GOVERNMENT PENSION FUND GLOBAL
ANNUAL REPORT 2012





NBIM
Norges Bank Investment Management

2012 IN BRIEF

- The Government Pension Fund Global returned 13 percent, or 447 billion kroner, in 2012.

- Equity investments returned 18 percent, while fixed-income holdings returned 7 percent. The return on real estate investments was 6 percent. In total, it was the second-best year in the fund's history.

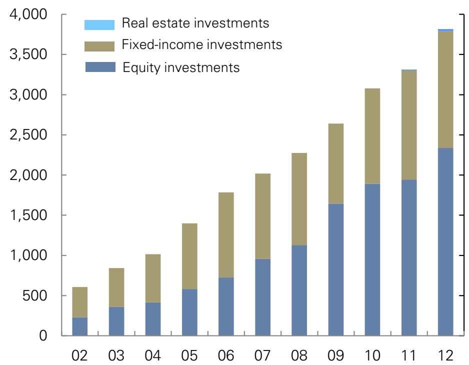
- The return on equity and fixed-income investments beat the fund's benchmark indices by 0.2 percentage point.

- The market value of the fund was 3,816 billion kroner at the end of 2012.

- The fund held 61.2 percent in equities, 38.1 percent in fixed income and 0.7 percent in real estate.

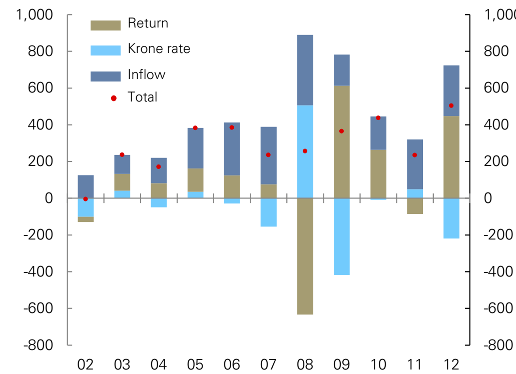
- European holdings accounted for 48 percent of the fund at the end of 2012, down from 53 percent a year earlier, after an increase in investments in emerging markets.

The fund´s market value. Billions of kroner



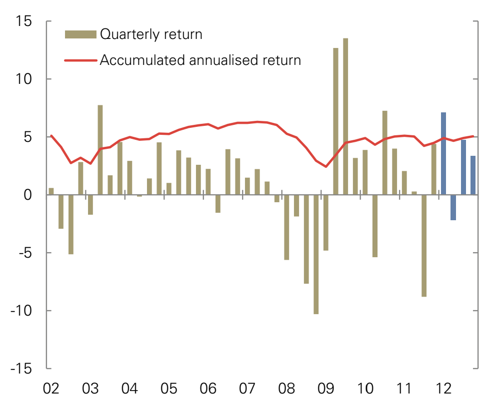
Source: NBIM

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



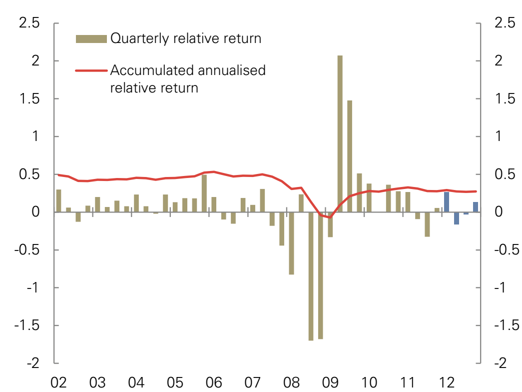
Source: NBIM

The fund´s quarterly and accumulated annualised return. Percent



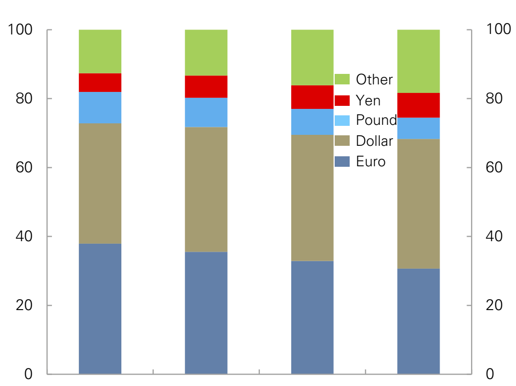
Source: NBIM

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



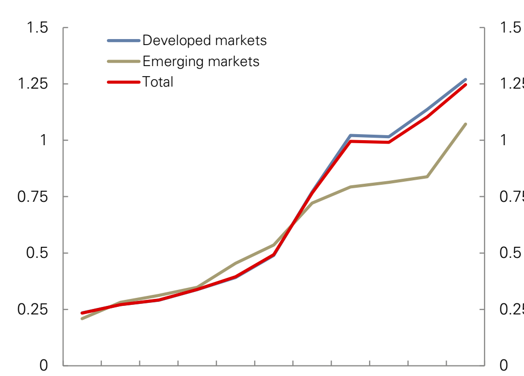
Source: NBIM

Currency composition of the fund´s fixed-income investments. Percent



Source: NBIM

The fund´s holdings in equity markets. Percentage of the FTSE Global All Cap Index´s market value



Source: FTSE, NBIM

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

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ØYSTEIN OLSEN

LOWER LONG–TERM RISK IN THE FUND

The Government Pension Fund Global is intended to support long-term management of Norway's petroleum revenues. Owing to recent years' solid growth, the fund is now equal to 140 percent of the mainland gross domestic product.

The objective of the management of the fund is to achieve the highest possible international purchasing power. The best means of ensuring this is to have broad-based ownership of global production of goods and services. In line with this objective, the fund's investment strategy was revised substantially in 2012. To reduce long-term risk, there is now a better balance in the geographical allocation of investments than previously.

On the whole, emerging markets are characterised by factors that, in isolation, contribute to higher risk – in the short term. Nevertheless, we believe that over time, the changes that have been implemented are firmly in keeping with the objective of Norges Bank's management of the fund: safeguarding financial wealth for future generations.

Results for the past year reflect developments in global financial markets. The return of 13 percent for 2012 is the second-best performance in the history of the fund.

Oslo, 27 February 2013

Øystein Olsen

Øystein Olsen

Chairman of the Executive Board

YNGVE SLYNGSTAD

SOLID RETURNS IN A TURBULENT YEAR

The fund returned 13.4 percent in 2012, the second-best result in its history, in a year marked by continued market turmoil and slow global economic growth. The total return since the fund's inception passed a trillion kroner in November.

The performance last year was driven by equity investments, which returned 18.1 percent amid broad gains in global markets. European equity investments performed particularly well, returning 20.8 percent. Fixed-income investments returned 6.7 percent and real estate investments 5.8 percent.

The fund has received 3,060 billion kroner in petroleum revenue from the government since its first capital injection in 1996. Capital inflows amounted to 276 billion kroner in 2012, little changed from the year before. While we spent 150 billion kroner of new funds in 2011 on European stock purchases, we last year invested nearly the same amount in emerging market bonds. We raised

These are the biggest strategic changes since the equity allocation was raised to 60 percent in 2009.

our holdings of government bonds issued in emerging market currencies to 10 percent of the fixed-income holdings at the end of 2012 from 0.4 percent a year earlier.

The share of the fund that is invested in Europe was reduced during the year to 48 percent from 53 percent. The proportion will eventually drop to about 40 percent as we boost investments in other regions, especially in emerging markets. We revised the allocation of fixed-income investments in 2012, weighting government bonds based on the size of a country's economy instead of the size of its debt.

These are the biggest strategic changes since the equity allocation was raised to 60 percent in 2009 from 40 percent in 2007. We seek to secure the international purchasing power of future generations by broadening the fund's exposure to growth in the global economy. We develop our organisation and investment strategy with this objective in mind.

Norges Bank manages vast assets. We endeavour to do this as efficiently, prudently and transparently as possible without reducing expected returns. Management costs in 2012 fell to 0.06 percent of the fund's capital. Risk management and active ownership were strengthened and our investment strategy became more transparent. We will continue in this direction in the years to come.

Oslo, 27 February 2013

Yngve Slyngstad
CEO of NBIM

RESULTS FOR 2012

SECOND–BEST YEAR IN THE FUND'S HISTORY

The Government Pension Fund Global returned 13 percent in 2012, the second-best year in its history, boosted by gains in global stock and bond markets.

The equity investments rose 18 percent, fixed-income holdings climbed 7 percent and the real estate investments returned 6 percent. In total, it was the best year since the record 26 percent return in 2009.

The fund measures its returns on equity and fixed-income investments against global benchmark indices for stocks and bonds compiled by the FTSE Group and Barclays Capital, respectively. The return on equity and fixed-income investments beat the benchmarks by 0.2 percentage point in 2012.

Return tops 1 trillion kroner

The Norwegian government first transferred capital to the fund in May 1996. By the end of 2012, the fund had received 3,060 billion kroner and amassed a cumulative return of 1,107 billion kroner. The trillion-krone mark was passed in November.

Norges Bank Investment Management (NBIM) was set up 1 January, 1998, to manage the fund. From NBIM's start and through to the end of 2012, the fund generated an annual gross return of 5 percent. After management costs and inflation, the annual return was 3 percent.

Increased market value

The fund's market value rose 504 billion kroner to 3,816 billion kroner in 2012. The market value is affected by investment returns, capital inflows and exchange rates. The fund returned 447 billion kroner in 2012 and received 276 billion kroner from the government. A strengthening of the krone against several major currencies reduced the market value by 220 billion kroner.

The fund held 61.2 percent in equities, 38.1 percent in fixed income and 0.7 percent in real estate at the end of 2012.

Table 1-1 Returns as of 31 December 2012

	2012	2011	4Q 2012	3Q 2012	2Q 2012	1Q 2012
Returns in international currency						
Return on equity investments (percent)	18.06	-8.84	4.69	6.48	-4.57	10.99
Return on fixed-income investments (percent)	6.68	7.03	1.26	2.16	1.52	1.58
Return on real estate investments (percent)	5.77	-4.37	0.49	2.68	0.31	2.18
Return on fund (percent)	13.42	-2.54	3.34	4.74	-2.18	7.11
Return on equity and fixed-income investments (percent)	13.45	-2.55	3.35	4.75	-2.18	7.13
Return on benchmark equity and fixed-income indices (percent)	13.24	-2.42	3.22	4.78	-2.02	6.87
Relative return on equity and fixed-income investments (percentage points)*	0.21	-0.13	0.14	-0.02	-0.17	0.27
Relative return on equity investments (percentage points)	0.52	-0.48	0.21	0.12	-0.17	0.33
Relative return on fixed-income investments (percentage points)	-0.29	0.52	-0.05	-0.27	-0.07	0.11
Management costs (percentage points)	0.06	0.08	0.02	0.01	0.02	0.02
Return on fund after management costs (percent)	13.35	-2.63	3.32	4.73	-2.19	7.10
Returns in kroner (percent)						
Return on equity investments	11.07	-7.77	2.08	3.98	-2.66	7.49
Return on fixed-income investments	0.36	8.30	-1.26	-0.23	3.56	-1.63
Return on real estate investments	-0.50	-0.79	-2.01	0.28	2.33	-1.04
Return on fund	6.70	-1.39	0.76	2.29	-0.21	3.74
Return on equity and fixed-income investments	6.73	-1.39	0.78	2.30	-0.22	3.76

*The fund's relative return for the second and third quarter of 2012 has been restated in this table following a revision of the return on the benchmark indices. The relative return is 0.01 percentage point lower than previously reported for the second quarter and 0.01 percentage point higher than previously reported for the third quarter.

Table 1-2 Historical key figures as of 31 December 2012. 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)	13.42	6.61	3.14	5.99	5.05
Return on equity and fixed-income investments (percent)	13.45	6.62	3.15	6.00	5.05
Return on benchmark equity and fixed-income indices (percent)	13.24	6.26	3.14	5.79	4.78
Relative return on equity and fixed-income investments (percentage points)	0.21	0.36	0.01	0.20	0.27
Standard deviation (percent)	6.44	8.25	11.31	8.44	7.74
Tracking error for equity and fixed-income investments (percentage points)	0.22	0.37	1.20	0.89	0.77
Information ratio (IR)* for equity and fixed-income investments	0.95	0.99	0.01	0.23	0.36
Return on fund (percent)	13.42	6.61	3.14	5.99	5.05
Annual price inflation (percent)	1.95	2.26	2.00	2.15	1.92
Annual management costs (percent)	0.06	0.08	0.10	0.10	0.09
Annual net return on fund (percent)	11.18	4.17	1.02	3.66	2.97

* 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 1-3 Contributions from equity and fixed-income management to the fund's relative return in 2012. Percentage points

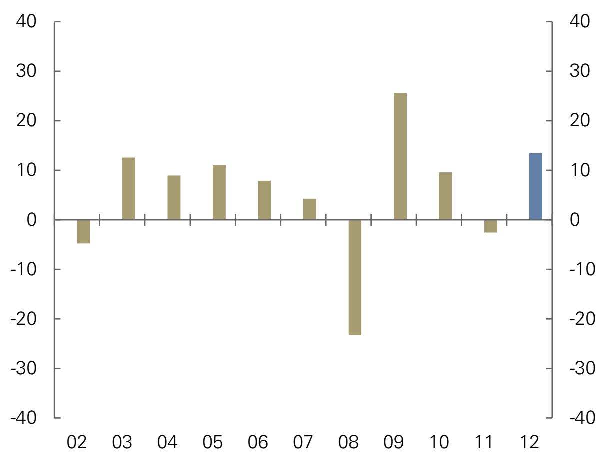
	External management	Internal management	Total*
Equity management	0.03	0.32	0.35
Fixed-income management	0.03	-0.17	-0.14
Total	0.06	0.15	0.21

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

Table 1-4 The fund´s return in 2012 in different currencies. Percent

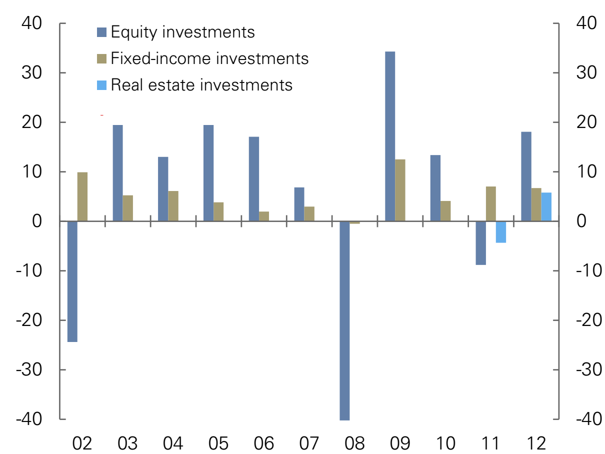
	USD	EUR	GBP
Return	14.42	12.66	9.39

Chart 1-1 The fund's annual return. Percent



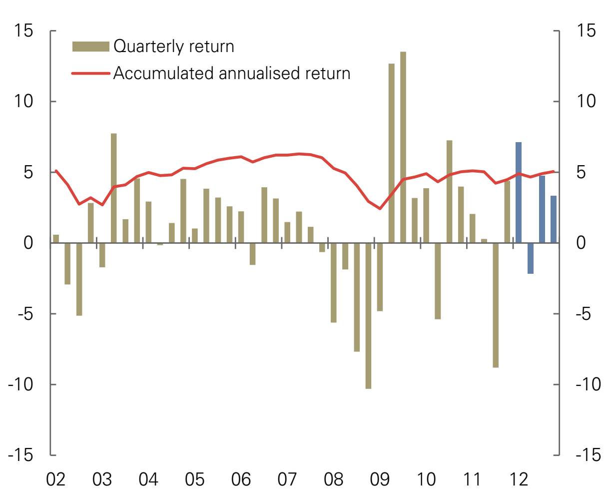
Source: NBIM

Chart 1-2 Annual returns for equity, fixed-income and real estate investments. Percent



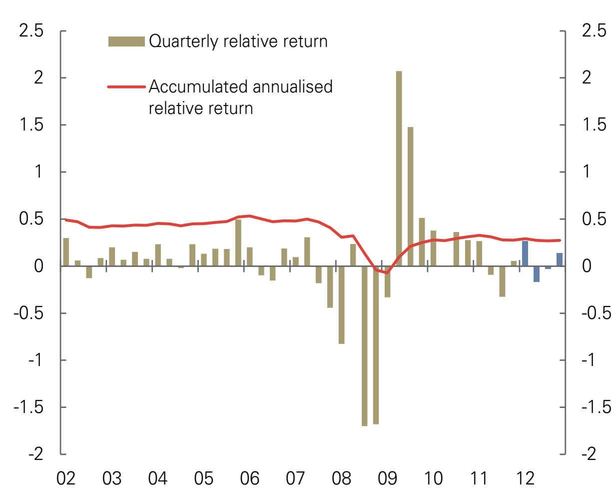
Source: NBIM

Chart 1-3 The fund's quarterly and accumulated annualised return. Percent



Source: NBIM

Chart 1-4 Quarterly relative return and accumulated annualised relative return on the fund, excluding real estate investments. Percentage points.



Source: NBIM

Table 1-5 Key figures as of 31 December 2012

	2012	2011	4Q 2012	3Q 2012	2Q 2012	1Q 2012
Market value (billions of kroner)*						
Market value of equity investments	2,336	1,945	2,336	2,247	2,122	2,122
Market value of fixed-income investments	1,455	1,356	1,455	1,465	1,428	1,364
Market value of real estate investments	25	11	25	11	11	11
Market value of fund	3,816	3,312	3,816	3,723	3,561	3,496
Inflow of new capital*	276	271	64	80	72	60
Return on fund	447	-86	123	167	-77	234
Change due to fluctuations in krone	-220	49	-94	-85	70	-110
Total change in fund	504	234	92	162	65	185
Management costs (percent)						
Estimated transition costs**	0.03	0.05	0.00	0.01	0.01	0.01
Annualised management costs	0.06	0.08	0.06	0.06	0.07	0.07
Changes in value since first capital inflow in 1996 (billions of kroner)						
Gross inflow of new capital	3,060	2,782	3,060	2,996	2,915	2,842
Management costs***	21	19	21	20	20	19
Inflow of capital after management costs	3,039	2,763	3,039	2,975	2,895	2,823
Return on fund	1,107	660	1,107	985	817	894
Change due to fluctuations in krone	-331	-111	-331	-237	-151	-221
Market value of fund	3,816	3,312	3,816	3,723	3,561	3,496
Return after management costs	1,087	641	1,087	965	798	875

* The fund market value shown in this table does not take into account the management fee to NBIM from the Ministry of Finance. The market value therefore differs somewhat from the Balance sheet and the Statement of changes in owner's capital in the financial-reporting section. The inflows in this table differ somewhat from inflows 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 and unsettled inflows (see Statement of cash flows).

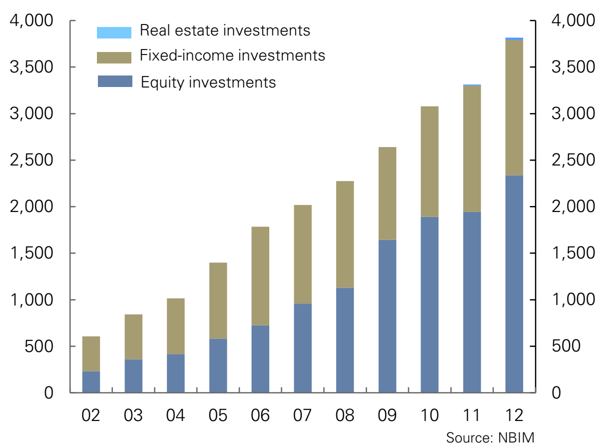
** Estimated transition costs of new capital inflows. These do not include costs due to strategic changes in the fund and costs from implementing benchmark index changes, for instance when companies, issuers and bonds are added to or excluded from the benchmark indices for equities and fixed income.

*** Management costs at subsidiaries, see Table 5.2 in the financial-reporting section, are not included in the management fee. Management costs at subsidiaries have been deducted from the fund's return before management fees.

Table 1-6 Accumulated returns since first captial inflow in 1996. Billions of kroner

	2012	2011	4Q 2012	3Q 2012	2Q 2012	1Q 2012
Return on equity investments	579	226	579	474	338	437
Return on fixed-income investments	528	434	528	510	480	457
Return of real estate investments	0	0	0	0	0	0
Total return	1,107	660	1,107	985	817	894

Chart 1-5 The fund's market value. Billions of kroner



Charts 1-6 Changes in the fund's market value. Billions of kroner

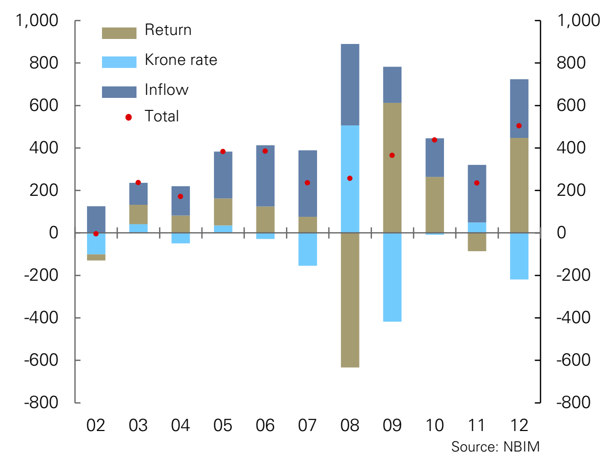
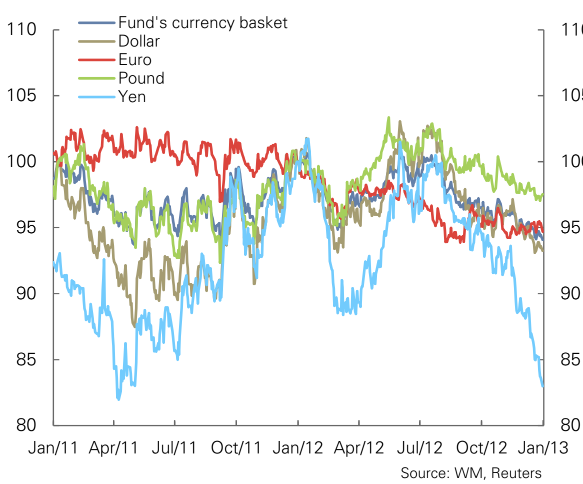


Chart 1-7 Movements in currency exchange rates against the krone. Indexed. 31 Dec 2011 =100



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 currency. Changes in the 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 benchmark indices for equities and bonds. The fund's currency basket consisted of 35 currencies at the end of 2012. The krone gained 5.9 percent against the basket last year.

INVESTMENT STRATEGY

MAJOR STRATEGIC CHANGES

The fund's investment strategy was developed in 2012 to expand into more markets and capture a larger share of the global output.

The fund invests outside of Norway, targeting a 60 percent share in equities, 35 percent to 40 percent in fixed income and as much as 5 percent in real estate. The investment strategy is set by the Ministry of Finance, which receives advice from Norges Bank and others.

The strategy was changed last year to gradually reduce investments in Europe to about 40 percent of the fund from more than 50 percent. The fund will at the same time increase investments in other regions, especially in emerging markets.

The change, presented in a report to the Norwegian parliament in March 2012, was made to spread the fund's risk and to benefit from a broader exposure to global production. The fund seeks to achieve the highest possible long-term return with moderate risk.

More countries and currencies

NBIM in 2012 completed several of the strategy changes. Government bond investments were weighted according to the size of a country's economy rather than the size of its debt, reducing holdings of bonds from some of the most indebted countries. Investments in government debt issued in emerging-market currencies were raised to 10 percent of the fixed-income holdings at the end of the year from 0.4 percent a year earlier. The fund for the first time invested in government bonds from countries such as Taiwan, Russia and Turkey.

