

The top of the page features a blue header with a background of faint, semi-transparent graphics. On the left, there is a stylized image of the Statue of Liberty. In the center and right, there are digital-style displays showing city names and times: 'New York 02:50', 'London 07:50', 'Tokyo', '08:50', and 'Date/Time'.

**NBIM**

Norges Bank Investment Management

# Report on the management of the Government Petroleum Insurance Fund

Annual report 2010

## Report on the management of the Government Petroleum Insurance Fund. Annual report 2010

At the end of 2010, the Government Petroleum Insurance Fund was wound up and its assets were transferred to the Government Pension Fund Global, cf. the Norwegian parliament's resolution 34 (2010-2011) of 17 December 2010. This is therefore the final report on the Petroleum Insurance Fund.

The purpose of the Petroleum Insurance Fund was to provide a reserve for payments to cover losses and liability associated with the State's Direct Financial Interest in petroleum activities (SDFI). The Ministry of Petroleum and Energy owned the fund. Pursuant to the Act relating to the Government Petroleum Insurance Fund, Norges Bank was responsible for the operational management of the fund. The reason for winding up the fund on 31 December 2010 was that there was no longer a need for the fund, due partly to the size of the Government Pension Fund Global. To reduce market impact and transaction costs, the Petroleum Insurance Fund's assets amounting to 19.8 billion kroner were transferred in their entirety to relevant fixed-income portfolios in the Government Pension Fund Global. (The portfolio transferred is shown in the appendix.)

The strategic benchmark portfolio for the fund defined by the Ministry of Petroleum and Energy consisted of 50 percent euro, 15 percent pounds sterling and 35 percent US dollars. The benchmark index consisted of Barclays Global Aggregate treasury indices for the three currencies and a money market deposit to weight the interest rate risk as measured by modified duration in each currency to 4 (see Section 3).

During the year, the currency weights in the actual benchmark portfolio would fluctuate with market developments. However, at the beginning of July each year, the actual weights were returned to the strategic currency weights. The table below shows the weights in the fund's actual and strategic benchmark portfolios at the beginning of the fourth quarter.

Government Petroleum Insurance Fund. Benchmark portfolio at the beginning of the fourth quarter. Percent

Currency	Strategic benchmark portfolio	Actual benchmark portfolio
Euro	50.0	52.2
Pounds sterling	15.0	14.8
US dollars	35.0	33.0
<b>Total</b>	<b>100</b>	<b>100</b>

## 1 Key figures

Global financial markets in 2010 were bolstered by a maturing economic upswing following the financial crisis in 2008, moderated by fresh fears about government debt and deficits in a number of euro countries. This created a favourable climate with solid returns in most markets. At the same time, uncertainty about some European countries' government finances and fears of an economic downturn in Europe and the US led to substantial swings in prices in fixed-income markets during the year.

The fund returned 2.93 percent in 2010 in international currency, which was 0.22 percentage point higher than the return on the benchmark portfolio.

In the fourth quarter, the fund returned -1.83 percent and the benchmark portfolio -1.84 percent. The fund's market value at the time of the transfer on 31 December 2010 was 19.8 billion kroner, up from 18.9 billion kroner a year earlier.

Table 1-1 provides a historical overview of risk and return for the fund, while Chart 1-1 shows movements in the fund's market value. Over the ten years to the end of 2010, the annual return was 4.73 percent and the annual excess return was 0.20 percentage point.

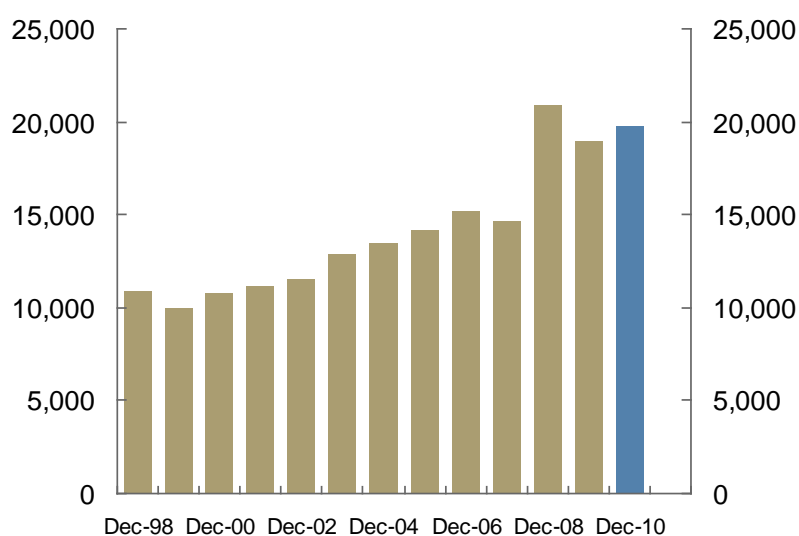
**Table 1-1** Risk and return. Annualised figures as at 20 December 2010

