Note 6</b> Repurchase and reverse repurchase agreements	85
<b>Note 7</b> Equities and units / Bonds and other fixed income instruments	87
<b>Note 8</b> External agency securities lending	88
<b>Note 9</b> Financial derivatives	90
<b>Note 10</b> Real estate	91
<b>Note 11</b> Other financial assets / Other financial liabilities	94
<b>Note 12</b> Currency distribution	95
<b>Note 13</b> Fair value measurement	96
<b>Note 14</b> Risk	101
<b>Note 15</b> Subsidiaries and jointly controlled entities	109
Independent Auditor's Report	110

## Income Statement

<i>Amounts in NOK million</i>	<b>Note</b>	<b>2011</b>	<b>2010</b>
<b>Profit/loss on the portfolio excluding foreign exchange gains and losses</b>			
Interest income from bank deposits		162	377
Interest income, lending associated with reverse repurchase agreements		1 004	350
Net income/expenses and gains/losses from:			
- Equities and units		- 173 099	207 070
- Bonds and other fixed income instruments		92 346	60 316
- Financial derivatives		- 5 693	- 3 552
- Financial assets real estate		86	-
- Investment properties	10	- 130	-
Share of the profit/loss in jointly controlled entities, real estate	10	- 31	-
Interest expense repurchase agreements		- 629	- 574
Other interest expense		- 286	- 105
Other expenses	4	24	- 9
<b>Profit/loss on the portfolio before foreign exchange gains and losses</b>	<b>3</b>	<b>- 86 246</b>	<b>263 873</b>
Foreign exchange gains and losses		49 205	- 8 498
<b>Profit/loss on the portfolio</b>		<b>- 37 041</b>	<b>255 375</b>
Management fee	5	- 2 539	- 2 959
<b>Profit/loss for the period</b>		<b>- 39 580</b>	<b>252 416</b>

## Statement of Comprehensive Income

<i>Amounts in NOK million</i>	<b>Note</b>	<b>2011</b>	<b>2010</b>
Profit/loss for the period		- 39 580	252 416
Translation reserve arising from consolidation of foreign subsidiaries		- 3	-
<b>Total comprehensive income</b>		<b>- 39 583</b>	<b>252 416</b>

## Balance sheet

<i>Amounts in NOK million</i>	<b>Note</b>	<b>31.12.2011</b>	<b>31.12.2010</b>	<b>31.12.2009</b>
<b>ASSETS</b>				
<b>Financial assets</b>				
Deposits in banks		7 276	6 303	4 644
Lending associated with reverse repurchase agreements	6	79 820	255 501	191 473
Cash collateral paid		-	-	140
Unsettled trades		2 272	4 864	17 572
Equities and units	7	1 806 798	1 733 378	1 496 759
Equities lent	7, 8	137 130	162 483	150 847
Bonds and other fixed income instruments	7	1 324 255	1 038 793	918 500
Bonds lent	7, 8	3 256	215 090	161 990
Financial derivatives	9	2 227	3 068	2 263
Financial assets real estate	10	4 415	-	-
Jointly controlled entities, real estate	10	2 546	-	-
Other financial assets	11	3 244	1 358	251
<b>Total financial assets</b>		<b>3 373 239</b>	<b>3 420 838</b>	<b>2 944 439</b>
<b>Non-financial assets</b>				
Investment properties	10	4 062	-	-
Other non-financial assets		6	-	-
<b>Total non-financial assets</b>		<b>4 068</b>	<b>-</b>	<b>-</b>
<b>TOTAL ASSETS</b>	<b>12, 13, 14</b>	<b>3 377 307</b>	<b>3 420 838</b>	<b>2 944 439</b>
<b>LIABILITIES AND OWNER'S CAPITAL</b>				
<b>Financial liabilities</b>				
Short-term borrowing		11	2 939	6 238
Borrowing associated with repurchase agreements	6	19 280	132 992	109 536
Cash collateral received	8, 9	36 926	172 309	154 676
Unsettled trades		3 310	20 358	11 925
Short-sale bonds	7	-	809	10 278
Financial derivatives	9	5 957	9 372	8 118
Other financial liabilities	11	251	4 639	3 625
Management fee payable		2 539	2 959	3 228
<b>Total financial liabilities</b>	<b>12, 13, 14</b>	<b>68 274</b>	<b>346 377</b>	<b>307 624</b>
Owner's capital		3 309 033	3 074 461	2 636 815
<b>TOTAL LIABILITIES AND OWNER'S CAPITAL</b>		<b>3 377 307</b>	<b>3 420 838</b>	<b>2 944 439</b>

## Statement of cash flows

<i>Amounts in NOK million</i>	2011	2010
<b>Operating activities</b>		
Interest received on deposits in banks	179	377
Net cash flow in connection with reverse repurchase agreements	170 095	-57 392
Net cash flows arising from purchase and sale of equities and units	-239 987	-70 201
Net cash flows arising from purchase and sale of bonds and other fixed income instruments	-21 094	-180 835
Payments made to acquire financial assets real estate	-4 270	-
Payments made to acquire investment properties	-4 301	-
Payments made to acquire jointly controlled entities, real estate	-2 620	-
Net cash flows arising from financial derivatives	-9 147	-1 433
Dividends received from investments in equities and units	49 208	41 257
Interest received on bonds and other fixed income instruments	48 036	45 752
Income received in connection with equity and bond lending	2 230	1 676
Income received from investments in financial assets real estate	130	-
Income received from investments in investment properties	60	-
Interest paid on short-term borrowing from banks	-21	-209
Net cash flows related to repurchase agreements	-114 347	23 742
Cash collateral received/paid related to securities lending, derivatives and reverse repurchase agreements	-135 382	17 773
Cash flow related to other financial assets, other financial liabilities and other non-financial assets	-5 587	1 112
Payment of other expenses	-248	-29
Management fee paid to Norges Bank	-2 959	-3 228
<b>Net cash outflow from operating activities</b>	<b>-270 025</b>	<b>-181 640</b>
<b>Financing activities</b>		
Inflow from the Norwegian government	274 155	185 230
<b>Net cash inflow from financing activities</b>	<b>274 155</b>	<b>185 230</b>
<b>Net change in cash and cash equivalents</b>		
Cash and cash equivalents at 1 January	3 363	-1 594
Net cash payments in the period	4 130	3 590
Foreign exchange gains and losses on cash and cash equivalents	-228	1 367
<b>Cash and cash equivalents at 31 December</b>	<b>7 265</b>	<b>3 363</b>
<b>Cash and cash equivalents comprise:</b>		
Deposits in banks	7 276	6 303
Short-term borrowing	-11	-2 939
<b>Total cash and cash equivalents at 31 December</b>	<b>7 265</b>	<b>3 363</b>

## Statement of changes in owner's capital

<i>Amounts in NOK million</i>	<b>Inflows from owner</b>	<b>Retained earnings</b>	<b>Translation reserve foreign subsidiaries</b>	<b>Deposits in krone account*</b>
1 January 2010	2 319 481	317 334	.	2 636 815
Total comprehensive income	.	252 416	.	252 416
Inflows during the period	185 230	.	.	185 230
<b>31 December 2010</b>	<b>2 504 711</b>	<b>569 750</b>	<b>.</b>	<b>3 074 461</b>
1 January 2011	2 504 711	569 750	.	3 074 461
Total comprehensive income	.	- 39 580	- 3	- 39 583
Inflows during the period	274 155	.	.	274 155
<b>31 December 2011</b>	<b>2 778 866</b>	<b>530 170</b>	<b>- 3</b>	<b>3 309 033</b>

\* Due to different accounting frameworks owner's capital for the Government Pension Fund Global (GPF) according to Norges Bank's financial statements will each year deviate slightly from the equity capital of the GPF in the central government accounts. This is due to the transfers to the GPF through the year being based on estimates of income in the GPF. Actual recognised income (net accrual) in the central government accounts will not be known until after year end. In the central government accounts the difference between the net accrual and the transfers is shown as receivables/payables between the GPF and the treasury. In cases of too high transfers to the GPF, the treasury has a receivable from the GPF, and the GPF correspondingly has a lower equity capital in the central government accounts than as shown in the statement in Norges Bank's financial statements. On the other hand, in cases of too low transfers to the GPF compared to the recognised income, the GPF has a receivable from the treasury, and correspondingly higher equity capital for the GPF is shown in the central government accounts than in the Norges Bank statement. See the central government accounts chapter 3 for further information.

# Notes to Financial Reporting

## Note 1 Transition to International Financial Reporting Standards (IFRS) and accounting policies

### 1. Introduction

Norges Bank is Norway's central bank. The bank shall promote economic stability in Norway. Norges Bank has executive and advisory responsibilities in the area of monetary policy and is responsible for promoting robust and efficient payment systems and financial markets. Norges Bank manages Norway's foreign exchange reserves and the Government Pension Fund Global

Pursuant to Section 30 second paragraph of the Norges Bank Act, the annual financial statements of Norges Bank have been prepared in accordance with the Accounting Act and the Regulation concerning annual financial reporting for Norges Bank, which has been laid down by the Ministry of Finance. The regulation applies as from the 2011 accounting year and requires that Norges Bank financial statements are prepared in accordance with International Financial reporting Standards as endorsed by the EU (IFRS), but sets certain specific requirements for the presentation of the investment portfolio of the Government Pension Fund Global and subsidiaries that exclusively constitute investments as part of the management of the investment portfolio. The regulation requires Norges Bank's financial statements to include the financial reporting of the investment portfolio of the Government Pension Fund Global, which shall be prepared in accordance with IFRS.

Norges Bank prepares annual financial statements with a closing date of 31 December that includes financial reporting for the investment portfolio of the Government Pension Fund Global. In addition, Norges Bank prepares interim financial statements, which solely comprise the quarterly financial reporting of the investment portfolio of the Government Pension Fund Global, with closing dates of 31 March, 30 June and 30 September.

The annual financial statements of Norges Bank for 2011 were approved by the Executive Board on 29 February 2012 and adopted by the Supervisory Board on 15 March 2012.

### 2 Norges Bank and the Government Pension Fund Global

The Government Pension Fund Global is invested in its entirety outside Norway. Parliament has established the legal framework in the act on the Government Pension Fund, and the Ministry of Finance has formal responsibility for investment management. The Government Pension Fund Global shall support saving to finance future government expenditure and underpin long-term considerations relating to the use of Norway's petroleum revenues.

The Ministry of Finance has deposited funds for investment in a krone account in Norges Bank specified for this purpose. The corresponding value of the krone account constitutes an investment portfolio managed by Norges Bank in accordance with the act on the Government Pension Fund and management mandate for the Government Pension Fund Global issued by the Ministry of Finance. The Executive Board has delegated day-to-day asset management to the bank's asset management area, Norges Bank Investment Management (NBIM).

Norges Bank is not exposed to financial risk from its management of the Government Pension Fund Global. The return on the portfolio is transferred in its entirety to the krone account and does not affect total comprehensive income or owner's capital in Norges Bank. The net value of the investment portfolio is 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 in the Norges Bank balance sheet.

### 3 Transition to IFRS

#### *Transition effects for the investment portfolio of the Government Pension Fund Global*

Adoption of IFRS has not required any changes in recognition, measurement or classification for assets and liabilities or changes in the IFRS income statement for the investment portfolio of the Government Pension Fund Global for comparative periods in 2010. Accordingly, owners' capital has remained unchanged in all periods. In accordance with IAS 1 *Presentation of Financial Statements*, a separate statement of comprehensive income is included, and as at the reporting date, comprises only foreign exchange translation differences that arise upon consolidation of foreign subsidiaries in Norwegian kroner. Also included is a statement of changes in owner's capital in accordance with IAS 1, in that this information has now been moved from a note disclosure to a separate statement as required by the adoption of IFRS. The previous financial reporting framework did not require presentation of a statement of cash flows for the investment portfolio of the Government Pension Fund Global. As part of the transition to IFRS, such a statement has been presented, along with comparative amounts for 2010.

### 4 Accounting policies

#### *4.1 Income statement, statement of comprehensive income and balance sheet*

The income statement, statement of comprehensive income and balance sheet have been prepared in accordance with IAS 1 *Presentation of Financial Statements*. The balance sheet presentation format is based on liquidity.

#### 4.2 Statement of cash flows

The statement of cash flows has been prepared in accordance with IAS 7 *Statement of Cash Flows* using the direct method, whereby major classes of cash receipts and cash payments are disclosed separately. Specific categories of cash flows, primarily arising from the purchase and sale of financial instruments, are shown on a net basis when appropriate. All investment activity is defined as operating activities. The management fee for the Government Pension Fund Global, which is charged to the investment portfolio and paid by the Ministry of Finance to Norges Bank, is also shown as an operating cash flow. Cash transfers to the Government Pension Fund Global's krone account, in the form of a contribution from the owner, are classified as a financing activity and presented as a transfer from the Norwegian government. The investment portfolio of the Government Pension Fund Global has no investing activities as defined in IAS 7.

Cash and cash equivalents comprise Deposits in banks and Short-term borrowing.

#### 4.3 Statement of changes in owner's capital

Norges Bank presents a statement of changes in owner's capital for the Government Pension Fund Global. The statement has been prepared in accordance with IAS 1 *Presentation of Financial Statements*.

Owner's capital for the Government Pension Fund Global comprises contributed capital in the form of transfers from the Norwegian government and retained earnings in the form of total comprehensive income.

#### 4.4 Currency

Norges Bank's functional currency is the Norwegian krone (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 closing rate at the balance sheet date. The presentation currency for financial reporting is the Norwegian krone.

In the income statement, the foreign exchange element linked to realised and unrealised gains and losses on assets and liabilities is disaggregated and presented on a separate line. Foreign exchange adjustments for the period are estimated based on the cost 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.

Foreign subsidiaries that are consolidated into the investment portfolio's financial reporting and have a functional currency different from the one of Norges Bank are translated into Norwegian kroner. Income statements are translated at an average exchange rate for the period, and balance sheets are translated at the reporting period's closing rate. Any translation differences are included in Total comprehensive income and presented as Translation reserve arising from consolidation of foreign subsidiaries.

See also Note 2 Significant estimates and critical accounting judgements.

#### 4.5 Income and expenses

Interest income from deposits in banks, interest income from lending associated with reverse repurchase agreements and investments in bonds and other fixed income instruments is recognised when the interest is earned and classified in each of the respective lines in the income statement.

Dividends from investments in equity instruments are recognised as income when the dividends are formally approved by the shareholders' meeting or comparable responsible party. Dividends are included in the line Net income/expenses and gains/losses from equities and units.

Income from securities lending is presented as a net income comprising securities lending fees, expenses related to cash collateral received, reinvestment income, and the deduction of the security lending agents' fees connected to the handling of the transaction. Net income is calculated and classified in accordance with the type of security that is lent as either Net income/expenses and gains/losses from equities and units or Net income/expenses and gains/losses from bonds and other fixed income instruments.

Rental income related to investment property, less direct expenses incurred in connection with the signing of lease agreements, is recognised as income straight-line over the lease term. Incentive schemes related to signing lease agreements are recognised straight-line over the lease term, even if payment streams deviate from this basis.

