GOVERNMENT PENSION FUND GLOBAL ANNUAL REPORT

2009

NBIM
Norges Bank Investment Management

Our goal is to foster the financial interests of the fund's owners through active management and by exercising our ownership rights

2009 in brief

- Gains in international equity and fixed income markets boosted the value of the Government Pension Fund Global in 2009. The fund had a record return of 25.6 percent, equivalent to 613 billion kroner. That compares with -23.3 percent in 2008 when global securities markets tumbled.

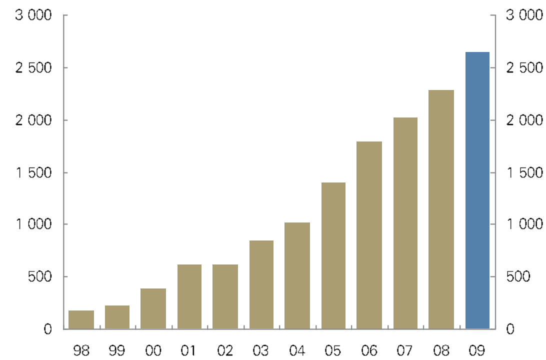
- The fund's return was 4.1 percentage points higher than the return on the benchmark portfolio in 2009. The fixed income portfolio had an excess return of 7.4 percentage points, while the equity portfolio's excess return was 1.8 percentage points.

- The fund's market value rose by 365 billion kroner to 2 640 billion kroner in 2009.

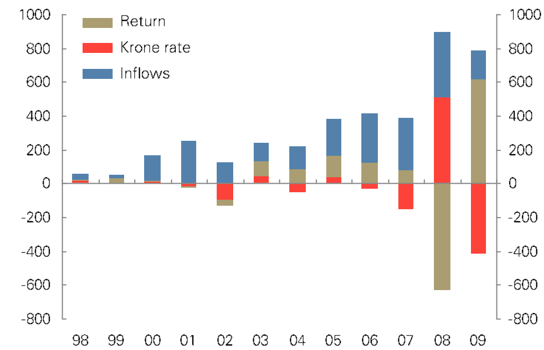
- Capital transfers to the fund amounted to 169 billion kroner in 2009. That is the lowest level since 2004 and less than half of the amount in 2008.

- Equities made up 62.4 percent of the fund's total investments at the end of 2009, while fixed income instruments constituted 37.6 percent of the investments.

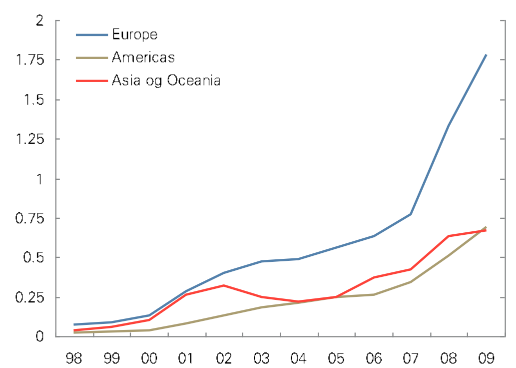
Market value at year-end 1998 – 2009. In billions of NOK



Changes in market value 1998 – 2009. In billions of NOK

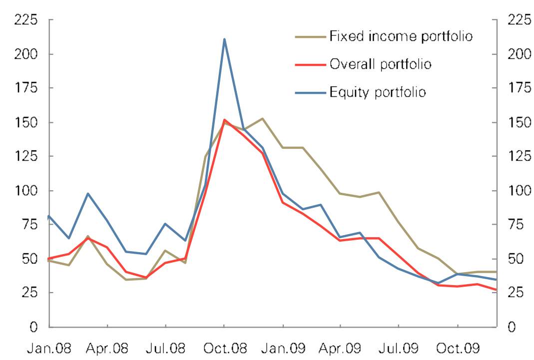


Ownership of equity markets 1998 – 2009. Percentage of FTSE All-World Index's market capitalisation

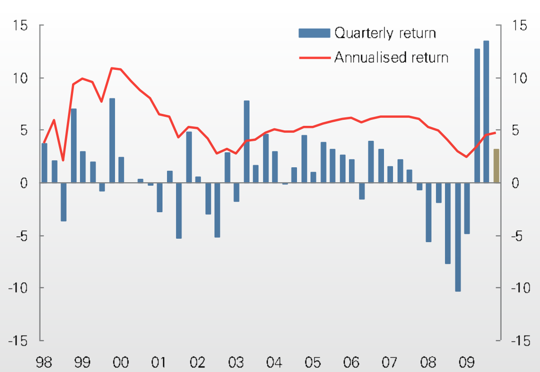


Source: FTSE, NBIM

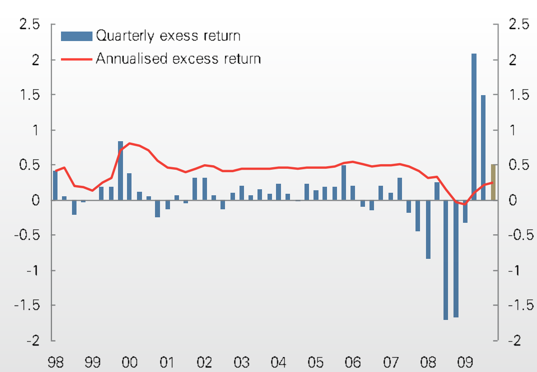
Expected relative volatility 2008 – 2009. Basis points



Quarterly and annualised return since inception 1998 – 2009. Percent



Quarterly and annualised excess return since inception 1998 – 2009. Percentage points



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Published on www.nbim.no

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Translation from Norwegian. For information only.

Svein Gjedrem

Long-term management has weathered the crisis well

The financial crisis led to the steepest fall in global capital markets in the post-war period. Since its inception, the Government Pension Fund Global has experienced two periods of sharp decline, the first in 2001-2002 and most recently in 2008. Losses turned fairly quickly into gains following both periods. The long-term management of the fund fared well through both crises.

The Norwegian government transfers its share of the country's petroleum revenues to the fund. The government simultaneously withdraws the expected long-term annual real return on the fund averaged over a business cycle – or 4 percent of the fund.

The average annual real return since the management of the fund began is now 2.7 percent, up from just 1 percent a year ago. The figure reflects the recent recovery from the sharpest deterioration in capital markets since World War II. According to the fiscal guidelines, annual government petroleum revenue spending shall be 4 percent of the fund's capital over time. With an unchanged risk profile, the average return may move back towards this level after a period.

Norges Bank has been entrusted with several tasks in the management of the fund. The Bank is to ensure prudent investment of fund capital in global capital markets. Inflows of capital are to be invested efficiently. As a shareholder, the Bank shall exercise ownership rights at more than 8 000 companies. Moreover, the Bank advises the Ministry of Finance on the fund's long-term investment strategy. The Bank also performs active management within the limits laid down by the fund's owner and the Bank itself.

These tasks are closely related. Our advice on strategy is based partly on close monitoring of the market as part of our active management, which facilitates the effective ownership rights at companies that we have analysed and followed closely over time. Cost control and management are also reinforced by operating an entity with a clear economic purpose.

Norges Bank's Executive Board sets limits for all activities in the Norges Bank's investment management unit NBIM. Oversight of investment management has been strengthened. The Executive Board introduced new principles for risk management in 2009 based on a common framework supplemented by more concrete risk limits in an investment mandate.

The size and scope of active strategies are determined by the Executive Board, which sets its own limits for risk in addition to those set by the Ministry of Finance. Our assessment after 12 years is that active management can make an important contribution to the fund's returns

The fund's results for 2009 show that considerable values have been recovered and faster than we dared hope a year ago.

in the long term, but must be subject to restrictions and closely monitored. The fund's results for 2009 show that considerable values have been recovered and faster than we dared hope a year ago. The goal is to safeguard and build financial wealth for future generations through a highly skilled investment management organisation.

The reporting on activities and accounts has become increasingly transparent over the past two to three years. Reporting has been expanded further this year, with additional and more detailed analyses of management results and risk evaluation along more dimensions. The notes to the financial reporting are more extensive, especially with regard to risk and valuation. Remuneration figures for all members of NBIM's management team are included. The Executive Board's investment management rules will be published on NBIM's website with the fund's holdings and voting at general meetings. Publication of daily figures for the size of the fund will commence in the near future.

Oslo, 5 March 2010

Svein Gjedrem

Governor of Norges Bank and Chairman of the Executive Board

Yngve Slyngstad

From major challenges to record results

The past year marked a turning point for the Government Pension Fund Global and NBIM. The financial crisis ended earlier than we had anticipated and the fund posted a record return. A year that began with big challenges went on to become the fund's best year ever, by a large margin.

NBIM presented the fund's annual report for 2008 when stock markets bottomed out in March last year. Many people questioned our investment strategy at the time. We seek to safeguard the fund and build wealth for future generations. The fund's size and investment horizon are substantially greater than for most other investors, so it is important to stick with our long-term strategy even in periods of setbacks. This was demonstrated last year when the fund returned a record 25.6 percent. This was 4.1 percentage points higher than the return on the benchmark portfolio and better than we could have expected given our investment strategy. Much of it was due to a reversal of the fixed income portfolio's negative results in 2007 and 2008.

The fund's market value rose to 2 640 billion kroner at the end of 2009. The return on investments was 613 billion kroner, while capital inflows of 169 billion kroner were the lowest since 2004. NBIM reached a target of 60 percent in equity investments in June, after two years and 1 010 billion kroner in stock purchases. The long transition period was favourable as we were able to exploit falling equity prices during the financial crisis.

The fund has stakes in more than 8 300 companies. NBIM uses its ownership rights to protect these investments, promote shareholder rights and encourage better social and environmental standards at companies. We continued to develop our ownership work in 2009, using new methods and adopting a strategy with two new focus areas. Well-functioning financial markets became such an area after the collapse of fixed income markets in 2008. Better water management at companies was the other new focus.

NBIM has emerged from the financial crisis stronger. We continued the extensive reorganisation that started in 2008, with a new governance model and organisation structure. We recruited many talented employees, including a new management team with broad international experience. The organisation has gained valuable experience, particularly in crisis and risk management, strengthening its competence and structure.

Investment is about looking ahead. The purpose of the fund is to ensure that future generations get a share of today's petroleum wealth through solid long-term returns.

> We learned some important lessons in the past two years and we look enthusiastically forward to further developing a world-class investment management organisation.

The fund´s investments will always be exposed to the risk of changing conditions. We learned some important lessons in the past two years and we look enthusiastically forward to further developing a world-class investment management organisation.

NBIM aims to provide open and detailed information about its fund management. We have seen that expectations of openness, transparency and accountability are particularly high in challenging times. We hope that this annual report will give readers a broad picture of the fund's management over the past year and provide useful information about how we have discharged the important task we have been entrusted with.

Oslo, 5 March 2010

Yngve Slyngstad
Executive Director NBIM

Governance model

Clear division of roles and responsibilities

The Government Pension Fund Global shall support government saving for future pension expenditure and underpin long-term considerations in the use of Norway's petroleum revenues.

Norway's parliament has laid down the framework for the fund in the Government Pension Fund Act. The Ministry of Finance has formal responsibility for the fund's management. The operational management is handled by the Norwegian central bank (Norges Bank) through the investment management unit Norges Bank Investment Management (NBIM).

A management agreement regulates the relationship between the Ministry of Finance as client and Norges Bank as manager. The ministry has also issued guidelines for the fund's investments through regulations and supplementary provisions. It also lays down ethical guidelines for the fund's management.

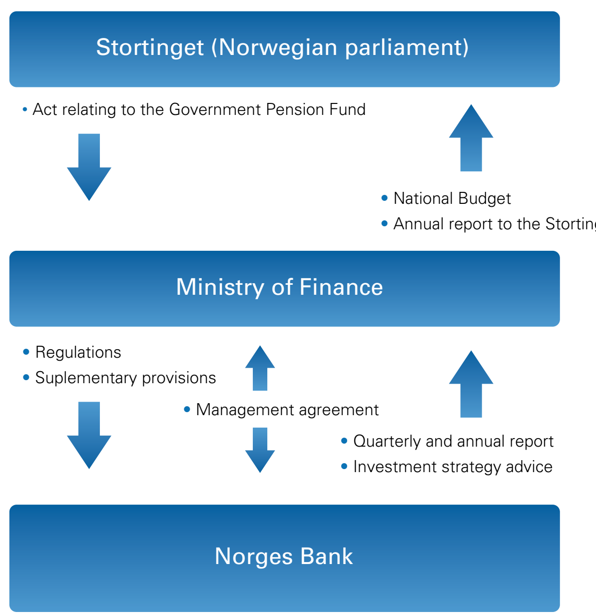
Norges Bank manages substantial assets on behalf of the Norwegian people. The fund shall ensure that future generations get a reasonable share of the country's petroleum wealth. This gives the present generation an ethical obligation to manage the fund in a responsible manner that contributes to good long-term returns.

The Executive Board's oversight

The Executive Board is responsible for Norges Bank's operations. It has seven members appointed by the King in Council. The Governor and Deputy Governor of Norges Bank are its chairman and vice-chairman respectively.

The Executive Board lays down guidelines and strategic plans for NBIM's management activities. The aim is to add value through active management of the government's and Norges Bank's foreign financial assets, foster the owners' long-term financial interests through active ownership and implement the owners' management strategy in a cost-effective, prudent and confidence-inspiring way. In addition to the Government Pension Fund Global, NBIM manages the bulk of Norges Bank's foreign exchange reserves and the Ministry of Petroleum and Energy's Government Petroleum Insurance Fund.

NBIM's governance model differs from other parts of Norges Bank. NBIM's Executive Director has the responsibility and authority of CEO of the unit. He reports directly to the Executive Board and is subject to continuous oversight by the Governor on behalf of the board.



The Executive Board has reinforced its oversight of NBIM in recent years. In 2008, it issued a job description and an investment mandate for NBIM's Executive Director. The mandate supplements the Ministry of Finance's investment limits by setting additional rules for what the fund may invest in and how much risk NBIM can take in its management.

The Executive Board adopted new principles for risk management at NBIM in 2009. These are based on a common framework and risk is split into four categories: market risk, credit risk, counterparty risk and operational risk. The principles for risk management in each of

Executive Board
Lays down strategic plans
Sets principles for risk management
Sets NBIM investment mandate
Sets NBIM CEO job description

NBIM committees
Advises NBIM CEO

NBIM CEO
Lays down policies
Delegates mandates
Delegates work tasks through job descriptions

NBIM control and compliance
Compliance monitoring
Risk and compliance reporting

NBIM Leader Group
Implements policies through guidelines
Delegates work tasks
Monitors, follows up and reports

these categories are supplemented by more concrete risk limits for the organisation. The monthly, quarterly and annual reporting from NBIM to the Executive Board shall reflect the guidelines in the investment mandate. These documents are available on NBIM's website, www.nbim.no.

The Executive Board also set up a remuneration committee in 2009 as a subcommittee and preparatory body for the Executive Board. The committee shall prepare recommendations for the Executive Board on the main terms and pay bands for the Executive Director of NBIM and other senior managers reporting directly to him. It shall also prepare recommendations for the Executive Board on the principles for performance-based remuneration and, annually, on the overall limits for the payment of performance-based remuneration.

Supervisory Council, oversight and auditing

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

Central Bank Audit is Norges Bank's statutory audit unit which performs financial audits and oversight on behalf of the Supervisory Council. In 2007, the Supervisory Council entered into an agreement with accountancy firm Deloitte AS on financial auditing of the Government Pension Fund Global. Deloitte and Central Bank Audit submit a separate audit statement to the Supervisory Board on the financial reporting for the fund presented in a note to Norges Bank's annual financial statements.

The Office of the Auditor General audits and performs checks on the Government Pension Fund Global in line with applicable legislation and instructions. This work is based partly on the audit performed by Central Bank Audit and Deloitte.

Changes to the Norges Bank Act

Norway's parliament (the Storting) approved a number of changes to the Norges Bank Act in 2009 in areas including accounting and auditing. A new audit and oversight system will be introduced in 2010 so that the Central Bank Audit will be replaced by an external auditor. The supervisory responsibilities of the Supervisory Council and Executive Board are also clarified. The Executive Board's Internal Audit unit is given statutory status and a new statutory secretariat to the Supervisory Board will be created to continue and develop the oversight work currently performed by Central Bank Audit, organise the Supervisory Board's activities and manage the agreement with the external auditor.

The Supervisory Council has appointed Deloitte AS as the bank's external auditor to audit the bank's annual financial statements from 2010 onwards. Central Bank Audit is the auditor responsible for the bank's annual financial statements for 2009. The financial reporting for the Government Pension Fund Global for 2009 has been audited with Deloitte in line with the existing agreement with the Supervisory Council.

The entry into force of the new accounting rules requires the preparation of a separate regulation and work is under way with a view to implementation from 1 January 2011.

NBIM's role

Responsible management at every level

Norges Bank Investment Management (NBIM) is entrusted with the operational management of the Government Pension Fund Global. The aim is to safeguard and build wealth for future generations.

The Ministry of Finance sets the key requirements for the fund's investments, its mix of assets and regions, the maximum holding in individual companies and the limits for active management. The ministry also sets ethical guidelines for the fund's investments.

NBIM is a separate wing of Norges Bank focused on investment management. Its objective is to safeguard and build financial wealth for future generations by responsibly and cost-effectively implementing the investment strategy laid down by the Ministry of Finance. The goal is to safeguard the owners' long-term financial interests through active management and ownership.

NBIM performs several important tasks

NBIM ensures that capital transfers to the fund are invested in the markets at the lowest possible costs in line with the guidelines from the Ministry of Finance and Norges Bank's Executive Board. NBIM shall ensure a cost-effective exposure to the benchmark portfolio once the capital has been invested in the markets.

We seek to outperform the benchmark portfolio set up by the Ministry of Finance. Our target is an average annual added value of 25 basis points.

We use our ownership rights to protect the fund's investments by promoting good corporate governance and by demanding high ethical, social and environmental standards at companies. The active ownership shall reflect the ethical guidelines for the fund.

Norges Bank advises the Ministry of Finance on the fund's long-term investment strategy. The aim is to

The objective is to safeguard and build financial wealth for future generations.

generate the highest possible long-term return within the limits set by the ministry. The introduction of new capital, implementation of the client's investment strategy and exercise of ownership rights are best carried out as a combined process within the same organisation. Active investment management, on the other hand, is performed with the help of a large number of external management organisations as well as NBIM's internal managers.

Strategic benchmark portfolio

The Government Pension Fund Global's strategic benchmark portfolio consists of an equity index and a bond index compiled by the FTSE Group and Barclays Capital respectively. The benchmark consists of 60 percent equities and 40 percent fixed income instruments. The equity portion consists of equities listed on stock exchanges in Europe (50 percent), the Americas and Africa (35 percent), and Asia and Oceania (15 percent). The fixed income part consists of 11 currencies. Its regional distribution is 60 in percent Europe, 35 percent in the Americas, and 5 percent in Asia and Oceania.

Learn more about our investment management

NBIM's website (www.nbim.no) contains all reports on the management of the Government Pension Fund Global, as well as information on the fund's strategy and the organisation of investment management at Norges Bank. The site also contains the text of the Government Pension Fund Act and the regulations, supplementary provisions and guidelines issued by the Ministry of Finance.

Investment strategy

Long-term approach pays off

The fund's long-term outlook – one of the pillars of its investment strategy – paid off with record-high returns in 2009. The past year strengthened our conviction that active management ensures profitable and sound management of the fund.

The Government Pension Fund Global follows the investment strategy laid down by the Ministry of Finance in consultation with advisers including Norges Bank. The most important decision for the fund's future returns and risk levels is how much capital will be invested in equities and fixed income instruments. The ministry decided in June 2007 that 60 percent of the fund's capital would be invested in equities and 40 percent in fixed income, a target that was reached in June 2009. Another important decision is the regional weights for the various markets in which the fund invests. This strategy forms the basis for the benchmark portfolio that the fund is measured against.

The ministry has set limits for how much risk NBIM may take in its active management of the fund. The most important limit is expressed as expected tracking error (relative volatility) and puts a ceiling on how far the return on the fund may be expected to deviate from the return on the benchmark portfolio. The expected tracking error limit is 1.5 percentage points. This means that the difference between the fund's return and the benchmark portfolio's return is expected to be more than 1.5 percentage points in one out of every three years and more than 2.5 percentage points in one out of every ten years.

Five tasks

The fund's management has five main tasks. We invest new capital in the markets at the lowest possible cost. We manage the invested capital to maintain the market portfolio cost-effectively. We seek to increase returns through active investment decisions and through active ownership. Norges Bank advises the Ministry of Finance on the fund's long-term investment strategy.

Our active management seeks to generate a higher return than the benchmark portfolio, adding value for future generations. It involves three strategies: management of the market portfolio, fundamental strategies, and exposure to and risk management of systematic return patterns.

Managing the market portfolio involves active decisions, such as when the fund should buy securities that are due to be included in the benchmark portfolio and whether the fund should participate in initial public offerings. This kind of management helps us secure favourable asset prices. It also ensures cost-effective management of the fund's capital.

Active investment decisions are made when we use fundamental strategies to invest in companies. Our portfolio managers analyse individual issuers of securities – both equities and debt – to find and exploit assets that are mispriced. Knowledge of specific industries and companies is an important part of this strategy. The fund's long-term investment outlook allows us to invest in mispriced assets expected to yield solid returns over time.

We make active investment decisions in our management of systematic risk factors. These are common characteristics that securities have to varying degrees and that contribute to both risk and return on different securities. Systematic risk is a key part of our risk management. It can also be a source of excess return through active investment decisions. Systematic risk will be an important variable when explaining an active manager's results and active management will therefore to a large extent involve risk management. Liquidity and volatility are among the most important systematic risk factors.

Managers will seek to create an excess return through fundamental analysis of companies within a focused and concentrated mandate.

Delegation and specialisation

The key elements of the investment strategy are delegation of decision making powers, specialised mandates, diversification across independent mandates and cost-effective implementation.

NBIM awards mandates to managers with expertise in defined investment areas, such as a specific sector, country or region. Managers will seek to create an excess return through fundamental analysis of companies within a focused and concentrated mandate. Detailed analysis raises confidence in investment decisions and the likelihood of excess returns. Each manager makes decisions within the limits of a mandate and the results are measured regularly. A diversified mandate structure promotes independent decisions, reducing the risk of different mandates being exposed to the same underlying risk. The fund's size gives NBIM access to company management, as well as other relevant institutions and trade organisations. Its size also provides economies of scale for analysis. The knowledge gained through specialised analysis of specific areas opens up opportunities to exploit mispricing in the markets. This applies particularly to emerging markets, which are often less efficient than established markets.

Development of the strategy

The investment strategy builds on the fund's long-term investment outlook and substantial size. We benefited from this approach in 2009.

The fixed income portfolio had a record excess return, mainly from illiquid positions established before the financial turmoil began two years earlier. The same positions had negative returns in 2007 and 2008. The fund's long-term outlook meant we could sit on these investments when other investors were forced to sell assets at low prices during the financial crisis. The fixed income strategy was adjusted in 2009 to include lower leverage and decreased use of derivatives and trades that exploit price differences between two similar securities. Fundamental analysis of issuers was strengthened.

In equity management the internal management of global sectors was reorganised with greater emphasis on concentrated portfolios. Coverage of emerging markets was also strengthened with new external mandates. We established four environmental equity mandates at the end of the year, two in water management and two in clean technology. All of these seek to outperform the benchmark portfolio.

Norway's parliament approved in June 2008 a plan to invest up to 5 percent of the fund's capital in real estate. NBIM has since built up real estate expertise in anticipation of an investment mandate from the Ministry of Finance.

25.11.08 The US Federal Reserve announces plans to buy Fannie Mae, Freddie Mac og Ginnie Mae. The Fed also sets up TALF.

NOVEMBER 2008

01.01.09 Bank of America buys 94-year-old Merrill Lynch, one of many acquisitions in a banking industry that is barely recognisable from 2007.

JANUARY 2009

26.01.09 The Icelandic banking system collapse.

11.02.09 Ireland announces nationalisation of two banks. Irish credit default swaps hit all-time high of 400 basis points.

17.02.09 Newly elected US President Barack Obama signs USD 787 billion stimulus bill.

FEBRUARY 2009

05.03.09 The Bank of England cuts interest rates to 0.5%, the lowest level since the bank was founded in 1694.

05.03.09 The Bank of England starts quantitative easing to kick-start the economy.

MARCH 2009

09.03.09 The S&P 500 bottoms out after dropping 57% from its peak 17 months earlier.

18.03.09 The US Federal Reserve announces plans to buy government bonds.

02.04.09 The G20 meeting announces a "global solution" to a "global crisis".

APRIL 2009

Market developments

The financial crisis winds down

The collapse of investment bank Lehman Brothers in September 2008 spread fear through the financial markets, pushing down prices and causing extreme volatility until March 2009. Massive support packages from policymakers worldwide helped stabilise the markets and reverse the negative trend. The fund's fixed income portfolio benefitted particularly from the return to more normal market conditions.

The start of the financial turmoil in 2007 and subsequent market developments sent shockwaves through the world's financial systems. A liquidity crisis in fixed income markets developed into a banking crisis that triggered a global credit crunch. The background for these events was the collapse of the US mortgage market and a decline in fixed income prices in the summer of 2007. The plunge accelerated in the autumn of 2008 as the consequences of the problems in the housing market became more apparent. The bankruptcy of Lehman Brothers and near-collapse of the insurer AIG in September 2008 led to a virtual standstill in the credit market and there was fundamental uncertainty about banks' ability to survive. Capital for companies dried up as banks reduced risk and tightened lending. The start of 2009 was marked by huge uncertainty in both financial markets and the global economy, which went into its steepest downturn since World War II.

Investors shied away from risky investments amid heightened uncertainty over companies' future income. The broad FTSE All-World Index fell to a six-year low on 9 March as investors priced in expectations of a continued deterioration of the global economy.

Authorities worldwide responded with massive and coordinated support packages to supply the markets with liquidity and avoid the collapse of more large financial institutions. On 17 February, the US president signed a 787 billion dollar economic stimulus package. This was followed by a pledge from the G20 nations on 2 April to spend more than 1 trillion dollars to support the global economy. China had announced a 4 trillion yuan stimulus package in November 2008.

As the scope for further cuts in key policy rates was gradually exhausted, some central banks turned to quantitative easing, including buying securities in the market to increase the money supply. The Bank of England announced such purchases on 5 March and simultaneously reduced its key rate to the lowest since it was founded in 1694. About two weeks later, the Federal Reserve unveiled plans to buy US government bonds and securities from government-sponsored mortgage enterprises for 1 050 billion dollars, injecting liquidity into capital markets and contributing to stability.

Confidence and liquidity in financial institutions returned and the likelihood of a market collapse receded as financial institutions became more willing to accept each other's creditworthiness. When the Federal Reserve published results of a stress test of the largest banks' capital base on 7 May, it estimated they needed 75 billion dollars in capital as a buffer against further deterioration in the economy. It soon became clear that the banks were able to fetch more than this, primarily from private sources.

