
NORGES BANK'S SUPERVISORY COUNCIL REPORT FOR 2011

Document No. 9 (2011–2012)



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TO THE STORTING

Norges Bank's Supervisory Council is elected by the Norwegian parliament – the Storting – and charged with supervising the Bank's activities and ensuring that the rules governing the Bank's operations are observed, including the management of the Government Pension Fund Global.

The Council's first report to the Storting on the supervision of Norges Bank discussed changes in the management framework for the Bank's operations and the Council's duties. Further changes followed in 2011, with adjustments to new accounting rules and a new mandate for the management of the Government Pension Fund Global. Norges Bank also began investing the Fund in real estate.

The Council worked systematically on developing its supervision of the Bank in line with the new control structure and the Storting's guidance in 2011. The global financial turmoil impacted on Norges Bank's operations in the second half of the year. The Council has monitored the Bank's work in this area as part of its supervision.

The composition of the Supervisory Council is altered every other year in accordance with the Norges Bank Act. With effect from 1 January 2012, four new members were appointed and four of the members from 2011 stepped down.

The Council has considered Norges Bank's annual report and adopted its financial statements for 2011. The annual report on the management of the Government Pension Fund Global for 2011 has also been considered. Reference is made to these reports for a more detailed presentation of the operations statements of the central bank.

The Council adopted this report on the supervision of Norges Bank in 2011 at its meeting of 15 March 2012, and it is hereby presented to the Storting.

Oslo, 27 March 2012

Reidar Sandal
Chairman, Norges Bank's Supervisory Council



1. Hovedsædet i Kristiania (

a. **Direktører.**

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SECTION 1

SUMMARY

Pursuant to section 5 of the Norges Bank Act, the Supervisory Council supervised the Bank's activities and ensured that the rules governing the Bank's operations were observed in 2011.

Under the 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 supervises the Executive Board to ensure that the Board's management and control of the Bank's operations and compliance with legislation, agreements, decisions and other regulatory frameworks are satisfactory. The Council also approves the Bank's budget and adopts its annual financial statements.

The Council's report to the Storting for 2010 (Document No. 17 S (2010–2011)) set out a number of priorities for future supervisory work. Aspects of its supervision that were singled out in the Standing Committee on Finance and Economic Affairs' recommendation¹ to the Storting were addressed in the Council's supervision in 2011 and are discussed in this year's report.

The Council performed its duties on the basis of consideration of minutes, matters and statements from the Executive Board. Reports and statements from the Office of the Supervisory Council and the external auditor were also considered.

This report on supervision in 2011 provides an overview of the Council's activities, expenditure and methodological approach. It also presents the Council's supervision of the Executive Board's minutes and its management and control system, and the Council's supervision of the Bank's operations. The Council paid particular attention to the Bank's compliance with the regulation on risk management and internal control at Norges Bank.

The Council's consideration of the Bank's budget and financial reporting is described in a separate section. It was the first year for which the Bank's financial statements have been prepared in accordance with the new regulation relating to the annual financial statements of Norges Bank and International Financial Reporting Standards. These standards are helping make the Bank's operations more transparent.

The supervision of investment management had high priority. Particular attention was paid to the new mandate for the management of the Government Pension Fund Global and the building up of investments in real estate. The Executive Board and Supervisory Council have worked together on establishing an appropriate management framework for real estate investments tailored to the provisions of the Norges Bank Act. The Council also carried out an assurance engagement assessing the framework for counterparty risk. The Council monitored developments in the external management of the Fund throughout the year.

The Supervisory Council has attached importance to establishing an appropriate supervisory and control structure for the Government Pension Fund Global with dialogue and coordination between the various internal and external audit and control bodies. In 2011 the Storting further clarified the division of roles and responsibilities between the Supervisory Council and the Office of the Auditor General, and the Council's follow-up of the principles established for collaboration with the Office of the Auditor General is based on this clarification.

When it comes to central banking activities, the Council focused, in the light of developments in the global economy, on the Bank's role and responsibilities in the areas of monetary policy and financial stability, including contingency plans and the Executive Board's adjustments to the guidelines for the foreign exchange reserves.

¹ Recommendation of the Standing Committee on Finance and Economic Affairs on the Report from Norges Bank's Supervisory Council for 2010 (Recommendation No. 435 S (2010–2011), cf. Document No. 17 S (2010–2011)).

THE SUPERVISORY COUNCIL'S OVERALL CONCLUSION

The Council received all of the information it requested in connection with its supervisory work in 2011.

The Supervisory Council is of the opinion that the Executive Board exercised satisfactory management and control of Norges Bank in accordance with the Norges Bank Act, the mandate and guidelines for the management of the Government Pension Fund Global, and the regulation on risk management and internal control at Norges Bank.

The supervision of the Bank's activities and compliance with the rules for its operations revealed no cause for special remarks under the Act.

The Supervisory Council has reviewed the Executive Board's minutes for 2011. Questions were raised about specific matters, and the Central Bank Governor gave satisfactory explanations. The Council did not minute any special remarks on the Executive Board's minutes in 2011.

The Council has approved the Bank's budget and adopted its financial statements for 2011.

SECTION 2

THE SUPERVISORY COUNCIL'S ROLE AND RESPONSIBILITIES

Section 75c of the Norwegian Constitution requires the Storting to “*supervise the monetary affairs of the Realm*”. This role is performed partly by Norges Bank's Supervisory Council, which is appointed by the Storting pursuant to the Norges Bank Act².

Norges Bank is an independent legal entity owned by the state. Its duties and management structure are regulated by the Norges Bank Act. The Bank's governing bodies are the Executive Board and the Supervisory Council. The Council's authority and duties are set out in the Act, the key provisions being as follows (text in italics quoted from the Act).

“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 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 task of managing the Government Pension Fund Global is delegated to the Bank in the Government Pension Fund Act³ and regulated by a management mandate issued by the Ministry of Finance. The mandate is implemented within the bounds of the Norges Bank Act. It was specified in the preparatory work on the amendments to the Norges Bank Act in 2009⁴ that the Supervisory Council's supervisory role extends to the

Bank's management of the Government Pension Fund Global.

