
NORGES BANK'S SUPERVISORY COUNCIL REPORT FOR 2016

Document No. 9 (2016–2017)



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TO THE STORTING

Norges Bank's Supervisory Council is charged with supervising the running of the central bank and ensuring that the rules governing the Bank's operations are observed. In keeping with the guidelines from the Storting – the Norwegian parliament – the Council attaches great importance to supervising the operational management of the Government Pension Fund Global (GPFG) and compliance with the management mandate for the GPFG.

The Council considers it part of its role to contribute to the healthy development of the central bank.

In 2016, the Council again paid special attention to the Executive Board's handling of operations and governance by means of guidelines and organisational measures. In its supervision, the Council was particularly interested in physical and IT security, both in Norway and in the overseas operations. Assessments were made of the Executive Board's handling of tax issues, remuneration, costs and the overall management and control structure.

Now that net transfers to the GPFG may be reduced, expectations of good returns and effective cost control will be even greater. The Council monitors operational developments through the approval of budgets and through the Executive Board's reporting during the year. Questions were asked about cost-effectiveness across Norges Bank and about governance through the strategies and targets set.

The Council has considered the Bank's annual report and adopted its annual financial statements for 2016. The Bank had equity of NOK 224.7bn on 31 December 2016, after negative comprehensive income for the year of NOK 2.9bn. In accordance with the guidelines on provisions and allocations of the Bank's earnings, NOK 17.7bn was allocated for transfer to the Treasury. Transfers to the Treasury were also made in 2014 and 2015.

The annual report on the management of the GPFG in 2016 has also been considered. The fund's market value grew by NOK 35bn after a return for the year of NOK 447bn. Withdrawals were made from the fund for the very first time in 2016 and amounted to NOK 101bn.

A more detailed presentation of the Bank's activities can be found in the aforementioned reports.

The Council adopted this report on the supervision of Norges Bank in 2016 at its meeting of 16 March 2017, and the report is hereby presented to the Storting.

Oslo, 5 April 2017
Reidar Sandal
Chairman of Norges Bank's Supervisory Council

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CHAPTER 1

SUMMARY AND MAIN CONCLUSIONS

EXECUTIVE SUMMARY OF THE REPORT

In this report for 2016, Norges Bank's Supervisory Council provides an account of its supervision and control activities pursuant to the Norges Bank Act.

Norges Bank plays a key role in society and administers policy instruments that are very important for the Norwegian economy. The Bank holds a position of immense trust as Norway's central bank and manager of the Government Pension Fund Global (GPFG). Under the Norges Bank Act, executive and advisory authority at the Bank is vested in the Executive Board, which is in charge of the Bank's operations and manages its resources.

The Supervisory Council oversees whether the Board exercises satisfactory management and control of the Bank's operations and compliance with relevant laws, regulations and mandates. The Council also approves the Bank's annual budget and adopts its annual financial statements.

The Bank's activities are described only in general terms in this report. More detailed information can be found in the Bank's annual report and financial statements for 2016, the annual report on the management of the GPFG in 2016, and other reports published by the Bank.

The Council's report to the Storting for 2015 (Document No. 9 (2015–2016)) set out priorities for future supervisory activities. The prioritised tasks have been carried out. The present report provides an overview of the Council's activities, expenditure and supervisory methodology in 2016. It also covers the supervision of the Board's management and controls both at an overall level and in central banking and investment management specifically.

The minutes of Executive Board meetings play an important role in the Council's supervisory activities, as they provide a good overview of the matters considered by the Board and a basis for requesting additional information or clarifications. Many of the matters considered by the Board were also presented to the Council.

The Council monitored developments in the regulatory framework for the central bank in general and the man-

agement of the GPFG in particular. Attention was paid to the Executive Board's updating of internal rules and management models. The Council's supervision included the Board's implementation of strategies and action plans and oversight of internal control, risks and expenditure.

The Executive Board reported on risk management and internal control throughout the year. The Council noted that the Board oversees the Bank by means of limits, guidelines and consideration of periodic reporting. No significant events or breaches of the rules were identified that entailed diminished internal control. The Board has been asked to keep the Council informed about the implementation of risk reduction measures.

Supervisory reviews were conducted during the year of the control structure at Norges Bank based on established principles for enterprise risk management. On the investment management side, supervision reports were submitted on the remuneration structure in the management of the GPFG, Norges Bank's tax position and the Executive Board's management and control of management costs.

Monitoring work on security and contingency planning is a priority for the Council, and 2016 saw a supervisory review of the management of security at Norges Bank's overseas offices. The central bank's processes for fulfilling its responsibilities as issuer of notes and coins and supplying society with cash were reviewed. The project for the issue of a new banknote series is being followed closely with regard to risks and contingency planning.

The Supervisory Council has adopted the budget for Norges Bank for 2017 subject to two remarks on the proposal submitted by the Executive Board. During its consideration of the budget, the Council requested information from the Board on the strategies and targets set, assessments of cost levels based on comparisons with the Bank's peers, and cost-benefit analyses for strategic choices. The Council has asked the Board to provide this additional material by 15 May 2017.

MAIN CONCLUSIONS FOR 2016

The Council has received the information it has requested, including clarifications at meetings.

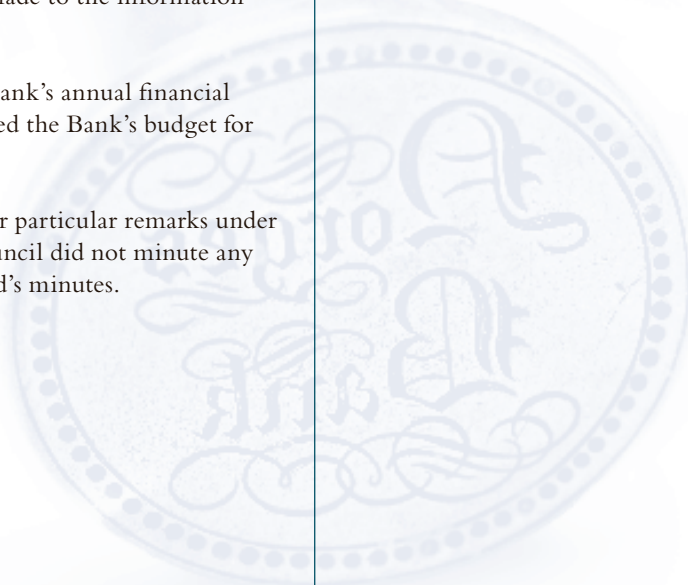
The minutes of Executive Board meetings in 2016 have been reviewed. Questions were raised about specific matters, and the Governor gave detailed briefings on a number of these.

The Council is of the opinion that the Executive Board exercised satisfactory management and control of Norges Bank's operations in 2016 in accordance with the Norges Bank Act, the mandate and guidelines for the management of the GPF, and the regulation on risk management and internal control at Norges Bank.

There are no major differences in how the Executive Board and the Supervisory Council view risk and compliance. The Council nevertheless believes that these activities should be developed further given their scope and complexity. Reference is also made to the information presented below.

The Council has adopted the Bank's annual financial statements for 2016 and approved the Bank's budget for 2017.

Its supervision gave no cause for particular remarks under the Norges Bank Act. The Council did not minute any particular remarks on the Board's minutes.



CHAPTER 2

HOW THE COUNCIL'S SUPERVISION OF NORGES BANK IS ORGANISED

DUTIES AND RESPONSIBILITIES

On 24 May 2016, the Storting – the Norwegian parliament – resolved to include Norges Bank in the Norwegian Constitution in a new Article 33: “Norges Bank is the central bank of Norway.” Article 75c of the Constitution requires the Storting to “supervise the monetary system of the realm”.

Norges Bank plays a key role in society and administers policy instruments that are very important for the Norwegian economy. Besides central banking, the management of the Government Pension Fund Global (GPF) is an important function for the Bank. The Bank's functions are mainly regulated by the Norges Bank Act¹ and associated regulations, the Government Pension Fund Act and the management mandate for the GPF.

Norges Bank is a separate legal entity owned by the state.² Confidence in the central bank depends on effective and efficient performance of its duties and satisfactory management and control. Its operations are monitored by both the Storting and the government, and an extensive management and control structure has been established.

The Supervisory Council's duties have evolved over time as a result of legislative changes. Under the current Norges Bank Act, introduced in 1985, the Council's principal duties are to supervise the Bank's activities and ensure that the rules governing the Bank's operations are observed, and to approve the Bank's budget and adopt its annual financial statements. The Council appoints the auditor for Norges Bank's overall activities.

The Council's supervisory role is defined in the third paragraph of Section 5 of the Norges Bank Act and covers all of the Bank's activities. The supervision of the Bank requires a broad knowledge of its operations and organisation and of its management and control framework.

“The Supervisory Council shall supervise the Bank's activities and ensure that the rules governing the Bank's operations

are observed. The Supervisory Council shall in this respect supervise the Executive Board to ensure that the Executive Board's management and control of the Bank's administration and operations are satisfactory and that appropriate procedures have been established so that the Bank's activities are conducted in accordance with legislation, agreements, decisions and other regulatory frameworks. The Executive Board's exercise of discretionary authority under the Act is not subject to the Supervisory Council's supervision. The Supervisory Council has the right of access with respect to all of the Bank's affairs and may conduct any investigations it deems necessary in order to fulfil its responsibilities under the Act. [...]”

The second paragraph of Section 5 states that:

“[...] executive and advisory authority is vested in the Executive Board. The Executive Board is in charge of the Bank's operations and manages its resources. The Executive Board shall ensure the sound organisation of, and establish satisfactory frameworks, objectives and principles for, the Bank's operations. The Executive Board shall ensure that the Bank's operations, including accounting and asset management, are subject to sound governance and control. The Executive Board shall supervise the Bank's administration and other activities.”

The Bank is to conduct its operations in accordance with the economic policy guidelines drawn up by the government authorities and with Norway's international commitments.

Norges Bank is an independent financial entity, and its budget and annual financial statements are not included in the government budget or the government accounts. Responsibility for the Bank's financial management is regulated by Sections 29 and 30 of the Norges Bank Act. The Executive Board is to prepare an annual report and annual financial statements and submit a proposed budget for the coming financial year. The Council approves the budget and adopts the annual financial statements. In the light of its budgetary responsibility, the Council has issued special budget rules for the Bank.

The Norges Bank Act gives the Executive Board the authority to decide that activities that are part of the management of the GPF shall be performed by companies

¹ Act No. 28 of 24 May 1985 relating to Norges Bank and the Monetary System etc. (Norges Bank Act).

² Norges Bank Act, Section 2, fourth paragraph.

wholly or partly owned by the Bank.³ The Supervisory Council may, on the proposal of the Executive Board, decide that the production of banknotes and coin or other commercial activities that fall within the scope of the Act shall be performed by companies that are partly or wholly owned by the Bank.⁴ The Executive Board represents Norges Bank as owner of the Bank's companies.

The Supervisory Council is responsible for supervising such companies and has the right to require the disclosure of information by a company's managing director, its board and the selected auditor as is necessary for such supervision to be conducted. The Council may conduct its own inspections of a company as necessary. The Council shall be notified before a company's general meeting is held and has the right to attend the meeting. The Council has issued specific guidelines concerning the supervision of companies associated with the GPFG's real estate investments. The regulation on risk management and internal control at Norges Bank (Internal Control Regulation) also applies to companies owned by the Bank as part of its operations.

The Council also has a number of other functions and responsibilities under the Norges Bank Act.⁵ The Council has laid down general rules for the Bank's loans to employees. Both the Executive Board and the Supervisory Council consider matters of an administrative nature concerning the management of the Bank. These might be matters with implications for employees or public disclosure. The Bank's employees elect two members from their ranks to supplement the Executive Board when matters of an administrative nature are discussed. The employee representatives on the Board may also attend and speak at meetings of the Council when administrative matters are being considered. In case of doubt, the Council decides whether a matter considered by the Executive Board is of an administrative nature.

At least once a year, the Council is to present to the Storting a statement on the minutes of Executive Board meetings and its supervision of the Bank in line with the fourth

paragraph of Section 30 and the fifth paragraph of Section 5 of the Norges Bank Act.

“The statement concerning the supervision of the Bank shall, as a minimum requirement, comprise the following:

1. *an account of how the supervision of the Bank has been organised,*
2. *an account of supervisory activities conducted and the Supervisory Council's priorities for its activities ahead,*
3. *an account of the Supervisory Council's supervision of the Bank's investment management activities,*
4. *the Supervisory Council's assessment of the Executive Board's management and control of the Bank's administration and operations, cf. Section 5, third paragraph, second sentence,*
5. *an account of the Supervisory Council's work in connection with its approval of the Bank's budget and adoption of the accounts, cf. Section 5, fourth paragraph, second sentence,*
6. *any particular remarks arising from supervisory activities.”*

This report presents the work carried out by the Supervisory Council in 2016. Through its supervisory activities, the Council keeps itself updated on Norges Bank's activities and the Executive Board's management. The report provides a general description of the management and control frameworks, the Executive Board's management model and the organisation of operations that form the basis for its assessments.

ORGANISATION OF SUPERVISION

FRAMEWORK FOR THE SUPERVISORY COUNCIL'S WORK

On the basis of its duties under the Norges Bank Act, the Supervisory Council has issued rules of procedure for its own activities and a mandate for its preparatory committee – the Permanent Committee. The framework also includes instructions for the Council's secretariat – the Office of the Supervisory Council – and a job description for the Office's director. The director is the general and administrative manager of the Office of the Supervisory Council.

³ Cf. Norges Bank Act, Section 5, third paragraph.

⁴ Cf. Norges Bank Act, Section 5, sixth paragraph.

⁵ Largely regulated in Section 5 of the Norges Bank Act.

FIGURE 1 FRAMEWORK FOR THE SUPERVISORY COUNCIL'S SUPERVISORY ACTIVITIES

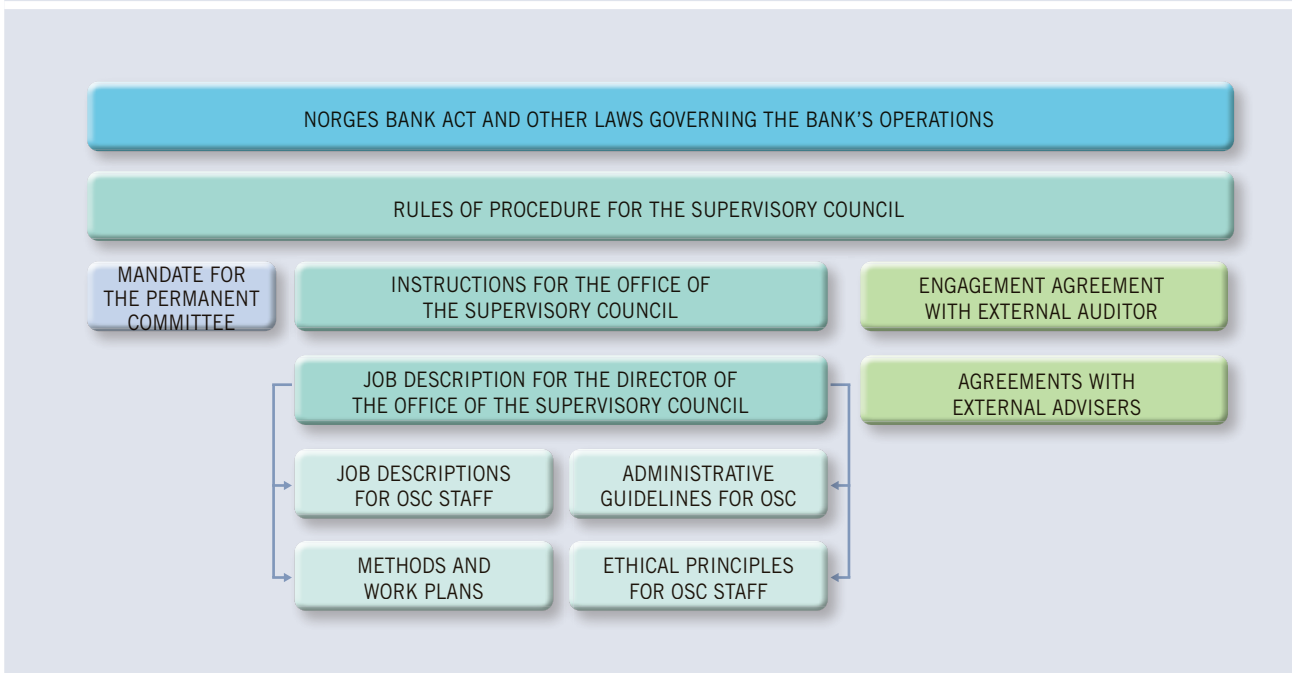
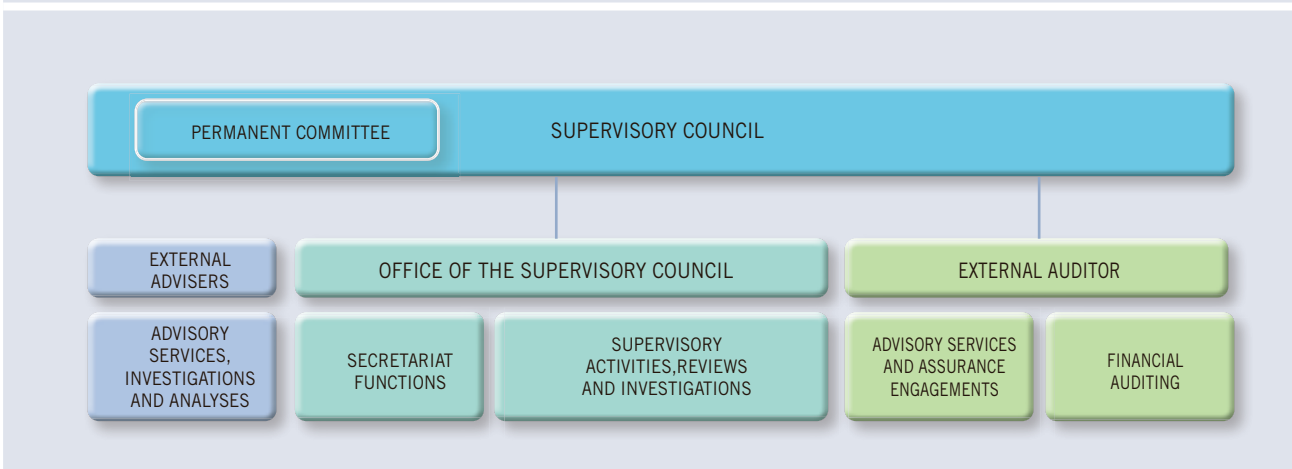


FIGURE 2 THE SUPERVISORY COUNCIL'S ORGANISATION STRUCTURE



The rules of procedure and the mandate for the Permanent Committee were reviewed and adjusted in 2016. The updates take account of the amendments made to the Norges Bank Act from 1 January 2016⁶, including the number of alternate members of the Council and the Council's role in the formation of subsidiaries under the previous Section 8a. The Council's rules of procedure are published on its website.

The documents in this management structure, together with assessments of topical issues and general risk assessments, provide useful guidance for the planning and implementation of supervision. The Council produces three-year strategies with targets and action plans that also cover the Office of the Supervisory Council. The Council prepares an annual meeting schedule and approves a supervision plan. It is also informed about the external auditor's audit plan. A budget is adopted for all activities.

An overview of the framework for the Council's activities can be found in Figure 1.

THE COUNCIL'S ORGANISATION AND WORKING PROCESSES

The Supervisory Council's organisation structure is shown in Figure 2.

The Supervisory Council has 15 full members and two alternate members elected by the Storting for a four-year term.⁷ The two alternates attend and may speak at all meetings of the Council. From among the members, the Storting appoints a chairman and deputy chairman for a term of two years. Reidar Sandal has been appointed chairman and Tormod Andreassen deputy chairman for the period 2016–2017. Five of the 15 full members, or 33 per cent, are women.

Members of the Council have a political background, broad professional expertise and experience from key areas of Norwegian society, public administration and industry. Appendix 1 to the report contains profiles of all members and alternates for 2016–2017.

⁶ Cf. Bill 90 L (2014-2015). Sections 5, 6, 7 and 9 were amended, and Section 8a repealed.

⁷ Cf. Norges Bank Act, Sections 7 and 9.

The Bank's operations attract considerable attention both in Norway and abroad. The starting point for supervisory work is the framework of laws, regulations and mandates for Norges Bank and the Executive Board's management and control of its operations. The Council makes priorities on the basis of guidance from the Storting, wider social considerations and supervisory experience.

Supervision is risk-based, and the Council needs to have a good insight into all areas of risk in Norges Bank's operations. The need for management and control is greatest where the risks are considerable. Supervision is tailored to the tasks with which Norges Bank is entrusted at any given time, and the annual supervision plans are based on assessments of risk and materiality.

The Council considers matters submitted by the Executive Board and the Office of the Supervisory Council, including periodic reports and reports from supervisory reviews in particular areas as set out in the annual supervision plan. Supervision extends to both central banking activities and investment management activities carried out under the mandate from the Ministry of Finance. Compliance with applicable laws, regulations and mandates,⁸ the Executive Board's management and control of operational risk, expenditure and Norges Bank's reputation are a priority.

The Council pays particular attention to periodic reports on governance, operational risk and internal control in both central banking and the management of the GPF. Norges Bank's management and control of other risks in investment management will also affect the basis for the Council's supervision.

Assessments of potential threats and the implementation of security measures form part of the ongoing supervisory process. It is very important that areas such as physical and data security are addressed so as to avoid danger to lives and health, damage to property or loss of sensitive information. Like the Executive Board, the Supervisory Council has zero tolerance of irregularities and unethical behaviour. Incidents that may have implications for Norges Bank's reputation are given special attention. Importance is attached to transparency in reporting.