07.05.09 Stress test results for major US banks are made public, well received by markets.

07.05.09 The European Central Bank announces plans to buy covered bonds for EUR 60 billion.

14.07.09 Goldman Sachs posts record second-quarter profit.

01.10.09 IMF warns against very high levels of public deficits and debt.

07.10.09 Australia becomes the first G20 nation to raise its benchmark interest rate.

03.11.09 Lloyds bank raises GBP 34 billion, avoids government asset protection program.

MAY 2009 | JUNE 2009 | JULY 2009 | OCTOBER 2009 | NOVEMBER 2009

01.06.09 General Motors files for bankruptcy.

17.06.09 J.P. Morgan chase and nine other banks say they will repay Tarp funds.

29.10.09 Third-quarter GDP figures show the US is pulling out of recession after four consecutive quarters with shrinking GDP.

Fixed income markets also began to function again at the beginning of the year, with record-high issuance of corporate bonds. Turnover in the secondary market picked up in the second quarter, helped by increased risk appetite among investors. Historically high liquidity and credit risk premiums gradually fell back and prices returned to more normal levels from the second quarter. Bid-ask spreads were still abnormally high, leading to substantial costs for investors and unusually high earnings for investment banks. Prices for many of NBIM's fixed income instruments rose as the market thawed and liquidity returned. This contributed to a record excess return on the fund's fixed income portfolio in 2009.

Equity markets also profited from increased risk appetite and a brighter economic outlook. The FTSE All-World Index gained 75 percent from its March low to the end of the year. Cost cutting helped many companies beat analysts' expectations and a number of large financial institutions exploited the difficult market conditions and delivered strong results. The largest gains were in emerging economies and sectors that benefit from stronger expectations for developments in these markets. NBIM's equity portfolio grew in value in 2009, helped by investments in a broad range of sectors and regions.

The financial crisis – which can be broken down into a liquidity crisis, banking crisis and credit crisis – gradually ended in 2009. There was still considerable uncertainty about how hard the global economy had been hit by the crisis and the measures taken to combat it. The economic downturn continued, with rapidly rising unemployment, lower industrial production and a steep fall in world trade. According to estimates presented by the International Monetary Fund (IMF) in January 2010, the global economy contracted by 0.8 percent in 2009, driven by the slump in euro area countries and other advanced economies, such as the US and Japan. By contrast, China, India and other emerging markets continued to expand, with overall economic growth of 2.1 percent in 2009, compared with 6.1 percent in 2008.

Chart 1-1 Spread between three-month interbank rates (LIBOR) and three-month US Treasury bill rates. Percentage points

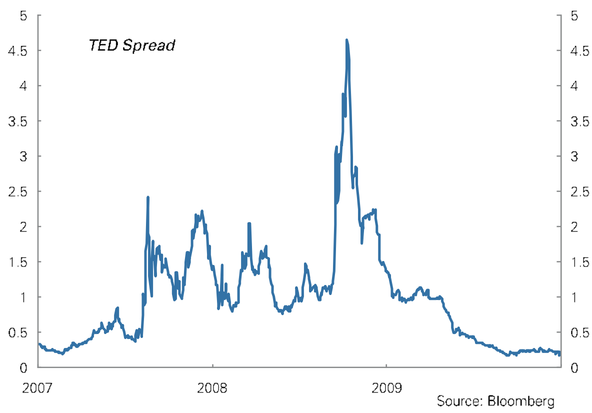


Chart 1-2 Credit spread between corporate bonds and US Treasury bonds, with ten to thirty year maturity. Percentage points

Market value

Rose by 1 billion kroner per day

The fund's market value increased to 2 640 billion kroner at the end of 2009, boosted by 169 billion kroner in new capital.

The fund's market value rose by 365 billion kroner in 2009, helped by gains in equity investments. The equity portfolio grew by 515 billion kroner, while the value of the fixed income portfolio fell by 150 billion kroner.

A total 62.4 percent of the fund's capital was invested in equities at the end of the year, up from 49.6 percent at the end of 2008. That is higher than the long-term goal of 60 percent equities that the Ministry of Finance has set and is due to strong gains in equity markets in 2009. The fund follows rules for how the share of equities shall be readjusted to the long-term goal of 60 percent. These rules are covered in a chapter on rebalancing.

The fund's market value is affected by a number of factors, including returns, capital inflows and exchange rates. The return on investments was 613 billion kroner in 2009, while inflows from the government's petroleum revenues totalled 169 billion kroner. This was less than half of the record inflows of 384 billion kroner in 2008 and the lowest level since 2004. The fund only invests outside Norway in international currencies. A stronger krone relative to other currencies reduced the fund's market value by 418 billion kroner in 2009. Changes in the krone exchange rate have no effect on the fund's international purchasing power, since the fund's investments remain abroad.

Total capital of 2 310 billion kroner has been transferred to the fund since 1996. The total return on the fund in international currency has been 482 billion kroner, while a stronger krone has reduced the fund's market value by 152 billion kroner.

Chart 2-1 Market value at year-end. Billions of NOK

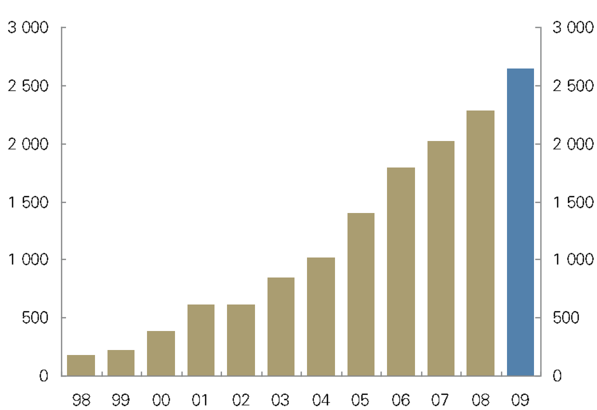


Chart 2-2 Changes in market value. Billions of NOK

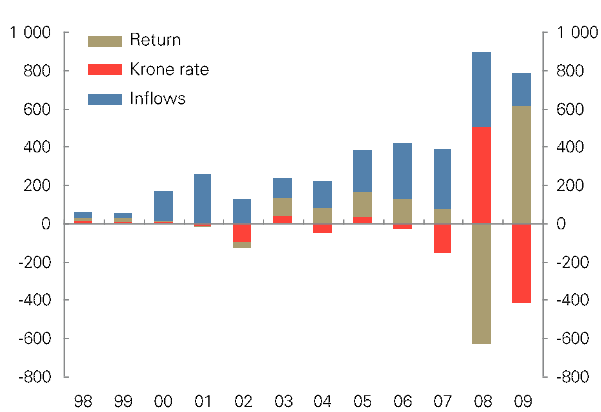


Table 2-1 Key figures as of 31 December 2009

	2009	2008	Q4 2009	Q3 2009	Q2 2009	Q1 2009
Market value (billions of NOK)						
Market value of fixed income portfolio	996	1 146	996	967	948	985
Market value of equity porfolio	1 644	1 129	1 644	1 581	1 438	1 091
Market value of fund	2 640	2 275	2 640	2 549	2 385	2 076
Inflows of new capital	169	384	36	49	40	44
Return	613	-633	84	325	270	-66
Change due to movements in krone	-418	506	-28	-211	-1	-177
Total change in fund	365	257	92	163	309	-199
Return in international currency						
Equity portfolio (percent)	34.27	-40.70	4.73	17.69	19.49	-8.84
Fixed income portfolio (percent)	12.49	-0.52	0.75	7.19	5.07	-0.88
Fund (percent)	25.62	-23.30	3.18	13.51	12.67	-4.81
Benchmark portfolio (percent)	21.52	-19.92	2.67	12.03	10.60	-4.48
Excess return (percentage points)	4.10	-3.38	0.51	1.48	2.07	-0.33
Management costs (percent)	0.14	0.11	0.03	0.04	0.04	0.04
Return after management costs (percent)	25.48	-23.40	3.14	13.47	12.63	-4.85
Return in NOK (percent)						
Equity portfolio	15.31	-27.84	3.68	8.63	19.69	-14.46
Fixed income portfolio	-3.39	21.05	-0.25	-1.06	5.25	-6.99
Fund	7.88	-6.66	2.15	4.76	12.86	-10.67
Benchmark portfolio	4.36	-2.55	1.64	3.40	10.78	-10.36
Management costs (percent)						
Estimated transition costs	0.09	0.27	0.00	0.01	0.02	0.06
Annualised management costs	0.14	0.11	0.14	0.15	0.15	0.16
Changes in value since inception (billions of NOK)						
Gross inflow of new capital	2 323	2 150	2 323	2 286	2 236	2 195
Management costs	13	10	13	12	12	11
Inflows of capital	2 310	2 140	2 310	2 273	2 224	2 184
Return	482	-131	482	398	73	-197
Change due to movements in krone	-152	266	-152	-123	88	89
Market value of fund	2 640	2 275	2 640	2 549	2 385	2 076
Return after management costs	469	-140	469	386	62	-207

Returns

The best year in the fund's history

The return on the fund was 25.6 percent in 2009. This was 4.1 percentage points higher than the benchmark portfolio's return and the highest annual return in the fund's history.

The record-high return was mainly due to gains in the fund's equity investments, but also to an improvement in fixed income markets. The return was 34.3 percent for the equity portfolio and 12.5 percent for fixed income investments. The figures are measured in international currency.

The fund's return is measured against the return on the benchmark portfolio set up by the Ministry of Finance. The difference between the two is referred to as the fund's relative or excess return. The fund had an excess return of 4.1 percentage points in 2009. That is the largest annual excess return in the fund's history, primarily because of gains in fixed income investments.

The fixed income portfolio had a record excess return of 7.4 percentage points in 2009. Liquidity in fixed income markets improved during 2009 from abnormally low levels at the start of the year. This contributed to more normal price levels for instruments that became illiquid during the financial crisis. Most of the excess return in the fixed income portfolio stemmed from positions that were established before the financial turmoil began in 2007, mainly in securitised debt and corporate bonds.

The fund's equity investments had an excess return of 1.8 percentage points. Both internal and external equity management contributed positively to the result.

The fund had an annualised gross return of 4.7 percent in international currency from 1 January 1998 to 31 December 2009. This corresponds to an annual net real return of 2.7 percent for the period after management costs and inflation are deducted.

Equity and fixed income management are presented in more detail in separate sections of the report.

Chart 3-1 Annual return since inception. Percent

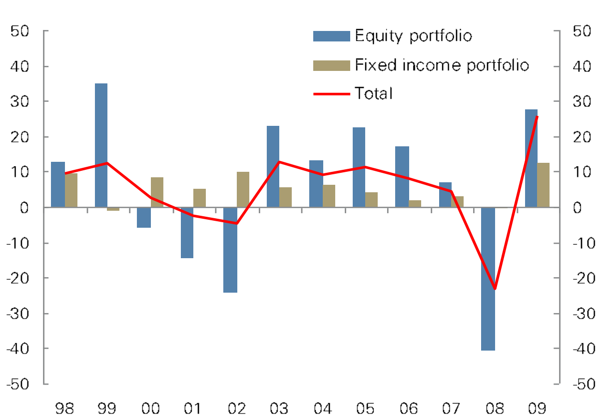


Chart 3-2 Quarterly and annualised return since inception. Percent

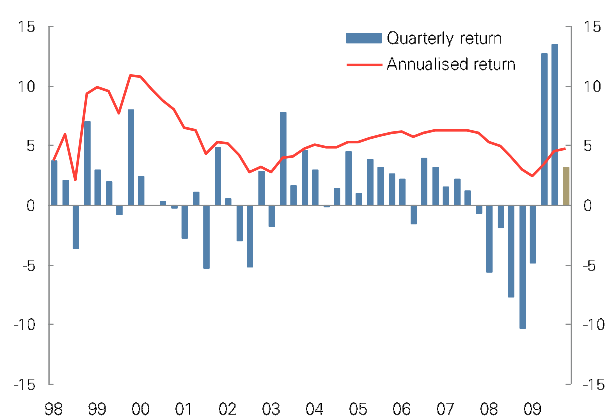


Table 3-1 Key figures as of 31 December 2009. Annualised data in international currency

	Past year	Past 3 years	Past 5 years	Past 10 years	Since inception (1.1.1998)
Portfolio return (percent)	25.62	0.15	3.79	3.47	4.66
Benchmark return (percent)	21.52	0.56	3.82	3.31	4.41
Excess return (percentage points)	4.10	-0.41	-0.03	0.17	0.25
Standard deviation (percent)	12.57	12.27	9.77	7.90	7.63
Tracking error (percentage points)	1.13	1.56	1.23	0.90	0.84
Information ratio (IR)*	3.64	-0.26	-0.02	0.18	0.30
Gross annual return (percent)	25.62	0.15	3.79	3.47	4.66
Annual price inflation (percent)	1.64	2.03	2.11	1.96	1.81
Annual management costs (percent)	0.14	0.11	0.11	0.10	0.10
Annual net real return (percent)	23.45	-1.95	1.54	1.38	2.70

* The information ratio (IR) is a measure of risk-adjusted return and used as a measure of skill in investment management. It is calculated as the ratio of excess return to the actual relative market risk to which the portfolio has been exposed. The IR indicates how much excess return has been achieved per unit of risk.

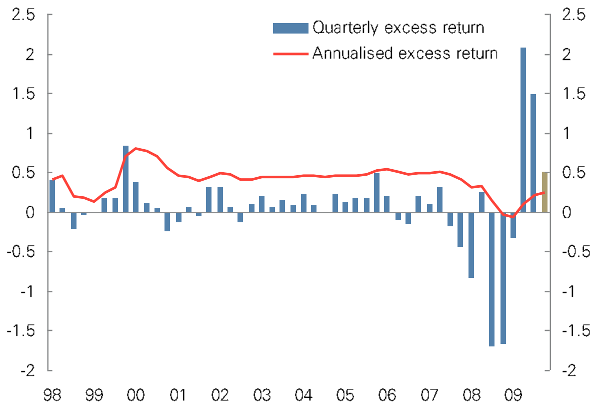
Table 3-2 Breakdown of 2009 excess return by type of management. Percentage points

	External management	Internal management	Total
Equity management	0.32	0.52	0.84
Fixed income management	0.32	2.93	3.25
Total	0.64	3.46	4.10

Table 3-3 Return on the fund in 2009 in different currencies

	USD	EUR	GBP
Return on the fund (percent)	30.77	26.69	16.42
Return on the benchmark portfolio (percent)	26.50	22.56	12.62
Excess return (percent)	4.27	4.13	3.80

Chart 3-3 Quarterly and annualised excess return since inception. Percentage points



Verified GIPS standards

The accountancy firm Ernst & Young has verified that NBIM follows the internationally recognised Global Investment Performance Standards (GIPS) when measuring returns on the fund. Ernst & Young has verified that NBIM complies with the principles of this standard for the reporting period 1998 – 2009. The GIPS reports are available on NBIM's web site, www.nbim.no.

Transaction costs

Transaction costs are incurred when new capital is phased into the fund and when the benchmark portfolio is rebalanced. The direct and indirect transaction costs associated with phasing in new capital and rebalancing amounted to 2.08 billion kroner in 2009, equivalent to 1.23 percent of the 169 billion kroner transferred to the fund in 2009 and 0.09 percent of the fund's market value at the start of the year. The benchmark portfolio is not adjusted for these transaction costs. The costs associated with the fund's excess returns are described in an article on active management at the end of this report.

Our investments

1 percent of the world's equities

The Ministry of Finance decided in June 2007 to increase the fund's share of equity investments to 60 percent from 40 percent. The target was reached two years later after more than 1 trillion kroner in equity purchases, doubling the fund's holdings in global stock markets.

The fund was invested in global equity and fixed income markets in 2009. The share of equity investments is crucial to the fund's future returns because equities are expected to produce higher returns over time than fixed income instruments. The decision to increase the portion of equity investments was based on an assessment of expected long-term returns relative to the risks associated with fluctuations in the fund's market value.

Equity purchases of more than 1 trillion kroner

The fund increased the share of equities by buying 1 010 billion kroner in stocks from June 2007 to June 2009. Inflows of capital from government petroleum revenues accounted for 641 billion kroner, while 369 billion kroner came from interest payments, maturing securities and the sale of bonds in the fund's fixed income portfolio. Almost half of the bond portfolio's capital transfer took place in the first months of 2009 as equity prices were falling. Government bonds were sold at historically high prices at this time, while equities were bought at significantly lower prices than at the start of the transition period.

Companies and countries in the equity benchmark portfolio

The fund's investments shall reflect the investment strategy outlined in the benchmark portfolio set up by the Ministry of Finance. The benchmark portfolio consists of one global index for equities and one for fixed income instruments.

The equity index is compiled by the FTSE Group. It consisted of 7 209 stocks in 46 countries at the end of 2009 and was made up of large, medium and small-cap listed companies in developed and emerging markets.

NBIM can choose not to invest in a market in the benchmark index if operational factors such as unsatisfactory settlement systems or capital regulations mean investments may not be sufficiently safe or possible to sell. NBIM may also invest in a market that is not included in the benchmark index following an equivalent assessment of profitability in relation to market-related and operational risks.

Asset class breakdown per region
Fixed income Equities

The fund is broadly invested in equities in a variety of regions and countries. The fund's average holding in global stock markets rose to 1 percent at the end of 2009 from 0.77 percent at the end of 2008. It has doubled since the end of 2007.

The fund's average holding in listed European companies climbed to 1.78 percent at the end of 2009 from 1.33 percent at the end of 2008. The average holding also increased elsewhere in the world, but was somewhat lower than in Europe. The benchmark portfolio's

Chart 4-1 Breakdown by asset class. Percent of the fund

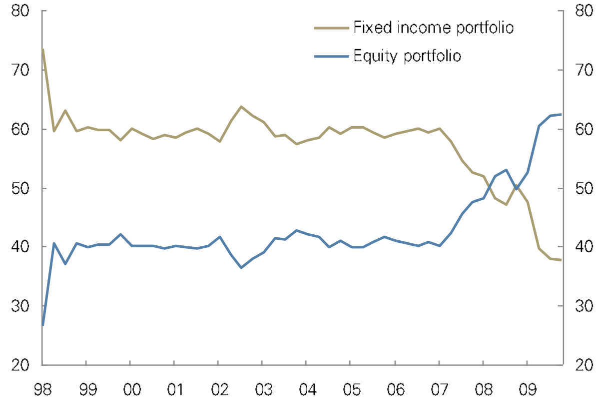
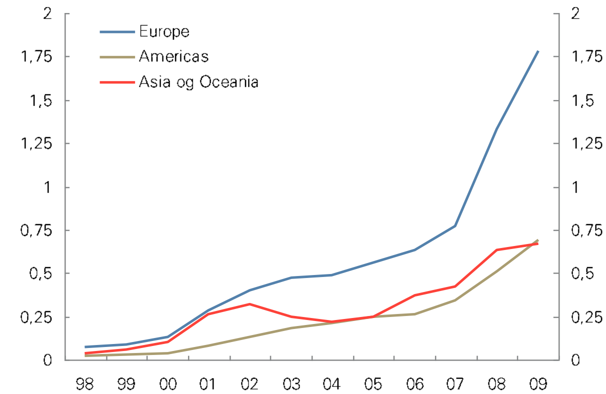


Chart 4-2 Ownership of equity markets. Percent of FTSE All-World Index's market capitalisation



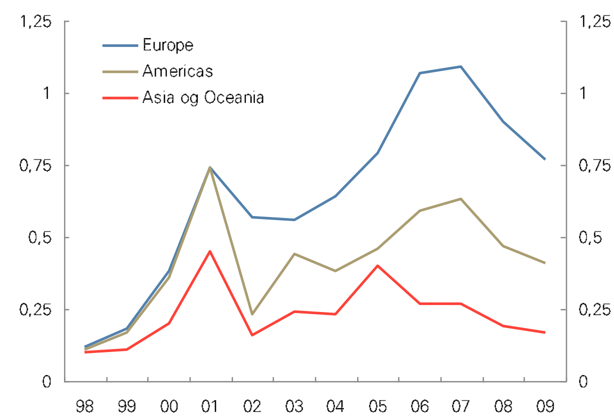
Source: FTSE, NBIM

strategic weights mean the fund must place 50 percent of its equity investments in Europe, 35 percent in the Americas and Africa, and 15 percent in Asia and Oceania.

Issuers and currencies in the fixed income benchmark portfolio

As with equities, the fund's fixed income portfolio is well-diversified. The benchmark index for the portfolio is compiled by Barclays Capital and consisted of 10 763 instruments in 11 currencies at the end of 2009. The index comprises government bonds (including inflation-linked bonds), bonds issued by other public institutions (such as regional administrations and government corporations), company bonds and securitised debt. There are no emerging currency markets in the benchmark index, but NBIM may invest in such currencies following an assessment of profitability and operational factors. However, there are significant restrictions on foreigners' rights to invest in large emerging markets such as Brazil, Russia, India and China.

Chart 4-3 Ownership of fixed income markets. Percentage of Barclays index's market capitalisation



Source: Barclays, NBIM

The fund's holdings in global bond markets have decreased in recent years, because of the reduction in its share of fixed income investments and a substantial issuance of new government bonds in 2009. The fund held 0.51 percent of the world's bonds at the end of 2009, the lowest level since 2004. Bond holdings in Europe were larger than in the other two geographical regions.

Chart 4-4 Regional breakdown of the equity portfolio as of 31 December 2009. Percent

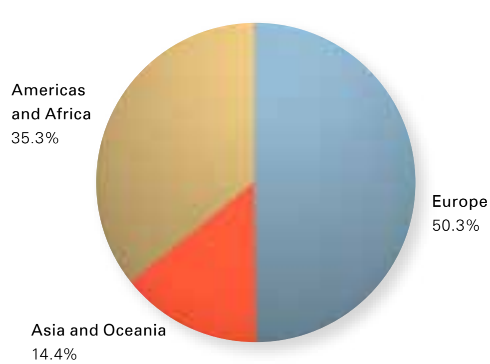
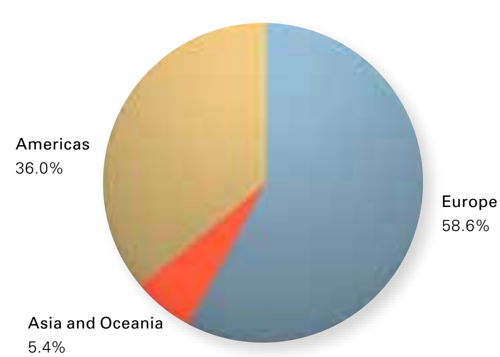
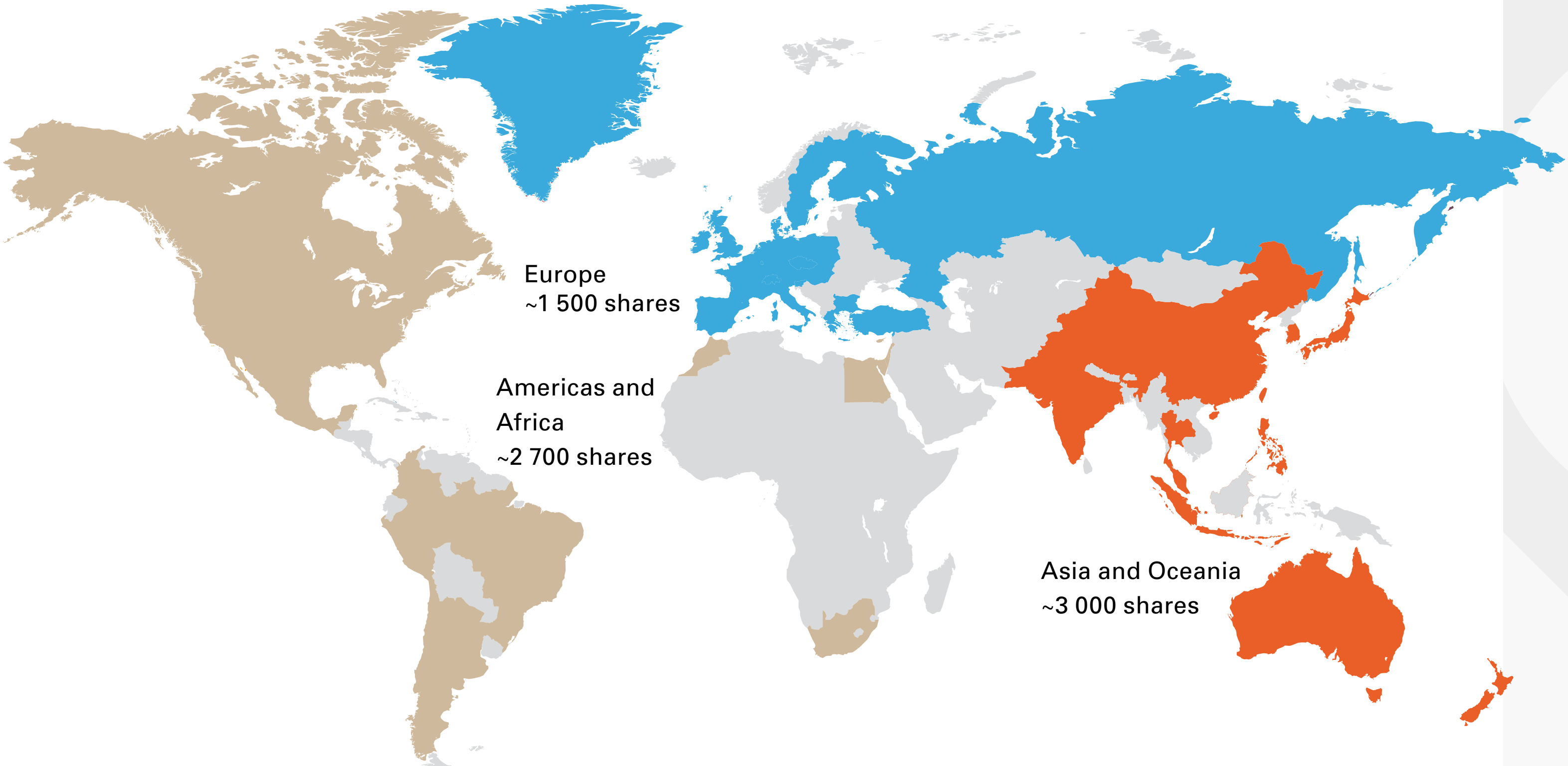
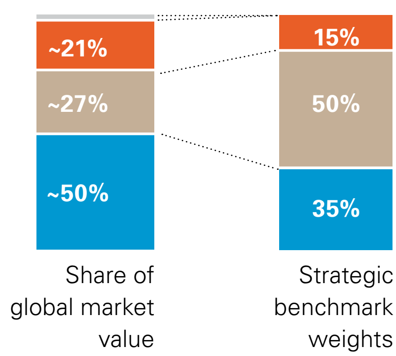


Chart 4-5 Regional breakdown of the fixed income portfolio as of 31 December 2009. Percent

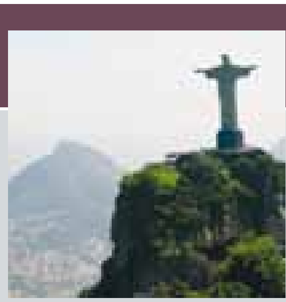




- Countries outside strategic benchmark portfolio
- Asia and Oceania
- Americas and Africa
- Europe



Brazil



- 1.6 percent of the equity benchmark portfolio
- 116 companies in the fund
- Key industries: textile, chemicals, cement, agriculture, car industry and oil production

Malaysia

- 0.3 percent of the equity benchmark portfolio
- 103 companies in the fund
- Key industries: electronics, chemistry, car industry and palm oil

Individual positions

An increasing number of large investments

The number of companies where the fund's holdings exceeded 2 percent rose by 150 to 345 in 2009. The single largest investment was in HSBC Holdings.