The Act states that “the Executive Board's exercise of discretionary authority under the Act” is not subject to the Council's supervision. This means that the Council is not to appraise the Executive Board's discretionary assessments within the regulatory framework for Norges Bank, including the exercise of its executive authority, monetary policy decisions and advice.

The general supervision of the Bank's activities will, however, include the organisation and processes established by the Bank as a basis for the exercise of this discretionary authority.

“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 this Act shall be performed by companies that are partly or wholly owned by the Bank. The Supervisory Council shall be responsible for supervising such companies.” This provision was relevant in 2011 when the Bank set up subsidiaries for real estate investments.

“The Supervisory Council adopts the annual accounts of the Bank and, on the proposal of the Executive Board, approves the budget.” The Council appoints the external auditor and is required by law to have a secretariat.

The Council also has statutory powers in a number of specific areas.

“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 Supervisory Council issues 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.”

² Act No. 28 of 24 May 1985 relating to Norges Bank and the Monetary System etc. (the Norges Bank Act), last amended on 17 December 2010, sections 5, 7, 8a, 30 and 30a.

³ Act No. 123 of 21 December 2005 on the Government Pension Fund and Regulation No. 1414 of 8 November 2010 on the Mandate for the Management of the Government Pension Fund Global.

⁴ Proposition No. 58 (2008-2009) to the Odelsting on Amendments to Act No. 28 of 24 May 1985 relating to Norges Bank and the Monetary System etc. (new accounting and auditing system etc.), section 5.1 “Current supervision and control system”.

Section 30 of the Act requires the Council to submit a statement to the Storting at least once a year, which “*shall, at the minimum, 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 Council’s supervision of the Bank’s investment management activities,
4. the 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 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 information is provided in the present report.

DIVISION OF ROLES AND RESPONSIBILITIES BETWEEN THE SUPERVISORY COUNCIL AND THE OFFICE OF THE AUDITOR GENERAL

The division of roles and responsibilities between the Supervisory Council and the Office of the Auditor General when it comes to the supervision and audit of the Government Pension Fund Global was discussed in the Council’s report for 2010. This was based on the division of roles described in the preparatory work on the amendments to the Norges Bank Act in 2009, the Ministry of Finance’s report to the Storting on the management of the Government Pension Fund in 2009⁵ and the Standing Committee on Scrutiny and Constitutional Affairs’ recommendation to the Storting on the Office of the Auditor General’s Document No. 1 (2010–2011) for the 2009

budget year⁶. The agreement entered into in December 2010 on the general principles for the exchange of information and coordination between the two bodies in relation to the Government Pension Fund Global was also mentioned. In the opinion of the Supervisory Council, this agreement provided a sound basis for practical collaboration in 2011.

The division of roles and responsibilities between the Supervisory Council, Norges Bank’s external auditor and the Office of the Auditor General was also described and clarified during the Storting’s consideration of the government’s report to the Storting on the management of the Government Pension Fund in 2010⁷. Recommendation 436 S (2010–2011) from the Standing Committee on Finance and Economic Affairs refers to previous clarifications:

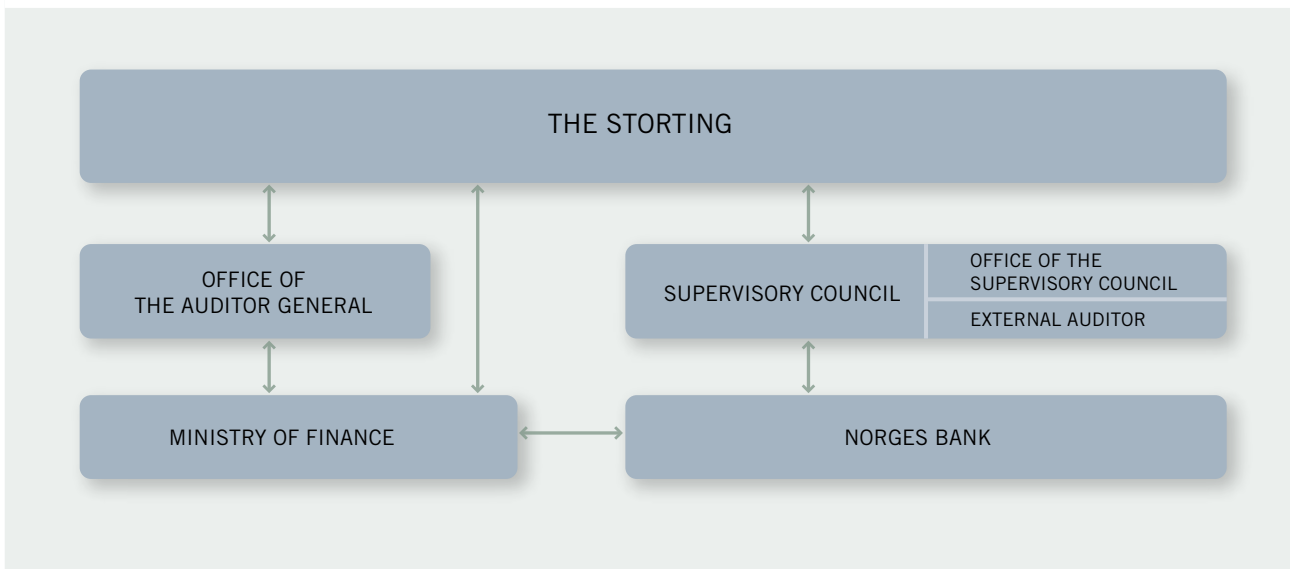
“A majority of the Committee, all except for the members from the Progress Party, has noted that questions have been raised about the interpretation of the role of the Office of the Auditor General in relation to the Government Pension Fund. The majority refers to the Storting’s clarification, most recently in connection with the consideration of Document No. 1 (2010–2011) and Document No. 3:2 (2010–2011) from the Office of the Auditor General, that the Office of the Auditor General is to ensure that the Ministry of Finance manages the Fund in accordance with the Storting’s intentions and decisions, while the Supervisory Council, based on the work of the external auditor, is to ensure that Norges Bank’s management of the Fund complies with the guidelines issued by the Ministry. (...) The majority stresses the importance of a clear division of roles and responsibilities, including between the various bodies overseeing the Government Pension Fund. The majority notes that the Office of the Auditor General is to carry out a performance audit of the Ministry of Finance and a financial audit of the

⁵ Report No. 10 (2009–2010) to the Storting on the Management of the Government Pension Fund in 2009, section 4.2.