⁸ See also references to the Compliance functions of the Bank within this report

FIGURE 3 THE SUPERVISORY COUNCIL'S WORKING PROCESS

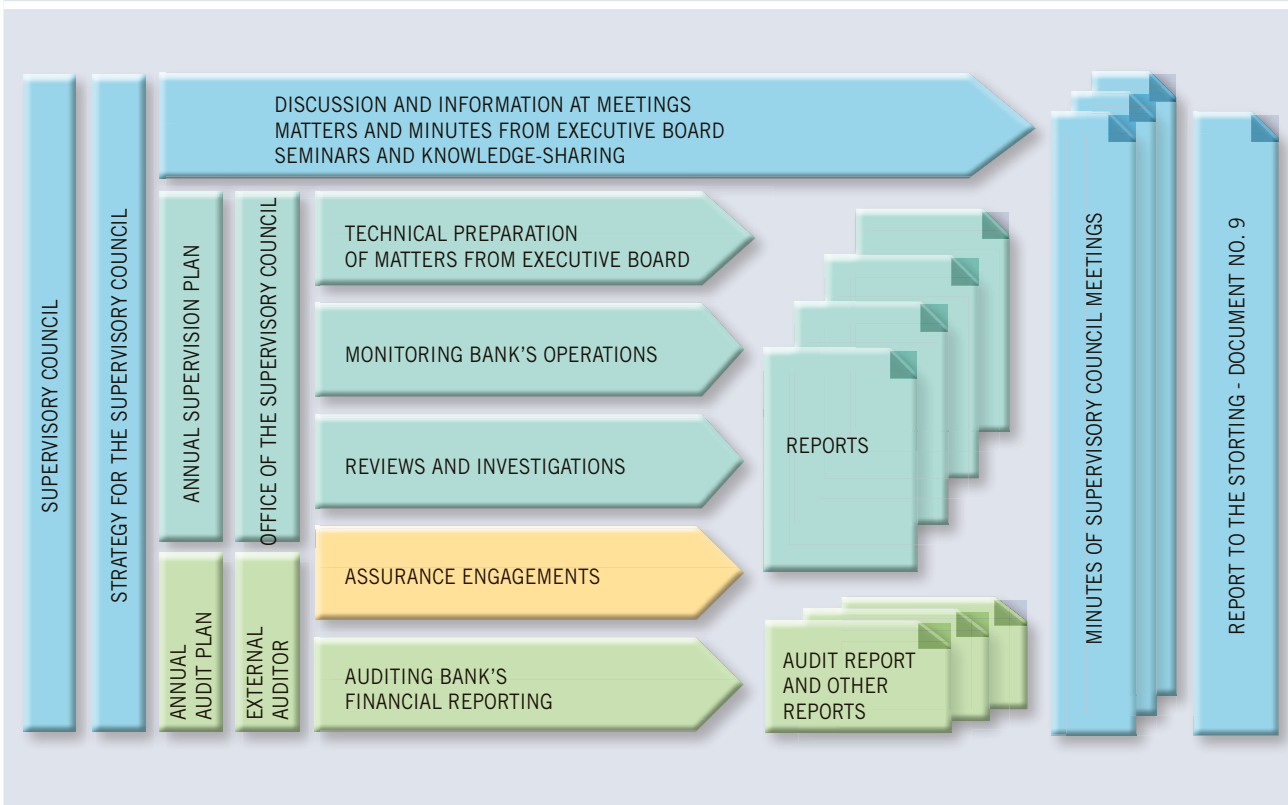


Figure 3 presents the Council's consideration of matters and supplementary reports, and the various elements of the working processes for supervision and auditing.

The Council has the right of access to all of Norges Bank's affairs. The Governor and Deputy Governors are to attend meetings unless the Council decides otherwise or there is another valid reason.⁹ Further information on matters under consideration may be requested, and the Governor provides additional information and answers questions on these matters.

Briefings on topical issues by the Governor at the Council's meetings provide it with supplementary information about Norges Bank's activities. It has also become an established practice for the Council to receive an annual statement from the chairman of the Executive Board's Audit Committee on matters considered and plans for its future work. In principle, it is up to the Council to assess the need for information and its relevance to the Council's supervisory duties.

The Council's supervision does not extend to the Executive Board's exercise of discretionary authority under the Norges Bank Act.¹⁰ This means that the Council does not consider or comment on the Board's interest rate decisions, consultation responses or advice to political authorities. It also applies to Norges Bank's advisory role in the management of the GPFG and its work on macro supervision and the monitoring of systemic risk where the aim is help reduce vulnerability in the financial system. The supervision of the Bank's operations will, however, include the processes at Norges Bank that form the basis for the Board's exercise of discretionary authority. The Council is kept informed about the Bank's work in these areas.

Discussion of matters submitted and topical issues raised by the Council's members may prompt a request for further information or investigations from the Office of the Supervisory Council or the Executive Board.

⁹ *Norges Bank Act, Section 7, sixth paragraph.*

¹⁰ *Cf. Section 5, fourth paragraph. An investigation carried out for the Supervisory Council in 2013 clarified supervisory responsibilities concerning the Executive Board's discretionary authority.*

The minutes of the Council's meetings are intended to provide sufficient information on its deliberations and enable follow-up of its decisions. Both ongoing supervisory activities and the follow-up of supervisory reviews will generally create a need for written clarifications between the Council and the Board. It is therefore appropriate for letters to and from the Board to be appended to the Council's minutes.

THE PERMANENT COMMITTEE

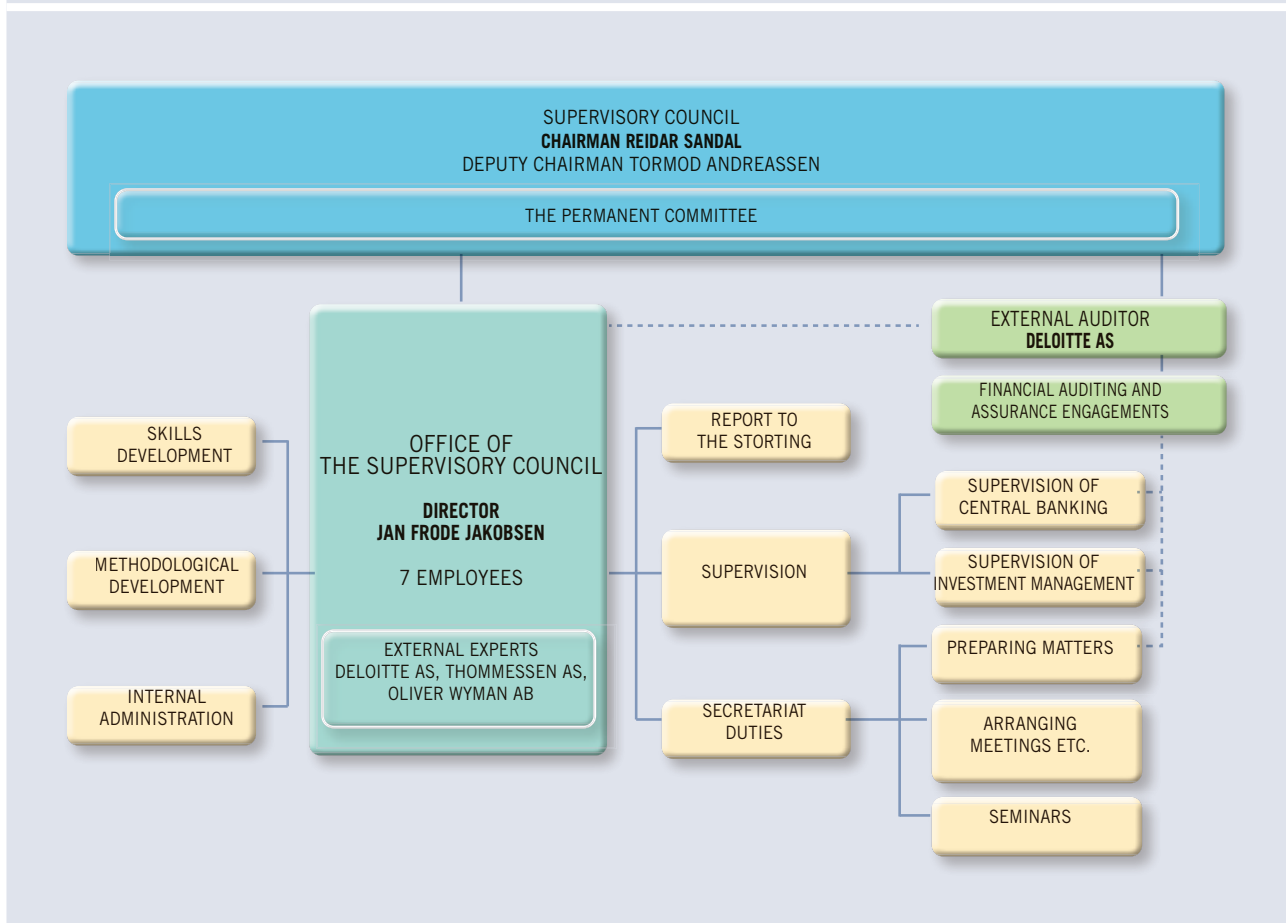
The Permanent Committee is a working committee of the Council established in accordance with the Norges Bank Act.¹¹ It consists of the Council's chairman and deputy chairman and three other members elected by and from the Council's members for a term of two years. In 2016–2017, the Committee comprises Reidar Sandal, Tormod Andreassen, Toril Hovdenak, Frank Sve and Synnøve Søndergaard. The last three members and five personal alternates were elected at the Council's inaugural meeting on 14 January 2016.

The Committee prepares matters to be considered by the Council. As a committee of the Supervisory Council, the Permanent Committee has the right of access to all of the Bank's affairs. As a preparatory body, the Permanent Committee does not take decisions itself. Minutes of its meetings are submitted to the Council.

The Governor may be asked to attend meetings of the Permanent Committee. The Governor or the Executive Board may raise matters with the Permanent Committee with a view to their consideration by the Council, and may present their assessments before the Committee makes its recommendation for a decision on a matter. Where there is good reason, the Committee may inform the Governor of its intended recommendation.

¹¹ *Norges Bank Act, Section 7, fourth paragraph: "From its members the Supervisory Council may appoint committees to consider matters to be dealt with by the Supervisory Council."*

FIGURE 4 THE OFFICE OF THE SUPERVISORY COUNCIL'S ORGANISATION AND DUTIES



THE OFFICE OF THE SUPERVISORY COUNCIL'S ORGANISATION AND WORK

In accordance with the Norges Bank Act¹², the Council has established a secretariat – the Office of the Supervisory Council – to assist with its work. The Office is organised in close association with Norges Bank's operations but reports directly to the Council, independently of both the Executive Board and the Bank's management. The Office's activities and administrative affairs are regulated by instructions, supervision plans and guidelines issued by the Council.¹³

The Council's organisation and duties are outlined in Figure 4.

The Office's previous director retired at the end of 2016. His successor has been appointed by the Council and started on 1 February 2017. The recruitment process is discussed later in the report. The Council decides on the director's remuneration and other terms of employment.

The Office is to be appropriately staffed with adequate and relevant professional expertise. Its annual expenditure is approved by the Council. Its professional expertise is to be maintained and continuously developed. In 2016, the Office had seven employees besides the director. The employees have broad professional experience in areas such as accountancy, finance, law, corporate governance, risk management and internal control. In addition to relevant professional expertise, considerable importance is attached to integrity, professionalism, loyalty, objectivity and due care in the conduct of duties. When carrying out supervisory tasks, the need to bring in supplementary professional expertise is always considered, especially when it comes to investment management and some legal issues. Good access to relevant resources has been achieved through a number of framework agreements.

The Office's principal purpose is to provide a sound basis for the Council's supervision of Norges Bank's operations and compliance. Its work is to be carried out methodically and on the basis of relevant professional standards. There is

no established, documented standard for the supervision of central banks, but the Office monitors developments at central banks, other comparable institutions and relevant standard setters such as the BIS¹⁴, OECD¹⁵ and ECB. International standards on internal auditing¹⁶ and external auditing¹⁷ also provide relevant guidance on the methodological approach to supervisory reviews. Within Norway, the financial supervisory authority Finanstilsynet's methodology and reporting on the supervision of banks and other financial institutions, and the Office of the Auditor General's methodology for auditing government bodies are related areas.

In its ongoing supervision of the Bank's operations, the Office monitors the Bank's activities and reporting. The Office handles the Council's relations and contact with the Executive Board and the Bank's management. Meetings are held regularly with the Bank's management, the operational areas, the compliance and risk management functions, Internal Audit and the external auditor.

The director attends meetings of the Executive Board and the Audit Committee when matters relevant to supervision are being considered. In connection with the Council's meetings, the Office reviews matters submitted by the Executive Board and liaises with the Executive Board's secretariat. In some cases, it obtains additional information or technical assessments to facilitate the Council's deliberations. This work gives the Office an in-depth insight into and knowledge of the Bank's activities. This is essential in order that the Council can be kept constantly updated on matters material to its supervision.

Special supervisory reviews and investigations are performed in selected areas, resulting in separate reports to the Council. Technical resources and information from the external auditor and external advisers are used where required. In these supervisory reviews, assessment criteria

¹² Cf. Section 5, fourth paragraph, final sentence: "The Supervisory Council shall have a secretariat."

¹³ Discussed in Proposition to the Odelsting No. 58 (2008-2009).

¹⁴ *Bank for International Settlements, including the Basel Committee on Banking Supervision's Core Principles for Effective Banking Supervision (Core Principles)*, 2012

¹⁵ *The Organisation for Economic Co-operation and Development*

¹⁶ *The Institute of Internal Auditors (IIA) Code of Ethics and International Standards for the Professional Practice of Internal Auditing*

¹⁷ *The most relevant standards are the International Standard on Assurance Engagements (ISAE) 3000 series.*

are defined on the basis of overall goals and risks and the formal regulatory requirements for Norges Bank. Assessments of established control structures and processes are based partly on the model in the COSO ERM risk management framework. Comparisons are made with relevant established standards and practices for peer institutions. Information on the introduction of internal rules and the organisation and implementation of this work is obtained through meetings and the review of documents.

Supervision includes reviewing Internal Audit's reports and the periodic reporting to the Executive Board by the compliance functions and the operational areas.

The results of ongoing supervision and supervisory reviews in 2016 are discussed later in the report. The Office prepares the Council's strategies and work plans. It also works on preparing case documents and draft minutes, consultation responses and the annual report to the Storting. The Office arranges the Council's meetings, presentations and professional activities. The Office's director takes part in meetings of the Council and the Permanent Committee and may bring along experts.

The Supervisory Council has entered into an engagement agreement with an external auditor. The agreement is administered by the Office of the Supervisory Council. The Office also has engagement agreements with external advisers and experts on law and investment management.

The Office holds regular meetings with the Ministry of Finance to exchange information relevant to the supervision of the management of the GPF. At these meetings, briefings are given on the Council's report to the Storting, the annual supervision plan and the supervisory activities performed.

The Office co-ordinates co-operation between Norges Bank, the external auditor and the Office of the Auditor General, especially when it comes to the management of the GPF, the government's accounts with Norges Bank and the management of government debt. One aim of this collaborative model is to help the Office of the Auditor General obtain information about, and build on, the audits and supervision performed by the external auditor and the Supervisory Council.

THE EXTERNAL AUDITOR

The Supervisory Council has appointed Deloitte AS external auditor for Norges Bank.¹⁸ The engagement agreement covers the auditing of Norges Bank's annual financial statements, Norges Bank's pension fund and other related bodies.¹⁹ Deloitte AS also audits the financial reporting for the investment portfolio of the GPF that forms part of Norges Bank's annual financial statements. In the case of the GPF's financial reporting for the first three quarters of the year, an assurance review is performed. The Council has also adopted guidelines to ensure that Norges Bank's external auditor is normally appointed auditor of subsidiaries²⁰ established for investments in real estate outside Norway.

The audit reports on Norges Bank's annual financial statements and the financial statements for the GPF's investment portfolio, as well as the assurance review reports on the GPF's interim financial statements, are presented to the Council. After all audits have been completed, an annual auditing report is sent to the Executive Board and the Supervisory Council.

Deloitte AS submits an annual plan for the financial auditing of Norges Bank and keeps the Office of the Supervisory Council and the Council itself informed during the year about issues material to the execution and scope of its auditing. The Supervisory Council has given permission for the external auditor to provide certain consulting services for Norges Bank subject to approval from the Office of the Supervisory Council. Potential assignments are carefully assessed to avoid conflicts of interest, and such work has been limited in scope.

The engagement agreement with Deloitte AS includes an option for providing relevant assurance, auditing and advisory services to the Council or the Office of the Supervisory Council. Where assurance engagements form part of the Council's supervision, separate engagement agreements are entered into. Assurance engagements comply

¹⁸ The engagement agreement has a term of six years and covers the 2016-2021 financial years.

¹⁹ Norges Bank's Economic Research Foundation, Norges Bank Headquarters Pensioners' Foundation and Governor N. Rygg Foundation

²⁰ Companies formed under Section 5, third paragraph, of the Norges Bank Act and other subsidiaries with an obligation to prepare accounts

with international standards²¹ and result in a report or statement that is published.

Agreement has been reached on two annual assurance statements on the Bank's responsibilities in relation to the management of the Central Government Group Account and the management of government debt. These statements are sent to the Ministry of Finance.

The audit report on the pension fund's annual financial statements is sent by the Executive Board to the Council for information. Deloitte AS also submits an independent annual statement²² on risk management and internal control to the board of Norges Bank's pension fund.

The external auditor's work is important for the Council's supervisory activities, and there are regular technical discussions between the Office of the Supervisory Council and Deloitte AS. The partner at Deloitte AS responsible for Norges Bank attends Council meetings while relevant matters are being considered.

EXTERNAL EXPERTISE

Framework agreements are entered into with leading external experts in Norway and abroad following open invitations to tender.

The engagement agreement with Deloitte AS also provides access to broad global expertise in areas such as corporate governance, financial management, tax issues, data security, risk management and internal control. The law firm Thommessen AS²³ assists with legal expertise. Oliver Wyman AB²⁴ is an international adviser on investment management. Other experts are contacted as required.

²¹ International Standard on Assurance Engagements (ISAE) 3000: "Assurance engagements other than audits or reviews of historical financial information".

²² Given under the Regulation on Risk Management and Internal Control at Norges Bank, issued by the Ministry of Finance on 22 December 2008.

²³ The agreement with Thommessen AS was renewed in 2016 for a period of four years.

²⁴ The agreement with Oliver Wyman AB covers the period 2015-2018.

SPECIAL ACTIVITIES IN 2016

PROFESSIONAL DEVELOPMENT

Seminars, study trips and meetings with relevant organisations and institutions are arranged to stay up-to-date on relevant and important technical developments. Technical seminars were held in connection with three of the Council's meetings in 2016.

At the Council's inaugural meeting, information was provided on Norges Bank's governance structure and duties and on the Council's role and way of working. There were also presentations on key investment management issues, both in general and specific to the GPFG, followed by discussions.

At a second technical seminar, one of the Deputy Governors and the CEO of Norges Bank Investment Management (NBIM) presented the work of the Executive Board and Norges Bank on responsible management and compliance with the mandate and guidelines in this area. The deputy chairman of the Council on Ethics for the Government Pension Fund Global²⁵ provided information on the Council on Ethics' mandate, the issues it faces, and its relationship with Norges Bank. The changes to its mandate in 2015 and the subsequent reorganisation of its work on the criteria for the observation and exclusion of companies were discussed.

The responsibilities and duties of the board of directors at large companies, good board practices and the relationship between board and management were the theme of a third seminar. Corporate governance, the organisation of the board's work, good management practices and the company's relations with all relevant stakeholders, including the board's relations with subsidiaries and associates, were among the topics discussed.

A study trip to Tokyo saw a meeting with the Bank of Japan, where the bank's governance model and key priorities in a persistently low-growth economy were discussed. There were also meetings with the Tokyo Stock Exchange and the Financial Services Agency, where presentations were given on new guidelines for board practices in Japan

²⁵ Appointed by the Ministry of Finance

with an emphasis on risk management. Japan's Government Pension Investment Fund (GPIF) is known as the world's largest public pension fund and provided information on its investments and management. The fund is an independent administrative entity organised under the Ministry of Health, Labour and Welfare.

Japan is a key global player, the world's third-largest economy and an important trading partner for Norway. Norges Bank's investment operation in Japan as part of the GPF's real estate management was on the agenda. At the offices of the newly formed Japanese real estate subsidiary, information was provided on the company's activities and on the peculiarities and development of Japan's financial and real estate markets.

In Norway, the chairman of the Supervisory Council and the director of the Office of the Supervisory Council held meetings with the Office of the Auditor General and the Parliamentary Oversight Committee on Intelligence and Security Services, both bodies set up by the Storting. The aim of the meetings included learning more about other organisations' more extensive supervisory duties. Contact of this kind promotes the further development of focused and effective supervision.

The Council hosts the Governor's annual address, an annual tradition since 1922 except for the period 1941–1945. Since 1986, the main theme has been "Economic perspectives". The address is attended by members of the Council and invited guests from the government, the Storting, academia, industry and wider society.

The Council participated in the official celebration of Norges Bank's bicentenary in Trondheim on 14 June 2016.

CONTACT WITH THE COMMITTEE FOR THE REVIEW OF THE NORGES BANK ACT

The Ministry of Finance has appointed and instructed a committee²⁶ to review the Norges Bank Act, the Bank's governance structure and the relationship between Norges Bank and the government authorities. The review is to take account of Norges Bank's special responsibility for the management of the GPF under the Government Pension Fund Act. The committee is also to base its assessments on the guidelines for monetary policy. Its mandate was extended in 2016 to include an assessment of alternative governance and holding models for the GPF.²⁷

The Council has noted that the committee's work may result in changes to the regulatory framework for Norges Bank. The committee's mandate is considered to be relatively broad in terms of assessing the governance structure.

There is broad agreement on the Council that it should contribute actively on the basis of the experience and knowledge it has amassed through its supervision of the Bank. In a letter to the committee during the year, the Council provided input in a number of areas concerning its duties and responsibilities under current legislation. Among other things, the Council proposed that its role as the Storting's independent control and supervisory body for Norges Bank is regulated in law more clearly and in one place. It also noted that direct submission of the central bank's budget and financial statements to the Storting following the Council's deliberations might help strengthen the relationship between Norges Bank and the Storting via the Supervisory Council. At present, they are submitted via the Ministry of Finance.

In the current system, the Council has no direct formal authority to impose sanctions or issue instructions in relation to its supervisory activities. Issues are normally dealt with by means of dialogue between the Council and the Executive Board. The Council may include remarks from its supervision in its minutes and make special remarks as set out in the Norges Bank Act in its annual report to the

²⁶ Mandate issued by the Ministry of Finance on 10 April 2015. The committee is chaired by Svein Gjedrem, a former Governor of Norges Bank. The committee is to submit its report to the Ministry by 30 June 2017.

²⁷ Recommendation 326 S (2015-2016)

Storting. It is proposed that the review committee considers whether it might be appropriate to specify a right for the Council to issue detailed guidelines within its areas of responsibility such that its supervision is assured of a greater impact.

AMENDMENT OF THE NORGES BANK ACT IN 2016 – CONSULTATION RESPONSE

The Ministry of Finance circulated a letter and report in 2016 outlining proposals to grant an exemption from confidentiality in the second paragraph of Section 12 of the Norges Bank Act concerning the submission of information to the tax authorities. The Council considered the proposed amendment unproblematic and had no comments in its response to the Ministry. Nor did the Executive Board have any objections to the amendment in its response. The amendment entered into force from 1 January 2017 in line with the Ministry's proposals.

EVALUATIONS

Members of the Supervisory Council perform an annual self-evaluation. The aim of this is to identify areas with room for improvement and to strengthen the Council's supervision and other work. The questionnaire is completed anonymously by indicating the level of agreement with a number of statements concerning the Council's way of working and interaction with the Office of the Supervisory Council, external auditor and external advisers. There is also scope to add comments on areas the Council should prioritise in its future work. The results of the survey are discussed at a meeting, and any proposed measures are followed up by the Office.

TRANSPARENCY AND REPORTING

The Supervisory Council has noted increased public interest in Norges Bank's operations and supervision. Transparency about the Council's work is achieved within the constraints and limits laid down in the Norges Bank Act and other relevant rules on the Bank's operations. Its members are subject to the provisions on confidentiality in Section 12 of the Norges Bank Act. Any exemptions from the duty of confidentiality concerning information on Norges Bank's business affairs are decided by the Council's chairman in cases that concern the Council and do not concern the Executive Board's areas of operation and responsibility. Exemptions for other matters must be decided in consulta-

tion with the Governor. Under the Council's rules of procedure, it is the chairman – or the person nominated by him – who makes public statements on behalf of the Council.