The scope of equity investments was also broadened to include more emerging markets such as Qatar, Kenya and Romania. The fund will gradually move away from an equity allocation of 50 percent in Europe, 35 percent in the Americas, Africa and Middle East and 15 percent in Asia and Oceania toward a more market-weighted approach. The shift will allow the equity investments to largely reflect the size of the world's various stock markets. The greatest exposure will be to Europe and North America, followed by developed markets in Asia and Oceania and emerging markets. The change seeks to improve the diversification of risk.

Real estate investments were also spread into new markets in 2012. The fund purchased its first property in Switzerland and agreed to buy its first buildings in Germany. It also made its inaugural investment in a shopping centre and entered the market for logistics properties. The mandate was broadened in December to permit investments in real estate outside Europe starting in January 2013.

The strategy was changed last year to gradually reduce investments in Europe to about 40 percent of the fund from more than 50 percent.

Long-term investments

The fund invests for future generations. It has no short-term liabilities 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 to make short-term decisions. This happened most recently in the autumn of 2011, when the fund bought substantial amounts of stocks as markets slumped.

A new rule was introduced in October 2012 determining the extent to which the fund's equity holdings may deviate from the strategic 60 percent allocation, a practice known as rebalancing. The limit was set at 4 percentage points and entails that the fund will invest heavily in shares when falling stock markets decrease the fund's equity portion.

NBIM uses operational reference portfolios for equities and bonds that are designed to take advantage of the fund's long-term approach and size. The reference portfolio for bonds was refined in 2012, partly to take account of a country's fiscal strength when investing in government debt.

Responsible ownership

The fund's portfolio managers analyse stocks, bonds and properties in their specialist areas to find the potential for good long-term returns. Each manager has a clearly defined mandate and results are measured regularly. Decisions are based on in-depth analysis and NBIM reinforced its analytical capacity in several areas in 2012. NBIM also published 16 discussion notes on topics relevant to the investment strategy, such as tail risk in currency positions, systematic risk premiums and returns in emerging equity markets.

A good long-term return depends on sustainable economic, environmental and social developments. Environmental, social and governance risks are considered in the fund's management and exercise of ownership in companies. NBIM in 2012 better integrated its ownership policies with the fund's investment processes. Analysts from the ownership policy group were transferred to the equity management department to contribute more directly to investment decisions and better follow up on ownership issues.

Read more about the operational reference portfolios in the sections on equity and fixed-income management and in the feature article on pages 50–51.

Read more about rebalancing in the feature article on pages 52–53.

Go to www.nbim.no for more information on NBIM's discussion notes and letters to the Ministry of Finance.

EQUITY MANAGEMENT

STOCKS GAIN MOST IN THREE YEARS

The fund's equity investments returned 18 percent in 2012 as global stock markets rallied the most in three years.

All stock sectors gained in 2012 as European, US, Chinese and other central banks announced measures to combat the slowest global economic growth since 2009. Shares rose the most in Europe, where European Central Bank President Mario Draghi in July pledged to do whatever it takes to defend the euro and contain the region's three-year sovereign debt crisis.

Financial stocks were the fund's best-performing sector, returning 30 percent in 2012. Draghi's comments eased concerns over potential bank losses stemming from a possible break-up of the euro. European Union nations also in December agreed to give the ECB supervisory powers over banks, paving the way for the European Stability Mechanism to give direct financial support to European banks with funding difficulties.

Investments in European financial stocks returned 34 percent, while US and Asian financial shares gained 25 percent and 29 percent, respectively. Financials were the fund's largest equity sector, accounting for 23 percent of the stockholdings at the end of the year.

Investments in consumer goods and consumer services returned 24 percent and 22 percent, respectively, helped by increased optimism that stimulus measures would boost consumer spending. The ECB in July lowered its main interest rate to a record-low 0.75 percent, while the People's Bank of China cut its rate for the second time in a month. In the US, the world's largest economy, the labour and housing markets improved in the second half of the year as the Federal Reserve kept its interest rate near zero.

Holdings of industrial and basic materials stocks, which are particularly sensitive to swings in the global economy, returned 20 percent and 13 percent, respectively. Shares of oil and gas companies performed the worst with a return of 0.4 percent.

Regional performance
The MSCI All Country World Index, which includes listed companies in 45 developed and emerging markets, gained 13 percent in 2012. This was the most since a 32 percent gain in 2009. The STOXX Europe 600 Index rose 14 percent

in 2012, while the US Standard & Poor's 500 Index gained 13 percent. The MSCI Asia Index climbed 14 percent.

Europe accounted for 49 percent of the fund's equity investments at the end of the year, followed by North America with 31 percent and Asia with 14 percent. Equity investments in these regions returned 21 percent, 16 percent and 14 percent, respectively. The fund also held shares in Oceania, Latin America, Africa and the Middle East.

The US was the fund's single largest equity market, accounting for 28 percent of the shares at the end of 2012. Measured in local currency, the return was 17 percent, boosted by measures to stimulate the economy. The Federal Reserve announced in December that it would keep its key rate close to zero as long as unemployment remained above 6.5 percent and inflation expectations did not exceed 2.5 percent. Unemployment fell to a four-year low of 7.7 percent in November, according to data published in December. The housing market also showed signs of improvement, with sales of new and existing homes rising in November to their highest since April 2010.

Equity investments in China, the world's second-largest economy, returned 13 percent, as measured in local currency. Chinese authorities announced several measures in the year to stimulate economic growth, which in the third quarter slowed for a seventh consecutive period to 7.4 percent. The central bank in June lowered its main rate for the first time since 2008. It also raised the ceiling for deposit rates at Chinese banks and allowed banks to offer loans at lower rates. The authorities in the same month raised the total quota for foreign investors' purchases of Chinese A-shares to 80 billion dollars from 30 billion dollars. The fund in the second quarter became the first foreign investor to be awarded the maximum

Table 3-1 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
2012	18.06	0.52

Table 3-2 Return on the fund's equity investments in 2012. By sector. Percent

Sector	Return in international currency	Share of equity investments
Financials	29.7	22.9
Consumer goods	24.5	13.5
Industrials	20.5	13.0
Oil and gas	0.4	9.8
Consumer services	22.4	9.3
Healthcare	18.1	8.6
Technology	14.5	7.3
Basic materials	13.2	7.5
Telecommunications	2.9	3.9
Utilities	4.0	3.7

quota of 1 billion dollars, up 300 million dollars from its previous allotment. Investments in China accounted for 1.6 percent of the fund's equity holdings at the end of the year.

Individual stocks

UK bank HSBC contributed the most to the return on equity investments in 2012, followed by US technology company Apple and Swiss food producer Nestlé. The worst-performing stock was UK oil and gas company BG Group, followed by Telefonica, Spain's largest telecommunications company, and Repsol, a Spanish oil and gas company.

Globally, sales of shares in initial public offerings fell 27 percent to 124 billion dollars in 2012, according to researcher Dealogic. The largest IPO the fund took part in was Facebook's May offering, where the fund bought shares for 152 million dollars, or about 911 million kroner. This was followed by offerings at Russian mobile telephone operator MegaFon and Germany's Telefonica Deutschland. The fund bought shares worth 60 million dollars and 38 million euros, respectively, in these companies.

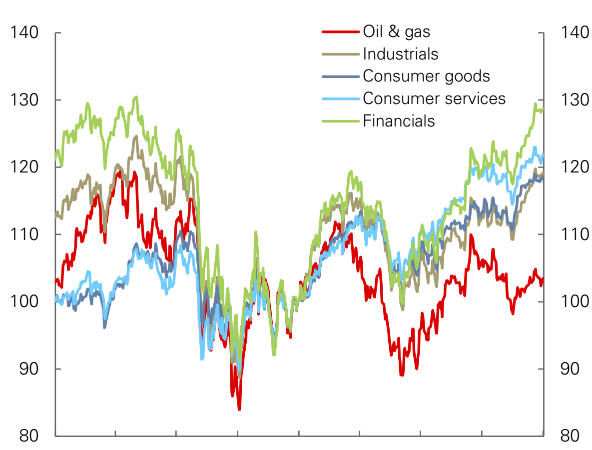
The fund for the first time invested in an unlisted company planning an IPO through the purchase in June of shares in the company owning the commercial rights to Formula 1 motor racing.

Relative return

The fund owned shares in 7,427 listed companies at the end of 2012. These investments are measured against a benchmark index from FTSE Group consisting of 7,103 listed companies.

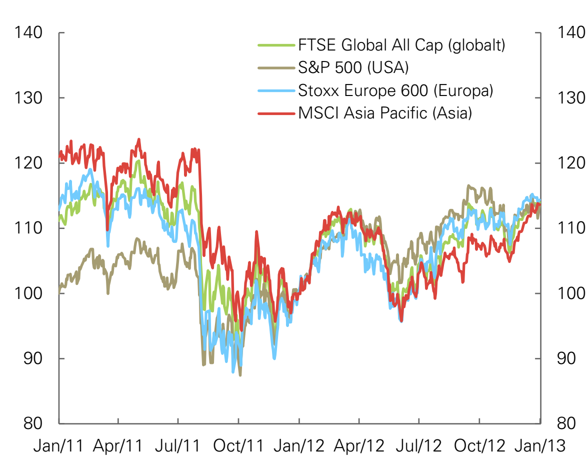
The return on the fund's equity investments in 2012 was 0.5 percentage point higher than the benchmark's return. Holdings of consumer goods and consumer services companies contributed the most to the excess return, while investments in healthcare and oil and gas shares contributed the most negatively. Of the countries the fund is invested in, US and Swedish stocks contributed the most to the excess return, while investments in Australia and China contributed the most negatively.

Chart 3-1 Price moves in stock sectors in the FTSE Global All Cap Index. Measured in US dollars. Indexed. 31 Dec 2011 = 100



Source: FTSE

Chart 3-2 Price developments in regional and global equity markets. Measured in US dollars, except for the Stoxx Europe 600, which is measured in euros. Indexed. 31 Dec 2011 = 100



Source: Bloomberg

Operational reference portfolio

NBIM has constructed an operational reference portfolio for equities. The reference portfolio is designed to take advantage of the fund's size and long-term approach and achieve the best possible trade-off over time between risk and return.

Five emerging economies – Qatar, Kenya, Romania, Croatia and Jordan – were added to the reference portfolio in 2012 to broaden the exposure to global output. Several palm oil producers were removed from the portfolio because their long-term business model was deemed unsustainable. The reference portfolio's exposure to so-called value stocks and small-capitalisation compa-nies was increased during the year.

The operational reference portfolio consisted of shares in 7,195 companies at the end of 2012. It returned 17.5 percent, in line with the return on the benchmark index compiled by the FTSE Group.

Read more about the operational reference portfolio in the feature article on pages 50–51.

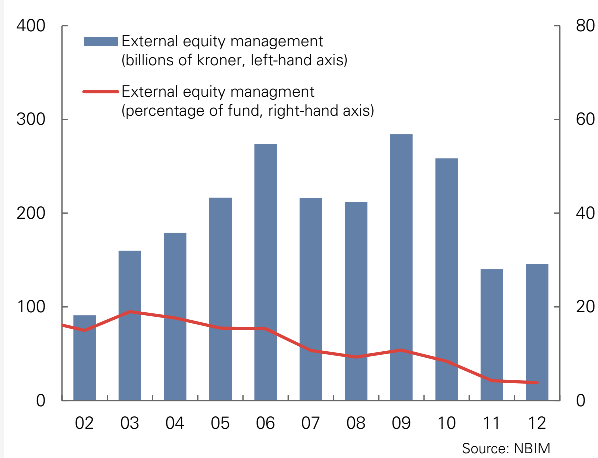
EXTERNAL EQUITY MANAGEMENT

NBIM awards investment mandates to external equity managers with expertise in specific markets. The mandates are in markets and segments where it is not expedient to build internal expertise and the potential for excess returns is considerable. The mandates typically cover investments in emerging markets and small-capitalisation companies in developed markets.

The fund had 146 billion kroner, or 3.8 percent of its capital, under external management at the end of 2012, compared with 140 billion kroner at the start of the year. A total of 55 mandates were managed externally by 51 organisations. These included 31 mandates for investments in emerging markets such as Mexico, Chile and South Africa, 16 mandates for investments in small-capitalisation companies in developed equity markets such as South Korea and Japan and eight mandates for environmentally-related investments.

Go to www.nbim.no for a list of the fund's external managers.

Chart 3-3 Assets under external equity management at year-end. Billions of kroner and percentage of fund



BOND PRICES RISE

The fund's fixed-income investments returned 7 percent in 2012, led by gains on corporate bonds issued by the financial sector.

Risk appetite among investors increased in the second half of the year after authorities announced measures to stimulate the economy and combat the European sovereign debt crisis. Corporate bond prices rose, as investors shifted to higher-yielding investments from the perceived safety of government bonds from countries such as the US, Germany and Japan.

Bonds issued by banks and other financial-sector companies were the biggest gainers. The fund's holdings of securitised debt, consisting mainly of bonds issued by banks and secured by assets such as home mortgages, returned 13 percent and were the best-performing sector. Investments in other types of corporate bonds returned 11 percent.

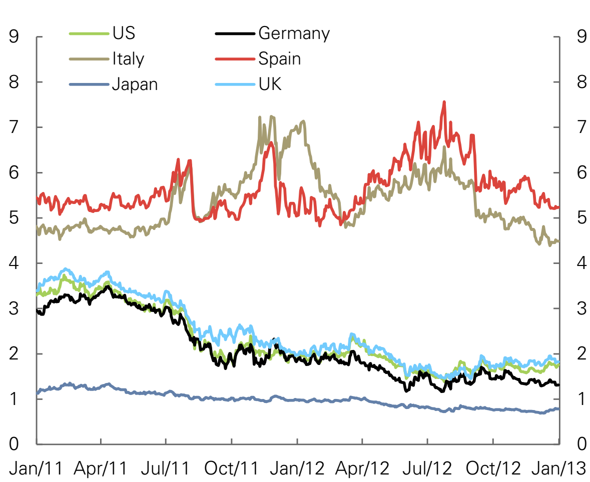
Sovereign-debt concern eases

The European Central Bank president's pledge in July to do whatever it takes to defend the euro eased concern over possible sovereign defaults in countries such as Italy and Spain. Ten-year Spanish government bond yields fell to 5.3 percent at the end of 2012 from a euro-era record of 7.6 percent on 24 July. Similar-maturity Italian bond yields fell to 4.5 percent at the end of the year from 7.1 percent at the beginning of 2012. The yield an investor demands for lending money through a bond normally falls when the expected risk of default declines. The price moves inversely to the yield.

The fund's government bond holdings returned 4 percent in 2012 and made up almost 60 percent of the fixed-income investments at the end of the year. US Treasuries gained 2 percent, as measured in local currency. The bonds were the largest holding of government debt from a single issuer, accounting for about a fifth of the fund's fixed-income investments. Euro-denominated government bonds returned 11 percent, as measured in euros, and amounted to 12 percent of the fixed-income holdings.

The fund also holds bonds from government-related institutions such as the European Investment Bank,

Chart 4-1 10-year government bond yields. Percent



Source: Bloomberg

Table 4-1 Return on the fund's fixed-income investments

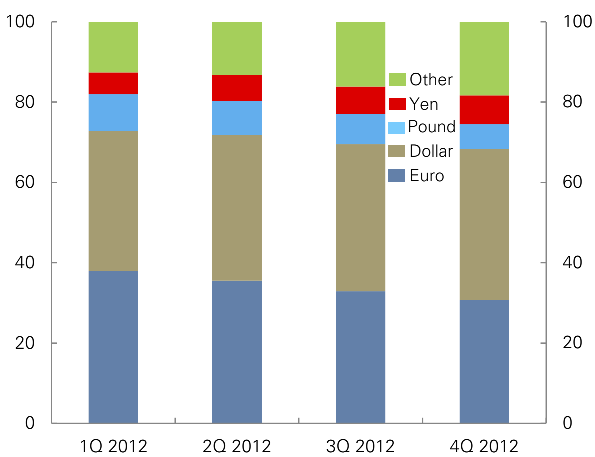
	Return (percent)	Relative return (percentage points)
1999	-0.99	0.01
2000	8.41	0.07
2001	5.04	0.08
2002	9.90	0.49
2003	5.26	0.48
2004	6.10	0.37
2005	3.82	0.36
2006	1.93	0.25
2007	2.96	-1.29
2008	-0.54	-6.60
2009	12.49	7.36
2010	4.11	1.53
2011	7.03	0.52
2012	6.68	-0.29

Kreditanstalt für Wiederaufbau and the World Bank. These returned 10 percent and accounted for 11 percent of the fixed-income investments at the end of the year.

Significant changes in holdings

Holdings of government bonds and government-related bonds increased to 73 percent of fixed-income investments at the end of 2012 from 66 percent a year earlier after an adjustment to the fund's investment strategy. Investments in government bonds issued in emerging-market currencies rose to 10 percent of the fixed-income holdings from 0.4 percent.

Chart 4-2 Currency composition of the fund's fixed-income investments. Percent



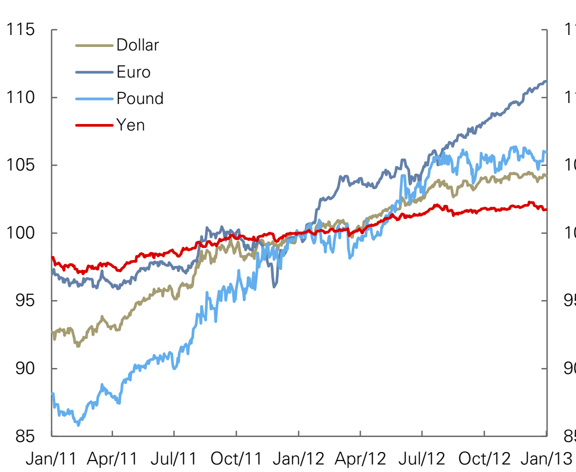
Source: NBIM

The fund held government debt in the currencies of 19 emerging markets, including Mexico, Poland, Indonesia, Turkey and Taiwan, at the end of 2012. Bonds denominated in dollars, euros, pounds and yen fell to 82 percent of the fixed-income investments from 94 percent a year earlier.

The fund in 2012 boosted its investments in government bonds from the US, Japan and Germany and reduced its holdings of French, British, Spanish and Italian government debt. The three largest investments in new bond issues other than government debt were in bonds from Agence Française de Développement, UBS and Caisse centrale Desjardins du Québec.

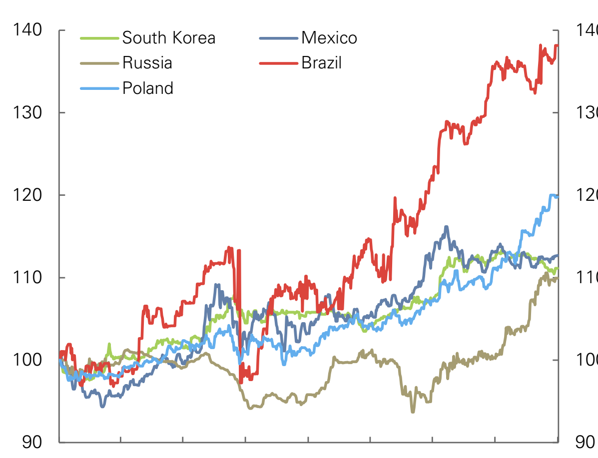
The bond holdings had a duration of 5.4 years and a yield of 1.9 percent, on average, at the end of the year. Duration is the average time it takes for an investor to receive the cashflow on a bond. The longer the duration, the more sensitive the price of the bond will be to movements in interest rates.

Chart 4-3 Price developments for bonds issued in dollars, euros, pounds and yen in the Barclays Global Aggregate Index, measured in local currencies. Indexed. 31 Dec 2011 = 100



Source: Barclays Capital

Chart 4-4 Price developments for 10-year government bonds issued in emerging-market currencies. Indexed. 31 Dec 2011 = 100



Source: Bloomberg

The fund held government debt in the currencies of 19 emerging markets, including Mexico, Poland, Indonesia, Turkey and Taiwan, at the end of 2012.

Relative return

The fund held 4,047 bonds from 1,196 issuers at the end of 2012. These investments are measured against a benchmark index from Barclays Capital consisting of 9,487 bonds from 1,926 issuers.

The fixed-income return was 0.3 percentage point lower than the benchmark index's return in 2012. A higher exposure than the benchmark to emerging market government debt contributed to the shortfall. The result was also damped by a lower exposure to US corporate bonds than the benchmark and a shorter average duration, meaning the fund was less affected by falling interest rates than the benchmark. A larger exposure to euro-denominated covered bonds and government-related bonds pulled in the other direction.

Operational reference portfolio

NBIM has constructed an operational reference portfolio for bonds. The reference portfolio is designed to take advantage of the fund's size and long-term approach to achieve the best possible trade-off over time between risk and return.

Government bonds issued in the currencies of emerging markets such as India, Brazil, Russia, Turkey and Indonesia were included in the reference portfolio in 2012 to spread investments and risk across more markets. The reference portfolio was refined to take into account a country's fiscal strength when investing in government debt. This led to a reduction in holdings of government bonds from some of the most heavily-indebted countries.

The operational reference portfolio consisted of 4,226 bonds at the end of 2012. It returned 7 percent, which was 0.1 percentage point more than the benchmark index compiled by Barclays Capital.

Read more about the operational reference portfolio in the feature article on pages 50–51.

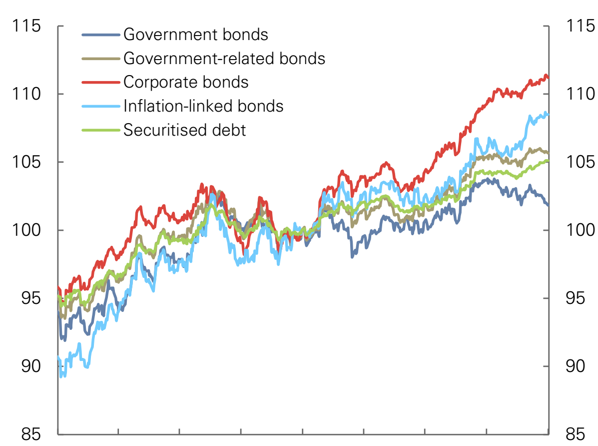
Table 4-2 Return on the fund's fixed-income investments in 2012. By sector. Percent

Sector	Return in international currency	Share of fixed-income investments*
Government bonds**	4.1	58.7
Government-related bonds**	10.1	11.4
Inflation-linked bonds**	5.4	2.9
Corporate bonds	11.3	13.3
Securitised debt	12.8	13.3

* The individual percentages do not add up to 100 percent as the table excludes investments in short-term securities, bank deposits and derivatives.

** Governments may issue different types of bonds and the fund's investments in these bonds are grouped accordingly. Bonds issued by a country's government in the country's own currency are categorised as government bonds. Bonds issued by a country's government in another country's currency are grouped with government-related bonds. Inflation-linked bonds issued by governments are grouped with inflation-linked bonds.

Chart 4-5 Price developments in fixed-income sectors in the Barclays Global Aggregate Index, measured in US dollars. Indexed. 31 Dec 2011 = 100



Source: Barclays Capital

REAL ESTATE MANAGEMENT

INCREASED INVESTMENTS IN REAL ESTATE

The share of real estate investments in the fund rose to 0.7 percent in 2012, bolstered by new purchases in Europe.

The fund entered several European property markets for the first time in 2012. It bought its first property in Switzerland and agreed to invest in its first buildings in Germany. It also invested in its first shopping centre and entered the market for logistics properties through an agreement to invest in distribution facilities in 11 European countries. Real estate investments amounted to 0.7 percent of the fund at the end of the year, up from 0.3 percent a year earlier.