	Past year	Past 2 years	Past 3 years	Past 5 years	Past 7 years	Past 10 years	From inception
Actual return (percent)	2.93	2.04	4.33	4.06	4.32	4.73	4.56
Benchmark return (percent)	2.71	1.60	4.01	3.82	4.10	4.53	4.42
Excess return (percentage points)	0.22	0.44	0.32	0.23	0.22	0.20	0.14
Standard deviation (percent) <sup>1)</sup>	2.59	2.62	3.11	2.72	2.51	2.58	2.52
Tracking error (percentage points)	0.12	0.16	0.20	0.17	0.15	0.13	0.17
Information ratio <sup>2)</sup>	1.81	2.71	1.64	1.39	1.49	1.51	0.87

1) The standard deviation is a measure of variations in the return/excess return during a period. Each monthly return/excess return is compared with the mean for the period. The higher the standard deviation, the greater the variations relative to the mean and the higher the risk.

2) The information ratio (IR) is a measure of risk-adjusted return. It is calculated as the ratio of excess return to the actual relative market risk (as measured by tracking error) to which the portfolio has been exposed. The IR indicates how much excess return has been achieved per unit of risk.

**Chart 1-1** Market value. In millions of NOK



## 2 Market value and return

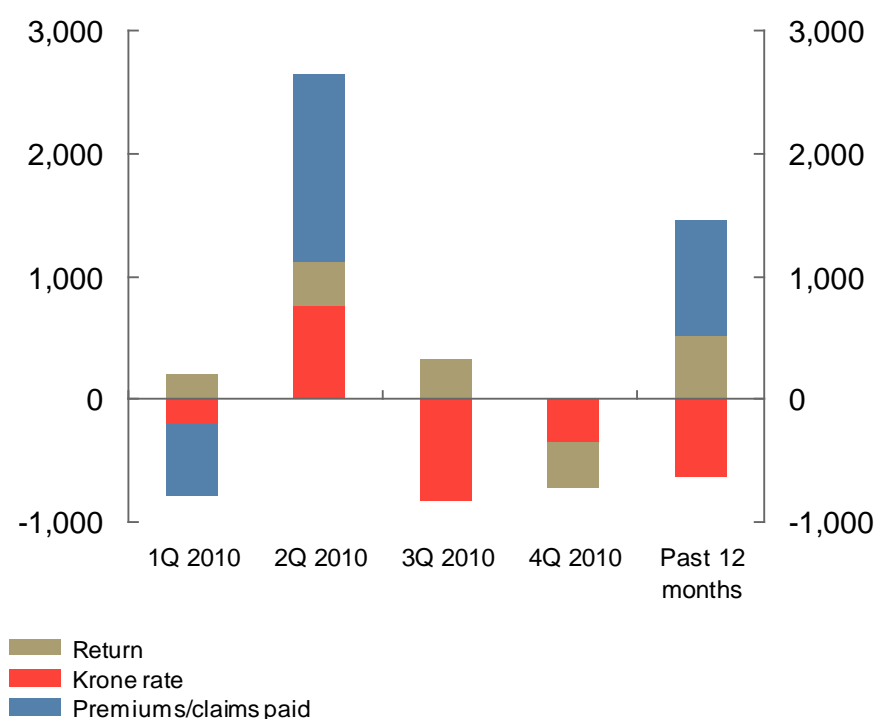
The fund's market value decreased by 0.7 billion kroner during the fourth quarter of 2010, from 20.5 billion kroner to 19.8 billion kroner at the time of the transfer. The return on investment in international currency reduced the fund's market value by 0.35 billion kroner, and a stronger krone against the currencies in which the fund was invested reduced its value by 0.38 billion kroner.

Table 2-1 shows the composition of the fund by currency. Chart 2-1 shows movements in the fund's market value over the past 12 months and in each quarter of 2010.