The fund's investments are spread across many different companies and issuers. These investments include some large individual positions, particularly in bond markets that are a source of government funding.

The fund's benchmark portfolio lays the basis for the size of its positions. The fund will normally have large holdings in companies that have a high market value, because these companies account for a major part of the benchmark portfolio. Since oil companies and financial institutions are among the world's biggest companies, they are well represented on the list of the fund's largest shareholdings by market value. Three oil companies and two financial institutions were on the list of the fund's ten biggest equity holdings at the end of 2009, with HSBC Holdings topping the list. The fund's 1.9 percent stake in the bank had a market value of 22.4 billion kroner.

The Ministry of Finance has decided that the fund may own up to 10 percent of a listed company. The fund's largest percentage holding in a company at the end of 2009 was 7.2 percent of Finnish paper producer UPM-Kymmene. The fund had a stake of more than 5 percent in a total of six companies at the end of the year, up from four a year earlier. The number of companies where the fund owned more than 2 percent rose to 345 from 195.

Table 5-1 Largest equity holdings as of 31 December 2009

Company	Country	Holding in millions of NOK
HSBC Holdings plc	UK	22 356
Royal Dutch Shell plc	UK	18 964
BP plc	UK	18 384
Nestlé SA	Switzerland	17 016
Total SA	France	15 837
Vodafone Group plc	UK	12 879
Banco Santander SA	Spain	12 768
Roche Holding AG	Switzerland	12 591
Telefónica SA	Spain	12 554
Novartis AG	Switzerland	12 439

Table 5-2 Largest bond holdings as of 31 December 2009

Issuer	Country	Holding in millions of NOK
United States of America	US	107 703
UK Government	UK	65 230
Japanese Government	Japan	43 696
Federal Republic of Germany	Germany	42 971
French Republic	France	36 868
Italian Republic	Italy	33 240
Bank of Scotland plc	UK	21 850
European Investment Bank	Supranational	21 700
Kreditanstalt für Wiederaufbau	Germany	18 036
Nationwide Building Society	UK	14 013

Holdings of 1-2 percent frequently put the fund among the top 20 shareholders in large companies, where ownership is often more widely distributed. This makes it easier for NBIM's portfolio managers and ownership department to gain access to a company's management. At the same time, the fund will always be a minority shareholder that largely depends on the support of other investors to push through demands to the board or management of a company. Equal treatment of shareholders is therefore an important focus area for NBIM.

The fund's stock holdings are spread across different countries, sectors and regions. The decision in 2008 to add more emerging markets to the benchmark portfolio has increased investment in these markets. In 2009, NBIM handed out equity mandates for the first time in Poland, Turkey, Brazil and Thailand.

Governments are the largest bond issuers and the fund will normally have substantial holdings of government debt. The US, the UK, Japan, Germany, France and Italy were the issuers of the fund's six biggest bond holdings at the end of 2009. The Bank of Scotland, European Investment Bank and Kreditanstalt für Wiederaufbau were also among the issuers of the fund's top ten bond holdings. This is because a number of large public and semi-public institutions, as well as a variety of supranational organisations, also borrow in international capital markets. Companies generally borrow less in the bond market, especially outside the US.

Table 5-3 Largest ownership interests on 31 December 2009. Percent

Company	Country	Interest
UPM-Kymmene Oyj	Finland	7.2
Hutchison Telecommunications International Ltd	Hong Kong	6.8
Mondi plc	UK	6.5
Telecity Group plc	UK	5.8
Aspen Insurance Holdings Ltd	US	5.2
China Water Affairs Group Ltd	Hong Kong	5.1
Pigeon Corp	Japan	5.0
Forthnet SA	Greece	4.9
China Medical Technologies Inc	Cayman Islands	4.8
Catlin Group Ltd	France	4.7

HSBC

- International bank established in Hong Kong
- More than 335 000 employees in 86 countries
- Net revenue of 84 billion dollars in 2008

Vodafone

- British telecommunication company established in 1984
- 323 million customers and 79 000 employees
- Sales of 41 billion pounds in 2009

Roche

- One of the world's biggest healthcare companies located in Switzerland
- More than 80 000 employees with sales in more than 150 countries
- Sales of 49 billion Swiss Francs in 2009

Rebalancing

Adjusting asset allocation

Divergent movements in equity and bond prices will affect the size of the fund's holdings in each asset class over time. The fund applies a rebalancing plan to prevent excessive deviation from the strategic weights set by the Ministry of Finance.

It is important to distinguish between the fund's strategic benchmark portfolio and its actual benchmark portfolio. The strategic benchmark portfolio is defined by the fixed weights set by the Ministry of Finance for regions and asset classes, normally referred to as the strategic weights. Market capitalisation weights are used for each country and currency within each region.

These are the initial weights in the actual benchmark portfolio that the fund's management follows and is measured against. Divergent price movements in the different asset classes and regions will over time lead to weight changes in the actual benchmark portfolio. For example, a stronger increase in equity prices will push the equities portion above 60 percent. As a result, the actual benchmark portfolio may deviate from the strategic long-term benchmark portfolio.

Rebalancing is the process of bringing the weights in the actual benchmark portfolio back in line with the strategic weights by buying or selling assets. With the exception of deviations due to active management, NBIM will follow the actual benchmark portfolio in its management of the fund. This means that when the weights in the actual benchmark portfolio are changed through rebalancing, NBIM will normally make the same changes to the actual portfolio.

Rebalancing results in transaction costs from buying and selling assets. If the rebalancing frequency is too low,

Divergent price movements in the different asset classes and regions will over time lead to weight changes in the actual benchmark portfolio.

the portfolio may stray away from the strategic weights, while a high rebalancing frequency will result in high transaction costs. The rebalancing regime set by the Ministry of Finance ensures an appropriate rebalancing frequency.

The ministry has set rules for full rebalancing back to the strategic weights. These specify the maximum permitted deviation between the weights in the actual benchmark portfolio and the strategic benchmark portfolio before the fund must be rebalanced.

Equities 60%

- Americas and Africa **21%**
- Europe **30%**
- Asia and Oceania **9%**

Fixed income 40%

- Americas and Africa **14%**
- Europe **24%**
- Asia and Oceania **2%**

Equity management

From market pessimism to optimism

The return on the fund's equity portfolio was 34.3 percent in 2009 as global stock markets surged. The return was 1.8 percentage points higher than the return on the benchmark portfolio.

The start of 2009 was dominated by a lack of confidence in the markets and considerable uncertainty about listed companies. The FTSE All-World equities index fell to a six-year low on 9 March, before government support packages and growing optimism contributed to a 75 percent gain in the rest of the year. Expected volatility in the stock market, as measured by the US VIX index, returned to levels seen before the financial crisis by the end of year.

The Government Pension Fund Global benefited from the drop in prices at the start of the year, raising its share of equity investments to 60 percent in June from 49.6 percent at the end of 2008. The fund bought stocks worth 275 billion kroner in 2009.

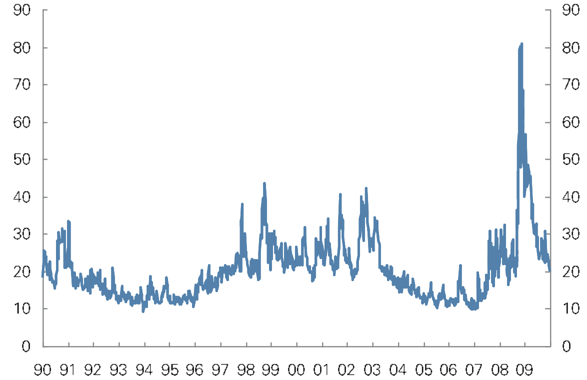
The equity portfolio's market value rose by 515 billion kroner to 1 644 billion kroner in 2009. The portfolio returned 34.3 percent measured in international currency, compared with a negative 40.7 percent in 2008. It was the second-best return ever for the equity portfolio and 1.8 percentage points higher than the return on the benchmark portfolio's equity index.

NBIM's equity management has three aims: to phase in capital from the government's petroleum revenue, to keep exposure to the equity market as defined by the benchmark portfolio and to generate a higher return than the benchmark portfolio. The excess return is achieved mainly through enhanced indexing, internal sector mandates and external management, as well as with contributions from the fund's treasury and trading division.

Table 6-1 Return on the equity portfolio. Percent and percentage points

	Actual portfolio	Benchmark portfolio	Excess return
1999	34.81	31.32	3.49
2000	-5.82	-6.31	0.49
2001	-14.60	-14.66	0.06
2002	-24.39	-24.47	0.07
2003	22.84	22.33	0.51
2004	13.00	12.19	0.81
2005	22.49	20.31	2.18
2006	17.04	17.14	-0.09
2007	6.82	5.67	1.15
2008	-40.70	-39.54	-1.16
2009	34.27	32.46	1.80

Chart 6-1 Expected change in the S&P 500 Index over the next 30 days (VIX Index). Annualised, percent



Source: CBOE Volatility index, Ecowin

Enhanced indexing

The benchmark portfolio's equity investments are based on a broad global equity index from the FTSE Group. In principle, the equity portfolio should reflect the benchmark's exposure to the stock market, meaning changes to the composition of the benchmark portfolio will require corresponding changes to the fund's portfolio.

In practice, however, it's not always economical to make changes to the fund in exactly the same way or at the same time as the benchmark portfolio changes. Some stocks in the benchmark trade in such small volumes that it would not be cost-effective to buy them on the scale needed by the fund. In addition, several thousand changes to the benchmark index are announced each year. Acting on all of these would lead to enormous transaction costs and the prices achieved would probably be unfavourable because the timing would be known to other market participants. Better prices can often be obtained by buying and selling these equities at other times.

NBIM aims to make changes to the fund at the lowest possible cost and to achieve an excess return, a strategy known as enhanced indexing. About 75 percent of the equity portfolio was managed with this strategy in 2009, mainly in the US and UK and to a limited extent in Asia.

NBIM exploits the fund's long-term investment outlook partly by substituting equities in the benchmark index with related stocks that are more favourably priced. These may be equities in the same company or ownership structure. The fund also participates in share sales where companies in the benchmark index offer new shares at a discount to the market price of existing shares, as well as in initial public offerings by companies expected to be included in the benchmark index.

Enhanced indexing accounted for 25 percent of the equity portfolio's excess return in 2009. The fund benefited from a narrowing of price differentials between closely related equities during the year and from taking part in share issues. Companies in the benchmark portfolio raised a record amount of capital in 2009.

Internal sector mandates

A number of NBIM's equity managers have expertise in particular sectors and have investment mandates within specific industrial areas.

Such mandates accounted for about 20 percent of the equity portfolio's excess return in 2009. Investments in Europe accounted for three-quarters of this outperformance and 17 out of the 21 mandates contributed a positive excess return.

The internal sector managers are based mainly at NBIM's offices in London, New York and Shanghai. They have extensive dealings with management at companies and other industry contacts. These managers held almost 2 000 meetings with companies in 2009 to gain insight into their strategies, value chains and the long-term trends in their sectors. The information is used for internal analysis to pick stocks that will outperform the sector average.

Equity issuance

Companies occasionally strengthen their financial position by raising capital. This may be done by issuing new shares and selling them to investors, typically at a lower price than the market price of the company's existing shares.

A company can raise new equity in one of four ways: a traditional rights issue, an entitlement offer, a public offering or a private placing. These options vary considerably in how they treat shareholders. It is important for active ownership to follow up on such transactions.

In a traditional rights issue all shareholders are given rights to buy new shares at a favourable price in proportion to their holdings. Shareholders who do not wish to exercise their rights can sell them in the market and so be compensated for the dilution of their holdings. Traditional rights issues are particularly common in Europe.

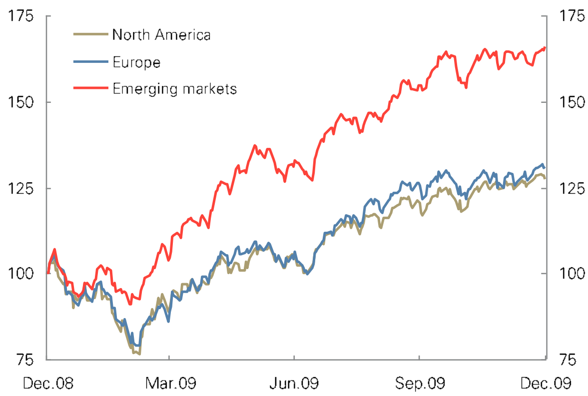
An entitlement offer is similar to a traditional rights issue but gives shareholders a very short period to exercise their rights. This favours professional investors who have the capability and systems to capture these events. Entitlement offers are used mainly in Oceania.

In a public offering new shares are offered to large market participants, often without regard of existing ownership. These investors are given a small discount to the market price, while the holdings of other shareholders are diluted. The allotment of new shares is performed by the underwriters, possibly based on guidelines from the company's board. A great deal of power is transferred from existing shareholders to the underwriting investment banks. These offerings are common in the US and Japan.

In a private placing shares are offered to a limited group of investors. This select group is usually chosen by the company's board or general meeting, and generally consists of a small number of investors. The stakes of other shareholders will be diluted.

The amount raised through public offerings and entitlement offers almost doubled in 2009 from 2008. Companies in the benchmark index conducted more than 200 traditional rights issues and almost 700 other issues during the year for a total value of about 600 billion dollars. The fund's internally managed equity portfolio invested about 4 billion dollars in more than 230 traditional rights issues and more than 300 other new issues in 2009.

Chart 6-2 Returns in regional equity markets. Local currency, indexed



Source: FTSE All-World

Chart 6-3 Volume of traditional rights issues at companies in the benchmark portfolio. Billions of USD

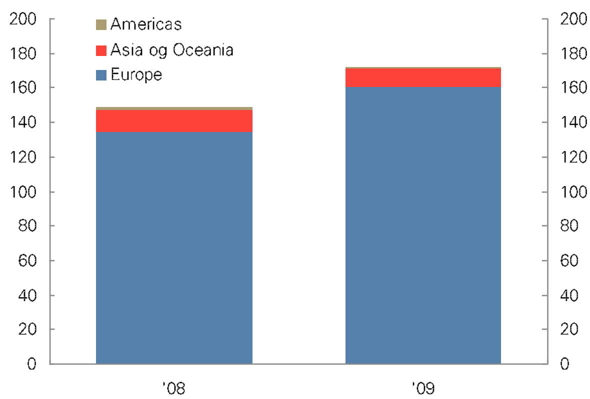
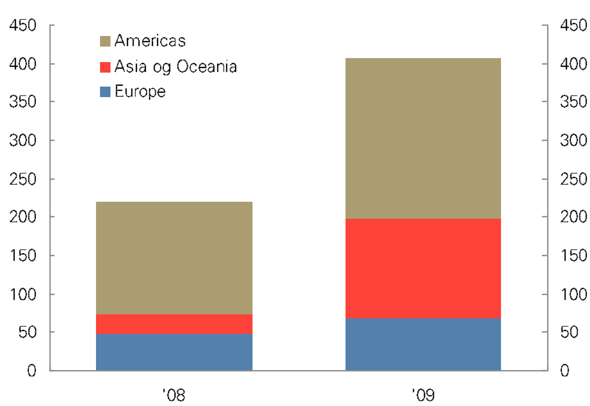


Chart 6-4 Volume of public offers and entitlement offers at portfolio companies. Billions of USD



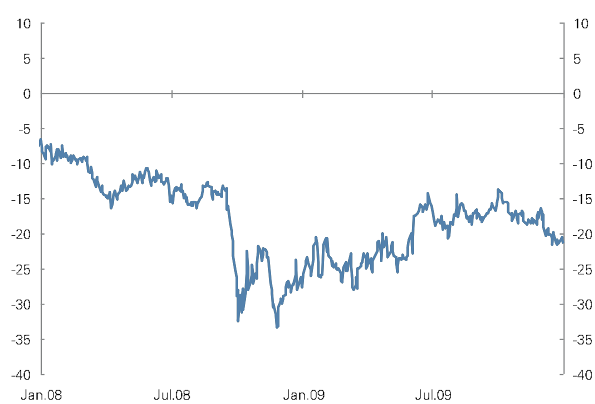
Christian Dior SA

NBIM seeks to exploit price differences in closely related equities, such as those in the same company or ownership structure. Luxury goods producers Christian Dior SA and LVMH Moët Hennessy – Louis Vuitton SA are an example of this because of their common ownership structure. Both Christian Dior and LVMH were part of the benchmark portfolio in 2009 and the fund had holdings in each company.

Christian Dior held 42 percent of LVMH's share capital and controlled 64 percent of the votes at the end of 2009. Its largest shareholder, Bernard Arnault, was chairman and chief executive officer of both companies. Holdings in LVMH accounted for 93 percent of Dior's assets. An ownership structure like this creates an expectation that dividend streams from the two companies will be very similar over time. It is also creates an element of uncertainty because dividends from Dior's investments in LVMH are not directly available to investors. Dior's holding in LVMH therefore trades at a discount to LVMH's market price. This discount varies due to short-term changes in the capacity of investors to take risk and their investment horizon.

The fund benefited from a narrowing of the price differential between Christian Dior and LVMH in 2009. The discount on Christian Dior's holding in LVMH fell to 20 percent from about 30 percent during the year. The fund's investments in Christian Dior and LVMH gained more than the benchmark portfolio's holdings in these companies, because we exploited the price differential between the two stocks.

Chart 6-5 The discount on Christian Dior´s shareholding in LVMH. Percent



Source: Bloomberg, NBIM

Fixed income management

Normalisation of the markets

Liquidity in fixed income markets improved markedly in 2009. The fund's fixed income portfolio had a record excess return as bond prices climbed.

The fixed income portfolio returned 12.5 percent in 2009, compared with a negative 0.5 percent in 2008. This exceeded the return on the benchmark portfolio by 7.4 percentage points and was a record both in absolute and relative terms.

Liquidity in fixed income markets came back during 2009 from abnormally low levels at the start of the year. Prices recovered, including for instruments that were largely illiquid during the financial crisis. Most of the excess return came from positions that were established before the financial turmoil began in 2007, especially from securitised debt and corporate bonds. The same positions were behind most of the negative excess return in 2007 and 2008.

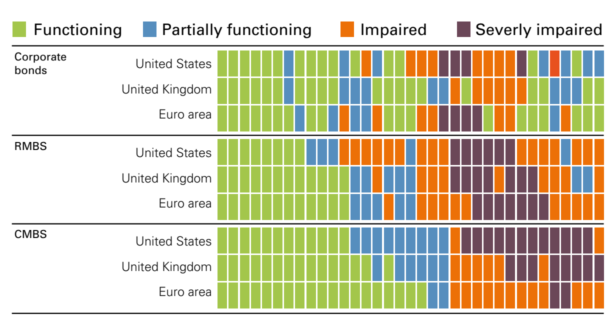
The least liquid holdings were at the start of the year separated from the rest of the portfolio, which was kept relatively close to the benchmark index. The portfolio was reintegrated at the end of the year and will now be managed with a more fundamentally based strategy, including reduced leverage, less use of derivatives and increased focus on analysing issuers.

The market value of the fixed income portfolio fell by 150 billion kroner to 996 billion kroner in 2009 as the fund's share of fixed income investments was reduced to 37.6 percent from 50.4 percent at the start of the year. The Ministry of Finance decided in 2007 to increase the fund's share of equity investments, bringing the fixed income portion down to 40 percent from 60 percent.

Until January 2009, the allocation to equities was increased by using the monthly inflows of capital to the fund to buy shares. Interest and income from bonds were simultaneously reinvested in stocks. In the first half of 2009, NBIM also sold bonds to fund share purchases.

There were periods of considerable market volatility in 2009 and a substantial number of bonds were downgraded by the credit rating agencies. These bonds were automatically removed from the index, often at low prices. NBIM chose to keep many of these since their underlying value was deemed to be higher than market prices. These bonds climbed sharply in value when the fixed income market recovered in the second half of the year.

Chart 7-1 Primary markets for bonds



Sources: Bank of America Merrill Lynch, Dealogic, JP Morgan Chase & Co. and Bank of England

Table 7-1 Return on the fixed income portfolio. Percent and percentage points

	Actual portfolio	Benchmark portfolio	Excess return
1999	-0.99	-1.00	0.01
2000	8.41	8.34	0.07
2001	5.04	4.96	0.08
2002	9.90	9.41	0.49
2003	5.26	4.77	0.48
2004	6.10	5.73	0.37
2005	3.82	3.46	0.36
2006	1.93	1.68	0.25
2007	2.96	4.26	-1.29
2008	-0.52	6.08	-6.60
2009	12.49	5.13	7.36

Money market investments

NBIM participates in the global market for borrowing and lending securities and some of the cash collateral from lending debt has been reinvested in short-term fixed income instruments. As uncertainty in the money market fell in 2009, NBIM recovered more than 80 percent of the loss of value associated with bond lending in 2007 and 2008. The size of these re-investments was also greatly reduced through sales and maturation. The positions were cut to just below 27 billion kroner at the end of 2009, down by about 85 percent since summer 2007.

Money market investments accounted for 10 percent of the fixed income portfolio's excess return in 2009.

US securitised debt

The financial crisis began with a drop in the price of securities backed by US sub-prime mortgages. At the start of the crisis, the fund was exposed through external fixed income mandates to US securitised debt in the non-agency MBS category. These are mortgage bonds not guaranteed by the government-sponsored mortgage corporations, Fannie Mae and Freddie Mac. Although most of these bonds had the highest possible credit rating, this exposure contributed significantly to the fund's underperformance in 2007 and 2008.

US house prices fell about 30 percent during the financial crisis and US unemployment more than doubled. The debt servicing capacity of many borrowers was substantially reduced and the value of their collateral fell, leading to the near-collapse of the US mortgage market.

The US introduced a number of measures to support the market in late 2008 and early 2009. The aim was to boost demand for securitised debt, stimulate refinancing and home purchases, and limit foreclosures. The measures helped stabilise the mortgage market and halt the slide in home values. The US housing market is expected to

Chart 7-2 Gross re-investments of cash collateral in money market instruments. Billions of NOK

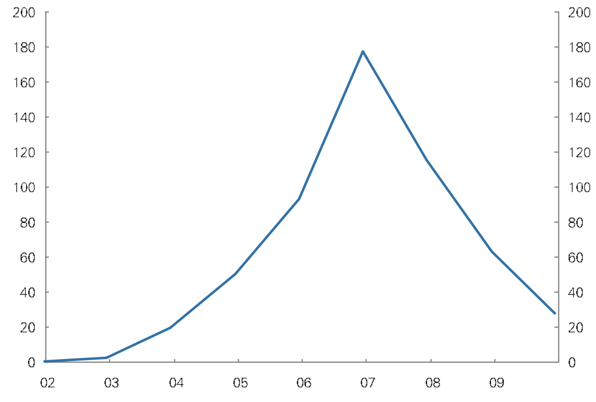
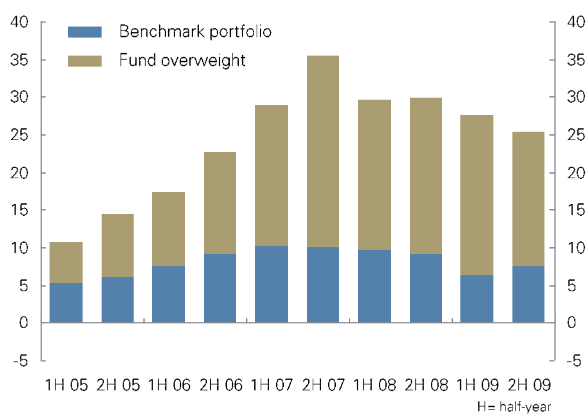


Chart 7-3 Holdings of covered bonds.Billions of Euro



continue to be affected in coming years by foreclosures and bankruptcies among the 5 million or more mortgages that have defaulted.

The fund's non-agency MBS exposure increased greatly in value in 2009, recovering almost half the losses on these instruments in 2007 and 2008.

US securitised debt accounted for about a quarter of the fixed income portfolio's excess return in 2009.

European bank funding

Normal sources of funding for banks in the capital market failed to function at the beginning of 2009. A lack of confidence in banks, combined with investors' need to reduce their balance sheets and exposure, made it difficult for banks to refinance in the conventional capital market. Authorities introduced a number of measures to improve funding options for banks in the first half of the year and their willingness and ability to support banks through recapitalisation eased some concerns of systemic collapse. The ability to issue bonds with a government guarantee was particularly useful to banks. Further support packages, such as the ECB's covered bond purchase programme, were announced in spring 2009.

Risk premiums on fixed income instruments rose sharply during the financial crisis. These premiums fell by 50 percent to 70 percent, depending on segment, as the market gradually improved during 2009. Price differentials between issuers still remained substantially larger than two years earlier. The fund kept substantial investments in covered bonds from the end of 2008, while holdings in capital instruments issued by banks and other financial institutions were reduced. The fund recovered more than 80 percent of the losses incurred from these positions during the financial crisis.

The financial crisis revealed a number of weaknesses in banks' hybrid capital, which is a cross between equity and loan capital and included in the calculation of capital adequacy. The future will likely bring stricter requirements for the nominal level of hybrid capital and its capacity to absorb losses.

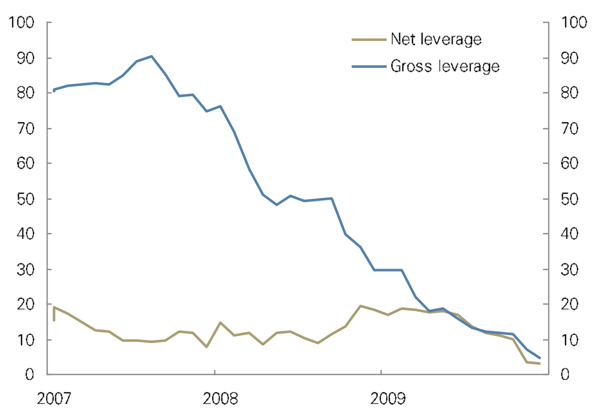
Investments in bonds issued by European banks accounted for about a third of the fixed income portfolio's excess return in 2009.