⁶ Recommendation 138 S (2010–2011) from the Standing Committee on Scrutiny and Constitutional Affairs on the Office of the Auditor General’s Report on the Annual Financial Audit and Control for the Budget Year 2009.

⁷ Report No. 15 (2010–2011) to the Storting on the Management of the Government Pension Fund in 2010.

FIGURE 1 DIVISION OF ROLES AND RESPONSIBILITIES BETWEEN NORGES BANK'S SUPERVISORY COUNCIL AND THE OFFICE OF THE AUDITOR GENERALSTORTING



“Government Pension Fund” item in the National Accounts, and oversee the minister’s exercise of his authority, but beyond this the Office of the Auditor General is not to oversee Norges Bank and the Government Pension Fund Global or Folketrygdfondet and the Government Pension Fund Norway.”

The division of roles and responsibilities between the Supervisory Council and the Office of the Auditor General is illustrated in Figure 1.

The Supervisory Council notes that, in its report to the Storting on the annual audit and control for the 2010 budget year (Document No. 1 (2011–2012)), the Office of the Auditor General refers to previous statements on the audit of the Government Pension Fund Global made by the Standing Committee on Scrutiny and Constitutional Affairs. The Office of the Auditor General writes that it will carry out its audits in line with the Storting’s intentions.

The Standing Committee on Scrutiny and Constitutional Affairs states in its recommendation⁸ on Document No. 1 (2011–2012) that the Fund’s various supervisory and control bodies should engage in appropriate dialogue. The Committee also notes that guidelines have been laid down for the exchange of information and coordination of auditing and supervision between the Office of the Auditor General and the Supervisory Council when it comes to the Government Pension Fund Global.

In the opinion of the Supervisory Council, the Storting’s clarifications of roles and responsibilities, the Office of the Auditor General’s statement on the subject, and the agreed guidelines together provide sound foundations for future interaction between the supervisory and audit bodies.

⁸ Recommendation 211 S (2011–2012) from the Standing Committee on Scrutiny and Constitutional Affairs on the Office of the Auditor General’s Report on the Annual Financial Audit and Control for the Budget Year 2010.



Back row: Reidar Åsgård, Ingebrigt S. Sørffonn,
Marianne Lie, Tormod Andreassen,
Eva Karin Gråberg and Vidar Bjørnstad.

Third row: Randi Overland and Morten Lund.

Second row: Synnove Sondergaard,
Rumbjørg Bremset Hansen, Tine Sundtoft and
Erland Vestli.

Front row: Frank Sve (deputy chairman),
Reidar Sandal (chairman) and Monica Salthella.

SECTION 3

THE SUPERVISORY COUNCIL'S COMPOSITION AND ORGANISATION

The Supervisory Council has 15 members elected by the Storting for a four-year term. From among the members, the Storting elects a chairman and deputy chairman for a term of two years. A named alternate is also elected for each full member. The members of the Council have a broad professional background and experience from key areas of Norwegian society, public administration and industry.

The Storting's election of members to the Supervisory Council for the period 2012–2016⁹ resulted in four members being re-elected and four new members being appointed. The new members serving from 1 January 2012 are Vidar Bjørnstad, Tine Sundtoft, Ingebrigt S. Sørffonn and Randi Øverland. Kåre Harila, Terje Ohnstad, Tom Thoresen and Gunvor Ulstein stepped down on the same date. Reidar Sandal and Frank Sve were re-elected as chairman and deputy chairman for the next two years.

The appendix to this report provides a full list of members and alternates for 2012–2013 with their terms of office.

Pursuant to the Norges Bank Act, the Council has established a Permanent Committee consisting of its chairman, deputy chairman and three other members elected by the Council for a term of two years. The Committee has no decision-making powers but prepares and makes recommendations on matters to be considered by the Council.

In 2010–2011 the Committee comprised Reidar Sandal (chairman), Frank Sve (deputy chairman), Runbjørg Bremset Hansen, Monica Salthella and Tom Thoresen. The chairman and deputy chairman have been re-elected for 2012–2013, as have Runbjørg Bremset Hansen and Monica Salthella, while Reidar Åsgård has joined as a new member. Appendix 1 provides a full list of members and alternates for the period 2012–2013.

⁹ Recommendation 121 S (2011–2012) of the Election Committee on the Election of Members and Alternates to Norges Bank's Supervisory Council and the Remuneration of the Supervisory Council and the Permanent Committee.