The Council's annual report to the Storting gives the general public an insight into its activities and is designed to paint a complete picture of the Council's duties, assessments of Norges Bank's control structure and supervisory activities carried out. The minutes of the Council's meetings are published on Norges Bank's website.²⁸ The minutes are also sent to the Office of the Auditor General.²⁹ Case documents relating to matters considered at Council meetings are exempt from public access under Section 14 of the Freedom of Information Act on internal documents, unless otherwise indicated in the document itself.

MEETINGS AND EXPENDITURE IN 2016

MEETINGS AND MATTERS CONSIDERED

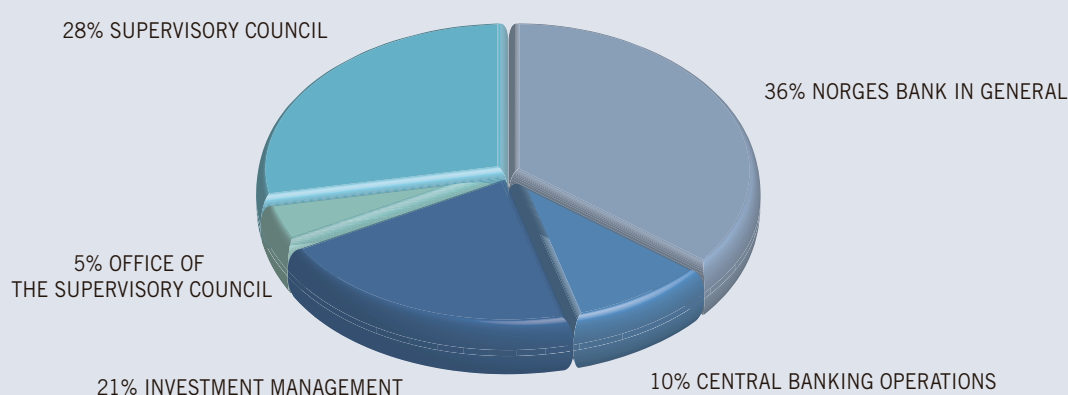
The Council held ten meetings in 2016. Seven ordinary meetings and an inaugural meeting in line with the agreed schedule were supplemented with a meeting to appoint a new director of the Office of the Supervisory Council and an extraordinary meeting to consider and approve Norges Bank's budget for 2017. The Permanent Committee held seven ordinary meetings, one conference call and one extraordinary meeting relating to the budget for 2017.

A new director of the Office of the Supervisory Council was appointed in 2016. The chairman, deputy chairman and one other member of the Permanent Committee were appointed to a nominating committee that handled the recruitment process. An external recruitment agency was engaged. There were a total of 17 applicants for the position, and the list of applicants was made public. The appointment was made unanimously by the Council on the recommendation of the nominating committee.

The Council considered a total of 109 matters in 2016, including the minutes of its own meetings and meetings of

²⁸ See www.norges-bank.no/representantskapet/

²⁹ Cf. the Storting's Instructions of 11 March 2004 concerning the Activities of the Office of the Auditor General, Section 12

FIGURE 5 MATTERS CONSIDERED BY THE SUPERVISORY COUNCIL IN 2016**TABLE 1** THE SUPERVISORY COUNCIL'S EXPENDITURE

THOUSANDS OF NOK	2017 BUDGET	2016	2015
Supervisory Council	4 010	4 506	2 602
Office of the Supervisory Council	13 090	12 494	11 522
External experts	8 000	6 623	10 955
Financial auditing	15 500	16 194	18 261
Total	40 600	39 817	43 340

TABLE 2 BREAKDOWN OF FIXED FEES PAID IN 2016

FIXED FEES	SUPERVISORY COUNCIL	PERMANENT COMMITTEE	TOTAL PER MEMBER	TOTAL FIXED FEES
Chairman	60 000	90 000	150 000	150 000
Deputy chairman	40 000	60 000	100 000	100 000
Three other members of Permanent Committee	30 000	60 000	90 000	270 000
Ten other members of Supervisory Council	30 000		30 000	300 000
Two alternates	30 000		30 000	60 000
Total fixed fees paid				880 000

the Permanent Committee. The chairman calls meetings in line with an agreed schedule and also where there is a special need or where requested by five or more of its members or by the Executive Board.³⁰

A further 19 items in the form of technical reports and supplementary information about Norges Bank's operations were also discussed, but no decisions are taken on such matters.

Figure 5 provides a breakdown of the types of matters considered by the Council.

All in all, 67 per cent of matters concerned the supervision of Norges Bank's operations. 36 per cent were of a general nature or common to both operational areas, while matters specifically concerning investment management came to 21 per cent of the total, and central banking 10 per cent. Taken together, issues pertaining to investment management account for a substantial part of the Council's attention in its supervisory work. Internal matters included consideration of 19 sets of minutes from meetings of the Council and the Permanent Committee.

THE SUPERVISORY COUNCIL'S EXPENDITURE IN 2016

The Council approves an annual budget for its activities, including costs for the Office of the Supervisory Council, the external auditor and the use of external advisers. The budget and reporting of this expenditure are considered as separate items by the Council. These costs are included in Norges Bank's overall budget and annual accounts. The Council's total expenditure in 2016 was NOK 39.8m. Expenditure in 2017 is estimated at NOK 40.6m in the approved budget.

Table 1 gives a breakdown of this expenditure.

The Storting sets the fees payable to members of the Supervisory Council and the Permanent Committee.³¹ A total of NOK 898,400 was paid out in fees in 2016, including fixed fees of NOK 880,000 as shown in the breakdown in Table 2. In addition, fees were paid to attending alternate members of the Permanent Committee. Documented losses of earnings due to attendance of meetings are also reimbursed in line with criteria set by the Council.

The director of the Office of the Supervisory Council was paid a salary and other fees of NOK 1,912,217 in 2016. Pension contributions and other benefits for the director came to NOK 541,499 and NOK 14,331 respectively.

The costs for financial auditing cover Deloitte AS's work as Norges Bank's external auditor in the 2016 calendar year. The Council approves the external auditor's fee for auditing Norges Bank's annual financial statements. Deloitte AS also receives fees for financial auditing of subsidiaries and associates which are charged directly to those companies. Around 85 per cent of costs for the external auditor and other external experts relate to investment management.

³⁰ *Norges Bank Act, Section 7, fifth paragraph*

³¹ *The rates for fees in 2016 and 2017 were set by the Storting from 1 January 2016, cf. Recommendation No. 137 S (2015-2016).*

CHAPTER 3

SUPERVISION OF OVERALL MANAGEMENT AND CONTROL

NORGES BANK'S OPERATIONS

Norges Bank's responsibilities and management structure are primarily governed by the Norges Bank Act of 24 May 1985. The central bank's mission is to promote economic stability in Norway. The Bank has executive and advisory responsibilities in the area of monetary policy and is responsible for promoting robust and efficient payment systems and financial markets. It also manages Norway's foreign exchange reserves.

The Ministry of Finance has overall responsibility for the management of the Government Pension Fund, which comprises the Government Pension Fund Global (GPF Global) and the Government Pension Fund Norway.³² The GPF Global takes the form of a deposit at Norges Bank, which handles the operational management of the fund in accordance with rules and guidelines set by the Ministry.³³

Pursuant to the Norges Bank Act, the Ministry has issued regulations on risk management and internal control at the Bank, on the Bank's annual financial statements, on monetary policy, and in various other areas. Norges Bank in turn has issued regulations on banks' access to borrowing and deposit facilities at the Bank and a number of regulations concerning notes and coins. In addition, the Bank's operations are governed by general legislation in areas such as accounting, tax, freedom of information, public procurement, public administration, security, equal opportunities and the working environment. International investment management activities may be subject to local rules. Norges Bank has its headquarters in Oslo and may open offices both in Norway and abroad.³⁴

ORGANISATION OF THE EXECUTIVE BOARD

In 2016, the Executive Board had eight full members appointed by the King in Council.³⁵ These include five external members appointed for a term of four years. Two

alternates also attend and have the right to speak at Board meetings. Following the amendment of the Norges Bank Act in 2015, a second Deputy Governor was appointed with effect from 2016. The Governor, who chairs the Executive Board, and the two Deputy Governors, who are its first and second deputy chairmen, are appointed to full-time positions for a period of six years.

As mentioned above, two employee representatives join the Executive Board when it is considering administrative matters. The two alternates then act as full members.

Remuneration and pensions for the Governor and Deputy Governors, and fees for the other members, are set by the Ministry of Finance.

The Executive Board has the flexibility to organise the Bank's operations to reflect its responsibilities and objectives. It has set up four preparatory and advisory subcommittees:

- The *Audit Committee* was established pursuant to the Internal Control Regulation. The committee's duties centre on monitoring, oversight and control of financial reporting, operational risk, compliance and systems for risk management and internal control. Internal Audit is to provide necessary support for the Audit Committee and serve as its secretariat.
- The *Risk and Investment Committee* is to help strengthen and streamline the Executive Board's work on investment strategy, exposures, evaluation of performance, setting and use of risk limits, and particularly large and important investment decisions.
- The *Remuneration Committee* is to prepare matters relating to Norges Bank's pay and remuneration arrangements and ensure that there are regular assessments of compliance with applicable limits and requirements.³⁶
- The *Ownership Committee* is to prepare matters relating to responsible investment and the observation and exclusion of companies from the GPF Global.

³² Cf. *Government Pension Fund Act, Section 2, first and second paragraphs*

³³ *The Management Mandate for the Government Pension Fund Global of 8 November 2010, last amended with effect from 1 February 2016, and the Guidelines for the Observation and Exclusion of Companies from the Government Pension Fund Global.*

³⁴ Cf. *Norges Bank Act, Section 8*

³⁵ *Norges Bank Act, Section 6, amended with effect from 1 January 2016 to provide for a second Deputy Governor.*

³⁶ Cf. *the former Regulation on Remuneration Systems at Financial Institutions. A new Regulation on Financial Institutions and Financial Groups (Financial Institutions Regulation) applies from 1 January 2017. Chapter 15 covers financial institutions' remuneration systems.*

The Board has drawn up rules of procedure for its work³⁷ and mandates for the subcommittees. The rules of procedure are published on Norges Bank's website.

The mandates for the Audit Committee, the Remuneration Committee and the Risk and Investment Committee were revised in 2016, and the Supervisory Council was kept informed. The subcommittees' activities do not alter the responsibilities of the Executive Board or its individual members. At least one joint meeting of the Remuneration Committee and the Risk and Investment Committee are to be held each year to discuss topics relevant to the work of both subcommittees. The subcommittees may otherwise agree on joint meetings as required.

The Second Deputy Governor chairs the Risk and Investment Committee and the Ownership Committee. Each has two further members chosen from among the Executive Board's external members and alternates. The members of the Audit Committee are elected by and from the Executive Board's external members in line with the Internal Control Regulation.³⁸

Under the Norges Bank Act, executive and advisory authority at the Bank is vested in the Executive Board, which is in charge of the Bank's operations. Decisions of a strategic nature and on matters of principle are to be taken by the Board. The Board may give special authority to the Governor or others to take decisions in specific areas.³⁹ Delegated authority is overseen through regular reporting.

The Governor has a general authority to take decisions that fall to the Executive Board where an immediate decision is needed and there is neither time nor opportunity to call a meeting of the Board to reach a decision. This authority may not be delegated further.

A new General Secretariat was formed in 2016. The executive director of the department reports to the Governor. The department is to serve as a secretariat, provide administrative support for management and for the Executive Board and its subcommittees, and handle contact with

Internal Audit and the Office of the Supervisory Council. Its work also includes monitoring the legal framework for the central bank's activities and the Executive Board's external communications.

The Executive Board keeps minutes of its meetings, which are submitted to the Supervisory Council once approved. The minutes are also submitted to the Ministry of Finance⁴⁰ and the Office of the Auditor General of Norway⁴¹, and are made public⁴² with the exception of confidential information, etc. The minutes of interest rate meetings are made public after 12 years.

The Executive Board discusses its role and working methods on an annual basis.

INTERNAL AUDIT

An Internal Audit unit has been set up in line with the provisions of the Norges Bank Act and the Internal Control Regulation. Its role is to support the Executive Board's oversight by providing assessments of risk management and internal control. Its duties are performed on the basis of instructions from the Executive Board and international standards for internal auditing practices.⁴³ The Executive Board approves the unit's work plans, and the unit reports to the Board via the Audit Committee.

The director of Internal Audit is appointed and terminated by the Executive Board and reports administratively to the Governor. The Internal Control Regulation gives the director of Internal Audit the right to attend Executive Board meetings.

Internal Audit prepares an annual report to the Executive Board on risk management and internal control in line with the Internal Control Regulation. Its assessments are based on observations from audit projects performed, the follow-up of conclusions from previous audits, and continuous contact with the operational areas. The report sup-

³⁷ Last amended on 16 December 2015

³⁸ Regulation on Risk Management and Internal Control at Norges Bank, Section 10

³⁹ Norges Bank Act, Section 30

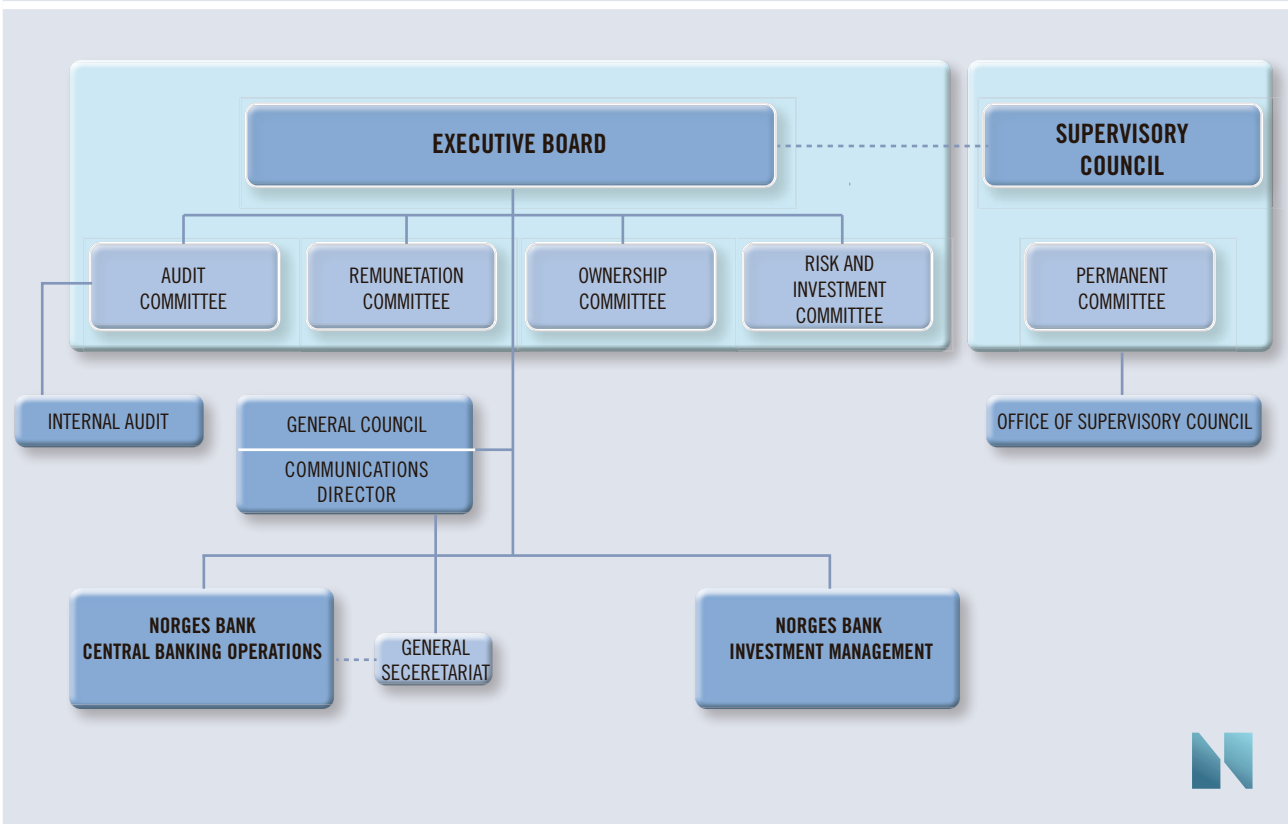
⁴⁰ Norges Bank Act, Section 30, second paragraph

⁴¹ Cf. the Storting's Instructions of 11 March 2004 concerning the Activities of the Office of the Auditor General, Section 12.

⁴² See www.norges-bank.no.

⁴³ Standards issued by the Institute of Internal Auditors.

FIGURE 6 NORGES BANK'S ORGANISATIONS STRUCTURE



ports the overall assessment of internal control by the Governor and Executive Board.

The Supervisory Council is kept abreast of Internal Audit's plans and reporting through the Executive Board's minutes and dialogue with the Office of the Supervisory Council.

TWO OPERATIONAL AREAS

Norges Bank's duties are fulfilled by two operational areas: Norges Bank Central Banking Operations (NBCBO) and Norges Bank Investment Management (NBIM) and their underlying departments. The Executive Board appoints the head of each department in NBCBO, the CEO of NBIM, and the CEO of Norges Bank Real Estate Management (NBREM). The Executive Board also appoints the head of the General Secretariat, the General Counsel, the Communications Director and the director of Internal Audit.

The Governor is in charge of Norges Bank's administration and has overall responsibility for the implementation of decisions. The Executive Board has delegated overall responsibility for the management of the GPF to the CEO of NBIM, who is also responsible for submitting matters in his area. A Central Executive Managers Forum has been set up to discuss guidelines issued by the Governor and matters of importance for the whole of Norges Bank before they are considered by the Executive Board.

The supervision of NBCBO and NBIM is presented in Chapters 4 and 5 of the report respectively.

Norges Bank's organisation structure is presented in Figure 6.

SUPERVISORY ACTIVITIES AND CONCLUSIONS IN 2016

THE EXECUTIVE BOARD'S OVERALL MANAGEMENT OF THE BANK

Central banking and the management of the GPF are conducted on the basis of strategies, targets and management systems. The Supervisory Council monitored developments in the organisation of this work during the course of 2016 through various reports from the Executive Board and oral information at meetings. Norges Bank is a single legal entity, and the Council attaches importance to the

Board exercising good management and control at a general, overall level as well as within each of the operational areas.

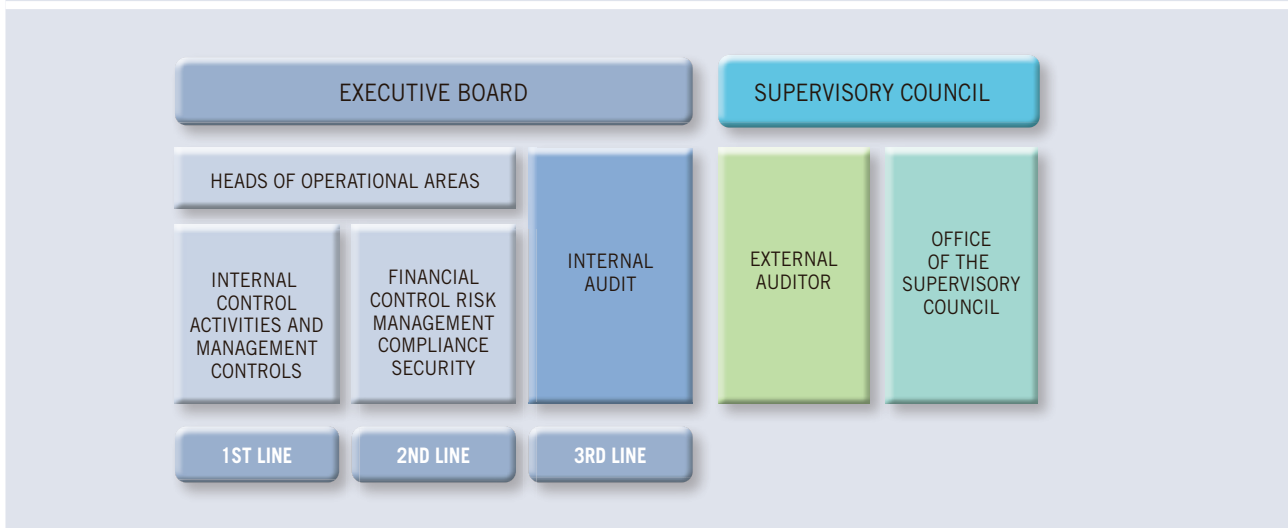
The Executive Board produces general strategic plans for a three-year period setting out challenges and priorities. It also considers strategies for the two operational areas. Together with statutory requirements and internal guidelines, these strategies provide guidance for the development of the Bank's operations.

In the strategy for 2014–2016, the Board attached importance to the Bank modernising and further developing its core activities. The Bank is to help set the standard internationally for the exercise of monetary policy, the monitoring and analysis of financial stability, and global investment management. The Board presents these strategies to the Council and provides further information on them. Performance against targets and action plans is reported through periodic operational reports and budget updates from the Board.

The Board lays down rules and principles for risk management and internal control at a general level for the whole of the Bank. The principles for risk management mark out a systematic and comprehensive approach. The Board sets a risk profile, risk limits and principles for risk management both for the Bank as a whole and for each individual operational area. Risk management is an integral part of operational management intended to help strike a balance between goals, risk and control measures. The Governor is to ensure adequate risk management and internal control on the basis of an assessment of relevant risks in accordance with guidelines issued by the Executive Board.

The governance structure entails a high degree of delegation to the operational areas. Each operational area draws up supplementary guidelines on implementation. The operational areas have established functions to co-ordinate and oversee risk management and compliance internally.

The Executive Board considers regular management reports during the year on the status of strategies, action plans and expenditure. It also considers reports on operational risk management and compliance. Critical incidents are to be reported to the Executive Board immediately.

FIGURE 7 CONTROL MODEL AT NORGES BANK (LINES OF DEFENCE)

1st line of defence: Functions in the operational departments that own risks and are responsible for managing risks and performing control activities in everyday operations.

2nd line of defence: Units with specialised control duties relating to governance, compliance and areas such as security and financial management. This second line must be independent of the operational first line. The second line identifies particular risks, contributes to the implementation of measures, monitors risks and control activities across the operational units, and is responsible for reporting on this to management.

3rd line of defence: Internal Audit was set up as an objective control and advisory function reporting directly to the Executive Board.

The Supervisory Council has discussed oversight of the overall management and organisation of the Bank's operations as part of its supervision. Various supervisory reviews have highlighted areas that could, from a governance perspective, be organised jointly at Bank level. The Council has also asked questions about the cost-effective use of resources and the potential for drawing on expertise and realising economies of scale across the operational areas. The Bank has established various joint meetings for the exchange of information and knowledge, especially on communication, human resources, compliance and physical security.

