



NORGES BANK
INVESTMENT MANAGEMENT

STRATEGY 2011-2013 CLOSE OUT

10 March 2014

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Introduction

Norges Bank Investment Management's mission is to safeguard and build financial wealth for future generations.

Our main goals for the 2011-2013 strategy period were to:

- Implement an investment strategy built on the fund's defining characteristics and the owner's target of absolute return, with strategies that are long-term oriented, scalable and focused on underlying value.
- Simplify our infrastructure, obtaining an efficient and robust execution platform.
- Strengthen the investment culture across NBIM, while maintaining our risk awareness and attention to detail where it matters.

Our main achievements in the strategy period were:

- We moved the organisation towards a long-term return focus, and successfully launched real estate investments.
- We simplified the portfolio and systems and reduced the number of service providers.
- We strengthened our investment culture through investment analysis and improved communication.

Investment strategy – improve risk/return

INVESTMENT OBJECTIVE

We moved the organisation towards a long-term return focus

The market value of the Government Pension Fund Global rose from 3,077 billion kroner to 5,038 billion kroner in the strategy period. The fund is invested in equities, fixed income and real estate across the world. The Ministry of Finance has a long-term expectation of a real return of around 4 percent. The fund provided an annual return of 8.62 percent in the period. Equity investments returned 10.77 percent, while fixed-income investments returned 4.55 percent. Investments in real estate returned 4.57 percent¹. The annualised relative return on equity and fixed-income investments was 0.33 percentage point. Equity and fixed-income investments had an annualised excess return on 0.34 percentage points and 0.16 percentage points respectively. The annual net return adjusted for inflation and management costs was 6.35 percent in the period.

We advised the Ministry of Finance on new strategic indices for both fixed-income and equity investments. The Ministry made its decision in early 2012. The new strategic index for fixed income applies GDP weights for government bonds and a fixed market-weighted allocation to corporate bonds. The new strategic index for equity investments implies a move away from fixed regional weights towards market weights. The new strategic indices entail a new geographical distribution for the fund and signal a major shift in the fund's strategy. A larger share of the fund has been invested in Asia and Americas. The new geographical distribution will improve the overall diversification of the fund and put the fund in a better position to capture global value creation.

We expanded our investments into new currencies and markets. 21.3 percent of the fixed income portfolio was invested outside the four main currencies at the end of 2013, up from 6.7 percent at the beginning of 2011. The number of currencies in the strategic index for fixed-income

investments increased from 11 to 21 in the period. The number of currencies in the fixed-income portfolio increased from 24 to 32, since we had started investing in emerging markets prior to the change in the strategic index. The number of countries in the strategic equity index remained unchanged at 46, while the number of countries in our equity portfolio increased from 45 to 56.

We advised the Ministry of Finance on a new rebalancing rule, and the Ministry announced a public rebalancing rule in 2012. We changed the way we manage inflows to reduce transaction costs and market impact by spreading transactions over several days or weeks.

The Ministry sets a strategic benchmark index. In the period, we established an operational reference portfolio, which serves as the starting point for our management of the fund. In the operational reference portfolio we choose securities, instruments and markets from a wider opportunity set than used in the strategic benchmark index to move the starting point closer to the global market portfolio. We address unwarranted rules, complexity and weaknesses in the strategic index, and ensure appropriate aggregate exposures towards systematic risks. To position the fund better on an absolute return/risk relationship, we established capacity for a more dynamic allocation.

To further support our long-term perspective, we have strengthened our internal research capacity. We have published 23 discussion notes on research topics relevant to the development of the investment strategy for the fund. The discussion notes also form the foundation for our advice to the Ministry of Finance. We sent four letters directly connected to our discussion notes to the Ministry with advice on major changes in the fund's investment strategy.

EQUITY MANAGEMENT

We became more focused and improved our investment analysis

During the strategy period we have strengthened our capacity to conduct fundamental analysis of companies we invest in. Within equities, the research processes have been structured through more formal requirements for company coverage, investment cases, financial models, documentation of company meetings and consideration of environmental, social and

¹ From 01.04.2011

governance issues. All research is documented and shared internally.