OFFICE OF THE SUPERVISORY COUNCIL

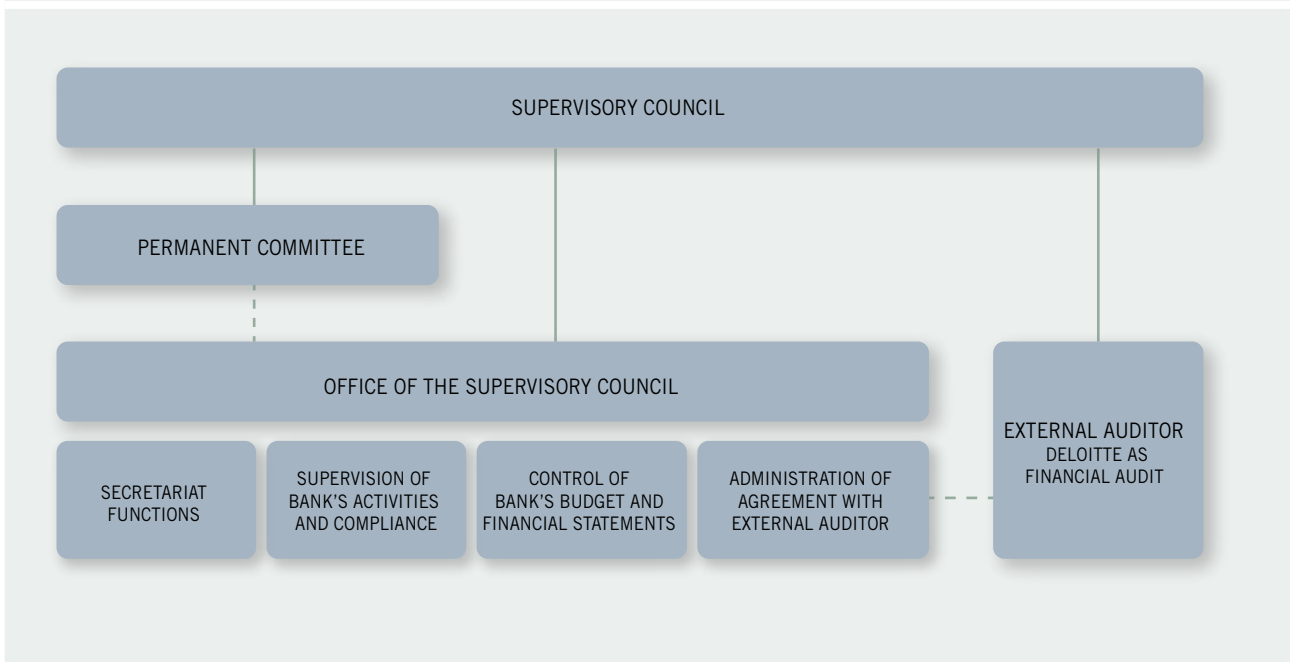
The Office of the Supervisory Council performs supervisory and control work, administers the agreement with the external auditor, and provides secretariat functions for the Council. The Office also serves as a coordinator between Norges Bank, the external auditor and the Office of the Auditor General, especially when it comes to the Government Pension Fund Global. The Office is professionally and administratively independent of Norges Bank. The Supervisory Council issues standing instructions for the Office, appoints its director and approves the director's job description and terms of employment.

The Council approves the Office's annual supervision plan, budget and expenditure. The Office of the Supervisory Council has nine employees, all of whom have a university education and extensive experience in fields such as economics, accountancy, auditing and law. Where necessary, the Office's personnel are supplemented with external expertise.

EXTERNAL AUDITOR

The Supervisory Council has appointed Deloitte AS external auditor for Norges Bank and signed an engagement agreement running for six years from 2010. Deloitte is one of the largest accountancy firms both in Norway and globally. Its main task is the audit of Norges Bank's annual financial statements, including the financial reporting for the Government Pension Fund Global. The agreement also covers the audit of Norges Bank's subsidiaries and the review of the Fund's quarterly financial statements. Other auditing and advisory services may also be provided under the terms of the agreement.

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

FIGURE 2 THE SUPERVISORY COUNCIL'S ORGANISATION STRUCTURE

SECTION 4

THE SUPERVISORY COUNCIL'S ACTIVITIES AND EXPENDITURE IN 2011

The Supervisory Council considered 100 matters in 2011, and a further 21 were submitted to the Supervisory Council for information. Due to the increased caseload and greater public interest in the quarterly reports for the Government Pension Fund Global, the number of ordinary meetings was increased in 2011 from the usual five to six. The Permanent Committee held 13 meetings.

Figure 3 provides a breakdown of the matters considered by the Council between Norges Bank in general, central banking and investment management. These include both matters put forward by the Executive Board and technical matters from the Office of the Supervisory Council and the external auditor. It also shows the number of administrative matters relating to the Office of the Supervisory Council and the Council's own activities.

The Council held a technical seminar in 2011 examining Norges Bank's duties, priorities and challenges in greater depth. Topics covered included the Bank's handling of the financial crisis, ethical challenges in investment management, investing in emerging markets, and risk management.

The Supervisory Council's expenditure in 2011 totalled NOK 29.7m. Table 1 breaks down this expenditure between the Council's own activities, the Office of the Supervisory Council and the external auditor.

TABLE 1 THE SUPERVISORY COUNCIL'S EXPENDITURE (NOK THOUSANDS)

UNIT	2011	2010	2009
Supervisory Council	2 378	1 936	1 845
Office of the Supervisory Council	11 108	11 220	10 306
Deloitte AS – assurance and supervision projects	4 100	5 000	3 250
Deloitte AS – financial auditing	12 073	14 483	12 387
Total	29 659	32 639	27 788

Fees payable to Deloitte AS by the Supervisory Council totalled NOK 16.2m in 2011. Deloitte also supplied services costing NOK 0.8m directly to Norges Bank. Approximately 80 per cent of the fees payable to the external auditor concerned investment management.

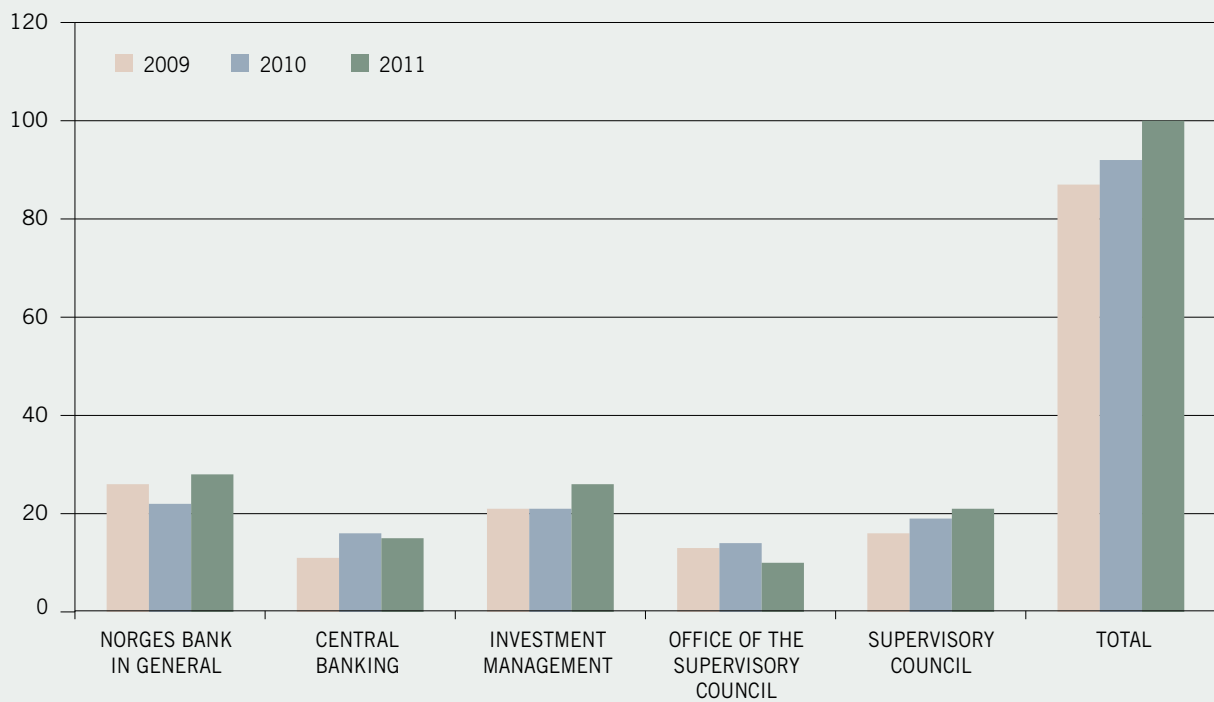
The amendments to the Norges Bank Act coming into effect on 1 January 2011 transferred the decision on the fees payable to members of the Supervisory Council from the Ministry of Finance to the Storting. The Storting decided during the year to adjust these fees in line with inflation with effect from 1 January 2012. The fees paid for 2011 were set with effect from 1 January 2009.