For a description of accounting using the equity method, see 4.12 Jointly controlled entities and jointly controlled assets.

Interest expense is measured and recognised as incurred in the income statement and presented as either Interest expense repurchase agreements or Other interest expense.

Transaction costs are defined as all costs directly attributable to the completed transaction. For investments in equities and fixed income instruments, this includes normal commission fees and stamp duties. Commission fees include an amount paid as part

of the commission fee to cover analytical research services through CSAs (commission sharing agreements; agreements to allocate commission between transaction commission and research commission). For investments within the investment asset class real estate, transaction costs will also typically include fees to advisors, typically lawyers and valuation experts and stamp duty. Transaction costs are expensed as incurred and classified in accordance with the type of investment as either Net income/expenses and gains/losses from equities and units, Net income/expenses and gains/losses from bonds and other fixed income instruments, or Net income/expenses and gains/losses from financial assets real estate. For investment property and jointly controlled entities, directly attributable transaction costs are recognised in the balance sheet as a portion of the cost at initial recognition. For financial instruments that at initial recognition are measured at amortised cost, transaction costs are recognised in the balance sheet as part of the instrument's cost.

The management fee comprises the Ministry of Finance's reimbursement of Norges Bank's expenses connected with the management of the Government Pension Fund Global, which is recognised in the income statement for the investment portfolio of the Government Pension Fund Global as an expense, and recognised as revenue in the Norges Bank income statement. Operating expenses are reimbursed by the Ministry of Finance within an agreed limit. The management fee accrues during the financial year, but cash settles in the year following.

#### 4.6 Taxation

Norges Bank's activities in Norway are not subject to tax. In some foreign markets, Norges Bank is liable to tax, in the form of withholding tax on dividend and interest income and corporate tax paid by foreign subsidiaries for operations in other countries.

#### 4.7 Classification and presentation of financial instruments

At initial recognition all financial assets are classified in one of the following categories depending on the type of instrument and purpose of the investment:

- Financial assets held for trading,
- Financial assets designated as at fair value through profit or loss (fair value option), or
- Financial assets classified as loans and receivables measured at amortised cost.

At initial recognition financial liabilities are classified in one of the following categories:

- Financial liabilities held for trading,
- Financial liabilities designated as at fair value through profit or loss (fair value option), or
- Other financial liabilities, measured at amortised cost.

Norges Bank does not engage in hedge accounting, and therefore none of the financial instruments are designated as hedging instruments.

##### Financial assets or liabilities held for trading

All positions in financial derivatives are classified in the category financial assets held for trading or financial liabilities held for trading. Other assets and liabilities are classified as held for trading if the investment is primarily made with the intention of sale or repurchase in the short-term, or at the point of first recognition is part of a portfolio that is managed at the portfolio level and where there is evidence of an actual pattern of short-term realisation of profit. None of the investments in equities or bonds are as at the balance sheet date classified as held for trading.

##### Financial assets and liabilities designated as at fair value through profit or loss (fair value option)

Financial instruments are classified in this category if the following criteria are met: the financial instruments are part of a portfolio that is managed and followed up based on the fair value in connection with a documented risk management strategy or a documented investment strategy. This implies that a fair value business model is used for the portfolio or the asset, and the primary objective is to have gains over the longer term connected to changes in fair value.

All portfolios of equities and bonds under management are as at the balance sheet reporting date classified in this category. Positive holdings of equities and other equity instruments are presented on the same line in the balance sheet, as are positive holdings of bonds and other fixed income instruments presented on a separate line in the balance sheet. Net short positions in similar instruments are presented as Short-sale bonds.

Investments in the asset class real estate in the form of a share in the cash flow from underlying properties are classified in this category and presented on a separate line in the balance sheet.

##### Loans and receivables and other financial liabilities, measured at amortised cost

Financial assets and liabilities that are not held for trading and are not designated as at fair value through profit or loss, and are not listed in an active market, are classified as loans and receivables or other financial liabilities.

Short-term financial assets and liabilities with positions in repurchase and reverse repurchase agreements and deposits/debt in the money market along with cash collateral are classified as loans and receivables or other financial liabilities and measured at amortised cost.

#### Earned and accrued interest

Earned and accrued interest is presented in the balance sheet in the same line as the respective financial asset or liability.

#### *4.8 Recognition and derecognition, financial instruments*

Financial assets or liabilities are recognised in the balance sheet when Norges Bank becomes party to the instrument's contractual benefits, or when the risks and rewards of ownership are transferred if this occurs at a different point in time. The transaction is recognised at trade date, in that the purchase or sale of the instrument occurs under normal market conditions. Financial assets are derecognised when the contractual rights to the cash flows expire, or when the financial asset and substantially all the risks and rewards of ownership are transferred. Average acquisition cost is used upon derecognition. Financial liabilities are derecognised when the obligation is extinguished.

#### 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 terminates, the identical securities are returned to Norges Bank. The borrower is obliged to compensate the lender for corporate events relating to the securities. 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. During the lending period the securities are accounted for in the same way as other securities holdings. Loaned securities are presented on separate lines in the balance sheet, Equities lent and Bonds lent.

Collateral received in the form of cash is recognised as an asset together with a corresponding liability measured at amortised cost, Cash collateral received. Collateral received in the form of securities is not recognised in the balance sheet unless reinvested.

Reinvestments of cash collateral in the form of reverse repurchase agreements and bonds are recognised in the balance sheet and accounted for in the same manner as comparable investments.

#### Repurchase and reverse repurchase agreements

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

In connection with reverse repurchase agreements, the received underlying security is not reinvested and therefore is not recognised on the balance sheet. The cash paid is derecognised, and a corresponding receivable reflecting the cash amount that will be received in return is recognised as an asset at amortised cost, Lending associated with reverse repurchase agreements.

Income and expenses connected with repurchase and reverse repurchase agreements are presented in separate lines in the income statement, Interest income, lending associated with reverse repurchase agreements and Interest expense repurchase agreements.

#### *4.9 Measurement of financial instruments*

##### Initial recognition

Financial assets and liabilities classified in categories with subsequent measurement at fair value through profit or loss are recognised at fair value on the trade date. Fair value will normally be the transaction price unless a different value can be justified based on transactions observed in the market.

Financial assets and liabilities that are measured at amortised cost after initial recognition are recognised on the trade date at fair value including directly attributable transaction costs. Transaction costs are described further in 4.5.

##### Subsequent measurement – fair value

All equities, bonds and other fixed income instruments, real estate investments and financial derivatives classified as financial assets and liabilities held for trading or designated as at fair value through profit or loss are measured at fair value on the reporting dates after first recognition. Gains and losses from changes in fair value are recognised in profit or loss in the period in which they arise. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

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

If the market for a security is not active, fair value is established by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide

reliable estimates of prices obtained in actual market transactions, that technique is used. The chosen valuation technique makes maximum use of market inputs. For further information on valuation techniques, see Note 13 Fair value measurement.

Changes in fair value are recognised in the income statement line related to the relevant instrument type, i.e. Net income/expenses and gains/losses from equities and units, Net income/expenses and gains/losses from bonds and other fixed income instruments, Net income/expenses and gains/losses from financial derivatives and Net income/expenses and gains/losses from financial assets real estate.

#### Subsequent measurement – amortised cost

Financial assets and liabilities classified as loans and receivables or other financial liabilities are measured at amortised cost after initial recognition. The effective interest is recognised in the income statement. The effective interest rate is determined as the rate that discounts contractual cash flows within the agreed maturity to the recognised amount. The cash flows include directly attributable transaction costs.

#### *4.10 Netting*

Financial assets and financial liabilities are presented net in the balance sheet if Norges Bank has a legal right to offsetting in addition to the intention to in practice settle on a net basis.

Financial derivatives are not netted based on these criteria not being fulfilled. This implies that positions with positive market values are presented as assets and positions with negative market values are presented as a liability.

#### *4.11 Investment property*

Properties held for the purpose of earning rental income or capital appreciation within the real estate asset class are accounted for as investment property in the investment portfolio's balance sheet.

Investment property is recognised as an asset when it is probable that the future rental income and value changes that are associated with the investment property will flow to Norges Bank and the cost of the investment property can be measured reliably. An investment property is derecognised when sold, i.e. when substantially all the risks and potential for returns related to the property have been transferred to a buyer.

An investment property is measured initially at its purchase price, plus directly attributable transaction costs.

Investment property is measured at fair value at the reporting dates following initial recognition. Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction and is determined without deduction for transaction costs that will incur on sale or other disposal. External appraisals and valuations are regularly obtained as the primary basis for the determination of fair value. See Note 13 Fair value measurement for further information about valuation. Changes in the fair value of properties classified as Investment property in the balance sheet of the investment portfolio are presented in the investment portfolio's income statement as Net income/expenses and gains/losses from investment properties.

#### *4.12 Jointly controlled entities and jointly controlled assets*

Jointly controlled entities and jointly controlled assets are investments where subsidiaries established as part of the management of the investment portfolio of the Government Pension Fund Global have joint control through an agreement with a counterparty over the entity's strategic, financial and operational decisions, or comparable decisions related to the asset.

Jointly controlled entities are accounted for using the equity method. Investments in jointly controlled entities are recognised as an asset when it is probable that the future economic benefits that are associated with the interest in the entity will flow to Norges Bank and the cost of the investment can be measured reliably. Jointly controlled entities are derecognised when sold, i.e. when substantially all the risks and returns have been transferred to a buyer.

Cost at initial recognition comprises the consideration paid, plus directly attributable transaction costs. Investments in such entities are presented as Investments in jointly controlled entities, real estate in the investment portfolio's balance sheet. All jointly controlled entities report to Norges Bank using the accounting policies of Norges Bank, including measuring investment properties held by a jointly controlled entity at fair value.

In subsequent reporting periods, the carrying amount of the investment will be adjusted by the share of the profit or loss for the period, which comprises the investment portfolio's share of changes in the investee's equity for the period, adjusted for dividends received and any amortisation of excess value. The investment portfolio's share of the profit or loss for the period is presented as Share of the profit/loss in jointly controlled entities, real estate.

Jointly controlled assets are accounted for using proportionate consolidation. Such investments are recognised on the same basis as for jointly controlled entities. Cost at initial recognition comprises the consideration paid, plus directly attributable transaction costs. Under proportionate consolidation, the investment portfolio accounts for its proportionate share of assets, liabilities,

income and expenses, on the basis of their nature. Jointly controlled assets primarily comprise investment property (see above). Income and expenses associated with management of investment property are presented as Net income/expenses and gains/losses from investment properties.

#### 4.13 Consolidation of subsidiaries

Norges Bank has established subsidiaries that exclusively constitute investments as part of the management of the investment portfolio of the Government Pension Fund Global. Consolidated financial statements are prepared for the investment portfolio. Pursuant to Section 3-4 first paragraph last sentence of the Regulation relating to annual financial reporting for Norges Bank only consolidated financial statements shall be prepared for the investment portfolio.

The subsidiaries exclusively constitute investments as part of the management of the investment portfolio of the Government Pension Fund Global, and are omitted from consolidation in the financial statements of Norges Bank pursuant to Section 2-3 fourth paragraph of the above-mentioned regulation.

The accounting policies are applied consistently when consolidating ownership interests in subsidiaries. Intra-group transactions and intercompany balances are eliminated in the preparation of consolidated financial statements. Intra-group items comprise loans and equity financing from the investment portfolio to subsidiaries to finance property investments in subsidiaries. Loans are made at market interest rates and are issued in the subsidiary's functional currency. Except for the above mentioned items, all items recognised in subsidiaries' financial statements are included in the investment portfolio's statement of comprehensive income, balance sheet and statement of cash flows. This includes subsidiary operating expenses and management costs, presented as Other expenses.

#### 4.14 Related parties

Norges Bank is owned by the Norwegian government and under IAS 24.25 is exempt from the disclosure requirements in relation to related party transactions with the government.

### 5 Standards, amendments and interpretations not applicable in 2011

*IASB final standards and IFRS and IFRIC interpretations with application dates after 2011*

#### Amendments to IAS 12 Income Taxes

Under the amended IAS 12, if a deferred tax asset or liability arises from investment property that is measured using the fair value model in IAS 40 Investment Property, there is a rebuttable presumption that the carrying amount of the investment property will be recovered through sale (rather than through use). The presumption is rebutted if two criteria are met. The amendments also incorporate SIC 21 Income Taxes – Recovery of Revalued Non-Depreciable Assets into IAS 12. As a result, IAS 12 will require that measurement of a deferred tax asset or liability that arises from a non-depreciable asset measured using the revaluation model in IAS 16 Property, Plant and Equipment reflect the tax consequences of recovering the carrying amount through sale (rather than through use).

The amended IAS 12 is effective for annual periods beginning on or after 1 January 2012, but the standard has not yet been endorsed by the EU. Norges Bank expects to apply the amended standard as from 1 January 2012, under the assumption that it will be endorsed by the EU. Norges Bank does not expect any material effect on other comprehensive income or the fair value of investment property in the balance sheet upon adoption.

#### Amendments to IFRS 7 Financial Instruments – Disclosures

The amendments relate to disclosure requirements for financial instruments that are derecognised in their entirety, but where the entity has a continuing involvement. The amendments will give users a clearer picture of the potential risks that remain with the transferor.

The amended IFRS 7 is effective for annual periods beginning on or after 1 July 2012, but the standard has not yet been endorsed by the EU. Norges Bank expects to apply the amended standard as from 1 January 2012, under the assumption that it will be endorsed by the EU. Application is not expected to have any material effect on Norges Bank's note disclosures.

#### IFRS 9 Financial Instruments

IFRS 9 replaces the classification and measurement rules for financial instruments in IAS 39 *Financial Instruments – Recognition and Measurement*. In accordance with IFRS 9, financial assets with basic loan features shall be carried at amortised cost, unless the business model indicates that they should be carried at fair value. All other financial assets shall be measured at fair value.

Classification and measurement of financial liabilities under IFRS 9 is a continuation of IAS 39, with the exception of financial liabilities designated as at fair value through profit or loss (fair value option), where changes in fair value relating to own credit risk shall be separated and be presented in other income and expenses.

All portfolios of equities, bonds and financial derivatives have as at the date of transition to IFRS a business model that is also consistent with the classification measured at fair value under IFRS 9. In Norges Bank's judgement, should the business model change to an extent that requires reclassification to measured at amortised cost in accordance with IFRS 9, classification under the categories

loans and receivables or held to maturity for financial assets, or other liabilities, will become applicable under IAS 39 *Financial Instruments – Recognition and Measurement*.

IFRS 9 is effective for annual periods beginning on or after 1 January 2013, but the standard has not yet been endorsed by the EU. Norges Bank expects to apply IFRS 9 as from 1 January 2013, under the assumption that it will be endorsed by the EU. Application of IFRS 9 is not expected to result in material changes in classification, recognition or measurement for Norges Bank's financial reporting.

#### IFRS 10 Consolidated Financial Statements

IFRS 10 *Consolidated Financial Statements* (IFRS 10) supersedes IAS 27 *Consolidation and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities*. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 requires a parent entity (an entity that controls one or more other entities) to present consolidated financial statements; defines the principle of control, and establishes control as the basis for consolidation; sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee and sets out the accounting requirements for the preparation of consolidated financial statements.