Japanese inflation-linked bonds

The fixed income portfolio has had large positions in inflation-linked bonds in a number of markets, including the US and Japan. The US market normalized in 2009 and some of the fund's positions in US inflation-linked bonds were sold during the year.

The return was 7.4 percentage points higher than the return on the benchmark index. It was a record in both absolute and relative terms.

Chart 7-4 Gross and net leverage as a percentage of the fund's market value



In Japan, liquidity was relatively weak and inflation expectations – represented by the spread between nominal and real interest rates – were slightly lower than analysts' estimates even as Japanese authorities repurchased inflation-linked bonds. NBIM still had substantial positions in the Japanese market at the end of 2009.

Inflation-linked bonds accounted for about 5 percent of the fixed income portfolio's excess return in 2009.

Leverage reduced

The fund aims to exploit differences in interest rates through active positions using derivatives, forward contracts and repurchase agreements. This is reflected in the fund's balance sheet when the gross value of its bonds and short-term investments exceeds the net value of the fixed income portfolio. Leveraging as described above was scaled back in 2009 because of the changes in market conditions and the reorganization of fixed income management in 2008 and 2009.

Structural challenges

Investor confidence in the valuation of fixed income instruments was restored as liquidity improved from March 2009. Many of the positions that became illiquid as the crisis escalated from August 2007 to March 2009 gained significantly in value during the remainder of the year. The fund's long-term investment outlook let it profit by keeping large parts of the fixed income portfolio through the crisis.

The liquidity and pricing in some segments of the fixed income market were at the end of 2009 still well below levels seen before the financial crisis. The crisis revealed shortcomings in important market mechanisms, which authorities, supervisory bodies and market participants are attempting to remedy, partly through changes in capital requirements for banks, revised credit rating models, and increased use of centralised marketplaces and settlement systems for trading. There will be continued uncertainty in the market until new frameworks and requirements are in place.

External management

Excess return in nine out of 11 years

The fund's external equity management had its highest excess return in a decade in 2009, helped by investments in emerging markets and the US. External fixed income management was further scaled down.

NBIM uses external managers to handle parts of the portfolio. We award management mandates to organisations with expertise in clearly defined investment areas.

The fund's externally managed mandates had a market value of 316 billion kroner at the end of 2009. That's equivalent to 12 percent of the fund's total market value, compared with 13 percent a year earlier. There were a total of 75 mandates managed by 45 different organisations, 70 of which were equity mandates. External mandates have delivered an excess return in nine out of 11 years, including 2009.

The market value of externally managed equity mandates was 286 billion kroner at the end of 2009, equal to 17 percent of the fund's equity investments. The mandates had an excess return of 3.9 percentage points in 2009, measured in international currency. That's their highest excess return since 1999 and about 40 percent of the equity portfolio's total excess return in 2009. External equity management has had an annualised excess return of 2.1 percentage points since the first external mandate was awarded in 1998.

NBIM hands out external mandates in markets and segments where it is not practical or realistic to build up internal expertise. Most are specialist mandates, such as for Indonesian and Malaysian equities, small Brazilian companies, health-care technology and transport. Many of the external mandates are in markets where we see great potential to create excess return through active management. This is particularly the case in emerging markets, because these often are less efficient than established markets. In an efficient market all investors have access to the same information at the same time, so that market prices always reflect this information.

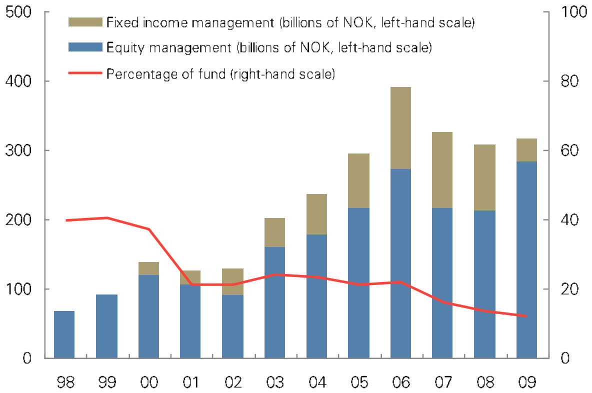
Inefficiencies may result in a mispricing of assets that a long-term investor like NBIM can exploit.

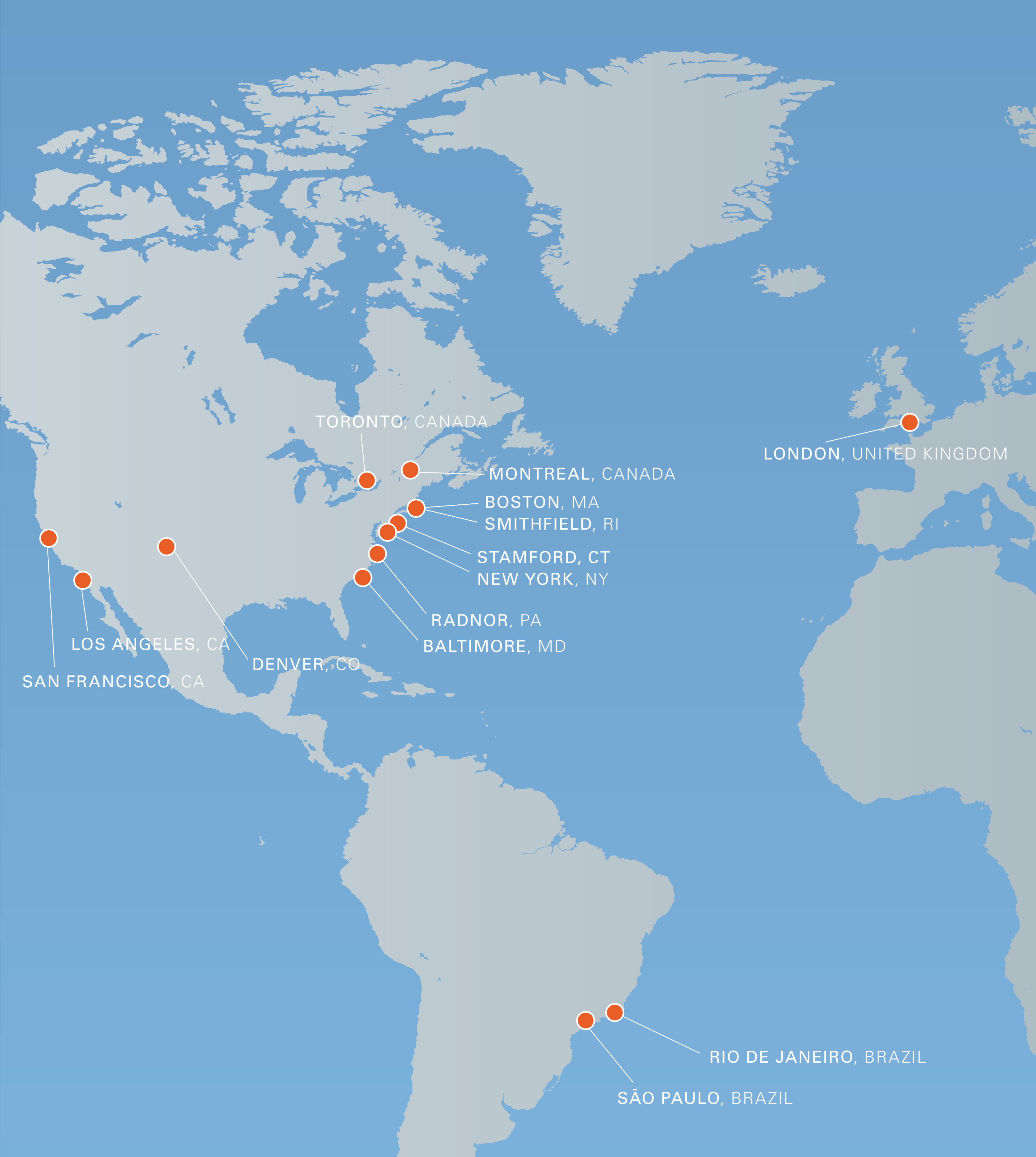
NBIM has gradually increased the proportion of specialist country and sector mandates. We awarded 16 new specialist mandates in 2009, ten of which were in emerging markets and five in specific sectors. Specialist mandates accounted for 71 percent of the market value of external active equity mandates at the end of 2009, up from 62 percent a year earlier. Only 29 percent of the equity mandates' market value was based on broad global, European or American investment strategies.

Investment mandates will be in the same geographical area where a manager is based or in an industry where a manager has particular expertise. Managers will seek to create an excess return through fundamental analysis of companies within a focused and concentrated investment mandate. Managers apply considerable analytical capacity to a limited number of equities and have substantial internal analytical resources in their specialist field.

Externally managed fixed income mandates had a market value of 32 billion kroner at the end of 2009. That equals 3.2 percent of the market value of the fund's fixed income portfolio. The number of external fixed income mandates has been gradually reduced following a restructuring of the fund's fixed income management in 2008 and 2009. NBIM had five external fixed income managers at the end of 2009, down from 14 at the end of 2008 and 38 in 2007. All were specialist mandates and mainly in US mortgage bonds.

Chart 8-1 External management. Billions of NOK and percentage of fund at year-end

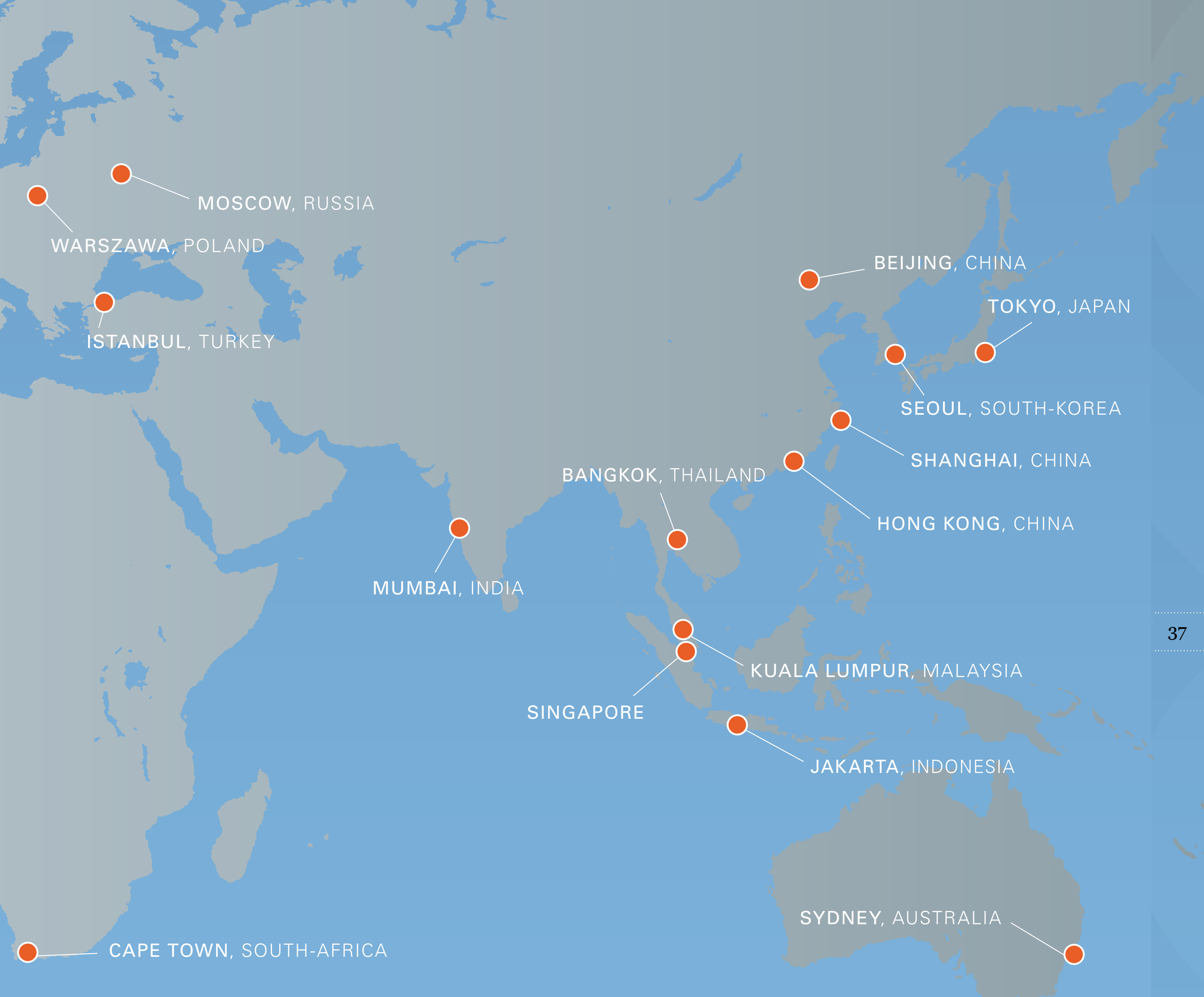




External equity managers as of 31 December 2009

Aberdeen Asset Management
AEW Capital Management
Altrinsic Global Advisors
Atlantis Fund Management
Ayudhya Fund Management
BlackRock
Black River Asset Management
BNY Mellon Asset Management
BPH TFI
Capital International Limited
Cephei Capital Management
Columbus Circle Investors
Cramer Rosenthal McGlynn
Ecofin
Ellerston Capital
FIL Pensions Management
Pyramis Global Advisors
Gartmore Investment
GLG Partners
J. H. Whitney Investment Management
Janus Capital
Keywise Capital Management
Lazard Asset Management
Levin Capital Strategies
Martin Currie Investment Management

Many of the external mandates are in markets where we see great potential to create excess return through active management. This is particularly the case in emerging markets



NWQ Investment Management
Old Mutual Investment Group
Pheim Asset Management
Polaris Capital
Primecap Management
Prosperity Capital Management
Quantum Advisors Private Limited
RHB Investment Management
Rheos Capital Works

Scheer, Rowlett & Associates
Schroder Investment Management
Sectoral Asset Management
Sparx Asset Management
State Street Global Advisors
T Rowe Price
Victoire Brasil Investimentos
Water Asset Management
Wellington Management Company

External fixed income managers as of 31 December 2009
BlackRock
Greylock Capital Management

Investment risk

Decreasing risk in capital markets

2009 saw big swings in capital markets, but there were clear signs of risk subsiding towards the end of the year.

The large fluctuations in capital markets in recent years have underlined the necessity of having a broad platform of procedures, systems and models to map and manage the fund's risk. NBIM has significantly increased both staffing and expertise in risk management over the past two years. We have also developed a number of methods for measuring and interpreting the risk outlook, which supplement more traditional models based on historical relationships. This approach does not give a single measure of the fund's risk levels but provides a set of information that, combined with our own evaluations, gives the best possible picture of risk.

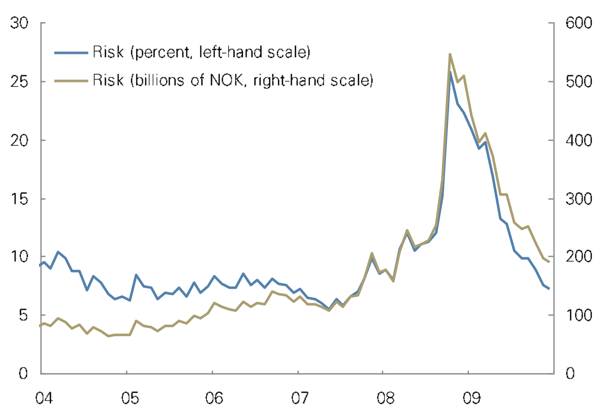
NBIM's risk management is divided into four main areas: market, credit, counterparty and operational risk. We have separate frameworks in each category for how risk is measured, checked and managed.

Market risk

The fund's equity and fixed income investments are subject to market risk and a relatively high probability of large variations in annual performance. This has been underlined by the fluctuations in the fund's market value over the past two years. Market risk is determined primarily by the composition of the benchmark portfolio and largely influenced by movements in equity prices, exchange rates, interest rates and the pricing of credit risk in the fixed income portfolio.

There is no single measure that can describe all types of risk in a portfolio. In our measurement of market risk we use a number of different measures that can be grouped into the following main categories: model-based risk measures, concentration analysis, factor exposures and liquidity risk.

Chart 9-1 Absolute volatility. Percent and billions of NOK

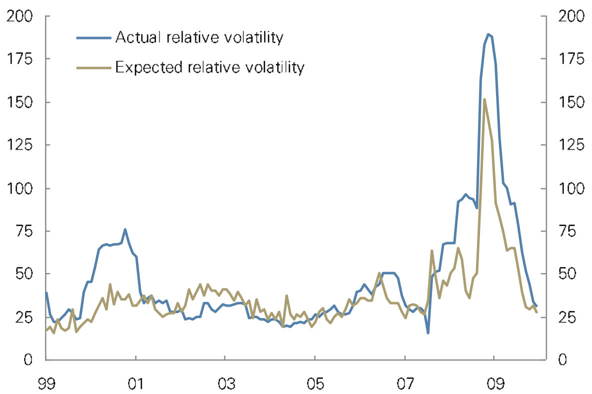


Model-based risk measures

Expected volatility, measured by the statistical concept of standard deviation, describes how much returns may be expected to vary in normal periods. Day-to-day fluctuations in the markets were considerable in the first part of 2009, but decreased as the year went on, due partly to increased risk appetite among investors. This meant that expected volatility in the return on the fund also decreased significantly during the year, especially in the equity portfolio. The fund's absolute volatility was about 7 percent, equivalent to 200 billion kroner, at the end of the year, down from 22 percent, or around 508 billion kroner, at the beginning of the year.

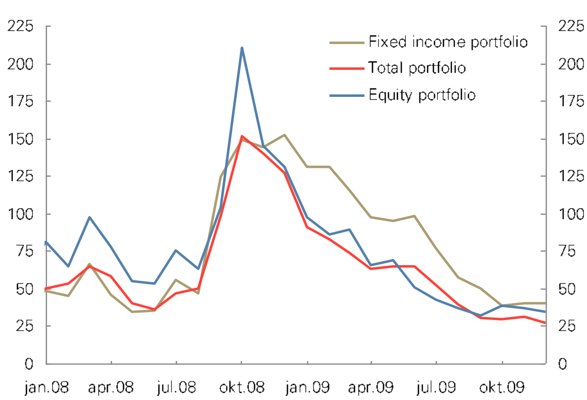
The ministry has set limits for how far NBIM may deviate from the benchmark portfolio in its active management of the fund. The most important limit is expressed as tracking error (expected relative volatility) and puts a ceiling on how far the return on the fund can be expected to deviate from the benchmark portfolio. Expected tracking error must not exceed 1.5 percentage points (150 basis points). This means that the difference between the return on the fund and the return on the benchmark portfolio is expected to be more than 1.5 percentage points in one out of every three years and more than 2.5 percentage points in one out of every ten years.

Chart 9-2 Expected and actual relative volatility. Basis points



Expected tracking error fell in 2009 from levels of more than 100 basis points at the beginning of the year to less than 30 basis points at the end of the year. Most of the decrease was due to lower volatility in the market in general and lower correlation between the fund's investments. The reduction in active positions in the equity and fixed income portfolios contributed to a lesser extent to lower expected tracking error.

Chart 9-3 Expected relative volatility 2008 -2009. Basis points



Expected and actual risk

Expected tracking error and absolute volatility are statistical measures of risk that capture and measure volatilities and correlations in the fund's exposures across asset classes, markets, instruments and currencies.

The model that estimated the fund's expected daily and weekly volatility in 2009 had a high degree of accuracy in relation to actual volatility during the year. Accuracy over longer return horizons was not as high, mainly because the markets in 2009 featured moderate day-to-day fluctuations in portfolio values, while the cumulative effects over the year as a whole were considerable.

Concentration analysis

The financial crisis triggered extreme market fluctuations which traditional model-based risk measures did not predict. Most model-based risk systems estimate risk on the basis of historical relationships. When these relationships change significantly in a short space of time, as during the financial crisis, the model will not be able to provide reliable estimates of future volatility. As a result, NBIM also uses supplementary methods and various stress tests to estimate risk.

Simple model-independent measures are often best when markets move sharply in a short space of time. One of the simplest measures we have of risk in the equity portfolio is the degree of overlap with the benchmark index. A 100 percent overlap would mean that the equity portfolio is exactly the same as the benchmark index and that the fund's equity management has the same risk as the benchmark index. The actual overlap at the end of 2009 was about 85 percent, which means that about 85 percent of the fund's equity portfolio corresponded to the benchmark index, while the remainder of the investments deviated from the benchmark index as a result of NBIM's active management. To assess the risk associated with investments that deviate from the benchmark index, we measure the concentration of investments in individual companies, sectors and regions.

Factor exposures

NBIM also measures the fund's covariance with systematic risk factors. These are common characteristics that most securities have to varying degrees and that contribute to both the risk and the return on different securities.

Chart 9-5 shows movements in factor exposures for our equity portfolio in 2009. This form of factor analysis is based on the observed return on the equity portfolio and attempts to explain this by looking at the return on a number of factors, such as the market portfolio, emerging economies, value stocks and small-cap companies, over long time series. The analysis indicates, among other things, that the equity portfolio's investments were more exposed to small-cap stocks in 2009 than the benchmark portfolio was, whereas exposure to the other factors varied during the year. The results are uncertain, however, and alternative approaches will often provide useful information. We therefore also look at individual companies' exposure to various factors. The collective result for all the companies provides a better basis for analysing the equity portfolio's overall factor exposures.

Liquidity risk

2008 was largely dominated by the liquidity crisis and the collapse of fixed income markets. We define liquidity risk as our ability to change the composition of the fund's equity and fixed income portfolios at low cost. It is the size of our positions relative to overall market turnover that determines how quickly such changes can be made. With positions in listed equities, such as those in our portfolio, calculating the liquidity risk is relatively straightforward. It is more challenging with the fixed income portfolio, where a high proportion of trading is not on regulated exchanges and reliable data on trading volumes for individual bonds are not available. We have had models for managing liquidity in equities for many years and in 2009 we also developed models for fixed income.

Chart 9-4 Overlap between equity portfolio and benchmark index. Percent

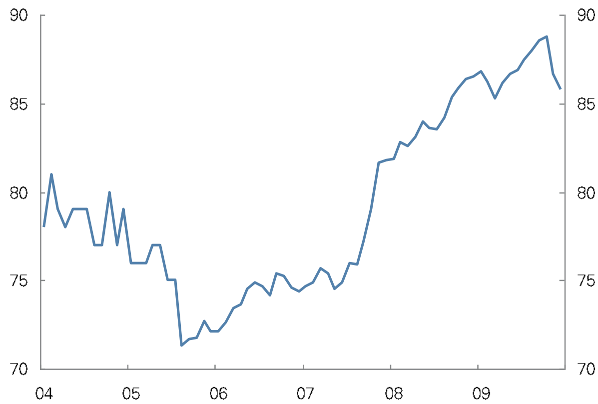


Chart 9-5 Equity portfolio's factor exposures 2009

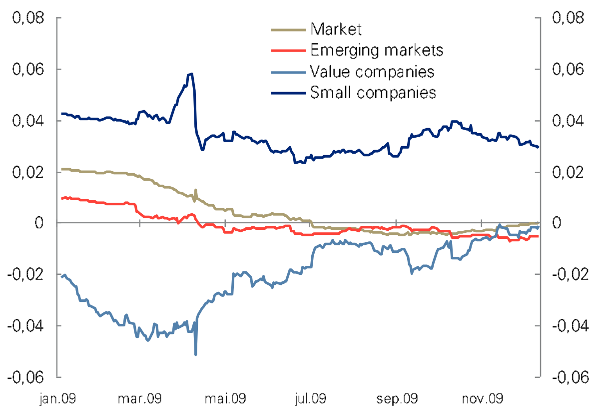
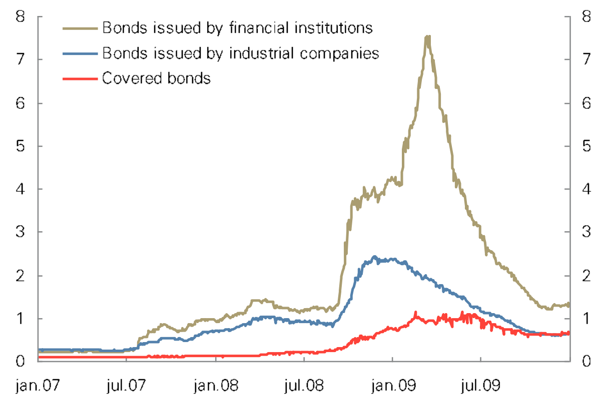


Chart 9-6 Average spread between bid and ask prices for European bonds. Percent



Source: FTSE, NBIM

We can assess movements in liquidity risk in the fixed income portfolio partly by looking at differences in buying and selling prices, volatility and turnover in the market. This measure is supplemented with qualitative assessments. Chart 9-6 shows that liquidity in European bonds decreased sharply in late 2008 and early 2009, but has increased significantly since March 2009.

Credit risk

The fund's credit risk arises primarily as a result of the Ministry of Finance's choice of investment strategy, but also as a result of active management. The aim is to have a fixed income portfolio of high quality that is well-diversified without large concentrations of positions within specific geographical areas, sectors or issuers.

NBIM measures changes in the credit quality of the fixed income portfolio partly by using credit ratings issued by credit rating agencies. Table 9-1 provides an overview of fixed income securities rated by Moody's, Standard & Poor's (S&P) or Fitch at the end of the year.

NBIM introduced credit risk models for parts of the fixed income portfolio in 2009. These provide a basis for statistically based calculations of the probability of default and expected losses in the longer term. In addition to using credit ratings from the agencies, we use two different expressions of the probability of default in the corporate bond portfolio. One includes volatility and capital structure as model assumptions, while the other is based on the price of bankruptcy insurance (credit default swaps). Both models are influenced by the market's view of changes in credit risk, while the use of credit ratings shows more the probability of default as an average over the business cycle. These models are used with supplementary methods to measure and manage credit risk.

Counterparty risk

The fund's counterparty risk arises from the use of unlisted derivatives, foreign exchange contracts, repurchase and reverse repurchase agreements, and unsecured bank deposits. It also arises vis-à-vis custodian institutions with which securities are deposited and vis-à-vis international settlement and custody systems. NBIM has high credit rating requirements when selecting and evaluating counterparties. These requirements are more stringent for unsecured credit exposure than for exposure with some form of collateral. The Ministry of Finance has decided that no counterparties in unsecured transactions may have a credit rating lower than A- from Fitch, A3 from Moody's or A- from S&P. Changes in counterparties' credit quality are monitored continuously.

Counterparty risk is checked against set limits by measuring expected future exposure. To reduce the risk associated with unlisted derivatives and foreign exchange contracts, bilateral netting agreements are entered into with counterparties. NBIM has strict collateral requirements for these exposures.

The large fluctuations in capital markets in recent years have underlined the necessity of having a broad platform of procedures, systems and models to map and manage the fund's risk.