The Council has recommended that the Board considers clarifying roles and responsibilities for Bank-wide support functions in the light of Norges Bank being a single legal entity. The Board's creation of a General Secretariat and Central Executive Managers Forum may result in better follow-up of this recommendation.

Supervisory reviews of the Board's processes for the strategic management of the Bank have recommended that the Board considers clarifying operational targets in its future strategic work. The operational areas' reporting to the Board could also be tied more directly to strategic targets and action plans.

In its response to the Council, the Board comments that strategies have been made more concrete with operational targets in the annual action plans, which are then followed up in performance reporting. The Board plans to return to this in the coming strategy period. The Council will monitor developments through the Board's reporting on its work on a new strategy for 2017–2019.

THE EXECUTIVE BOARD'S RESPONSES TO AND FOLLOW-UP OF SUPERVISORY REVIEWS

The Executive Board sends the Council written responses to reports from supervisory reviews during the year. In addition, it has become an established practice for the Board to report annually on the status of the follow-up of the Council's supervisory reports.

In its letter of 10 March 2017, the Executive Board provides a status report on the follow-up of 12 supervisory reports, with more detailed responses to the recommen-

dations in nine of the supervisory reviews. Four of these are discussed later in this report under "The control structure at Norges Bank", "Management and control of the remuneration system in the management of the GPF", "Cost management in the management of the GPF" and "Framework for the management and control of tax costs in the management of the GPF – Norges Bank's tax position". The other reports were discussed previously in the Supervisory Council's annual reports for 2014 and 2015.

The Council monitors developments in the Board's consideration of supervisory reports. The Office of the Supervisory Council has been asked to review the Board's letters and come up with proposals for further follow-up of the recommendations in the individual supervisory reviews. Ascertaining whether previous recommendations have been acted on is an important part of the supervisory process and will be a priority in 2017.

THE CONTROL STRUCTURE AT NORGES BANK

It is very important to the Supervisory Council that the Executive Board and the Governor have in place appropriate structures for the overall control of the Bank's activities in line with applicable laws and regulations. Against the background of the supervision plan for 2016, the Office of the Supervisory Council has undertaken a review of the control structure at Norges Bank on the basis of established risk management principles.

The conclusions of the review have been drawn on the basis of the enterprise risk management model in the COSO framework and comparisons with generally accepted management and control practices. The organisation of overall management and control is also described in a control model⁴⁴ with three lines of defence. Under this model, the Executive Board and the Bank's management are to establish line functions, monitoring and quality assurance that together provide comprehensive internal control.

Norges Bank's control model is illustrated in Figure 7.

⁴⁴ ECIIA/FERMA, *Guidance on the 8th EU Company Law Directive, Article 41*

As part of the review, information was obtained on work on internal control at other central banks and comparable institutions, including through dialogue with the Bank for International Settlements (BIS) and the Swedish public pension fund Första AP-fonden. Relevant policy documents were used as the basis for the work, and interviews were held with key personnel in the management and follow-up of internal control at Norges Bank at both administrative and Board level. A number of issues were discussed with an external legal adviser.

The main conclusion of the review was that the Executive Board has established a control structure for Norges Bank and processes for following up internal control that comply with the Internal Control Regulation. It is nevertheless recommended that the Board considers whether overall responsibility for control work at Norges Bank and between NBIM and NBREM is sufficiently clear. The Board was advised to consider establishing a systematic and regular process for evaluating overall reporting to the Board tailored to its management and control duties.

The Board responds that it has a specific discussion of its working methods and duties each year. The level and quality of reporting to the Board is a fixed item in these reviews. The discussion documents for the most recent discussion of the Board's working procedures announced that a detailed review was to be made of reporting to the Board. This work is in the process of being completed when it comes to reporting on the GPF. There may be a need for an equivalent review of reporting from NBCBO.

Generally accepted principles⁴⁵ dictate that it is very important for the Board to establish independent risk and compliance functions with direct reporting lines. The Bank has not established an enterprise-wide function for the second line of defence when it comes to risk management and compliance: instead these duties are carried out by three separate departments at NBCBO, NBIM and NBREM. It was recommended that the Board considers reinforcing the independence of the compliance function through involvement in the recruitment process and direct follow-up.

In its response to the report, the Board notes that overall control work is well taken care of. A memo from the Governor to the Executive Board on the organisation of the Bank stresses the principle that effective risk management and control require knowledge, skill and familiarity with the Bank's operations. The Board therefore believes that risk management and control should be carried out close to operations, given the different nature and management structure of the operational areas, and given the need for clear responsibilities.

In the Board's opinion, the independence of the compliance functions is assured through the established reporting lines to the Board. The Board does not consider it to be an established market practice for boards themselves to conduct recruitment processes for the heads of risk and compliance functions. At the same time, a number of developments suggest that the Board should take a more central role in such recruitment processes. The Board will consider making changes at the Bank in the light of these developments.

The CEO of NBIM is responsible for the management of the GPF, which includes the management of real estate investments. When it comes to reporting by NBREM, the review found ambiguity in reporting lines and recommended that the Board clarifies them.

In its response, the Board notes that the job description issued by the Board requires the CEO of NBIM to delegate responsibility for the management of unlisted real estate investments to the CEO of NBREM. It is, however, stated clearly that overall responsibility for the management of the GPF rests with NBIM. In future, the Board will require all matters coming from NBREM to be approved by the CEO of NBIM before being submitted to the Board.

The supervisory report recommends that the Board considers establishing an independent external whistleblowing channel for the Bank. The Board comments that Internal Audit is the whistleblowing channel for NBCBO and NBIM. At NBIM and NBREM, the two compliance functions also serve as whistleblowing channels. These established whistleblowing channels may, where necessary, draw on external resources when considering cases. The

⁴⁵ BIS, *Corporate Governance Principles for Banks*

Board believes that this enhances the independence of their assessments.

The current arrangement with Internal Audit as a common independent whistleblowing channel is, to some extent, a result of following up the Supervisory Council's recommendations following a previous supervisory review.⁴⁶ The Board also notes that the government has recently appointed an expert committee to review and assess the whistleblowing rules. Among other things, the committee is to look at schemes with external whistleblowing channels. It may be wise to await the results of this work before the Board makes any changes to the whistleblowing scheme.

The Council has provisionally taken note of the Board's response and has asked the Office of the Supervisory Council to consider further follow-up of the Board's response.

SECURITY AND CONTINGENCY PLANNING

Good IT security, cybersecurity, physical security and contingency planning are a priority at Norges Bank. The Bank's operations are covered by the Security Act and the Document Security Instructions, and the requirements for security clearance of personnel and authorisation for access to information have been made more stringent. The Council considers it very important that the Bank's critical role in national security is addressed, and that the safety of employees and the protection of assets are given high priority.

The Executive Board has issued principles for security, contingency planning and crisis management at Norges Bank. For the Bank as a whole, there are joint rules to protect assets that are important to both NBCBO and NBIM. A joint contingency plan with a description of the crisis organisation at the Bank was introduced in 2016. The Governor has issued guidelines on physical security at the Bank to flesh out the Board's principles. Under these guidelines, a strategic threat analysis is to be performed and presented to the Board at least annually. The Council has been kept abreast of this work.

The revision of the overall guidelines for physical security has clarified the division of responsibility between the operational areas' security organisations. The heads of the operational areas have ultimate responsibility for security within each area. The guidelines from the Governor specify that some security tasks are to be handled for the whole Bank by NBCBO, and some tasks are to be performed by NBCBO as shared services. Regular meetings are to be held to enable the active exchange of security information between the operational areas.

Norges Bank works with security experts at the Storting, government ministries, the police, central and local government bodies and other relevant stakeholders both in Norway and abroad. The National Security Authority (NSM) oversees security at the organisations covered by the Security Act, which include Norges Bank. NSM carries out checks to ensure compliance with the Security Act's provisions on protective security services. Procedures are in place for reporting incidents to NSM under these rules.

Norges Bank works systematically on the basis of current potential threats, partly through an established contingency plan and by holding regular exercises. The Council considers it important that threat assessments are realistic and that contingency work is prioritised with plans for a range of scenarios.

Security matters are also monitored through ordinary management reporting and the Board's plans and budget proposals. In response to external events and assessments of potential threats, any necessary changes are to be made to contingency processes and control procedures to protect Norges Bank's assets and organisation. Extensive plans, instructions and agreements are in place covering the most extreme situations the country may face. Norges Bank as a critical institution is best placed to protect its assets.

The Council pays particular attention to security and contingency planning and has been kept informed about the Board's principles for this work. The Bank's priorities for measures to enhance security and contingency planning are discussed regularly. It has been noted that the greatest threats are associated with IT and outsourcing.

⁴⁶ Supervisory review of Internal Audit's work in 2013

Resources for implementing measures are allocated through annual budgets. In exceptional circumstances, the Board can cover the cost of safeguarding lives, health and major assets without any special allocation of funds, but a report must then be submitted to the Council. No such cases were reported in 2016.

WORKING ENVIRONMENT

A number of joint employee/employer committees have been set up to comply with the provisions of the Working Environment Act and agreements between employee organisations and Norges Bank. The Working Environment and Works Council helps promote a good working environment and ensure that the requirements of the Inclusive Workplace (IA) agreement are met.⁴⁷ It is chaired by the Central Bank Governor and the Chief Shop Steward in alternate years. Staff Consultation and HR Committees have also been set up to ensure communication, collaboration and staff consultation in agreements between employer and employees, one for NBCBO and one for NBIM. A Negotiation Committee is appointed for each collective agreement period to facilitate pay negotiations with employee organisations. The Supervisory Council considers the annual reports of the Working Environment and Works Council.

As part of its work on gender equality, the Executive Board has set targets for the percentage of female employees over rolling three-year periods. The Bank's work on gender equality is a long-term undertaking, and the goal is for at least 40 per cent of employees to be women. The current target for the share of women in NBCBO is 40 percent for both executive-level and non-executive employees. For NBIM, the target is 25 per cent for executives and 33 per cent for other staff. The differences in the targets are due to the availability of female candidates in some areas still being limited.

The Bank's annual report presents developments in gender equality and pay levels. The Council looks positively on the introduction and application of targets to achieve gender equality, but questioned the Bank's management about the achievement of the targets seeming to be taking longer than anticipated.

The Council is satisfied that relevant laws and agreements concerning the working environment have been observed and reported on.

NORGES BANK'S PENSION FUND

Norges Bank's Pension Fund was established by the Supervisory Council on 1 June 1916. The purpose of the fund is to pay pensions to members and other beneficiaries at the Bank. The fund may also provide pension arrangements for former employees of Norges Bank who have been transferred to other companies as a result of the transfer of activities.

The fund's articles of association are adopted by the Council.⁴⁸ Changes to the articles of association are to be approved by the pension fund's board and presented to Norges Bank and the boards of any member companies for information. Changes are also to be approved by the financial supervisory authority Finanstilsynet. The pension fund is a separate legal entity independent of Norges Bank.

The fund is headed by its own board with six full members plus alternates. Four full members and two alternates are appointed by the Executive Board of Norges Bank, at least one of whom must have no connection to the pension fund, the Bank or member companies. Two full members and their alternates are appointed by employee organisations. The fund's activities are supervised by Finanstilsynet.⁴⁹ The fund's board enters into an agreement with an actuary, who must be approved by Finanstilsynet and reports to Finanstilsynet.⁵⁰

⁴⁷ The government and the social partners signed a fourth letter of intent for a more inclusive workplace (IA Agreement) on 4 March 2014. Norges Bank has signed up to the agreement, which runs from 4 March 2014 to 31 December 2018.

⁴⁸ Adopted on 13 December 2007 and last amended on 25 November 2010. The articles of association and any changes to the articles of association must be approved by the King, cf. the Act on Insurance Companies, Pension Undertakings and Their Activities etc., Section 7-4.

⁴⁹ Act on the Supervision of Financial Institutions etc. (Financial Supervision Act), Section 1, first paragraph, item 15

⁵⁰ Act on the Supervision of Financial Institutions etc. (Financial Supervision Act), Section 1, first paragraph, item 15

Norges Bank guarantees the Bank's share of the premium reserve. The Council is keen for the pension fund to have good financial strength and generate good returns. The Council has been kept abreast of Norges Bank's appointment of members to the board and receives annual reports from the fund. The Bank provided a briefing at the Council's request on remuneration practices for the board's full members and alternates.

Norges Bank's pension scheme and changes to age limits and the retirement age mirror the Norwegian Public Service Pension Fund. In 2016, the Executive Board approved changes to age limits and the retirement age in line with changes in the Public Service Pension Fund. Among other things, the general age limit for service at Norges Bank was set at 70 years. The Council has taken note of Norges Bank's adjustments to the pension scheme.


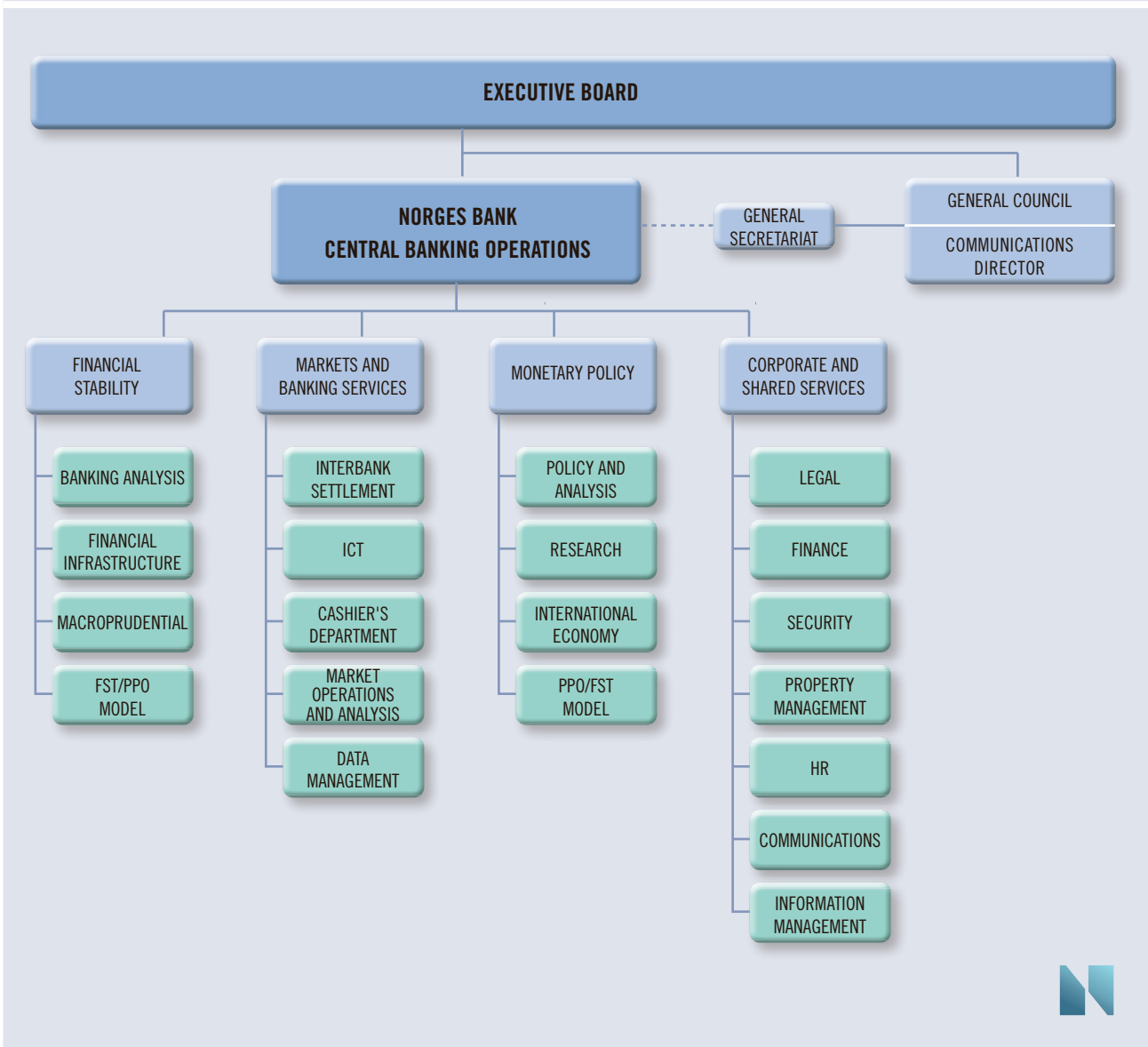


FIGURE 8 CENTRAL BANKING OPERATIONS ORGANISATIONS STRUCTURE



CHAPTER 4

SUPERVISION OF CENTRAL BANKING OPERATIONS

RESPONSIBILITIES AND ORGANISATION

Norges Bank's mission is to promote economic stability in Norway. The central bank has an advisory and executive role in monetary policy.⁵¹ It is also to issue banknotes and coins, promote an efficient payment system nationally and internationally, and monitor developments in the money, credit and foreign exchange markets.⁵² The Bank may undertake regular and public quotation of exchange rates pursuant to further rules laid down by the King, and is to invest the official foreign exchange reserves with a view to maintaining the foreign exchange policy that has been established.⁵³ This work is organised into three departments at Norges Bank Central Banking Operations (NBCBO): Monetary Policy, Financial Stability, and Markets and Banking Services.

The Governor has established an organisation and management structure with clear roles and responsibilities. When it comes to the execution of the Bank's core activities, the heads of department are responsible for risk management, internal control and financial management in their particular department. They also issue internal guidelines. The Corporate and Shared Services Department provides administrative support for NBCBO as well as functions and processes covering the whole of the Bank. A central Governance, Risk and Compliance (GRC) function has been set up to support the heads of department and the Governor in their work on managing operational risk and compliance. The management of rules and guidelines and the follow-up of incidents employ electronic tools that are available to all NBCBO employees.

NBCBO's organisation structure is illustrated in Figure 8.

⁵¹ *Norges Bank Act, Section 1, paragraph 1, second and third sentences: "The Bank shall be an executive and advisory body for monetary, credit and foreign exchange policy. It shall issue banknotes and coin, promote an efficient payment system domestically as well as vis-à-vis other countries, and monitor developments in the money, credit and foreign exchange markets."*

⁵² *Cf. Norges Bank Act, Section 1*

⁵³ *Cf. Norges Bank Act, Section 24*

SUPERVISORY ACTIVITIES AND CONCLUSIONS IN 2016

OVERSIGHT OF NBCBO BY THE EXECUTIVE BOARD AND GOVERNOR

The Executive Board reviews management reporting for NBCBO every six months. This includes the status of action plans and expenditure, operational risk, compliance and internal control. Based on the general principles for risk management at Norges Bank, the Executive Board has adopted risk management principles for NBCBO. The Board has also considered criteria for assessing the level of operational risk. The Governor has issued supplementary guidelines on risk management that include definitions of risk, management of incidents, responsibilities and reporting. Work on identifying and assessing risks is reported to the Governor on a quarterly basis.

The Office of the Supervisory Council held regular meetings with the GRC function during the year and discussed incidents and follow-up procedures. Any breaches of the rules or other incidents are included in the management reporting from the Executive Board to the Council. No significant breaches material to NBCBO were reported during the year.

The Council has been kept informed about the principles and guidelines for risk management. It is very important for the Council's supervision that there are documented procedures for reporting events and implementing risk reduction measures. The management of NBCBO is overseen through twice-yearly reporting by the Board and consideration of the Board's minutes. The status of action plans is considered together with the management reporting presented and the adoption of annual budgets for Norges Bank.

The Board has issued principles for bonus arrangements at NBCBO, and the Governor issued supplementary guidelines in 2016. The scheme covers employees of NBCBO who have individual portfolio management mandates and currency mandates in the management of the foreign exchange reserves. The scheme must not encourage employees to take unnecessary risks or prioritise activities that may trigger bonus payments.

In 2016, the Governor updated the general principles for handling market-sensitive information that apply to NBCBO employees. Market-sensitive information covers not only information defined as “inside information” in the Securities Trading Act but also information that may have a bearing on market pricing and market conditions and that is confidential or exempt from public access. There are also special rules for information classified as confidential or strictly confidential under the Document Security Instructions.⁵⁴

The Council kept abreast of the amendments to the principles through its consideration of the Board's minutes.

MANAGEMENT OF INTERNATIONAL RESERVES

Norges Bank's international reserves consist of foreign exchange reserves and International Monetary Fund (IMF) reserve positions. The foreign exchange reserves are the Bank's contingency funds in international currency and are to be available for conducting monetary policy, promoting financial stability and meeting the Bank's international commitments to the IMF and individual countries.⁵⁵

The reserves make up around 90 per cent of the Bank's assets excluding the GPF. Their market value at the end of 2016 was NOK 480.9bn (2015: NOK 470.1bn). The foreign exchange reserves comprise a petroleum buffer portfolio, a fixed-income portfolio and an equity portfolio. The petroleum buffer portfolio receives the state's foreign-currency cash flows from petroleum activities and any transfers from the GPF. Until 1 December 2016, the fixed-income portfolio consisted of a money market portfolio and a long-term portfolio.

The Governor has issued guidelines for the petroleum buffer portfolio and for the management of the fixed-income portfolio. Guidelines have also been introduced for transfers from the equity portfolio to the fixed-income portfolio in the event of a need to enhance the Bank's preparedness. Considerable importance is attached to liquid-

ity. Norges Bank is exposed to various types of financial risk in its management of the foreign exchange reserves, primarily market, credit and counterparty risk. The Bank is not exposed to liquidity risk in Norwegian kroner.

Until 1 December 2016, the equity portfolio and the long-term portfolio were managed by NBIM, while the money market portfolio and the petroleum buffer portfolio were managed by NBCBO. From 1 December 2016, all fixed-income management for the foreign exchange reserves has been brought together under NBCBO. This reorganisation was undertaken mainly to strengthen NBCBO's preparedness for financial crises. This concentration of fixed-income management may also bring increased market insight and so ensure useful information for the Bank's work on monetary policy and financial stability. The Board decided on these changes, which take the form of updated principles for the management of the foreign exchange reserves.⁵⁶

The Council has monitored the changes in the organisation of the fixed-income portfolio and attaches importance to the organisation realising the management objective, strategy and risk profile for the foreign exchange reserves. In answer to questions at meetings, the Governor provided information on the adjustment of the Board's principles and on the cost of transferring the management of the fixed-income portfolio.

The Council has considered reports from the Board on financial risk and the management of the foreign exchange reserves. The reserves remained within the maximum limits for risk set by the Governor throughout the year. The Council notes that the Board and Governor are actively engaged in this important area for the central bank.

MONETARY POLICY AND FINANCIAL STABILITY

Banks may deposit excess liquidity at Norges Bank, or obtain sufficient liquidity for the settlement of payments at the Bank by borrowing against collateral in the form securities. At the end of 2016, banks had net deposits at the

⁵⁴ *Instructions for the Handling of Documents Requiring Protection for Reasons Other than those Stipulated in the Security Act and Associated Regulations (Document Security Instructions).*

⁵⁵ *This corresponds to the IMF definition of foreign exchange reserves.*

⁵⁶ *Laid down by Norges Bank's Executive Board on 23 January 2013, pursuant to Section 10, first paragraph, and Section 24 of the Norges Bank Act. Last amended 27 January 2016.*

Bank of NOK 52,846bn. The interest rate paid on banks' deposits at the Bank is the most important rate in the conduct of monetary policy (key policy rate).