We have continued to focus on specialised sector mandates with fewer positions managed by each portfolio manager. In so doing, we have enabled longer-term holding periods which incentivise each portfolio manager to take higher conviction positions. The number of sector mandates managed internally was reduced from 30 to 21 in the strategy period. The reduction was mainly due to a slower industry specialist recruitment pace than expected and due to fewer portfolio managers managing more than one portfolio.

In addition to the sector mandates, we have established a capital allocation team to make larger investments in individual companies. The team focuses on long-term investments and special situations, including investments in companies undergoing changes in their capital structure. The team is also responsible for listed real estate, listed infrastructure and unlisted equity investments. The first pre-IPO investment was undertaken in May 2012. The number of large positions with a dollar value above 300 million increased from 7 to 38 in the period from 2011 to 2013.

A large part of the equity portfolio in developed markets has historically been managed on an index tracking market exposure basis. For these portfolios we have moved our strategy from index replication to broad market exposure.

The value of assets under external management increased slightly in absolute terms, but was reduced significantly as a proportion of total assets under management. At the end of 2013, 3.7 percent of the fund was managed through 67 external equity mandates. Our external equity managers are primarily country specialists focusing on small and medium-sized companies in emerging and frontier markets, including specialist environmental mandates. 49 of the mandates were in emerging markets and the share of assets in emerging markets has increased from 34 percent to 69 percent of assets under external management. The external manager contracts are subject to a cap that in some cases has prevented us from attracting some managers.

FIXED-INCOME MANAGEMENT

We simplified the fixed-income portfolio

We simplified the fixed-income portfolio and significantly reduced the number of fixed-income instruments. Complex over-the-counter instruments have been removed from the investment universe, together with some types of securitised debt. The number of bond holdings decreased from 9,500 at the beginning of 2011 to around 4,500 at the end of 2013. We started to invest in emerging-market government bonds in line with the strategy, to diversify the portfolio on more currencies.

In addition to the individual market segment mandates, we now manage term, credit and liquidity for the entire fixed-income portfolio on an overall basis.

The fund is currently invested in approximately 2,000 corporate bonds. This is down from 3,500 bonds at the beginning of 2011. We strengthened our research capacity in credit to improve our analysis of issuers and covenants on single issues, and analyse all new issues we participate in. We have concentrated our participation on new issues, where we now take around four times larger stakes and participate in fewer issues. In the strategy period, we participated in 652 new bond issues with a total nominal value of 193 billion kroner.

We increased our capacity in macro research, and integrated this into allocation and fixed-income positioning. The main focus has been on emerging markets.

A limited portion of the fixed-income portfolio is externally managed. During the period, we gradually reduced our exposure to externally managed US securitised debt without significant losses and awarded two new external fixed-income mandates in emerging markets. At the end of 2013 this constitutes 0.1 percent of the fund.

REAL ESTATE MANAGEMENT

We successfully made our first real estate investments

Real estate investments were started in this period, but represented only 1.0 percent of the fund's value at the end of 2013. 51.8 billion kroner was invested in ten separate real estate structures in Europe and the US in the office,

retail and industrial sectors. We executed the strategy through joint ventures with partners that possess local market knowledge and strong asset management capabilities and balance sheet capacity.

We have built a real estate organisation of 36 people, with a focus on developing investment and research capabilities in key markets. Systems and support functions have been established within a comprehensive risk and governance framework. We established due-diligence processes covering financial, legal, tax, operational, technical, insurance and environmental aspects. We have also set up real estate support functions responsible for cash transfer processes and transparent reporting.

We established the Luxembourg subsidiary NBIM S.à r.l. in 2011. NBIM S.à r.l. is a holding company wholly owned by Norges Bank, responsible for the administration of real estate assets in continental Europe.

OWNERSHIP

We integrated ownership activities into the investment process

NBIM seeks to safeguard investments in more than 8,000 companies worldwide. We have worked to promote good standards of corporate governance, as well as sustainable business models from an environmental and social perspective. Over the last three years we have had around 7,000 company meetings with more than 2,000 companies.

We reorganised the ownership group and integrated ownership activities with the investment processes. A research database for environmental, social and governance factors was established, easily available to all portfolio managers, with information on approximately 4,000 companies.