IFRS 10 is effective for annual periods beginning on or after 1 January 2013, with early application permitted if adopted as part of the "package of five" standards issued by the International Accounting Standards Board (IASB) in May 2011. The standards that must all be adopted simultaneously are IFRS 10 *Consolidation and Separate Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IAS 27 *Separate Financial Statements* (as amended in 2011), and IAS 28 *Investments in Associates* (as revised in 2011). IFRS 10 is expected to be endorsed by the EU in 2012.

Norges Bank does not expect that the adoption of IFRS 10 will have a significant impact on the consolidated financial statements of the investment portfolio of the Government Pension Fund Global or of Norges Bank in other respects. Norges Bank expects to apply IFRS 10 as from 1 January 2013, under the assumption that the standard will be endorsed by the EU.

#### IFRS 11 Joint Arrangements

IFRS 11 *Joint Arrangements* (IFRS 11) supersedes SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*. A joint arrangement is an arrangement over which two or more parties have joint control, and has the following characteristics, that the parties are bound by a contractual arrangement and the contractual arrangement gives two or more of those parties joint control over the arrangement. A joint arrangement is either a joint operation (the parties that have joint control over the arrangement have rights to the assets, and obligations for the liabilities) or a joint venture (the parties that have joint control of the arrangement have rights to the net assets). While IFRS 11 specifies two primary accounting methods, it clearly indicates when a particular method must be used, unlike the choice of accounting method permitted currently. Unless the fair value exception is used, jointly controlled entities shall be accounted for using the equity method as described in IAS 28 *Investments in Associates* (as revised in 2011).

IFRS 11 is effective for annual periods beginning on or after 1 January 2013, with early application permitted if adopted as part of the "package of five" standards issued by the IASB in May 2011. See above under IFRS 10 for a list of these five standards. IFRS 11 is expected to be endorsed by the EU in 2012.

Norges Bank does not expect that the adoption of IFRS 11 will have a material impact on the financial reporting for the investment portfolio of the Government Pension Fund Global or of Norges Bank in other respects. Norges Bank expects to apply IFRS 11 as from 1 January 2013, under the assumption that the standard will be endorsed by the EU.

#### IFRS 12 Disclosure of Interests in Other Entities

IFRS 12 *Disclosure of Interests in Other Entities* (IFRS 12) requires the disclosure of information that enables users of financial statements to evaluate the nature of and risks associated with interests in other entities as well as the effects of those interests on the entity's balance sheet, income and cash flows. IFRS 12 is required to be applied by an entity that has an interest in subsidiaries, joint arrangements (joint operations or joint ventures), associates, or unconsolidated structured entities.

IFRS 12 is effective for annual periods beginning on or after 1 January 2013, with early application permitted if adopted as part of the "package of five" standards issued by the IASB in May 2011. See above under IFRS 10 for a list of these five standards. IFRS 12 is expected to be endorsed by the EU in 2012.

Norges Bank does not expect that the adoption of IFRS 12 will have a material impact on the financial reporting for the investment portfolio of the Government Pension Fund Global or of Norges Bank in other respects. Norges Bank expects to apply IFRS 12 as from 1 January 2013, under the assumption that the standard will be endorsed by the EU.

#### IFRS 13 Fair Value Measurement

IFRS 13 *Fair Value Measurement* (IFRS 13) defines fair value and sets out a single IFRS framework for measuring fair value and disclosures about fair value measurement. IFRS 13 applies when another IFRS requires or permits fair value measurement or disclosures concerning fair value measurement.

IFRS 13 is effective for annual periods beginning on or after 1 January 2013, with early application permitted. IFRS 13 is expected to be endorsed by the EU in 2012. Norges Bank does not expect that the adoption of IFRS 13 will have a significant impact on its financial reporting. Norges Bank expects to apply IFRS 13 as from 1 January 2013, under the assumption that the standard will be endorsed by the EU.

## Note 2 Significant estimates and critical accounting judgements

The preparation of the financial statements of Norges Bank, which includes the financial reporting for the investment portfolio of the Government Pension Fund Global in accordance with the accounting policies in Note 1, involves the use of estimates and judgements that may affect assets, liabilities, income and expenses. Estimates and judgements are based on historical experience and expectations about future events that are considered probable at the time the financial statements are presented.

Estimates are based on best judgement; however, actual results may deviate from estimates. In cases of particularly uncertain estimates, this is described in the respective notes.

### Significant estimates

Below is an overview of significant estimates on the reporting date.

#### *Fair value of securities, financial assets, financial derivatives and investment property not traded or quoted in an active market*

Part of the holdings within the investment portfolio of the Government Pension Fund Global is not traded in active markets, i.e. they have been allocated to the Level 2 or 3 pricing categories. This is primarily the case for bond holdings, OTC financial derivatives and real estate investments, while nearly all equities are allocated to Level 1 (traded in active markets).

Level 2 and 3 holdings are priced using models, and the resulting value is defined as an estimate. The resulting values of holdings allocated to Level 3, with significant use of non-observable inputs, are regarded as particularly uncertain estimates. Generally, widely accepted, standard pricing models are used. For further information on pricing models and control environment, see Note 13 Fair value measurement.

Valuation of investment properties relies on external appraisals and valuations. The determination of fair value in such appraisals requires the use of estimates such as future cash flows from assets (based on assumptions regarding tenant occupancy rates, tenant profiles, future revenue streams, the capital value of property, plant and equipment and the overall physical condition of the property) and discount rates applicable to those assets. These estimates are based on local market conditions on the reporting date.

#### *Gains/losses on securities before foreign exchange gains and losses, and Foreign exchange gains and losses*

Gains and losses on securities and financial derivatives resulting from changes in the price of the security/instrument (before foreign exchange gains and losses) and gains and losses resulting from changes in foreign exchange rates (foreign exchange gains and losses) are presented separately in the income statement. The method of allocating total gains and losses in Norwegian kroner for a holding for a period to a security element and foreign exchange element is an estimate, as different methods will result in different allocations.

#### Foreign exchange element:

Norges Bank calculates unrealised gains and losses due to changes in foreign exchange rates based on the cost in local currency of the holding and the change in the foreign exchange rate from the time of purchase until the balance sheet date. If the holding has been purchased in a previous period, gains and losses from previous periods that have already been recognised in profit or loss are deducted to arrive at the gain or loss for the current period. Accordingly, for realised gains or losses, the foreign exchange rate on the date of sale is used instead of the closing rate at the end of the reporting period, and previously recognised unrealised gains or losses for the holding are reversed in the current period.

#### Security element:

Unrealised gains and losses from changes in the security price are calculated based on the change in the security price from the purchase date to the balance sheet date and the closing rate at the balance sheet date, and gains and losses recognised in the income statement in previous periods are deducted to arrive at the gain or loss from security prices for the current period. Realised gains and losses from changes in security prices are based on the selling price as opposed to the price on the balance sheet date and previously recognised unrealised gains or losses for the holding are reversed in the current period.

### Significant critical accounting judgements related to the application of accounting policies

The following are the judgements made by management related to the application of accounting policies regarded to have the greatest impact on the amounts recognised in the financial statements.

#### *Choice of functional currency*

The management of Norges Bank judges the Norwegian krone to be the functional currency of the bank, as this is the dominant currency with regard to the underlying activities of the bank. The owner's capital of the Government Pension Fund Global in the

form of the Government Pension Fund Global krone account is denominated in Norwegian kroner, and a significant share of the costs related to the management of the assets is in Norwegian kroner.

The financial reporting of the investment portfolio of the Government Pension Fund Global is part of the financial statements of Norges Bank, and on this basis the judgement is that the investment portfolio's functional currency is also the Norwegian krone. The bank's and the investment portfolio's results are measured and reported internally and to the owner in Norwegian kroner, while the percentage return for the investment portfolio is reported both in Norwegian kroner and in the currency basket specified in the investment mandate given by the Ministry of Finance. Furthermore, no single investment currency stands out as dominant in the area of asset management.

When subsidiaries are established or acquired in connection with the management of the real estate asset class within the investment portfolio of the Government Pension Fund Global, an assessment is made concerning the appropriate functional currency for use in the subsidiary's financial reporting, and for use in the consolidation into the consolidated financial statements of the investment portfolio. Normally the local currency will be indicative of the appropriate functional currency for the company, given that this is the currency of the economic environment in which the entity operates, and the currency for all of its transactions. In cases where there is doubt related to which currency is the functional currency or whether the entity has operations, then the currency of its financing activities and the denomination of any income and expenses will be considered, together with the consideration of whether the entity is merely an extension of Norges Bank into the local market.

#### *Assessment of degree of control*

In relation to investments in entities or assets made by Norges Bank on behalf of the investment portfolio of the Government Pension Fund Global, through wholly-owned holding companies, together with a partner and where the bank has a substantial ownership interest, an assessment is made to establish whether the bank has control over the entity or the asset. This assessment is necessary to establish whether the investment should be accounted for as an investment in a financial asset, an associate, a jointly controlled entity/asset or a consolidated subsidiary. In connection with the assessment of the degree of control, the ownership interest will be given significant consideration, along with the contractual terms in the shareholder and joint venture agreements that may suggest a greater or lesser degree of control than that based on an observation of the ownership interest taken in isolation. A total assessment of all relevant elements in each specific case forms the basis for a conclusion concerning whether or not the bank has control over the investment.

### Note 3 Profit/loss on the portfolio before foreign exchange gains and losses

Table 3.1 Specification of profit/loss on the portfolio before foreign exchange gains and losses, 2011

<i>Amounts in NOK million</i>	<b>Interest income/ expense</b>	<b>Divi- dends</b>	<b>Net income/ expense</b>	<b>Realised gains/ losses</b>	<b>Unrealised gains/ losses</b>	<b>Total</b>
Interest income on bank deposits	162	.	.	.	.	162
Interest income, lending associated with reverse repurchase agreements	1 004	.	.	.	.	1 004
Net income/expense and gains/losses from:						
- Equities and units*	.	49 793	1 869	27 067	-251 827	-173 099
- Bonds and other fixed income instruments*	48 691	.	349	4 600	38 706	92 346
- Financial derivatives	-1 407	.	.	-6 358	2 072	-5 693
- Financial assets real estate	.	.	-52	.	138	86
- Investment property	.	.	60	.	-190	-130
Share of the profit/loss in jointly controlled entities, real estate	.	.	.	.	-31	-31
Interest expense from repurchase agreements	-629	.	.	.	.	-629
Other interest expense	-286	.	.	.	.	-286
Other expenses	.	.	24	.	.	24
<b>Profit/loss on the portfolio before foreign exchange gains and losses</b>	<b>47 534</b>	<b>49 793</b>	<b>2 250</b>	<b>25 309</b>	<b>-211 132</b>	<b>-86 246</b>

\* Net income/expense equities and units and bonds and other fixed income instruments is from security lending activities.

Table 3.2 Specification of profit/loss on the portfolio before foreign exchange gains and losses, 2010

Amounts in NOK million	Interest income/expense	Dividends	Net income/expense	Realised gains/losses	Unrealised gains/losses	Total
Interest income from bank deposits	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 from repurchase agreements	-574	.	.	.	.	-574
Other interest expense	-105	.	.	.	.	-105
Other expenses	.	.	-9	.	.	-9
<b>Profit/loss on the portfolio before foreign exchange gains and losses</b>	<b>44 606</b>	<b>42 775</b>	<b>1 711</b>	<b>35 229</b>	<b>139 552</b>	<b>263 873</b>

\* Net income/expense equities and units and bonds and other fixed income instruments is from security lending activities.

## Note 4 Other expenses

Table 4.1 Specification other expenses

Amounts in NOK million	2011	2010
Salary, social security and other personnel related costs	2	-
IT, information and decision support systems, outsourced administrative services	2	-
Consulting and legal fees	11	-
Fees related to real estate asset management (external)	6	-
Other costs, subsidiaries real estate	5	-
<b>Total operating expenses, subsidiaries real estate</b>	<b>26</b>	<b>-</b>
Other costs, investment portfolio excluding subsidiaries	-50	9
<b>Total other expenses</b>	<b>-24</b>	<b>9</b>

The operating expenses in subsidiaries related to management of real estate investments shown in table 4.1 in the amount of NOK 26 million, are not included in operating costs in Norges Bank that form part of and are covered by the management fee from the Ministry of Finance. See further information in Note 5 Management fee. Under the real estate asset class additional costs related to property management exist, and are included in the income statement lines Net income/expenses and gains/losses on Investment properties and Share of profit/loss in jointly controlled entities, real estate. These costs are incurred by the company that owns the property.

The income of NOK 50 million, presented as Other costs, investment portfolio excluding subsidiaries in table 4.1, is primarily attributable to the reversal of a provision for capital gains withholding tax on equities in China, based on a reduction of unrealised capital gains during 2011 in this market. The provision was reduced by an amount of NOK 75 million.

## Note 5 Management fee

Table 5.1 Specification management fee

Amounts in NOK million	2011		2010	
		Percent		Percent
Salary, social security and other personnel related costs	447		389	
IT, information and decision support systems	214		223	
Custody and settlement costs	406		382	
Outsourced IT and analysis costs	254		213	
Consulting and legal fees	73		116	
Base fees to external managers	371		452	
Other costs	107		81	
Allocated common costs Norges Bank	121		115	
<b>Management fee excluding performance-based fees</b>	<b>1 993</b>	<b>0,06</b>	<b>1 973</b>	<b>0.07</b>
Performance-based fees to external managers	546		986	
<b>Total management fee</b>	<b>2 539</b>	<b>0,08</b>	<b>2 959</b>	<b>0.11</b>

Table 5.1 shows costs incurred by Norges Bank that are reimbursed by the Ministry of Finance as the principal for the management of the investment portfolio of the Government Pension Fund Global. Fees to external managers and custody and settlement fees are invoiced directly and paid individually for each of the portfolios managed by NBIM. All other costs included in the basis for calculation of the management fee are costs that are common for the management of both portfolios, and are allocated to the individual portfolio using a cost allocation model based primarily on market values and asset class composition. The management fee is a function of expenses presented in the Norges Bank income statement as Total other operating expenses.

In addition to the operating expenses that are shown above and that are reimbursed through the management fee from the Ministry of Finance, operating and administrative expenses are incurred in the subsidiary companies that are incorporated as a part of the management of the investment portfolio for the Government Pension Fund Global. These expenses are consolidated into the income statement of the investment portfolio of the Government Pension Fund Global, and are paid using funds received or earned by the investment portfolio. Subsidiaries that are consolidated into the financial reporting for the investment portfolio are not consolidated into the annual financial statements of Norges Bank, as per the accounting regulation for Norges Bank § 2.3, paragraph 4, and these expenses will therefore not be included in Norges Bank's operating expenses. These expenses will through consolidation be shown as expenses in the income statement for the investment portfolio, and are deducted from Profit/loss on the portfolio. In 2011 these costs amounted to NOK 26 million. See also note 4 Other expenses.