Annual fees payable to the Supervisory Council in 2011:

- chairman NOK 43,000
- deputy chairman NOK 27,000
- other full members NOK 21,000
- alternates NOK 3,500
- members of the Permanent Committee received an additional NOK 43,000

Total fees in 2011 came to NOK 646,000. The chairman and deputy chairman were paid a total of NOK 86,000 and NOK 70,000 respectively.

The Supervisory Council sets the salary of the director of the Office of the Supervisory Council, which was NOK 1,619,000 in 2011, an increase of 4 per cent on the previous year. His pension earnings and other benefits came to NOK 384,000 and NOK 16,000 respectively. The director recruits and sets the salaries of employees at the Office within limits laid down by the Council. Employees at the Office are members of Norges Bank's pension fund and are covered by Norges Bank's personnel schemes.

FIGURE 3 BREAKDOWN OF MATTERS CONSIDERED BY THE SUPERVISORY COUNCIL IN 2011

SECTION 5

METHODOLOGICAL APPROACH TO SUPERVISORY WORK

The starting point for supervisory work is the Supervisory Council's supervision of the Executive Board's management and control of the Bank's operations. The Council's supervision is based on an assessment of risk and materiality. It entails considering a combination of minutes and matters from the Executive Board and matters from the Office of the Supervisory Council and the external auditor. The Council can request the provision of further documentation and written statements from the Board.

Under its rules of procedure, the Council may lay down detailed guidelines for the Bank within its specific areas of authority.

The Council's chairman calls meetings in line with the agreed schedule, where deemed necessary, or where requested by five or more of its members or by the Executive Board. The Council passes a decision on all matters considered. Its supervision is documented in minutes of meetings and summarised in reports to the Storting. The minutes of its meetings are sent to the Ministry of Finance and the Office of the Auditor General.

The Central Bank Governor and Deputy Central Bank Governor attend these meetings unless the Council decides otherwise or there is another valid reason. Other members of the Executive Board may also attend and speak unless the Council decides otherwise. The employee representatives on the Executive Board generally attend. The Central Bank Governor may elaborate on matters and answer questions during their consideration, and may bring along experts from the Bank's operational units. Where necessary, additional information and presentations on specific matters and fields may be given at the meetings.

From 2011 a briefing by the Central Bank Governor was introduced as a separate item at the beginning of the Council's meetings. Here the Governor covers topical issues concerning the Bank's core operations and other matters of particular relevance to the Bank's operations.

It has become a tradition for the Council to hold an annual study trip and technical seminar as well as its ordinary meetings.

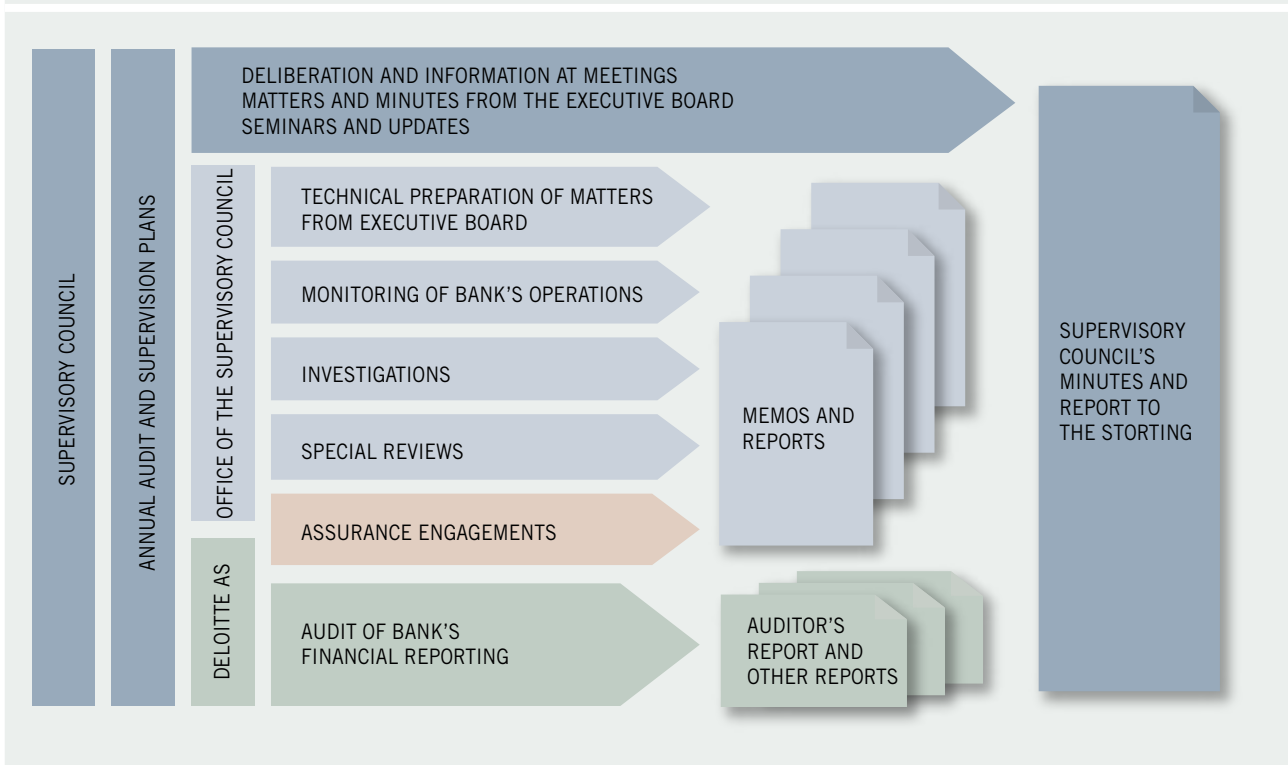
The Supervisory Council and the Office of the Supervisory Council continued their work on developing the supervision system and supervisory methodology in 2011. The Council's overall activities and supervisory process are illustrated in Figure 4.