We have voted on average at 97.8 percent of all shareholder meetings, representing in total about 31,000 meetings over the last three years. We have given more attention to the issue of nomination of directors and contact with boards, and participated for the first time in a board nomination committee. We also established a Corporate Governance Advisory Board, to improve our work on corporate governance.

We have a global investment mandate with a starting point that we should invest broadly in all regions and many countries. We use a framework to manage our long term sustainability risks which include risk assessments on country, sector and company level. Some countries, sectors and companies we choose not to invest in based on our ownership risk analysis. This has led to disinvestments in some palm oil and mining companies.

We have continued our ownership efforts within six focus areas and highlighted deforestation as a topic within climate change. We improved our expectation documents on children's rights, climate change and water management, and published six sector reports. We did not, however, expand our overall ownership research capability in line with our ambitions and will focus on this going forward.

In the strategy period, we responded to several public consultations and surveys organised by various regulators on topics such as high-frequency trading and corporate governance frameworks. We have supported and provided input to standard setters including the development of disclosure and reporting standards such as the Global Reporting Initiative and the International Integrated Reporting Council.

Investment execution – simplify the investment platform

TRADING

We ensured cost-efficient implementation of our investment decisions

We have had a high focus on trading cost since inception. Total inflows to the fund for the period amounted to 787 billion kroner.

Changes to the strategic index led to significant transitions. The new strategic indices for fixed income and equities resulted in a significant change in the geographical composition of the fund. We started the transition during the strategy period with a total trade amount of 447 billion kroner in fixed income and 162 billion kroner in equities. The transition excluding inflow has so far been implemented at a low total cost of 6.8 basis points. The fixed-income transition has

been completed, and the equity transition will continue into 2014.

We implemented an internal trade pricing system giving traders more discretion in execution. We have moved from trading analytics to execution analytics, with the main purpose of ensuring the best possible timing of trade execution, and to reduce transaction costs. For equity single stock trading, the average order size has increased, and the average order implementation time has gone from 2.3 days to 6.2 days.

In the period, electronic trading for fixed income decreased slightly from 46 percent to 43 percent due to our increased investments in emerging markets. Electronic trading for equities decreased from 55 percent to 44 percent in the period, with a focus more on finding natural liquidity in the market.

The treasury functions of financing, cash and currency management and securities lending have been centralised across asset classes. This has improved the efficiency of cash, foreign exchange and collateral management, as well as the risk management of the combined activities in this area.

We believe well-functioning markets are essential to the management of the fund. NBIM approached several regulators and exchanges directly to influence market microstructure. We did however not achieve our targets in this area.

RISK MANAGEMENT

We developed new risk measures to support the long-term investment strategy

A well-functioning and efficient risk control environment is core to NBIM. We have implemented a more efficient and standardised reporting process, and a broader risk analytics coverage. We have developed new tools for risk analysis with improved attribution and views on risk and return drivers.

We established new risk measures to include cash flows, shortfall and factor risk. We improved our forward-looking risk models by using option prices in combination with cash flows and historical prices.

We expanded our operational risk framework to include business continuity management, event risk, and financial and reputational risk tolerance

levels. We designed and implemented a simulation model to calculate the total operational risk exposure based on incident and risk factor information. Our ambition has been to integrate legal, ownership and operational risk into an overall business risk framework, with a strengthened emphasis on safeguarding the fund. Work still remains to ensure an efficient implementation of the integrated business risk approach.

We have continued our internal governance structure, with clearly documented processes, policies and guidelines, and division of roles and responsibilities. Our committee structure was maintained. The governance framework has seen increased adoption across the organisation, resulting in more efficient organisational management and improved risk management and internal control. This has been reflected in conclusions and feedback from 51 audit projects during the strategy period.

OPERATIONS

We simplified the portfolio and systems

Consolidation and simplification have been key drivers for the changes to our technology, infrastructure and system portfolio. Our target has been a simple, efficient and consistent infrastructure.

The technology platform was transferred to a new infrastructure provider. This increased our operational stability and general performance, and significantly reduced the overall system complexity.