## Note 6 Repurchase and reverse repurchase agreements

Norges Bank uses the markets for repurchase and reverse repurchase agreements in its financing activities internally and through securities lending programmes (see Note 8 External agency securities lending). At any time the bank will have lent portions of its holdings in bonds through repurchase agreements, against receiving a corresponding amount in cash (repos and sell buy backs). 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 a higher interest rate and thus creating additional income or returns. In addition, the bank is a party to reverse repurchase agreements where the counterparty has transferred bonds or equities to the bank and where the bank has transferred cash to the counterparty (reverse repo, buy sell backs and triparties). Such contracts are used in connection with placing liquidity and also through agency securities lending as reinvestments of cash collateral received related to lent securities. Rules have been laid down regarding the types of securities eligible as collateral. To be eligible as collateral, bonds shall have a credit rating of at least A or the equivalent from the rating agencies Fitch, Moody's or Standard & Poor's.

For repurchase agreements, the lent security is not derecognised. Received cash is recognised as Deposits in banks, with a corresponding liability to pay back the cash, recognised as Borrowing associated with repurchase agreements. For reverse repurchase agreements, the security received as collateral is not recognised in the balance sheet, while transferred cash is derecognised from Deposits in banks. A corresponding receivable is recognised as an asset, Lending associated with reverse repurchase agreements.

In addition to collateral related to each transaction, the bank has established a process for monitoring the net market value of the outstanding contracts by comparing the collateral value against the transaction value per counterparty, where additional collateral in the form of either securities or cash is posted or received if the exposure is above a threshold value. Within the investment portfolio of the Government Pension Fund Global, the bank had not received or posted such cash collateral at year-end. In the financial statements, posted and received additional collateral in the form of securities is treated in the same manner as other security collateral.

In the second half of 2011, the volume of outstanding repurchase and reverse repurchase agreements was reduced significantly, especially in EUR-denominated securities, as part of a reduction in exposures due to high financial market risk.

Table 6.1 shows total outstanding repurchase and reverse repurchase agreements at year-end 2011, with comparative amounts for 2010, and corresponding securities collateral or lent securities. Transferred and received securities are shown as measured at fair value. In order to show the total exposure for the contracts, unsettled trades have been shown separately and included under received and posted collateral/lent securities. This securities collateral has not yet been transferred and therefore is not included in the lines Bonds posted as collateral or lent and Bonds/Equities received as collateral in table 6.1, while the corresponding cash amount to be transferred is included in Borrowing associated with repurchase agreements and Lending associated with reverse repurchase agreements.

Table 6.1 Specification of repurchase and reverse repurchase agreements

Amounts in NOK million	31.12.2011		31.12.2010	
	Carrying amount	Fair value	Carrying amount	Fair value
<b>Repurchase agreements</b>				
Borrowing associated with repurchase agreements (cash borrowed or received as collateral)	19 280	19 280	132 992	132 992
Bonds posted as collateral or lent (asset)	17 551	17 551	130 198	130 198
Unsettled trades (asset)*	1 410	1 410	205	205
<b>Net overcollateralisation (undercollateralisation) repurchase agreements</b>	<b>319</b>	<b>319</b>	<b>2 589</b>	<b>2 589</b>
<b>Reverse repurchase agreements</b>				
Reverse repurchase agreements outside of securities lending programme	44 393	44 393	101 990	101 990
Reverse repurchase agreements through securities lending programme (reinvestment of cash collateral)	35 427	35 427	153 511	153 511
<b>Lending associated with reverse repurchase agreements (cash lent or placed)</b>	<b>79 820</b>	<b>79 820</b>	<b>255 501</b>	<b>255 501</b>
Bonds received as collateral	-	67 399	-	243 481
Equities received as collateral	-	13 161	-	5 813
<b>Total collateral received reverse repurchase agreements</b>	<b>-</b>	<b>80 560</b>	<b>-</b>	<b>249 294</b>
Unsettled trades (liability)**	1 537	1 537	7 820	7 820
<b>Net overcollateralisation (undercollateralisation) reverse repurchase agreements</b>	<b>-</b>	<b>2 277</b>	<b>-</b>	<b>1 613</b>
<b>Additional collateral repurchase/reverse repurchase agreements</b>				
Posted cash collateral (additional collateral)	-	-	-	-
Posted bond collateral	-	-	505	505
Received bond collateral	-	72	-	384
<b>Total additional collateral</b>	<b>-</b>	<b>72</b>	<b>-</b>	<b>121</b>
<b>Net overcollateralisation (undercollateralisation) repurchase and reverse repurchase agreements</b>	<b>-</b>	<b>2 668</b>	<b>-</b>	<b>4 081</b>

\* Cash not yet received, securities not transferred to counterparty. Repurchase agreement has been recognised.

\*\* Cash not yet transferred, securities not received from counterparty. Reverse repurchase agreement has been recognised.

The table shows that outstanding repurchase agreements were reduced by 86 percent from year-end 2010 to year-end 2011, while outstanding reverse repurchase agreements were reduced by 69 percent in the same period. The change was implemented in the second half of the year and was due to high risk in the financial markets.

At the same time table 6.1 shows that the investment portfolio of the Government Pension Fund Global was overcollateralised in the amount of NOK 319 million with regard to repurchase agreements at year-end 2011, compared to NOK 2 589 million at the end of 2010. This implies that the bank has a surplus of this amount of received cash over posted collateral/lent securities. Correspondingly, Norges Bank is overcollateralised with regard to reverse repurchase agreements in the amount of NOK 2 277 million as at 31 December 2011, since the bank had an excess of received securities collateral relative to cash placed in this amount. The corresponding overcollateralisation as at year-end 2010 was NOK 1 613 million. Total overcollateralisation across these instrument types, including additional collateral, was NOK 2 668 million at 31 December 2011 compared to NOK 4 081 million the previous year-end.

Outside of agency securities lending programmes, Norges Bank had lent a net amount of NOK 25 billion for the investment portfolio of the Government Pension Fund Global at year-end 2011, compared to net borrowing of NOK 31 billion at year-end 2010. This comprises

the net effect of cash borrowed of NOK 19 280 million and cash lent of NOK 44 393 million at year-end 2011 (borrowed cash of NOK 132 992 million and lent cash of NOK 101 990 million at year-end 2010), and reflects zero leverage at the end of 2011, based on a significant share of cash in the securities portfolios at the end of 2011. See also a further description of leverage in Note 14 Risk.

## Note 7 Equities and units / Bonds and other fixed income instruments

Table 7.1 Specification of equities and units

Amounts in NOK million	31.12.2011			31.12.2010		
	Fair value excluding dividends	Accrued dividends	Fair value including dividends	Fair value excluding dividends	Accrued dividends	Fair value including dividends
<b>Equities and units</b>						
Listed equities and units	1 940 789	3 139	1 943 928	1 893 714	2 147	1 895 861
<b>Total equities and units</b>	<b>1 940 789</b>	<b>3 139</b>	<b>1 943 928</b>	<b>1 893 714</b>	<b>2 147</b>	<b>1 895 861</b>
<i>Of which equities lent</i>			<i>137 130</i>			<i>162 483</i>

Table 7.2 Specification of bonds and other fixed income instruments

31.12.2011 Amounts in NOK million	Nominal value*	Fair value excluding accrued interest	Accrued interest	Fair value including accrued interest
<b>Government bonds</b>				
Government bonds issued in local currency	554 293	605 600	6 965	612 565
<b>Total government bonds</b>	<b>554 293</b>	<b>605 600</b>	<b>6 965</b>	<b>612 565</b>
<b>Government related bonds</b>				
Sovereign bonds**	12 592	13 184	279	13 463
Bonds issued by local authorities	26 016	27 855	527	28 382
Bonds issued by supranational bodies	33 629	35 819	505	36 324
Bonds issued by federal agencies	94 454	97 488	1 507	98 995
<b>Total government related bonds</b>	<b>166 691</b>	<b>174 346</b>	<b>2 818</b>	<b>177 164</b>
<b>Inflation-linked bonds</b>				
Inflation-linked bonds issued by government authorities	83 105	105 175	541	105 716
<b>Total inflation-linked bonds</b>	<b>83 105</b>	<b>105 175</b>	<b>541</b>	<b>105 716</b>
<b>Corporate bonds</b>				
Bonds issued by utilities	19 709	21 781	376	22 157
Bonds issued by financial institutions	85 842	78 589	1 643	80 232
Bonds issued by industrial companies	77 733	84 583	1 369	85 952
<b>Total corporate bonds</b>	<b>183 284</b>	<b>184 953</b>	<b>3 388</b>	<b>188 341</b>
<b>Securitised bonds</b>				
Covered bonds	223 642	219 041	4 761	223 802
Mortgage-backed securities	48 581	11 046	80	11 126
Asset-backed securities	7 061	4 244	8	4 252
Commercial mortgage-backed securities	13 539	4 524	21	4 545
<b>Total securitised bonds</b>	<b>292 823</b>	<b>238 855</b>	<b>4 870</b>	<b>243 725</b>
<b>Total bonds and other fixed income instruments</b>	<b>1 280 196</b>	<b>1 308 929</b>	<b>18 582</b>	<b>1 327 511</b>
<i>Of which bonds lent</i>				<i>3 256</i>
<i>Of which short-sale bonds</i>				<i>-</i>

31.12.2010 Amounts in NOK million	Nominal value*	Fair value excluding accrued interest	Accrued interest	Fair value including accrued interest
<b>Government bonds</b>				
Government bonds issued in local currency	485 739	501 175	6 394	507 569
<b>Total government bonds</b>	<b>485 739</b>	<b>501 175</b>	<b>6 394</b>	<b>507 569</b>
<b>Government related bonds</b>				
Sovereign bonds**	12 290	13 162	264	13 426
Bonds issued by local authorities	32 321	33 142	667	33 809
Bonds issued by supranational bodies	25 581	27 565	441	28 006
Bonds issued by federal agencies	83 789	85 615	1 345	86 960
<b>Total government related bonds</b>	<b>153 981</b>	<b>159 484</b>	<b>2 717</b>	<b>162 201</b>
<b>Inflation-linked bonds</b>				
Inflation-linked bonds issued by government authorities	88 544	102 835	502	103 337
<b>Total inflation-linked bonds</b>	<b>88 544</b>	<b>102 835</b>	<b>502</b>	<b>103 337</b>
<b>Corporate bonds</b>				
Bonds issued by utilities	19 609	21 013	384	21 397
Bonds issued by financial institutions	114 637	108 892	2 060	110 952
Bonds issued by industrial companies	68 332	73 468	1 363	74 831
<b>Total corporate bonds</b>	<b>202 578</b>	<b>203 373</b>	<b>3 807</b>	<b>207 180</b>
<b>Securitised bonds</b>				
Covered bonds	195 974	192 780	4 210	196 990
Mortgage-backed securities	112 611	55 356	246	55 602
Asset-backed securities	18 366	14 117	19	14 136
Commercial mortgage-backed securities	18 807	6 026	33	6 059
<b>Total securitised bonds</b>	<b>345 758</b>	<b>268 279</b>	<b>4 508</b>	<b>272 787</b>
<b>Total bonds and other fixed income instruments</b>	<b>1 276 600</b>	<b>1 235 146</b>	<b>17 928</b>	<b>1 253 074</b>
<i>Of which bonds lent</i>				<i>215 090</i>
<i>Of which short-sale bonds</i>				<i>809</i>

\* Nominal values have been translated into NOK at the closing rate at the balance sheet date.

\*\* In 2011, sovereign bonds were reclassified as government related bonds. Comparative amounts have been restated.

At the end of 2011 the holdings in bonds issued by the sovereign states Portugal, Ireland, Italy, Greece and Spain amounted to NOK 57 billion. Of this Portuguese holdings amounted to 1 percent, Irish 7 percent, Italian 58 percent, Greek 3 percent and Spanish 31 percent. The total holdings as at 31 December 2010 issued by these sovereigns amounted to NOK 94 billion.

## Note 8 External agency securities lending

Norges Bank has entered into securities lending agreements with external agents, giving these agents the right to lend securities held by Norges Bank to other market participants with borrowing needs. Both equities and bonds are lent. The purpose of the lending activity is to create additional returns for the investment portfolio of the Government Pension Fund Global from 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 behalf of Norges Bank. Agreements with agents have provisions reducing the bank's counterparty risk in cases where collateral has been received in the form of cash or government bonds. These provisions ensure the bank will be compensated if the counterparty is unable to return the borrowed securities or if the collateral posted for the loan is insufficient to cover any losses in the event of borrower default. Norges Bank bears this risk itself in cases where collateral has been received in the form of equities. Reinvestments by the agent of cash collateral received take the form of positions in the repo market: reverse repurchase agreements, buy sell backs and triparties (see Note 6 Repurchase and reverse repurchase agreements). At 31 Decem-

ber 2011, all reinvestments were in the form of reverse repurchase agreements. By comparison, similar contracts accounted for 90 percent of total reinvestments at year-end 2010, the rest being in the form of bonds.

Securities lent are presented on separate lines in the balance sheet. Cash collateral received is recognised in the balance sheet as part of Deposits in banks with a corresponding liability Cash collateral received, since Norges Bank has the right to dispose of this cash. Collateral received 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 manner as ordinary investments. Due to increased risk in financial markets in the second half of 2011, Norges Bank reduced its lending programme towards year-end. Exposure has been reduced in general, and specifically with regard to securities lending and collateral denominated in euro and collateral in the form of US securitised bonds.

Norges Bank earns a net income from these securities lending programmes. The net income comprises the pure lending fee, from which costs related to cash collateral received are subtracted, as well as interest income and realised returns from reinvestments. The agent's portion, which is a consideration for carrying out the transactions, is also deducted. Net income from securities lending is presented on the income statement line Net income/expenses and gains/losses from equities and units and Net income/expenses and gains/losses from bonds and other fixed income instruments. Net income related to equities lending within the investment portfolio of the Government Pension Fund Global amounted to NOK 1 869 million in 2011, while the corresponding income from bond lending amounted to NOK 349 million in 2011 (see also Note 3 Profit/loss on the portfolio before foreign exchange gains and losses). Corresponding amounts for 2010 were NOK 1 446 million and NOK 274 million, respectively.

Tables 8.1 and 8.2 present an overview of positions within external agent securities lending programmes at year-end 2011 compared with year-end 2010:

Table 8.1 Securities lent

Amounts in NOK million	31.12.2011		31.12.2010	
	Carrying amount	Fair value	Carrying amount	Fair value
<b>Securities lent</b>				
Equities lent	137 130	137 130	162 483	162 483
Bonds lent	3 256	3 256	215 090	215 090
<b>Total securities lent</b>	<b>140 386</b>	<b>140 386</b>	<b>377 573</b>	<b>377 573</b>
<b>Collateral received</b>				
Cash collateral received	36 405	36 405	172 309	172 309
Equities received as collateral	-	102 170	-	123 995
Bonds received as collateral	-	11 337	-	98 962
<b>Total collateral received related to securities lending</b>	<b>36 405</b>	<b>149 912</b>	<b>172 309</b>	<b>395 266</b>
<b>Net overcollateralisation</b>	<b>-</b>	<b>9 526</b>	<b>-</b>	<b>17 693</b>

Table 8.2 Reinvestments of cash collateral related to securities lending

Amounts in NOK million	31.12.2011	31.12.2010
	Carrying amount	Carrying amount
<b>Reinvestment related to securities lending</b>		
Reverse repurchase agreements	35 427	153 511
Asset-backed securities	-	13 541
Other fixed income instruments	-	3 831
Total reinvestment in the form of bonds and other fixed income instruments	-	17 372
<b>Total reinvestment of cash collateral</b>	<b>35 427</b>	<b>170 883</b>
Unrealised loss bonds and other fixed income instruments	-	1 341

## Note 9 Financial derivatives

Table 9.1 is a specification of financial derivative holdings at market value as at 31 December 2011 and 31 December 2010, classified as assets or liabilities. Table 9.2 shows the nominal values of positions in financial derivatives for purchased (long) and sold (short) positions as exposure. Nominal values are the basis for the calculation of any cash flows and gains/losses for the contracts.