Return on real estate

The fund got a mandate to invest in real estate in 2010 and made its first property investments the following year. These comprised 25 percent of a portfolio of buildings on Regent Street in London and 50 percent of 10 properties in and around Paris. The properties consisted of office and retail premises of a high standard in prime locations.

Rental income from these buildings contributed to a return of 6 percent on the fund's real estate investments in 2012. The return was also boosted by an increase in the market value of the Regent Street portfolio after a rise in expected rental income from the properties.

Prices of high-quality retail premises in the West End of London, where Regent Street is located, generally rose in 2012 following a 16 percent rise in rents, according to real estate adviser CBRE. Prices of retail premises of the same standard in Paris also increased because of higher rents. Office premises in London and Paris rose in price during the year because of higher demand for such property. Rents on these buildings were largely unchanged.

Gradual build-up

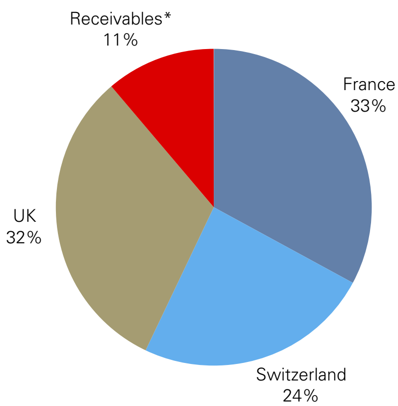
The mandate to invest in real estate was broadened in December to permit investments outside Europe starting in January 2013. This was in line with the strategy of spreading the fund's investments and risk across more markets. Real estate investments will be increased over time to as much as 5 percent of the fund. New investments will generally be in well-developed markets and in office and retail properties.

Read more about real estate investments in note 11 to the financial reporting.

Table 5-1 Return on the fund's real estate investments in 2012. Measured in international currency. Percent

	Components of the return
Net rental income	4.2
Net change in value of properties and debt	0.4
Transaction costs for property purchases	-0.6
Foreign exchange adjustments	1.8
Overall return	**5.8**

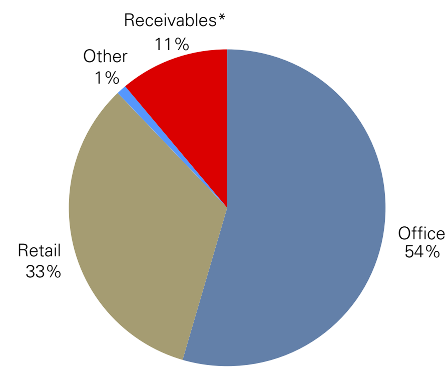
Chart 5-1 The fund's real estate investments by country as of 31 December 2012. Percent



Source: NBIM

* A receivable for the investment in Germany that was completed 1 Jan 2013.

Chart 5-2 The fund's real estate investments by sector as of 31 December 2012. Percent



Source: NBIM

* A receivable for the investment in Germany that was completed 1 Jan 2013.

SIGNIFICANT NEW REAL ESTATE INVESTMENTS IN 2012

- 50 percent of five properties in Paris for 275 million euros (2.1 billion kroner). The transaction was completed in the fourth quarter.
- 50 percent of Meadowhall shopping centre in the UK for 348 million pounds (3.2 billion kroner). The transaction was completed in October.
- 100 percent of the Uetlihof office building in Zürich for 1 billion Swiss francs (6.1 billion kroner). The transaction was completed in November.
- 50 percent of two buildings in Germany for 388 million euros (2.8 billion kroner). The transaction was completed 1 January 2013.
- 50 percent of a portfolio of 195 logistics properties in 11 European countries for 1.2 billion euros (8.9 billion kroner). The transaction shall be completed in the first quarter of 2013.

The real estate investments were made in conjunction with partners, with the exception of the Swiss purchase.

GLOBAL INVESTMENTS

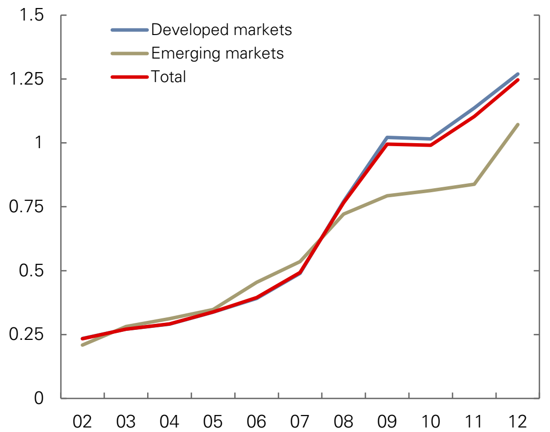
ENTERING NEW MARKETS

The fund invested more than a third of its capital inflow in emerging markets in 2012.

The fund's investments increased to 72 countries at the end of 2012 from 68 countries a year earlier after it entered markets such as Qatar, Kenya and Romania. The number of currencies the fund was invested in rose to 43 from 36, helped by new investments in emerging-market government bonds.

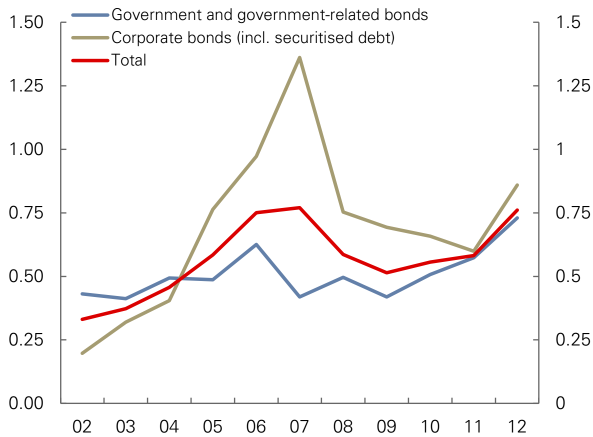
The increases were in line with a strategy to broaden the exposure to global economic growth. The fund's capital inflows of 276 billion kroner were 56 percent invested in equities, 39 percent in fixed income and 5 percent in real estate. About 40 percent of the investments were in emerging markets.

Chart 6-1 The fund's holdings in equity markets. Percent of FTSE Global All Cap Index's market value.



Source: FTSE, NBIM

Chart 6-2 The fund's holdings in fixed-income markets. Percent of the market value of bond indices compiled by Barclays Capital



Source: Barclays Capital, NBIM

1.2 percent of the world's equities

New equity investments helped boost the fund's average holding in the world's listed companies to 1.2 percent at the end of 2012 from 1.1 percent a year earlier, measured as a share of the FTSE Global All Cap stock index. The largest average holding was in Europe at 2.5 percent, up from 2.3 percent a year earlier.

The fund's holdings in listed companies in emerging markets rose to 1.1 percent, on average, from 0.8 percent. The average shareholding in developed markets climbed to 1.3 percent from 1.1 percent.

The US was the single-largest market, accounting for 28 percent of the fund's equity investments at the end of 2012, followed by the UK at 16 percent and France at 7 percent. The largest shareholding in an emerging market was in China with 1.6 percent of total equity investments, followed by Brazil with 1.5 percent and Taiwan with 1.3 percent.

Investments in single companies

The largest investment in a single company was in the Swiss food producer Nestlé. The fund's 2.6 percent stake had a market value of about 30 billion kroner at the end of the year. The fund's top ten holdings also included three oil and gas companies, three drugmakers, two financial-sector companies and an information technology company.

The largest percentage holding was a 9.5 percent stake in Irish packaging company Smurfit Kappa Group, worth about 1.4 billion kroner.

The fund held shares in 7,427 companies at the end of 2012, down from 8,005 at the end of 2011. It had stakes of more than 2 percent in 891 companies and exceeded 5 percent ownership in 34 companies.

The number of countries approved by NBIM as marketplaces for the fund's stock trading rose in the year to 52 from 47, after Qatar, Jordan, Kenya, Croatia and Romania were added.

Bond holdings

The fund's fixed-income investments consisted of 73 percent government and government-related bonds and 27 percent corporate bonds at the end of 2012.

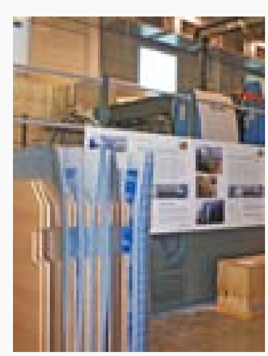
US Treasuries constituted the largest holding of bonds from a single issuer, followed by Japanese and German government debt. Mexican government bonds were for the first time among the top ten bond holdings, after the fund raised investments in government debt issued in emerging market currencies to 10 percent of the fixed-income holdings at the end of 2012. That compares with 0.4 percent a year earlier. Bonds issued in euros, dollars, pounds and yen accounted for 82 percent of fixed-income investments, down from 94 percent.

NESTLÉ

- Nestlé is a Swiss food producer with brands including Nespresso, Mövenpick and Kit Kat.
- It has about 330,000 employees and 461 factories in 83 countries. The company reported sales of 92 billion Swiss francs in 2012.

SMURFIT KAPPA GROUP

- Smurfit Kappa is an Irish packaging producer with about 41,000 employees in 32 countries.
- Customers include the food, electronics and healthcare industries. The company reported sales of 7.3 billion euros in 2012.

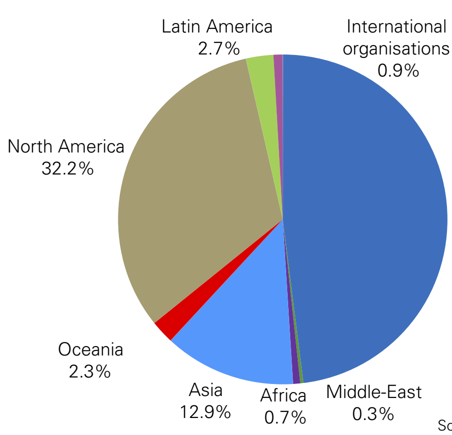


Several additional currencies were approved for the fund in 2012, including the Hungarian forint, Russian rouble and Thai baht. Fixed-income investments were in 30 currencies at the end of the year, up from 26 a year earlier. The bond holdings consisted of 4,047 securities from 1,196 issuers, down from 5,215 securities from 1,404 issuers.

New real estate markets

Property investments were also spread across new markets in 2012. The fund invested for the first time in Swiss real estate and agreed to buy its first properties in Germany. It also agreed to invest for the first time in a shopping centre and a portfolio of logistics properties. The fund's mandate was expanded in December to allow real estate investments outside Europe.

Chart 6-3 The fund's investments sorted by region as of 31 Dec 2012. Percent



Source: NBIM

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 holdings at the end of 2012. Subject to the above reservations, we estimate that the fund was among the top ten shareholders in about 550 companies and among the top 20 in about 840 companies. The highest rankings were in Europe, where the fund held half its equity investments at the end of 2012.

Table 6-1 The fund's ten largest country holdings as of 31 December 2012. Percent of the fund

Country	Total (percent)	Equity (percent)	Fixed income (percent)
US	28.6	17.4	11.2
UK	13.0	9.6	3.4
Germany	7.4	3.9	3.5
France	6.6	4.2	2.4
Japan	6.1	3.3	2.8
Switzerland	4.6	3.8	0.8
Canada	3.0	1.5	1.5
Spain	2.9	1.2	1.7
The Netherlands	2.5	1.2	1.3
Sweden	2.3	1.6	0.7

Table 6-2 The fund's ten largest currency holdings as of 31 December 2012. Percent of the fund

Currency	Total (percent)	Equity (percent)	Fixed income (percent)
USD	32.6	18.7	13.9
EUR	25.5	13.6	11.9
GBP	11.6	9.1	2.5
JPY	6.0	3.3	2.7
CHF	4.3	3.7	0.6
CAD	2.5	1.4	1.1
AUD	2.1	1.6	0.5
SEK	2.0	1.4	0.6
HKD	1.9	1.8	0.1
KRW	1.5	1.0	0.5

Table 6-3 The fund's largest equity holding as of 31 December 2012

Company	Country	Holdings in millions of kroner
Nestlé SA	Switzerland	30,061
Royal Dutch Shell Plc	UK	28,829
HSBC Holdings Plc	UK	27,272
Novartis AG	Switzerland	21,218
Apple Inc	US	20,698
Roche Holding AG	Switzerland	18,192
BlackRock Inc	US	17,766
BP Plc	UK	16,546
Sanofi	France	16,403
Exxon Mobil Corp	US	16,154

Table 6-4 The fund's largest bond holdings as of 31 December 2012

Issuer	Country	Holdings in millions of kroner
United States of America	US	323,983
Japanese government	Japan	103,001
Federal Republic of Germany	Germany	63,926
UK government	UK	59,784
French Republic	France	44,016
Italian Republic	Italy	26,535
Kreditanstalt für Wiederaufbau	Germany	25,884
Government of the Netherlands	The Netherlands	24,624
Mexican government	Mexico	22,569
Canadian government	Canada	22,141

Table 6-5 The fund's largest company holdings by percent as of 31 December 2012

Company	Country	Interest
Smurfit Kappa Group Plc	Ireland	9.5
Great Portland Estates Plc	UK	8.9
BlackRock Inc	US	8.8
CSR Plc	UK	8.7
Telecity Group Plc	UK	8.5
Stora Enso OYJ	Finland	8.1
UPM-Kymmene OYJ	Finland	7.9
CNinsure Inc	Cayman Islands	7.8
Capital & Counties Properties Plc	UK	7.6
China Water Affairs Group Ltd	Hong Kong	7.6

SOUTH KOREA

- Accounted for 1.6 percent of the fund's investments at the end of 2012
- These were in 229 companies and bonds from 16 issuers

ENVIRONMENTAL INVESTMENTS

NBIM had ten equity mandates with a particular focus on environmental investments in 2012. Eight of these were managed externally and worth 13 billion kroner at the end of the year. Two were managed internally and were worth 13 billion kroner. The mandates returned 9 percent in 2012.

Seven of the mandates were for investments in renewable energy and environmental technology. These include companies that produce or distribute renewable energy or develop the equipment needed for its production, as well as companies that develop technology for more efficient energy distribution and consumption.

The largest investment in this area at the end of 2012 was in Johnson Controls. This was followed by Cree, Pall, Enel Green Power and Regal Beloit.

The other three environmental mandates were for investments in water and waste management. This includes companies that develop or operate infrastructure for treating and distributing water, often in emerging markets, as well as companies that develop technology for improving water quality and companies that manage or make use of waste, including for energy production.

The five largest investments in these areas at the end of 2012 were in United Utilities Group, Pentair, Progressive Waste Solutions, Clean Harbors and Veolia Environment.

MEXICO

- Accounted for 0.9 percent of the fund's investments at the end of 2012
- These were in 50 companies and bonds from five issuers

CHINA

- Accounted for 1.2 percent of the fund's investments at the end of 2012
- These were in 303 companies and bonds from four issuers

AN ACTIVE OWNER

NBIM aims to safeguard the fund's long-term value by promoting good corporate governance and sustainable social and environmental standards.



A good long-term return on the fund depends on sustainable economic, environmental and social development. NBIM uses its rights as a shareholder to promote such development and improve standards of corporate governance. We engage in 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 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

Our ownership approach is based on the UN Global Compact and the OECD's Principles of Corporate Governance and Guidelines for Multinational Enterprises.

More coordinated approach

NBIM in 2012 moved to better integrate its ownership policies with the fund's investment processes. Analysts from the ownership policy group were transferred to the equity management department to contribute more directly to investment decisions and better follow up on ownership issues. The move paved the way for the analysts and equity managers to increase information-sharing on NBIM's voting and engagement with companies. This contributed to a clearer communication with the companies.

We engaged with about 300 companies on a range of ownership issues in 2012 through meetings, letters and telephone calls. Some of the contact was part of our long-term ownership work, while other engagements were prompted by company-specific events. For example, we met the chairmen of several European banks to discuss the role of the board and well-functioning markets. We also met members of the board of Xstrata to advocate better terms for the mining company's shareholders in connection with its planned merger with Glencore.

We last year further developed a database of environmental, social and governance information on about 4,000 of the largest companies the fund invests in. The database also contains financial information on the companies, which accounted for 90 percent of the fund's equity investments at the end of 2012. It was expanded to include more company-specific information on issues such as greenhouse gas emissions and risk indicators for human rights, health, safety and environmental performance, also in the supply chains of some companies. The expansion gave the fund's analysts and equity managers a broader base for making investment decisions.

Shareholders, boards and markets

We published a document in 2012 exploring the reasons for our focus on equal treatment of shareholders and the role of the board. The document outlines our expectations for companies and boards in these areas and builds on academic literature and input from selected chairmen, investors and other market participants. We expect a company's board to treat shareholders equally and to justify any deviations from such a practice. Shareholders must also be able to hold a board accountable for its decisions and the consequences of these decisions.

In a separate analysis, we looked at the basis for well-functioning financial markets and their importance in achieving long-term goals in the fund's management. The analysis explores the ways markets function, the vulnerabilities of markets and the transparency of company reporting. It describes how NBIM can promote well-functioning financial markets.

Voting and shareholder proposals

NBIM actively uses its voting rights as a shareholder in more than 7,000 companies to safeguard the fund's long-term interests. We voted at 10,231 annual and extraordinary general shareholder meetings in 2012. Our voting was based on the principles for our ownership activities. We voted for proposals that would further a company's long-term interests and against proposals that would undermine our shareholder rights. This included voting against proposed company mergers that would undermine shareholders' rights by failing to ensure adequate board independence. We also voted against transactions at companies where large shareholders had previously discriminated against other shareholders.

NBIM has in the past years filed shareholder proposals aimed at making boards more accountable to shareholders. We have filed proposals requesting the legal separation of the CEO and chairman roles to strengthen the board's ability to oversee a company's management. We have also filed shareholder proposals at US companies to give shareholders proxy access, or the right to nominate candidates for board elections on company ballots. This right is fundamental to good corporate governance, yet cumbersome and costly to exercise in the US. Our proposals aim to simplify the process and strengthen shareholder rights. We filed proxy access proposals at four US companies in 2012.

NBIM in 2012 collaborated with investors such as Fidelity International, Capital Group International and APG Asset Management to make voting processes more efficient.

Table 7-1 Voting at shareholder meetings

	2012			2011		
Regions	Number of meetings	Meetings where NBIM voted	Share	Number of meetings	Meetings where NBIM voted	Share
Africa	145	82	56.6%	192	126	65.6%
Asia	5,094	5,058	99.3%	6,108	6,050	99.1%
Europe	1,939	1,837	94.7%	2,069	1,854	89.6%
Latin America	404	403	99.8%	408	399	97.8%
Middle East	130	130	100.0%	153	139	90.8%
North America	2,398	2,395	99.9%	2,389	2,385	99.8%
Oceania	327	326	99.7%	347	347	100.0%
Total	**10,437**	**10,231**	**98.0%**	**11,666**	**11,300**	**96.9%**

FOCUSING ON CHILDREN'S RIGHTS, CLIMATE AND WATER

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

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

We published three status reports in the first quarter of 2012 evaluating how companies reported on these risks in 2011. Only 39 of the 1,078 companies assessed received top marks for their reporting and more than a third of the companies scored zero. In general, large businesses were best at reporting on these risks. Companies in the US and Europe were better than those in Asia.

We contacted 60 of the companies in our evaluation to encourage improved reporting in these areas. The selected companies were either leading in their industries or above a certain size in the fund's equity holdings. Our aim was to get the companies to change their behaviour, setting an example for other industry members to follow.

Children's rights

NBIM expects companies to safeguard children's rights in their operations and supply chains. Companies need to show they have adequate systems in place to manage the risk of children's rights violations.

We last year concluded three of four dialogues on child labour with companies operating in India's cotton seed industry. The dialogues were ended in December after the companies reported a decrease in the incidence of child labour since the start of talks in 2007. The companies had also developed systems during this period to manage the risk of child labour and expanded these systems to include other types of seed and geographical areas. We continued our dialogue with the fourth company as its reporting on child labour remained unsatisfactory.

NBIM in 2012 joined a group that advises UNICEF on how companies can apply the Children's Rights and Business Principles introduced in March 2012 by UNICEF, the UN Global Compact and Save the Children.

We expect companies to safeguard children's rights in their operations and supply chains.

Climate change

NBIM expects companies to develop strategies for managing risks related to climate change. We also expect businesses to report on the measures they take to reduce the risk that climate change may hurt their profitability.

We broadened our focus in this area in 2012 to include climate change caused by tropical deforestation, adding to our existing focus on greenhouse gas emissions caused by the burning of fossil fuels. Tropical deforestation contributes to climate change by releasing large quantities of carbon stored in rainforests into the atmosphere. We expect companies that cause deforestation through their production to take steps to reduce the scope of this deforestation or replant the affected areas.

In the first quarter of 2012 we sold our stakes in 23 companies that by our reckoning produced palm oil unsustainably. Before reaching this decision, we reviewed a number of companies contributing to tropical deforestation through their involvement in the palm oil industry in Malaysia and Indonesia. We contacted several of the companies to obtain information on how they managed deforestation and we placed weight on whether the companies had committed to the Roundtable on Sustainable Palm Oil, which provides an international certification scheme for sustainable palm oil production.

NBIM in 2012 became a member of the Carbon Disclosure Project (CDP), which aims to improve corporate reporting on risks related to climate change and water scarcity. NBIM has since 2009 increasingly supported CDP, which was backed by more than 600 institutional investors in 2012.

Water management

Limited access to fresh water is a growing risk for many companies. NBIM hosted a seminar at the Singapore International Water Week in July 2012 on the importance of managing and reporting on water-related risks at companies in Asia and Australia. Growth in the economies and populations of these areas is fuelling demand for water, as changes in weather patterns, pollution and regulation limit supplies. NBIM has since 2011 engaged with companies in Asia and Australia that are particularly exposed to these risks. These dialogues show that companies inadequately manage water-related risks in the supply chains. We expect companies to improve their measurement and disclosure of water consumption and water-related risks and to standardise reporting in this area.

NBIM in 2012 teamed up with Dutch pension fund PGGM to hold talks with mining and power companies in China and India. The talks aimed to improve the companies' reporting on water-related risks.

INVESTMENT RISK

SMALLER FLUCTUATIONS IN THE FUND'S VALUE

Announced measures to stimulate the economy and defend the euro eased uncertainty in capital markets in the second half of 2012.

Volatility in equity and fixed-income markets decreased in 2012 as authorities in several countries announced measures to spur economic growth and the ECB pledged to defend the euro. The Markit iTraxx Europe index, which measures credit insurance premiums for 125 European companies with an investment-grade credit rating, fell 0.5 percentage point in the year to 1.2 percent. The index typically goes down when investor confidence grows and the need for insurance declines.

The VIX index, a measure of expected volatility in the US stock market, fell to 18 percent at the end of the year from a peak of 28 percent on 4 June. The equivalent European VSTOXX index in the same period dropped to 21 percent from 38 percent.

Fluctuations in fund value

The fund's market risk is determined by the composition of its 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, NBIM uses a variety of measures and analyses, including expected tracking error, factor exposures, concentration analysis and liquidity risk.

The fund's expected absolute volatility, calculated using the statistical measure standard deviation, uses a three-year price history to estimate how much the annual return on the fund's equity and fixed-income investments will fluctuate. Expected absolute volatility was 8.6 percent, or about 300 billion kroner, at the end of 2012. That compares with 9.6 percent a year earlier.