Table 9-1 Fixed income portfolio by credit rating* as of 31 December 2009. Percentage of portfolio

	Aaa	Aa	A	Baa	Ba	Lower	No rating
Government and government-related bonds	33.34	6.91	2.36	0.91	-	0.01	0.06
Inflation-linked bonds	4.39	3.78	0.12	-	-	-	-
Corporate bonds	0.42	3.95	9.27	6.67	0.62	0.22	0.12
Securitised debt	20.72	3.96	0.28	0.35	0.23	1.24	0.05
Total bonds and other fixed income instruments	**58.88**	**18.60**	**12.03**	**7.94**	**0.85**	**1.47**	**0.23**

*Based on credit ratings from at least one of the following rating agencies: Moody's, Standard & Poor's and Fitch. The "No rating" category consists of securities not rated by these three agencies; these securities may, however, have been rated by other, local agencies.

Table 9-2 Key figures for risk and exposure. Percent and percentage points

Risk	Limits				Actual
		31.03.2009	30.06.2009	30.09.2009	31.12.2009
Market risk	Tracking error max. 1.5 percentage points	0.74	0.65	0.30	0.27
Asset mix	Fixed income portfolio 30-50%	47.4	39.7	38.0	37.6
	Equity portfolio 50-70%	52.6	60.3	62.0	62.4
Currency distribution, fixed income	Europe 50-70%	60.0	60.1	59.8	58.6
	Americas 25-45%	35.1	34.8	35.0	36.0
	Asia and Oceania 0-15%	4.9	5.0	5.2	5.4
Market distribution, equities	Europe 40-60%	49.4	49.8	51.1	50.3
	Americas and Africa 25-45%	35.2	35.1	34.4	35.3
	Asia and Oceania 5-25%	15.3	15.1	14.5	14.4
Ownership	Max. 10% of a company	9.47	9.50	9.00	7.23

Active ownership

New focus areas

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

As a shareholder in more than 8 300 companies, NBIM has both rights and obligations. Active ownership is about how we exercise our rights and execute our obligations. NBIM uses its position as a long-term and large investor to promote shareholder rights to companies and regulatory authorities. We also seek to improve social and environmental issues that affect companies' operations and, consequently, the fund's investments.

Norges Bank's Executive Board in 2009 revised the principles and strategy for NBIM's active ownership. There are now six strategic focus areas:

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

The first two address important principles of good corporate governance. Equal treatment of shareholders is important for NBIM and other minority shareholders' ability to influence the overall strategy and capital structure at companies.

NBIM also seeks to improve companies' management of risks related to climate change, water management and children's rights. This is to ensure their operations generate positive long-term financial results with acceptable social and environmental impacts. We have published a number of documents explaining how companies should manage these risks.

Water was one of two new strategic focus areas for NBIM in 2009. The other was the promotion of well-functioning and efficient financial markets.

New focus area

Promoting water management at companies

Increasingly scarce water supplies are a growing risk for companies. Managing this risk is important for companies' long-term financial results and the fund's investments.

Water is an important input and output factor at more than 1 100 companies in NBIM's portfolio. The fund's holdings in these companies had a combined market value of 307 billion kroner at the end of 2009. We have identified seven industries that are particularly exposed to the risk of scarce water supplies. These are food, agriculture, pulp and paper, pharmaceuticals, mining, water supply and electricity production.

Companies with inadequate water management already face significant operational risks, such as supply interruptions and higher treatment costs. There are also risks associated with regulation and opposition from local communities and activist groups to companies' water use. Poor water management can lead to liability for damages or the loss of licences and permits. Access to the quantity and quality of water needed for production, as well as more stringent requirements for wastewater emissions, may impact the results of an increasing number of companies in the future.

Many companies in high-risk sectors lack a proper water management policy that assesses and reports on risk associated with water. Their management of this risk may be critical to the future value of our investments. We outline our expectations for companies' water management in *NBIM Investor Expectations: Water Management*. The document is used as a basis for dialogue with companies in our portfolio.

NBIM is lead sponsor of CDP Water Disclosure, an initiative launched in December 2009 to increase the availability and quality of information on companies' water management. The project will in 2010 send out a questionnaire to about 300 of the world's largest companies in water-intensive industries to survey their consumption and water-related risks.

New focus area

Promoting well-functioning markets

NBIM in 2009 led an initiative to strengthen parts of the European covered bond market, which was hit hard by the financial crisis.

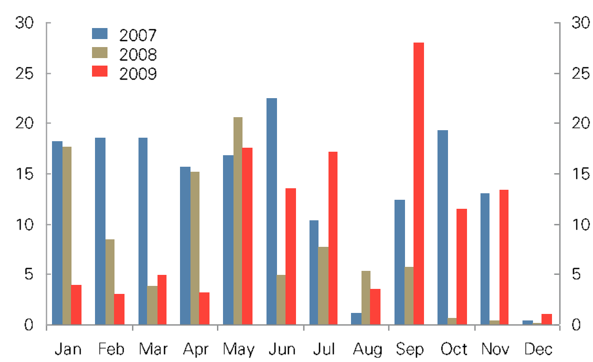
NBIM and other large investors set up the Covered Bond Investor Council (CBIC) to improve liquidity and transparency for covered bonds after the financial crisis undermined confidence. A well-functioning covered bond market is essential for banks' long-term funding capacity and, consequently, for the financing of home mortgages and the public sector in Europe.

NBIM has invested in European covered bonds in recent years. These are a type of debt secured against loans to the public sector and property loans, primarily high-quality residential mortgages. Such bonds first appeared in Germany in 1770 and have a long tradition in Denmark and France. Most other European countries have introduced covered bond legislation in recent years and work to introduce equivalent legislation in the US is underway. There has never been a default on this type of debt in Europe.

The financial crisis undermined confidence in the collateral underlying these bonds, increasing the liquidity premium on the bonds. Greater transparency and liquidity are crucial for a positive development in this market. NBIM and other CBIC investors in 2009 called for more disclosure of information about the covered bond programmes in Europe. Despite fundamental similarities between the actual bonds, legislation in European countries is often very different, resulting in a fragmented market. The quality of publicly available information on collateral, for example, varies widely. The CBIC recommended that common minimum standards be established for European covered bonds.

Much of the confidence in covered bonds returned by the end of 2009. Eighteen European financial institutions issued bonds for 1 billion euros or more, so-called jumbo covered bonds, for the first time. The European Central Bank's decision in May to invest 60 billion euros in covered bonds over a one-year period helped restore confidence, while European issuers, regulators and central banks acknowledged the need for improvements in the market. NBIM expects covered bonds to account for an increasing share of funding for banks in the medium and long term.

Chart 10-1 Issuance of large covered bonds (Jumbo bonds) 2007 – 2009. Billions of EUR



Jumbo OMF

The CBIC is seeking to redefine jumbo covered bonds, which have a minimum size of 1 billion euros. Before the financial crisis at least four brokers had to commit to marketing the bond by quoting prices to other brokers. This collapsed during the financial crisis. The CBIC believes that a new definition must include an obligation for brokers to quote prices to investors, helping to improve liquidity in the market.

Our principles

NBIM's corporate governance and ownership principles

Good corporate governance underpins the development of profitable business. It secures shareholder rights and a fair distribution of returns. NBIM laid down new extensive principles for corporate governance and ownership principles in 2009, which we communicated to the companies and markets we invest in.

Corporate Governance Principles

The company's goal is to build and safeguard long-term shareholder value
The company must have a clearly defined objective and a business strategy. To protect the interests of shareholders and prevent the company from diverging from value-creating strategies, fundamental decisions should be taken by the general meeting, such as changes to the company's memorandum and articles of association, changes to shareholder rights, significant changes to the share capital, and the election of directors. The company must provide adequate and timely information on all matters material to the valuation of the company.

The company's board of directors must work in the interest of all shareholders
The board must take a long-term view of value creation, be sufficiently independent, and provide management with opportunity and adequate incentive to build profitable business that can be sustained. It is the board's responsibility to ensure internal control and equitable treatment for all shareholders. In fulfilling its tasks, the board is accountable to shareholders for its decisions. Shareholders should be able to propose, elect and dismiss directors at general meetings without unreasonable hindrance.

The company must address the impact of its activities on society and the environment
The company's board of directors is responsible for the establishment of a strategy and policies securing business practices that are consistent with sustainable development.

As an active and responsible owner, NBIM will

Communicate our concerns and be open about our activities
We will communicate our principles and concerns. We will work with other investors to strengthen our influence and we will participate in international networks to promote good corporate governance and sustainable business practices. We will work to solidify and improve regulation and market standards to support value creation and sustainable practices.

Engage with companies
We will be clear on our investor expectations towards companies and we will enter into dialogue with the boards of companies on significant matters. We will engage to improve business practices and influence board composition.

Exercise our shareholder rights
We will exercise our shareholder rights, including voting at general meetings worldwide and, if needed, propose resolutions and board candidates. We will take legal action when necessary.

NBIM's ownership principles are based on internationally accepted standards, such as the OECD's Principles of Corporate Governance and Guidelines for Multinational Enterprises and the UN Global Compact. They are supplemented by Norges Bank's voting guidelines and NBIM's Investor Expectations documents. NBIM is a signatory of the United Nation's Principles for Responsible Investment.

Our methods

How we work

NBIM increasingly uses new methods to influence companies. We filed our first shareholder proposals in 2009, participated in consultations, published a letter to a company and extended the principles we follow. We also produced new expectations documents for how companies should handle water management and climate change.

Annual general shareholder meetings in 2009 focused on the board of director's role, composition and accountability after the financial crisis tested the results, structures and processes at companies. NBIM increased its focus on the board's role in relation to management. We sought to ensure that boards act in the interests of all shareholders regarding equity issues and corporate transactions.

The fund's share of equity investments rose to 62.4 percent from 49.6 percent during the year. The fund's average holding in listed companies worldwide rose to 1 percent at the end of 2009 from 0.8 percent a year earlier. The strengthened ownership position led to increased involvement with companies, authorities and other standard setters. We used methods such as voting, shareholder proposals, dialogue and collaboration with other investors to promote high standards at companies.

Voting and shareholder proposals

One of NBIM's principles of good corporate governance is that the chairman of a company must be independent of management. One of the board's most important tasks is appointing and dismissing the chief executive officer. The board should contribute to long-term strategy and value creation while overseeing the company's activities and risk-taking. An independent chairman is essential for the board's ability to execute these tasks and adequately supervise the company's management.

We sought to promote such independence in markets where this is not standard practice, most notably the US, Japan and France, by engaging with companies, voting, filing shareholder proposals and holding talks with market regulators.

NBIM in 2009 voted against candidates nominated as chairman of a company where they were CEO. We proposed changes to the bylaws of five US companies to prevent the same person from serving as both chairman and CEO. This was the first time NBIM filed shareholder proposals. We engaged in constructive dialogue with these companies and other investors on this topic. Sara Lee Corp. chose to change its guidelines and will appoint an independent chairman when the current chairman and CEO retires. NBIM withdrew its proposal at this company. The proposals at the remaining companies won 15-25 percent of the vote at annual shareholder meetings. The work to promote independent chairmen is long term.

Shareholder proposals to introduce independent chairmen won increased support in the US, where investors were also less supportive of board candidates put forward by a board's nomination committee. Board independence was also an issue at shareholder meetings in European markets such as Germany and France, and in Japan. There was increased pressure from both international and Japanese investors for greater independence on the boards of Japanese companies, which with few exceptions are made up of senior executives.

Many environmentally related shareholder proposals in 2009 concerned greenhouse gases and how companies should set targets to cut emissions. NBIM applied the same guidelines as in 2008, supporting proposals where companies can set their own targets.

Collaboration with other investors

NBIM collaborates with other investors to develop and improve corporate governance standards. We can often achieve results more effectively by cooperating in concrete situations. For example, NBIM and other investors sent joint letters and submissions on the equal treatment and protection of shareholders to standard setters and regulatory authorities in the Netherlands and Sweden in 2009. NBIM was also represented by another European investor at shareholder meetings in Taiwanese companies where failure to introduce real and effective voting was questioned.

NBIM had regular contact with other investment management institutions in 2009 to exchange information and experience. We discussed voting, upcoming equity issues, board changes and other corporate events. For example, we had talks with other investors about changes at some French companies that we believe weakens their governance structure. NBIM and another large European investor also held joint talks with a number of cocoa producers on how their supply chains manage the risk of child labour.

Engagement with companies

We produced documents outlining our expectations for how companies should handle climate change and water management in 2009. These followed a previously published expectations document on children's rights.

We use these expectations as a basis for systematic analysis of companies' management of risk associated with climate change, children's rights and, from 2010, water management. The expectations provide a basis for dialogue with companies. The aim is to encourage companies to introduce guidelines and systems that manage these risks in their operations and supply chains. NBIM had dialogue on children's rights with 77 companies in the cocoa, seed, textile, mining and steel industries in 2009. We had dialogue on climate change with 24 companies in the energy and cement sectors. We had dialogue on water management with 14 companies in the motor, construction, mining, oil and gas, retail and media industries.

We also discussed corporate governance with companies in our portfolio, raising the issue of equal treatment of shareholders, shareholder influence and the board's role and accountability. We encouraged companies to appoint an independent chairman in markets where this is not standard practice. We also addressed cases where our rights as a minority shareholder were not being

Table 10-1 Voting

	2009			2008		
Meetings/Region	Number	Voted	%	Number	Voted	%
Americas	3 120	3 067	98.3%	3 143	3 093	98.4%
Europe	2 258	1 456	64.5%	2 147	1 444	67.3%
Asia and Oceania	5 843	5 572	95.4%	3 510	3 334	95.0%
Total	**11 221**	**10 095**	**90.0%**	**8 800**	**7 871**	**89.4%**

It is important to NBIM, both financially and as a matter of principle, to prevent controlling shareholders from enriching themselves at the cost of other shareholders.

upheld, including discrimination in connection with takeovers and differences in voting and dividend rights.

Promoting better market standards
We can more easily hold the board and management accountable for their decisions when we get authorities and other standard setters to raise standards for corporate governance. This strengthens shareholders' rights.

NBIM worked to improve standards for the governance and supervision of companies in the US, UK, Netherlands, Brazil, Sweden and China in 2009. We also participated in the development of new global corporate governance principles through the investor network International Corporate Governance Network (ICGN).

In the US, NBIM promoted independent chairmen and increased competition for directorships. In the UK, we recommended that directors be re-elected annually. In Hong Kong, we supported demands that listed mineral and extraction companies should provide more transparent information on project assessments and environmental consequences. In the Netherlands, Brazil, Sweden and Hong Kong, we emphasised the importance of equal treatment and protection of shareholders, especially in takeover situations. For example, the rules of the stock exchange in Stockholm were changed in October based on recommendations from NBIM and other investors. Buyers of companies must now pay the same price for shares with reduced voting rights as for shares with enhanced voting rights.

Industry initiative to combat child labour

On 12 June – World Day Against Child Labour – four companies in NBIM's portfolio (Monsanto, Bayer, Syngenta and DuPont) announced plans to work together to combat child labour in seed production. The partnership was initiated by NBIM. The industry standard *CropLife Position on Child Labor in the Seed Supply Chain* was published by CropLife International, a global trade association for the plant science industry. The standard describes the joint effort these companies will make to eliminate the use of child labour by suppliers and other partners in the seed sector. NBIM will continue its active dialogue with these companies. We believe that initiatives of this kind can promote better market standards.

NBIM criticises the board of Volkswagen

NBIM only publishes its communications with companies in exceptional circumstances. In October 2009, NBIM sent an open letter to the board of Volkswagen AG criticising the company for not providing enough information about transactions with its parent company Porsche SE and its owner families. The Porsche and Piëch families control Porsche SE and indirectly also Volkswagen AG.

It is important to NBIM, both financially and as a matter of principle, to prevent controlling shareholders from enriching themselves at the cost of other shareholders. Transactions within ownership pyramids need to be monitored carefully to avoid the abuse of ownership rights for private gain. It is particularly important to ensure high levels of transparency and credible valuations when controlling shareholders transfer valuable assets between company units with varying economic rights for the different participants.

The starting point for the transactions was Porsche SE's near-insolvency early in 2009 after the company gained control of almost three-quarters of Volkswagen's voting shares in a debt-financed takeover attempt using controversial means. NBIM reacted to news of an agreement that Volkswagen AG would be used in a financial undertaking at the troubled parent company Porsche SE. We made it clear to Volkswagen's board that we expected equal treatment of shareholders and that we wanted dialogue. When it became known that Volkswagen had issued Porsche SE a sizeable loan as part of the management of the crisis, we again asked to discuss the matter. We also asked the board to account for the systems in place for handling conflicts of interest in this case.

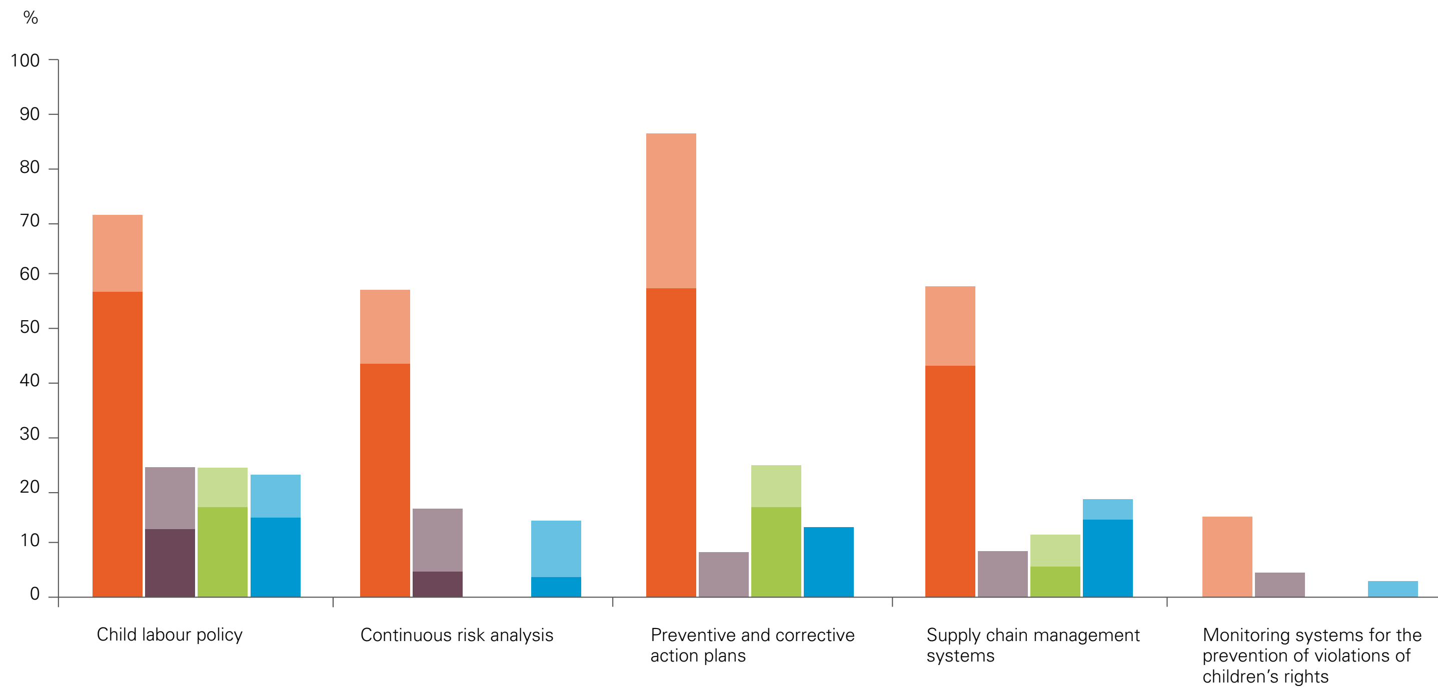
In August, the companies published an agreement where Volkswagen AG would acquire assets in the financially stretched Porsche SE at a higher price than market players thought they were worth. Volkswagen had also agreed to buy the Porsche families' privately-held car dealership business. These transactions, in addition to investments in Porsche SE by a large institutional investor and the issue of new non-voting shares in both Volkswagen and Porsche SE, were to pave the way for a merger that would leave the Porsche and Piëch families as the largest and controlling shareholders of the merged business.

NBIM and other investors demanded more information to be able to verify the valuations used as a basis for these transactions and assess the board's handling of conflicts of interest. The information from Volkswagen's board was not sufficient to allay suspicions that the company had discriminated against other shareholders to save the controlling families' investments in Porsche SE. Volkswagen's board is chaired by a representative of these families. According to the press, the board was split on these transactions and independent members opposed the agreements when they came up for final approval.

NBIM's decision to publish one of its communications by letter came after the Volkswagen board had refused talk with outside shareholders for a lengthy period. Our demands for more information to the market and dialogue with key shareholders were partly met.

NBIM believes this unresolved situation is important for the development of principles of good corporate governance in Europe. We expect companies that aim to be commercial leaders to maintain high standards of corporate governance. This case shows that there is a need for stronger protection of minority shareholders' rights in the German market in takeover situations and related-party transactions.

Sector comparison: The chart illustrates to what extent 135 companies met NBIM's expectations to children's rights in 2008 and 2009.



Compliance reports

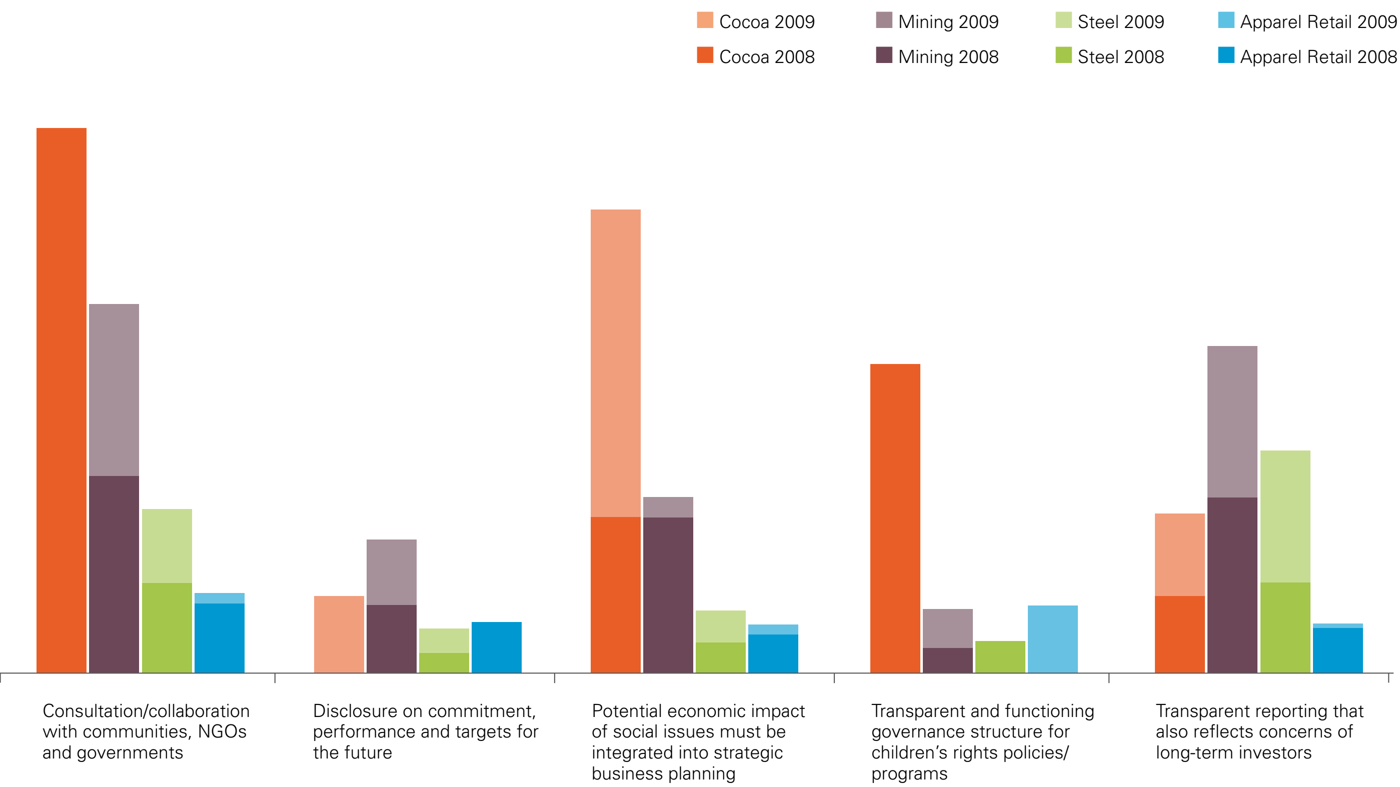
Evaluating companies' management of children's rights

NBIM publishes annual reports assessing companies' compliance with our expectations on climate change and children's rights.

NBIM published the document *NBIM Investor Expectations on Climate Change* in 2009, which followed the previously published *NBIM Investor Expectations on Children's Rights*. The documents are directed towards companies in our portfolio with operations or value chains in sectors and regions that are exposed to risks associated with climate change or children's rights. They explain how we expect companies to manage these risks. Failure to manage such risks may adversely affect companies' operations and performance, putting the fund's investments at risk.

NBIM systematically assesses how the companies in our portfolio meet our expectations in managing risks associated with climate change and children's rights. The annual assessments are based on publicly available information. We publish the results of the assessments in annual compliance reports. We use the findings in the reports as a basis to engage in dialogue with companies to try to change their behaviour.

Our first compliance report assessed the extent to which 430 companies complied with NBIM's expectations for children's rights in 2008. Based on the findings in the report, we contacted some of these companies and suggested how their management of children's rights could be improved. When we reassessed these companies' track record a year later in another compliance report, 33 percent of the 135 companies we contacted had improved their performance and reporting on child labour and children's rights.