The Bank issues criteria for deposits and borrowing through its regulation on banks' access to lending and deposit facilities at the Bank.⁵⁷ In 2016, the Bank revised the criteria for banks and credit institutions with cross-border operations in Norway. New criteria were also introduced for the collateral for loans. Changes to the regulation are made after consulting the trade organisation Finance Norway and the financial supervisory authority Finanstilsynet, among others.

The Supervisory Council does not supervise the Executive Board's technical assessments, advice or exercise of discretionary authority,⁵⁸ but keeps itself informed through the Board's minutes and the Governor's presentations at meetings on the current economic situation.

In accordance with the regulation on the countercyclical capital buffer⁵⁹, Norges Bank produces documentation as a basis for decisions and gives the Ministry of Finance advice quarterly on the level of this buffer at the banks. Vulnerability in the bank sector is analysed continuously. The requirement of a 1 per cent countercyclical capital buffer⁶⁰ forms part of the overall capital requirements for banks.

The Council is informed about the Bank's monetary policy report with an assessment of financial stability, which is published four times a year. The report contains the Board's assessment of the outlook for the key policy rate and the required countercyclical capital buffer at banks. The Council also receives the Board's annual report on financial stability, which looks more closely at long-term and structural trends in the banking system.

Through its review of the Board's minutes, the Council followed the Bank's consultation responses in 2016,

⁵⁷ Issued pursuant to Sections 19 and 20 of the Norges Bank Act

⁵⁸ Cf. Norges Bank Act, Section 5 fourth paragraph.

⁵⁹ Ministry of Finance, laid down by Order in Council on 4 October 2013

⁶⁰ The recommendation from Norges Bank is to build and maintain a buffer of 1 per cent from 30 June 2015 and 1.5 per cent from 30 June 2016. At its meeting on 14 December 2016, the Executive Board decided to issue a new recommendation to increase the required buffer to 2 per cent from 31 December 2017.

including those on crisis management in the bank sector and new legislation on a debt registry. The Council pays particular attention to developments in new payment systems and the Bank's role in this context. The content of these reports is technically outside the Council's supervisory responsibilities, but provides important background information on the Bank's core activities and the implementation of processes in this area.

NORGES BANK'S SETTLEMENT SYSTEM

Payment transactions between banks in Norway are settled through accounts at Norges Bank. The central bank is the top level of Norges Bank's settlement system (NBO) and is tasked with promoting efficiency and security in the payment system. The payment system and financial infrastructure provide a critical function for society. NBO is therefore covered by the Security Act's requirements for the protection of "sensitive objects".⁶¹ NBO must comply with, and report in line with, relevant international standards.

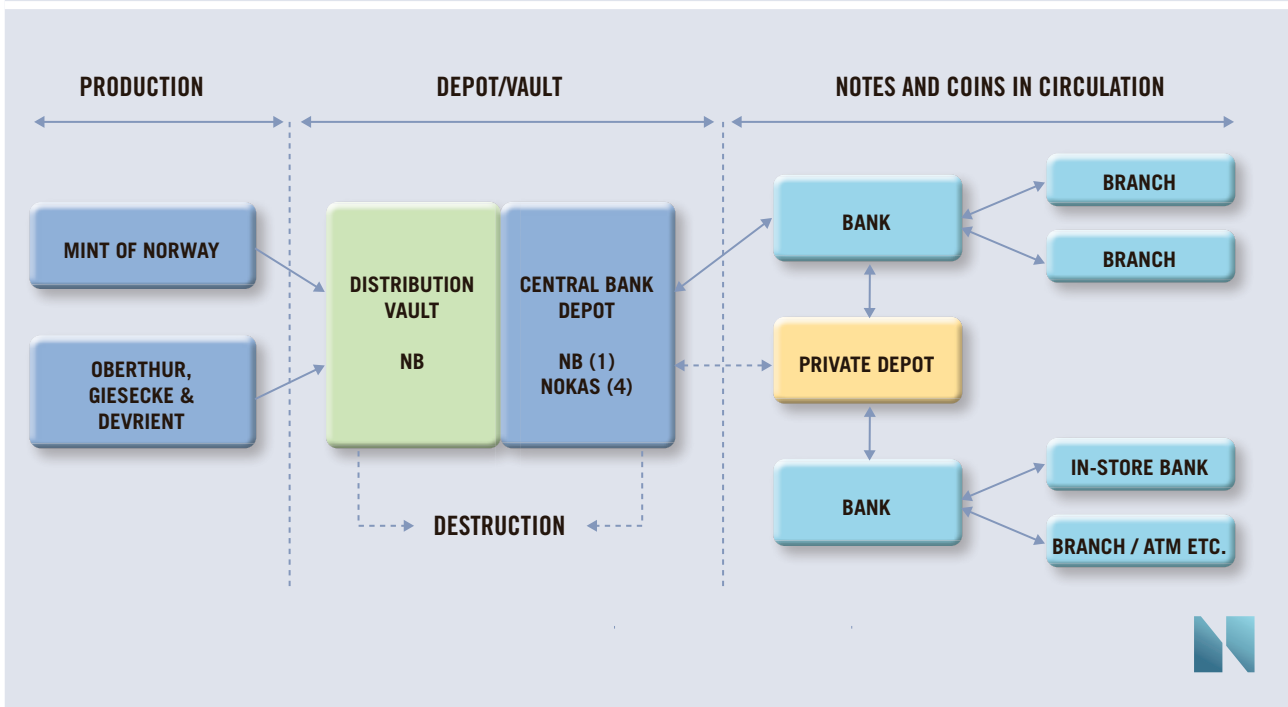
The National Security Authority (NSM) oversees whether the requirements for security measures are met. The Bank receives supervision reports from NSM, and any nonconformities are addressed and followed up through general reporting on security. Norges Bank is not formally covered by Finanstilsynet's ICT regulations, but uses them as a management framework for its operation and development of ICT solutions for the settlement system.

2015 saw a supervisory review of the management and control of cybersecurity⁶² in NBO. The development and operation of the settlement system rely on components from multiple suppliers. The management of security both at Norges Bank and at suppliers in relation to NBO was examined. One recommendation was that the Bank should strengthen its work on managing cybersecurity. The central bank has drawn up a plan of action to follow up the recommendations in the report. The Board's response to the report referred to its work on new strategies for 2017–2019.

⁶¹ Security Act, Section 17. The Critical Asset Regulations contain requirements for the selection, classification and protection of assets defined in the Security Act as being of critical national importance.

⁶² The term "cybersecurity" is an extension of the concept of information security and reflects society's ever-growing dependence on IT systems.

FIGURE 9 MODEL FOR THE SUPPLY OF NOTES AND COINS



The average daily volume of payments handled by the settlement system in 2016 was NOK 221bn. Suppliers' control procedures are documented in annual reports⁶³ which are reviewed by, and contain important information for, Norges Bank and the external auditor. Security exercises are carried out each year.

At meetings, the Council asked for the Governor's assessment of the market for the provision of IT services for the central bank, and of the risk assessments that are performed when outsourcing. The Bank regularly reviews its contracts with suppliers and is mindful of the risk associated with having only a small number of players to choose between. The operation of the settlement system takes place in Norway, but the technical systems used are developed and maintained by foreign IT companies.

The Board regularly reviews risk assessments and incidents relating to NBO. The annual report for 2016 confirms that the operation of the settlement system was stable with no serious disruptions. The Council has been kept informed about contingency planning and significant operational events. The Bank's annual report on the settlement system and public report on financial infrastructure for 2016 will be considered later in 2017.

The Council notes that the Board pays considerable attention to stable operation and IT security and will keep abreast of the supplier situation.

NORGES BANK'S ROLE AS ISSUER OF BANKNOTES AND COINS

Norges Bank has a sovereign right to issue Norwegian banknotes and coins. This role is set out in the Norges Bank Act. The issuance and supply of cash involves processes such as the design and production of new notes and coins, stock management, transport, destruction of worn and obsolete notes and coins, and distribution to banks in Norway. The Executive Board decides on the issue of jubilee and commemorative coins under authority delegated by the Ministry of Finance.

Norges Bank's distribution warehouse is a "sensitive object" under the Security Act. High levels of security have been established with internal control processes and oversight by Internal Audit, the external auditor and the Office of the Supervisory Council. The Board and the Governor have issued general internal guidelines on governance, risk management, security, public procurement and other areas relevant to the management of the supply of notes and coins. The Governor's new guidelines on physical security at the Bank include general requirements for security standards in vaults and premises that also apply to central bank depots and suppliers' warehouses.

The central bank is responsible for promoting an efficient payment system and ensuring that the public has the necessary access to cash. The public must also be confident that the cash in circulation is genuine. In its operational work, the Bank largely plays the role of a wholesaler, with production and distribution carried out by various suppliers under long-term contracts. The issue and supply of notes and coins is an area that is effectively reserved for central banks. Producers and service providers are limited in number. The risk in such a model is associated with the processes for concluding contracts, the monitoring of suppliers and any shortcomings in their performance. Figure 9 illustrates the model for the supply of notes and coins.

⁶³ *Assurance Reports on Controls at a Service Organisation, issued by the external auditor at Evry ASA in accordance with International Standard on Assurance Engagements (ISAE) 3402.*

Notes and coins in circulation outside Norges Bank amounted to NOK 50.5bn at the end of 2016, down around NOK 2.6bn on a year earlier. The Council considers the Bank's annual reports on notes and coins and relevant management reporting. The Council has discussed the security and availability of cash in Norway. The Council is particularly concerned with the considerable inherent risk of irregularities and external threats associated with cash. No significant nonconformities with established procedures were reported in 2016.

The Office of the Supervisory Council performed a review of Norges Bank's role as issuer of notes and coins in accordance with the approved supervision plan for 2016. The aim was to assess whether Norges Bank has established appropriate regulatory and operational structures for its role as supplier of cash.

The main conclusion of the report is that the Board and Governor closely monitor Norges Bank's role and responsibilities in the supply of cash. An extensive model has been established for ensuring management and control through requirements set by Norges Bank and contracts with suppliers. The Bank's procedures and control processes in this area are considered to be organised at the level of comparable central banks in Europe. The supply model established helps the Bank fulfil its role by breeding confidence in Norwegian notes and coins as a secure means of payment.

The Council endorsed the conclusions of the supervision report concerning Norges Bank's role as issuer of notes and coins. The report was submitted to the Executive Board for information.

The Council has been kept informed about, and approved resources for, the ongoing project to develop a new bank-note series. The plan is for the first denominations to be available to the public in the second quarter of 2017.

In connection with the new Financial Institutions Act, Norges Bank together with Finanstilsynet advised the Ministry of Finance on contingency planning in the payment system.⁶⁴ Public access to cash is based on Norges Bank supplying banks, which then supply their customers in turn. Clarifying the banks' responsibilities for ensuring that customers can access their accounts by depositing and withdrawing cash is important. These rules are very important to the public given the risk of a failure in electronic payment services or uncertainty about access to funds being blocked in some other way.

The Council looks positively on the Bank working with Finanstilsynet and the Ministry of Finance to establish clear rules covering every stage of the cash supply chain. Following an overall assessment, the Council is of the opinion that adequate management and control of roles and responsibilities has been established in the area of notes and coins.

A number of central banks, including Norges Bank, are assessing the development of new ways of supplying cash through the use of electronic, digital or virtual central bank money. It will be natural for the Council to monitor this work in its future supervision.

GOVERNMENT ACCOUNTS AT NORGES BANK

Central government deposits at Norges Bank amounted to NOK 147.2bn at the end of 2016. The agreement entered into with the Ministry of Finance on the management of the government's accounts at the Bank was adjusted in 2016. This work is to be performed in accordance with the regulations on financial management in central government and the guidelines for settlement accounts in the group account system. The Bank is responsible for implementing and overseeing the agreement's stipulations on security, backups and emergency procedures, including tasks performed by external suppliers of operational and account management services.

⁶⁴ On 31 January 2017, the Ministry of Finance sent out for consultation a proposed regulation from Finanstilsynet and Norges Bank on banks' responsibility for cash distribution in a crisis. The proposed regulation is intended to ensure that banks meet their obligation under Section 16-4 of the Financial Institutions Act.

Under the agreement with the Ministry, an annual independent assurance statement is to be obtained on Norges Bank's compliance with operational, security and contingency planning requirements. Deloitte AS has issued such a statement with an assessment of control procedures for 2016. The statement, which has a positive conclusion, has been noted by the Council and forwarded to the Ministry of Finance.

MANAGEMENT OF GOVERNMENT DEBT

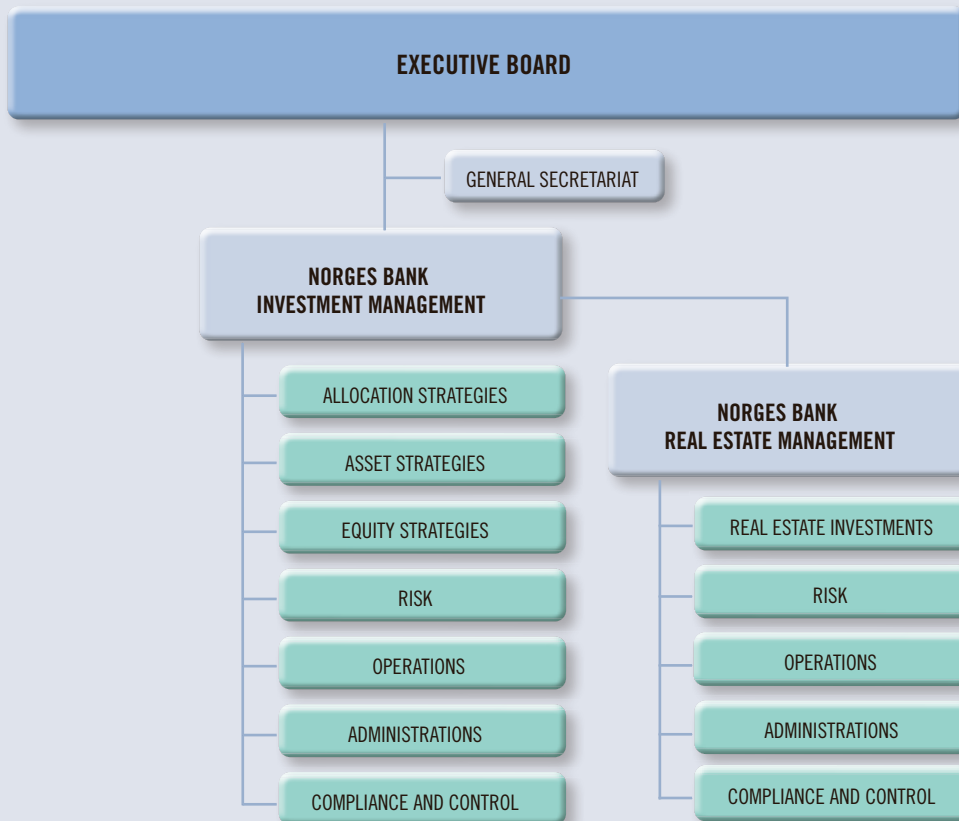
Norges Bank provides banking services for the state, state-owned banks and publicly owned funds, and provides services in connection with the issue and management of government debt under an agreement with, and mandate from, the Ministry of Finance. The agreement on the management of the government's accounts at Norges Bank also covers these services. An annually agreed fee is received from the Ministry.

Government debt forms part of the central government accounts and is not included in Norges Bank's financial statements. Quarterly reports are submitted to the Ministry of Finance and published by Norges Bank.

The rules on financial management in the central government sector require all entities to establish systems and procedures with inbuilt internal control. This also applies to tasks delegated to others. At the request of the Ministry of Finance, an independent assurance review was performed of the framework and processes for accounting and payments in the management of government debt. Deloitte AS submitted an assurance report⁶⁵ with a positive conclusion, which has been noted by the Supervisory Council and forwarded to the Ministry of Finance. In addition, the Office of the Auditor General received a report from Deloitte AS on control procedures relating to the accounts for government debt management.

⁶⁵ Assurance engagement under ISAE 3000

FIGURE 10 NBIM ORGANISATION STRUCTURE



CHAPTER 5

SUPERVISION OF INVESTMENT MANAGEMENT

RESPONSIBILITIES AND ORGANISATION

The operational management of the Government Pension Fund Global (GPFG) is carried out by NBIM. The management of the foreign exchange reserves is discussed earlier in this report.

Norges Bank manages the GPFG in accordance with the Government Pension Fund Act and the management mandate and guidelines for the GPFG. The GPFG takes the form of a krone deposit at Norges Bank and is only invested abroad. The mandate requires the Bank to invest the fund in its own name in a portfolio consisting primarily of equities, bonds and unlisted real estate. The aim of these investments is to generate the highest possible return after costs with moderate risk and within the other constraints that apply to the management of the fund.

The Ministry of Finance has defined the overall objective for the GPFG in the management mandate: *“The Bank shall seek to achieve the highest possible return after costs measured in the investment portfolio’s currency basket and within the applicable management framework.”*⁶⁶ The Ministry has stipulated a benchmark index from which the Bank is permitted to deviate slightly (1.25 per cent relative volatility).

The Executive Board is to have a strategic plan for the execution of its management assignment. This plan is to be updated regularly and in the event of significant changes in the management of the fund. The Board is to evaluate regularly the extent to which the targets in the strategic plan have been achieved.⁶⁷

The market value of the GPFG’s investments increased by NOK 35bn in 2016 to NOK 7,510bn. At the end of the year, the GPFG’s investments comprised 62.5 per cent equities, 34.3 per cent fixed-income instruments and 3.2 per cent unlisted real estate. Oil revenue of NOK 3,397bn has been transferred to the fund since its inception. The return on the fund over the same period has been NOK

3,123bn. In 2016, money was withdrawn from the fund for the first time. These withdrawals totalled NOK 101bn.

The Executive Board has issued a job description and an investment mandate for the CEO of NBIM. He is responsible for NBIM’s leadership, investment management and development, and reports directly to the Board.

The management of unlisted real estate investments is organised in a separate department: Norges Bank Real Estate Management (NBREM). The CEO of NBREM is appointed by the Executive Board on the recommendation of NBIM’s CEO and reports to NBIM’s CEO. The mandate and job description for NBREM’s CEO are issued by NBIM’s CEO. The latter has overall responsibility for all matters put before the Executive Board, including those concerning real estate management.

Separate risk management units and units to ensure compliance with laws, regulations, mandates and guidelines have been set up at both NBIM and NBREM.

NBIM’s organisation structure is shown in Figure 10.

Operations are led from Oslo. NBIM also has offices in London, New York, Singapore and Shanghai, while NBREM has formed four wholly-owned administrative and operating subsidiaries in Luxembourg, Singapore, London and Tokyo. Investments in real estate are held through holding structures in the US and the UK and under the Luxembourg subsidiary. The companies with legal title to the properties may be subsidiaries or associates.

The mandate for the GPFG requires Norges Bank to report publicly on various aspects of its investment performance. Three quarterly reports and an annual report were published in 2016. The Bank also published reports on responsible investment, real estate management, and performance and risk.

⁶⁶ *Management Mandate for the Government Pension Fund Global, Section 1-3: “The management objective”.*

⁶⁷ *Cf. Management Mandate for the Government Pension Fund Global, Section 1-7*

SUPERVISORY ACTIVITIES AND CONCLUSIONS IN 2016

THE EXECUTIVE BOARD'S OVERSIGHT OF THE MANAGEMENT OF THE GPFG

The management mandate for the GPFG requires the Executive Board to have a strategic plan for the execution of its management assignment.⁶⁸ This plan is to be updated regularly and in the event of significant changes in the management of the fund. The Board adopted a strategy for the GPFG for 2014–2016. The most important objective for this period was for Norges Bank's investment management to help safeguard the fund's assets for future generations. Advantage is to be taken of the fund's special characteristics – above all its size and long-term horizon – to deliver good returns. 2016 brought work on a new strategy for the management of the fund for the period 2017–2019.

The Board is to evaluate regularly the extent to which the goals in the strategic plan have been achieved. The Board presented its evaluation of the 2014–2016 strategy period in a letter to the Ministry of Finance. The Board's conclusion was that the goals in the strategic plan were largely achieved.

Norges Bank has an advisory duty and a right to express an opinion when it comes to the GPFG's investment strategy and changes to the mandate for the GPFG. Its advice in letters to the Ministry of Finance is on the public record. The Council is kept informed about such advice and opinions.

The annual report on the management of the GPFG contains the Board's assessment of the results achieved.⁶⁹ In the report for 2016, the Board expresses its satisfaction that the various strategies have together produced an average annual excess return before management costs of 0.20 percentage point since 2013, but considers it important also to assess performance over a longer period. In 2016 in isolation, asset management strategies made a positive contribution to the fund's relative return, whereas security selection and fund allocation strategies pulled it down. The Board also expresses satisfaction that the return on the

fund's equity and bond portfolio has exceeded the benchmark return over time.

The Council has taken note of the Board's assessment.

Changes to the mandate of the GPFG are implemented through regular updates of internal guidelines. The Board establishes principles and issues supplementary provisions and limits in the investment mandate for NBIM's CEO. In 2015, the Board created and awarded a mandate to a new Real Estate Investment Board (REIB), which is chaired by NBIM's CEO and has five members. The Board appoints two external members for a term of one year which may be extended. Investment decisions above USD 750m must be approved by the REIB. Single investments above USD 1.5bn must be approved by the Executive Board after being considered by the REIB and the Executive Board's Risk and Investment Committee.

The Board has issued principles for operational risk management at NBIM that include a financial tolerance limit. The principles are subject to regular review, and the Council is kept updated.

There is considerable interest in the performance of the GPFG. The mandate requires internationally accepted standards to be used for valuation, performance measurement and the management, measurement and control of risk. Key return data are provided in the notes to the quarterly and annual reports for the GPFG and Norges Bank's annual financial statements.

The Executive Board oversees investment management partly through periodic reports on return and risk, operations, compliance and internal control. These reports are forwarded to the Council. As part of the Council's consideration of the quarterly reports, presentations are given on investment management activities, performance and risk. The Council is satisfied that there is considerable transparency in the reporting of unwanted events. There was an increase in such incidents in 2016, but the financial consequences are considered to be insignificant. No significant breaches of compliance with the mandate and the guidelines for the management of the GPFG were reported during the year.

⁶⁸ Management Mandate for the Government Pension Fund Global, Section 1-7.

⁶⁹ Management Mandate for the Government Pension Fund Global, Section 6-2.

The Council is keen for the organisation of Norges Bank to ensure overall responsibility for the management of the GPFG through clear reporting lines to the Executive Board. There has been particular discussion of the division of responsibilities between the CEOs of NBIM and NBREM. The Council has asked whether the creation of a separate real estate department may entail a risk of doubling up on administrative functions and cost increases, and whether cost management may be less well co-ordinated as a result of this structure.

RETURN AND RISK

The mandate requires the Bank to aim for the highest possible return after costs in its management of the GPFG. Each year, NBIM publishes a report on return and risk, which includes a presentation of the principles for risk-adjusted return data and compliance with the management mandate's requirements for reporting on risks and returns.