**Table 2-1** Market value. Millions of NOK

Currency	31.03.2010	30.06.2010	30.09.2010	31.12.2010
Euro	9 222	10 556	10 710	10 259
Pounds sterling	2 587	3 133	3 044	2 979
US dollars	6 576	7 342	6 772	6 600
<b>Total market value</b>	<b>18 385</b>	<b>21 031</b>	<b>20 525</b>	<b>19 838</b>

**Chart 2-1** Change in market value<sup>1</sup>. In millions of NOK



The return on the fund in the fourth quarter of 2010 was -1.83 percent in international currency (i.e. measured in terms of a currency basket corresponding to the composition of the fund's benchmark portfolio). Measured in kroner, the return was -3.54 percent. The difference is due to the appreciation of the krone during the quarter against the currencies included in the benchmark portfolio. The actual return was 0.01 percentage point higher than the benchmark return.

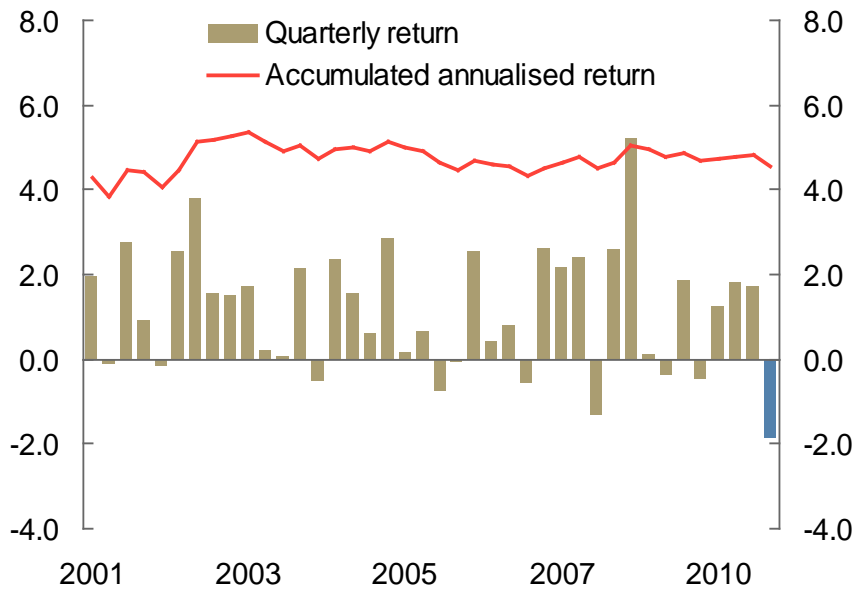
**Table 2-2** Return. Percent

	Actual portfolio	Benchmark portfolio	Excess return
1Q 2010	1.22	1.19	0.03
2Q 2010	1.82	1.68	0.14
3Q 2010	1.73	1.70	0.03
4Q 2010	-1.83	-1.84	0.01
<b>2010</b>	<b>2.93</b>	<b>2.71</b>	<b>0.22</b>

<sup>1</sup> Premiums/claims paid are approximated here as transfers between the settlement account and the investments. The transfer to the Government Pension Fund Global on 31 December 2010 is not shown here.

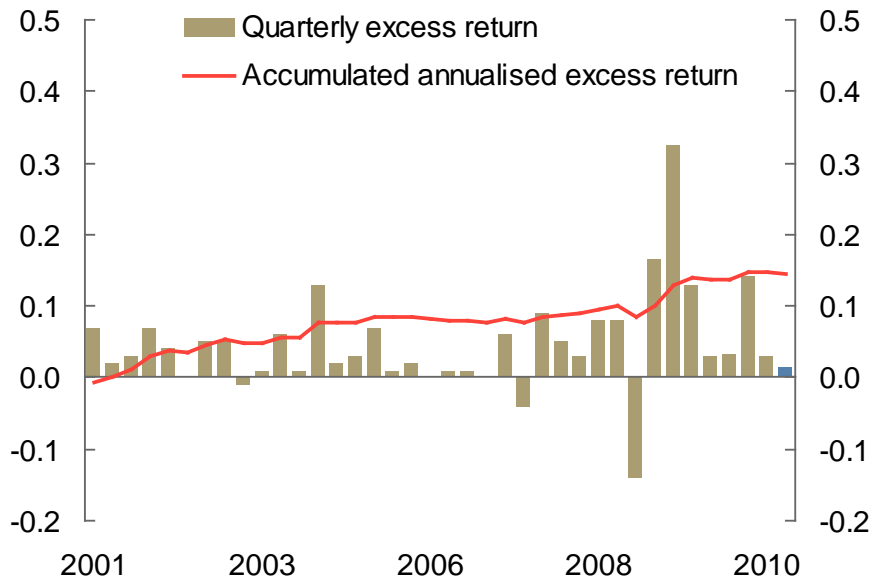
**Chart 2-2** Quarterly and accumulated annualised return since 31 August 1998.