Table 9.1 Specification of financial derivatives

Amounts in NOK million	Fair value					
	31.12.2011			31.12.2010		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Foreign exchange contracts	1 603	964	639	402	316	86
Listed futures contracts	5	224	-219	43	22	21
Interest rate swaps	463	4 639	-4 176	1 847	7 300	-5 453
Credit default swaps	2	-	2	41	749	-708
Equity swaps	154	130	24	21	77	-56
<b>Total swap contracts</b>	<b>619</b>	<b>4 769</b>	<b>-4 150</b>	<b>1 909</b>	<b>8 126</b>	<b>-6 217</b>
Options	-	-	-	714	908	-194
<b>Total financial derivatives</b>	<b>2 227</b>	<b>5 957</b>	<b>-3 730</b>	<b>3 068</b>	<b>9 372</b>	<b>-6 304</b>

Table 9.2 Financial derivatives – exposure

Amounts in NOK million	Exposure							
	2011		Average 2011		2010		Average 2010	
	Pur-chased	Sold	Pur-chased	Sold	Pur-chased	Sold	Pur-chased	Sold
Foreign exchange contracts	132 848	-	64 778	-	29 849	-	27 468	-
Listed futures contracts	1	14 682	5 228	9 851	16 791	17 056	20 557	16 267
Interest rate swaps	8 163	18 956	20 106	52 806	25 002	74 689	14 035	70 908
Credit default swaps	1 645	12	19 373	280	37 092	2 246	30 926	2 434
Equity swaps	30	335	25	550	39	128	823	85
<b>Total swap contracts</b>	<b>9 838</b>	<b>19 303</b>	<b>39 504</b>	<b>53 636</b>	<b>62 133</b>	<b>77 063</b>	<b>45 784</b>	<b>73 427</b>
Options	-	-	14 464	11 987	33 845	15 217	24 829	15 840
<b>Total financial derivatives</b>	<b>142 687</b>	<b>33 985</b>	<b>123 974</b>	<b>75 474</b>	<b>142 618</b>	<b>109 336</b>	<b>118 638</b>	<b>105 534</b>

### Foreign 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.

### Listed futures contracts

Futures contracts are listed contracts to exchange a specified asset (security, index, interest rate or other) at an agreed price, with future delivery, normally settled in cash, and with initial and daily margin settlement of gains and losses. Exposure is the nominal value of the contracts.

### Over-the-counter (OTC) financial derivatives

#### Interest rate swaps

Interest rate swaps generally comprise contracts in which two parties agree to exchange interest payment streams based on different interest rate calculation methods; typically one party pays a floating rate, and the other pays a fixed rate.

Exposure is the nominal value of the contract, and the direction (purchased/sold) 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 (by a credit event). A credit event might, for example, be a default on the underlying credit or bond. The protection normally expires after the first credit event.

The underlying assets for credit default swaps are corporate bonds, securities issued by sovereign states and corporate bond indices.

Exposure direction (purchased/sold) 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 exchange cash flows based on changes in the underlying securities. In addition to the periodic cash flow, payments are received in connection with dividends and corporate events.

Exposure corresponds to the nominal value of the contracts. The direction (purchased/sold) indicates whether Norges Bank receives or pays cash upon settlement.

#### Options

The buyer of an option has the right to buy or sell an asset at an agreed price at an agreed time in the future, while the seller has the obligation to buy or sell the asset at the agreed price and time. Options include swaptions which are agreements which grant the buyer the right to enter into a swap.

Exposure is the nominal value of the contracts. Options written by Norges Bank are reported as sold. Options where Norges Bank has paid a premium are reported as purchased contracts.

Table 9.3 Collateral related to positions in financial derivatives

Amounts in NOK million	31.12.2011	31.12.2010
<b>OTC financial derivatives</b>		
Net fair value OTC (carrying amount)	-3 535	-6 269
Cash collateral received related to OTC positions	521	1
<b>Futures contracts and equity swaps</b>		
Fair value futures contracts	-219	21
Fair value equity swaps	24	-56
Deposits with clearing brokers (collateral posted)	433	331
Bonds posted as collateral to clearing brokers	762	620

Norges Bank delivers or receives cash collateral in connection with positions in foreign exchange contracts and OTC financial derivatives (interest rate swaps, credit default swaps and swaptions). Follow-up against collateral thresholds is done per counterparty, and if the net market value of positions held by the counterparty exceed the given threshold limits, the party with the negative position is required to post additional collateral to the other party. At year-end 2011, Norges Bank had received cash collateral from counterparties related to OTC positions in the amount of NOK 521 million, an amount significantly higher than the NOK 1 million of cash collateral received at 31 December 2010. The general increase in collateral received is due to various factors including the downgrading of some counterparties during 2011. A downgrade results in a lowering of the threshold for the counterparty, resulting in turn in a requirement for the counterparty to post additional cash collateral. Other factors include market volatility and increased foreign currency trading. Norges Bank has not delivered any cash collateral on negative market value positions at year-end 2011 or year-end 2010 on behalf of the investment portfolio of the Government Pension Fund Global, due to Norges Bank's high creditworthiness.

## Note 10 Real Estate

The real estate asset class in the investment portfolio of the Government Pension Fund Global comprises unlisted investments classified as financial assets, jointly controlled entities and investment properties.

2011 was the first accounting year with investments in this asset class, and at year-end, the investment portfolio of the Government Pension Fund Global has interests in real estate in London and in Paris. At total of NOK 11 009 million was invested in financial assets, investment properties and jointly controlled entities during the year. These assets have a carrying amount of NOK 11 023 million as at 31 December 2011. Total net carrying amount for the asset class at 31 December was NOK 11 129 million.

Tables 10.1 and 10.2 show profit/loss items for the period and balance sheet items for the asset class, respectively. The tables are followed by descriptions of the investments as classified for financial reporting purposes under IFRS. Tables 10.3 and 10.4 provide a total overview of investment properties, those owned directly as well as those owned through jointly controlled entities.

Table 10.1 Income statement items - real estate asset class

Amounts in NOK million	2011	2010
<b>Profit/loss on the real estate asset class excluding foreign exchange gains and losses</b>		
Interest income from bank deposits	1	-
Net income/expenses and gains/losses from:		
- Financial assets real estate	86	-
- Investment properties	-130	-
Share of the profit/loss in jointly controlled entities, real estate	-31	-
Other interest expenses	-1	-
Other expense	-4	-22
<b>Profit/loss on the real estate asset class before foreign exchange gains and losses</b>	<b>-79</b>	<b>-22</b>

Table 10.2 Balance sheet items - real estate asset class

Amounts in NOK million	31.12.2011	31.12.2010
<b>ASSETS</b>		
<b>Financial assets</b>		
Deposits in banks	138	1
Financial assets real estate	4 415	-
Jointly controlled entities, real estate	2 546	-
Other financial assets	14	-
<b>Total financial assets, real estate asset class</b>	<b>7 113</b>	<b>1</b>
<b>Non-financial assets</b>		
Investment properties	4 062	-
Other non-financial assets	6	-
<b>Total non-financial assets</b>	<b>4 068</b>	<b>-</b>
<b>TOTAL ASSETS</b>	<b>11 181</b>	<b>1</b>
<b>FINANCIAL LIABILITIES</b>		
Other financial liabilities	52	22
<b>Total financial liabilities, real estate asset class</b>	<b>52</b>	<b>22</b>
Net assets, real estate asset class	11 129	-21

### Financial assets real estate

The first real estate investment in the investment portfolio of the Government Pension Fund Global was completed on 1 April 2011 and entitles the portfolio to a 25 percent share in the net operating income (NOI) generated by properties that are located in and around Regent Street in London. This portfolio of properties is managed by The Crown Estate. Two additional investments were made in the third quarter of 2011. The total purchase price, including additional investments, of investments made in 2011 was NOK 4 270 million, of which NOK 182 comprised transaction costs.

The investment is accounted for as a financial asset under IAS 39 Financial Instruments: Recognition and Measurement. The investment is measured at fair value and presented as Financial assets real estate in the balance sheet. As at 31 December 2011, the fair value of the investment was measured at NOK 4 415 million.

Earned income and fair value changes as well as transaction costs to complete the investment are shown in the income statement as Net income/expenses and gains/losses from financial assets real estate. Net operating income amounted to NOK 130 million, transaction costs, NOK 182 million, and fair value changes NOK 138 million, adding up to the total amount on the income statement line Net income/expenses and gains/losses from financial assets real estate for 2011 of NOK 86 million.

For additional information, see Note 13 Fair value measurement.

### Investment properties

Norges Bank has acquired 50 percent of seven properties in and around Paris for the investment portfolio of the Government Pension Fund Global. All properties are jointly controlled and managed by Norges Bank and AXA Group and are regarded as being jointly controlled assets under IAS 31 Interests in *Joint Ventures*. The properties are accounted for as investment property at fair value under IAS 40 *Investment Property*. A total of NOK 4 301 million was invested in investment properties during the year. At year-end 2011, the carrying amount was NOK 4 062 million. AXA Group is the manager of all the properties.

For additional information see Note 2 Significant estimates and critical accounting judgements and Note 13 Fair value measurement.

### Jointly controlled entities

Norges Bank has acquired 50 percent of three French companies (*société civile immobilière*) for the investment portfolio of the Government Pension Fund Global, each of which owns properties in and around Paris. All companies are jointly controlled and managed by Norges Bank and AXA Group and are regarded as being jointly controlled entities under IAS 31. These investments are accounted for using the equity method in the consolidated financial statements for the investment portfolio. The properties are accounted for in the underlying entities as investment property at fair value under IAS 40.

A total of NOK 2 620 million was invested in jointly controlled entities during the year. At year-end 2011, the carrying amount was NOK 2 546 million. AXA Group is the manager of these properties.

For an overview of jointly controlled entities see Note 15 Subsidiaries and jointly controlled entities. For additional information see also Note 2 Significant estimates and critical accounting judgements and Note 13 Fair value measurement.

Table 10.3 Specification of net income/expenses and gains/losses from investment properties and Share of the profit/loss in jointly controlled entities, real estate

Amounts in NOK million	2011	
	Investment properties*	Jointly controlled entities, real estate**
Gross rental income	74	53
Direct property expenses	-14	-
Net rental income	60	53
Fair value changes	-190	-71
<b>Net income/expenses and gains/losses from investment properties</b>	<b>-130</b>	
Other income/expenses in jointly controlled entities, real estate		-13
<b>Share of profit/loss in jointly controlled entities, real estate</b>		<b>-31</b>

\* Income and expenses from directly held investment properties.

\*\* Share of income and expenses in jointly controlled entities.

External valuations have been obtained of all the properties as at 31 December 2011 that differ somewhat from the purchase price. As there are no observed factors indicating that the value of the properties has changed materially since the transaction date, it is the assessment of management that the consideration paid in the recent transaction is the best estimate of fair value as at 31 December 2011. Recognised fair value changes correspond to transactions costs attributed to the individual property.

The portfolio primarily comprises office properties in central Paris. The portfolio has a well-diversified tenant structure, with over 50 leases.

Table 10.4 Investment properties directly held and held in jointly controlled entities

<i>Amounts in NOK million</i>	<b>Investment properties*</b>	<b>Jointly controlled entities, real estate**</b>
Investment properties at 31.12.2010	-	-
Additions (new investments)	4 300	2 617
Capital expenditure	1	-
Disposals	-	-
Fair value changes	-190	-71
Net exchange differences from translation into NOK	-49	-43
<b>Investment properties at 31.12.2011</b>	<b>4 062</b>	<b>2 503</b>
Share of other assets (net) in jointly controlled entities		43
<b>Jointly controlled entities, real estate</b>		<b>2 546</b>

\* Investment properties directly held.

\*\* Share of investment properties and other assets (net) in jointly controlled entities.

Table 10.4 shows the investment portfolio's share of investment properties and net other assets in jointly controlled entities.

Total assets and liabilities in jointly controlled entities as at 31 December 2011 are shown in table 10.5:

Table 10.5 Jointly controlled entities, total assets and liabilities\*

<i>Amounts in NOK million</i>	<b>31.12.2011</b>	<b>31.12.2010</b>
Current assets	170	-
Investment properties	5 006	-
Current liabilities	84	-
Equity capital	5 092	-

\* One hundred percent of the carrying amounts of the jointly controlled entities, prepared in accordance with IFRS.

## Note 11 Other financial assets/ Other financial liabilities

Specification of other financial assets and other financial liabilities is shown in tables 11.1 and 11.2.

Table 11.1 Other financial assets

<i>Amounts in NOK million</i>	<b>31.12.2011</b>	<b>31.12.2010</b>
Withholding tax	744	1 239
Accrued income from external agency securities lending	106	119
Receivables from other portfolios under common management*	2 371	-
Other receivables, subsidiaries real estate	23	-
<b>Other financial assets</b>	<b>3 244</b>	<b>1 358</b>

\* Receivables from other portfolios under common management comprise the net value of deposits and repurchase and reverse repurchase agreements vis-à-vis other portfolios managed by Norges Bank. These related party transactions have been conducted under the arm's length principle.

Table 11.2 Other financial liabilities

Amounts in NOK million	31.12.2011	31.12.2010
Tax due on foreign equities gains	-	88
Other liabilities abroad	199	229
Other liabilities, subsidiaries real estate	52	-
Liabilities to other portfolios under common management*	-	4 322
<b>Other financial liabilities</b>	<b>251</b>	<b>4 639</b>

\* Liabilities to other portfolios under common management comprise the net value of deposits and repurchase and reverse repurchase agreements vis-à-vis other portfolios managed by Norges Bank. These related party transactions have been conducted under the arm's length principle.