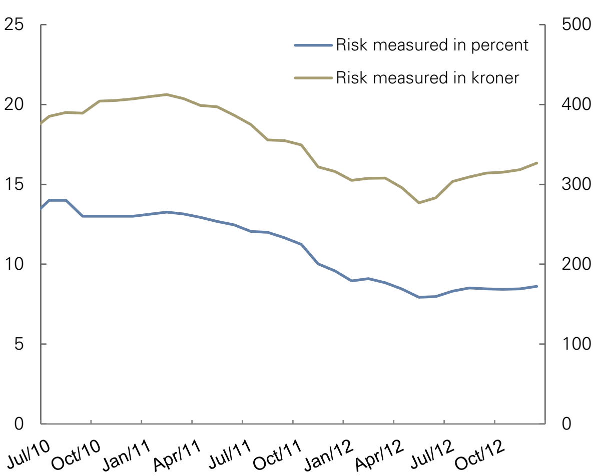
The Ministry of Finance has set limits for how much NBIM may deviate from the fund's benchmark indices in managing the equity and fixed-income investments. Expected relative volatility, or tracking error, is one of these limits and caps how much the return on these investments may be expected to deviate from the return on the benchmark indices. NBIM should aim for an expected relative volatility of no more than 1 percentage point. The actual figure was 0.5 percentage point at the end of 2012, compared with 0.4 percentage point a year earlier and a peak of 0.6 percentage point in May 2012.

Factor exposures

NBIM measures the fund's exposure to systematic risk factors such as small companies, value stocks and credit. These are common characteristics that securities have to

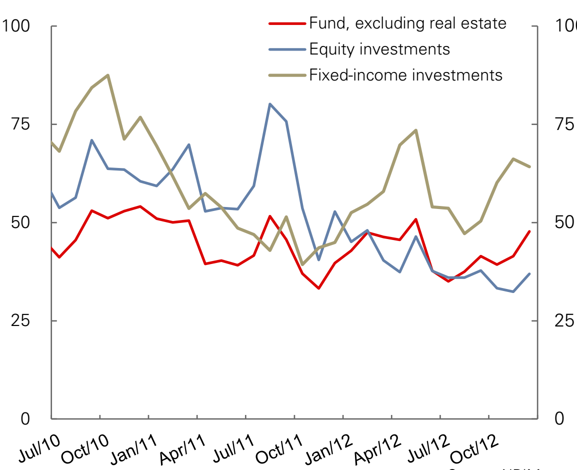
The fund's market risk is determined by the composition of its investments and will be influenced by movements in share prices, exchange rates, interest rates and credit risk premiums.

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



Source: NBIM

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



Source: NBIM

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

		31/12/2012	30/09/2012	30/06/2012	31/03/3012
	Limits set by the Ministry of Finance				
Exposure	Equities 50–70 % of fund's market value	61.1	60.3	59.0	60.7
	Real estate 0–5 % of fund's market value	0.7	0.3	0.3	0.3
Market risk*	1 percentage point expected tracking error for equity and fixed-income investments	0.5	0.4	0.4	0.5
Credit risk*	Maximum 5 % of fixed-income investments may be rated below BBB-	0.7	1.1	0.9	1.1
Maximum ownership	Maximum 10 % of voting shares in a listed company	9.5	9.6	9.7	9.6

* Limit for equity and fixed-income investments.

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

Analyses of factor exposures in 2012 show, 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 first half of the year. The analyses also show that the relative return on the fund's equity investments were decreasingly explained by exposure to value stocks, small companies and emerging markets. About 10 percent of the fluctuations in the relative return on equity investments could be explained by these risk factors at the end of the year, down from about 70 percent a year earlier.

The analyses of the fund's factor exposures also shows that the relative return on the fund's fixed-income investments were minimally explained by movements in credit premiums and forward premiums. About 12 percent of the fluctuations in the relative return on fixed-income investments were explained by this type of analysis at the end of 2012, an increase from about 8 percent a year earlier.

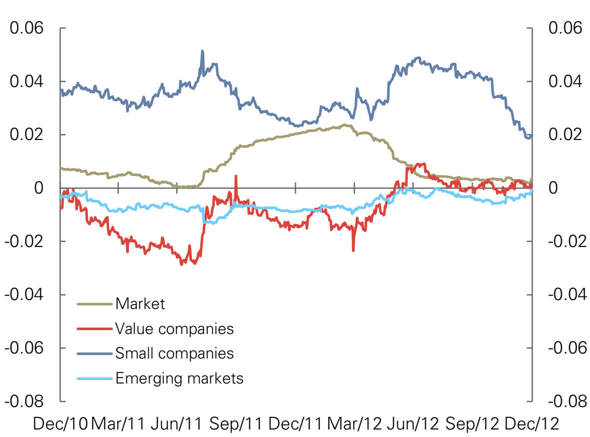
The results of such statistical analyses are uncertain and NBIM also uses several other approaches to analyse the fund's factor exposures.

For more information on the fund's investment risk, see note 15 to the financial reporting.

Table 8-2 The fund's bond investments as of 31 December 2012 based on credit ratings*. Percentage of bond holdings

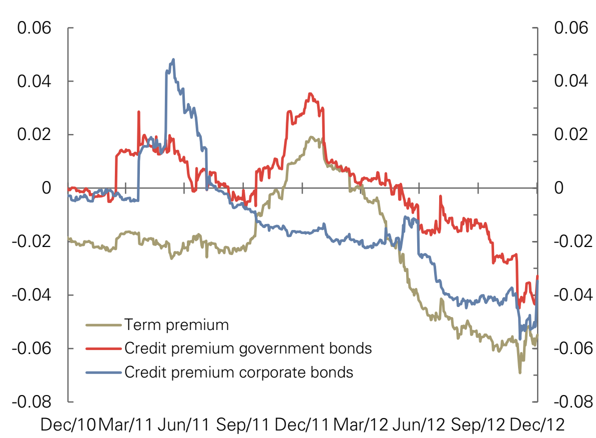
	AAA	AA	A	BBB	Lower rating	Total
Government bonds	36.7	12.9	2.4	6.7	0.0	58.8
Government-related bonds	6.1	3.2	0.7	1.2	0.2	11.5
Inflation-linked bonds	2.0	0.3	0.0	0.5	-	2.9
Corporate bonds	0.0	1.1	6.5	5.7	0.2	13.5
Securitised debt	7.7	1.1	2.9	1.3	0.3	13.4
Total bonds	**52.6**	**18.6**	**12.6**	**15.4**	**0.7**	**100.0**

Chart 8-3 Factor exposures of the fund's equity investments. Coefficients



Source: NBIM

Chart 8-4 Factor exposures of the fund's fixed-income investments. Coefficients

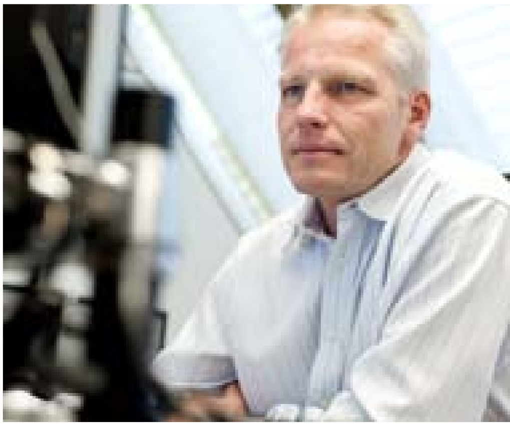


Source: NBIM

OPERATIONAL RISK MANAGEMENT

FEWER UNWANTED EVENTS

The number of unwanted incidents at NBIM dropped 8 percent in 2012.



Norges Bank's Executive Board sets limits for operational risk management and internal controls at NBIM. The board has decided there must be less than 20 percent probability that operational risk factors will result in gains and losses totalling 500 million kroner or more over a 12-month period, a limit known as the board's risk tolerance. NBIM's risk exposure was within this limit in 2012.

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.

Unwanted events in 2012

NBIM registered 199 unwanted events in 2012, down from 217 events in 2011. Most of these had no financial consequences, either because they were discovered early enough or because they only had potential reputational consequences. The estimated total financial impact of these incidents was a loss of 15 million kroner.

The move to a new information-technology infrastructure supplier caused one of the more serious incidents in 2012. Access to NBIM's computer network was unstable for a period because of technical problems related to the move, causing indirect financial losses of about 4 million kroner.

NBIM votes at shareholder meetings using an electronic platform or a custodian bank or other representative following our instructions. One of these representatives voted for the wrong board candidate at a Brazilian company in 2012.

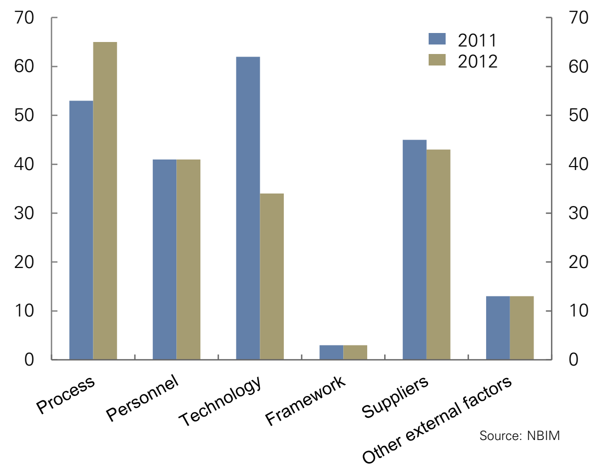
Another unwanted event occurred when an internal transfer of more than 8 million pounds failed to trigger the required electronic approvals. The incident did not lead to any financial loss.

Compliance with guidelines

The Ministry of Finance has set guidelines for the fund's management. No significant breaches of these guidelines were registered in 2012. NBIM in the period did not receive any notifications from supervisory authorities of any significant breaches of market rules or general legislation.

We work systematically to identify unwanted events and improve processes to prevent such incidents.

Chart 9-1 Unwanted events at NBIM sorted by cause. Percent



Source: NBIM

NBIM

336

336 EMPLOYEES FROM 27 NATIONS


27



NBIM

DEVELOPING THE ORGANISATION

NBIM seeks constantly to build expertise to safeguard the assets of a fast-growing fund.



We hired additional portfolio managers and analysts in 2012 to strengthen our investment capabilities and support the strategy of spreading investments across more markets.

NBIM's number of permanent employees increased by 21 to 336 people during the year. Most of the new recruits were portfolio managers or analysts in equity, fixed-income or real estate management. About a third of the recruits joined our offices in London, New York, Singapore and Shanghai, while the rest were employed at the main office in Oslo. Proximity to international markets improves our access to investment opportunities and ensures that we can follow up the fund's investments around the clock.

NBIM's working environment is result-oriented and fast-paced. Our employees must have a global perspective to manage a fund that is invested worldwide. Our workforce consisted of people from 27 nations at the end of 2012. English is our working language.

Competency at every level

Competency development takes place at every level of the organisation. We strengthened analytical capacity in fixed-income management in 2012. We also introduced a series of courses through the NBIM Academy aimed at increasing employees' understanding of the fund's investment areas. Our four-year trainee programme, the Investment Talent Programme (ITP), helps develop the organisation's capabilities.

We last year awarded the first doctoral scholarship and the first prize for a Master's thesis through the Norwegian Finance Initiative (NFI). The initiative supports financial research and education in areas of importance to the fund's long-term management.

Lower costs

NBIM aims to maximise the fund's long-term return after costs. We seek to maintain a high level of cost awareness in the organisation and realise economies of scale. We also attach importance to upholding high standards of quality in the fund's management and ensuring 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 2.2 billion kroner in 2012 from 2.5 billion kroner in 2011, mainly because of lower fees to external managers. Settlement, custody and information-technology costs also decreased as we renegotiated contracts and

The working environment is result-oriented and fast-paced. Our employees must have a global perspective to manage a fund that is invested worldwide.

Kari has been with NBIM since 2006. Based in Singapore, Kari trades stocks and bonds on the Asian exchanges.

"I value the international environment NBIM offers and the challenges I face as a trader. A trader needs to be good at making decisions, organised and capable of multitasking. More women should choose this career path!"

Kjetil is an analyst in the project management department. He joined NBIM in 2001.

"NBIM offers a wide range of opportunities. I started as an IT consultant in 2001, but with experience and training I've developed a broad knowledge of asset management. Helping improve the way we manage the fund's assets for future generations is particularly rewarding."

Maren is an analyst in the allocation group in Oslo.
She joined NBIM in 2012.

"NBIM gives me the opportunity to work in an international investment environment, and in particular with emerging markets, which is exciting and rewarding. I get to work with knowledgeable colleagues with different backgrounds and experience who I learn a great deal from."

realised economies of scale. By contrast, the salary and staff costs rose as the workforce grew. Management costs fell to 6.1 basis points of assets under management in 2012 from 8.1 basis points in 2011. Excluding performance-based fees, costs decreased to 5.3 basis points from 6.4 basis points.

NBIM's remuneration system

Norges Bank's Executive Board sets the rules for NBIM's salary system. All employees receive a fixed salary, while those working directly with investment decisions are also entitled to performance-based pay.

Performance-based pay is calculated on the basis of the performance of the fund, group and individual measured against set targets. Accrued performance-based pay is paid over several years, with half paid the year after it is accrued. The other half is held back and paid over the following three years. The amount held back is adjusted for the return on the fund.

NBIM's investment departments had 139 employees with performance-based pay in 2012. Their fixed salaries totalled 128 million kroner, while the upper limit for performance-based pay was 163 million kroner. On average, employees eligible for performance-based pay accrued 53 percent of the limit for 2012 based on a multi-year performance. For 2012 in isolation, the average amount accrued was 64 percent of the upper limit. Half of the amount accrued on the basis of multi-year performance will be paid in 2013. The remainder will be held back for payment over the following three years.

Members of NBIM's senior management group only receive 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 5.93 million kroner in 2012. Other than senior management and employees in receipt of performance-based pay, NBIM had 190 permanent employees working in risk management, control, operations and support at the end of 2012. Their fixed salaries totalled 155 million kroner.

Chart 10-1 Number of employees by area as of 31 Dec 2012

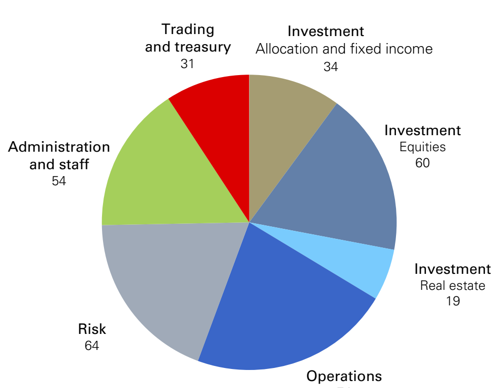


Chart 10-2 Number of employees by location as of 31 Dec 2012

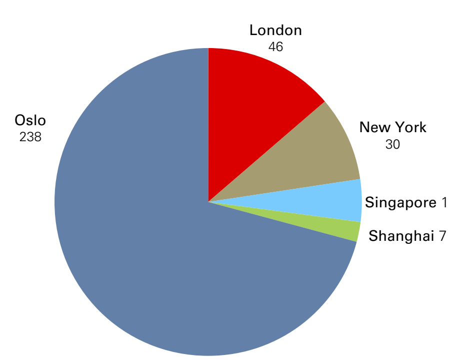


Chart 10-3 Management costs as a share of assets under management, 1998–2012. Basis points

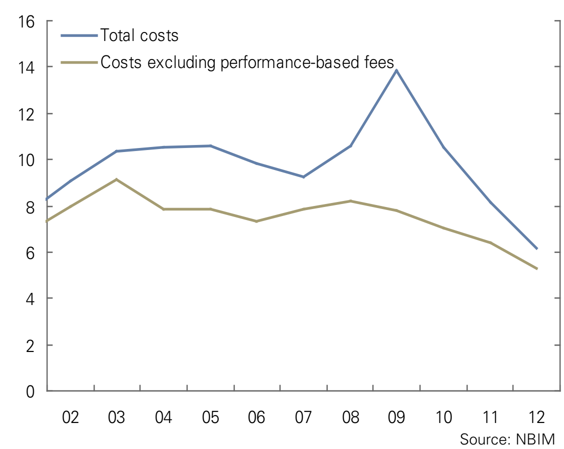


Chart 10-4 Development of individual cost components, 1998–2012. Costs (millions of kroner, left-hand axis) and market value (billions of kroner, right-hand axis)

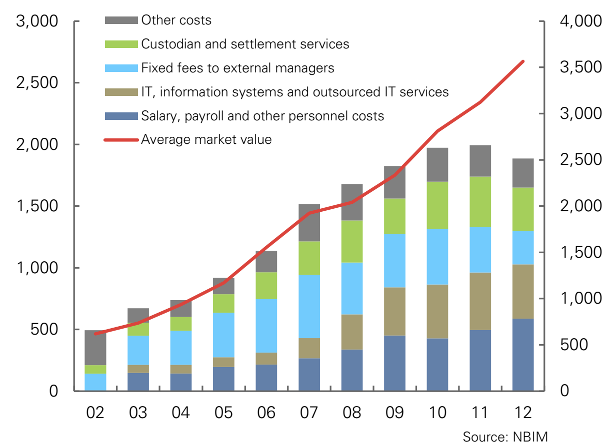


Chart 10-5 Performance-based pay relative to upper limit in 2012. Percentage of workforce

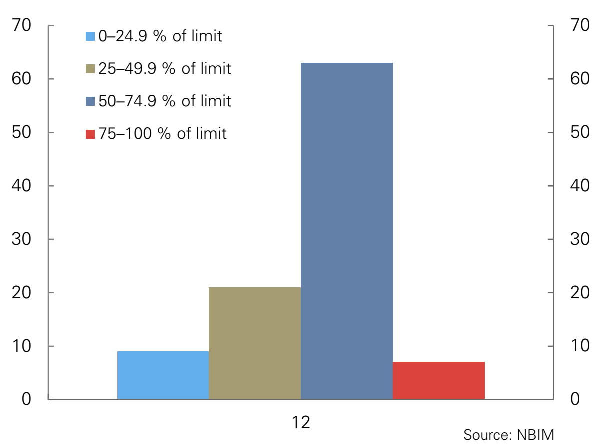


Table 10-1 Compensation to senior management at NBIM in 2012

Position	Name	Paid salary	Value of other benefits	Pension benefit earned	Emloyee loan
Chief Executive Officer	Yngve Slyngstad	5,930,377	46,933	542,241	704,662
Deputy CEO og Chief of Staff	Trond Grande	3,791,524	19,549	426,830	-
Chief Investment Officer, Equities	Petter Johnsen	4,903,500	60,400	490,350	-
Chief Investment Officer, Real Estate	Karsten Kallevig	3,800,367	31,235	424,906	-
Chief Treasurer	Jessica Irschick	4,903,500	208,987	490,350	-
Chief Risk Officer	Jan Thomsen	3,433,215	12,532	407,460	-
Chief Operating Officer	Age Bakker	3,059,321	16,097	457,104	-

A GLOBAL INVESTOR

The fund's geographical allocation was revised in 2012. The new geographical allocation is based on market weights for equities and corporate bonds, and GDP weights for government debt. Nine new currencies have also been added to the bond portfolio.

The revised allocation translates into a broader, more diversified portfolio with relatively more invested in emerging markets and less in Europe than under the previous fixed regional weights. This means that the fund will better reflect global value creation, which will help safeguard its long-term international purchasing power, one of the key objectives in the management of the fund.

New geographical allocation of equity investments
The objective of the greatest possible long-term international purchasing power is best served by broad ownership of global production of goods and services. Investments in equities confer ownership of a stake in the issuing companies' future value creation.

The Ministry of Finance introduced a new geographical allocation for the fund's investments in 2012. Investments in equities were revised – from fixed regional weights – to market weights and factors for the main regions. Market weighting means that the regional allocation is no longer fixed but varies with the size of the various equity markets. The change entails a reduction in investments in European equity markets of about 10 percentage points from 50 percent to 40 percent, while equity investments in the developed markets of North America and Asia and in emerging markets will increase.

Investments in emerging equity markets have delivered substantially higher returns over the past two decades than equivalent investments in developed markets, especially since 1999. The picture is more mixed in the decades before 1990.[1] Data spanning the period from the 1970s through to today reveal a lower return on investments in emerging equity markets than in developed markets, due to poor returns in emerging equity markets in the 1980s. One possible explanation for the high return over the past two decades is that economic growth has been particularly strong. NBIM has looked more closely at the relationship between economic growth and stock market returns in emerging markets.[2] There appears to be something of a positive relationship between growth and returns in some countries, while in others it is more the reverse. Our analysis shows, for example, that stock returns in a number of Latin American countries, such as Brazil and Peru, have outstripped economic growth. The opposite is true for listed companies in some Asian countries, such as China and Malaysia, where returns have lagged economic growth by some margin.

Our analysis does not provide support for a clear-cut relationship between economic growth and returns on listed stocks in individual countries. This may be because globalisation is making companies more dependent on developments in the global economy, rather than just in the countries where they are listed. Another possible explanation is that much of the economic growth in a country is generated by unlisted companies.

GDP weights for government bonds
The composition of bond investments was also revised in 2012. The Ministry of Finance's benchmark index is now divided into 70 percent government debt and 30 percent corporate debt.

Previously the entire bond portfolio was allocated on the basis of fixed regional weights and market weights within each region. This meant that the more debt a country issued, the greater the weight its bonds would have.
The role of bond investments is primarily to reduce short-term fluctuations in the fund's value. It is mainly government bonds issued by countries with a good debt-servicing capacity that have this property.

A country's total output – gross domestic product (GDP) – is the basis for its ability to repay its debt in the longer term. Investments in government debt are now allocated between countries on the basis of GDP weights.[3] Investments in corporate debt are market-weighted.

Previously 60 percent of the bond portfolio was invested in Europe. The revised weighting regime will lower the fund's holdings of bonds issued by European nations to around 40 percent. The fund will invest less in bonds from countries with a high ratio of debt to GDP.

New currencies in the bond portfolio

The objective for the management of the fund is to achieve the highest possible international purchasing power within moderate risk. One important way of reducing risk is to diversify investments. Bond investments were previously concentrated in a small number of currencies: securities issued in dollars, euros, pounds and yen accounted for 94 percent of bond holdings at the beginning of 2012.

In 2012 NBIM approved another nine currencies from emerging markets for fixed-income investments. Emerging markets currencies now have a combined weight of 10 percent of the fund's government bonds and include the Taiwanese dollar, the Russian rouble and the Hungarian forint.

Taken together, the changes entail a substantial shift in the geographical composition of the bond portfolio.

Lower risk in the long run

About 10 percent of the fund is now invested in emerging markets. Some risk factors appear to be more pronounced in these markets than in developed markets. Factors such as a stable governance structure, the regulation of financial markets, the legal system and the quality of legislation, the extent of corruption and the danger of expropriation are important and need to be addressed. In some cases, foreign investors and the interests of minority shareholders enjoy less protection.

Foreign investors in some markets are subject to special rules and restrictions, and some countries do not fully allow the free movement of capital in their currency. In this light, investments in emerging markets may appear riskier in the short run. Studies have also shown that markets tend to fall together. This limits the opportunity to reduce risk through diversification. All of these factors apply particularly in the short term.

The fund's long-term investment perspective means that, rather than focusing on short-term fluctuations in the portfolio, we should attach more importance to the risk of unique events in a particular country or region. The best way of reducing this type of long-term risk is to hold a global portfolio that is as diversified as possible. Spreading the investments broadly also makes it more likely that the fund will benefit from unexpectedly strong growth and returns wherever they crop up.

The geographical allocation of the fund's investments must contribute to the best possible spread of risk. The fund's perspective dictates that the emphasis should be on long-term risk. The new geographical allocation will reduce the representation of European securities and increase the representation of emerging markets, so contributing to a broader and more diversified portfolio in the long run.