Percent



**Chart 2-3** Quarterly and accumulated annualised excess return since 31 August 1998.

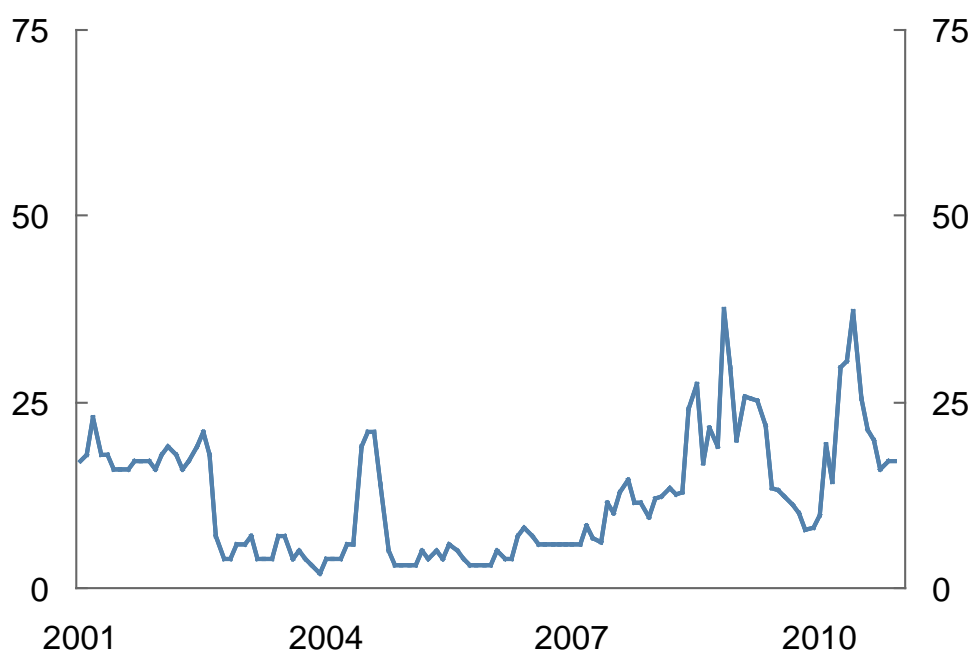
Percentage points



### 3 Market risk and management guidelines

Market risk in the fund was measured partly as expected tracking error. This is a statistically-defined measure of risk which said something about the amount of variation we could normally expect between the return on the benchmark portfolio and the return on the actual portfolio in which the fund was invested. The Ministry of Petroleum and Energy decided that the fund's tracking error must always be less than 0.75 percentage point. This meant that, under normal market conditions, the annual return on the actual portfolio was expected to deviate from the return on the benchmark portfolio by less than 0.75 percentage point in two out of every three years. Chart 3-1 shows movements in expected tracking error. Expected tracking error was 0.16 percentage point (16 basis points) at the end of the fourth quarter,<sup>2</sup> down from 0.20 percentage point at the end of the third quarter.

**Chart 3-1** Expected tracking error. Basis points



The Ministry of Petroleum and Energy also set a limit for interest rate risk in the fund as measured by modified duration. This measure said something about the expected change in the value of the fund following a change in general interest rate levels. The ministry decided that the fund's modified duration was to be a maximum of 5. Table 3-1 shows the fund's modified duration as at 29 December 2010, while Table 3-2 shows the composition of the bond portfolio by credit rating.

<sup>2</sup> Measured here as at 29 December 2010. The portfolio was wound up immediately before the end of the year.