In 2016, the Council followed up the conclusions of a supervisory review in 2015 which found that overall objectives for the management of the GPFG have been established in accordance with leading practice. However, it was noted that the Executive Board should consider establishing a set of Key Performance Indicators to systematise the oversight of investment management. For example, it might consider concrete return targets and targets for the use of the risk limits set by the Ministry of Finance. The Board responded to this by referring to the work on the new strategy for the GPFG for 2017-2019.

In its status report on the follow-up of supervisory reviews⁷⁰, the Bank states that in the new strategic plan the Executive Board attaches importance to justifying the choice of investment strategies in the management of the fund. Particular importance is attached to how the strategies leverage the fund's special characteristics and NBIM's management strengths. The strategic plan also describes the purpose of the different strategies. Some strategies are intended to improve the trade-off between the fund's absolute return and risk, while others focus on maximising the fund's long-term return.

Letters from the Executive Board on return and risk were received each quarter in 2016. In its consideration of these letters, the Council noted instances of negative relative returns, and there was particular discussion of the persistently low use of the risk limits in the mandate from the Ministry of Finance. The Governor provided information on the Board's oversight of the different strategies. He also replied to questions about the Board's monitoring of country risk in the light of the downgrading of Brazilian bonds and the effects of the UK referendum on EU membership ("Brexit") and other geopolitical risks. Information was also provided on the risks to the bond portfolio from low interest rates.

MANAGEMENT AND CONTROL OF THE REMUNERATION SYSTEM IN THE MANAGEMENT OF THE GPFG

The management mandate for the GPFG contains general requirements for the establishment of a remuneration system for employees at NBIM.⁷¹ The mandate also states that the regulation on remuneration schemes at financial institutions applies to Norges Bank subject to "necessary adaptations".⁷² The regulation contains requirements not only for how the remuneration system is established and monitored, but also for the components it may include. If the framework for the management and control of the remuneration system does not comply with regulations or best practice, this could have a negative effect on Norges Bank's reputation.

In line with the management mandate for the GPFG, the Executive Board has issued guidelines and limits for the remuneration system for NBIM employees. The system must contain special provisions for senior executives and various other employee groups whose work involves control tasks and risk exposure. The aim is to help promote and create incentives for good management and control of risks in investment management, avoid excessive risk exposure and prevent conflicts of interest. The remuneration system is to be designed such that it creates an

⁷¹ *Management Mandate for the Government Pension Fund Global, Section 5-2.*

⁷² *The Regulation on Remuneration Systems at Financial Institutions, Securities Companies and Securities Fund Managers of 1 December 2010. The regulation implemented EU requirements for remuneration schemes. From 1 January 2017, this regulation ceased to apply, and remuneration systems are now regulated instead in Chapter 15 of a new Regulation on Financial Institutions and Financial Groups.*

⁷⁰ Cf. the aforementioned letter of 10 March 2017

incentive structure aligned with the organisation's overall objectives, risk tolerance and long-term interests. Excessive pay levels that are not aligned with goals and strategies could push up costs without the organisation's strategic goals being achieved. If pay and remuneration levels are too low, on the other hand, there is a risk of failing to attract and retain the desired expertise.

Based on proposals from the Remuneration Committee, the Executive Board sets intervals for executive pay, and NBIM's CEO sets a fixed salary for each executive in the leader group. Only staff who work on investment decisions and analyses, or execute trades and transactions, receive performance-based pay. Information on the remuneration system in the management of the GPFG is published on NBIM's website and discussed in Norges Bank's annual reports.

The Office of the Supervisory Council conducted an assessment of the remuneration system at NBIM in 2016. The review revealed that the Executive Board has set general limits and oversees the system at NBIM in accordance with applicable rules. The report recommended that the Board conducts a detailed review of the principles for the remuneration system to ensure that they are aligned with the objectives and strategy for the management of the GPFG.

The Council endorsed the conclusions of the report, which was forwarded to the Board for its consideration. In its response, the Board took note of the recommendation for a detailed review of the principles for the remuneration system to ensure that they are aligned with the objectives and strategy for the management of the GPFG. The Board's principles for remuneration are revised at least annually. Senior executives at NBIM and NBREM do not receive bonuses. The report's recommendations will be considered during the next review, including requirements for minimum vesting and payment periods and principles for performance-based pay in real estate management.

In connection with the report from this supervisory review, the Council also considered the Board's review of the remuneration system in 2016. Internal Audit issued a statement on compliance with regulatory requirements concerning remuneration. A revised mandate for the

Remuneration Committee was also presented. The Council discussed the Board's annual review and took note of it.

The Council will continue to monitor the Board's work on remuneration arrangements.

COST MANAGEMENT IN THE MANAGEMENT OF THE GPFG

With assistance from Oliver Wyman AB, the Office of the Supervisory Council conducted a review of cost management in the management of the GPFG in 2016. The aim was to assess the Executive Board's rules and processes for managing cost levels.

Norges Bank's costs for the management of the GPFG have increased with the size of the fund and new tasks. The budget for 2016 assumed that total management costs at NBIM would rise from NOK 3.3bn to an estimated NOK 4.8bn during the 2014–2016 strategy period, or from 5.8 to 6.3 basis points of assets under management. Actual management costs in 2016 came to around NOK 3.9bn, almost NOK 1bn less than budgeted. The main reason for these lower costs was a reduction in performance-based fees as a result of weaker results than expected.

One key provision in the Supervisory Council's budget rules for Norges Bank is that the Bank's use of resources *“shall be cost-effective and ensure that the Bank's operations and management of assets and wealth are conducted responsibly.”* Another requirement is that cost levels must *“be commented on in the light of established strategies and objectives and available external comparisons”*. Key decisions that increase costs must be presented with cost-benefit analyses.

The Executive Board's financial rules for Norges Bank specify that the relationships between strategy, activities and expenditure must be made clear. The strategic plan attaches importance to expenditure being sober and responsible. The Board establishes the premises for cost levels in the management of the GPFG by issuing strategies and objectives.

The supervisory review included an assessment against best practice at comparable institutions. It found it positive

that the Board has established a target for internal management costs, but that this limit should serve as a clear benchmark in the budget. The supervisory report recommended that the Board considers including concrete cost-benefit analyses and scenario analyses more systematically in strategy and budgeting processes. Norges Bank uses an external benchmark for costs in its budget proposals, primarily the Ministry of Finance's CEM analysis. This analysis is not adjusted for the strategic choices that Norges Bank has made, and does not therefore shed light on efficiency in the execution of the strategies.

A model showing what drives costs in an organisation is presented in Figure 11. The model at Norges Bank is compared with a standard cost management model.

The supervision report recommends that the Board concretises the requirements in the budget rules for cost-effective use of resources in its financial rules, and considers providing further guidance on managing cost levels. The Board should also consider establishing additional key figures for cost management and regularly check whether the external cost benchmarking used is relevant.

The Council endorsed the conclusions and recommendations of the supervisory review, and forwarded the report to the Board.

In a letter to the Council on the recommendations in the report, the Board responded that more systematic use of cost-benefit analyses would be introduced as part of the new strategy for the management of the GPFG for the period 2017–2019. This will ensure good insight into the consequences of different choices. The Board refers to analyses from CEM Benchmarking which compare the fund's costs with those of other funds around the world on behalf of the Ministry of Finance. Concerning the Council's recommendation that it consider the relevance of external cost benchmarks, the Board replies that the CEM analysis is the best source, and also that it is difficult to make adjustments for strategic choices. The Board will nevertheless consider establishing key figures that can complement existing reporting on costs.

In its status report on the follow-up of supervisory reviews⁷³, the Board also states that it aims to review the Bank's financial rules during the first half of 2017 to concretise the requirements for cost-effective use of resources, including requirements for cost comparisons.

The Council noted that the Board will be acting on the recommendations from the supervision report. The Board was asked to present cost comparisons when submitting its budget for 2017. Reference was made to the supervisory review in the Council's consideration of the budget, as discussed later in this report.

FRAMEWORK FOR THE MANAGEMENT AND CONTROL OF TAX COSTS IN THE MANAGEMENT OF THE GPFG – NORGES BANK'S TAX POSITION

Norges Bank's activities are exempt from tax in Norway but are taxable in a number of countries where investments are made. The Council attaches importance to tax issues and to compliance with the rules in this area.

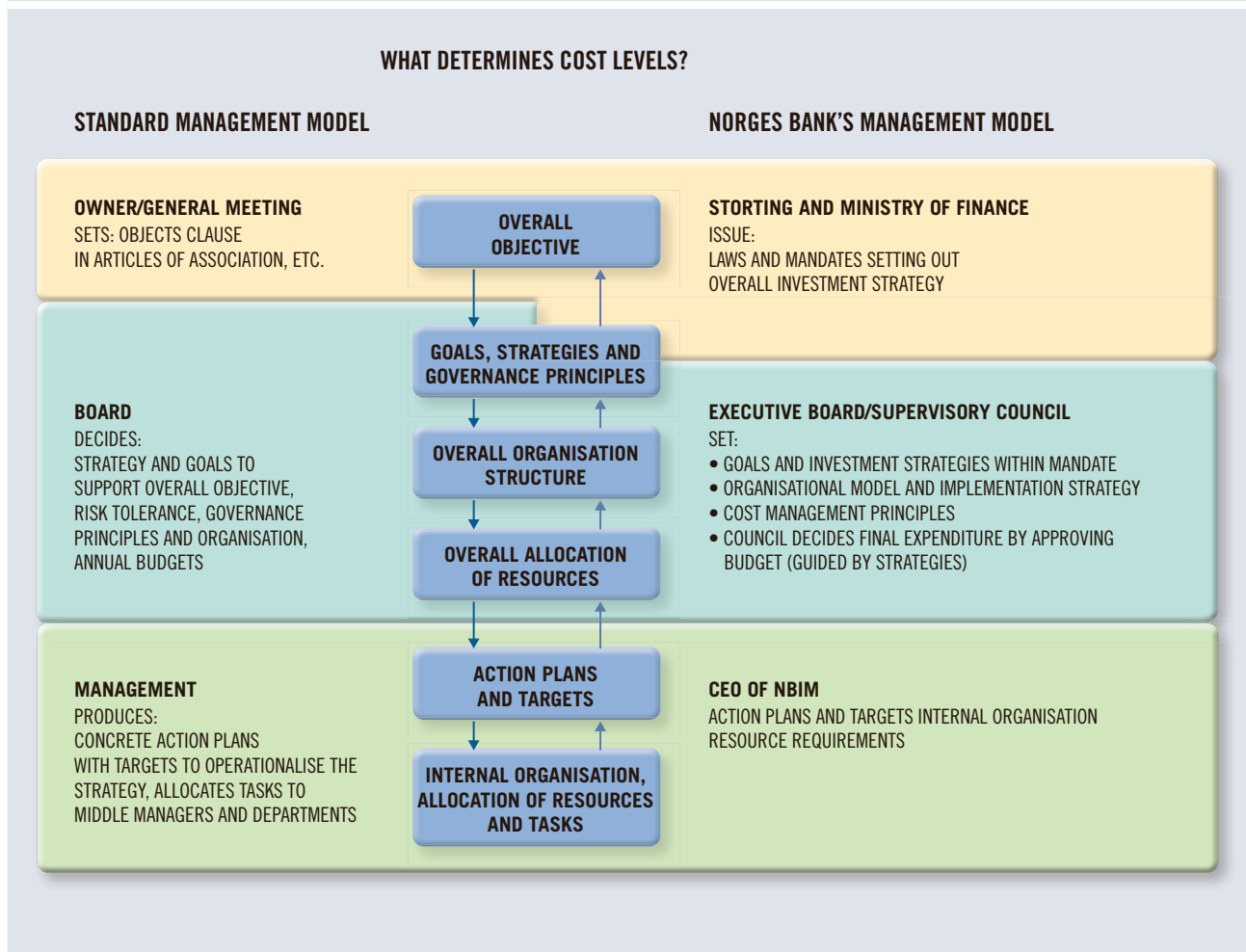
Norges Bank's risk management and control framework for tax matters was assessed in 2016 in an assurance assignment by Deloitte AS in conjunction with the Office of the Supervisory Council. It looked at the risk management and control mechanisms put in place to ensure compliance with relevant laws and rules. Monitoring of financial and reputational risk was assessed together with internal division of roles and responsibilities, risk tolerance and follow-up systems in the area.

The review also covered the Bank's openness about tax. Disclosure practices were assessed against central tax transparency initiatives, the expectations of authorities, NGOs and society in general, and Deloitte's experience of market practices.

The assurance report from the supervisory review concludes that the Bank has designed and implemented a framework for tax risk management and control that essentially conforms with best practice in Norway and abroad. The Executive Board and the CEO of NBIM have defined a tax strategy that takes account of general principles and guidelines for tax management, including risk tol-

⁷³ Cf. the aforementioned letter of 10 March 2017

FIGURE 11 DECISION MODEL COST DRIVERS



erance and relations with the tax authorities. Following a risk assessment, Norges Bank has decided not to establish a framework for tax management and control for NBCBO.

The assurance report recommended that the Bank strengthens its tax expertise in the control and compliance functions based on a concrete assessment of tax risk in each operational area, and clarifies the tax responsibilities assigned to the Director of Finance at NBCBO. It was also pointed out that the planned transfer of the management of parts of the foreign exchange reserves from NBIM to NBCBO would require a tax framework to be established at NBCBO.

The report also concluded that Norges Bank's practice in terms of transparency on its approach to taxation is leading. The Board was nevertheless advised to consider formalising and clarifying its overall expectations for tax transparency.

The Council endorsed the conclusions of the assurance report from Deloitte AS and forwarded the report to the Board. In its response, the Board took note of the positive comments in the report and the various concrete recommendations for further developing its tax framework.

As mentioned earlier, NBCBO took over the management of the fixed-income portfolio in the foreign exchange reserves from 1 December 2016. As part of this, Norges Bank found it natural to conduct a fresh assessment of the need for a tax framework at NBCBO too, including what tax responsibilities are to be assigned to the head of the compliance function and the Director of Finance.

The Board thought it best to address the topics discussed in the assurance report when its tax guidelines are next adjusted. The report's recommendations on tax expertise in the control and compliance functions will also be considered at that time. The Board will keep the Council informed about its follow-up.

The Council has take note of the Board's response and assessments. Developments in the tax framework are an area that will be important for future supervision.

Deloitte AS has also produced a memo for the Council on secrecy jurisdictions which presents developments nationally and internationally as well as various issues that the Bank may run into in its international investment management.

RISK MANAGEMENT AND CONTROL IN REAL ESTATE MANAGEMENT

Changes were made to the Norges Bank Act from 1 January 2016. The Council's previous authority to approve the formation of subsidiaries in the management of the GPFG was removed from the Act, but the Council's supervision of these subsidiaries was not affected by the changes. The Executive Board may decide that activities that are part of the management of the GPFG should be performed by companies wholly or partly owned by the Bank.

The Council's guidelines and the Board's principles for the formation and supervision of companies in real estate management were updated in 2016 to reflect the change in the legislation. The guidelines highlight the Board's responsibility to ensure that the Council has real and effective access for supervision. This is to be regulated through formal governance and corporate documents at the individual company. Further changes have been made to ensure that Norges Bank's auditor or another recognised auditor is appointed.

The Office of the Supervisory Council monitors developments in the organisation, new real estate transactions, company formations and regulatory compliance. The aim is to understand corporate structures with different risks and ensure that it has an adequate basis for insight and control at the companies formed. Guidelines issued by the Council on the supervision of subsidiaries form the basis for this work, which revealed a need to amend the guidelines so that they are better suited to the different holding structures used by NBREM.

In 2016, the GPFG's real estate investments comprised both listed and unlisted investments. Norges Bank increasingly owns 100 per cent of its properties and manages individual property companies through subsidiaries. Such a management model entails greater responsibilities and risks for Norges Bank in terms of asset and tenant manage-

ment than a model where it works with a partner in a joint venture.

The Council keeps itself informed by considering the Board's minutes and discussions of investment management processes and specific decisions.

THE MANAGEMENT OF PHYSICAL SECURITY AT NORGES BANK'S OVERSEAS OFFICES

From the Council's viewpoint, it is important that the Bank's work on physical security is systematic and helps prevent and detect unwanted events. This applies wherever Norges Bank has offices and staff. Compliance with established rules and reporting on follow-up are very important in terms of preparedness. The Bank's reputation may also be harmed if the security setup has weaknesses of significance to property, lives and health.

A supervisory review in 2016 assessed the Board's management and oversight of Norges Bank's work on security and contingency planning at its overseas offices. The review focused on the Board's formulation of principles, establishment and organisation of work, and oversight. The processes for drawing up contingency plans were also reviewed. Comparisons were drawn with the guidance on security management issued by the National Security Authority (NSM), which provides advice on the establishment and development of security systems.

In line with applicable guidelines, a strategic threat analysis of physical security at Norges Bank is conducted annually. Together with risk reporting from the operational areas, this gives the Executive Board a basis from which to manage security work. The Central Bank Heads of Security network has been set up as a joint forum on security matters. The network consists of 35 central banks from around the world plus the BIS. Participation in the network gives Norges Bank access to information on international best practices in the security field.

The review noted that the recommendations on security management from NSM are observed through a consistent method for security assessments at the Bank. Regular meetings with the active exchange of relevant information between the security department at NBCBO and security

personnel at NBIM are very important for achieving overall management of security work at the offices.

The Council endorsed the conclusions of the report, which was forwarded to the Board for information.

ACTIVE OWNERSHIP AND RESPONSIBLE INVESTMENT

Norges Bank reports extensively on responsible investment in both annual and quarterly reports. There is considerable openness about its activities and decisions. The Supervisory Council monitors interaction with the Council on Ethics and the procedures Norges Bank has established for following up the guidelines. The Executive Board nominates candidates for the Ministry of Finance to appoint to the Council on Ethics.

Monitoring the Board's oversight of compliance with the mandate and the development of reporting is an important part of the Council's supervision. The Council has been kept informed about Norges Bank's dialogue with the Ministry of Finance on following up white papers on the management of the Government Pension Fund when it comes to environmental issues and human rights. In a technical seminar in 2016 attended by the deputy chairman of the Council on Ethics and the management of Norges Bank, the Council discussed the new organisation of work on responsible management. This is also discussed earlier in this report.

The Council has noted Norges Bank's new and extended duties. Supervision in this area covers the Board's processes for dealing with recommendations from the Council on Ethics. The Board's principles for responsible management were revised in 2016 and also cover the real estate portfolio, including investment partners. When it comes to the environment, the Ministry of Finance's management mandate for the GPFG requires Norges Bank to prioritise areas such as energy efficiency, water management and waste management.

Norges Bank's role as decision maker in cases of exclusion and observation based on recommendations from the Council on Ethics was discussed. The Executive Board takes the final decision on observation and exclusion of companies. Exclusions can also be reversed following a decision of the Board on the recommendation of the

Council on Ethics. The Ministry is to be informed of these decisions.

With effect from 1 February 2016, the Ministry of Finance added a new product-based coal criterion to the guidelines for the observation and exclusion of companies from the GPFG. The new criterion is a result of the Storting's consideration of investments in, and active ownership of, coal companies in the management GPFG. The Council took note of the changes, which are important for Norges Bank's management of the GPFG.

The Council on Ethics' recommendations are made public, and this creates an expectation of precision and accountability in this work. NBIM and the Council on Ethics hold meetings where active ownership is linked to the Council on Ethics' processes. The Executive Board and the Council on Ethics meet to discuss experience of their relationship. An attempt is made to balance market sensitivity in the decisions by giving NBIM early warning of matters where exclusion is recommended.

From its consideration of reports and presentations, the Council finds that Norges Bank complies with the established framework and takes independent decisions on exclusions.

EXTERNAL MANAGEMENT

The mandate for the GPFG allows Norges Bank to use external managers, but requires it to have guidelines in place for when outsourcing may take place.⁷⁴ NBIM assigns a small part of the management of the equity and bond portfolio in the GPFG to external managers, primarily in new markets or market segments. Extensive rules have been put in place on selecting external managers and monitoring their performance.

The fee structure in agreements with external managers is to be aligned with the GPFG's financial interests, taking account of the time horizon for the investment strategies in question. Ceilings have been introduced for the fees

paid to external managers. NBIM closely monitors return and risk, mandate compliance and fees.

As part of the supervisory process, meetings are held with the unit at NBIM that monitors external managers. NBIM has established an extensive framework of rules on the selection of external managers. The Council is kept informed about external management at a general level through regular reporting on results, special risk factors and costs. It has been noted that fees to external managers are linked to the returns achieved.

⁷⁴ *Management Mandate for the Government Pension Fund Global, Section 1-8, cf. Regulation on Risk Management and Internal Control at Norges Bank, Section 5.*



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CHAPTER 6

ASSESSMENT OF THE EXECUTIVE BOARD'S MANAGEMENT AND CONTROL

THE EXECUTIVE BOARD'S REPORTING ON RISK AND INTERNAL CONTROL

The Internal Control Regulation requires the Executive Board to prepare an overall assessment of risk and internal control each year.⁷⁵ The Board's assessment is submitted to the Council together with annual reports on operational risk and internal control for NBCBO, NBIM and NBREM, and the annual report from Internal Audit.⁷⁶ An evaluation of physical security at the Bank is also submitted.

No significant breaches of compliance with laws and regulations were identified during the course of 2016 in NBCBO. In the management of the GPFG, there were a few minor breaches of the management mandate from the Ministry of Finance. Breaches and other unwanted events with critical consequences are discussed in the reporting, and NBIM's handling of them is described.

Internal Audit's annual report presents conclusions and assessments from 12 completed audit projects and ongoing contact with the operational areas in 2016. Internal Audit has not identified any significant shortcomings in internal control, and the operational areas are to report to the Executive Board on their follow-up of the recommendations in these reports.

The Board is of the opinion that operational risk exposure in investment management was within its defined risk tolerance during the year, and that operational risk exposure at NBCBO is acceptable. The Board's overall assessment is that internal control was conducted satisfactorily. In response to a previous request from the Council, the Board provided an overview of risk reduction measures implemented in 2016. The measures prioritised for 2017 were also specified.

The Council is of the opinion that the Bank has established processes that ensured compliance with the requirements of the Internal Control Regulation in 2016. These processes were presented in the various reports submitted. The Board has been asked to keep the Council informed about the implementation of risk reduction measures.

THE COUNCIL'S OVERALL ASSESSMENT

Under Section 5 of the Norges Bank Act, the Supervisory Council is to issue “a statement on the minutes of the meetings of the Executive Board, the supervision of the Bank and matters submitted to it by the Executive Board”. It is also to report any particular remarks arising from supervisory activities.⁷⁷

The minutes of all Executive Board meetings in 2016 have been reviewed by the Council. Around 60 per cent of the matters considered by the Board in 2016 were submitted to the Council for a decision or as part of its supervision of the Bank, a similar level to previous years. This is an important element of the Council's supervision and provides an overview of the matters considered by the Board and of its decisions on specific matters. The Governor and Deputy Governors attended the Council's meetings and provided supplementary information on the matters considered by the Board and on its minutes. The Governor provided regular risk assessments and presented measures planned and implemented.