The Office of the Supervisory Council keeps constantly abreast of Norges Bank's activities, partly by reviewing policy documents, reports and other case documents from meetings of the Executive Board.

When relevant matters are considered, the director of the Office of the Supervisory Council may attend meetings of the Executive Board and the Audit Committee. The director attends meetings of the Permanent Committee and the Supervisory Council, and may make supplementary comments on matters being considered. Additional meetings with the Bank's operational units are also held where necessary.

The Office of the Supervisory Council performs special supervisory and control procedures on selected themes in line with an annual supervision plan approved by the Council. The plan is prioritised on the basis of risk and materiality considerations. Supervision and control procedures are performed as general document-based supervision or more extensive audit and assurance reviews. Supervision is normally based on the laws and rules for the Bank's activities and the Executive Board's management and control processes. The work of the Office is summarised in an annual report to the Council. Major reviews and assurance engagements are reported on separately.

FIGURE 4 THE SUPERVISORY COUNCIL'S SUPERVISORY PROCESS



A system has been introduced in consultation with the Ministry of Finance covering concrete processes and issues in the management of the Government Pension Fund Global that the Ministry believes it is appropriate for the Council's supervision to cover. This system was mentioned in the preparatory work for the amendments to the Norges Bank Act in 2009. Recommendations from the Ministry are considered when drawing up the annual supervision plan.

Reviews have so far been performed by the external auditor as assurance engagements in accordance with internationally recognised standards¹⁰. Reports on these reviews are sent to the Ministry of Finance for information.

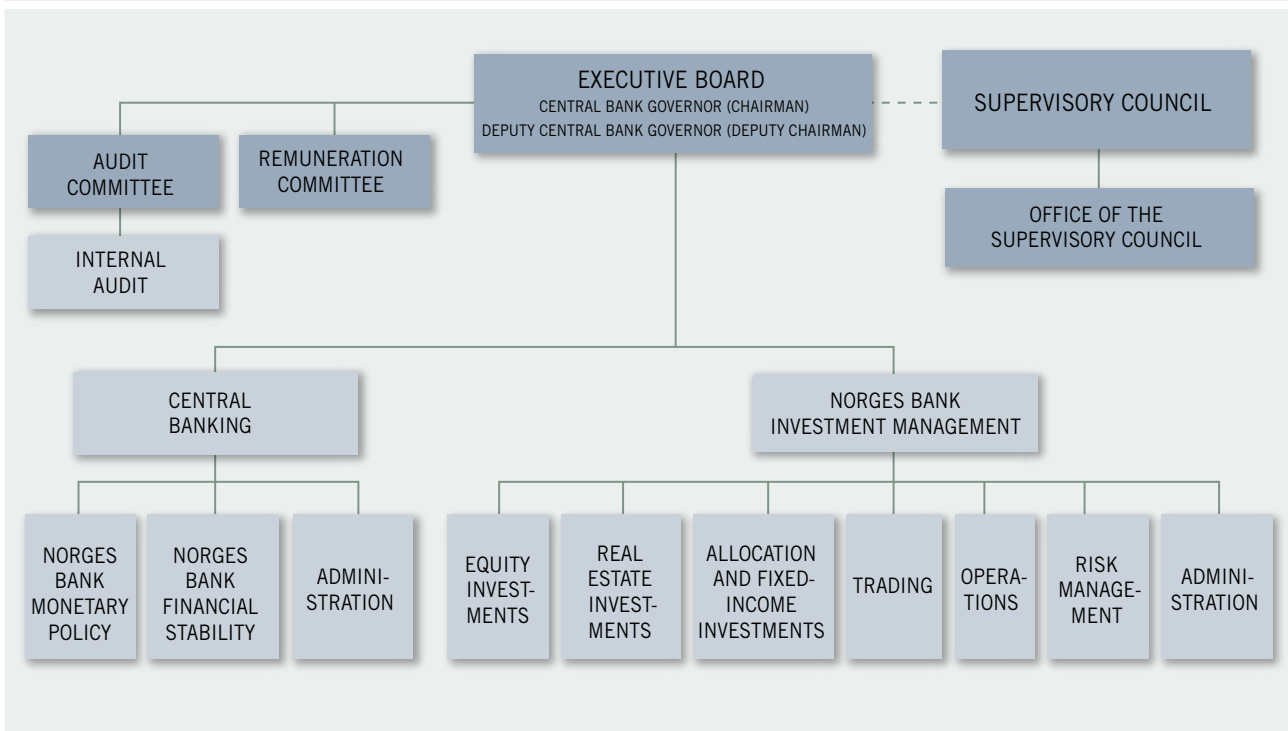
The Council has attached importance to establishing a comprehensive and balanced control and supervision regime at Norges Bank, partly through appropriate dialogue and coordination of activities between the Office of the Supervisory Council, the external auditor and the Bank's Internal Audit unit. The Council examines the external auditor's audit plan, statutory auditor's reports and other audit reports. The Office also monitors the external auditor's work during the year. There is regular contact between the Office of the Supervisory Council, the external auditor and Internal Audit. The Office and the external auditor review Internal Audit's reports and work, and assess whether this can be used in their supervisory work and financial auditing.