## Note 12 Currency distribution

Table 12.1 Currency distribution of the balance sheet as at 31 Desember 2011 and 31 Desember 2010

Amounts in NOK million	31.12.2011							Total
	USD	CAD	EUR	GBP	CHF	JPY	Other	
Deposits in banks	1 866	85	270	94	755	78	4 128	7 276
Lending associated with reverse repurchase agreements	51 096	5 353	5 938	7 820	-	3 497	6 116	79 820
Unsettled trades	539	-	24	3	-	880	826	2 272
Equities and units	592 945	49 222	432 975	279 278	117 154	83 784	251 440	1 806 798
Equities lent	38 030	834	1 175	20 292	2 532	25 949	48 318	137 130
Bonds and other fixed income instruments	463 286	27 845	560 223	151 410	4 249	67 444	49 798	1 324 255
Bonds lent	3 256	-	-	-	-	-	-	3 256
Financial derivatives	2 372	-39	694	242	-13	20	-1 049	2 227
Financial assets real estate	-	-	-	4 415	-	-	-	4 415
Jointly controlled entities, real estate	-	-	2 546	-	-	-	-	2 546
Other financial assets	161	272	2 949	-334	68	87	41	3 244
<b>Total financial assets</b>	<b>1 153 551</b>	<b>83 572</b>	<b>1 006 794</b>	<b>463 220</b>	<b>124 745</b>	<b>181 739</b>	<b>359 618</b>	<b>3 373 239</b>
Investment properties	-	-	4 062	-	-	-	-	4 062
Other non-financial assets	-	-	6	-	-	-	-	6
<b>TOTAL ASSETS</b>	<b>1 153 551</b>	<b>83 572</b>	<b>1 010 862</b>	<b>463 220</b>	<b>124 745</b>	<b>181 739</b>	<b>359 618</b>	<b>3 377 307</b>
<b>Short-term borrowing</b>	-14	0	0	25	0	0	0	11
Borrowing associated with repurchase agreements	10 888	-	105	-	-	2 452	5 835	19 280
Cash collateral received	36 405	-	521	-	-	-	-	36 926
Unsettled trades	223	4	17	10	7	876	2 173	3 310
Financial derivatives	595	60	1 365	3 461	5	186	285	5 957
Other financial liabilities	198	-	41	12	-	-	-	251
Management fee payable	.	.	.	.	.	.	2 539	2 539
<b>Total financial liabilities</b>	<b>48 295</b>	<b>64</b>	<b>2 049</b>	<b>3 508</b>	<b>12</b>	<b>3 514</b>	<b>10 832</b>	<b>68 274</b>

<i>Amounts in NOK million</i>	31.12.2010							Total
	USD	CAD	EUR	GBP	CHF	JPY	Other	
Deposits in banks	422	41	681	170	-11	50	4 950	6 303
Lending associated with reverse repurchase agreements	67 503	277	168 506	7 365	-	7 231	4 619	255 501
Unsettled trades	1 487	33	2 523	31	60	288	442	4 864
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	-	8 211	215 090
Financial derivatives	-7 660	-32	-1 061	-2 312	-2	-162	14 297	3 068
Other financial assets	122	-	291	12	932	-	1	1 358
<b>Total financial assets</b>	<b>1 095 427</b>	<b>82 246</b>	<b>1 179 793</b>	<b>408 668</b>	<b>110 922</b>	<b>168 400</b>	<b>375 382</b>	<b>3 420 838</b>
Short-term borrowing	2	-	-	-	1 706	359	872	2 939
Borrowing associated with repurchase agreements	34 392	462	66 482	19 521	-	7 831	4 304	132 992
Cash collateral received	54 398	-	116 713	1 198	-	-	-	172 309
Unsettled trades	11 374	479	7 383	198	36	270	618	20 358
Short-sale bonds	809	-	-	-	-	-	-	809
Financial derivatives	201	63	3 877	2 540	-192	7 508	-4 625	9 372
Other financial liabilities	207	-48	1 547	2 571	-50	358	54	4 639
Management fee payable	.	.	.	.	.	.	2 959	2 959
<b>Total financial liabilities</b>	<b>101 383</b>	<b>956</b>	<b>196 002</b>	<b>26 028</b>	<b>1 500</b>	<b>16 326</b>	<b>4 182</b>	<b>346 377</b>

## Note 13 Fair value measurement

### Control environment

The control environment for fair value measurement of financial instruments and investment property is organised around a formalised and documented valuation policy and guidelines which are supported by work and control procedures. The policy document lays down valuation policies and sets reporting requirements for the NBIM valuation committee.

The valuation committee, which comprises the NBIM leader group, meets every quarter prior to the publication of the financial reporting. The committee reviews the documentation, discusses major pricing issues and approves the valuation.

The valuation environment has been established in accordance with best market practices for valuation. This is implemented in practice through daily valuation of all holdings, except for real estate investments, where valuations are performed on a quarterly basis. These processes are scalable with regard to market changes and are based on internal and external data solutions.

Generally, all holdings and investments are valued by external, independent valuation specialists. Valuation providers have been chosen on the basis of thorough analyses performed by the internal unit in NBIM responsible for the valuation. Valuation providers are followed up on an ongoing basis through regular discussions, controls and price challenges for individual securities. For a large portion of holdings, prices from independent price providers are based on observable market prices. For holdings that are insufficiently liquid for valuation to be based on observable prices, widely accepted models are used. Here observable inputs are used to the degree possible, but in some cases, owing to illiquid markets, non-observable inputs are used.

The valuation process is subject on a daily basis to numerous controls by NBIM's valuation department as well as by the external fund accountant. Controls are based on defined thresholds and sensitivities, which are monitored and adjusted in accordance with prevailing market conditions. At each month-end for financial instruments and at the end of each quarter for real estate investments, more extensive controls are performed to ensure fair value measurement. In this connection, particular attention is paid to illiquid financial instruments and real estate investments, i.e. investments deemed to pose valuation challenges. Illiquid instruments are identified with the help of sector and currency classifications, price differences between different external price providers, degree of 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 each quarter-end documenting the results of the controls performed and the most important sources of uncertainties in the valuations.

### Valuation techniques

#### Equities and units, bonds and other fixed income instruments, and financial derivatives

NBIM has defined hierarchies for price sources 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 through the use of reputable independent external price providers' prices. In NBIM, analyses are done as part of the extended controls at month end in which prices provided by the hierarchy are compared with alternative price sources. Adjustments are made when alternative prices are considered to be more representative of fair value.

In the price hierarchy, equities are valued almost exclusively on the basis of official closing prices from stock exchanges or last traded exchange prices, and are thus observable market prices. Sixty-six percent of the holdings in bonds are also valued using observable market prices. Over 85 percent of the investments for the Government Pension Fund Global as at year-end 2011 comprised holdings traded in active markets and are therefore associated with low valuation risk (Level 1).

Portions of the bond portfolio and most interest rate derivatives are valued by price providers using models because the instruments are not traded in active markets. Observable market data are used in the models as much as possible. The models are generally a combination of market standard and proprietary models but based on standard valuation principles. Model types vary according to the asset class or sub-class under review. For bonds these will include 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 floating-rate bonds. In the OTC derivative market, option pricing models as well as implicit yield curves and credit spreads are mainly used.

Data used in the different valuation models, observable as well as unobservable, include the following elements:

- Bond prices – prices based on price quotes and relevant market activity.
- Credit spreads - obtained from the credit derivative market as well as trades of more liquid bonds.
- Yield curves – often the foundation of the valuation model obtained from various fixed income markets.
- Foreign exchange rates - obtained from exchanges and trading markets for use in the valuation of spot, forward and futures contracts.
- Equity prices – obtained from exchanges or standard data sources.
- Prepayment rates – early repayment of principal. Estimates based on both historical and expected levels can have a material effect on the valuation of individual types of bonds, obtained from various market sources.
- Default and recovery estimates – assumptions regarding expected default and loss given default are important inputs in the models that price structured instruments. 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 an essential input for such instruments. Data sources are the same as for prepayment rates.
- Volatility – the extent to which the price of a security fluctuates is a key input in the valuation of options. Data sources are the same as for prepayment rates.
- Correlation - the extent to which changes in one variable are interdependent with changes in another variable. 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, owing to the existence of netting agreements and the use of collateral.

#### Real estate investments

Investments in the real estate asset class consist of financial assets real estate, investment property and jointly controlled entities, see note 10 real estate for further information. For all these investments fair value is the relevant measurement basis, for the financial asset where the ownership interest relates to an income stream, and at the property level where the bank has an ownership interest in investment property, either directly or through jointly controlled entities. At each reporting date real estate investments are adjusted to reflect their fair values as estimated by external independent valuation specialists using the discounted cash flow method or the yield method, unless it is deemed that the purchase price is a better estimate of fair value.

The property portfolio valuations are by nature predisposed to significant forward looking judgements, key assumptions and estimates respective of the individual property type, location, expected future cash flows (such as lettings, tenants' profiles, future revenue streams, and the property's overall repair and condition) as well as applicable discount rates. Such estimates generally reflect recent market transactions of comparable properties having similar location, nature and quality characteristics. In addition, and as applicable, development risks (such as future construction costs and letting risks) are considered when determining the fair value of properties under construction or development. These assumptions are market standard and in accordance with international valuation standards. As a result, the valuations reflect best local market estimates at the valuation date and are sensitive to fluctuations to key assumptions. Events of assumptions not being achieved may have a material effect on the value of the property portfolio.

The discounted cash flow method involves the projection of a series of periodic cash flows either to an operating property or a development property, or from a portfolio of properties as is the case for the interest in an income stream. To this projected cash flow series, an appropriate risk adjusted market discount rate is applied to establish an indication of the present value of the income stream associated with the property. The calculated periodic cash flow is typically estimated as gross rental income, less vacancy, collection losses, direct and indirect operating expenses and other obligations to arrive at the net operating income. A series of periodic net operating incomes, along with an estimate of the terminal value (calculated using a consistent valuation approach as described here) are discounted to present value. The terminal value is the capitalized present value estimate of the net cash flow at disposition that is anticipated at the end of the projection period. The aggregate of these net present values equals the market value of the property or the financial asset.

The yield method converts anticipated future cash flow benefits in the form of rental income into present value. This approach requires careful estimation of future benefits and the application of investor yield or return requirements. Properties valued using this method capitalise net rental income on the basis of an initial yield, generally referred to as the 'net initial yield' approach, adjusted for factors not included in net rental income, for example vacancy, lease incentives, and refurbishment.

### Valuation uncertainty

All equities, bonds, financial derivatives and real estate investments have been allocated to categories reflecting assessed valuation uncertainty. Level 1 comprises investments that are valued on the basis of observable prices in active markets and are considered to have very limited valuation risk. Investments allocated to Level 2 are valued using models with observable market data. These holdings have some pricing uncertainty. Holdings allocated to category 3 are priced using models with considerable use of unobservable inputs, which implies substantial uncertainty regarding the establishment of fair value. These investments, too, 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 pricing providers varies only to a limited extent.

Table 13.1 groups the investments into categories of assessed pricing uncertainty as at 31 Desember 2011 and 2010.

Table 13.1 Specification of investments by level of valuation uncertainty

Amounts in NOK million	Level 1		Level 2		Level 3		Total	
	31.12.2011	31.12.2010	31.12.2011	31.12.2010	31.12.2011	31.12.2010	31.12.2011	31.12.2010
<b>Equities</b>	<b>1 942 777</b>	<b>1 894 319</b>	<b>995</b>	<b>1 454</b>	<b>156</b>	<b>88</b>	<b>1 943 928</b>	<b>1 895 861</b>
<b>Total bonds</b>	<b>876 381</b>	<b>726 521</b>	<b>438 838</b>	<b>501 291</b>	<b>12 292</b>	<b>25 262</b>	<b>1 327 511</b>	<b>1 253 074</b>
Government bonds	600 790	491 061	11 775	16 508	-	-	612 565	507 569
Government related bonds*	98 370	77 769	78 148	84 168	646	264	177 164	162 201
Inflation-linked bonds	98 431	75 182	7 285	28 155	-	-	105 716	103 337
Corporate bonds	3 513	1 389	184 543	204 077	285	1 714	188 341	207 180
Securitised bonds	75 277	81 120	157 087	168 383	11 361	23 284	243 725	272 787
<b>Total financial derivatives</b>	<b>-219</b>	<b>21</b>	<b>-3 511</b>	<b>-6 325</b>	<b>-</b>	<b>-</b>	<b>-3 730</b>	<b>-6 304</b>
Assets	5	43	2 222	3 025	-	-	2 227	3 068
Liabilities	-224	-22	-5 733	-9 350	-	-	-5 957	-9 372
<b>Total real estate</b>	<b>.</b>	<b>.</b>	<b>.</b>	<b>.</b>	<b>11 023</b>	<b>-</b>	<b>11 023</b>	<b>-</b>
Financial assets real estate	.	.	.	.	4 415	-	4 415	-
Jointly controlled entities, real estate	.	.	.	.	2 546	-	2 546	-
Investment properties	.	.	.	.	4 062	-	4 062	-
<b>Total</b>	<b>2 818 939</b>	<b>2 620 861</b>	<b>436 322</b>	<b>496 420</b>	<b>23 471</b>	<b>25 350</b>	<b>3 278 732</b>	<b>3 142 631</b>

\* As from 2011, sovereign bonds issued in foreign currency are included in government-related bonds. Comparative amounts for 2010 have been restated.

The table above comprises the balance sheet lines Equities and units, Equities lent, Bonds and other fixed income instruments, Bonds lent, Short-sale bonds, Financial derivatives (asset and liability), Financial assets real estate, Jointly controlled entities, real estate and Investment properties. Other balance sheet items are thus not included.

Almost all of the equity holdings are classified as Level 1. Equities classified as Level 2 mainly comprise relatively illiquid holdings, which are priced on the basis of similar more liquid shares issued by the same company. Equities classified as Level 3 comprise a small number of holdings, the valuation of which is particularly uncertain due to a lack of market activity, and equities whose trading has been suspended.

Valuation of bonds is more uncertain and complex than valuation of equities. NBIM carries out analyses for each reporting date to identify the extent to which there have been transactions and price transparency with related market liquidity for different types of bonds as well as for a number of individual securities. Most government bonds and inflation-linked bonds have been allocated to Level 1, and pricing is thus primarily based on observable market prices. Bonds issued by European sovereigns with a high extent of unresolved debt issues are allocated to Level 2, while the more liquid European securities continue to be assessed as belonging to Level 1, with a single bond classified as Level 3. Extensive analyses of pricing and liquidity have been done for this segment. Government-related bonds are allocated to Levels 1, 2 and 3 on the basis of variation in the degree of trading and price transparency in the markets. Most corporate bonds belong to Level 2, though with some exceptions to both Levels 1 and 3. Covered bonds are mostly categorised in the observable levels 1 and 2 on the basis of a relatively high degree of liquidity and price transparency in the markets. Other securitised bonds are allocated to Levels 2 and 3 on the basis of varied and in part limited price transparency. Thus, a substantial portion of securitised bonds are still allocated to Level 3 owing to limited activity in the market for these instruments, and the use of unobservable inputs in pricing as well as complex models.

All real estate investments have been allocated to Level 3, as key assumptions, estimates and judgements factor prominently in property valuation models.

### Movements of Level 3 holdings

Table 13.2 shows a reconciliation of changes in balance sheet amounts for all Level 3 holdings in 2011 and 2010.