The Council considers Norges Bank's operations as a whole to be exposed to significant risks associated with markets, security and operational factors. During the year, the Council considered a number of matters concerning the Board's updating of the Bank's overall management and control framework. Particular attention was paid to compliance with legislation, mandates and guidelines. During the Council's deliberations, questions were asked particularly about the status of actions and developments in risks over the past year. The Council took note of the Board's assessment of internal control and risk at Norges Bank.

⁷⁵ Regulation on Risk Management and Internal Control at Norges Bank, Section 8

⁷⁶ Internal Audit's annual report is prepared pursuant to the Regulation on Risk Management and Internal Control at Norges Bank, Section 9.

⁷⁷ Norges Bank Act, Section 30, fourth paragraph, item 6

The Council received all of the information requested from the Board.

The Council reviewed reports from the Office of the Supervisory Council and Deloitte AS dealing with assessments of the Board's management and control. These are discussed earlier in this report. The importance of the Board's oversight was underlined in these discussions. It has become an established practice for the Board to report annually on the status of matters that have been considered by the Council and require follow-up action from the Board. It is very important to the Council that it is kept up-to-date and adequately involved.

The supervision of the Bank's operations and compliance with the rules governing its activities gave no grounds for particular remarks under the Norges Bank Act. No special remarks on the Executive Board's minutes were minuted in 2016.



CHAPTER 7

NORGES BANK'S ANNUAL FINANCIAL STATEMENTS, OPERATING RESULTS AND BUDGET

NORGES BANK'S ANNUAL REPORT AND FINANCIAL STATEMENTS FOR 2016

REPORTING PROCESSES

The Board is to prepare an annual report and annual financial statements. The Bank's annual financial statements and the Board's annual report are prepared in accordance with the Norwegian Accounting Act's rules for large enterprises and the regulation on the Bank's annual financial statements. This regulation requires the Bank's financial reporting to comply with International Financial Reporting Standards (IFRS)⁷⁸, and contains special requirements for the presentation of the GPFG and subsidiaries. The GPFG is integrated into Norges Bank's annual financial statements as a deposit in a krone account and income from the fund's management. This income is presented in note 20 to the financial statements. A separate annual report on the management of the GPFG, including financial reporting, is also prepared.

The Council adopts the annual financial statements and takes note of the Board's annual report. The annual report for the GPFG is considered at the same time. The Council takes note of the audit reports from Deloitte AS on the Bank's annual financial statements and the annual report for the GPFG. The Board's annual report, the audited annual financial statements, the audit report and the Council's decision to adopt the financial statements are sent to the Ministry of Finance for submission to the King in Council and communication to the Storting.⁷⁹

Norges Bank also produces quarterly reports for the GPFG. The content of the quarterly and annual reports and requirements for their publication are set out in the management mandate.⁸⁰ Deloitte AS submits review reports to the Supervisory Council in accordance with the international standard on the review of interim financial information. Three unqualified review reports were provided on the quarterly reports for the GPFG in 2016.

Quarterly reports are also published on the management of the foreign exchange reserves, as well as monthly balance sheets showing the results of Norges Bank's operations. In addition, there are annual reports on financial infrastructure, financial stability, responsible investment, real estate investment, and risk and return in the GPFG. The Council is of the opinion that Norges Bank practises considerable transparency about its activities and results.

CONSIDERATION OF THE ANNUAL FINANCIAL STATEMENTS FOR 2016

Norges Bank's annual report was approved by the Executive Board on 8 February 2017. The annual report and financial statements for 2016 and the annual report on the management of the GPFG were considered at the Council's meeting of 23 February 2017. The Council adopted the annual financial statements and the allocation of comprehensive income for 2016 proposed by the Board.

Norges Bank's financial statements for 2016 show negative total comprehensive income of NOK 2,951m (2015: positive NOK 66,469m). Income consisted primarily of returns in international currency on equity and fixed-income investments in the foreign exchange reserves of NOK 18,306m. A stronger krone exchange rate resulted in foreign exchange losses of NOK 20,321m. There was an operating loss of NOK 4,664m. Performance-based fees to external managers in the GPFG totalled NOK 222m. The return on the GPFG is not included in the calculation of the Bank's operating results. The fee for the management of the GPFG, which is approved by the Ministry of Finance, is paid from the fund's capital and amounted to NOK 3,731m or 5.2 basis points of average assets under management in 2016, against NOK 3,933m and 5.7 basis points in 2015.

The Council's oversight of expenditure in 2016 is discussed later in this report.

Norges Bank's balance sheet showed total assets of NOK 8,081bn on 31 December 2016, consisting of both assets relating to central banking and assets under management in the GPFG. The balance sheet total excluding the GPFG was NOK 574.6bn (2015: NOK 542.9bn). The value of the krone deposit for the GPFG in Norges Bank's balance sheet was NOK 7,506.7bn at the end of 2016 net of the

⁷⁸ International Financial Reporting Standards (IFRS) as adopted by the EU

⁷⁹ Norges Bank Act, Section 30

⁸⁰ Management Mandate for the Government Pension Fund Global, Chapter 6: "Public reporting"

FIGURE 12 NORGES BANK'S BALANCE

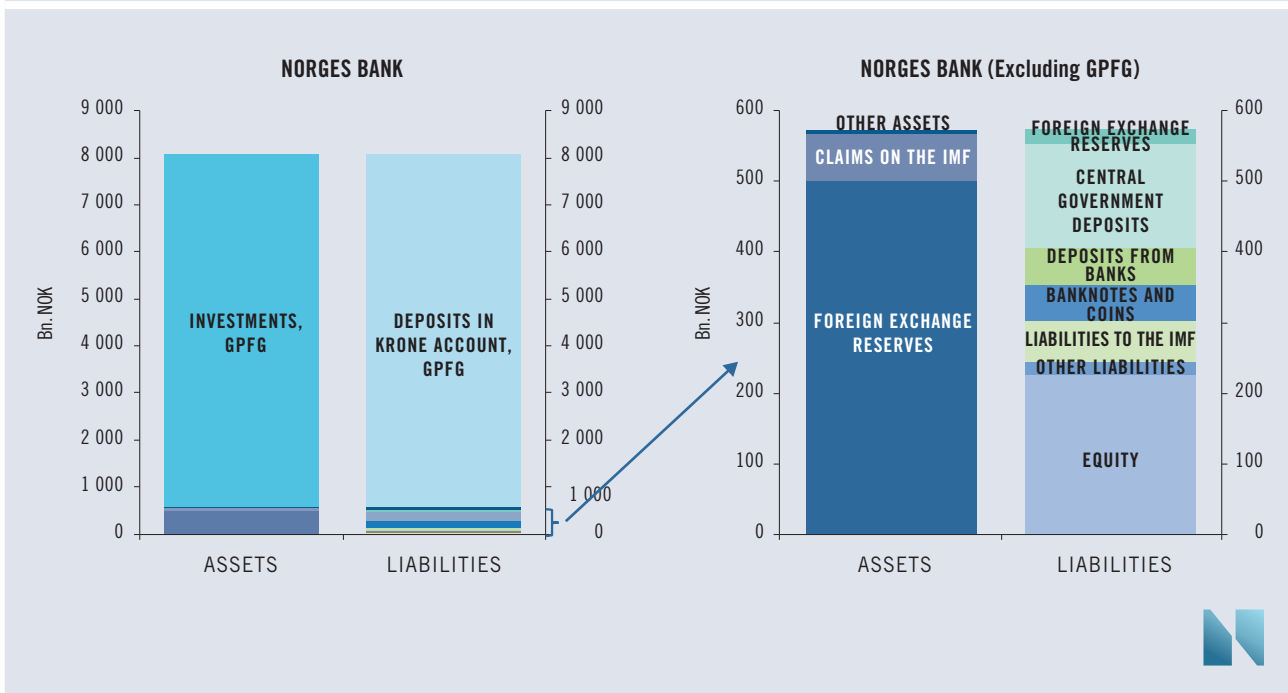
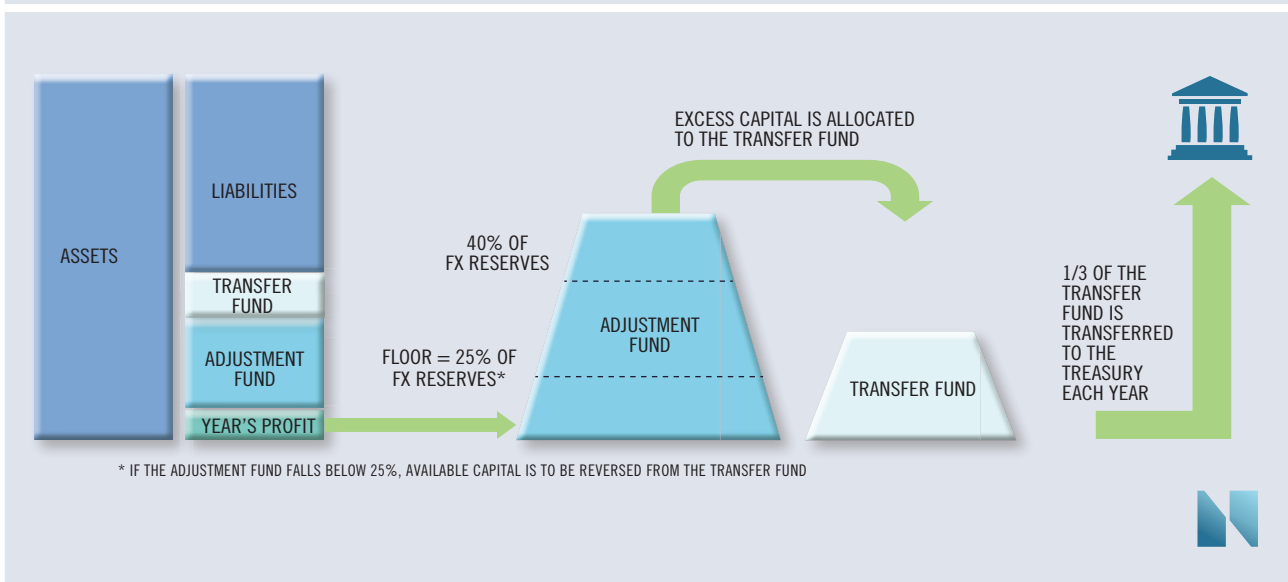


FIGURE 13 EQUITY MECHANISM



Bank's management costs. There were no inflows into the fund in 2016; rather the government withdrew a total of NOK 101bn net. The return on the fund was NOK 447bn. A stronger krone reduced the market value of the fund in NOK terms by NOK 306bn.⁸¹

The balance sheet with and without the GPFG is presented in Figure 12.

Norges Bank had equity of NOK 224.7bn on 31 December 2016, a decrease of around NOK 20.7bn over the year. This equity comprised NOK 189.4bn in an exchange equalisation reserve and NOK 35.5bn in a transfer fund after the allocation of NOK 17.7bn for transfer to the Treasury.

Deloitte AS submitted two audit reports dated 8 February 2017. The audit reports for 2016 are based on a new international standard. They describe key aspects of internal control which, in the auditor's opinion, were of great significance in the audit of the financial statements for 2016. The Council has noted that, in the auditor's opinion, the annual financial statements for Norges Bank and the financial reporting for the investment portfolio in the GPFG were prepared in accordance with applicable laws and regulations. An audit memorandum for the Supervisory Council has also been considered.

The Council believes that the Board's annual report and Norges Bank's annual financial statements have evolved positively and provide good information on its activities. The following decision was taken on the Bank's financial statements for 2016:

- *The Supervisory Council takes note of the Executive Board's annual report for 2016.*
- *The Supervisory Council takes note of the auditor's report and adopts Norges Bank's financial statements for 2016.*
- *In accordance with the guidelines, the negative total comprehensive income of NOK 3bn is to be covered by a transfer from the exchange equalisation reserve. A third of the transfer fund, or NOK 17.7bn, is to be transferred to the Treasury.*

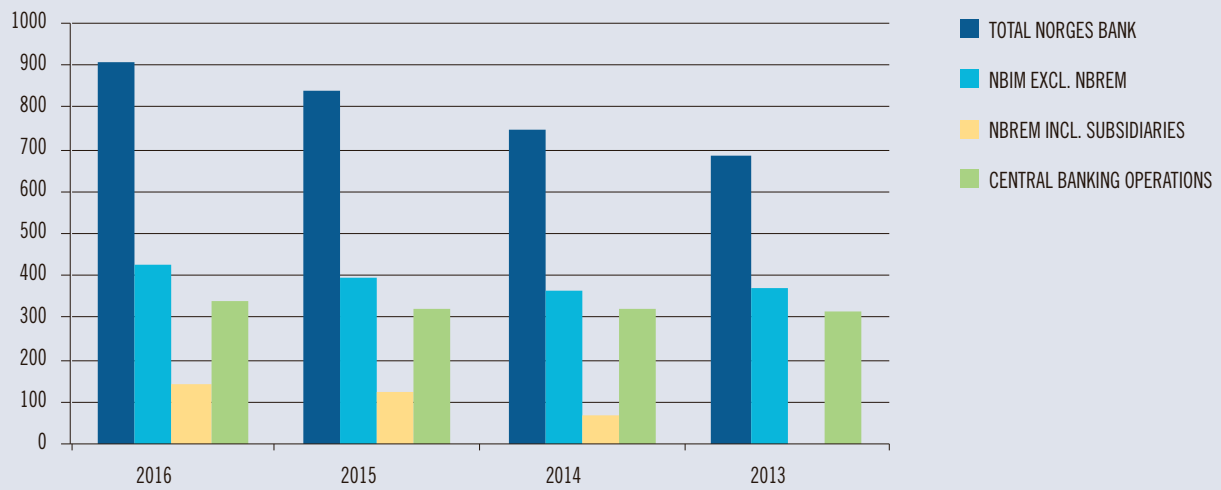
Under Section 30 of the Norges Bank Act, the King lays down guidelines for provisions and allocations of the Bank's net profit.⁸² Decisions on transfers from Norges Bank to the government must be approved by the Storting and are carried out in the first quarter of the following year. The transfer from the transfer fund to the Treasury for 2015 amounted to NOK 26.6bn. Figure 13 illustrates the mechanism for the allocation of net profit/loss, accumulation of equity and transfers to the Treasury.

The Accounting Act's requirements for reporting on social responsibility apply to Norges Bank.⁸³ The Bank must also account for what it has done to integrate human rights, labour rights and social, environmental and anticorruption issues. This information is to be provided in the Executive Board's annual report or in another publicly available document. Given the public interest in the Bank's operations, the Council has emphasised the importance of the Board paying great attention to this area. Deloitte AS's audit report confirmed that the information on social responsibility provided in the Board's annual report complies with the applicable guidelines for Norges Bank. The Council has taken note of the information in the Board's annual report.

⁸¹ For more detailed information, see Norges Bank's annual report and financial statements for 2016 and the report on the management of the GPFG in 2016.

⁸² Guidelines issued by the King in Council on 7 February 1986 and most recently amended by Royal Decree on 6 December 2002. For further information, see the statement of changes in equity in Norges Bank's annual financial statements and the note on accounting policies.

⁸³ Accounting Act, Section 3-3 c

FIGURE 14 GROWTH IN THE WORKFORCE AT NORGES BANK FORM 2013 TO 2016

OVERSIGHT OF NORGES BANK'S EXPENDITURE IN 2016

Under the budget regulation, the Executive Board is responsible for performance of activities in such a way that targets are achieved within the financial constraints set out in the budget decision. The management of the GPFG is also to be managed in such a way that costs are kept within the limit for reimbursement set by the Ministry of Finance. The Board summarises the status of expenditure at Norges Bank as a whole as at the end of June and December. The Council also monitors expenditure during the year in management reports prepared quarterly by NBIM and biannually by NBCBO.

In the status reports for the first half of 2016, the Council noted that actual expenditure and the forecast for the year were within the approved budget. Replying to questions, the Governor provided further information on costs at NBIM as a share of assets under management, and the proportion of these costs that were associated with real estate management. The Council took note of this information and the report.

Operating expenses totalled NOK 4.8bn in 2016 (2015: NOK 5.0bn). Including fees for the management of the GPFG but excluding the Supervisory Council's costs, there was an operating loss of NOK 895m (2015: NOK 902m). Personnel expenses accounted for 38 per cent of total operating expenses. The operating loss was smaller than budgeted, due partly to lower pension expenses, lower performance-based fees both externally and internally, a smaller rise in the number of employees at NBIM/NBREM and lower use of temporary staff at NBCBO than anticipated when the budget was prepared.

Operating expenses for the management of the GPFG were NOK 961m less than estimated in the budget for 2016, and NOK 193m less than they were in 2015. The main reason for this lower expenditure was a reduction in performance-based fees to external managers due to lower excess returns, together with reduced custody costs due to lower assets under management. Around 70 per cent of expenses are denominated in foreign currency. In isolation, the weaker krone would have increased the budget by NOK 143m relative to the approved budget in NOK.

Planned purchases of notes and coins budgeted for 2016 were postponed in the light of the issue of a new series of banknotes from spring 2017.

Norges Bank had 915 permanent employees at the end of 2016, including executive management, central administration and Internal Audit (2015: 848). Of these, 339 (322) were employed at NBCBO and 568 (518) at NBIM, including 139 (122) at NBREM of whom 17 (18) were employed by the subsidiaries in Luxembourg, Tokyo and London. An additional five (six) employees were employed in Internal Audit, and three (two) in executive management (the Governor and Deputy Governors). The Office of the Supervisory Council's employees are not included in these figures.⁸⁴

Figure 14 presents growth in the workforce at Norges Bank from 2013 to 2016.⁸⁵ NBREM's organisation was established in 2014.

The Council has taken note of the Board's status report. The Board managed expenditure in 2016 within the approved budget and reported in accordance with the budget rules for Norges Bank. Costs for the management of the GPFG were kept within the limit set by the Ministry of Finance.

Table 3 shows operating results and capital expenditure (actual and budgeted) in the period 2015–2017 for Norges Bank as a whole.

See also Figure 15 presenting actual costs at Norges Bank in the period 2013–2016 and the budget for 2017 in NOK terms.

CONSIDERATION OF AND DECISION ON NORGES BANK'S BUDGET FOR 2017

BUDGET RULES AND PROCESS FOR APPROVING THE BUDGET

The Executive Board is to propose a budget for the coming year, which is then adopted by the Supervisory Council and communicated to the Ministry of Finance.⁸⁶

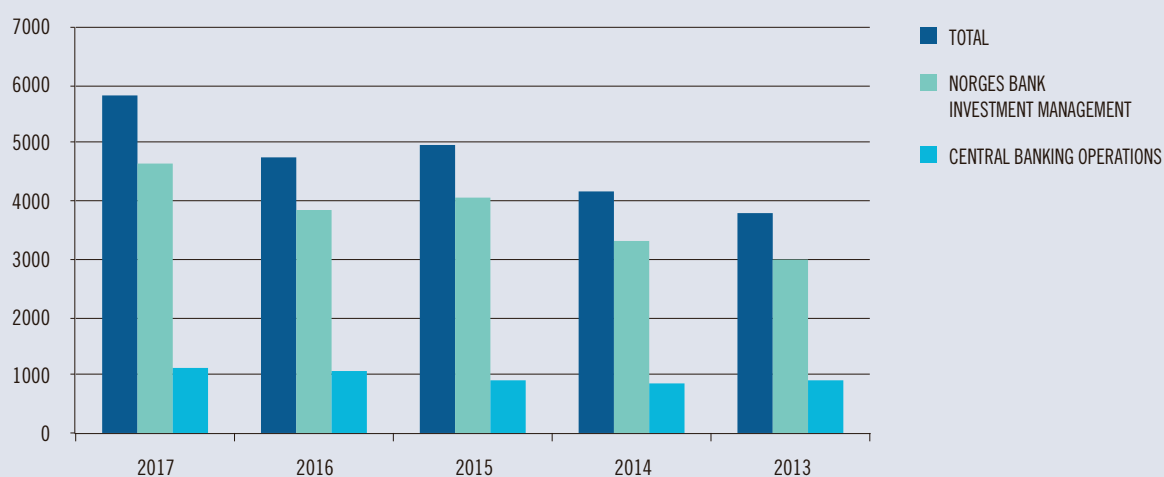
⁸⁴ For the Council's own expenditure, see the separate discussion earlier in the report.

⁸⁵ Excluding the Governor, the Deputy Governors, Internal Audit and the Office of the Supervisory Council

⁸⁶ Norges Bank Act, Section 29.

TABLE 3 NORGES BANK'S OPERATING RESULTS EXCLUDING THE SUPERVISORY COUNCIL'S EXPENSES

MILLIONS OF NOK	BUDGET 2017	ACTUAL 2016	ACTUAL 2015	ACTUAL 2014	ACTUAL 2013
Operating revenue, NBCBO	128	128	125	128	126
GPFM management fee	4 605	3 731	3 933	3 202	2 889
Total operating revenue	4 733	3 859	4 058	3 330	3 015
Expenses, NBCBO	-1 148	-1 080	-903	-856	-904
Expenses, NBIM	-4 665	-3 863	-4 057	-3 296	-2 980
Total operating expenses	-5 813	-4 754	-4 960	-4 152	-3 789
Operating loss	-1 081	-895	-902	-822	-774
Capital expenditure, NBCBO	160	127	178	167	140
Capital expenditure, NBIM	279	197	165	83	112
Total capital expenditure	439	324	343	250	252

FIGURE 15 NORGES BANK'S OPERATING EXPENSES 2013–2017

The Council has issued budget rules for Norges Bank⁸⁷ setting out general guidelines and criteria for budget decisions. One principle in the budget rules is that the annual decision covers the whole of Norges Bank's operations. The Board has issued supplementary financial rules with principles for financial management and the budget process.

In its consideration of the budget, the Council checks that responsible financial limits have been set for the Bank's duties and operations. The budget must apply essentially the same principles as applicable accounting rules laid down in the regulation on the Bank's annual financial statements. At a general level, budget criteria and assumptions must be consistent across the Bank's operations.

The Board considers budget proposals for each operational area and submits a combined budget to the Council. The scope and content of the underlying information in the proposal must be tailored to the Council's budget responsibilities and supervisory role. The aim is to give the Council a complete picture of the Bank's operations presented at the same level as the external financial reporting. Proposed capital expenditure is presented for each operational area with estimates for individual items.

Strategies, targets and action plans are to be adopted by the Board, and the expected economic consequences presented to the Council. Information is to be provided on the key features of the activities and investments that are planned for both the budget year and subsequent years. Cost levels are to be commented on in the light of established strategies and targets and available external comparisons. Information is to be provided on the main cost drivers and risk factors. One important basis for the Council's consideration of the budget is that estimates of costs are based on targets, and that adequate economic analyses with a high degree of assurance have been made when making choices about the development of the Bank's operations. Requirements for such information are set out in the budget rules.

Each year, the Ministry of Finance sets an upper limit for the reimbursement of costs incurred in the management of

the GPF. The Ministry's decision must generally be available by the time the budget decision for Norges Bank is made. The Bank runs no financial risk in respect of management costs for the GPF within this limit.