There has been increased public interest in the role and duties of the Supervisory Council in recent years. Openness about the Supervisory Council's work is achieved within the constraints and limits laid down in, among others, the Norges Bank Act, the Security Act and the Document Security Instructions, as well as the Freedom of Information Act and other public administration rules. The Council conducted a review of these constraints on its operations in 2011. Its members are subject to the Norges Bank Act's provisions on confidentiality. Any exemptions from the duty of confidentiality or increases in openness are decided on a case-by-case basis by the chairman of the Supervisory Council.

In principle, the minutes of the Supervisory Council's meetings are publicly available, while the case documentation is exempt from publication. The Council's public report to the Storting is designed to present a broad and complete picture of the Council's work and assessments. Separate reports are also published following the completion of assurance engagements.

¹⁰ *International Standard on Assurance Engagements (ISAE) 3000: Assurance engagements other than audits or reviews of historical financial information.*

FIGURE 5 NORGES BANK'S ORGANISATION



SECTION 6

NORGES BANK'S ORGANISATION AND OPERATIONS IN 2011

The Supervisory Council's supervision requires a broad knowledge of Norges Bank's operations and organisation and its management and control system. The following provides a general description of the Bank's organisation and operations in 2011. A fuller account of the established management and control structure is provided in sections 8–10. More detailed information can also be found in Norges Bank's official annual reports for 2011.

Norges Bank's operations are governed primarily by the Norges Bank Act, the Government Pension Fund Act and the Mandate for the Management of the Government Pension Fund Global issued by the Ministry of Finance. The Bank has introduced goals and values, with particular emphasis on promoting price stability, financial stability, and prudent and effective asset management.

Its operations and management are organised into central banking and investment management (Norges Bank Investment Management (NBIM)). In 2011 central banking activities were organised into three areas: the core areas of monetary policy and financial stability, and administration. NBIM is organised into three investment units – equities, real estate and fixed-income/allocation – and departments for trading, risk management, operations/IT and administration. The Bank's operations are led from its head office in Oslo. NBIM also has offices in London, New York, Singapore and Shanghai.

Norges Bank's organisation structure at the end of 2011 is shown in Figure 5.

The Bank had 629 employees at the end of 2011, divided into 314 in central banking and 315 at NBIM. Employees at the overseas offices accounted for 22 per cent of NBIM's workforce. The Bank has outsourced many operational support activities to external suppliers in Norway and abroad.

The tables below present selected data from the Bank's financial reporting in 2011 together with comparative data for 2010.

TABLE 2 CONDENSED BALANCE SHEET FOR NORGES BANK

BILLIONS OF KRONER	2011	2010
Financial assets	341	395
Investments, Government Pension Fund Global	3 309	3 075
Other assets	2	2
Total assets	3 652	3 472
Deposits from banks etc	92	80
Deposits from the Treasury	82	137
Notes and coins in circulation	55	54
Other liabilities	41	62
Deposits in krone account, Government Pension Fund Global	3 309	3 075
Equity	73	64
Total liabilities and equity	3 652	3 472

TABLE 3 NORGES BANK'S OPERATING INCOME AND EXPENSES

MILLIONS OF NOK	2011	2010
Management fees, Government Pension Fund Global	2 539	2 959
Other operating income	112	151
Personnel expenses	- 870	- 909
Other operating expenses	- 2 411	- 2 944
Depreciation, amortisation and impairment losses	- 93	- 77
Total other operating expenses	- 3 374	- 3 931
Net operating expenses¹¹	-723	-821

Besides operating income and operating expenses, Norges Bank generates income from financial instruments related to its foreign exchange reserves, which amounted to NOK 12bn net in 2011. The Bank's annual financial statements show total comprehensive income of NOK 8.4bn, which was allocated to equity.

Deposits in the krone account for the Government Pension Fund Global show the total value of the Fund, which was NOK 3,309bn at the end of the year. The increase from the year before breaks down into transfers of capital from the government during the year of NOK 274bn and a negative overall investment return of NOK 39.6bn. Before foreign exchange gains, there was a negative investment return of NOK 86bn. The return on the management of the Fund does not impact on the Bank's profit or equity but is taken directly to the krone account for the Government Pension Fund Global. Costs for the management of the Fund were covered by the Ministry of Finance's budget for 2011. The total fee for the year was NOK 2,539m.

Reference should also be made to the detailed information on the Bank's operations, management and results in its annual report and financial statements and the annual report on the management of the Government Pension Fund Global for 2011. The Council's consideration of the annual financial statements is presented in section 11 below.

¹¹ Net operating expenses are not presented on the face of Norges Bank's income statement.