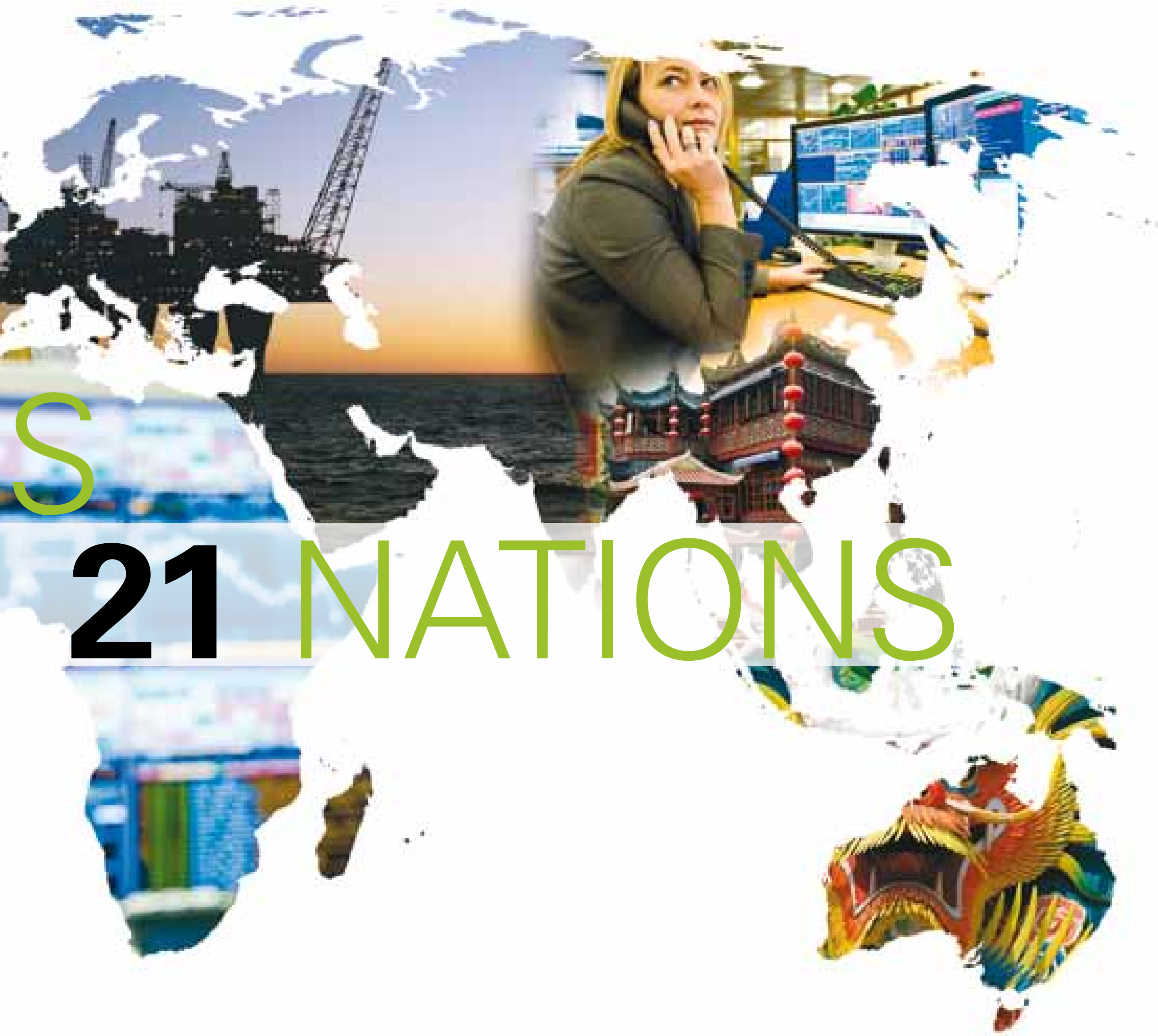


NBIM systematically assesses how the companies in our portfolio meet our expectations in managing risks associated with climate change and children's rights.

The number of companies that disclose a child labour policy had increased by 62 percent, while the number of companies that said they assess risk associated with child labour had more than tripled. There was also an increase in the number of companies that reported preventive and corrective action plans related to child labour, both in direct operations and supply chains.

These improvements were most apparent in the cocoa- and apparel retail sectors. The mining and steel companies had an increased number of policies on child labour. Transparency improved in all sectors.

249 EMPLOYEE FROM



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21 NATIONS

NBIM

Strengthening the international scope

NBIM recruited 51 new employees from eight different countries in 2009. An ever broader management mandate has increased the need for resources, not least international expertise and specialisation.

For NBIM to manage the Government Pension Fund Global effectively, we need to work close to the global markets we invest in. We have built up international expertise and presence at three regional offices in London, New York and Shanghai.

NBIM had 249 employees at the end of 2009, of which 79 were non-Norwegian nationals. Our working language is English.

Organisational development

In response to a broader fund management mandate, NBIM restructured its organisation in 2009, focusing on increased specialisation, delegation and global expertise. We set up a senior management team with extensive international experience. Four of the nine managers are non-Norwegian nationals.

There is also a constant focus on skills development at every level of the organisation, from a management development programme for NBIM's top 30 managers to a new four-year trainee programme for talented graduates looking for a career in global investment management.

NBIM systematically maps skills in the organisation, not least the specialist expertise associated with individual positions and career development, to ensure improvement and continuity in all key positions.

Our working environment is international and result-oriented. We work to develop and reinforce the organisation's investment culture.

Remuneration

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

32 %

- 32 percent of permanent employees are non-Norwegian nationals
- 43 percent of new recruits in 2009 were non-Norwegian nationals
- 27 percent of permanent employees are women

22 %

22 percent of our employees work at our offices in:
- New York
- London
- Shanghai

Performance-based pay is calculated on the basis of results achieved relative to set targets. Employees who make investment decisions are assessed quantitatively on the basis of returns and the performance-based component is a substantial element of their pay.

The salary of the Executive Director of NBIM is set by the Governor of Norges Bank following an annual assessment and within limits set by the Executive Board. All NBIM employees on Norwegian contracts are covered by Norges Bank's pension scheme, which is presented in Norges Bank's annual report.

The table below shows the agreed annual fixed salary for 2010 for NBIM's senior management team. The team members do not have performance-based components in their salaries.

Position	Name	Agreed annual salary as of 31.12.2009
Chief Executive Officer	Yngve Slyngstad	3 500 000
Deputy Chief Executive Officer	Stephen A. Hirsch	5 250 000
Chief Strategic Relations Officer	Dag Dyrdal	2 250 000
Chief Compliance Officer	Jan Thomsen	3 250 000
Chief Investment Officer	Bengt O. Enge	4 750 000
Chief Treasurer	Jessica Irschick	4 890 000
Chief Administrative Officer	Mark Clemens	2 300 000
Chief Operating Officer	Age Bakker	2 500 000
Chief Risk Officer	Trond Grande	2 750 000

Numbers in NOK

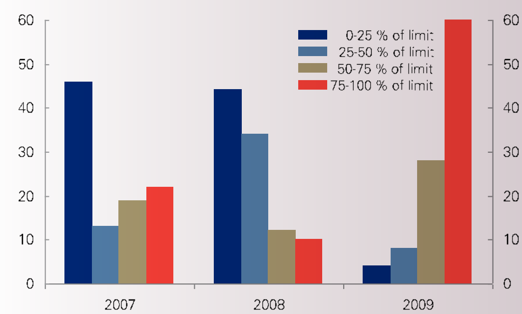
Remuneration at NBIM

Front-office departments:
Number of employees with performance-based pay: 106 employees. Total fixed pay: 96.1 million kroner. Upper limit for performance-based pay: 173.4 million kroner. Performance-based pay as a percentage of limit: 77 percent.

Other departments:
Number of employees with performance-based pay: 120 employees. Total fixed pay: 84.9 million kroner. Upper limit for performance-based pay: 30.5 million kroner. Performance-based pay as a percentage of limit: 78 percent.

Total performance-based pay in 2009 was 77 percent of the upper limit for performance-based pay. The upper limit for performance-based pay was 3.5 percent higher than in 2008. The average payment per employee was 258 percent higher than in 2008.

Performance-based pay relative to upper limit. Percentage of workforce:



These figures exclude the remuneration of the Executive Director of NBIM and the other members of the senior management team.

Organisation

Stronger compliance and control functions

NBIM introduced a new organisation structure and management team with broad international expertise in 2009 as part of a major reorganisation of its operations over the past two years.

Stronger business controls

NBIM made substantial changes to its organisation in 2008. A number of functions that were previously separate for equity and fixed income management were integrated, risk management was significantly strengthened and fixed income management was restructured.

The reorganisation process continued in 2009 with a new management structure and senior management team with broad international experience. Five of the team's nine members were recruited to NBIM in 2009 and key functions such as compliance and risk management are represented on the team.

One important aim of the reorganisation was to strengthen the investment functions and overarching compliance functions. We have made a clear distinction between departments responsible for investment decisions and departments responsible for operational and compliance functions. There is also a clear division of responsibilities on the investment side. Those who make investment decisions are not responsible for executing trades, financing positions or managing securities lending. The settlement of trades is handled by a third department. There is also a division on the administrative side between support functions for the investment side and more general administrative duties. The division of responsibilities at this level, with guidelines built into the trading systems, is an important measure to reduce the risk of error or irregularity at the individual level.

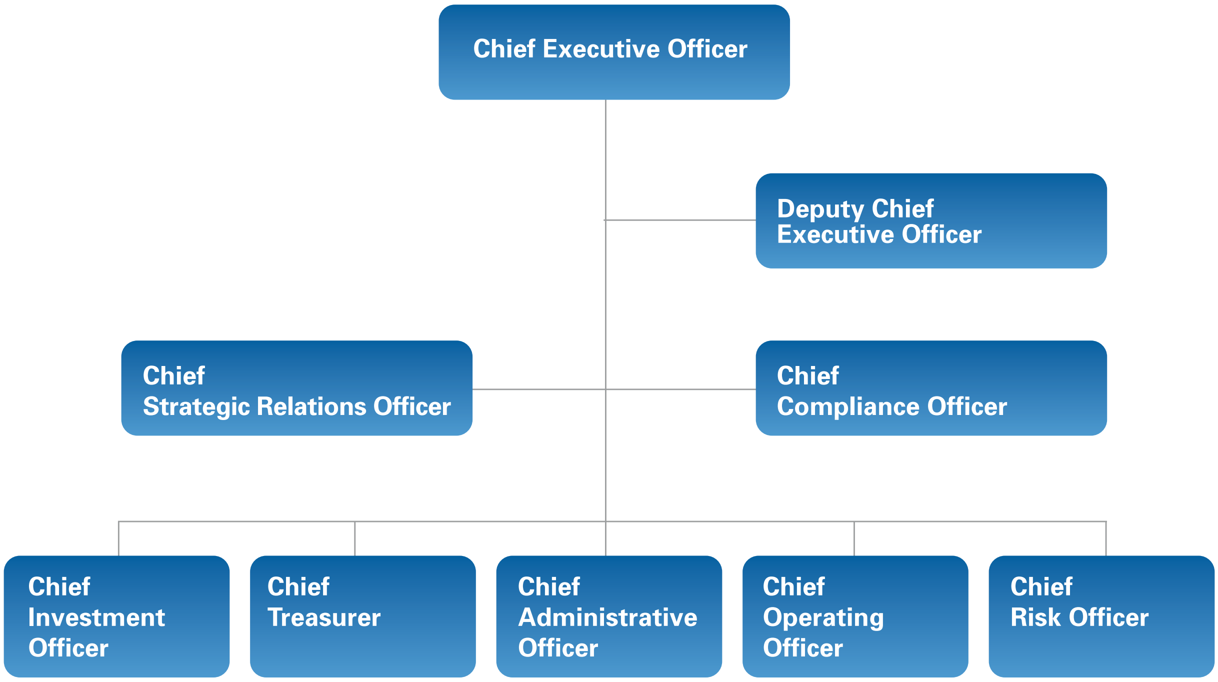
Stronger risk management and compliance

NBIM has built up a risk management department to monitor market risk, credit risk and counterparty risk across the investment units. The department was previously part of a centralised administration. It has been brought closer to the departments and employees who are responsible for active risk-taking in the fund.

NBIM has strengthened the compliance functions that ensure NBIM follows market regulations, investment mandates and guidelines. The compliance unit is also responsible for preparing internal approval of new investment instruments and a subsequent authorisation structure. The unit has been given a broader mandate to monitor NBIM's business risks. In practice, this entails a responsibility to ensure that all departments follow up the risks associated with their activities, including operational risk, IT and information risk, legal risk and reputational risk in the broad sense.

NBIM has established a formal committee structure that draws on expertise from across the organisation. These committees are advisory and are used by NBIM's CEO to discuss relevant issues before decisions are made. The committees also play an important part in the design of guidelines for NBIM's operations. NBIM had five committees in 2009: one for instrument approval, one for credit and counterparty risk, one for business policies, one for investment risk and one for valuation. All approved instruments were subject to a new risk assessment and review in 2009.

Norges Bank has established a new structure for investment mandates. The content of the mandates has been redesigned, with risk limits issued along more dimen-



sions than before. There are both quantitative model-based limits and risk limits that are based on gross nominal exposures and derivatives usage. In addition, the new investment mandates contain guidance on desired liquidity and limits for systematic exposure to specific market factors.

Outsourcing

The management of the fund requires a global organisation. Our operations run around the clock, the complexity of our solutions is considerable and our demands of suppliers are exacting. Large parts of our operational activities are carried out using suppliers with specialist expertise. This helps NBIM operate as a relatively small and flexible organisation.

All of our offices have access to the same services. It is important that all systems use the same platform regardless of geographical location. Our suppliers need to be able to provide local support, given that we have offices in different parts of the world.

It is important to maintain adequate oversight of outsourced activities. NBIM attaches great importance to retaining internal expertise in all specialist fields where we use external suppliers. To assure the quality of services, we have frequent formal and informal contact with our partners. The formalisation of service agreements provides a reassuring framework for outsourcing activities, while systematic evaluation of suppliers on the basis of quantitative and qualitative key indicators ensure delivery and quality.

Operational risk

Monitoring and controlling complex operations

NBIM continuously strives to improve operational risk management. We reduced risk in a number of areas in 2009 by decreasing the complexity of some investments, instruments and types of financing, as well as the associated internal processes.

Framework for operational risk
NBIM's risk level can be explained as a combination of the probability of a risk factor occurring and the impact of occurrence. We seek to assess both inherent and residual risk, as well as expected future risk if further action is taken.

Inherent risk is the underlying risk in an organisation and its activities before actions are taken to reduce this risk. Residual risk is the risk that remains after internal control procedures and actions have been implemented. If the residual level is beyond the limits set by Norges Bank's Executive Board, further action is taken to reduce expected future risk.

NBIM is a relatively small organisation considering the substantial assets under management. Decentralised external management and investments in global markets entail high levels of inherent risk for a fund of our size. This covers everything from mistakes in daily routines to criminal matters such as corruption, fraud and irregularity on the part of suppliers, external managers and employees. We work systematically and actively to mitigate this risk at every level of the fund management.

NBIM lowered its operational risk in a number of areas in 2009, partly by reducing the complexity of investments and their associated internal processes. This involved reviewing and reducing the number of approved instruments we can invest in, leading to a decrease in trading in complex unlisted derivatives. The financing structure and programmes for borrowing and lending were also substantially revised and work on operational risk management in relation to suppliers and external managers was stepped up. NBIM's risk level after these actions is considered acceptable.

Operational risk management
Operational risk is assessed on the basis of NBIM's value chain and the associated processes and activities, including the oversight and control of suppliers and external managers.

In each of the various processes in NBIM's operations, we identify potential events that are undesirable in terms of our overall goals. These events are then classified according to whether they stem from internal or external factors. One example of a process where potential undesirable events could have occurred is the reorgani-

NBIM identifies potential undesirable events and seeks to improve processes so that these events do not occur.

sation of NBIM over the past two years. This entailed an inherent risk of employees in new positions not having their responsibilities sufficiently clarified during the start-up phase, that could have impacted operations. We developed job descriptions and a new management structure that helped reduce this risk. Another example of operational risk is related to projects. Failure to prioritise, insufficient resources and unrealistic schedules are all risk factors that can make it difficult to carry out a project. This is an important area to follow up, as NBIM had more than 50 projects in 2009.

Low-impact high-probability risks are viewed as areas with room for improvement. For example, NBIM constantly seeks to reduce the risk associated with the complexity of its infrastructure and IT systems. At the other end of the scale are a number of high-impact low-probability risks. Typical examples are natural disasters, corruption and breach of contract. These risks are managed through constant focus on preparedness and crisis management. NBIM conducts exercises for various crisis scenarios several times a year.

NBIM identifies potential undesirable events and seeks to improve processes so that these events do not occur. Risk factors are reduced as far as is practically feasible, normally based on an assessment of the cost of the events relative to the benefits of risk mitigation. We also record actual undesirable events on an ongoing basis and take steps to reduce the probability of and consequences of losses from these events. Databases are used to ensure follow-up and planning of actions.

NBIM's management is responsible for risk management at every level. The risk picture is an integral part of line management reporting and is monitored continuously by management. Quarterly status reports on operational risk and internal control are presented to Norges Bank's Executive Board.

From oil and gas to financial wealth

The story of Norwegian oil and gas effectively began with the discovery of the Ekofisk field on 23 December 1969. Today, some 60 fields are in production on the Norwegian continental shelf. Almost 40 years of petroleum production have generated net government revenues of around 4 000 billion kroner in 2009 prices. According to the Ministry of Finance, around 40 percent of the government's net cash flow from petroleum production has so far been spent through the public budgets.[1] Since 1996, the remainder has been transferred to the Government Pension Fund Global and invested in global equity and fixed income instruments.

The Norwegian Petroleum Directorate estimates that around 40 percent of total reserves on the Norwegian continental shelf have been recovered.[2] Future production levels will among other things depend on new discoveries and their size, as well as the recoverable resources on existing fields. The government's share of the remaining petroleum wealth is estimated in the National Budget 2010 at 4 089 billion 2010 kroner. There is considerable uncertainty about the size of the government's net cash flow from petroleum activities and transfers to the Government Pension Fund Global in the years ahead. Estimates suggest that both the production on the Norwegian continental shelf and the government's annual petroleum revenues have peaked.[3]

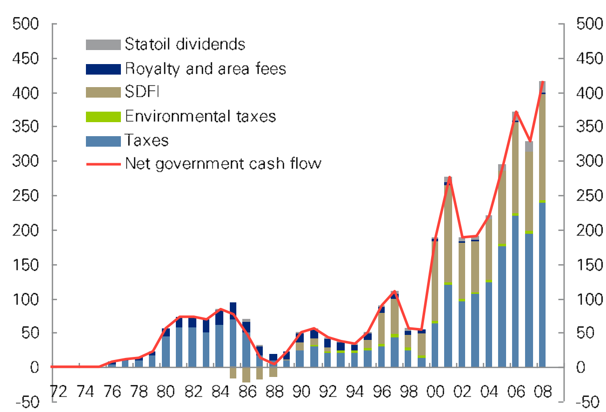
The creation of the Government Pension Fund Global

The Government Pension Fund Global was formally established by act of parliament in 1990 under the name of the Government Petroleum Fund, and the first transfers of capital to the fund took place in 1996. The fund is an important instrument of economic policy in Norway, intended to underpin long-term considerations in the use of government petroleum revenues and support government saving to finance public pension expenditure.

Oil and gas are non-renewable resources. By transferring revenues from petroleum activities to the fund, wealth from oil and gas resources on the continental shelf is converted into a diversified portfolio of global financial assets.

In spring 2001, the government introduced a fiscal rule for the spending of petroleum revenues over the central government budget. Under this rule, annual spending over time is to correspond to the expected real return on the Government Pension Fund Global, estimated at 4 percent of assets under management.

Chart 11-1 Net government cash flow from petroleum activities by source 1971 – 2008. Billions of NOK, at 2008 values



Source: Ministry of Petroleum and Energy, Norwegian Petroleum Directorate

Norges Bank manages the fund on behalf of the Ministry of Finance. In 1998, the Bank established a separate investment management unit, Norges Bank Investment Management (NBIM), which manages the fund.

The government's net cash flow from petroleum activities

Petroleum activities have generated a positive net cash flow for the government since 1971. Chart 11-1 shows

1 Source: How much oil money have we spent so far?], Ministry of Finance web site.
2 Source: The shelf in 2009 – Resources overview (provisional figures as at 31 December 2009), Norwegian Petroleum Directorate.
3 Source: National Budget 2010, Ministry of Finance.

the cash flow in the period 1971-2008 in 2008 kroner, broken down into the various sources of revenue. Around 50 percent of the total cash flow in 2008 kroner was generated in the last six years of the period. The government's net cash flow peaked in 2008 at NOK 416 billion in 2008 kroner.

Over the whole period from 1971 to 2008, taxes contributed most to government petroleum revenues, accounting for almost 60 percent of the total net cash flow. Revenue from the State's Direct Financial Interest (SDFI) in petroleum activities was the second largest source of revenue, contributing around 30 percent of the total net cash flow. The main contributions from the SDFI have come since the year 2000. Production and area fees were the government's sole source of petroleum revenues during the first five years. Revenues from these sources accounted for almost 10 percent of the total net cash flow in 1971-2008 but have been of limited significance in recent years. Environmental taxes and dividends from the oil company Statoil each contributed 2-3 percent of the government's total net cash flow during the period.

Transfers to the Government Pension Fund Global 1996 – 2009

The first transfer to what was then called the Government Petroleum Fund took place in May 1996. Inflows into the fund since 1996 have totalled around NOK 2 300 billion not adjusted for inflation. Around 65 percent of these inflows have been channelled into the equity portfolio, and the remainder into the fixed income portfolio.

Chart 11-2 shows the annual inflows into the fund not adjusted for inflation, broken down between the equity and fixed income portfolios. There have been substantial transfers to the fund and they have varied considerably in size. There have also been a number of changes to the strategic benchmark portfolio. For example, the allocation to equities was increased from 40 to 60 percent, resulting in the sale of part of the fixed income portfolio. This is the reason why inflows into the fixed income portfolio in 2008 and 2009 are negative in the chart. Large inflows and changes to the benchmark portfolio present challenges to the fund management, and NBIM puts considerable resources into this aspect of its management. One of NBIM's most important goals is to ensure prudent and cost-effective implementation of the owner's management strategy.

Capital is normally transferred to the fund monthly, with the exception of December. The Ministry of Finance informs Norges Bank of how much is to be transferred, and the inflows are distributed between the equity and fixed income portfolios on the basis of rules laid down by the ministry.

NBIM allocates the inflows to individual portfolios which are managed either internally or by external managers with mandates from NBIM. The portfolio managers are informed of the inflows and decide which securities they wish to purchase. The transactions are then executed by a central trading team.

Chart 11-2 Annual inflows into the fund by asset class. Billions of NOK, current pricesInflows into fixed income portfolio

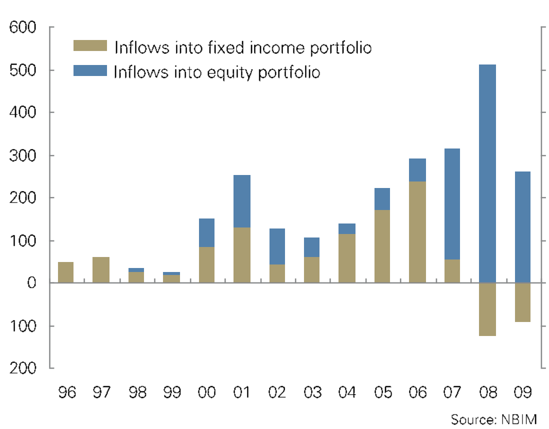


Chart 11-3 Development in oil prices, share values and the fund's equity purchases. Monthly numbers

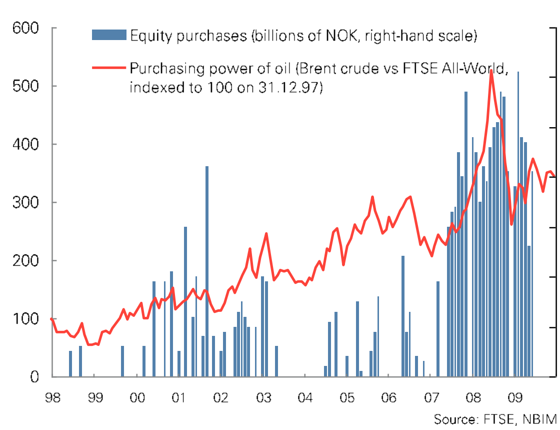
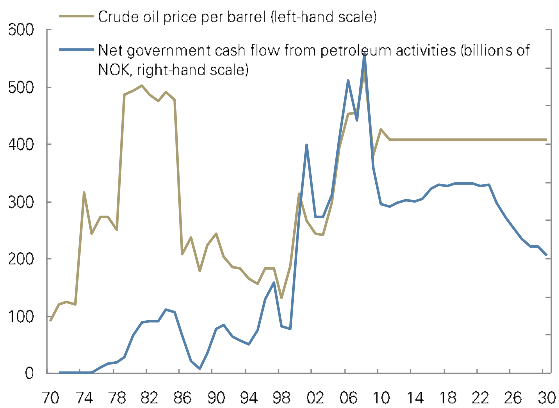
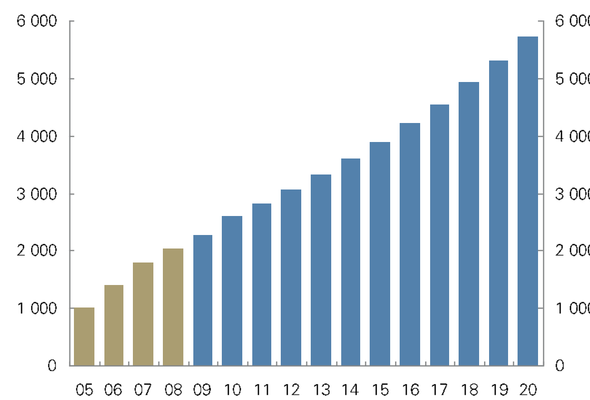


Chart 11-4 Net government cash flow from petroleum activities 1970 – 2030. NOK per barrel and billions of NOK, at 2010 values



Source: National Budget 2010, Ministry of Finance

Chart 11-5 Projected fund market value. Billions of NOK, current prices



Source: National Budget 2010, Ministry of Finance

One characteristic of the Government Pension Fund Global that sets it apart from most other funds is its long investment horizon. Due to the long-term perspective, is too early to assess the profitability of the decision to convert petroleum revenues into global securities. Other things being equal, the government will secure the greatest overall wealth from saving where the real rate of return is highest, whether this means leaving the oil in the ground or investing in global securities markets. In practice, however, many other considerations will influence the pace and level of petroleum production.

Chart 11-3 provides a simplified illustration of the relative value of oil and equities, measured as the price of Brent crude oil relative to the FTSE All-World equity index. In basic terms, the higher this ratio, the more equities a barrel of oil will buy. Around 70 percent of the inflows into the equity portfolio since the fund was started up have come in the past three years (2007-2009). Equities were relatively cheap in relation to oil during this period in comparison with earlier years.

What can we expect from the future?

In the National Budget 2010, total petroleum wealth – defined as the present value of future annual cash flows from petroleum activities from 2010 onwards – is estimated at 4 744 billion 2010 kroner. The government's share of this wealth is estimated at NOK 4 089 billion kroner.[4] This is roughly equivalent to the government's total net cash flow from petroleum activities from 1971 to 2009, in 2010 kroner. In other words, we have recovered around 50 percent of the petroleum wealth on the continental shelf if we compare the real value of the government's net cash flow to date with the estimated present value of future net cash flows. However, estimates of future petroleum production and revenues are associated with considerable uncertainty.

The Norwegian Petroleum Directorate estimates that around 40 percent of total reserves on the Norwegian continental shelf have been recovered. Relatively stable petroleum production is expected in the coming years, with falling oil production and rising gas exports.[5] In the longer term, production levels will depend on the number

4 The government's share of total wealth is defined as the present value of the government's net cash flow from petroleum activities.
5 Source: Facts 2009, Ministry of Petroleum and Energy and Norwegian Petroleum Directorate.