**Table 3-1** Modified duration by currency as at 29 December 2010

Currency	Benchmark portfolio	Actual portfolio
Euro	3.74	3.54
Pounds sterling	3.73	3.65
US dollars	3.69	3.77
<b>Total</b>	<b>3.72</b>	<b>3.63</b>

**Table 3-2** Market value as at 28 December 2010 by credit rating<sup>1)</sup>

Percentage of fixed-income portfolio	Aaa	Aa	A	Baa
Government and government-related bonds	78.7	19.2	0.6	0.6
Securitised bonds	0.9	0.0	0.0	0.0
<b>Total bonds and other fixed-income instruments</b>	<b>79.6</b>	<b>19.2</b>	<b>0.6</b>	<b>0.6</b>

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

Table 3-3 provides an overview of the limits for risk exposure set out in the regulation and guidelines, and shows the portfolio's actual exposure in relation to these limits at the end of each quarter. There were no breaches of the ministry's guidelines in the fourth quarter of 2010.

**Table 3-3** Key figures for risk and exposure

Risks	Limits	Actual			
		31.03.2010	30.06.2010	30.09.2010	29.12.2010
Market risk	Tracking error max. 0.75 percentage point	0.14	0.37	0.20	0.16
Interest rate risk	Modified duration max. 5.0	3.77	3.69	3.91	3.63

## 4 Financial reporting

The Government Petroleum Insurance Fund's accounts were kept by Norges Bank, but the fund was not included in the Bank's financial statements.

### Operating expenses

The management agreement between the Ministry of Petroleum and Energy and Norges Bank established the principles for Norges Bank's remuneration for managing the

Petroleum Insurance Fund. A fee of 0.06 per cent of the average market value of the fund was stipulated for 2010. The management fee accrued for 2010 was 11.8 million kroner.

Profit and loss account and balance sheet

**Table 4-1** Government Petroleum Insurance Fund. Profit and loss account

(Figures in kroner)	Quarter		Year to date	
	4Q 2010	4Q 2009	31.12.2010	31.12.2009
<i>Profit/loss on financial assets excl. exchange rate adjustments</i>				
Interest income, lending associated with reverse repurchase agreements	-9 114 795	-3 867 512	-23 355 750	-21 768 761
Net income/expenses and gains/losses from:				
- securities and deposits	385 064 045	103 341 021	-496 749 165	-65 066 936
- financial derivatives	0	0	0	-620 875
Interest expenses, borrowing associated with repurchase agreements	4 648	13 186	69 338	196 486
Other interest expenses	0	3 820	0	61 517
Other expenses	0	0	0	386
<b>Profit/loss before exchange rate adjustments</b>	<b>375 953 897</b>	<b>99 490 514</b>	<b>-520 035 578</b>	<b>-87 198 184</b>
Exchange rate adjustments	351 034 421	227 214 569	623 938 827	3 083 939 695
<b>Profit/loss</b>	<b>726 988 318</b>	<b>326 705 084</b>	<b>103 903 248</b>	<b>2 996 741 511</b>
Accrued management fee	3 044 270	3 114 431	11 800 390	12 050 755
<b>Profit/loss after management fee</b>	<b>730 032 588</b>	<b>329 819 515</b>	<b>115 703 638</b>	<b>3 008 792 266</b>

**Table 4-2** Government Petroleum Insurance Fund.  
Balance sheet

(Figures in thousands of kroner)	31.12.2011	31.12.2009
<b>FINANCIAL ASSETS</b>		
Lending associated with reverse repurchase agreements	0	8 719 352
Securities and deposits	0	9 604 303
Bonds lent	0	4 854 943
Financial derivatives	0	0
Unsettled trades	0	0
<b>TOTAL FINANCIAL ASSETS</b>	<b>0</b>	<b>23 178 599</b>
<b>FINANCIAL LIABILITIES</b>		
Borrowing associated with repurchase agreements	0	0
Cash collateral received	0	4 071 080
Financial derivatives	0	0
Unsettled trades	0	145 696
Other liabilities	0	0
Management fee due	0	12 051
<b>TOTAL FINANCIAL LIABILITIES</b>	<b>0</b>	<b>4 228 827</b>
<b>NET PORTFOLIO*</b>	<b>0</b>	<b>18 949 772</b>

\*) The difference between market value in Table 2.1 and the net portfolio in the balance sheet is due primarily to differences in the treatment of unsettled transfers to the portfolio, which were not recognised in the balance sheet at the end of the quarter.

## Appendix: Portfolio transferred to GPFG 31.12.2010

(Thousand NOK)	Euro	British pounds	US dollars	Total
Government bonds	6 737 422	1 170 708	4 820 601	12 728 733
Govt. related bonds	20 543			20 543
Securitized bonds	116 196			116 196
Cash	3 385 111	1 808 311	1 778 952	6 972 376
<b>Total</b>	10 259 274	2 979 020	6 599 554	19 837 850