Investment income from the fund's management is not budgeted, due in part to the considerable uncertainty associated with movements in exchange rates and financial markets. Norges Bank is not exposed to financial risk through the GPF's investment results, as they are offset against the fund's deposit account.

Administrative expenses at subsidiaries for the GPF's real estate investments are included in the Council's budget decision.

BUDGET DECISION FOR 2017

Norges Bank's budget for operating activities and capital expenditure in 2017 was prepared and submitted by the Executive Board and adopted at the Supervisory Council's meeting of 20 December 2016. On initial submission, questions were raised about whether the proposal contained all of the information required by the budget rules.

The Board has established three-year strategy periods for Norges Bank, and a new period runs from 2017 to 2019. The strategy adopted for NBCBO accompanied the proposed budget, and information was provided on key aspects of the work on the strategy. Other strategies for the Bank's operations were missing. On that basis, it was pointed out that not all of the formal requirements were in place for approving the budget at the ordinary meeting on 8 December. The Board was asked to present more detailed analyses.

At a fresh meeting on 20 December, the Council received a letter from the Board dated 7 December 2016 entitled "Proposed budget for Norges Bank for 2017 – supplement" as a basis for its consideration of the budget. Appended to this document was a general strategy document for Norges Bank as a whole labelled "Draft". It can be seen from the minutes of the Executive Board's meeting of 7 December 2016 that the Board approved the strategy document for Norges Bank for 2017–2019 and that the Governor was authorised to finalise the document. These minutes were submitted to the Council at its meeting on 23 February 2017.

⁸⁷ Adopted by the Supervisory Council on 15 November 2012. Last amended on 5 November 2015.

FIGURE 16 APPROVED BUDGET FOR NORGES BANK FOR 2017

In accordance with the Norges Bank Act and the budget rules for Norges Bank, the Supervisory Council has considered the Executive Board's proposed budget for Norges Bank for 2017.

Reference is made to the Council's previous consideration of budgetary matters and the recommendation of the Standing Committee on Finance and Economic Affairs on the management of the Government Pension Fund in 2015 (Recommendation No. 326 S (2015-2016)).

The Supervisory Council has the following remarks on the proposed budget and expects the Executive Board to follow them up by 15 May 2017:

- 1) The Supervisory Council asks the Executive Board to submit approved strategies and targets for the period 2017-2019 with cost-benefit analyses of strategic decisions, both for Norges Bank as a whole and for the operational areas.
- 2) The Supervisory Council asks the Executive Board to submit relative cost comparisons and analyses of Norges Bank's operations.

With reference to the remarks above and the letter from the Ministry of Finance dated 7 December 2016 on the management fee for the GPF, the Supervisory Council hereby approves the following budget for Norges Bank for 2017 (in millions of NOK):

GPF management fee	4 605
Other operating revenue	128
Total operating revenue, Norges Bank	4 733
Personnel expenses, NBCBO	- 522
Other operating expenses, NBCBO	- 626
Personal expenses, NBIM	-1 397
Other operating expenses, NBIM	-3 268
Total operating expenses, Norges Bank	-5 813
Operating loss, Norges Bank	-1 081
Capital expenditure, NBCBO	160
Capital expenditure, NBIM	279
Total capital expenditure, Norges Bank	439

The budget for capital expenditure comprises new investments of NOK 186m at NBCBO and NOK 105m at NBIM. Previously approved and ongoing investments amount to NOK 27m at NBCBO and NOK 174m at NBIM. Of the total investment budget for 2017, it is expected that NBCBO will account for NOK 160m and NBIM NOK 279m.

The Supervisory Council approves a budget of NOK 90m for operating expenses at operating companies in the GPF's real estate management.

The Council's budget for supervision and audit costs was approved in a separate decision on 8 December 2016.

Norges Bank's overall budget will be submitted to the Ministry of Finance in accordance with section 29 of the Norges Bank Act.

The Council discussed the budget thoroughly. It was noted that there was no approved strategy for NBIM. The Board's final approval of the strategy for the management of the GPFG had been postponed to the first quarter of 2017, partly in anticipation of mandate changes by the Ministry of Finance entering into force from 1 January. The budget proposal described action plans with major budgetary consequences. The Board's supplement contained information on key strategic choices and initiatives with budgetary consequences and a number of cost comparisons.

The Council discussed matters of principle concerning the budget for Norges Bank in connection with three supervisory reviews. Reference is made to the discussion in the report to the Storting for 2015⁸⁸ on general oversight of risks and returns in the management of the GPFG. The oversight and management of costs for the management of the GPFG are covered earlier in this report. To follow up these reports, the Executive Board was asked to concretise the strategic direction for Bank-wide matters and to consider setting clear goals for the management of the GPFG.

In its recommendation⁸⁹ following its consideration of the management of the Government Pension Fund in 2015, the Standing Committee on Finance and Economic Affairs made the following remark about costs: *“The Committee notes that the fund's management costs measured in kroner have increased over time and are considerable in absolute terms. It is therefore important for there to be regular assessments of how the fund's management can be made more cost-effective, and the Committee has a clear expectation that economies of scale could be realised on account of the fund's ever greater value and scope.”*

In its recommendation, the Standing Committee advises the Storting to pass the following resolution:⁹⁰ *“The Storting asks that next year's review also assesses the results of, and cost-benefit analyses of, the different investment strategies, in both the short and the long term, and highlights any changes in the light of these assessments in connection with the white paper for 2017.”*

During its consideration of the budget, the Council attached importance to the remarks in the recommendation and to the Storting's resolution.

Norges Bank's budget for 2017 was approved by the Supervisory Council on 20 December with two remarks. The budget decision for 2017 is presented in its entirety in Figure 14.

The budget for Norges Bank for 2017 shows an overall operating loss of NOK 1,081m. Operating expenses are budgeted at NOK 5,813m. Of this, NOK 4,605m comprises costs for the management of the GPFG.

The Ministry of Finance has set a limit for management costs in 2017 of 7.5 basis points of the fund's average market value.⁹¹ This is lower than the Bank's proposal of 8 basis points as applied in 2016 and may indicate an expectation of cost reductions. In its letter, the Ministry also referred to the aforementioned recommendation from the Standing Committee on Finance and Economic Affairs. The limit includes costs at subsidiaries in the management of real estate investments, budgeted at NOK 90m. Performance-based fees to external managers are also reimbursed but are not included in the limit.

Altogether, the budget assumes 943 full-time equivalent employees (FTEs) at Norges Bank in 2017: 339 at NBCBO and 597 at NBIM, including 122 at NBREM and subsidiaries. An additional seven FTEs are budgeted at Internal Audit.

As stated above, the Council has also approved a budget for 2017 for the Supervisory Council, the Office of the Supervisory Council and the external auditor, which totals NOK 40.6m. The Office of the Supervisory Council has eight FTEs.

A letter on the budget decision dated 20 December 2016 was sent to the Ministry of Finance.

⁸⁸ Document No. 9 (2015-2016).

⁸⁹ Recommendation No. 326 S (2015-2016), Chapter 2.2

⁹⁰ Item No. 1, 3 June 2016, Resolution of the Storting No. 761 (2015-2016).

⁹¹ Letter from the Ministry of Finance to Norges Bank of 9 December 2016.

CHAPTER 8

PRIORITIES FOR FUTURE SUPERVISORY ACTIVITIES

Public reports in accordance with laws and mandates, reports for internal control purposes and other published information on Norges Bank's performance of its tasks have increased in number and scope in recent years. The Council considers the Bank's reports as part of its supervision and believes that transparency about the Bank's operations is crucial for the Bank to be able to operate with the necessary independence and legitimacy under the governance system in Norway.

A strong and independent central bank is essential for balanced economic policy. The management of the GPFG has become a key element of economic policy. By assigning responsibility for the fund's management to Norges Bank, the authorities have ensured that the long-term goals for petroleum wealth are addressed independently of the government's more short-term and situation-dependent budgetary position. It also addresses security and emergency response considerations.

Over time, the Council has received reports from a variety of supervisory reviews and assurance assignments looking at the Executive Board's management and control of the Bank's operations, including the management of the GPFG. These reports are forwarded to the Board, which responds in letters to the Council on how it has followed up their conclusions and recommendations. Ascertaining whether previous recommendations have been acted on is an important part of the supervisory process and will be a priority in 2017.

A strategy and action plans for the Supervisory Council and the Office of the Supervisory Council have been adopted for the period 2016–2018. Integrity, focus and efficiency are prioritised in supervisory work. Continuous development of skills, supervision methods and reporting are very important for the Office of the Supervisory Council. Supervision is risk-based and focuses on the management and control of operations.

In its supervisory work, the Council attaches importance to continuous development to meet the challenges associated with Norges Bank's extensive and complex operations. This applies not least to requirements and expectations for independent, transparent and competent supervision of the management of the GPFG. The Council has an unwavering focus on changes to the regulatory framework for Norges Bank and the management of the GPFG.

Developments and risks in investment management, with changes to the asset mix, reduced inflows of capital and varying withdrawals, will be monitored closely. Risk-based supervision requires the Supervisory Council and the Office of the Supervisory Council to have expertise and capacity concerning all operational and market risks in the Bank's operations, and this will be a priority in 2017.

The Office will conduct ongoing supervision and supervisory reviews in accordance with the approved supervision plan. Supervisory work will attach importance to changes in the risks facing Norges Bank's organisation and tasks. Controls will cover matters of principle concerning the Council's supervision of operations and compliance. Topics for special attention in 2017 are the Board's evaluation of performance against targets for the 2014–2016 strategy period and the implementation of the strategy for 2017–2019 in action plans and budgets. The Council will monitor the development of the new banknote series, with the first denominations being launched in 2017. Handling of the increased risk of cyber attacks on IT systems and infrastructure and high physical security risks will also attract special attention. Contracts with suppliers of IT services and the Bank's oversight of its responsibilities are important for supervision.

Supervisory reviews will include assessments of the Board's management and control of strategies and the management model for the GPFG, serious threats and crises in the management of the GPFG, and market regulation in countries where Norges Bank invests. The Board's control of subsidiaries and joint ventures in real estate management will be reviewed. Necessary adjustments to the Council's guidelines for the supervision of the Bank's subsidiaries will be considered against the background of changes to the Norges Bank Act and the management of unlisted real estate. The Bank's management of the foreign exchange reserves, including the Board's principles for the management of the reserves and the organisation of this work, will also be reviewed.

The Council will attach great importance to monitoring the work of the Committee for the Review of the Norges Bank Act. There is a broad consensus on the Council concerning the importance of contributing actively to the development of the legislative framework for Norges Bank and the task of managing the GPFG.

APPENDIX 1

NORGES BANK'S SUPERVISORY COUNCIL 2016–2017

SUPERVISORY COUNCIL

Full members	First elected	Current term
Reidar Sandal, chairman	2010	2014–2017
Tormod Andreassen, deputy chairman	2008	2016–2019
Vidar Bjørnstad	2012	2016–2019
Ingrid Fiskaa	2016	2016–2019
Helle Hammer	2016	2016–2019
Toril Hovdenak	2014	2014–2017
Kjetil Lund	2016	2016–2019
Morten Lund	2010	2016–2019
Peter Meidell	2014	2014–2017
Iver Nordseth	2014	2014–2017
Frank Sve	2006	2014–2017
Synnøve J. Søndergaard	2010	2014–2017
Ingebrigt S. Sørffonn	2012	2016–2019
Paul Birger Torgnes	2014	2014–2017
Randi Øverland	2012	2016–2019
Alternates		
Lars Bjarne Tvete	2014	2016–2019
Jonas Varhaug	2016	2016–2019
Permanent Committee	Alternates	
Reidar Sandal, chairman	Ingrid Fiskaa	
Tormod Andreassen, deputy chairman	Ingebrigt S. Sørffonn	
Toril Hovdenak	Paul Birger Torgnes	
Frank Sve	Peter Meidell	
Synnøve Søndergaard	Vidar Bjørnstad	

MEMBERS OF THE SUPERVISORY COUNCIL



Reidar Sandal

Acting CEO of Sogn og Fjordane Chamber of Commerce, adviser and chairman. Past experience includes Minister of Education, Research and Church Affairs, member of the Storting and chairman of its Standing Committee on Finance and Economic Affairs, county councillor, teacher, department director at Sogn og Fjordane County Municipality, adviser to Botnaneset Industriselskap AS, CEO of Sunnfjord Chamber of Commerce, chairman of Innovation Norway, Fjord1 AS, Nynorsk kultursentrum and Sunnfjord Næringsutvikling AS, and board member at Investinor AS. MA from the University of Bergen.



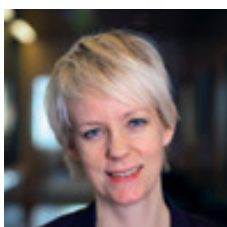
Tormod Andreassen

Board member at Lærdal Finans AS, Liberalt Forskningsinstitutt Lifo and Sparebank1 Nord-Norge Pension Fund, among others. Past experience includes deputy CEO and chief economist at Christiania Bank, chief investment officer and chief economist at SpareBank 1 Gruppen, CEO of Alfred Berg Norge AS and SR-Fonds, chairman of Berg Fondsforvaltning, department director at Statistics Norway, board member at the Norwegian Commercial Banks' Guarantee Fund and member of Finance Norway's life and pensions committee. BSc in Economics from the University of Oslo.



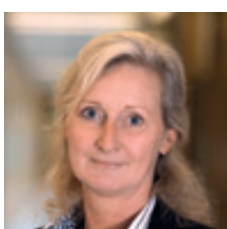
Vidar Bjørnstad

Head of the international department at the Norwegian Confederation of Trade Unions (LO). Past experience includes member of the Storting and of its Standing Committees on Social Affairs, Justice, Foreign Affairs and Education, Research and Church Affairs, political adviser at the Ministry of Development Cooperation, county operations leader at Amnesty International, member of the board of the European Movement and private secretary to the president of LO. BA from the University of Oslo.



Ingrid Fiskaa

Teacher at Sandnes Upper Secondary School. Past experience includes secretary of state at the Ministry of Foreign Affairs, member of the High Level Panel on Illicit Financial Flows from Africa, board member at Attac Norge and head of the Socialist Youth League of Norway. MA in History from the University of Oslo.



Helle Hammer

CEO of Cefor and council member at Det Norske Veritas. Board member at Maritimt Forum. Past experience includes secretary of state at the Ministry of Trade and Industry and the Ministry of Finance, political adviser in the Oslo City Government, Norwegian deputy governor of the EBRD, director of Innovation Norway's office in Houston and director of the Norwegian Shipowners' Association. BSc in Economics from Oslo Business Academy.



Toril Hovdenak

CEO of Bussbygg AS. Board member at Gjensidige Nordmøre og Romsdal. Past experience includes deputy mayor, chairwoman of Molde Municipal Pension Fund, deputy chairwoman of the Central Norway Regional Health Authority, and board member at Molde University College, Sparebanken Møre and Istad AS. MBA from Bodø Business School.



Kjetil Lund

Senior Vice President of Public Affairs at Statkraft. Past experience includes employment in the research department at Statistics Norway, secretary of state at the Ministry of Finance, head of the secretariat to the UN Special Envoy for Climate Change, adviser at the Office of the Prime Minister and the Ministry of Finance, and board member at Agenda. MSc in Economics from the University of Bergen.



Morten Lund

Retired. Past experience in self-employment and as farmer, researcher at the Norwegian College of Agriculture and the Norwegian Labour Inspection Authority, member of the Storting and chairman of its Standing Committee on Business and Industry, alternate member of the Board of Auditors General, mayor, chairman of Fosen Regional Council and the committee of Sør-Trøndelag Kraftselskap. BSc in Agriculture and PhD from the Norwegian College of Agriculture and the Norwegian Institute of Technology.



Peter Meidell

Executive chairman at P. Meidell AS. BSc in Economics from BI Norwegian Business School, MBA from the University of Wisconsin, Madison, and LLM from the University of Oslo.



Iver Nordseth

Local politician. County executive board member in Møre og Romsdal, county councillor and member of the transport committee. Board member at the Norwegian Association of Windpower Municipalities. Past experience includes mayor of Smøla, chairman of Nordmøre Chamber of Commerce, board member at Nordmøre Energiverk and teacher. BA from the University of Bergen and University of Trondheim.



Frank Sve

County executive board member in Møre og Romsdal, county councillor, member of the transport committee, municipal executive committee member in Stranda and member of the Regional Council for Western Norway. Chairman of Åknes/Tafjord Beredskap IKS. Past experience includes mayor, production director at Møremøbler/Stokke, and board member at St. Olavs Hospital HF, Norsk Maritime Kompetansesenter and Innovation Norway Møre og Romsdal. Vocational background.



Synnøve J. Søndergaard

Distriktssekretær ved LOs distriktskontor i Troms, leiar av NRK distriktsprogramråd og medlem av fylkestinget i Troms. Tidlegare erfaring m.a. som styremedlem i Innovasjon Noreg Troms, nestleiar i Inko Industri- og Kompetansesenter AS, førstekonsulent i Forsvarsbygg, ass.controller i Det Norske Veritas Rotterdam. Fylkesråd i Troms. IKT-utdanning frå Høgskolen i Østfold.



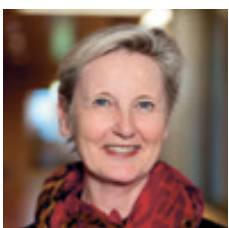
Ingebrigt S. Sørfonn

Self-employed. Chairman of the Egill Danielsen Foundation and eight Danielsen schools. Past experience includes member of the Storting, member of its Standing Committees on Finance and Economic Affairs, Business and Industry, and Foreign Affairs, mayor, various positions at Sunnhordland Kraftlag AS and chairman of the Norwegian Inner Mission Federation. Master of Management from BI Norwegian Business School.



Paul Birger Torgnes

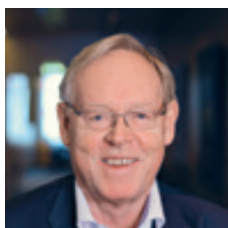
CEO of Fjord Marin Holding AS, chairman of Sjømat Norge, deputy chairman of NCE Aquaculture, vice president of the Federation of European Aquaculture Producers, municipal executive board member in Brønnøy and chairman of various companies. Past experience includes mayor and deputy mayor of Brønnøy, CEO of Fjord Seafood ASA and NorAqua AS, chairman of Torghatten ASA, political adviser to the Minister of Fisheries and secretary-general of the Norwegian Aquaculture Association. Studied business at the University of Nordland and the Norwegian Fisheries College.



Randi Øverland

Senior adviser at the University of Agder and member of Vest-Agder County Council. Board member at Agder Kollektivtrafikk, Lister Kompetanse, Agder county vocational training board, Sørlandsrådet and NSC Marine Resources Group, among others. Past experience includes secretary of state at the Ministry of Culture and Church Affairs and the Ministry of Education, Research and Church Affairs, chairwoman of Agder College Board, board member at the Norwegian Film Institute, county councillor and municipal executive committee member in Kristiansand, and headmistress. Degree from Telemark University College and further studies in political science at the University of Oslo.

ALTERNATES OF THE SUPERVISORY COUNCIL



Lars Bjarne Tvette

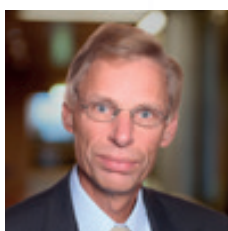
Chairman and owner of LBT Holding AS. Board member at Thomas Angells Stiftelser. Past experience includes member of Trondheim City Council and Sør Trøndelag County Council, chairman of Trondheim Municipal Pension Fund and board member at BN Kreditt ASA, CEO of Basale Eiendomsforvaltning AS and Nordenfjeldske Eiendomsutvikling AS, and assistant director of Den Nordenfjeldske Bykredittforening. Economics degree from Trondheim Business College.



Jonas Varhaug

CEO of Jærøk DA. Past experience includes farmer and municipal treasurer. State-authorized public accountant from the Norwegian Business School.

DIRECTOR OF THE OFFICE OF THE SUPERVISORY COUNCIL IN 2016



Svern Erik Forsstrøm

Past experience as central bank auditor at Norges Bank and partner at accountants Coopers & Lybrand. MBA from the Norwegian Business School and state-authorized public accountant.

DIRECTOR OF THE OFFICE OF THE SUPERVISORY COUNCIL FROM 1 FEBRUARY 2017



Jan Frode Jakobsen

Past experience includes CEO of pension fund Helseforetakenes Pensjonskasse, director of Oslo City Council's secretariat, economic adviser and head of secretariat for the Parliamentary Labour Party, secretary to the Standing Committee on Finance and Economic Affairs, adviser at the Ministry of Finance and inspector at Finanstilsynet. MBA from the Norwegian Business School and MSc from the London School of Economics.

APPENDIX 2

GLOSSARY

AP Funds	The six AP Funds manage the assets in Sweden's public pension system.
BIS	The Bank for International Settlements has 60 central banks as its members. Its mission is to serve central banks in their pursuit of monetary and financial stability, to foster international cooperation in those areas, and to act as a bank for central banks.
CEM Benchmarking	CEM Benchmarking is a global supplier of independent market analyses in investment and pension fund management.
COSO ERM	<ul style="list-style-type: none">– COSO: The Committee of Sponsoring Organizations of the Treadway Commission– ERM: Enterprise Risk Management– COSO's "Enterprise Risk Management – Integrated Framework", first published in September 2004, is referred to as the COSO ERM.
GPFG	The Government Pension Fund Global is the part of the Norwegian Government Pension Fund managed by Norges Bank.
GPIF	Japan's Government Pension Investment Fund is an independent administrative unit reporting to the Minister of Health, Labour and Welfare which carries out investments for the country's public pension system.
GRC	Governance, Risk and Compliance.
IFRS	The International Financial Reporting Standards (IFRS) published by the International Accounting Standards Board (IASB) have been adopted by the EU, and all listed companies are required to publish IFRS-compliant consolidated financial statements.
IIA	The Institute of Internal Auditors has published a series of standards for internal auditing and compliance: <ul style="list-style-type: none">– Code of Ethics and International Standards for the Professional Practice of Internal Auditing– International Professional Practices Framework– Guidance for Compliance Functions (Norwegian only)

IMF	The International Monetary Fund was created in 1945 and has 188 member countries. It aims, among other things, to promote international monetary cooperation and provide financial support for countries in need.
ISAE	The International Standards on Assurance Engagements are a series of standards for performing and reporting on external audits published by the International Federation of Accountants (IFAC).
NBCBO	Norges Bank Central Banking Operations
NBIM	Norges Bank Investment Management is the part of Norges Bank responsible for investment management.
NBO	Norges Bank's settlement system for transactions in the Norwegian payment system.
NBREM	Norges Bank Real Estate Management is the department of Norges Bank/NBIM responsible for managing the GPFG's unlisted real estate investments.
NSM	The National Security Agency of Norway.
OECD	The Organisation for Economic Co-operation and Development.
OSC	The Office of the Supervisory Council is the Supervisory Council's secretariat.
REIB	The Real Estate Investment Board is an advisory committee for decisions on investments in unlisted entities as part of the GPFG's real estate investments.

Norges Bank Supervisory Council
Report for 2016

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