Table 13.2 Specification of changes in Level 3 holdings

<i>Amounts in NOK million</i>	1 Jan. 2011	Net gains/losses	Purchases	Sales	Settled	Transferred from Level 1 or 2	Transferred to Level 1 or 2	Foreign exchange gains/losses	31.12.2011
<b>Equities and units</b>	88	5	43	-18	-71	110	-11	10	156
<b>Bonds</b>	25 262	-751	690	-11 265	-2 786	2 173	-794	-237	12 292
<b>Total real estate</b>	-	-83	11 009	-	.	.	.	97	11 023
Financial assets real estate*	-	138	4 088	-	.	.	.	189	4 415
Jointly controlled entities, real estate**	-	-31	2 620	-	.	.	.	-43	2 546
Investment properties*	-	-190	4 301	-	.	.	.	-49	4 062
<b>Total</b>	25 350	-829	11 742	-11 283	-2 857	2 283	-805	-130	23 471

\* Net gains/losses from financial assets real estate and investment properties are fair value changes recognised during the reporting period. For Financial assets real estate, Purchases does not include transaction costs, because this investment has been classified under the fair value option, and Net gains/losses does not include expensed transaction costs.

\*\* Net gains/losses from Jointly controlled entities, real estate include Share of the profit/loss from jointly controlled entities, real estate. Fair value changes from investment properties owned by jointly controlled entities are thus included in net gains/losses..

<i>Amounts in NOK million</i>	1 Jan. 2010	Net gains/losses	Purchases	Sales	Settled	Transferred from Level 1 or 2	Transferred to Level 1 or 2	Foreign exchange gains/losses	31.12.2010
Equities	5	-35	0	-11	-1	89	-2	43	88
Bonds	33 518	4 974	611	-7 400	-4 844	4 984	-6 892	311	25 262
<b>Total</b>	33 523	4 939	611	-7 411	-4 845	5 073	-6 894	354	25 350

Holdings allocated to Level 3 in the valuation hierarchy were reduced by NOK 1 879 million to NOK 23 471 million during 2011. A substantial decline in Level 3 bond holdings of NOK 12 969 million was almost counterbalanced by the addition of NOK 11 023 million in real estate investments. Sales were the primary reason for the reduction in bonds, and US securitised bonds not guaranteed by federal agencies accounted for most of these sales.

## Sensitivity for Level 3 holdings

Table 13.3 Additional specification of Level 3 and sensitivities

Amounts in NOK million	Sensitivities 31.12.2011			Sensitivities 31.12.2010		
	Specification Level 3 at 31. Dec. 2011	Unfavourable changes	Favourable changes	Specification Level 3 at 31. Dec. 2010	Unfavourable changes	Favourable changes
<b>Equities and units</b>	<b>156</b>	<b>-42</b>	<b>30</b>	<b>88</b>	<b>-21</b>	<b>14</b>
<b>Total bonds</b>	<b>12 292</b>	<b>-1 482</b>	<b>1 334</b>	<b>25 262</b>	<b>-3 130</b>	<b>2 238</b>
Government related bonds	646	-65	39	264	-21	49
<i>Sovereign bonds</i>	50	-4	2	-	-	-
<i>Bonds issued by local governments</i>	500	-48	32	64	-6	5
<i>Bonds issued by federal agencies</i>	96	-13	5	200	-15	44
Corporate bonds	285	-27	25	1 714	-204	159
<i>Bonds issued by financial institutions</i>	265	-26	23	1 651	-196	153
<i>Bonds issued by industrial companies</i>	20	-1	2	63	-8	6
Securitised bonds	11 361	-1 390	1 270	23 284	-2 906	2 030
<i>Covered bonds</i>	121	-9	6	-	-	-
<i>Mortgage-backed securities (MBS)</i>	9 970	-1 191	1 027	18 941	-2 417	1 615
<i>Asset-backed securities (ABS)</i>	1 087	-159	210	3 878	-424	371
<i>Commercial mortgage-backed securities (CMBS)</i>	183	-31	27	465	-65	44
<b>Total real estate</b>	<b>11 023</b>	<b>-620</b>	<b>659</b>	<b>-</b>	<b>-</b>	<b>-</b>
Financial assets real estate	4 415	-278	288	-	-	-
Jointly controlled entities, real estate	2 546	-132	143	-	-	-
Investment properties	4 062	-210	228	-	-	-
<b>Total</b>	<b>23 471</b>	<b>-2 144</b>	<b>2 023</b>	<b>25 350</b>	<b>-3 151</b>	<b>2 252</b>

NBIM's analyses indicate that valuation risk was reduced during 2011. The total exposure regarded as being particularly uncertain in relation to valuation was lower by only NOK 1 879 million during 2011, to a year-end exposure of NOK 23 471 million. However, the composition of holdings transitioned during the year towards more holdings with a lesser degree of perceived valuation risk. While US securitised bonds have an average perceived valuation uncertainty of around 12 percent, real estate holdings acquired in 2011 are viewed as having approximately 6 percent average valuation uncertainty. This is the major reason for the reduction of approximately NOK 1 007 million in downside valuation risk to NOK 2 144 million as of year-end 2011. The overall calculated sensitivity to favourable model input changes was slightly lower at NOK 2 022 million. It should be noted that the total valuation risk present in the level 3 holdings is expected to be less than this as the valuation of all holdings will not move in the same direction with the change of a single unobservable input parameter. For example, faster mortgage prepayments will have a positive impact on the valuation of some of the bonds held while having a negative result on other bond values, thereby representing partly offsetting effects to the total valuation.

The technique used to calculate the sensitivity of bond values is based on the availability of independent price sources and begins with the highest and lowest available price for a specific bond. Where a higher or lower price was not available, a standard sensitivity parameter was used. The level of the resulting valuation change is based on the bond type and the availability, reliability and variation of prices.

US mortgage-backed securities' sensitivity to changes to unobservable inputs contributed more than half of the overall valuation uncertainty of NOK 1 191 million unfavourable and NOK 1 027 million favourable. Around half of the total MBS exposure of NOK 9 970 million at year-end 2011 stemmed from agency backed interest-only collateralised mortgage obligations, where the most important unobservable parameter implicitly changed was prepayment speed assumptions. The remaining Level 3 MBS exposures comprised bonds not guaranteed by federal agencies. The key parameters changed in this case are various collateral performance related parameters, including expected severities, delinquencies and prepayment speed assumptions, in addition to the estimated yield spread applied to the expected cash flows of the bond in question.

Real estate investment valuations are particularly sensitive to changes in the rate of return (discount rate) and assumptions impacting future revenues. Under an unfavourable scenario changing the rate of return by +0.20 percentage points on a relative basis, and future market rents by -2.0 percent on an absolute basis, all else being equal, is expected to change the value of the real estate portfolio by about 5.6 percent or NOK 620 million. Under a favourable scenario changing the rate of return by -0.20 percentage points on a relative basis, and future market rents by +2.0 percent on an absolute basis, all else being equal, is expected to change the value of the real estate portfolio by about 6 percent or NOK 659 million.

## Note 14 Risk

### Government Pension Fund Global investment mandate

See note 1 for a description of the framework for management of the Government Pension Fund Global. Within the regulations of the mandate for management given by the Ministry of Finance, Norges Bank shall manage the kroner deposit in its own name by investing the funds in a portfolio of equities, fixed income securities and real estate, defined as the investment portfolio.

The bank shall seek to obtain the highest possible return after expenses measured in the currency basket of the benchmark. The Ministry's strategic benchmark portfolio is divided into asset classes and regions, with rule-based adjustments for certain fixed income sectors and exclusion of selected companies from the investment universe. The investment portfolio may not invest in securities issued by Norwegian entities or issued in Norwegian kroner. These securities are also excluded from the benchmark portfolio. Positions in financial derivatives are part of the relevant asset classes, but are shown separately in the income statement and balance sheet for the investment portfolio of the Government Pension Fund Global.

### Norges Bank's governance structure

The Executive Board of Norges Bank has delegated the responsibility for the management of the Government Pension Fund Global 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 authorised by a job description and an investment mandate. The Executive Board has issued principles for risk management at NBIM, which include operational and investment risk management, principles for ownership management, principles for organisation and management of NBIM, and principles for compensation to NBIM employees. NBIM must adhere to internationally recognised standards in the areas of valuation, performance measurement and management, measurement and control of risk. Reporting to the Executive Board is done monthly, and more extensively quarterly. The Governor of Norges Bank and the Executive Board are notified without delay in the event of particular events or significant matters.

### 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 in policies and guidelines. The composition of the NBIM leader group and the delegation of authority shall ensure segregation of duties between investment management, treasury and trading, operations, risk management and compliance.

The market risk committee, the credit and counterparty risk committee, and the investment universe committee complement the delegation of responsibility by advising 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 reporting. The CEO is notified without delay of particular events or serious breaches of the investment mandate.

### NBIM's framework for investment risk

In the investment mandate for the Government Pension Fund Global given to Norges Bank, there are a number of guidelines and restrictions for the combined equity and bond asset class, as well as for the individual asset classes.

Real estate investments are covered in the investment mandate by separate regulations. These regulations provide Norges Bank with a framework for establishing an asset class with diversified exposure to global real estate markets.

Segregation of roles and responsibilities is a cornerstone 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, or a person the CRO has authorised.

The Executive Board's principles for risk management are detailed further in NBIM through policies and guidelines. 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 at NBIM is defined as:

- Management of market risk
- Management of credit risk
- Management of counterparty risk
- Management of operational risk

The first three items listed are defined by NBIM as investment risk. In NBIM the investment area has responsibility for managing the portfolio 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.

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 parts of the portfolio as a result of changes in financial market variables. This includes movements in credit spreads. Market risk is measured by NBIM along the following dimensions: absolute and relative exposure as compared to the benchmark, volatility and correlation risk, systematic factor risk and liquidity risk. Market risk is actively taken to generate investment returns in line with the objectives 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, and 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, settlement risk and custodian risk. Counterparty risk is controlled and mitigated to the greatest extent possible, given the investment strategy.

Risk management process

NBIM uses several measurements, processes and systems to monitor and control investment risk. Robust and widely accepted risk management systems and processes are complemented by internally developed measurements and processes.

**Market risk**

Norges Bank measures risk in both absolute terms for the actual portfolio, and the relative market risk for investments in the Government Pension Fund Global.

Continuous monitoring, measurement and assessment of market risk are performed along multiple risk dimensions, employing a number of methodologies and approaches. Combining different and complementary risk measures provides a better insight into the risk profile of the holdings in the Government Pension Fund Global.

Asset class by region

The portfolio is invested across several asset classes and regions as shown in Table 14.1.

Table 14.1 Allocation by asset class and region

		Market value* in percent by region		Market value* in percent by asset class		Assets minus liabilities before management fee	
		31.12.2011	31.12.2010	31.12.2011	31.12.2010	31.12.2011	31.12.2010
Equities	Americas and Africa	35.9	36.1				
	Europe	49.7	48.2				
	Asia and Oceania	14.4	15.7				
<b>Total equities</b>				<b>58.7</b>	<b>61.5</b>	<b>1 944 721</b>	<b>1 891 250</b>
Bonds	Americas and Africa	37.7	35.2				
	Europe	56.1	59.2				
	Asia and Oceania	6.2	5.6				
<b>Total bonds</b>				<b>41.0</b>	<b>38.5</b>	<b>1 355 722</b>	<b>1 186 170</b>
Real estate	Europe	100	-				
<b>Total real estate</b>				<b>0.3</b>	<b>-</b>	<b>11 129</b>	<b>-</b>

\* As from 1 January 2011, the calculation of market value in the table above has been changed to include all positions in the portfolio, and not only equity and bond holdings. Comparative amounts for 2010 have been restated.

### Concentration risk

Within the holdings of the Government Pension Fund Global are substantial investments in government issued bonds. It is also normal for private companies to issue both bonds and equities.

Table 14.2 shows the largest holdings in bonds issued by governments, including government bonds issued in local currency, sovereign bonds and inflation-linked bonds issued in local currency:

Table 14.2 Largest holdings within the segment government bonds

Amounts in NOK million	Market value 31.12.2011	Amounts in NOK million	Market value 31.12.2010
USA	249 072	USA	164 627
UK	109 813	UK	98 581
France	79 790	Germany	73 609
Japan	67 036	Italy	58 461
Germany	51 294	Japan	54 991
Italy	32 914	France	52 345
Netherlands	20 218	Spain	25 361
Spain	17 975	Belgium	14 229
Austria	15 561	Netherlands	12 940
Belgium	14 813	Austria	11 224

Table 14.3 shows the portfolio's largest holdings of non-government issuers across both bonds and equities. Covered bonds are included in the bonds column, as issued by financial institutions.

Table 14.3 Largest total positions excluding sovereigns, for both bonds and equities

Amounts in NOK million, 31.12.2011	Sector	Bonds	Equities	Total
Royal Dutch Shell PLC	Oil & Gas	-	30 983	30 983
Nestle SA	Consumer Goods	-	25 346	25 346
European Investment Bank	Government related	24 099	-	24 099
Kreditanstalt fuer Wiederaufbau	Government related	22 703	-	22 703
HSBC Holdings PLC	Financials	948	19 583	20 530
Vodafone Group PLC	Telecommunication	1 338	18 858	20 196
Novartis AG	Health Care	-	19 281	19 281
Nationwide Building Society	Financials	17 618	-	17 618
BP PLC	Oil & Gas	-	17 277	17 277
Exxon Mobil Corp	Oil & Gas	-	16 901	16 901

Amounts in NOK million, 31.12.2010	Sector	Bonds	Equities	Total
HSBC Holdings PLC	Financials	2 780	21 152	23 932
Fannie Mae	Government related	22 828	-	22 588
European Investment Bank	Government related	22 273	-	22 273
Royal Dutch Shell PLC	Oil & Gas	-	21 403	21 403
Nestle SA	Consumer Goods	-	21 285	21 285
Bank of Scotland PLC	Financials	17 996	-	17 996
Kreditanstalt fuer Wiederaufbau	Government related	17 108	-	17 108
Vodafone Group PLC	Telecommunication	1 346	15 215	16 561
BP PLC	Oil & Gas	499	15 939	16 438
Banco Santander SA	Financials	5 854	8 794	14 648

Table 14.4 shows the allocation of the real estate portfolio by country, sector, the development share and the vacancy ratio.

Table 14.4 Allocation, real estate portfolio

Percent	31.12.2011	31.12.2010
<b>Country</b>		
- UK	40.0	-
- France	60.0	-
<b>Sector</b>		
- Office	63.2	-
- Retail	35.4	-
- Residential	0.4	-
- Industrial	0.0	-
- Other real estate	1.0	-
<b>Development</b>	<b>0.9</b>	-
<b>Vacancy</b>	<b>8.1</b>	-

#### Volatility and correlation risk

Norges Bank uses risk modelling to quantify the risk of value change associated with all or parts of a portfolio. These are standard risk measurement techniques based on statistical measures such as standard deviation, which take into account correlations between different instruments in the portfolio. This risk measurement technique provides an estimate of expected change or fluctuation in the portfolio's value on the basis of markets conditions over the past three years. Expected volatility can be expressed in terms of the portfolio's absolute risk or relative risk. The long-term model uses equally weighted weekly return data over the last three years and a parametric calculation methodology. The long-term model is tailored to the long-term investment horizon of the Government Pension Fund Global. The same models are used for both portfolio risk and tracking error. In addition to the long-term risk model, NBIM uses a responsive risk model. The model uses daily return data where newer data are given a greater weight than older data. The responsive model captures the market dynamics of recent periods to a greater extent, with the result that changes in modelled risk are best explained by short-term fluctuations.