[1] NBIM Discussion Note 6-2012: "Risks and Rewards in Emerging Equity Markets".
[2] NBIM Discussion Note 5-2012: "Economic Growth and Equity Returns".
[3] The GDP weights are set by the index supplier on the basis of figures from the IMF and adjusted for investability. This adjustment serves to reduce the weight assigned to emerging markets.

LONG-TERM ADJUSTMENTS TO THE FUND

NBIM has developed operational reference portfolios for the management of the fund. These portfolios are used to tailor leading market indices more closely to the fund's objective and characteristics, and they serve as a tool for managing and communicating the long-term adjustments NBIM makes in the management of the fund's equity and bond investments. NBIM made a number of changes to the operational reference portfolios in 2012.

Customised reference portfolios

The Ministry of Finance sets the strategic benchmark index on the basis of leading market indices. These indices represent the investment universe for the typical investor and are not tailored to the differing goals and characteristics of individual investors. The Government Pension Fund Global is very large, invests for the long term and has no short-term payment obligations. This means that, in some cases, it will have different investment opportunities from the typical investor.

NBIM has therefore constructed operational reference portfolios that deviate somewhat from the benchmark indices. These provide a basis for the investments more closely tailored to the fund's objective and characteristics.

Some of the adjustments address methodological shortcomings in the benchmark indices. The composition of the operational reference portfolios may also be customised to address structural changes in markets, reflect adjustments to the fund's investment universe or harvest various systematic risk premiums.

The adjustments we make in the operational reference portfolios reflect our long-term investment perspective, and the portfolios may at times deviate considerably from the benchmark index. This may result in differences in return between the index and the fund. The long-term aim of these adjustments is a better trade-off between expected return and risk.

Selection and weighting of securities

NBIM approves all new instruments and markets before the fund may invest in them. As part of this process, NBIM evaluates the operational risk associated with the instrument or market, including whether there are satisfactory settlement mechanisms and legal protection for investors. NBIM also considers market risk and suitability in the light of the fund's characteristics. These assessments are used to decide which markets, instruments and securities are included in the operational reference portfolios.

The suppliers of the most widely used indices aim as far as possible to include the investable universe in that asset class for the typical investor. Securities are generally weighted by free-float market capitalisation, which means that a company's weight in an index excludes shares that are not freely available for trading. This approach can have a significant impact on both the geographical and sector composition of an index. Our operational reference portfolios also employ alternative principles for weighting securities.

NBIM is required to take account of differences in countries' fiscal strength when investing in government bonds. This is achieved by basing the weight of government debt in the operational reference portfolio partly on indicators of fiscal strength that we have developed. This adjustment results in lower expected risk and return in this part of the portfolio.

The operational reference portfolios for both bonds and equities include a number of markets that fall outside the benchmark index. This results in better representation of global output and improves the diversification of risk.

We have chosen to remove some palm oil producers from the operational reference portfolio for equities, as these companies' business model is not considered sustainable in the longer term.

Inflation-linked bonds have different portfolio characteristics to nominal bonds and are not included in the operational reference portfolio for bonds.[1] Bonds issued by international organisations have also been removed to further streamline and simplify the bond portfolio.

Systematic risk factors

NBIM may also use alternative principles for weighting and portfolio construction to obtain exposure to various systematic risk factors.

The fund's characteristics mean that we may take a different view of long-term investment opportunities from the typical investor. We also consider whether, and to what extent, the portfolios' exposure to different risk factors should change over time. The desired exposure to systematic risk factors can be achieved in various ways, and expected return and risk characteristics may vary significantly depending on the method chosen.[2] Adjusting the operational reference portfolios to harvest systematic risk premiums is an integral part of NBIM's management mission.

NBIM has so far introduced exposure to two such risk factors in the operational reference portfolio for equities: the value effect and the small-firm effect. A value stock can be defined in different ways, but one common definition is a company with a high book value relative to its market value. A growth stock typically has a low book value relative to its market value.[3] The long-term average excess return of a portfolio of value stocks over a portfolio of growth stocks is known as the value effect. The small-firm effect is defined as the return on a portfolio overweight in the small companies and underweight in large companies.[4]

Major changes in the reference portfolios are made gradually to minimise market impact and transaction costs. This may contrast substantially with how standardised benchmark indices are adjusted.

Procedure for adjustments

The adjustments we make in the operational reference portfolios mean that these portfolios deviate from the benchmark index set by the Ministry of Finance. This is done within the risk limits in the management mandate. Deviations may be of a size, nature or duration that would not normally fall under the definition of active management. They may also lead to relatively large return differentials between the benchmark index and the operational reference portfolios in the short term.

All proposals for adjustments in the operational reference portfolios are put before a committee at NBIM which assesses the proposed changes in the light of operational risk, market risk and other considerations, such as how they might affect the trade-off between expected return and risk over time. The operational reference portfolios are maintained in internal systems, and we can calculate deviations from the benchmark index on a daily basis, right down to the level of the individual security. The operational reference portfolios also provide a starting point for different mandates in the management of the fund, and serve as a tool for managing and communicating the long-term adjustments NBIM makes in the management of the fund.

[1] NBIM Discussion Note 9-2012: «The Structure of Inflation-Linked Bond Markets», and NBIM Discussion Note 10-2012: «Risks and Rewards of Inflation-Linked Bonds».
[2] NBIM Discussion Note 8-2012: «Capturing Systematic Risk Premia».
[3] NBIM Discussion Note 16-2012: «The Value Effect».
[4] NBIM Discussion Note 12-2012: «A Survey of the Small-firm Effect».

A PUBLIC REBALANCING RULE

The Government Pension Fund Global has a long-term owner and no short-term liquidity needs and is not subject to rules that require reductions in risk in periods of particular uncertainty. The fund is therefore well-placed to increase risk when others must decrease it.

The fund's equity investments aim to capture long-term equity premiums. Rebalancing to a fixed equity allocation is a good approximation of a strategy that seeks to exploit time variation in the equity premium. This strategy means that risk in the fund increases when uncertainty about the outlook is high. A public rebalancing rule has now been introduced, ensuring that this strategy is implemented.

Rebalanced twice since 2002

The mandate for the management of the Government Pension Fund Global specifies fixed strategic weights for equities, bonds and real estate and a benchmark index for the fund. The prices of equities, bonds and real estate move asymmetrically, causing the benchmark index to drift away from the strategic weights over time. Rebalancing brings the benchmark index back to the target allocation and has been performed twice since 2002.[1]

At the beginning of 2003, it was decided to return the benchmark index to the strategic weights after falling stock prices and higher bond prices had taken the index too far away from the target allocation.

At the beginning of 2009, the equity allocation in the benchmark index had again strayed too far from the target allocation and so it was decided to rebalance. This was done during a period of falling share prices, which meant that the risk in the fund increased at a time of considerable economic uncertainty.

Why rebalance?

Much of the variation in stock prices over time seems to be explained by the risk premium in the equity market varying with the business cycle.[2] The equity premium is high in periods of great economic uncertainty, and low in periods of limited uncertainty. A strategy that mechanically buys shares after prices have fallen, and sells following an upsurge in prices, aims to exploit these variations in the equity premium.

However, this strategy means that the risk in the portfolio rises when uncertainty about the economic outlook is high. To pursue such a strategy, an investor must be particularly well-placed to bear this type of risk. With a long-term investment horizon and no short-term liquidity needs, the fund is just that. Rebalancing to a fixed equity allocation is an appropriate proxy of such a strategy.

A clear rebalancing rule

The Ministry of Finance set a rule in place in October 2012 for when and how the benchmark index is to be

To pursue such a strategy, an investor must be particularly well-placed to bear this type of risk. With a long-term investment horizon and no short-term liquidity needs, the fund is just that.

rebalanced. The rule is straightforward and part of the public regulatory framework. It governs decisions that must often be made in periods of great uncertainty. A clear and public rule ensures that the rebalancing strategy is implemented regardless of market conditions.

The rule specifies a limit for how far the equity allocation in the benchmark index may deviate from the strategic allocation before rebalancing must be performed. The limit is set at 4 percentage points, which means that if the equity allocation in the benchmark index is less than 56 percent or more than 64 percent at the end of a calendar month, it will be returned to 60 percent at the end of the following month.

The rebalancing rule specifies how the benchmark index is to be returned to the fixed allocation following changes in market conditions. The rule is a guideline for the proportions of equities, bonds and real estate in the fund, but does not dictate the allocation. Based on the current size of the fund, a change of 4 percentage points in the benchmark index's equity allocation would require the purchase or sale of shares for 160 billion kroner if the fund closely mirrored the benchmark index. Transactions of this magnitude could themselves have a significant market impact. NBIM aims, within the management mandate, to construct a portfolio that exploits time variation in risk premiums on the basis of the strategic allocations set by the Ministry of Finance in a cost-effective manner.

[1] From 2002 onwards, the size of inflows into the fund was used to calculate new weights in the benchmark index in order to bring them towards the fixed weights. Large inflows meant that the benchmark index lay close to the strategic allocation during the period, and the need to bring the benchmark index back in line was limited. The rules on such gradual adjustment of the benchmark index were revoked with effect from 8 October 2012.

[2] NBIM Discussion Note 1-2012: "Time-varying expected returns and investor heterogeneity: foundations for rebalancing".

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 27 February 2013 and adopted by Norges Bank's Supervisory Council on 7 March 2013. This financial reporting and an excerpt from Norges Bank's accounting policies and significant estimates and critical judgements are presented in the following pages.

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INCOME STATEMENT

Amounts in NOK million	Note	2012	2011
Profit/loss on the portfolio excluding foreign exchange gains and losses			
Interest income from bank deposits		102	162
Interest income, lending associated with reverse repurchase agreements		219	1 004
Net income/expenses and gains/losses from:			
- Equities and units		349 779	- 172 507
- Bonds and other fixed-income instruments		98 337	92 346
- Financial derivatives		- 269	- 5 693
- Financial assets real estate	11	514	86
- Investment properties	11	67	- 130
Share of the profit/loss in jointly controlled entities real estate	11	- 250	- 31
Interest expense, borrowing associated with repurchase agreements		- 130	- 629
Other interest income and interest expense		1	- 286
Tax expense	4	- 864	- 516
Other expenses	5, 6	- 80	- 52
Profit/loss on the portfolio before foreign exchange gains and losses	3	**447 426**	**- 86 246**
Foreign exchange gains and losses		- 219 559	49 205
Profit/loss on the portfolio		**227 867**	**- 37 041**
Management fee	5	- 2 193	- 2 539
Profit/loss for the period		**225 674**	**- 39 580**

STATEMENT OF COMPREHENSIVE INCOME

Amounts in NOK million	Note	2012	2011
Profit/loss for the period		225 674	- 39 580
Translation reserve arising from consolidation of foreign subsidiaries		- 5	- 3
Total comprehensive income		**225 669**	**- 39 583**

BALANCE SHEET

Amounts in NOK million	Note	31.12.2012	31.12.2011	31.12.2010
ASSETS				
Financial assets				
Deposits in banks		5 864	7 276	6 303
Lending associated with reverse repurchase agreements	7	61 440	79 820	255 501
Unsettled trades		1 677	2 272	4 864
Equities and units	8	2 212 951	1 806 798	1 733 378
Equities lent	8, 9	115 041	137 130	162 483
Bonds and other fixed-income instruments	8	1 447 182	1 324 255	1 038 793
Bonds lent	8, 9	5 325	3 256	215 090
Financial derivatives	10	1 447	2 227	3 068
Financial assets real estate	11	4 841	4 415	-
Jointly controlled entities real estate	11	7 431	2 546	-
Other financial assets	12	4 411	3 244	1 358
Total financial assets		3 867 610	3 373 239	3 420 838
Non-financial assets				
Investment properties	11	9 777	4 062	-
Other non-financial assets		5	6	-
Total non-financial assets		9 782	4 068	-
TOTAL ASSETS	13, 14, 15	3 877 392	3 377 307	3 420 838
LIABILITIES AND OWNER'S CAPITAL				
Financial liabilities				
Short-term borrowing		202	11	2 939
Borrowing associated with repurchase agreements	7	19 013	19 280	132 992
Cash collateral received	9, 10	33 001	36 926	172 309
Unsettled trades		4 442	3 310	20 358
Short-sale bonds	8	-	-	809
Financial derivatives	10	2 600	5 957	9 372
Other financial liabilities	12	2 365	251	4 639
Management fee payable		2 193	2 539	2 959
Total financial liabilities	13, 14, 15	63 816	68 274	346 377
Owner's capital		3 813 576	3 309 033	3 074 461
TOTAL LIABILITIES AND OWNER'S CAPITAL		3 877 392	3 377 307	3 420 838

STATEMENT OF CASH FLOWS

Amounts in NOK million	2012	2011
Operating activities		
Interest received on deposits in banks	99	179
Net cash flow in connection with reverse repurchase agreements	17 111	170 095
Net cash flows arising from purchase and sale of equities and units	-229 436	-239 987
Net cash flows arising from purchase and sale of bonds and other fixed-income instruments	-166 501	-21 094
Payments made to acquire financial assets real estate	-205	-4 270
Payments made to acquire investment properties	-6 102	-4 301
Payments made to acquire jointly controlled entities real estate	-5 404	-2 620
Net cash flows arising from financial derivatives	-3 090	-9 147
Dividends received from investments in equities and units	64 403	49 208
Interest received on bonds and other fixed-income instruments	49 062	48 036
Income received in connection with equity and bond lending	2 424	2 230
Income received from investments in financial assets real estate	177	130
Dividends received from investments in jointly controlled entites real estate	84	-
Income received from investments in investment properties	244	60
Interest paid on short-term borrowing from banks	-4	-21
Net cash flows related to repurchase agreements	2 878	-114 347
Cash collateral received/paid related to securities lending, derivatives and reverse repurchase agreements	-3 926	-135 382
Net cash flow related to other financial assets, other financial liabilities and other non-financial assets	1 161	-5 587
Payment of other expenses	-163	-248
Management fee paid to Norges Bank*	-2 539	-2 959
Net cash outflow from operating activities	**-279 727**	**-270 025**
Financing activities		
Inflow from the Norwegian government**	277 862	274 155
Net cash inflow from financing activities	**277 862**	**274 155**
Net change in cash and cash equivalents		
Cash and cash equivalents at 1 January	7 265	3 363
Net cash payments in the period	-1 865	4 130
Net foreign exchange gains and losses on cash and cash equivalents	262	-228
Cash and cash equivalents at 31 December	**5 662**	**7 265**
Cash and cash equivalents comprise:		
Bank deposits	5 864	7 276
Short-term borrowing	-202	-11
Total cash and cash equivalents at 31 December	**5 662**	**7 265**

* Management fee shown in the cash flow statement for a period is the settlement of the fee that was accrued and expensed in the previous year.

** The inflow includes only the transfers that have been settled during the period. Inflows in the statement of changes in owner's capital are based on accrued inflows.

STATEMENT OF CHANGES IN OWNER'S CAPITAL

Amounts in NOK million	Inflows from owner	Retained earnings	Translation reserve foreign subsidiaries	Deposits in krone account*
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
31 December 2011	**2 778 866**	**530 170**	**- 3**	**3 309 033**
1 January 2012	2 778 866	530 170	- 3	3 309 033
Total comprehensive income	.	225 674	- 5	225 669
Inflows during the period*	278 874		.	278 874
31 December 2012	**3 057 741**	**755 844**	**- 9**	**3 813 576**

* Of the total inflows to the krone account of the Government Pension Fund Global in 2012, NOK 2.5 billion was used to pay the 2011 accrued management fee to Norges Bank and NOK 276.4 billion was transferred into the investment portfolio. Comparative amounts for 2011 are NOK 3.0 billion and NOK 271.2 billion, respectively.

The Government Pension Fund Global forms part of the central government accounts. The fund's assets are placed for asset management as a deposit with Norges Bank. In the central government accounts the following explanation of differences that arise between these accounts and the financial reporting of the investment portfolio as part of the financial statements of Norges Bank is included:

Due to different accounting frameworks, owner's capital for the Government Pension Fund Global (GPFG) according to Norges Bank's financial statements will deviate slightly each year from the equity capital of the GPFG as stated in the central government accounts. This is because the transfers to the GPFG through the year are based on estimates of income to the GPFG. 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 GPFG and the Treasury. In cases of excessive transfers to the GPFG, the Treasury has a receivable from the GPFG, and, correspondingly, the equity capital for the GPFG as stated in the central government accounts is lower than as reported in Norges Bank's financial statements. On the other hand, in cases of insuffcient transfers to the GPFG compared to recognised income, the GPFG has a receivable from the Treasury, and, correspondingly, equity capital for the GPFG as stated in the central government accounts is higher than reported in Norges Bank's financial statements. See Chapter 3 of the central government accounts for further information.

NOTES TO THE FINANCIAL REPORTING

NOTE 1 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's 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 for the investment portfolio of the Government Pension Fund Global, which shall also be prepared in accordance with IFRS. On this basis, the annual financial statements of Norges Bank, including the investment portfolio of the Government Pension Fund Global, have been prepared in accordance with IFRS. Consolidated financial statements are prepared for the investment portfolio of the Government Pension Fund Global.

Norges Bank prepares annual financial statements with a closing date of 31 December that include 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 for 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 2012 were approved by the Executive Board on 27 February 2013 and adopted by the Supervisory Council on 7 March 2013.

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 Government Pension Fund Act, 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 relating to the Government Pension Fund and the 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 equity 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. Accounting policies

3.1 Income statement, statement of comprehensive income and balance sheet

The income statement, statement of comprehensive income and the balance sheet have been prepared in accordance with IAS 1 Presentation of Financial Statements. The liquidity presentation format is used for the statements.

3.2 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 classified as an operating activity. Cash and cash equivalents comprise *Deposits in banks* and *Short-term borrowing*.

Cash transfers to the Government Pension Fund Global's krone account, in the form of an inflow 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.

3.3 Statements of changes in equity and in owner's capital

Norges Bank presents statements of changes in equity and of changes in owner's capital (Government Pension Fund Global). The statements have 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 inflows from the Norwegian government and retained earnings in the form of total comprehensive income.

3.4 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 using the exchange 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 on the basis of 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 that 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.

3.5 Income and expenses

Interest income from deposits in banks, money market investments, reverse repurchase agreements and 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. The 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 recognition of income and expenses using the equity method, see 3.12 Jointly controlled entities and jointly controlled assets.

Interest expense is calculated and recognised as incurred in profit or loss and presented as either *Interest expense repurchase agreements* or *Other interest income and interest expense*.

Transaction costs are defined as all costs directly attributable to the completed transaction. For investments in equity 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 where part of the commission paid to the broker is allocated further to the party that has contributed with research). For investments within the real estate asset class, direct transaction costs will 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 part 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. The operating expenses are reimbursed by the Ministry of Finance within an agreed limit. The management fee accrues during the financial year, but is cash-settled in the year following.

3.6 Tax

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

Accrued withholding tax, after deductions for refundable withholding tax, capital gains tax and corporate tax are considered income taxes and are classified as *Tax expense* in the income statement.

3.7 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)
- Financial assets classified as loans and receivables

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)
- Other financial liabilities

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

<u>Financial assets or liabilities held for trading</u>
All positions in financial derivatives as well as short-sale bonds are classified in the category financial assets or financial liabilities held for trading. Other assets and liabilities are classified as held for trading if they are acquired or incurred principally for the purpose of selling or repurchasing it in the near term, or at the point of initial recognition it is part of a portfolio that is managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. None of the investments in equities or bonds are as at the balance sheet reporting date classified as held for trading.

<u>Financial assets and liabilities designated as at fair value through profit or loss (fair value option)</u>
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 whose performance is evaluated on a fair value basis in accordance with a documented risk management or 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 date classified in this category. Positive holdings of equities and other equity instruments and positive holdings of bonds and other fixed-income instruments are presented on separate lines in the balance sheet. Net short positions in similar instruments are presented as *Short-sale bonds*. Bond debt in jointly controlled entities is presented as *Jointly controlled entities real estate*.

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.

<u>Loans and receivables and other financial liabilities, measured at amortised cost</u>
Financial assets and liabilities that are not held for trading and are not designated as at fair value through profit or loss, and that are not quoted 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/loans 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 on the same line as the respective financial asset or liability.

3.8 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, where the purchase or sale of the instrument involves settlement 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, 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 from Norges Bank's balance sheet. During the lending period the securities are accounted for in the same way as other securities holdings. Lent 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 in 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 on separate lines in the income statement, *Interest income, lending associated with reverse repurchase agreements* and *Interest expense repurchase agreements*.

3.9 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 on the basis of 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 3.5 above.

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 initial 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 14 Fair value measurement.

Changes in fair value are recognised in the income statement line related to the relevant investment 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*.

<u>Subsequent measurement – amortised cost</u>
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 profit or loss. The effective interest rate is determined as the rate that discounts contractual cash flows through the expected life of the instrument to the recognised amount. The cash flows include directly attributable transaction costs.

3.10 Netting

Financial assets and financial liabilities are presented net in the balance sheet only if Norges Bank has a legal right to offset, and the intention and practice of settling on a net basis.

Financial assets and liabilities are not netted, because these criteria are not met. This implies that financial derivatives with positive market values are presented as assets and financial derivatives with negative market values are presented as liabilities.

3.11 Investment property

Properties held for the purpose of earning rental income and for capital appreciation within the real estate asset class are accounted for as investment property in the investment portfolio's, or the jointly controlled entity's if applicable, 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 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.

At initial recognition investment property is measured 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 be incurred on sale or other disposal. External appraisals and valuations are regularly obtained as the primary basis for the determination of fair value. See Note 14 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 income statement as *Net income/expenses and gains/losses from investment properties*. For property owned by jointly controlled entities, see the description of presentation below.

3.12 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 the 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 *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. The same applies to bond debt and financial derivatives.

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, including fair value changes, 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, Norges Bank accounts for the investment portfolio's 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 property management are presented as *Net income/expenses and gains/losses from investment properties*.

3.13 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 thus 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 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 real estate 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 administrative expenses, presented as *Other expenses*.

3.14 Internal trades between portfolios

Internal trades in the form of money market deposits/loans and repurchase agreements between the investment portfolio of the Government Pension Fund Global and Norges Bank's long-term reserves are presented as a net receivable/payable between the two reporting entities on the balance sheet line *Other financial assets* (for the party with the net receivable) and *Other financial liabilities* (for the party with the net payable). Corresponding income statement items are presented gross in the respective income statement as either interest income or interest expense. Such internal trades are made under the arm's length principle, i.e. on market terms.

3.15 Related parties

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

4. Standards, amendments and interpretations not applicable in 2012

IASB final standards and IFRS and IFRIC interpretations with application dates after 2012

IFRS 9 Financial Instruments
IFRS 9 replaces the classification and measurement rules for financial instruments in IAS 39 Financial Instruments – Recognition and Measurement. Under 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 carried 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 presented in other comprehensive income.

All portfolios of equities, bonds and financial derivatives, as well as real estate investments classified as financial assets, have a business model that is consistent with the classification measured at fair value under IFRS 9 as at 31 December 2012.

The effective date of IFRS 9 has been deferred to annual periods beginning on or after 1 January 2015, but the standard has not yet been endorsed by the EU. Norges Bank expects to apply IFRS as from 1 January 2015, 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 on the transition date.

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. See below on further amendments concerning investment entities.

In the EU IFRS 10 is effective for accounting periods beginning on or after 1 January 2014. IFRS 10 (excluding amendments relating to investment entities) was endorsed by the EU in the fourth quarter of 2012.

If the investment portfolio of the Government Pension Fund Global is not an investment entity (see below), Norges Bank does not expect that the adoption of IFRS 10 will have a material impact on the consolidated financial statements of the investment portfolio of the Government Pension Fund Global or other areas of Norges Bank. Norges Bank expects to apply IFRS 10 as from 1 January 2014.

Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)
In October 2012, the IASB issued amendments to IFRS 10, IFRS 12 and IAS 27 to provide an exception to the consolidation requirements in IFRS 10 for reporting entities that qualify as investment entities. Such reporting entities are required to measure investments in subsidiaries at fair value and recognise the investments as a single line item on the balance sheet. In addition, qualifying reporting entities shall measure investments in joint ventures and associates at fair value rather than using the equity method. Finally, financial instruments shall be measured at fair value through profit or loss. This means that only entities with primarily fair value business models may apply the investment entity model.

Norges Bank is in the process of clarifying whether the investment portfolio of the Government Pension Fund Global is an investment entity under the new rules. Norges Bank as such is not an investment entity. If the investment portfolio qualifies an investment entity, this will entail changes in its financial reporting. These mainly comprise a change from consolidation to fair value measurement for subsidiaries. In this respect, jointly controlled entities will also be measured at fair value.

The Investment Entity amendments to IFRS 10, IFRS 12 and IAS 27 are effective for annual periods beginning on or after 1 January 2014. The amendments are expected to be endorsed by the EU in the third quarter of 2013. Norges Bank expects to apply IFRS 10 including these amendments as from 1 January 2014, under the assumption that the amendments will be endorsed by the EU. Norges Bank is deferring application of IFRS 10, IFRS 11 and IFRS 12 until the Investment Entity rules have been endorsed, as allowed 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 over 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, joint ventures shall be accounted for using the equity method as described in IAS 28 Investments in Associates (as revised in 2011).

In the EU IFRS 11 is effective for annual periods beginning on or after 1 January 2014, and the standard was 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 other areas of Norges Bank, if the investment portfolio is not an investment entity (see above). If the investment portfolio is an investment entity, the accounting principles for joint ventures (now jointly controlled entities) will be changed from the equity method to fair value measurement when the new standard is adopted. Norges Bank expects to apply IFRS 11 as from 1 January 2014.

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.

In the EU IFRS 12 is effective for annual periods beginning on or after 1 January 2014, and the standard was 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 other areas of Norges Bank. Norges Bank expects to apply IFRS 12 as from 1 January 2014. If the investment portfolio is an investment entity, somewhat more substantial changes in note disclosures are expected when IFRS 10 and IFRS 12 are adopted.

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 for 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 was 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 will apply IFRS 13 as from 1 January 2013.

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

Parts of the holdings within the investment portfolio of the Government Pension Fund Global are not traded in active markets, i.e. they are allocated to Level 2 or Level 3 in the fair value hierarchy, as defined in IFRS 7.27A. This pertains primarily to 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 valued using models, and the resulting value is defined as an estimate. The resulting values of holdings allocated to Level 3, with significant use of unobservable inputs, are regarded as particularly uncertain estimates. Generally, widely accepted, standard pricing models are used. For further information on pricing models and the control environment, see Note 14 Fair value measurement.

Investment properties are measured at fair value. Fair value is based on external appraisals and valuations, or, recent comparable transactions in comparable markets. The determination of fair value in such appraisals and valuations 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 and are allocated to Level 3.

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 a foreign exchange element is an estimate, as different methods will result in different allocations.

<u>Foreign exchange element:</u>
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.

<u>Security element:</u>
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 exchange 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 in 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 for 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, even though changes in the Norwegian krone exchange rate versus other currencies do not affect the international purchasing power of the investment portfolio. The Bank's and the investment portfolio's nominal return is 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 management mandate given by the Ministry of Finance, see further information in Note 15 Risk. Furthermore, no single currency stands out as dominant in the 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 appear as 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 where transactions are in multiple currencies, or where the entity has no operations, 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 where the ownership share is significant, an assessment is made relating to the degree of control that exists. 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 profit/loss on the portfolio before foreign exchange gains and losses, 2012

Amounts in NOK million	Interest income/ expense	Divi-dends	Net income/ expense	Realised gains/ losses	Unrealised gains/ losses	Total
Interest income from bank deposits	102	.	.	.	.	102
Interest income, lending associated with reverse repurchase agreements	219	.	.	.	.	219
Net income/expense and gains/losses from:						
- Equities and units*	.	63 295	2 439	-11 079	295 124	349 779
- Bonds and other fixed-income instruments*	46 612	.	11	32 908	18 806	98 337
- Financial derivatives	-204	.	0	-3 395	3 330	-269
- Financial assets real estate	.	.	170	.	344	514
- Investment properties	0	0	244	0	-177	67
Share of the profit/loss in jointly controlled entities real estate	0	30	.	0	-280	-250
Interest expense, borrowing associated with repurchase agreements	-130	0	0	0	0	-130
Other interest income and interest expense	1	0	0	0	0	1
Tax expense	0	0	-864	0	0	-864
Other expenses	0	0	-80	0	0	-80
Profit/loss on the portfolio before foreign exchange gains and losses	**46 600**	**63 325**	**1 920**	**18 434**	**317 147**	**447 426**

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

Table 3.2 Specification profit/loss on the portfolio before foreign exchange gains and losses, 2011

Amounts in NOK million	Interest income/ expense	Divi-dends	Net income/ expense	Realised gains/ losses	Unrealised gains/ losses	Total
Interest income from 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*	.	50 372	1 869	27 079	-251 827	-172 507
- 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 properties	.	.	60	-	-190	-130
Share of the profit/loss in jointly controlled entities real estate	.	-	.	-	-31	-31
Interest expense, borrowing associated with repurchase agreements	-629	.	.	.	.	-629
Other interest income and interest expense	-286	.	.	.	.	-286
Tax expense	.	.	-516	.	.	-516
Other expenses	.	.	-52	.	.	-52
Profit/loss on the portfolio before foreign exchange gains and losses	**47 535**	**50 372**	**1 658**	**25 321**	**-211 132**	**-86 246**

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

NOTE 4 TAX EXPENSE

Tax expense comprises income tax.

Norges Bank, including the Government Pension Fund Global, is not subject to tax in Norway. However, Norges Bank must pay taxes related to investments in some foreign markets. This tax burden primarily follows from local tax rules, but is often offset by tax treaties between the Norwegian government and the government of the country where the investment is made.

Tax expenses comprise taxes which are not refunded to Norges Bank for the investment portfolio of the Government Pension Fund Global, either under local tax rules and regulations, or under tax treaties.Taxes are recognised in profit or loss as incurred and when it is not probable that they will be refunded. Taxes which Norges Bank considers refundable, but where refunds have not yet been received, are presented in the balance sheet as *Other financial assets,* see Note 12 Other financial assets for further information. If at a later date Norges Bank deems it less probable that the reclaim will be honoured, the refund will be reversed.

Tax expenses comprise taxes in accordance with IAS 12 Income Taxes. The applicable taxes are withholding tax on dividend and interest income, capital gains tax and income tax payable by real estate subsidiaries. Equities that are lent out on the ex-dividend date do not give rise to income taxes.

Other tax related expenses are also incurred as part of the asset management, and are typically tax related transaction costs, for instance stamp duty and transaction fees. These are mainly deducted from the income statement line for the relevant type of investment, while some such costs are presented as *Other expenses.* Such fees and taxes are classified as transaction costs, not as income taxes.

Under the real estate asset class various types of municipal taxes and fees will arise depending on type of property and market. These costs are not income taxes under IAS 12. The costs are considered to be property management costs, and are expensed as they incur.

Table 4.1 shows the different types of income/gains that trigger tax expenses, the tax deducted upon recognition of income, the tax refunded and the net tax expense. Both income before tax (gross) and income after tax (net) are presented.

Table 4.1 Tax expense per asset class and type of income

Amounts in NOK million	Gross income before taxes	Income taxes deducted	Income taxes refunded	Tax expense	Net income after taxes
			2012		
Dividends from equities – withholding tax	63 295	2 112	-1 258	854	62 441
Realised gains/losses from equities – capital gains tax	-11 079	0	-	0	-11 079
Interest income from bonds and other fixed-income instruments – withholding tax	46 612	63	-58	5	46 607
Realised gains/losses from bonds and other fixed-income instruments – capital gains tax	32 908	-	-	-	32 908
Income tax in real estate subsidiaries	550	5	-	5	545
Tax expense excl jointly controlled entities				864	
Income tax in jointly controlled entities	-250	2	-	2	
Total tax expense				866	

	Gross income before taxes	Income taxes deducted	Income taxes refunded	Tax expense	Net income after taxes
			2011		
Dividends from equities – withholding tax	50 372	1 583	-1 079	504	49 869
Realised gains/losses from equities – capital gains tax	27 079	12	-	12	27 067
Interest income from bonds and other fixed-income instruments – withholding tax	48 691	60	-60	-	48 691
Realised gains/losses from bonds and other fixed-income instruments – capital gains tax	4 600	-		-	4 600
Income tax in real estate subsidiaries	-43	0	-	0	-43
Tax expense excl jointly controlled entities				516	
Income tax in jointly controlled entities	-31	0	-	0	
Total tax expense				516	

Income tax in real estate subsidiaries comprises the tax incurred by wholly owned subsidiaries of the Government Pension Fund Global. Income taxes incurred by *Jointly controlled entities real estate*, form part of the *Share of the profit/loss in jointly controlled entities real estate* and are not presented separately on the line *Tax expense*. This tax expense has been included in the table to provide a full overview of income taxes payable in the real estate asset class. Any income taxes related to *Financial assets real estate* are deducted from the net operating income before the cash flow is recognised as income in the Government Pension Fund Global's income statement. Holding companies related to the investment are subject to tax, and income taxes incurred by these companies are included in the consolidated income statement as a *Tax expense.*

NOTE 5 MANAGEMENT COSTS

Management costs comprise operating expenses relating to the management of the investment portfolio of the Government Pension Fund Global. The majority of these expenses are incurred centrally in Norges Bank as asset manager, while in addition administrative expenses are incurred by subsidiaries related to real estate investments. Operating expenses incurred centrally by Norges Bank, see table 5.1, shall be covered up to a certain limit by way of the management fee paid by the Ministry of Finance. These expenses are indirectly charged to the investment portfolio's income statement by way of the Management fee, after *Profit/loss on the portfolio*. Administrative expenses in subsidiaries, see table 5.2, are charged directly to the profit/loss on the portfolio. Expenses incurred other than the management costs, such as interest expenses, transaction costs, tax expenses and expenses related to property management, are deducted before *Profit/loss on the portfolio*. Most transaction costs are deducted on the income statement line for the relevant type of investment, while other transaction costs are presented as *Other expenses,* see Note 6. Income taxes payable abroad are presented on a separate line in the income statement, see Note 4 Tax expense. Property management expenses are partly deducted on the income statement line for the relevant type of investment, while such costs incurred by subsidiaries are presented as *Other expenses* see Note 6.

Table 5.1 gives a specification of Norges Bank's operating expenses relating to the management of the Government Pension Fund Global, which are covered by the management fee from the Ministry of Finance.

Table 5.1 Specification management fee

Amounts in NOK million	2012	Percent	2011	Percent
Salary, social security and other personnel related costs*	587		495	
IT, information and decision support systems	222		214	
Custody and settlement costs	351		406	
Outsourced IT and analysis costs	218		254	
Consulting and legal fees	56		73	
Base fees to external managers	272		371	
Other costs*	90		95	
Allocated common costs Norges Bank*	90		85	
Management fee excluding performance-based fees	**1 886**	**0.05**	**1 993**	**0.06**
Performance-based fees to external managers	307		546	
Total management fee	**2 193**	**0.06**	**2 539**	**0.08**

* As from the annual financial statements for 2012, pension costs that were previously presented as part of Allocated common costs Norges Bank are presented on the line Salary, social security and other personnel related costs. Costs related to training and recruitment have been moved from Other costs, to Salary, social security and other personnel related costs. Comparative amounts for 2011 have been restated.

Table 5.1 shows Norges Bank's total operating expenses 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 to the management of the investment portfolio and the long term reserves, and are allocated to the individual portfolio using a cost allocation model based primarily on market values and asset class composition. Performance-based fees to external managers are covered outside of the set limit, as part of the management fee. The management fee is a function of expenses presented in Norges Bank's income statement as *Total other operating expenses.*

Table 5.2 specifies operating expenses in real estate related subsidiaries

Table 5.2 Specification operating expenses, subsidiaries real estate

Amounts in NOK million	2012	2011
Salary, social security and other personnel related costs	11	2
IT, information and decision support systemts, out-sourced administrative services	6	2
Consulting and legal fees	9	11
Fees related to real estate asset management (external)*	10	3
Other costs, subsidiaries	9	5
Total operating expenses, real estate subsidiaries	**45**	**23**

* As from the annual financial statements for 2012, fees comprising property management which are paid by subsidiaries are not included in Fees related to real estate asset management in table 5.2. These are presented as Property management expenses in subsidiaries in table 6.1, see Note 6 Other expenses. Comparative amounts for 2011 have been restated.

Table 5.2 presents expenses incurred by subsidiaries that are established as part of the investment portfolio of the Government Pension Fund Global, relating to administration of these companies. These expenses are consolidated into the income statement of the investment portfolio of the Government Pension Fund Global, and are paid using funds belonging to the portfolio. The subsidiaries' operating expenses are not included in Norges Bank operating expenses as they are excluded from consolidation into Norges Bank's financial statements (cf. Section 2-3 fourth paragraph of the regulation concerning annual financial reporting for Norges Bank). These expenses are presented as *Other expenses* in the income statement for the investment portfolio, and are charged directly to *Profit/loss on the portfolio*. See Note 6 Other expenses for further information.

Within the real estate asset class there are additional costs relating to property management, which are included in the income statement lines *Net income/expenses – gains/losses on investment propertie*s and *Share of profit/loss in jointly controlled entities real estate*. These costs are incurred by the entity that owns the property, and are considered to be expenses linked directly to the income from and management of the properties. In some cases such expenses, in the form of fees related to property management, will be incurred by subsidiaries and will be presented as *Other expenses*, see Note 6.

NOTE 6 OTHER EXPENSES

Table 6.1 Specification other expenses

Amounts in NOK million	2012	2011
Operating expenses, real estate subsidiaries	45	23
Property management expenses in subsidiaries	9	3
Other expenses, investment portfolio excluding subsidiaries*	26	26
Total other expenses	**80**	**52**

* As from the annual financial statements for 2012, income taxes previously presented as part of Other expenses are presented as Tax expense (see Note 4). Comparative amounts have been restated. These relate to capital gains tax on equity investments in China, and corporate tax payable by real estate subsidiaries.

Other expenses comprise expenses in subsidiaries related to the administration of subsidiaries, expenses in subsidiaries related to property management and other expenses related to the asset management. Expenses relating to property management comprise expenses directly related to income from and management of properties, that may be incurred by subsidiaries. Other expenses are paid using funds belonging to the investment portfolio of the Government Pension Fund Global, and are charged directly to the *Profit/loss on the portfolio*, before the management fee.

Expenses relating to the administration of subsidiaries within the real estate asset class, amounting to NOK 45 million in 2012, are specified in Table 5.2 in Note 5 Management costs.

Other expenses, investment portfolio excluding subsidiaries in Table 6.1 mainly include transaction related expenses incurred in the asset management, and can be related to all asset classes. Negative expenses normally comprise reversals of previous provisions.

NOTE 7 REPURCHASE AND REVERSE REPURCHASE AGREEMENTS

Norges Bank uses the markets for repurchase and reverse repurchase agreements in its financing activities internally and under securities lending programmes (see Note 9 External agency securities lending). At any time, the Bank will have lent part of its holdings in bonds through repurchase agreements, against receiving cash (repos and sell buy backs). This may be in the form of financing of asset management (borrowing of cash), or lending of securities with the aim of reinvesting received cash at higher interest and thus creating additional income/returns. In addition, the Bank is 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 in connection with securities lending. 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. Cash received 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 including a margin related to each transaction, the Bank has established a process for monitoring changes in the net market value of outstanding contracts by comparing the collateral market value with the transaction value, including the margin, per counterparty. 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 2012 there was less use of reverse repurchase agreements, while the volume of repurchase agreements remained unchanged.

Table 7.1 shows total outstanding repurchase and reverse repurchase agreements in the investment portfolio of the Government Pension Fund Global at year end 2012, with comparative amounts for 2011, 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 7.1, while the corresponding cash amount to be transferred is included in *Borrowing associated with repurchase agreements* and *Lending associated with reverse repurchase agreements*.

Table 7.1 Specification repurchase and reverse repurchase agreements

	31.12.2012		31.12.2011	
Amounts in NOK million	Carrying amount	Fair value	Carrying amount	Fair value
Repurchase agreements				
Borrowing associated with repurchase agreements (cash borrowed or received as collateral)	19 013	19 013	19 280	19 280
Bonds posted as collateral or lent (asset)	18 495	18 495	17 551	17 551
Unsettled trades (asset)*	328	328	1 410	1 410
Net over collateralisation (under collateralisation) repurchase agreements	**190**	**190**	**319**	**319**
Reverse repurchase agreements				
Reverse repurchase agreements outside of securities lending programme	26 479	26 479	44 393	44 393
Reverse repurchase agreements through securities lending programmes (reinvestment of cash collateral)	34 961	34 961	35 427	35 427
Lending associated with reverse repurchase agreements (total cash lent or placed)	**61 440**	**61 440**	**79 820**	**79 820**
Bonds received as collateral	-	55 392	-	67 399
Equities received as collateral	-	3 562	-	13 161
Total collateral received under reverse repurchase agreements	**-**	**58 954**	**-**	**80 560**
Unsettled trades (liability)**	2 385	2 385	1 537	1 537
Net over collateralisation (under collateralisation) reverse repurchase agreements		**-101**		**2 277**
Additional collateral repurchase and reverse repurchase agreements				
Cash collateral posted (additional collateral)	-	-	-	-
Bond collateral posted	-	1	-	-
Bond collateral received	-	-	-	72
Total additional collateral	**-**	**1**	**-**	**72**
Net over collateralisation (under collateralisation) repurchase and reverse repurchase agreements		**90**		**2 668**

* Cash not received, security not transferred to counterparty. The transaction has been recognised in the balance sheet as Borrowing associated with repurchase agreements.

** Cash not transferred, security not received from counterparty. The transaction has been recognised in the balance sheet as Lending associated with reverse repurchase agreements.

Total overcollateralisation across these instrument types, including additional collateral, is NOK 90 million at 31 December 2012 compared to NOK 2 668 million at the previous year-end.

NOTE 8 EQUITIES AND UNITS / BONDS AND OTHER FIXED-INCOME INSTRUMENTS

Table 8.1 Specification equities and units

Amounts in NOK million	31.12.2012 Fair value excluding dividends	31.12.2012 Accrued dividends	31.12.2012 Fair value including dividends	31.12.2011 Fair value excluding dividends	31.12.2011 Accrued dividends	31.12.2011 Fair value including dividends
Equities and units						
Listed equities and units	2 325 469	2 523	2 327 992	1 940 789	3 139	1 943 928
Total equities and units	**2 325 469**	**2 523**	**2 327 992**	**1 940 789**	**3 139**	**1 943 928**
Of which equities lent			*115 041*			*137 130*

Table 8.2 Specification bonds and other fixed-income instruments

Amounts in NOK million, 31.12.2012	Nominal value*	Fair value excl. accrued interest	Accrued interest	Fair value incl. accrued interest
Government bonds				
Government bonds issued in local currency	771 983	846 538	7 338	853 876
Total government bonds	**771 983**	**846 538**	**7 338**	**853 876**
Government related bonds				
Sovereign bonds	8 161	9 131	187	9 318
Bonds issued by local authorities	32 557	33 856	433	34 289
Bonds issued by supranational bodies	30 316	33 316	439	33 755
Bonds issued by federal agencies	81 857	87 927	1 128	89 056
Total government related bonds	**152 891**	**164 230**	**2 187**	**166 418**
Inflation-linked bonds				
Inflation-linked bonds issued by government authorities	30 642	41 520	235	41 755
Total inflation-linked bonds	**30 642**	**41 520**	**235**	**41 755**
Corporate bonds				
Bonds issued by utilities	18 005	20 637	333	20 970
Bonds issued by financial institutions	60 720	61 212	1 100	62 312
Bonds issued by industrial companies	102 216	111 762	1 396	113 158
Total corporate bonds	**180 941**	**193 611**	**2 829**	**196 440**
Securitised bonds				
Covered bonds	175 318	183 155	3 515	186 670
Mortgage-backed securities	5 518	3 304	13	3 317
Asset-backed securities	2 794	1 156	2	1 158
Commercial mortgage-backed securities	9 424	2 860	13	2 873
Total securitised bonds	**193 054**	**190 475**	**3 543**	**194 018**
Total bonds and other fixed-income instruments	**1 329 511**	**1 436 374**	**16 132**	**1 452 507**
Of which bonds lent				*5 325*
Of which short-sale bonds				-

Amounts in NOK million, 31.12.2011	Nominal value*	Fair value excl. accrued interest	Accrued interest	Fair value incl. accrued interest
Government bonds				
Government bonds issued in local currency	554 293	605 600	6 965	612 565
Total government bonds	554 293	605 600	6 965	612 565
Government related bonds				
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
Total government related bonds	166 691	174 346	2 818	177 164
Inflation-linked bonds				
Inflation-linked bonds issued by government authorities	83 105	105 175	541	105 716
Total inflation-linked bonds	83 105	105 175	541	105 716
Corporate bonds				
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
Total corporate bonds	183 284	184 953	3 388	188 341
Securitised bonds				
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
Total securitised bonds	292 823	238 855	4 870	243 725
Total bonds and other fixed-income instruments	1 280 196	1 308 929	18 582	1 327 511
Of which bonds lent				*3 256*
Of which short-sale bonds				-

* Nominal value amounts have been translated into NOK using the exchange rate on the balance sheet date.

At end-2012 the holdings in bonds issued by the sovereigns Italy and Spain amounted to NOK 32 billion (fair value). Bonds issued by the government of Greece amounted to NOK 0.19 billion. The investment portfolio had no holdings of Portuguese or Irish government debt. Total holdings at 31 December 2011 of bonds issued by these governments amounted to NOK 57 billion.

NOTE 9 EXTERNAL AGENCY SECURITIES LENDING

Norges Bank has entered into agreements with external agents regarding securities lending, 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 includes a margin and 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 that 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 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 reverse repurchase agreements (including buy sell backs and triparties, see Note 7 Repurchase and reverse repurchase agreements).

Securities lent are presented on separate lines in the balance sheet. Cash collateral received is recognised as an asset as *Deposits in banks* with a corresponding liability, *Cash collateral received,* since Norges Bank has the right to make use of this cash. Collateral received in the form of securities is not recognised in the balance sheet, because these are not reused (rehypothecated), but left in custody. Reinvestments in the form of reverse repurchase agreements are recognised in the balance sheet in the same manner as ordinary investments.

Norges Bank earns a net income based on these securities lending programmes. The net income comprises the pure lending fee, from which costs related to cash collateral received are deducted, 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 lines *Net income/expenses and gains/losses from equities and units* and *Net income/expenses and gains/losses from bonds and other fixed-income instruments.* Net income related to equities lending within the investment portfolio of the Government Pension Fund Global amounted to NOK 2 439 million in 2012, while the corresponding income from bond lending amounted to NOK 11 million in 2012. Corresponding amounts for 2011 were NOK 1 869 million and NOK 349 million, respectively.

Tables 9.1 and 9.2 present an overview of holdings in external agent securities lending programmes at year-end 2012 and 2011.