Estimates in the National Budget 2010 indicate that both production and the government's net revenues from petroleum activities have peaked

of new discoveries and their size. Estimates in the National Budget 2010 indicate that both production and the government's net revenues from petroleum activities have peaked.

Future revenues from oil and gas production depend partly on production levels, oil and gas prices in Norwegian currency, and production costs. There is considerable uncertainty about these variables, and the further ahead one looks, the greater the uncertainty in the estimates. As indicated in Chart 11-4, there have been substantial fluctuations in oil prices with a strong impact on revenues.

The size of the Government Pension Fund Global and transfers to the fund are also dependent on government spending of petroleum revenue. The size of the fund further depends on developments in global securities markets.

Summary
The Norwegian Petroleum Directorate estimates that around 40 percent of total oil and gas reserves on the Norwegian continental shelf have now been recovered. According to the Ministry of Finance, around 40 percent of government petroleum revenues have been spent through public budgets. The remainder has mainly been transferred to the Government Pension Fund Global. Estimates of the government's future net cash flow from petroleum activities and future transfers to the Government Pension Fund Global are associated with considerable uncertainty. This uncertainty relates partly to remaining reserves and future production, the cost of production, and oil and gas prices.

NBIM attaches great importance to phasing new capital into the fund, making changes in the benchmark portfolio, and ensuring prudent and cost-effective implementation of the owner's management strategy. These will continue to be important tasks in the management of the Government Pension Fund Global.

Active management of the Government Pension Fund Global

The Government Pension Fund Global has a number of distinguishing characteristics that can be used to generate an excess return on investments. Active management of the fund has helped to increase returns over the past 12 years, and also supports the performance of NBIM's other tasks. At the same time, the fund's costs for active management are relatively small, and there has been little change in risk due to active management.

The active decisions that have the greatest impact on the fund's returns are decisions that need to be taken even with a passive mandate for the manager. Besides asset allocation, the most important decisions relate to rebalancing the portfolio, phasing new capital into the fund, and adjusting the fund to changes in the benchmark portfolio.

It is possible for active management to add value

Active management is where investors and managers make their own assessment of different investment opportunities. In doing so, investors actively seek to generate a higher return – an excess return – than can be achieved with passive investment in financial markets. Passive management normally entails investing capital in line with specific indices. This means that these investments are largely determined by the prices prevailing after active investors have made their investments.

Passive management requires fewer resources than active management for the analysis of investment options. Most markets in which NBIM operates are nearly efficient.[1] These are typically markets with many active investors and analysts, which reduce the potential for excess returns. The expected return from performing additional analysis is therefore limited. Empirical studies may suggest that passive management, where the main aim is to invest relative to an index, is a sound alternative for most investors. This is due partly to the cost of active management, which is significant for investors of moderate size.

Recent research has, however, documented that market efficiency varies. Market frictions, the cost of gathering and analysing information, and restrictions relating to capital structure, are all important causes of inefficiency in financial markets. The degree of efficiency varies both between markets and over time. There are variations along multiple dimensions, and some markets will be less efficient than others for long periods.

Even a market that is normally efficient may, during periods of high volatility or reduced access to funding, present opportunities for an investor with risk-bearing capacity, solid funding and a long-term investment horizon. An active manager with a global universe will also be able to exploit persistent mispricings due to other investors categorising securities in different ways or

1. In an efficient market, all relevant information will be reflected in prices for securities. For a review of the research literature on market efficiency, see Norges Bank (2009): Norges Bank's assessment of the theoretical and empirical basis for active management and our strategy for the management of the Government Pension Fund Global, letter to the Ministry of Finance, 23 December 2009.

choosing to concentrate on specific markets. In addition, a long-term investor will be able to create value by exploiting the opportunities that arise when other investors are forced to adopt a short investment horizon due to special regulations or a short-term need to generate income for their owners.

This has led to a modified efficient market hypothesis. The modern version argues that financial markets are close to efficient most of the time, but that active investments help to eliminate mispricings and make markets more efficient. According to this hypothesis, active management can generate excess returns. An investor with high risk-bearing capacity who is present in numerous financial markets can exploit these departures from market efficiency.

Over the past 20 years, a number of characteristics, or risk factors, have been identified and documented which can help to explain the differences between the returns on securities. These factors include liquidity and volatility for fixed income instruments, and growth expectations and company size for equities. There is not a consensus on whether these risk factors, or anomalies, are an expression of mispricing in the market or an expression of systematic risk not captured by pricing models. Either way, a manager should take an active position on these factors and manage them actively and explicitly in order to improve the trade-off between expected return and risk.

Purely passive management is not possible

The opposite of active management is passive management, where the idea is to ensure that the fund is always virtually identical to the benchmark portfolio. A strategy of this kind assumes that there is some neutral reference to which we can relate passively or mechanically in the performance of our management assignment. This is not the case. There are several reasons why the fund cannot be a passive investor in the theoretical sense.

First, it is not possible to achieve a cost-effective market portfolio through an entirely passive approach. A benchmark portfolio follows mechanical rules for how it is to be adjusted to index changes. This means, for example, that adjustments are made at predetermined times. For an investor of NBIM's size, mechanical adjustment of this kind will produce high transaction costs. As a result, the return on a passive strategy will be lower than the return on the benchmark portfolio.

In addition, a traditional benchmark portfolio will not fully reflect all known risk premiums. A risk premium is the compensation an investor receives for bearing various types of underlying or systematic risk, such as liquidity risk, the risk of extreme events, or equity market risk. Risk premiums can play out over long periods of time. How and when an investor is best rewarded for exposure to a given risk factor will also change over time. As investment opportunities vary over time, a long-term investor should have the flexibility to adapt to this through active decisions.

An active management strategy is predicated on investment opportunities in the market varying over time, and some securities being mispriced in relation to their fundamental value. For financial markets to function effectively there must be investors who choose to purchase mispriced securities based on a perception of their fundamental value. In so doing, these investors can help to gradually eliminate these mispricings. In a simple model like this, the choice between active and passive management will be a matter of whether we are to take informed investment decisions ourselves or compensate other managers for doing so. In other words, passive management has a hidden cost which will, to a greater or lesser extent, correspond to the lower management costs from this strategy.

The fund's distinguishing characteristics

The relevant question is not whether the Government Pension Fund Global should be managed actively or passively, but how active NBIM is to be in its management. The answer is related to two of the fund's most important distinguishing characteristics, which set it apart from most other investors.

First, the fund is very large. A market value of more than NOK 2 600 billion at the end of 2009 makes it one of the largest funds in the world. For some, this might be an argument for passive management. Even if the fund's portfolio managers identify good investment opportunities, these will often be marginal in relation to the fund's overall size. On the other hand, there are economies of scale to be gained in fund management. Large investors have better access to information, have greater analytical capacity, and can operate with lower costs relative to assets under management. Economies of scale make it easier for a larger fund to achieve an excess return from active management. Large funds can also implement new investment strategies with a low marginal cost. NBIM can therefore establish special strategies in areas where smaller funds will find it uninteresting or impractical to deploy resources. Size also gives NBIM bargaining power when negotiating with service providers, making it possible to secure better terms.

The other distinguishing characteristic is the fund's investment horizon, which is in principle infinite. This means that we can ride out periods of extreme movements in capital markets. Unlike most other investors, the fund is not dependent on short-term funding, has no clearly defined obligations, and is not subject to special rules that can require costly adjustments at inopportune times. This results in considerable risk-bearing capacity and makes it possible to establish and implement a long-term active investment strategy. We can make investments where it may take a long time before the underlying value is realised. We can be patient in the execution of investments and increase risk-taking when specific situations arise.

Active management is cost-effective

We currently have three main strategies for active management: management of the market portfolio, management of investments in individual companies, and management of systematic risk.

The management of the market portfolio ensures cost-effective exposure to asset classes and markets which is close to the owner's benchmark portfolio. The benchmark portfolios for the various asset classes follow mechanical rules and have a number of technical weaknesses. The benchmark portfolios do not always fully represent the asset class, especially in the case of fixed income investments. The definition of the benchmark portfolio can introduce bias, because it excludes bonds with short maturities, bonds downgraded below a certain level, and floating-rate bonds. Through active management, we can build a portfolio which represents the fixed income market in a broader and more cost-effective way, and buy securities at lower prices by participating in new issues and by avoiding the times for index changes.

We take an active approach to the management of the market portfolio. A passive investment strategy which aims to minimise active risk in the management of the fund would be cost-generating, because it would force us to implement significant adjustments at given points in time.

Active management brings insight and expertise

We also aim to improve the portfolio by analysing individual companies in which we are shareholders or creditors. This management of company-specific risk builds up expertise and insight into the fund's underlying assets and also forms the foundation for our active ownership. Our internal management is based on analysis of individual companies – known as fundamental strategies – with specialists in different industries. A high degree of specialisation, delegated decision-making authority and concentration of positions are intended to ensure that our managers are in a position to attain an informational advantage. In our external active management, there is increased emphasis on markets that we believe to be less efficient and where it is impractical or unrealistic to build up internal expertise. The fund's size also brings bargaining power and cost advantages relative to other investors.

Active management ensures risk management

We analyse the fund's overall risk characteristics and take account of systematic risk factors in a number of ways. A given benchmark portfolio will not at any time provide an optimal or risk-neutral expression of the owner's investment preferences or risk tolerance. Based on analysis of these systematic risk factors, we manage the fund's overall risk with a view to improving the trade-off between return and risk. The fund's benchmark portfolio evolves slowly, and we make investments in parts of the market which are not included in the benchmark portfolio when these opportunities are considered to be attractive. On the other hand, we can also withdraw the fund from investments which are included in the benchmark portfolio if the risk is too great. This can push up expected tracking error, as the difference between the benchmark portfolio and the fund's actual portfolio increases. Decisions of this kind can nevertheless improve the portfolio's long-term trade-off between return and overall risk. Our long-term investment horizon means that we can be patient and increase exposure to systematic or aggregate risk as opportunities arise.

Active management ensures high levels of ambition, quality and oversight

Other than generating excess return through active management, NBIM's management assignment can be divided into four parts: we invest new capital in the markets at the lowest possible cost; the capital invested then needs to be managed in order to maintain the market portfolio in a cost-effective manner; we safeguard our long-term financial interests through active ownership; and we advise the Ministry of Finance on matters concerning the fund's long-term investment strategy. Active management and the expertise it brings to the organisation help to strengthen all of these other management tasks.

There is a particularly strong effect when it comes to the ownership role. We need to have a sound knowledge of the companies in which we invest when we engage in direct dialogue with their management in order to influence their operations and governance structure. The knowledge needed to establish and pursue effective dialogue is often generated through investment analysis. We believe that the potential to achieve the desired results from active ownership increases with the quality and competence of our active management. In given situations, active ownership can help to bring the governance of a company more into line with our intentions and so realise underlying value in the company from which the fund can profit through active management.

The overall goal for the management of the fund is to safeguard and build financial wealth for future generations through a skilled organisation. This requires a high level of ambition. When this goal is translated into expectations for managers, departments and individual employees, everyone will be required to help raise the quality of inputs into the fund management. Risk management and control functions are strengthened within such a framework. An active management mandate with high levels of ambition therefore helps to reduce operational risk in the management of the fund.

Higher returns, less risk

For a large, well-diversified fund such as the Government Pension Fund Global, the expected return will reflect the desired level of risk. Equities are expected to offer higher returns over time, but also carry more risk. The single most important decision in the design of the fund's current strategy has been the choice of a strategic allocation to equities of 60 percent. This decision is expected to dominate both the overall return and the risk in the fund over time.

NBIM aims to build a portfolio which gives the best possible trade-off between expected return and risk. Our active investment decisions increase the fund's overall risk to only a limited extent. Instead, they aim to increase the return for the level of risk chosen by the Ministry of Finance.

There are many theoretical and practical arguments in favour of NBIM exercising a degree of active management. These arguments are backed by experience and results over the past 12 years. NBIM's active decisions produced an average annual excess return of 0.25 percentage point from 1998 to 2009. With the current size of the fund, this is equivalent to NOK 6 billion. The additional costs from active management are limited. NBIM has added value to the fund since inception.

While active management has contributed to higher returns, risk has increased only slightly. On average, NBIM has used just 20 percent of the risk limit for active investment, as expressed by expected tracking error. It can be argued that this measure exaggerates the actual risk from active management. Active management forces managers to monitor investments more closely, which in itself probably leads to lower levels of risk in the fund.

Conclusion

For the average investor, the market portfolio is often the best option. The Government Pension Fund Global and NBIM as a manager differ from the average investor in a number of areas, primarily size and investment horizon. The active management strategy for the fund aims to turn these differences to the fund's advantage. This will be possible only if there is stability in the strategic framework.

We believe that a passive approach to operational decisions is an alternative without sound theoretical or practical justification. The operational management of the fund consists of a stream of many different decisions, each of which has substantial economic consequences. All decisions must be taken on an informed and analytical basis which seeks, within the given constraints, to achieve the highest possible return relative to the benchmark portfolio.

The cost of active management

Norges Bank's target for active management is an average annual net value added of 25 basis points. Net value added is the difference between the fund's actual results with active management and the results that could have been achieved with passive index management.

Norges Bank publishes regular data for gross excess return. This number is based on actual portfolio values and is a well-defined measure of return used widely in international funds' reporting. The reporting of gross excess return enables comparisons between funds and for a fund over time. Since its inception, the fund has produced an average annual gross excess return of 25 basis points.

While gross excess return is a number that emerges from the fund's accounting, the calculation of net value added is more of an approximation, as it compares actual results from active management with hypothetical results for a passively managed fund.

Passive index management is based on a benchmark, which is a theoretical index that follows set rules. Making actual investments identical to this index will result in a variety of costs. The most important of these costs are as follows:

1. *Transition and rebalancing costs* will be incurred with passive management. The fund has had substantial inflows of capital in recent years due to high petroleum revenues. Phasing in new capital is resource-intensive. Costs are also incurred when the strategic weights in the fund's benchmark portfolio are altered, for example due to new regional weights or a change in asset allocation. Liquidity costs, market impact and the costs associated with it sometimes not being possible to obtain some securities, mean that a passive strategy will generally produce a lower return than the benchmark index, which is not adjusted for these costs. The fund's transition and rebalancing costs have varied considerably, but have averaged around 10 basis points per year to date. Should inflows into the fund and changes in the benchmark index decrease in the years ahead, these costs may also fall.

2. *Ongoing indexing costs.* The composition of the benchmark portfolio is altered continuously by the market participants who own the market indices, in accordance with set rules. A passively managed fund will typically be adjusted mechanically to index changes, which entails costs for the fund. Norges Bank has previously estimated these costs at 4 basis points per year. This estimate is affected by the fund's investment universe and market conditions. For example, factors such as the inclusion of emerging markets and a lack of liquidity in fixed income markets will push up these costs.

3. *Management costs.* Management costs will be incurred whatever the strategy, and will be higher for active management. To date, the fund's management costs have averaged 10 basis points per year, including performance-related fees to external managers. As a rough estimate, about half of these costs can be attributed to active management. In recent years, external management has consisted primarily of active mandates.

Unlike the theoretical index, a passive index fund will also be able to generate some income. The most important source of income is as follows:

4. *Income from securities lending.* This is currently included in the gross excess return generated through active management of the fund. Since 1998, the fund has had average annual income from securities lending of 5 basis points. It is debatable how much securities lending income is compatible with a passive investment mandate, but it will be less than with active management. This income is not risk-free. As with other strategies that aim to create value for the fund, this activity depends on the skill and systems of the manager. Securities lending requires a sound knowledge of counterparties and the market, good technological solutions and a solid legal framework.

A rough estimate of the cost of passive index management can be obtained by adding together the costs in 1-3 above and subtracting the income in 4. On this basis, a passively managed index portfolio will typically generate a negative net excess return, which can tentatively be estimated at 10-15 basis points, depending on the assumptions made for levels of securities lending income and future transaction costs.

As stated above, net value added is defined as the difference between the fund's actual results with active management and the results that could have been achieved with passive index management.

Since its inception, the fund has produced an average annual gross excess return of 25 basis points. With management costs of 10 basis points per year, this gives a net excess return after all costs of 15 basis points. However, this excess return from active management cannot be compared with a theoretical benchmark index, only with practically feasible passive index management. Passive management of this kind will typically be able to produce a negative excess return of at least 10 basis points. The net value added from active management compared with such an alternative will therefore be in the region of 25 basis points.

On this basis, the actual gross excess return of 25 basis points per year is of the same order as the estimated net value added from active management. Although these two numbers can vary over time, previous calculations performed by Norges Bank have also found little difference between them historically.

Financial reporting

Norges Bank's annual financial statements, which include the Government Pension Fund Global, were approved by Norges Bank's Supervisory Council on 4 March 2010. These financial statements include a set of accounts and additional information for the Government Pension Fund Global presented in a separate note. These accounts and an excerpt from Norges Bank's accounting policies are reproduced below.

Profit and loss account

Figures in NOK million, year ended 31 December	Note	2009	2008
Profit/loss on financial assets excluding exchange rate adjustments			
Interest income on deposits in foreign banks		462	494
Interest income, lending associated with reverse repurchase agreements		696	14 189
Net income/expenses and gains/losses from:			
- Equities and units	3	488 082	-595 304
- Bonds and other fixed income instruments	3	118 971	-686
- Financial derivatives		7 398	-31 210
Interest expense repurchase agreements		-2 571	-20 124
Other interest expense		-60	-613
Other expenses		-193	45
Profit/loss before exchange rate adjustments	1	**612 785**	**-633 209**
Exchange rate adjustments		-417 607	506 163
Profit/loss before management fee		**195 178**	**-127 046**
Accrued management fee	2	-3 228	-2 165
Profit/loss for the year		**191 950**	**-129 211**

Balance sheet

Figures in NOK million, 31 December	Note	2009	2008
ASSETS			
FINANCIAL ASSETS			
Foreign bank deposits		4 644	18 111
Lending associated with reverse repurchase agreements	3	191 473	274 132
Cash collateral paid	3	140	114
Equities and units	4	1 496 759	943 337
Equities lent	3,4	150 847	182 612
Bonds and other fixed income instruments	4	908 222	1 421 565
Bonds lent	3,4	161 990	191 482
Financial derivatives	5	2 263	39 579
Unsettled trades		17 572	102 574
Other assets	6	251	17 164
TOTAL FINANCIAL ASSETS	8,9	**2 934 161**	**3 190 670**
LIABILITIES AND CAPITAL			
FINANCIAL LIABILITIES			
Short-term borrowing	3	6 238	133
Borrowing associated with repurchase agreements	3	109 536	514 395
Cash collateral received	3	154 676	188 608
Financial derivatives	5	8 118	75 899
Unsettled trades		11 925	132 718
Other liabilities	6	3 625	3 463
Management fee payable		3 228	2 165
TOTAL FINANCIAL LIABILITIES	8,9	**297 346**	**917 381**
Owners' capital	7	2 636 815	2 273 289
TOTAL LIABILITIES AND OWNERS' CAPITAL		**2 934 161**	**3 190 670**

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

Figures in NOK million, 31 December	2009	2008
ASSETS		
Investments for the Government Pension Fund Global	2 636 815	2 273 289
LIABILITIES		
Deposits in krone account Government Pension Fund Global	2 636 815	2 273 289

Notes to the financial reporting

Accounting policies

The accounting policies for Norges Bank are approved by the Supervisory Council. Pursuant to an agreement with the Ministry of Finance, Norges Bank's accounting policies are also applied to the Government Pension Fund Global. An extract of the accounting policies is given below.

1 General

Basis for preparing the annual financial statements

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

The reporting exceptions from the Norwegian Accounting Act are:

- The profit and loss account and balance sheet are presented in a manner more appropriate to the Bank's activities.
- A cash flow statement has not been prepared.
- The foreign exchange element linked to realised and unrealised gains and losses on financial instruments is specified and presented on a separate line.
- The information in the notes is presented in a manner appropriate to the Bank's activities.
- All equities, bonds and other fixed income securities and financial derivatives are measured at fair value.

Change in classification and presentation in 2009

With effect from the financial statements for 2009, the following changes have been made relating to classification and presentation:

- Financial derivatives and unsettled trades are not netted in the balance sheet.
- Securities lent are presented on separate lines in the balance sheet.

Comparative figures for 2008, originally presented at net, have been restated.

Presentation of the Government Pension Fund Global

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

2 Use of estimates when preparing the annual financial statements

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

3 Currency

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

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

4 Financial instruments

4.1 Recognition and derecognition

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

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

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

4.2 Fair value measurement

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

Subsequent measurement
Financial assets and liabilities are recognised at fair value on the balance sheet date. Fair value is the estimated realisable value of an asset or the etimated cost of settling a liability in an arm's length transaction between well-informed and willing parties.

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

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

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

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

4.3 Securities lending

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

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

Cash collateral received is recognised on the balance sheet together with a corresponding liability measured at amortised cost. The same applies to collateral in the form of securities if reinvested. Unrealised and realised gains and losses on reinvestments are recognised at fair value in the profit and loss account.

4.4 Repurchase/reverse repurchase agreements

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

In connection with reverse repurchase agreements, the underlying security is not recognised on the balance sheet. The cash paid is derecognised from the balance sheet, and a corresponding receivable reflecting the cash amount to be returned is recognised.

4.5 Accrued interest income and expenses

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

5 Taxation

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

Paid withholding tax on foreign dividends and coupons is recognised as a reduction of the applicable income. If the withholding tax can be refunded upon request it is recognised as a receivable.

6 Management fee

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

Note 1 Profit/loss before exchange rate adjustments

Figures in NOK million, year ended 31 December 2009	Interest income/ expense	Divi-dends	Income/ costs	Realised gains/ losses	Unrealised gains/ losses	Total
Interest income on deposits in foreign banks	462	.	.	.	.	462
Interest income,lending associated with reverse repurchase agreements	696	.	.	.	.	696
Net income/expense and gains/losses from:						
- Equities and units	.	38 632	1 707	-69 134	516 877	488 082
- Bonds and other fixed income instruments	56 800	.	457	1 081	60 633	118 971
- Financial derivatives	-6 195	.	.	-15 483	29 076	7 398
Interest expense repurchase agreements	-2 571	.	.	.	.	-2 571
Other interest expense	-60	.	.	.	.	-60
Other expenses	.	.	-193	.	.	-193
Profit/loss before exchange rate adjustments	**49 132**	**38 632**	**1 971**	**-83 536**	**606 586**	**612 785**

Note 2 Management costs

	2009		2008	
	NOK thousands	Percent	NOK thousands	Percent
Internal costs	779 520	.	658 423	.
Custody and settlement costs	289 279	.	341 135	.
Minimum fees to external managers	431 931	.	420 376	.
Performance-based fees to external managers	1 401 762	.	486 859	.
Other costs	325 488	.	258 430	.
Total management costs	**3 227 979**	**0.14**	**2 165 223**	**0.11**
Total management costs excluding performance-based fees	**1 826 217**	**0.08**	**1 678 364**	**0.08**

Note 3 Repurchase and reverse repurchase agreements, cash collateral paid/received and securities lending

3.1 Repurchase and reverse repurchase agreements

Norges Bank enters into repurchase and reverse repurchase agreements to finance positions at the lowest possible price and to generate additional income for the fund. The following tables present the repurchase and reverse repurchase agreements recognised in the balance sheet on 31 December 2009:

Lending associated with reverse repurchase agreements

Figures in NOK million	31.12.2009	31.12.2008
Lending associated with reverse repurchase agreements, financing activity	65 824	160 009
Lending associated with reverse repurchase agreements, reinvestment of cash collateral in connection with securities lending	125 649	114 123
Lending associated with reverse repurchase agreements	**191 473**	**274 132**

Short-term borrowing

This item comprises borrowing used in the liquidity management of the portfolio with a maturity of between one and ten days and amounted to NOK 6 238 million on 31 December 2009.

Borrowing associated with repurchase agreements

Figures in NOK million	31.12.2009	31.12.2008
Borrowing associated with repurchase agreements	**109 536**	**514 395**

3.2 Cash collateral

The fund pays and receives cash collateral in a number of contexts. These include the monitoring of positions in unlisted financial derivatives (OTCs), securities lending, and the margining of positions in repurchase and reverse repurchase agreements. Norges Bank has access to these bank deposits This cash collateral is recognised on the balance sheet because Norges Bank has access to the funds. The following tables show the amounts recognised on the balance sheet on 31 December 2009.

Cash collateral paid

Figures in NOK million	31.12.2009	31.12.2008
Cash collateral paid in connection with unlisted financial derivatives	-	114
Cash collateral paid in connection with margining repurchase and reverse repurchase agreements	140	-
Cash collateral paid	**140**	**114**

Cash collateral received

Figures in NOK million	31.12.2009	31.12.2008
Cash collateral received in connection with securities lending	154 676	185 606
Cash collateral received in connection with unlisted financial derivatives	-	2 883
Cash collateral received in connection with margining of repurchase and reverse repurchase agreements	-	119
Cash collateral received	**154 676**	**188 608**

3.3 Securities lending

Securities lent

The table below shows the securities lent out through lending programs at the end of the year. These assets are classified on the balance sheet under "Equities lent" and "Bonds lent".

Figures in NOK million	31.12.2009	31.12.2008
Loans of equities	150 847	182 612
Loans of bonds	161 990	191 482
Total loans of securities against collateral	**312 837**	**374 094**

Norges Bank has entered into lending agreements with external lending agents. These agreements contain provisions which protect Norges Bank's interests if the borrower of the securities is unable to return them or if the collateral provided for the loan is not sufficient to cover losses.

Collateral received in connection with securities lending

Figures in NOK million	31.12.2009		31.12.2008	
Collateral received	Book value	Fair value	Book value	Fair value
Collateral in the form of cash	154 676	154 676	185 606	185 606
Collateral in the form of equities	-	92 191	-	137 628
Collateral in the form of bonds	-	79 896	-	66 721
Total collateral	**154 676**	**326 763**	**185 606**	**389 955**

Reinvestment of cash collateral

Collateral in the form of cash is reinvested in reverse repurchase agreements or diversified bond funds with short maturities and the highest possible credit rating (Aaa from Moody's). The table below shows reinvestments at the end of the year as recognized on the balance sheet. Figures are at fair value.

Figures in NOK million		
Reinvestments in connection with securities lending	31.12.2009	31.12.2008
Lending associated with reverse repurchase agreements	**125 649**	**114 124**
Asset-backed securities	21 338	39 150
Structured investment vehicles	692	2 461
Other fixed income instruments	4 600	21 564
Total reinvestment in the form of bonds and other fixed income instruments	**26 630**	**63 175**
Total reinvestment in connection with securities lending	**152 279**	**177 299**

Reinvestments are recognised on the balance sheet under "Lending associated with reverse repurchase agreements" and "Bonds and other fixed income instruments."