Real estate investments are not included in the volatility calculations. This is consistent with the investment mandate issued by the Ministry of Finance and the Executive Board of Norges Bank in addition to internal guidelines for investment and risk management.

Tables 14.5 and 14.6 present risk both in terms of both the portfolio's absolute risk and the relative risk.

Table 14.5 Portfolio risk in terms of expected volatility, in percent

	Expected volatility, actual portfolio							
	31.12.2011	Min 2011	Max 2011	Average 2011	31.12.2010	Min 2010	Max 2010	Average 2010
<b>Long-term model</b>								
Portfolio	9.6	9.5	13.4	12.1	13.2	13.1	15.8	13.6
Equities	16.4	16.4	21.2	19.9	21.1	21.0	25.2	21.7
Bonds	10.5	10.5	12.7	12.0	12.3	11.2	13.4	12.2
<b>Responsive model</b>								
Portfolio	10.1	6.7	15.2	9.3	7.2	6.2	9.8	7.7
Equities	17.7	8.8	26.3	14.8	9.7	9.2	15.9	11.9
Bonds	10.6	6.9	14.4	9.9	8.3	6.3	13.9	9.6

Table 14.6 Relative risk, expected relative volatility in basis points

	Expected relative volatility							
	31.12.2011	Min 2011	Max 2011	Average 2011	31.12.2010	Min 2010	Max 2010	Average 2010
<b>Long-term model</b>								
Portfolio	40	33	65	46	54	37	58	48
Equities	53	40	111	64	61	45	71	58
Bonds	45	38	76	51	77	51	90	76
<b>Responsive model</b>								
Portfolio	44	23	57	35	24	24	59	34
Equities	62	29	115	53	29	27	47	38
Bonds	85	21	97	43	32	31	114	55

Risk measured by the long-term risk model declined for the portfolio as a whole and in both asset classes in 2011. For the portfolio as a whole, measured risk at year-end was 9.6 percent. This means that for the portfolio, annual fluctuations in value of just above NOK 300 billion can be expected. Correspondingly, measured risk at year-end 2010 was 13.2 percent, which implied that at the beginning of 2011 annual fluctuations of around NOK 400 billion could be expected. The actual loss on the portfolio for 2011 of NOK 37 billion was within this number, with pronounced fluctuations through the year. In line with the decline in equity markets, the proportion of investments in equities has been reduced due to decreases in market values, which has helped to reduce the risk in the investment portfolio. In addition to this effect, however, the decline was also an artefact of the model, which uses three years' historical data and consequently, historical data from the volatile period in 2008 was no longer included in the model at year-end. Despite the fact that 2011 was also characterised by market turbulence, it was of less magnitude than in 2008.

The mandate for the Government Pension Fund Global has a limit of 100 basis points expected relative volatility. Risk is measured and compliance with the limit monitored on the basis of the long-term model.

Expected relative volatility based both on the long-term model and the responsive model were within the limit in 2011. At the end of the fourth quarter of 2011, expected relative volatility for the portfolio according to the responsive model was somewhat higher than at the beginning of the year.

Fluctuations in equity and bond markets increased in 2011, driven by uncertainty regarding European sovereign debt, increased expectations of an economic downturn in the USA and persistent funding challenges for European banks in particular. The unrest reached a peak in the third quarter. Towards year-end 2011, unemployment in the USA fell, and economic growth picked up, so that underlying economic developments appear stronger. In December, the European Central Bank implemented measures to support banks, which also reduced market stress.

#### Strengths and weaknesses

The 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 and may have good forecasting capabilities in markets without significant changes in volatility. In periods with significant changes in volatility and correlation, estimates will be less reliable. Calculated volatility gives a point estimate of risk, and provides little information about the total risk profile and any tail risk. Annualisation means assuming that volatility and portfolio composition are constant over time. To compensate for these weaknesses, NBIM uses complementary models, methods and various stress tests. In addition, analyses are performed of concentration risk and realised return.

#### Back testing of models

Back testing of the models 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 on the following page summarises the total number of 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 intervals are considered. A ratio above one indicates that the risk has been underestimated.

Table 14.7 Comparison between portfolio's expected loss frequency and actual loss frequency

Risk measure	Period	Expected	Observed	Observed/ Expected
Standard deviation	2 years	83	75	0.90
Value-at-Risk 95%	2 years	26	26	1.00
Value-at-Risk 99%	2 years	5	9	1.73

Table 14.8 Comparison between expected and actual loss frequency on relative return

Risk measure	Period	Expected	Observed	Observed/ Expected
Standard deviation	2 years	83	66	0.79
Value-at-Risk 95%	2 years	26	18	0.69
Value-at-Risk 99%	2 years	5	6	1.15

### 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. Investments in bonds are made on the basis of internal assessments of expected return and the investment's risk profile and how it complements the portfolio.

Table 14.9 Bond portfolio by credit rating

Amounts in NOK million, 31.12.2011	AAA	AA	A	BBB	Higher risk	Total
Government bonds	495 162	79 563	28 235	6 248	3 357	612 565
Government related bonds	110 336	39 658	12 868	11 352	2 950	177 164
Inflation-linked bonds	77 634	21 011	6 857	-	214	105 716
Corporate bonds	283	25 219	94 555	65 667	2 617	188 341
Securitised bonds	183 963	35 719	12 476	6 672	4 895	243 725
<b>Total bonds and other fixed income instruments</b>	<b>867 378</b>	<b>201 170</b>	<b>154 991</b>	<b>89 939</b>	<b>14 033</b>	<b>1 327 511</b>

Amounts in NOK million, 31.12.2010	AAA	AA	A	BBB	Higher risk	Total
Government bonds	389 135	108 100	3 254	2 903	4 177	507 569
Government related bonds	98 950	39 655	11 145	11 779	671	162 201
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
<b>Total bonds and other fixed income instruments</b>	<b>758 524</b>	<b>278 588</b>	<b>100 641</b>	<b>86 399</b>	<b>28 921</b>	<b>1 253 074</b>

Credit risk in the bond market rose during the year, particularly as a consequence of the debt situation in Europe. Among evidence for this were the higher credit spreads observed on European treasury and corporate bond issues. In addition several sovereigns and companies were downgraded by the rating agencies. New bond investments in 2011 were primarily highly rated bonds, which overshadowed the effect of the downgrades. The composition of the bond portfolio saw an increase in the proportion of sovereign bonds and a reduction in corporate and securitised bonds. The composition by credit rating was characterised by a change in the allocation among the three best rating categories, whereby the share of AA instruments was reduced and that of AAA and A increased accordingly. At year-end 2011, defaulted bonds had a total market value of NOK 1.5 billion, or 0.1 percent of the bond portfolio; the nominal amount of defaulted bonds was NOK 9.3 billion, down from NOK 13.3 billion at year-end 2010. Defaulted bonds are grouped with "Higher risk" in the table above.

Table 14.10 Bond portfolio by credit rating category and currency in percent

31.12.2011	AAA	AA	A	BBB	Higher risk	Total
EUR	26.1	7.2	6.3	2.3	0.5	42.4
USD	24.7	2.0	4.1	3.6	0.5	34.9
GBP	9.5	0.4	1.0	0.6	0.0	11.4
JPY	0.0	5.1	0.0	0.0	0.0	5.1
CAD	1.4	0.5	0.1	0.1	0.0	2.1
Other currencies	3.6	0.0	0.2	0.2	0.1	4.1
<b>Total</b>	<b>65.3</b>	<b>15.2</b>	<b>11.7</b>	<b>6.8</b>	<b>1.1</b>	<b>100.0</b>

31.12.2010	AAA	AA	A	BBB	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
<b>Total</b>	<b>60.7</b>	<b>22.2</b>	<b>8.0</b>	<b>6.9</b>	<b>2.3</b>	<b>100.0</b>

During the course of 2011, the use of credit derivatives was reduced considerably (see Note 9 Financial derivatives).

In addition to the credit rating based approach credit risk management at Norges Bank is complemented by additional credit risk measures. These model-based approaches complement the credit rating method and are used to monitor credit risk independently of the credit rating. These methods are comparable to the volatility and correlation risk model in the manner in which credit risk is quantified into one number and is a function of observable credit spreads and equity prices as well as the volatility and correlations between them.

### 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, 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 by using several counterparties and by setting strict credit rating requirements. Concentration is also reduced by setting exposure limits for individual counterparties. Rating requirements for counterparties with unsecured bank deposits are higher than in situations when collateral is posted. Netting agreements are used to further mitigate counterparty exposure when trading in OTC derivatives and foreign exchange contracts. Additional mitigation of counterparty risk is ensured through collateral requirements for counterparty net positions with positive market value.

The methods used to calculate counterparty risk are in accordance with recommendations by the UK Financial Services Authority. Two methods are used: for OTC derivatives, time deposits, bank deposits, and foreign exchange contracts, a counterparty risk model in which exposures are repriced under different assumptions to take into account possible future market movements is used, estimated potential future exposure. Netting agreements and collateral are taken into account in determining net exposure. For repurchase agreements, securities lending transactions executed via external agents and securities posted as collateral for futures trades, a method is used that adds a premium to the market value that reflects the position's volatility. These positions are also adjusted for netting and actual received and posted collateral when determining net exposure. Table 14.11 is a breakdown of exposure by type of activity/instrument regarded as having counterparty risk. In addition to figures from the internal risk model, the counterparty risk in accordance with the balance sheet, adjusted for recognised and not-recognised collateral, is shown.

Securities lending through external agents was reduced during the second half of 2011 (see Note 8 External agency securities lending). Activity in repurchase agreements was also reduced in the fourth quarter, thus reducing total counterparty risk, particularly in terms of gross exposure.

Table 14.11 Counterparty risk by instrument group

<i>Amounts in NOK million, 31.12.2011</i>	Carrying amount adjusted for collateral	Gross exposure	Effect of netting	Collateral and guarantees	Net exposure
Time deposits and unsecured bank deposits	7 276	7 691	-	-	7 691
OTC derivatives including foreign exchange contracts	-3 511	5 355	1 601	2 009	1 745
Repurchase and reverse repurchase agreements*	-2 668	1 040	181		858
Securities lending transactions**	-9 526	18 097	-	7 624	10 472
Bonds posted as collateral for futures trades	762	772	-	-	772
<b>Total</b>		<b>32 955</b>	<b>1 783</b>	<b>9 633</b>	<b>21 538</b>

<i>Amounts in NOK million, 31.12.2010</i>	Carrying amount adjusted for collateral	Gross exposure	Effect of netting	Collateral and guarantees	Net exposure
Time deposits and unsecured bank deposits	6 075	5 989	-	-	5 989
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
Bonds posted as collateral for futures trades	620	638	-	-	638
<b>Total</b>		<b>51 871</b>	<b>6 041</b>	<b>19 178</b>	<b>26 652</b>

\* The column Carrying amount adjusted for collateral takes into account all positions in the repurchase market, including reinvestments of cash collateral. The internal measurement and monitoring of counterparty risk for these types of instruments do not include these reinvestments.

\*\* The column Carrying amount adjusted for collateral includes securities lent and collateral received and is adjusted for unrealised losses connected to reinvestments in the form of bonds.

The line OTC derivatives including foreign exchange contracts in the table comprises the net market value of foreign exchange contracts (NOK 639 million) and swaps (NOK -4 150 million). See also Note 9 Financial derivatives. Counterparty risk for derivative positions is followed-up on a net basis at 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 14.12 shows Norges Bank's counterparties classified according to credit rating category.

Table 14.12 Counterparties by credit rating

	Norges Bank counterparties (excl. brokers)		Brokers	
	31.12.2011	31.12.2010	31.12.2011	31.12.2010
AAA	3	3	3	3
AA	50	55	43	57
A	39	23	43	36
BBB	4	-	14	21
BB	-	-	2	6
B	-	-	12	3
<b>Total</b>	<b>96</b>	<b>81</b>	<b>117</b>	<b>126</b>

## Leverage

Leverage is used primarily to ensure effective management of the investments, and not with the aim of increasing the economic exposure to risky assets. The use of leverage is regulated both in the investment management mandate issued by the Ministry of Finance to Norges Bank and in the investment mandate issued by the Executive Board of Norges Bank to NBIM. Leverage is the difference between net exposure and market value. Net exposure is determined by including securities in the calculation at market value and the derivatives by the underlying exposure. When exposure is greater than market value, the portfolio is leveraged.

At the beginning of 2011, the portfolio had leverage of 2.2 percent. During 2011, the holding of cash increased, and at year-end 2011 the portfolio had no leverage.

Table 14.13 Net leverage

Percent	31.12.2011	2011 Q3	2011 Q2	2011 Q1	31.12.2010
Leverage	0.0	0.0	0.0	1.8	2.2

## 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 very rarely undertaken, and at year-end 2011, no securities had been sold in this manner.

## Note 15 Subsidiaries and jointly controlled entities

Norges Bank's ownership interests within the investment portfolio of the Government Pension Fund Global in all material subsidiaries and jointly controlled entities are given in Table 15.1.

Table 15.1 Subsidiaries and jointly controlled entities

Company	Office Location	Ownership and voting rights in percent
NBIM S.a.r.l	Luxembourg	100
NBIM Louis SPPICAV	Paris	100
NBIM Louis SAS	Paris	100
Matignon 16 SCI*	Paris	50
Champs Elysées Rond-Point SCI*	Paris	50
PB 12 SCI*	Paris	50
Burlington Number 1 (General Partner) Limited	London	100
Burlington Number 1 Partners LP	London	100

\* Jointly controlled entities

**To the Supervisory Council of Norges Bank**

## INDEPENDENT AUDITOR'S REPORT

We have audited the consolidated financial reporting of the Government Pension Fund Global for 2011 included in Norges Bank's annual financial statements. Subsidiaries of Norges Bank that exclusively constitute investments as part of the management of the investment portfolio of the Government Pension Fund Global are included in the financial reporting. The financial reporting comprises the balance sheet as at December 31, 2011, the income statement, the statement of comprehensive income, the statement of changes in owner's capital, the statement of cash flows 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 these financial statements in accordance with International Financial Reporting Standards as adopted by the EU, 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 statement 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 investment portfolio of the Government Pension Fund Global as at December 31, 2011 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Oslo, 29. February 2012

**Deloitte AS**

Aase Aa. Lundgaard  
State Authorised Public Accountant (Norway)



**Norges Bank v/Nancy Bundt:** Photos of Øystein Olsen and Yngve Slyngstad page 2 and 4.

**NBIM by Rolf Estensen:**

Photos of NBIM employees and NBIM office buildings on page 8, 18, 19, 25, 28, 32, 33, 37, 46, 50, 51, 52, 54, 55, 56, 68 and on cover.

**Scanpix:** Photo of drilling rig on cover.

**Nicky Twang:** Photos of children on page 8, 46, 49 and on cover.

**Statoil by Øyvind Hagen:** Photo drilling rig on page 8 and 46.

**Land Securities Group:** Photo on page 42 and 45.

**Jocelyne Tamssom:** Photo on page 26 and 62.

**The Crown Estate:** Photo on page 61.

**iStockphoto:** Photo on page 64.



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