We reduced the number of IT systems to minimise overall complexity in our operations. A cross-asset system for trade processing and portfolio accounting is under implementation for equities and fixed income. System implementation has taken more time than anticipated, mainly due to difficulties finding a suitable solution to meet NBIM's needs. The system solution will be further expanded to support portfolio management and trading in the next strategy period.

Management of information security has been given significant attention. We segregated responsibility between IT operations and the risk and control functions, and implemented monitoring of information security on an ongoing

basis. Our information security monitoring still needs development.

SERVICE PROVIDERS

We reduced the number of service providers and reduced costs

We continued to concentrate the organisation on core investment activities and reviewed the level of investment services outsourced to external providers.

We consolidated IT application support, system development, back-office processing and IT infrastructure services under one provider. The focus has been on delivery of services rather than technical components, which has modernised our IT infrastructure.

We consolidated the service model for core custody services, moved all assets to one global custodian and established a contingency custody solution with a second vendor. We insourced trade processing services for fixed income. These vendor consolidations have contributed considerably to cost savings. Total management costs excluding performance-based fees to external managers were 5.2 basis points of assets under management in 2013, compared to 7.0 basis points in 2010.

Investment organisation – a global investment culture

HUMAN RESOURCES

We expanded our global presence and remained small and agile

NBIM remains a small and agile organisation. The number of employees increased from 278 at the end of 2010 to 370 at the end of 2013.

The majority of recruitment was within the investment areas. The share of employees directly involved in investment decisions increased from 24 percent at the end of 2010 to 33 percent by the end of 2013. This strengthened our investment capabilities in new asset classes and in new markets. The allocation of employees to our international offices increased from 20 percent at the beginning of 2011 to 35 percent by the end of 2013.

A key objective was to recruit, retain and develop highly qualified staff. We improved our recruitment process, as well as our ability to recruit in the international labour market. We strengthened our performance management processes by closely linking our organisational targets with individual employee appraisals. We also established a longer-term incentive structure for our investment personnel.

We improved our talent management and strengthened our four-year Investment Talent Programme.

INVESTMENT CULTURE

We improved information sharing across the organisation

NBIM is a knowledge-based organisation, and we value employees with a desire to learn and improve their capabilities. In the strategy period, we introduced a series of investment-related courses for employees across all functions.

We increased the number of employees involved in investment decisions, and increased investment focus in the management group.

We launched a new system platform to improve internal knowledge sharing on investment analytics. We developed arenas for sharing investment knowledge and current market insight.

COMMUNICATION

We improved internal and external communication

We remained attentive to our dialogue with external stakeholders. We presented at more than 150 external speaking events in 20 countries. 50 percent of these events targeted Norwegian stakeholders.

Our web pages have been the main channel for external information sharing, and we have seen an increased number of visitors, especially among Norwegian stakeholders.

Our governance model, principles and policies are published on nbim.no. We have improved transparency on our voting by making our voting records publicly available immediately after the shareholder meeting. We have improved the content related to our investments on our

website, and during 2013 we worked to further improve the website for a broader audience.

We enhanced our public reporting through the implementation of International Financial Reporting Standards and improved our quarterly and annual reports.

We have established a close relationship with academia to gain insights we can use as a large global investor. We established the Norwegian Finance Initiative in 2011. As part of the initiative, we have arranged financial research conferences, awarded scholarships and given out publication bonuses. We have conducted research projects with renowned researchers and held more than 50 internal academic seminars with professors of finance and economics.

Summary

NBIM's objective is to safeguard the owners' long-term financial interests and build wealth over the long term. This should be done through investment decisions based on analytical insight, and by implementing the strategy in a simple, cost-efficient and controlled manner. The key elements of the 2011-2013 strategy period were to:

- Emphasise absolute returns, moving away from a relative return focus, as we capitalise on the fund's long-term outlook and size.
- Simplify the investment infrastructure.
- Strengthen our investment culture and be open about how we invest.

The key achievements in the strategy period have been:

- We obtained an annual real return of 5 percent for the fund.
- We improved our investment process and reduced costs.
- We strengthened our investment organisation.

The achievements the last three years has prepared us for future challenges and the direction set out for 2011-2013 will continue for the strategy period 2014-2016.