Net income of NOK 1 707 million from securities lending has been recognized in the profit and loss account as Net income/expenses and gains/ losses from equities and units. Net income consists of both income and expenses related to security lending activities. Net income of NOK 457 million from bond lending has been recognised under Net income/expenses and gains/losses from bonds and other fixed income instruments. As a result of a stronger market in 2009 and sales/maturities, previously recognised unrealised losses amounting to NOK 6 377 million have been reversed during 2009. This has been recognized under Net income/expenses and gains/ losses from bonds and other fixed income instruments. Part of this reversal is related to holdings that have been sold or have matured in 2009, and which have a corresponding realised gain or loss that is included in net income from securities lending. The change in unrealised loss during the year for bonds that were still in the holdings as at year end 2009 amounted to NOK 2 922 million and was recognised as a gain in 2009. A corresponding unrealised loss of NOK 5 640 million was recognised in 2008.

Note 4 Equities and units/bonds and other fixed income instruments

Figures in NOK million, 31 December 2009	Cost price	Fair value	Accrued interest/ dividends	Total fair value
Equities and units:				
Listed equities and units	1 637 821	1 645 746	1 860	1 647 606
Total equities and units	**1 637 821**	**1 645 746**	**1 860**	**1 647 606**
Hereof Equities lent				150 847
Government and government related bonds				
Government bonds	329 580	320 011	4 541	324 552
Bonds issued by local authorities	30 739	31 213	682	31 895
Bonds issued by supranational bodies	25 105	25 733	418	26 151
Bonds issues by agencies	85 057	82 552	1 343	83 895
Total government and government related bonds	**470 481**	**459 509**	**6 984**	**466 493**
Inflation-linked bonds:				
Inflation-linked bonds issued by government authorities	81 879	87 646	455	88 101
Inflation-linked bonds issued by companies	586	511	1	512
Total inflation-linked bonds	**82 465**	**88 157**	**456**	**88 613**
Corporate bonds:				
Bonds issued by utilities	22 458	21 610	399	22 009
Bonds issued by financial institutions	144 379	125 119	2 427	127 546
Bonds issued by industrial companies	79 360	76 616	1 496	78 112
Total corporate bonds	**246 197**	**223 345**	**4 322**	**227 667**
Securitised debt:				
Covered bonds	200 692	205 907	4 444	210 351
Mortgage Backed Securities	62 503	50 888	259	51 147
Asset Backed Securities	20 623	14 621	71	14 692
Commercial Mortgage Backed Securities	12 449	10 453	67	10 520
Total securitised debt	**296 267**	**281 869**	**4 841**	**286 710**
Units in securities funds	**644**	**729**	**-**	**729**
Total bonds and other fixed income instruments	**1 096 054**	**1 053 609**	**16 603**	**1 070 212**
Hereof Bonds lent				161 990

Note 5 Financial derivatives

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

	Exposure				Fair value		
	31.12.2009		Average 2009				
Figures in NOK million	Purchased	Sold	Purchased	Sold	Asset	Liability	Net
Foreign exchange contracts	**16 233**	**0**	**10 662**	**0**	**178**	**30**	**148**
Futures contracts	**20 185**	**11 037**	**23 890**	**22 655**	**105**	**393**	**288**
Interest rate swaps	826	64 571	62 351	109 385	120	5 419	-5 299
Credit default swaps	24 254	2 953	32 193	19 299	144	1 166	-1 022
Equity swaps	2 453	28	1 747	83	183	11	172
Total swaps	**27 533**	**67 552**	**96 291**	**128 767**	**447**	**6 596**	**-6 149**
Options	**34 764**	**19 149**	**33 859**	**20 986**	**1 533**	**1 099**	**434**
Total financial derivatives	**98 715**	**97 738**	**164 702**	**172 408**	**2 263**	**8 118**	**-5 855**

Foreign exchange contracts

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

Futures contracts

Exposure is the nominal value of the underlying derivative instrument.

Over-the-counter financial derivatives (OTC)

Interest rate swaps

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

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

Credit default swaps

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

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

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

Equity swaps

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

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

Option

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

Note 6 Other assets / Other liabilities

Figures in NOK million	31.12.2009	31.12.2008
Withholding tax	176	663
Receivables from other portfolios under common management	0	16 259
Accrued interest securities lent	75	242
Total other assets	**251**	**17 164**

Figures in NOK million	31.12.2009	31.12,2008
Capital gains tax payable abroad	256	87
Other foreign liabilities	176	3 376
Liabilities to other portfolios under common management	3 193	0
Total other liabilities	**3 625**	**3 463**

Oustanding accounts with other portfolios under management comprises the net value of deposits, loans, repurchase agreements and reverse repurchase agreements vis-a-vis other portfolios managed by Norges Bank. These related party transactions have been conducted on an arm's length basis.

Note 7 Owners' Capital

Figures in NOK million	2009	2008
Balance in the Norwegian krone account on 1 January	2 273 289	2 016 955
Inflows during the year	171 577	385 545
Management fee payble to Norges Bank	-3 228	-2 165
Profit/loss transferred to/from Norwegian krone account	195 177	-127 046
Owners' capital – deposits in the Norwegian krone account on 31 December	**2 636 815**	**2 273 289**

Note 8 Currency distribution

				31.12.2009			
Figures in NOK million	USD	CAD	EUR	GBP	JPY	Other	Total
Foreign bank deposits	1 806	27	432	66	151	2 161	4 644
Lending associated with reverse repurchase agreements	76 516	-	89 846	18 437	534	6 139	191 474
Cash collateral paid	140	-	-	-	-	-	140
Equities and units (incl. lent)	515 140	46 119	424 693	240 512	89 018	332 124	1 647 606
Bonds and other fixed income instruments (incl. lent)	352 835	22 133	503 028	121 222	45 310	25 684	1 070 212
Financial derivatives	3 344	682	-6 149	91	-3	4 298	2 263
Unsettled trades	15 358	62	599	246	159	1 150	17 572
Other assets	64	1	116	9	-	62	251
Total financial assets	**965 203**	**69 023**	**1 012 565**	**380 583**	**135 170**	**371 618**	**2 934 161**
Short-term borrowing	2 071	-141	-18	3 245	793	289	6 238
Borrowing associated with repurchase agreements	41 163	1 081	20 589	40 357	1 433	4 914	109 536
Cash collateral received	52 399	-	101 357	920	-	-	154 676
Financial derivatives	5 985	306	4 316	2 974	78	-5 541	8 118
Unsettled trades	7 747	151	584	141	191	3 111	11 925
Other liabilities	2 209	66	1 101	131	-140	257	3 625
Management fee payable	.	.	.	.	.	3 228	3 228
Total financial liabilities	**111 574**	**1 463**	**127 929**	**47 768**	**2 355**	**6 258**	**297 346**

Note 9 Risk and Valuation

Risk management is a key activity for Norges Bank. Processes have been established for identifying, measuring and monitoring all of the most important risks to which Norges Bank and the Government Pension Fund Global's owners are exposed in connection with their activities. The four most important risk assessments are related to market risk, credit risk, counterparty risk and operational risk. Norges Bank follows the guidelines given by the Norwegian Ministry of Finance related to the management and measurement of risk.

Financial markets stabilised during 2009. As a result of a decrease in risk aversion, an improved expectation of growth in the global economy and better liquidity in the bond market, there was a general price increase in the stock, bond and commodities markets from March 2009 through to the end of the year. Even though price uncertainty continues to remain at a fairly high level for segments of the portfolio, the market outlook is completely different than at the end of 2008 and has returned to a level with sufficient reliability related to the estimation of market values.

Market risk

Market risk is the risk of changes in the value of the Fund due to movements in interest rates, equity prices and/or exchange rates. Norges Bank measures risk in both absolute terms and the relative market risk for the Fund.

Absolute risk is estimated based on the actual portfolio as the standard deviation in the return. The standard deviation is a statistical metric that indicates the magnitude of variation that can be expected in the return on the portfolio. The table below illustrates market risk, expressed as the expected annual standard deviation, in the actual portfolio both at an overall level and for the two asset classes.

	Risk measure	31.12.09	Minimum 2009	Maximum 2009	Average 2009	31.12.08
Total portfolio risk	Standard deviation	7.2 %	7.2 %	21.7 %	13.7 %	22.2 %
Equity portfolio	Standard deviation	10.0 %	10.0 %	35.8 %	20.6 %	36.7 %
Fixed income portfolio	Standard deviation	10.0 %	10.0 %	22.6 %	15.6 %	21.5 %

The standard deviation as of 31 December 2009 means that, statistically, in two out of every three years, the value of the Fund can be expected to fluctuate within a band of +/- 7.2% of its total market value (one standard deviation) based on the actual portfolio at 31 December 2009. Market risk declined substantially during 2009, particularly in the first half of the year. Market risk can also be expressed on the basis of actual fluctuations in the portfolio during the year. The standard deviation when based on actual fluctuations in the portfolio during 2009 is an average of 13.4% and 7.0% at year end.

The 2009 reduction in market risk is due to lower market volatility and a normalisation of the general market situation during the year. There have been no changes during 2009 in the Fund's benchmark portfolio other than a completion of the implementation of the increased weight of the equity asset class of the total fund from 40 percent to 60 percent during the second quarter of the year.

Risk Model

The model used calculates the expected standard deviation in the value of the Fund based on the composition of the portfolio and assumptions about the portfolio's sensitivity to fluctuations in relevant market factors and the correlation between the different factors. Norges Bank performs risk calculations on a regular basis using both parametric calculations and calculations based on Monte Carlo simulations. Parametric risk models assume a population with a normal distribution. A Monte Carlo simulation generates a large series of returns and then determines the risk parameters based on the simulation-generated population and distribution. Both risk modelling approaches measure expected risk as the standard deviation, which is an estimate of expected volatility in the value of the Fund. The parametric method was used to calculate the figures in the table above. Volatilities and correlations are estimated on the basis of daily historical data where greater importance is attached to recent market data than to older data. As a result, the risk model responds very quickly to changes in the markets.

Risk models- strengths and weaknesses

Estimated volatility is a statistical measure of risk that captures and measures the correlation in the portfolio's exposures across asset classes, markets, instruments and exchange rates.

As the Fund is well-diversified, it is important to use a risk model that captures the interdependencies and gives an overall risk estimate. The accuracy of any risk model is dependent on the assumptions upon which the model is based. The most important weaknesses of the model are:

- Estimated volatility measures risk over a defined time period and assumes that the exposure is related to liquid holdings that can be closed within the allowed time period.
- The model assumes normal market conditions and will underestimate volatility in turbulent or abnormal market conditions.
- The estimated variance is a point risk estimate, and is statistically less informative related to the overall risk profile and the magnitude of the risk in the tail ends of the distribution.
- Annualised risk measures based on daily risk figures assumes that both the volatility and the composition of the portfolio is constant over time. Additionally, it is assumed that the expected return in future periods is zero (random walk assumption).

Liquidity risk

Norges Bank defines liquidity risk in relation to the management of the Government Pension Fund Global as the ability to make planned or unexpected changes in the composition of the investment portfolio due to exogenous or endogenous factors without incurring unusually high transaction costs. The management of liquidity risk is integrated throughout the Fund's control structure.

The measurement and management of liquidity risk for the Fund's positions in the equity market is not associated with major challenges, since the equity portfolio comprises equities listed on regulated stock exchanges. There are a few exceptions to this rule, however, as some regional exchanges are not as well-functioning than larger exchanges. Measurement is more complex for the fixed income portfolio, due to a high proportion of unlisted instruments in the portfolio. Market developments since the summer of 2007 have presented additional problems in terms of quantitative measures of liquidity for fixed income instruments.

Compared with 2008, liquidity risk is considerably reduced during 2009. After Lehman Brothers collapsed in 2008, liquidity in the fixed income market was close to nonexistent. During 2009 market liquidity has gradually returned. The Fund's ability to implement changes in the composition of the fixed income portfolio is therefore clearly better at the end of 2009 than in 2008. Liquidity in this market is still, however, lower than before the start of the economic crisis.

Credit risk

Credit risk is the risk of losses from issuers of fixed income instruments defaulting on their payment obligations to the Government Pension Fund Global. Another form of credit risk is the counterparty risk that arises in derivative, foreign currency exchange transactions and repurchase and reverse repurchase agreements. Settlement risk, which arises in connection with the purchase and sale of securities because not all transactions take place in real time, also involves counterparty risk.

Credit risk arises in the Government Pension Fund Global's fixed income portfolio partly as a result of the Ministry of Finance's choice of investment strategy and partly as a result of Norges Bank's active management. All fixed income instruments in the Fund's benchmark portfolio have a rating from one of the major credit rating agencies: Standard & Poor's, Moody's or Fitch. All three agencies classify the issuers of fixed income instruments on the basis of their creditworthiness. A credit rating scale from AAA to D is used for long-term bonds. The highest rating from S&P and Fitch is AAA and Aaa from Moody's. The lowest investment grade ratings are BBB from S&P and Fitch and Baa from Moody's. Lower ratings are termed non-investment grade. All bonds in the Fund's benchmark portfolio have an investment grade rating. The table below breaks down the fixed income portfolio on the basis of credit ratings from at least one of the rating agencies at the end of the year.

Fixed income portfolio by credit rating[1)]

Figures in NOK million	Aaa\AAA	Aa\AA	A	Baa\BBB	Ba\BB	Lower	No rating	Total
Government and government-related bonds	356 777	73 915	25 210	9 784	-	142	666	466 494
Inflation-linked bonds	45 671	40 449	1 231	-	-	-	1 262	88 613
Corporate bonds	46 301	42 339	99 149	71 337	6 666	2 310	1 235	227 667
Securitised debt	221 246	42 243	3 016	3 792	2 474	13 309	629	286 709
Units in securities funds	-	-	-	-	-	-	729	729
Total bonds and other fixed income instruments	**628 325**	**198 946**	**128 606**	**84 913**	**9 140**	**15 761**	**4 521**	**1 070 212**

1) The fixed income portfolio by credit rating is based on credit ratings from at least one of the credit rating agencies Moody's, Standard & Poor's and Fitch. The 'No rating' category includes securities not rated by these three agencies. These securities may, however, have been rated by other, local agencies.

The following table shows exposure to credit derivatives:

Figures in NOK million	Nominal amount	Fair value
Credit default swaps, protection purchased	24 254	-938
Credit default swaps, protection sold	2 953	-84

Protection purchased means that the Fund's credit risk has been reduced, while protection sold means increased credit risk. Overall, credit exposure has been reduced slightly through credit default swaps. These contracts relate primarily to credit risk in the Baa, Ba and lower categories.

Norges Bank has during 2009 implemented a new credit risk model for the portion of the fixed income portfolio related to corporate bonds. This model gives a better basis for a statistical calculation of credit events and expected longer-term losses.

Counterparty risk

Norges Bank is also exposed to risk vis-à-vis counterparties in the execution of transactions, vis-à-vis the custodian institutions with which securities are deposited, and vis-à-vis international settlement and custody systems (counterparty risk). The equity and fixed income portfolios include investments in unsecured bank deposits, OTC derivatives and foreign exchange contracts. Derivatives are used for both trading and hedging purposes in the portfolio. Repurchase and reverse repurchase agreements also give rise to counterparty risk.

Norges Bank manages counterparty risk partly through requirements for high credit ratings when selecting and evaluating counterparties. These requirements are more stringent for unsecured credit exposures than for credit exposure with some form of collateral. The Ministry of Finance has decided that no counterparties involved in unsecured transactions may have a credit rating lower than A- from Fitch or Moody and no lower than A3 from Standard and Poor's. Seventy-six percent of Norges Bank's approved counterparties have a rating of AAA-A. Transactions with all other counterparties are only conducted with settlement terms "delivery versus payment", such that transfer of ownership of an asset and payment occur simultaneously. Changes in counterparties' credit quality are monitored continuously, in addition to reviews of alternative credit indicators such as equity volatility and the price of bankruptcy insurance. Counterparty risk is controlled and measured against fixed credit limits established for each counterparty based on expected future exposures.

The table below shows counterparty risk associated with positions in financial derivatives, foreign currency exchange contracts, repurchase and reverse repurchase agreements (contracts with a positive market value) at year-end and cash holdings and receivables in connection with unsettled trades. Counterparty risk (expected future exposure) is disclosed as of 31 December 2009 and balance sheet values for both 31 December 2009 and 2008. The method that is used to calculate counterparty risk is in accordance with the Financial Services Authority (FSA) method, which is described in the FSA Handbook. The methods are called the mark to market plus add-on and internal haircut methods, and involve calculating the market value and an add-on to reflect the degree of volatility for the positions. For repurchase and reverse repurchase agreements actual collateral held and received has also been adjusted for.

	31.12.2009		31.12.2008
Figures in NOK million	Counterparty risk	Balance sheet value	Balance sheet value
Foreign currency exchange contracts	320	178	423
Credit default swaps	726	144	6 288
Interest rate swaps	195	120	26 280
Total return swaps	-	-	41
Equity swap contracts	483	183	820
Options	1 639	1 533	4 037
Total financial derivatives	**3 363**	**2 158**	**37 889**
Deposits in foreign banks	**4 644**	**4 644**	**18 111**
Repurchase and reverse repurchase agreements	**44 492**	**81 938**	**-**
Unsettled trades	**17 572**	**17 572**	**102 574**
Total	**70 071**	**106 312**	**158 574**

The positions are shown before netting, and collateral provided is not taken into account. To minimise counterparty risk, Norges Bank uses bilateral netting agreements for OTC derivative instruments and foreign exchange contracts. Norges Bank has strict high-quality requirements related to collateral for unsecured exposures. As of year-end 2009 Norges Bank did not have any cash collateral received connected to OTC financial derivatives, as compared to NOK 2 882 million as of 31 December 2008 (see note 4 Repurchase and reverse repurchase agreements, securities lending and cash collateral paid/received). The thresholds for requiring collateral are set at between EUR 0 and EUR 50 million or USD 50 million, and are measured as the net positive market value per counterparty.

Fair value measurement of financial instruments

Control environment

An effective process for daily valuation of the investment positions in the Fund has been established involving the sourcing and verification of prices at both the external fund accounting service provider and Norges Bank's operating units. Underlying prices are subject to extensive controls at each month end to ensure adherence to established pricing routines and fair value measurement principles. An internal valuation memo and report is prepared every quarter documenting the controls employed and reasons for the valuations. Valuations and the control routines related to the valuations are reviewed every quarter prior to the release of the quarterly report by the valuation committee, which is a forum for escalating significant pricing issues and which formally approves the valuations.

Establishing fair value

Hierarchies of independent price sources established by Norges Bank are used in the pricing process. Investments that are included in the benchmark portfolio are normally priced in accordance with the index providers' prices while the remaining equity and bond investments are priced almost exclusively by reputable independent external price providers. Prices are verified based on an comparative analysis of the applicable prices in the respective hierarchies with prices available from alternative pricing sources. When alternative pricing sources are regarded as more representative of the fair value, price adjustments are made to bring the valuation closer to expected fair value.

All equity and bond holdings in the fund have been allocated to categories of assessed pricing uncertainty. Category 1 consists of investments that are valued based on observable market prices in active markets and are regarded as having limited pricing risk. Investments in category 2 are valued using models with observable input factors. These holdings have some pricing risk associated with them, however, overall the valuation risk is viewed as being limited. Holdings allocated to category 3 are priced using models with greater uncertainty surrounding the establishment of fair value based on significant unobservable input factors. However, a majority of these investments have been valued by external price providers regarded as giving the best estimate of fair value and where the total valuation from different price providers vary only to a limited extent.

The table below breaks down the investment portfolios into categories of price uncertainty:

Figures in NOK million

Categories of investments by price uncertainty	Category 1 Observable market prices in active markets		Category 2 Model pricing with observable data points		Category 3 Model pricing with greater uncertainty about fair value		Total	
	31.12.2009	31.12.2008	31.12.2009	31.12.2008	31.12.2009	31.12.2008	31.12.2009	31.12.2008
Equities and units	**1 646 147**	1 124 096	**1 453**	1 641	**5**	212	**1 647 606**	1 125 949
Bonds	**514 290**	712 224	**522 404**	826 800	**33 518**	74 023	**1 070 212**	1 613 047
Total	**2 160 437**	1 836 320	**523 857**	828 441	**33 523**	74 235	**2 717 818**	2 738 996

The vast majority of the Fund's equity holdings are actively traded on listed stock exchanges with an official closing price, and are therefore considered to have limited risk related to pricing (category 1). Equity investments classified as category 2 holdings consist mainly of relatively illiquid equity holdings where the fair value estimate is modelled from similar more liquid equities issued by the same company. The pricing risk is generally quite limited also here because the modelling is simple and the input factors are observable. Equities classified as category 3 consist of a small number of equities for which the valuation is particularly uncertain because of suspension from trading based on special circumstances, for instance bankruptcy, nationalisation, liquidation etc.

Compared to equity pricing, the pricing of bonds is less certain and more complex. Norges Bank carries out analyses on balance sheet dates to obtain information on the degree of actual transactions, price transparency and liquidity in the markets, for different types of bonds and for a large amount of specific bond holdings. The pricing of most of the Fund's government bonds is based on observable market prices in an active market with quoted prices and frequent transactions (category 1). Government-related and inflation-linked bonds are categorised into either category 1 or 2 based on the bank's analyses of liquidity and the degree of trading and price transparency in the markets. The analysis shows a relatively high degree of liquidity for these bonds. Most corporate bonds are assessed as priced by models with observable input factors, while some especially illiquid corporate bonds belong to category 3. Securitised bonds are allocated to all three categories based on the complexity of the data factors and the degree of liquidity, actual transactions and price transparency in the markets. Covered bonds are placed in category 1 or 2 based on a relatively high observed degree of liquidity and price transparency in the markets. Some very liquid guaranteed mortgage backed securities belong to category 1 with observable market prices in active markets. Other guaranteed mortgage backed securities that are not tranched have been classified as priced by models using observable data inputs. Securitised bonds that are seen to be tranched such that they are associated with especially high exposure to unobservable data input factors belong to category 3. Other securitised bonds are allocated to categories 2 and 3 based on a lower observed degree of liquidity and price transparency in the markets.

The total exposure that is assessed as being particularly uncertain related to a correct fair value estimation was NOK 33.5 billion at year-end 2009. This consisted mainly of US securitised bonds not guaranteed by a federal agency (NOK 21.6 billion), and where comparisons between available price sources revealed high pricing uncertainty. In addition some types of US securitised bonds guaranteed by agencies (Fannie Mae, Freddie Mac etc.) were reclassified from category 2 to category 3 because of high uncertainty related to an input factor in the model, primarily pre-payment speed (NOK 4.8 billion). The remaining exposure consisted of miscellaneous other types of investments where the estimation of fair value was especially uncertain due to limited availability of prices from external price sources or large observed differences in prices between different price providers.

The size of the price uncertainty around the category 3 positions is difficult to estimate exactly. While the average price uncertainty on individual securities in this category is expected to be approximately +/- 10%, the group as a whole is expected to have a somewhat lower price uncertainty due to diversification effects. Estimated valuation uncertainty has therefore been calculated to approximately +/- 2 to 3 billion NOK within this category.

There was a decrease in the total fair value exposure to investments classified as particularly uncertain of NOK 40.7 billion from year-end 2008 when the exposure was NOK 74.2 billion. The decrease in exposure can for the most part be attributed to the reclassification of securitized bonds from category 3 to category 2 due to improved liquidity and transparency in pricing (NOK 25.3 billion). The remaining reduction in exposure was primarily because of maturity, repayment of principal and sales of securitised bonds.

The price uncertainty analysis of the most illiquid investments was further refined over the course of 2009. The main purpose of the evaluation is to identify if there is a need for additional adjustments in the determination of fair value. Although uncertainty concerning fair value estimation is still considerable for certain segments of the portfolio, Norges Bank perceives the result of the valuation, based on ordinary price sources as per the established pricing hierarchy as of 31 December 2009, to give an accurate picture of market values in accordance with the fair value principle and thus not requiring further accounting provisions related to price uncertainty. Norges Bank's analyses show that the price sources generally have priced in the remaining illiquidity that existed in the market at the end of 2009.

Comparisons performed as of year-end 2009 on the pricing from different pricing sources for the particularly uncertain holdings confirmed the valuation following from the established pricing hierarchies. The total valuation differences were viewed as acceptable, and overall the valuation of these holdings performed by alternative pricing sources was marginally higher than the valuation used in the financial reporting. The previous provision for pricing uncertainty, which amounted to NOK 3 424 billion at the end of 2008, was therefore reversed in full in 2009.

Norges Bank Investment Management's Annual Report for 2009 was submitted by Norges Bank's Executive Board on 24 February 2010

Central Bank Audit and Deloitte AS have submitted the following joint auditors' report to the Supervisory Council on the financial reporting of the Government Pension Fund Global as presented in the notes to Norges Bank's annual financial statements for 2009.

Translation from the original version

Auditors' report

To the Supervisory Council of Norges Bank

AUDITORS' REPORT ON THE FINANCIAL REPORTING OF THE GOVERNMENT PENSION FUND GLOBAL FOR 2009

We have audited the financial reporting of the Government Pension Fund Global for 2009 included in Norges Bank's annual financial statements. The financial reporting, showing a net profit for the year of NOK 191 950 million, comprises a profit and loss account, a balance sheet and notes to the financial reporting. The financial reporting of the Government Pension Fund Global has been prepared in accordance with the provisions of the Norwegian Accounting Act and generally accepted accounting principles in Norway with the departures set out in the accounting policies in the notes to the financial reporting. The financial reporting has been submitted by Norges Bank's Executive Board as part of Norges Bank's annual financial statements. Our responsibility is to express an opinion on the financial reporting.

We have conducted our audit in accordance with the Norwegian Act on Auditing and Auditors and generally accepted auditing practice in Norway, including auditing standards adopted by the Norwegian Institute of Public Accountants, and issue our auditors' report in accordance with International Standard on Auditing 800 "The auditor's report on special-purpose audit engagements". These auditing standards require that we plan and perform our audit to obtain reasonable assurance whether the financial reporting is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial reporting, assessing the accounting policies and significant accounting estimates applied, as well as evaluating the overall content and presentation of the financial reporting. To the extent required by generally accepted auditing practice, an audit also comprises a review of Norges Bank's financial affairs and its accounting and internal control systems relevant to the Government Pension Fund Global. We believe that our audit provides a reasonable basis for our opinion.

In our opinion,

- the financial reporting gives a true and fair view of the Government Pension Fund Global's financial position as of 31 December 2009 and of the results of its operations for the year then ended in accordance with the provisions of the Accounting Act and generally accepted accounting principles in Norway with the departures set out in the accounting policies in the notes to the financial reporting
- management has fulfilled its duty to ensure proper and well arranged recording and documentation of accounting information.

Oslo, 24 February 2010

Central Bank Auditor	**Deloitte AS**
Svenn Erik Forsstrøm State Authorised Public Accountant	Aase Aa. Lundgaard (sign.) State Authorised Public Accountant

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