Table 9.1 Securities lent

	31.12.2012		31.12.2011	
Amounts in NOK million	**Carrying amount**	**Fair value**	**Carrying amount**	**Fair value**
Securities lent				
Equities lent	115 041	115 041	137 130	137 130
Bonds lent	5 325	5 325	3 256	3 256
Total securities lent	120 366	120 366	140 386	140 386
Collateral received				
Cash collateral received	32 688	32 688	36 405	36 405
Equities received as collateral	-	76 679	-	102 170
Bonds received as collateral	-	17 254	-	11 337
Total collateral related to securities lending	32 688	126 621	36 405	149 912
Net overcollateralisation	-	6 255	-	9 526

Table 9.2 Reinvestments of cash collateral related to securities lending

	31.12.2012	31.12.2011
Amounts in NOK million	**Carrying amount**	**Carrying amount**
Reinvestment related to securities lending		
Reverse repurchase agreements	34 961	35 427
Total reinvestments of cash collateral	34 961*	35 427

* This amount includes unsettled trades to the amount of NOK 2 386 million.

NOTE 10 FINANCIAL DERIVATIVES

Financial derivatives are used in asset management to adjust the exposure in various portfolios, as a cost efficient alternative to trading in the underlying securities. This may be to adjust the exposure to equities, bond or the fixed-income markets in general, or to specific markets or companies.

Table 10.1 is a specification of financial derivatives holdings at market value as at 31 December 2012 and 31 December 2011, classified as assets or liabilities. Table 10.2 shows exposure expressed as the notional amount of financial derivatives for long and short positions. Notional amounts (the nominal values of the underlying) are the basis for the calculation of any cash flows and gains/losses for the contracts. The sum of the absolute amount of long and short positions is the gross exposure, which provides information about the extent to which different types of financial derivatives are used. The net position is the difference resulting from subtracting short positions from long positions. This is an indication of the total risk exposure from each type of financial derivative.

Table 10.1 Specification financial derivatives

	Fair value					
	31.12.2012			31.12.2011		
Amounts in NOK million	Asset	Liability	Net	Asset	Liability	Net
Foreign exchange contracts	88	145	-57	1 603	964	639
Listed futures contracts	221	91	130	5	224	-219
Interest rate swaps	703	2 120	-1 417	463	4 639	-4 176
Credit default swaps	-	-	-	2	-	2
Equity swaps	435	244	191	154	130	24
Total swap contracts	1 138	2 364	-1 226	619	4 769	-4 150
Options	-	-	-	-	-	-
Total financial derivatives	1 447	2 600	-1 153	2 227	5 957	-3 730

Table 10.2 Financial derivatives – exposure

	Exposure							
	31.12.2012		Average 2012		31.12.2011		Average 2011	
Amounts in NOK million	Long	Short	Long	Short	Long	Short	Long	Short
Foreign exchange contracts	49 729	-	81 006	-	132 848	-	64 778	-
Listed futures contracts	1	9 323	302	10 708	1	14 682	5 228	9 851
Interest rate swaps	4 293	13 271	5 333	15 849	8 163	18 956	20 106	52 806
Credit default swaps	-	-	728	5	1 645	12	19 373	280
Equity swaps	838	132	458	217	30	335	25	550
Total swap contracts	5 131	13 403	6 519	16 071	9 838	19 303	39 504	53 636
Options	-	-	-	-	-	-	14 464	11 987
Total financial derivatives	54 861	22 726	87 827	26 779	142 687	33 985	123 974	75 474

Exchange-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 notional amount of the contracts, and reflects whether Norges Bank receives (long positions) or pays (short positions) payments in the event of the underlying increasing in value.

Over-the-counter (OTC) financial derivatives

Foreign exchange contracts

This item consists of foreign currency exchange contracts (forwards) with normal settlement for future delivery. Contract exposure is the sum of the notional amount of the contracts at any given point in time. With a foreign exchange contract both a long and a short position are held, as one buys one currency and sells another. All positions are shown as long positions.

Interest rate swaps

Interest rate swaps are agreements between two parties to exchange interest payment streams based on different interest rate calculation methods; typically one party pays a floating rate of interest and the other pays a fixed rate.

Exposure is the notional amount of the contract and the direction (long/short) indicates whether Norges Bank is receiving (long) or is paying (short) a fixed rate of interest.

Credit default swaps

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

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

Exposure direction (long/short) 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 security (the equity leg) and normally a floating interest rate. In addition to the periodic cash flow, the buyer will receive payments in connection with dividends and corporate events. A variant of equity swaps are Contracts for Difference (CFD), where the buyer and the seller on an on-going basis will settle between them the difference between the present value of the underlying equity or index, and the value at the transaction date. If the difference is positive the seller will pay to the buyer, while if the difference is negative the buyer will pay to the seller.

Exposure corresponds to the notional amount of the contracts, and reflects whether Norges Bank shall receive (long) or pay (short) the return from the underlying equity, or for CFDs whether Norges Bank is receiving (long) or is paying cash as the value of the equity or index increases compared with the value at the transaction date.

Options

The buyer of an option pays for the right to buy or sell an asset at an agreed price at or within a certain 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 notional amount 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 10.3 Collateral related to financial derivatives

Amounts in NOK million	**31.12.2012**	**31.12.2011**
OTC financial derivatives*		
Net fair value OTC financial derivatives (carrying amount)	-1 474	-3 535
Cash collateral received related to OTC positions	313	521
Futures contracts and equity swaps		
Fair value futures contracts	130	-219
Fair value equity swaps	191	24
Deposits with clearing brokers (collateral posted)	166	433
Bonds posted as collateral with clearing brokers	1 301	762

* Foreign exchange contracts, interest rate swaps and credit default swaps

Norges Bank posts 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 exceeds the given threshold limits, the party with the negative postion is required to post additional collateral with the other party. The thresholds vary with credit rating. At year-end 2012 the bank had received cash collateral from counterparties related to OTC positions in the amount of NOK 313 million. Norges Bank had not posted any cash collateral related to negative market value positions at year-end 2012 or year-end 2011 on behalf of the investment portfolio of the Government Pension Fund Global, on account of the Bank’s high credit-worthiness.

NOTE 11 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.

Financial assets real estate comprise the right to 25 percent of the net operating income generated from properties in and around Regent Street, London, United Kingdom. Investment properties are directly held properties. Jointly controlled entities real estate comprise ownership interests in investment properties and other assets (net) in jointly controlled entities.

Tables 11.1 and 11.2 show the profit/loss on the portfolio and assets and liabilities for the asset class.

Table 11.1 Income statement – real estate asset class

Amounts in NOK million	2012	2011
Profit/loss on the portfolio excluding foreign exchange gains and losses, real estate asset class		
Interest income from bank deposits	0	1
Net income/expenses and gains/losses from:		
- Financial assets real estate	514	86
- Investment properties	67	-130
Share of the profit/loss in jointly controlled entities real estate	-250	-31
Other interest income and interest expense	25	-1
Tax expense	-5	0
Other expenses	-56	-4
Profit/loss on the portfolio before foreign exchange gains and losses, real estate asset class	**296**	**-79**

Table 11.2 Assets and liabilities – real estate asset class

Amounts in NOK million	31.12.2012	31.12.2011
ASSETS		
Financial assets		
Deposits in banks	253	138
Financial assets real estate	4 841	4 415
Jointly controlled entities real estate	7 431	2 546
Other financial assets	2 911	14
Total financial assets	**15 437**	**7 113**
Non-financial assets		
Investment properties	9 777	4 062
Other non-financial assets	5	6
Total non-financial assets	**9 782**	**4 068**
TOTAL ASSETS	**25 219**	**11 181**
Financial liabilities, excl. management fee payable		
Other financial liabilities	96	52
Total financial liabilities, excl. management fee payable	**96**	**52**
Net assets before management fee payable, real estate asset class	**25 123**	**11 129**

Total net assets for the asset class at 31 December 2012 was NOK 25 123 million, an increase from NOK 11 129 million at end 2011. This includes *Other financial assets* of NOK 2 911 million, of which NOK 2 845 million is a receivable relating to an investment in a jointly controlled entity in Germany, which was completed on 1 January 2013, but for which the consideration had been paid at the end of 2012.

Table 11.3 is a specification of the main income statement lines for this asset class, broken down by net rental income, fair value changes and other income and expenses.

Table 11.3 Specification Net income/expenses and gains/losses from Financial assets real estate, Investment properties and Share of the profit/loss in jointly controlled entities real estate

	2012			
Amounts in NOK million	Financial assets real estate	Investment properties*	Jointly c ontrolled entities real estate**	Total
Gross rental income	177	270	255	**702**
Direct property expenses	-	-27	-19	**-46**
Net rental income	**177**	**244**	**236**	**657**
Expensed transaction costs Financial assets real estate***	-7	.	.	**-7**
Net income/expenses	**170**	**244**	**236**	**650**
Fair value changes – properties****/financial asset real estate	344	-177	-90	**77**
Fair value changes – financial liability	-	.	-327	**-327**
Net income/expenses and gains/losses from Financial assets real estate and Investment properties	**514**	**67**		
Other income/expenses in jointly controlled entities real estate			-69	
Share of the profit/loss in jointly controlled entities real estate			**-250**	

	2011			
Amounts in NOK million	Financial assets real estate	Investment properties*	Jointly controlled entities real estate**	Total
Gross rental income	130	74	53	**257**
Direct property expenses	.	-14	-	**-14**
Net rental income	**130**	**60**	**53**	**243**
Expensed transaction costs Financial assets real estate***	-182	.	.	**-182**
Net income/expenses	**-52**	**60**	**53**	**61**
Fair value changes – properties****/financial asset real estate	138	-190	-71	**-123**
Net income/expenses and gains/losses from Financial assets real estate and Investment properties	**86**	**-130**		
Other income/expenses in jointly controlled entities real estate			-13	
Share of the profit/loss in jointly controlled entities real estate			**-31**	

* Income, expenses, gains and losses from directly held investment properties.
** Share of income, expenses, gains and losses in jointly controlled entities real estate.
*** These transaction costs are expensed on recognition and classified as expenses, as the asset is classified under the fair value option.
**** For investment properties and jointly controlled entities real estate transaction costs are presented as fair value changes.

Recognised fair value changes for the newly acquired properties correspond to transaction costs attributed to the individual property. The values used for properties and the financial asset at the end of 2012 result in recognition of a positive value change of NOK 77 million for 2012. This includes expensed transaction costs of NOK 119 million. In addition, a loss was recognised related to the fair value measurement of a liability item in a jointly controlled entity.

For additional information on fair value measurement, see Note 2 Significant estimates and critical accounting judgements and Note 14 Fair value measurement.

Table 11.4 is a specification of the changes in the carrying amounts for the main balance sheet items within the real estate asset class; *Financial assets real estate, Investment properties* and *Jointly controlled entities real estate.*

Table 11.4 Changes in carrying amounts for the main balance sheet items within the real estate asset class

	2012			
Amounts in NOK million	Financial assets real estate	Jointly controlled entities real estate	Investment properties	Total
Carrying amounts for the main balance sheet items within the real estate asset class as at 01.01.2012	4 415	2 546	4 062	11 023
Additions and improvements	199	5 404	6 102	11 705
Fair value changes – properties/financial asset real estate	344	-90	-177	77
Fair value changes – financial liability	.	-327	.	-327
Operating profit from investments accounted for under the equity method	.	167	.	167
Paid dividend and changes in equity capital	.	-103	.	-103
Other assets (net) in jointly controlled entities	.	-18	.	-18
Foreign currency translation effect	-117	-149	-210	-476
Carrying amounts for the main balance sheet items within the real estate asset class as at 31.12.2012	4 841	7 431	9 777	22 049

	2011			
Amounts in NOK million	Financial assets real estate	Jointly controlled entities real estate	Investment properties	Total
Carrying amounts for the main balance sheet items within the real estate asset class as at 01.01.2011	-	-	-	-
Additions and improvements	4 088	2 620	4 301	11 009
Fair value changes – properties/financial asset real estate	138	-71	-190	-123
Operating profit from investments accounted for under the equity method	.	40	.	40
Foreign currency translation effect	189	-43	-49	97
Carrying amounts for the main balance sheet items within the real estate asset class as at 31.12.2011	4 415	2 546	4 062	11 023

The table shows that investments (additions) and improvements amounting to NOK 11 705 million were made in 2012, compared with NOK 11 009 million the year before. Of this total, new investments amounted to NOK 11 618 million. NOK 11 499 million of the additions and improvements were completed and recognised in the fourth quarter of 2012. This pertained to investments in United Kingdom, Switzerland and France and comprised both jointly controlled entities and investment properties. In addition to this, an increase in fair value was a significant contributor to the change in the carrying amount for *Financial assets real estate*, while for both *Investment properties* and *Jointly controlled entities real estate* decreases in fair value related to properties and an increase in value of debt contributed to a reduction in carrying amounts.

In addition to new investments that were recognised in the balance sheet by year end, agreements were signed during the fourth quarter of 2012 to purchase property in Germany and to purchase a portfolio of logistics properties in Europe. These will be classified as jointly controlled entities real estate and the transactions will be completed in the first quarter of 2013.

In the first quarter of 2013 an agreement was signed to purchase property in the US. The transaction is expected to be completed during the first quarter of 2013 and the investment will be classified as an associate and accounted for under the equity method.

Table 11.5 shows total assets and liabilities in jointly controlled entities as at 31 December 2012.

*Tabell 11.5 Jointly controlled entities, total assets and liabilities**

Amounts in NOK million	31.12.2012	31.12.2011
Other assets	563	170
Investment properties	22 863	5 006
Current debt	373	84
Long term debt	11 809	-
Equity capital	11 245	5 092

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

For an overview of subsidiaries and jointly controlled entities in the investment portfolio, see Note 16 Subsidiaries and jointly controlled entities.

Table 11.6 shows how real estate investments are distributed by country, sector and development. The table also shows the vacancy rate, including and excluding development.

Table 11.6 Distribution of real estate investments

					31.12.2012			
Country	**Office**	**Retail**	**Residential**	**Industrial**	**Other**	**Development**	**Receiv-able***	**Total**
France	24.7 %	8.1 %	0.0 %	0.0 %	0.0 %	0.1 %	0.0 %	32.9 %
United Kingdom	5.3 %	25.2 %	0.1 %	0.0 %	0.1 %	0.9 %	0.0 %	31.7 %
Switzerland	24.2 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	24.2 %
Other	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %	11.2 %	11.2 %
Total	**54.2 %**	**33.3 %**	**0.1 %**	**0.0 %**	**0.1 %**	**1.0 %**	**11.2 %**	**100.0 %**

* The receivable comprises the investment in Germany (Berlin and Frankfurt), which was completed 1 January 2013.

Vacancy	5.1 %
Vacancy (excluding development)	2.0 %

				31.12.2011			
Country	**Office**	**Retail**	**Residential**	**Industrial**	**Other**	**Development**	**Total**
France	37.8 %	21.2 %	0.2 %	0.0 %	0.6 %	0.1 %	60.0 %
United Kingdom	24.5 %	14.2 %	0.2 %	0.0 %	0.4 %	0.8 %	40.0 %
Total	**62.3 %**	**35.4 %**	**0.4 %**	**0.0 %**	**1.0 %**	**0.9 %**	**100.0 %**

Vacancy	8.1 %
Vacancy (excluding development)	7.2 %

NOTE 12 OTHER FINANCIAL ASSETS / OTHER FINANCIAL LIABILITIES

Other financial assets and *Other financial liablities* are specified in tables 12.1 and 12.2.

Table 12.1 Other financial assets

Amounts in NOK million	31.12.2012	31.12.2011
Withholding tax	355	744
Accrued income from external agency securities lending	132	106
Receivables from other portfolios under common management*	-	2 371
Other receivables, subsidiaries real estate	2 911	23
Other receivables	1 013	0
Other financial assets	**4 411**	**3 244**

* Receivables from other portfolios under common management comprise the net value of deposits and repurchase and reverse repurchase agreements vis-a-vis other portfolios managed by Norges Bank. These related party transactions were carried out at arm's length.

Tabell 12.2 Annen finansiell gjeld

Amounts in NOK million	31.12.2012	31.12.2011
Tax due on foreign equities gains	100	-
Other liabilities abroad	131	199
Other liabilities, subsidiaries real estate	95	52
Liabilities to other portfolios under common management*	2 039	-
Other financial liabilities	**2 365**	**251**

* Liabilities to other portfolios under common management comprise the net value of deposits and repurchase and reverse repurchase agreements vis-a-vis other portfolios managed by Norges Bank. These related party transactions were carried out at arm's length.

NOTE 13 CURRENCY DISTRIBUTION

Table 13.1 Currency distribution of the Balance sheet as at 31 December 2012 and 31 December 2011

				31.12.2012				
Amounts in NOK million	USD	CAD	EUR	GBP	CHF	JPY	Other	Total
Deposits in banks	245	-103	529	80	3 213	78	1 822	5 864
Lending associated with reverse repurchase agreements	41 530	3 092	13 367	262	-	2 032	1 157	61 440
Unsettled trades	86	-	345	14	-	68	1164	1 677
Equities and units	697 508	54 036	487 884	344 881	138 301	105 699	384 643	2 212 951
Equities lent	16 339	1 143	30 495	3 049	3 822	18 858	41 334	115 041
Bonds and other fixed-income instruments	526 363	43 368	452 740	96 793	21 048	103 284	203 586	1 447 182
Bonds lent	5 325	-	-	-	-	-	-	5 325
Financial derivatives	1 167	82	214	442	-	-6 341	5 883	1 447
Financial assets real estate	-	-	-	4 841	-	-	-	4 841
Jointly controlled entities real estate	-	-	4 583	2 848	-	-	-	7 431
Other financial assets	1 176	-	3 107	31	29	-	68	4 411
Total financial assets	**1 289 740**	**101 618**	**993 262**	**453 243**	**166 413**	**223 677**	**639 656**	**3 867 610**
Investment properties	-	-	3 697	-	6 080	-	-	9 777
Other non-financial assets	-	-	5	-	-	-	-	5
Total assets	**1 289 740**	**101 618**	**996 964**	**453 243**	**172 493**	**223 677**	**639 656**	**3 877 392**

Amounts in NOK million	31.12.2012 USD	CAD	EUR	GBP	CHF	JPY	Other	Total
Short-term borrowing	-31	1	1	219	-	2	10	202
Borrowing associated with repurchase agreements	4 228	2 107	8 101	-	-	-	4 578	19 013
Cash collateral received	32 688	-	313	-	-	-	-	33 001
Unsettled trades	239	-	2 426	17	-	74	1 686	4 442
Financial derivatives	-5 261	-	589	1 548	17	-2 787	8 494	2 600
Other financial liabilities	-36	20	1 332	990	-12	-	73	2 365
Management fee payable	.	.	.	.	.	.	2 193	2 193
Total financial liabilities	**31 826**	**2 128**	**12 761**	**2 773**	**5**	**-2 712**	**17 033**	**63 815**

Amounts in NOK million	31.12.2011 USD	CAD	EUR	GBP	CHF	JPY	Other	Total
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
Total financial assets	**1 153 551**	**83 572**	**1 006 794**	**463 220**	**124 745**	**181 739**	**359 618**	**3 373 239**
Investment properties	-	-	4 062	-	-	-	-	4 062
Other non-financial assets	-	-	6	-	-	-	-	6
Total assets	**1 153 551**	**83 572**	**1 010 862**	**463 220**	**124 745**	**181 739**	**359 618**	**3 377 307**
Short-term borrowing	-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
Total financial liabilities	**48 295**	**64**	**2 049**	**3 508**	**12**	**3 514**	**10 832**	**68 274**

NOTE 14 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 accounting and valuation policy and guidelines which are supported by work and control procedures. The policy document lays down valuation policies and outlines procedures by the NBIM valuation committee.

The valuation environment has been adapted in accordance with market standards and established 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.

In general, 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 Norges Bank units 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 quoted market prices. For holdings that are insufficiently liquid for valuation to be based on quoted prices, widely accepted models are used. Here observable inputs are used to the degree possible, but in some cases, owing to illiquid markets, unobservable inputs are used.

The valuation process is subject on a daily basis to numerous controls by Norges Bank's valuation departments 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 valuation in accordance with fair value. As part of this review, particular attention is paid to illiquid financial instruments and real estate investments, i.e. investments deemed to pose valuation challenges. Illiquid instruments are identified using 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.

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.

Valuation techniques

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

Norges Bank has defined hierarchies for price sources used for valuation. Holdings that are included in the benchmark index 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 other reputable external price providers' prices. In Norges Bank, analyses are done as part of the extended controls at month-end in which prices according to 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 quoted market prices. Over half (72 percent) of the holdings in bonds are also valued using quoted market prices, and only 0.34 percent of the bond portfolio now comprise instruments classified as Level 3 holdings. 89 percent of the investments for the Government Pension Fund Global as at year-end 2012 comprised holdings traded in active markets and which 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 inputs 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 quoted 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.

Inputs 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 comprise financial assets real estate, investment property and jointly controlled entities, see Note 11 Real estate for further information. For all these investments assets and liabilities are measured, in full or in part, at fair value. Financial assets real estate and investment properties are measured at fair value, both where the investment portfolio has a direct ownership interest in the property and where the property is held through jointly controlled entities. At each reporting date, real estate investments' carrying amounts are adjusted to reflect their fair values as estimated by external independent valuation specialists using the discounted cash flow method or the income method, unless it is deemed that a recent transaction price is a better estimate of fair value. For valuation of any liabilities or financial derivatives in the real estate asset class reference is made to the section above.

Real estate valuations are by their nature predisposed to significant forward looking judgements, key assumptions and estimates in respect of the individual property type, location, expected future cash flows (such as tenants' contracts, future revenue streams, and the overall repair and condition of the subject property) as well as applicable discount rates. Such estimates generally reflect recent comparable market transactions of 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 development. Standard assumptions are used that are 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 real estate portfolio.

The discounted cash flow method involves the projection of a series of periodic cash flows to either an operating or a development property. 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 are discounted to present value. The terminal value is the capitalised 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 income 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 a market yield or return requirements. Properties valued using this method capitalise rental income using a market yield, and may include allowances for market adjustments (e.g. vacancy, lease incentives, and refurbishments) to the rental income.

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 quoted prices in active markets and are considered to have very limited valuation risk. Investments allocated to Level 2 are valued using models with observable inputs. These holdings have some pricing uncertainty. Holdings allocated to Level 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 valuers 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 14.1 groups the investments into categories of assessed valuation uncertainty as at 31 December 2012 and 2011.

Table 14.1 Specification of investments by level of valuation uncertainty

	Level 1		Level 2		Level 3		Total	
Amounts in NOK million	31.12.2012	31.12.2011	31.12.2012	31.12.2011	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Equities and units	**2 325 185**	**1 942 777**	**1 184**	**995**	**1 623**	**156**	**2 327 992**	**1 943 928**
Government bonds	759 914	600 790	93 962	11 775	-	-	853 876	612 565
Government-related bonds	122 187	98 370	43 652	78 148	579	646	166 418	177 164
Inflation-linked bonds	40 050	98 431	1 705	7 285	-	-	41 755	105 716
Corporate bonds	5 239	3 513	190 764	184 543	437	285	196 440	188 341
Securitised bonds	113 739	75 277	76 293	157 087	3 986	11 361	194 018	243 725
Total bonds	**1 041 129**	**876 381**	**406 376**	**438 838**	**5 002**	**12 292**	**1 452 507**	**1 327 511**
Financial derivatives (assets)	221	5	1 226	2 222	-	-	1 447	2 227
Financial derivatives (liabilities)	-91	-224	-2 509	-5 733	-	-	-2 600	-5 957
Total financial derivatives	**130**	**-219**	**-1 283**	**-3 511**	**-**	**-**	**-1 153**	**-3 730**
Financial assets real estate	.	.	.	.	4 841	4 415	4 841	4 415
Jointly controlled entities real estate	.	.	.	.	7 431	2 546	7 431	2 546
Investment properties	.	.	.	.	9 777	4 062	9 777	4 062
Total real estate	**.**	**.**	**.**	**.**	**22 049**	**11 023**	**22 049**	**11 023**
Total	**3 366 444**	**2 818 939**	**406 277**	**436 322**	**28 674**	**23 471**	**3 801 395**	**3 278 732**

Table 14.1 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 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, equities whose trading has been suspended and unlisted equities of companies whose board of directors have stated an intention to make an initial public offering of shares. The increase in Level 3 for equities in 2012 is due to an unlisted investment made this year, counteracted by some sales, currency effects and repayment of equity capital.

Valuation of bonds is more uncertain and complex than valuation of equities. Norges Bank 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 quoted market prices. Some emerging market government bonds and bonds issued by European sovereigns with substantial unresolved debt issues are allocated to Level 2. Extensive analyses of pricing and liquidity have been done for this segment. Government-related bonds are allocated to Levels 1, 2 and a few to Level 3 on the basis of variation in the degree of trading and price transparency in the markets. Most corporate bonds belong to Level 2, with some exceptions allocated to Levels 1 and 3. Covered bonds are primarily categorised in Level 1 at this year-end, owing to a 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. External valuations have been obtained for all properties and the financial asset as at 31 December 2012. All real estate investments are measured at the fair value estimated by the external valuers, with the exception of newly acquired properties where the purchase price excluding transaction cost is considered to be the best estimate of fair value. Received valuations for the newly acquired properties differ slightly from the purchase price, however factors indicating that the value of the properties has changed materially since the transaction date have not been observed. It is therefore the assessment of management that the consideration paid in the recent transactions is the best estimate of fair value as at 31 December 2012.

Changes in Level 3 holdings

Table 14.2 shows a reconciliation of changes in carrying amounts for all Level 3 holdings in 2012 and 2011.

Table 14.2 Specification of changes in Level 3 holdings

Amounts in NOK million	01.01.2012	Net gains/ losses	Pur-chases	Sales	Settle-ments	Trans-ferred from Level 1 or 2	Trans-ferred to Level 1 or 2	Foreign exchange gains and losses	31.12.2012
Equities and bonds	12 448	1 530	3 498	-7 200	-1 996	378	-940	-1 093	6 625
Total real estate	11 023	-205	11 705	-	.	.	.	-475	22 049
Financial assets real estate*	4 415	344	199	-	.	.	.	-117	4 841
Jointly controlled entities real estate**	2 546	-371	5 404	-	.	.	.	-149	7 431
Investment properties*	4 062	-177	6 102	-	.	.	.	-210	9 777
Total	23 471	1 325	15 203	-7 200	-1 996	378	-940	-1 568	28 674

Amounts in NOK million	01.01.2011	Net gains/ losses	Pur-chases	Sales	Settle-ments	Trans-ferred from Level 1 or 2	Trans-ferred to Level 1 or 2	Foreign exchange gains and losses	31.12.2011
Equities and bonds	25 350	-746	733	-11 283	-2 857	2 283	-805	-227	12 448
Total real estate	-	-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
Total	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 do 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 for Jointly controlled entities real estate includes Share of the profit/loss in jointly controlled entities real estate. Fair value changes from investment properties owned by the jointly controlled entities are thus included in net gains/ losses.

Holdings allocated to Level 3 in the valuation hierarchy increased by NOK 5 203 million to NOK 28 674 million during 2012. The decrease of Level 3 equities and bonds of NOK 5 823 million is due to a reduction in Level 3 bonds. This was more than counterbalanced by the addition of NOK 11 026 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 14.3 Additional specification Level 3 and sensitivities

Amounts in NOK million	Sensitivities 31.12.2012 Specification of Level 3 holdings 31.12.2012	Unfavourable changes	Favourable changes	Sensitivities 31.12.2011 Specification of Level 3 holdings 31.12.2011	Unfavourable changes	Favourable changes
Equities and units	**1 623**	**-486**	**178**	**156**	**-42**	**30**
Government related bonds	579	-61	36	646	-65	39
Corporate bonds	437	-57	39	285	-27	25
Securitised bonds	3 986	-619	391	11 361	-1 390	1 270
Total bonds	**5 002**	**-737**	**466**	**12 292**	**-1 482**	**1 334**
Financial assets real estate	4 841	-257	261	4 415	-278	288
Jointly controlled entities real estate	7 431	-459	582	2 546	-132	143
Investment properties	9 777	-363	888	4 062	-210	228
Total real estate	**22 049**	**-1 079**	**1 731**	**11 023**	**-620**	**659**
Total	**28 674**	**-2 302**	**2 375**	**23 471**	**-2 144**	**2 023**

Norges Bank's analyses indicate that valuation risk increased during 2012, viewing Level 3 in isolation. The total exposure regarded as being particularly uncertain in relation to valuation increased by NOK 5 203 million during 2012, to a year-end exposure of NOK 28 674 million. This is mainly due to the increase in the size of the real estate portfolio during 2012. On the other hand, the composition of Level 3 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 15 percent, real estate holdings are viewed as having approximately 5 percent average valuation uncertainty. Nevertheless, the total downside valuation risk increased by NOK 158 million to NOK 2 302 million as at year-end 2012 because of significant new real estate investments. The overall calculated sensitivity to favourable model input changes was slightly higher, at NOK 2 375 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 a change of a single unobservable input parameter. For example, while faster mortgage prepayments will have a positive impact on the valuation of some of the bonds held, they will have a negative impact on other bond values, so that the impacts on the total valuation will partly offset one another.

The valuation risk for equities has increased during 2012, and the table shows a NOK 486 million lower value in the event of unfavourable changes, and a NOK 178 million higher value in the event of favourable changes. The most important parameters causing this sensitivity are cash flow estimates and the discount rate.

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.

Securitised bonds show a sensitivity to changes to unobservable inputs which amounts to 27% of the overall valuation uncertainty, with a NOK 619 million lower value in the event of unfavourable changes and a NOK 391 million higher value in the event of favourable changes. 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.

Property values 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 is expected, all else being equal, to change the value of the real estate portfolio by about 4.9 percent or NOK 1 079 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, is expected, all else being equal to change the value of the real estate portfolio by about 7.9 percent or NOK 1 731 million. The reason for a larger estimated upside than downside is that alternative valuations for new investments at year-end indicate a probable value increase.

NOTE 15 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 krone 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 index is divided into asset classes. The fixed-income benchmark specifies a defined allocation between government bonds and corporate bonds, and a sub benchmark for each. Bonds in the government bond benchmark are weighted based on the GDP of the relevant countries, while the bonds in the benchmark for corporate bonds are weighted according to market capitalisation. The currency distribution follows from these weighting principles. The benchmark for equities is constructed on the basis of market capitalisation for shares in the countries included in the benchmark, where selected companies are excluded 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. Positions in financial derivatives are included in 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).

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 principles for ownershop 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 should be 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 investment risk committee complements the delegation of responsibility by advising on investment risk management, and the investment universe committee advises on the portfolio's investment 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 shold be 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 limits 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 authorised by the CRO.

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, credit risk, counterparty risk operational risk and risk related to environmental, social and governance factors. 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. Market risk for the equities and fixed-income portfolios 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 defaulting. 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 country and currency
The portfolio is invested across several asset classes, countries and currencies as shown in Table 15.1.

Table 15.1 Allocation by asset class, country and currency

		Market value in percent by country and currency			Market value in percent by asset class		Assets minus liabilities excluding management fee	
Asset class	Market	31.12.2012	Market	31.12.2011	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Equities	Developed	90.1	Developed	91.5				
	United States	28.5	United States	30.3				
	United Kingdom	16.0	United Kingdom	16.4				
	France	6.9	France	7.0				
	Switzerland	6.5	Switzerland	6.2				
	Germany	6.3	Germany	5.8				
	Total Other	25.9	Total Other	25.8				
	Emerging	9.9	Emerging	8.5				
	China	1.7	Brazil	1.7				
	Brazil	1.5	China	1.4				
	Taiwan	1.3	Russia	1.3				
	Russia	1.1	Taiwan	1.0				
	South Africa	0.7	India	0.5				
	Total Other	3.6	Total Other	2.6				
Total Equities					61.2	58.7	2 335 830	1 944 721

Asset class	Market	Market value in percent by country and currency 31.12.2012	Market	31.12.2011	Market value in percent by asset class 31.12.2012	31.12.2011	Assets minus liabilities excluding management fee 31.12.2012	31.12.2011
Fixed income	Developed	89.8	Developed	98.5				
	USD	37.6	EUR	39.9				
	EUR	30.7	USD	35.0				
	JPY	7.2	GBP	12.1				
	GBP	6.2	JPY	5.0				
	CAD	3.0	CAD	2.1				
	Total Other	5.2	Total Other	4.5				
	Emerging	10.2	Emerging	1.5				
	MXN	1.5	MXN	0.5				
	KRW	1.4	CNY	0.2				
	RUB	1.1	KRW	0.2				
	BRL	1.0	INR	0.2				
	PLN	0.7	BRL	0.1				
	Total Other	4.4	Total Other	0.2				
Total Fixed income					38.1	41.0	1 454 816	1 355 722
Real Estate	France	32.9	France	60.0				
	United Kingdom	31.7	United Kingdom	40.0				
	Switzerland	24.2						
	Other*	11.2						
Total Real estate					0.7	0.3	25 123	11 129

* Other comprises the investment in Germany (Berlin and Frankfurt), which was completed 1 January 2013.

Concentration risk

Within the investment portfolio of the Government Pension Fund Global there are substantial investments in government issued bonds. The portfolio is also invested in private companies that issue both bonds and equities.

Table 15.2 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 15.2 Largest holdings within the segment government bonds

Amounts in NOK million	Market value 31.12.2012
United States	323 983
Japan	103 001
Germany	63 926
United Kingdom	59 784
France	44 016
Italy	26 535
Netherlands	24 624
Mexico	22 569
Canada	22 141
South Korea	20 732

Amounts in NOK million	Market value 31.12.2011
United States	249 072
United Kingdom	109 813
France	79 790
Japan	67 036
Germany	51 294
Italy	32 914
Netherlands	20 218
Spain	17 975
Austria	15 561
Belgium	14 813

Table 15.3 shows the portfolio's largest holdings of non-government issuers across both bonds and equities. Covered bonds issued by financial institutions are included in the bonds column.

Table 15.3 Largest holdings excluding sovereigns, both bonds and equities

Amounts in NOK million, 31.12.2012	Sector	Bonds	Equities	Total
Nestle SA	Consumer Goods	0	30 061	30 061
Royal Dutch Shell PLC	Oil & Gas	0	28 829	28 829
HSBC Holdings PLC	Financials	1 057	27 272	28 329
Kreditanstalt für Wiederaufbau	Government related	25 884	0	25 884
Novartis AG	Health Care	0	21 218	21 218
UBS AG	Financials	7 398	13 456	20 854
Apple Inc	Technology	0	20 698	20 698
Roche Holding AG	Health Care	0	18 192	18 192
European Investment Bank	Government related	17 932	0	17 932
BlackRock Inc	Financials	0	17 766	17 766

Amounts in NOK million, 31.12.2011	Sector	Bonds	Equities	Total
Royal Dutch Shell PLC	Oil & Gas	0	30 983	30 983
Nestle SA	Consumer Goods	0	25 346	25 346
European Investment Bank	Government related	24 099	0	24 099
Kreditanstalt für Wiederaufbau	Government related	22 703	0	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	0	19 281	19 281
Nationwide Building Society	Financials	17 618	0	17 618
BP PLC	Oil & Gas	0	17 277	17 277
Exxon Mobil Corp	Oil & Gas	0	16 901	16 901

Volatility and correlation risk

Norges Bank uses risk modelling to quantify the risk of value changes associated with all or parts of the 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 measure 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 model uses equally weighted weekly return data from the last three years and a parametric calculation methodology. The 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 relative volatility. In addition to the mentioned model, Norges Bank uses other models that to a greater extent capture the market dynamics of recent periods. 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 15.4 and 15.5 present risk both in terms of the portfolio's absolute risk and the relative risk.

Table 15.4 Portfolio risk in terms of expected volatility, in percent

	Expected volatility, actual portfolio							
	31.12.2012	Min 2012	Max 2012	Average 2012	31.12.2011	Min 2011	Max 2011	Average 2011
Portfolio	8.6	7.9	9.9	8.6	9.6	9.5	13.4	12.1
Equities	14.3	13.9	16.6	14.6	16.4	16.4	21.2	19.9
Fixed-income	8.6	8.6	10.4	8.9	10.5	10.5	12.7	12.0

Table 15.5 Relative risk, expected relative volatility, in basispoints

	Expected relative volatility, basispoints							
	31.12.2012	Min 2012	Max 2012	Average 2012	31.12.2011	Min 2011	Max 2011	Average 2011
Portfolio	48	31	57	43	40	33	65	46
Equities	37	32	61	41	53	40	111	64
Fixed-income	64	40	77	58	45	38	76	51

Risk measured by the risk model showed a decline for the portfolio as a whole and in both asset classes in 2012. For the portfolio as a whole, measured risk at year-end was 8.6 percent. This means that for the portfolio, annual fluctuations in value of about NOK 300 billion can be expected. Correspondingly, measured risk at year-end 2011 was 9.6 percent, which implied that at the beginning of 2012 annual fluctuations of around NOK 320 billion could be expected. The actual profit on the portfolio for 2012 of NOK 228 billion was within this number, with fluctuations through the year. The decline was mainly driven by the model using three years' historical data and consequently, historical data from the volatile period in early 2009 was no longer included in the dataset at year-end. Despite the fact that 2012 was also characterised by market turbulence, it was of less magnitude than in early 2009.

The mandate for the Government Pension Fund Global outlines that Norges Bank shall facilitate management with the aim of not exceeding a limit of 100 basis points in expected relative volatility. Risk is measured and compliance with the limit monitored on the basis of the model described above. Expected relative volatility has been within the limit in 2012 and at the end of the year was at 0.5 percent, which is an increase from the end of 2011.

Volatility in global equity and fixed-income markets decreased slightly in 2012 compared to 2011, even though there was substantial uncertainty regarding European sovereign debt and the euro, and uncertainties regarding global growth. The unrest related to the euro area peaked in the second quarter, and declined through the second half of the year as a result of the statement made by Mario Draghi, the president of the European Central Bank (ECB), that the ECB would defend the euro by any means. This was followed up by specific plans to purchase bonds of troubled sovereigns.

Strengths and weaknesses

The strength of these types of risk models is that one can estimate the risk in a portfolio across different asset classes, markets, currencies, securities and derivatives and express this risk as a single numerical value 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 provide reliable forecast in markets without significant changes in volatility. In periods marked by significant changes in volatility and correlation, estimates will be less reliable. Calculated volatility is 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, Norges Bank 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. Both the risk model and the back testing takes into account the long term nature of the Government Pension Fund Global's investment horizon.

Credit risk

Credit risk is the risk of losses resulting from defaults by issuers of fixed-income instruments on their payment obligations. Fixed-income instruments in the portfolio's benchmark are all rated 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 risk profile.

Table 15.6 Bond portfolio specified by credit rating

Amounts in NOK million, 31.12.2012	AAA	AA	A	BBB	Lower rating	Total
Government bonds	533 495	187 356	35 158	97 841	25	853 876
Government related bonds	88 803	46 689	9 740	18 082	3 103	166 418
Inflation-linked bonds	29 743	4 508	229	7 275	-	41 755
Corporate bonds	404	16 258	94 819	82 143	2 816	196 440
Securitised bonds	111 639	15 922	42 763	19 030	4 665	194 018
Total bonds and other fixed-income instruments	**764 084**	**270 733**	**182 709**	**224 372**	**10 609**	**1 452 507**

Amounts in NOK million, 31.12.2011	AAA	AA	A	BBB	Lower rating	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
Total bonds and other fixed-income instruments	**867 378**	**201 170**	**154 991**	**89 939**	**14 033**	**1 327 511**

During the year a number of actions were taken to reduce the market turmoil in several southern European countries, as well as to reduce the uncertainty related to European banks. This led to reduced credit spreads on European government and corporate bonds. The credit risk in bond markets was thus reduced during the year, despite a year characterised by lower than expected growth and major challenges, especially in the eurozone. The situation in Europe remained uncertain in 2012, with weak growth prospects and several states with significant debt challenges. This led to a series of rating agency downgrades of both sovereigns and companies, reducing the bond portfolio's credit quality measured by credit rating. This reduction was only partly offset by new bond investments in 2012, a large proportion of which were in high credit quality bonds. There was also a substantial volume of new investment in emerging market government bonds. These holdings amounted to 9.9 percent of the bond portfolio at year- end. The result was a change in the composition of the bond portfolio on the basis of credit rating, whereby the proportion of AAA bonds has been reduced and that of BBB and AA bonds has been increased. The proportion of BBB bonds increased to 15.4 percent of the bond portfolio at year end 2012 from 6.8 percent at the end of 2011. At year-end 2012, defaulted bonds had a total market value of NOK 1.8 billion, or 0.1 percent of the bond portfolio; the nominal amount of defaulted bonds was NOK 7.4 billion, down from NOK 9.3 billion at year-end 2011. Defaulted bonds are grouped with "Lower rating" in the table above.

Table 15.7 Bond portfolio by credit rating and currency in percent

31.12.2012	AAA	AA	A	BBB	Lower rating	Total
USD	26.5	1.7	4.0	4.1	0.3	36.6
EUR	13.9	6.4	5.4	5.1	0.4	31.2
JPY	-	7.1	-	-	0.0	7.1
GBP	5.1	0.2	0.7	0.7	0.0	6.7
CAD	2.2	0.5	0.1	0.1	0.0	3.0
Other currencies	4.9	2.8	2.3	5.5	0.0	15.5
Total	**52.6**	**18.6**	**12.6**	**15.4**	**0.7**	**100.0**

31.12.2011	AAA	AA	A	BBB	Lower rating	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	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
Total	**65.3**	**15.2**	**11.7**	**6.8**	**1.1**	**100.0**

At end 2012 there were no credit default swaps in the portfolio, see Note 10 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 as a single 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. Rating requirements for counterparties with unsecured bank deposits are higher than in situations when collateral is posted. For instruments where collateral is used minimum requirements have been set, relating to the credit quality, time to maturity and concentration of the collateral. Concentration is also reduced by setting exposure limits for individual counterparties. Exposure per counterparty is measured daily against limits set by the board and the CEO of NBIM. 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. This leads to a measure of gross 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, to arrive at gross exposure. These positions are also adjusted for netting and actual received and posted collateral when determining net exposure. Table 15.8 is a breakdown of exposure by type of activity/instrument regarded as exposed to counterparty risk. In addition to gross and net exposure given by the internal risk model, counterparty risk based on the balance sheet, adjusted for recognised and not-recognised collateral, is shown as well. The reduction in measured counterparty risk is due to a reduction in agency securities lending in 2012, see Note 9 External agency securities lending, and less outstanding time deposits at the end of 2012 than at year-end 2011. The reduction is also due to further reductions in the use of financial derivatives during 2012, see Note 10 Financial derivatives.

Table 15.8 Counterparty risk by type of position

Amounts in NOK million, 31 December 2012	Carrying amount adjusted for collateral	Gross exposure	Effect of netting	Collateral and guarantees	Net exposure
Time deposits and unsecured bank deposits	5 864	5 754	-	-	**5 754**
OTC derivatives including foreign exchange contracts	-1 283	3 407	626	1 517	**1 264**
Repurchase and reverse repurchase agreements*	-89	927	5	-	**923**
Securities lending transactions**	-6 255	16 285	-	8 834	**7 450**
Bonds posted as collateral for futures trades	1 301	1 386	-	-	**1 386**
Total		27 759	631	10 351	16 777

Amounts in NOK million, 31 December 2011	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**
Total		32 955	1 783	9 633	21 538

* The column Carrying amount adjusted for collateral takes into account all positions in the repo market, including the reinvestment 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.

The line OTC derivatives including foreign exchange contracts in the table comprises the net market value of foreign exchange contracts (NOK -57 million) and swaps (NOK -1 266 million). See also Note 10 Financial derivatives. Counterparty risk for derivative positions is followed-up on a net basis at Norges Bank.

Norges Bank's 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 15.9 shows Norges Bank's counterparties classified according to credit rating category.

Table 15.9 Counterparties by credit rating*

	Norges Bank's counterparties (excluding brokers)		Brokers	
	31.12.2012	31.12.2011	31.12.2012	31.12.2011
AAA	-	3	-	3
AA	30	50	29	43
A	46	39	56	43
BBB	-	4	21	14
BB	-	-	3	2
B	-	-	9	12
Total	**76**	**96**	**118**	**117**

* As counterparties are counted per legal entity, several counterparties may be included per corporate group.

Leverage

Leverage may be used 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 total net exposure and market value for the portfolio. Net exposure is determined by including securities in the calculation at market value and by including derivatives converted to underlying exposure. When exposure is greater than market value, the portfolio is leveraged.

The Government Pension Fund Global was not leveraged in 2012. Leverage was also zero at the end of 2011.

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 2012, no securities had been sold in this manner.

NOTE 16 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 16.1.

Table 16.1 Subsidiaries and jointly controlled entities

		31.12.2012
Company	**Office Location**	**Ownership share and voting rights in percent**
NBIM S.à 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
NBIM Clemente S.à r.l	Luxembourg	100
NBIM Clemente OPCI SPPICAV	Paris	100
SCI Malesherbes*	Paris	50
SCI 15 Scribe*	Paris	50
SAS 100 CE*	Paris	50
SCI Daumesnil*	Paris	50
SCI 9 Messine*	Paris	50
NBIM Otto S.à r.l	Luxembourg	100
NBIM Otto W1 S.à r.l	Luxembourg	100
NBIM Otto W3 S.à r.l	Luxembourg	100
NBIM Otto NKE S.à r.l	Luxembourg	100
M. Vermögensverwaltungsgesellschaft mbH*	Hamburg	50
K. Vermögensverwaltungsgesellschaft mbH*	Hamburg	50
NBIM Antoine S.à r.l	Luxembourg	100
NBIM Antoine CHF S.à r.l	Luxembourg	100
NBIM Nerva S.à r.l	Luxembourg	100
NBIM Victoria GP Limited	London	100
NBIM Victoria Partners LP	London	100
MSC Property intermediate Holdings Limited*	London	50
NBIM George GP Limited**	London	100
NBIM George Partners LP**	London	100

* Jointly controlled entities

** These companies have changed name from "Burlington Number 1 (General Partner) Limited" and "Burlington Number 1 Partners LP" in 2012.

		31.12.2011
Company	**Office Location**	**Ownership share and voting rights in percent**
NBIM S.à 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

The annual report 2012 was submitted by Norges Bank's Executive Board on 27 February 2013.

Translation from the original Norwegian version

To the Supervisory Council of Norges Bank

INDEPENDENT AUDITOR'S REPORT

We have audited the consolidated financial reporting for the investment portfolio of the Government Pension Fund Global for 2012 included in Norges Bank's annual financial statements. Subsidiaries of Norges Bank that exclusively constitutes investments as part of the management of the investment portfolio are included in the financial reporting. The financial reporting comprise the balance sheet as at December 31, 2012, 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 the financial reporting in accordance with International Financial Reporting Standards as adopted by 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 law regulations, and auditing standards and practices generally accepted in Norway, including International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial reporting is free from material misstatement.

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

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

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

Opinion
In our opinion, the financial reporting presents fairly, in all material respects, the financial position for the investment portfolio of the Government Pension Fund Global as at December 31, 2012 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by EU.

Oslo, 27. February 2013
Deloitte AS

Aase Aa. Lundgaard
State Authorised Public Accountant (Norway)

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