SECTION 7

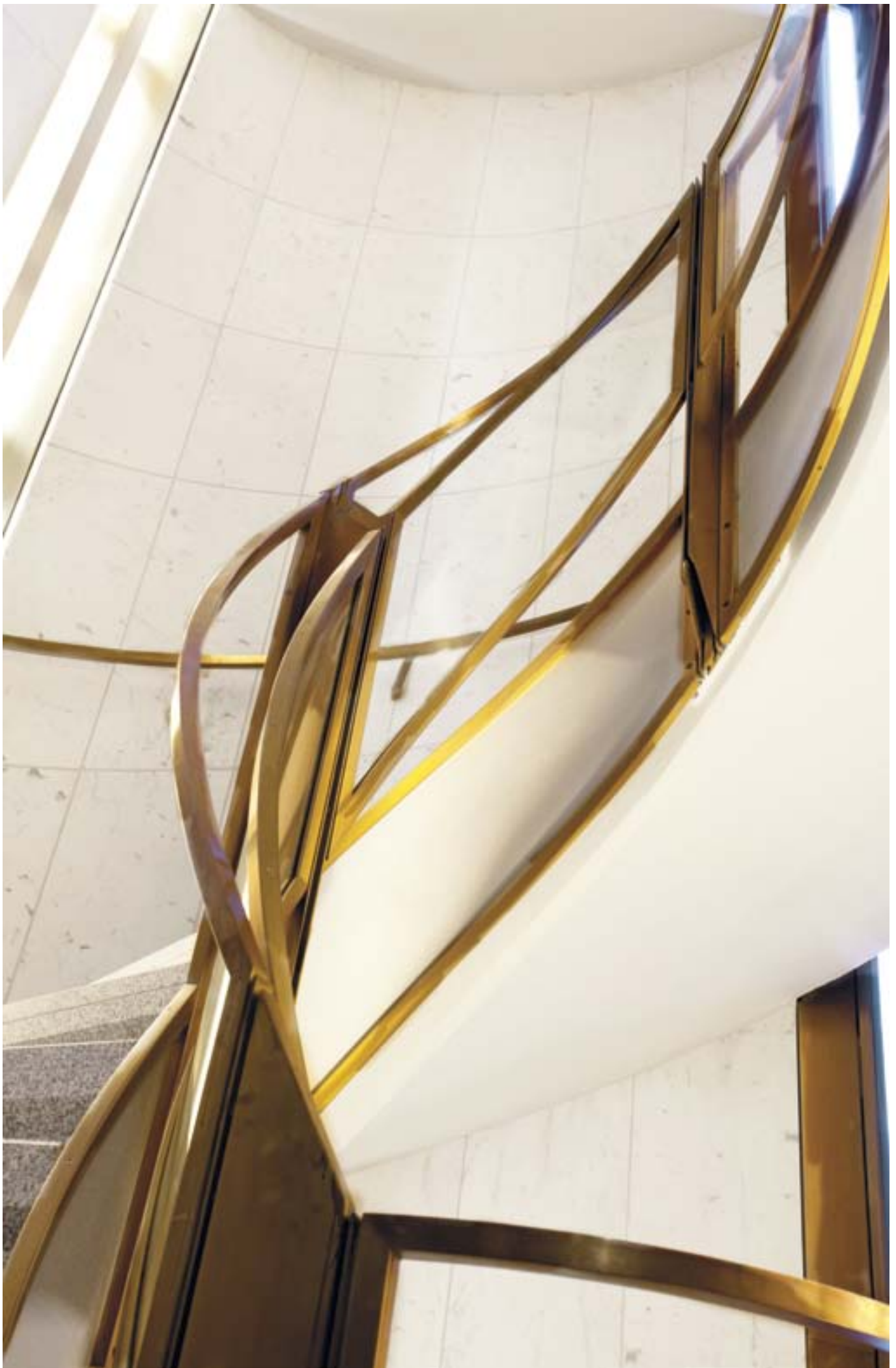
REVIEW OF THE EXECUTIVE BOARD'S MINUTES

The Supervisory Council's review of the Executive Board's minutes is a duty explicitly conferred upon it by the Norges Bank Act, which requires the Council to issue a "*statement on the minutes of the meetings of the Executive Board*".

The Council undertook a detailed assessment of this provision in 2011. The assessment confirmed the established practice of viewing the minutes of the Executive Board's meetings as a particularly important element in the Council's supervision of the Bank. The minutes provide an overview of the matters considered by the Executive Board and the decisions reached on specific matters. The minutes also give the Council a starting point for asking the Central Bank Governor for supplementary written information or additional verbal statements at meetings when considering the Executive Board's deliberations and decisions. The Council has noted an increase in both content and scope in recent years, with more information and statements on individual matters. This is helping to strengthen the basis for the Council's supervision.

The director of the Office of the Supervisory Council attends those parts of the Executive Board's meetings where matters relevant to supervision are considered. The Supervisory Council has reviewed all of the Executive Board's minutes for 2011. The Central Bank Governor attended meetings of the Supervisory Council and responded to questions on individual matters, and satisfactory answers were given.

The Council discussed some aspects of the Executive Board's minutes in greater depth during the year, but did not minute any special remarks on the Executive Board's minutes in 2011.



SECTION 8

SUPERVISION OF OVERALL MANAGEMENT AND CONTROL

ESTABLISHED MANAGEMENT AND CONTROL STRUCTURE

The Executive Board's appointment, composition, duties and responsibilities are governed by the Norges Bank Act. The Board has seven members, all appointed by the King in Council. The Central Bank Governor and Deputy Central Bank Governor are to be the chairman and deputy chairman of the Executive Board. The Bank's employees also appoint two members from their ranks who join the Executive Board for the consideration of administrative matters.

The Norges Bank Act states that the Executive Board *“shall be responsible for the organisation of, and for establishing satisfactory frameworks, objectives and principles for, the sound operations of the Bank. The Executive Board shall ensure that the Bank's operations, including accounting and asset management, are under satisfactory governance and control. The Executive Board shall supervise the Bank's administration and other activities.”*

The Executive Board has set up two subcommittees. The Audit Committee consists of three of the Board's five external members and is a preparatory and advisory body which is to help increase the quality and efficiency of the Executive Board's work on the management and oversight of financial reporting, risk management, internal control and internal auditing. A review of the Internal Audit unit's plans and work is a key part of the Committee's tasks.

The Committee's mandate has covered operational risk and internal control since its creation in 2006, and in 2011 its mandate was extended to include preparation of the Executive Board's consideration of financial reporting – both the quarterly and annual reports on the Government Pension Fund Global and the Bank's own annual report and financial statements. The Committee's extended area of responsibility entails closer contact with the external auditor.

Internal Audit reports to the Executive Board via the Audit Committee. The unit is to ensure that adequate and effective management of significant risks at Norges Bank is established and implemented, and that internal controls are appropriate and reassuring.

The Executive Board also has a Remuneration Committee consisting of two of the Board's external members. This is a preparatory and advisory body for matters concerning the Bank's pay and remuneration arrangements.

The Executive Board issues strategies and general policy documents defining premises and limits for the Bank's operations. Three-year general strategies have been drawn up for both central banking and investment management. The Central Bank Governor is the Bank's chief executive and, pursuant to section 5 of the Norges Bank Act, *“is in charge of the Bank's administration and the implementation of the decisions.”* The Executive Board has delegated the operational management of investment management to the Executive Director of NBIM. The control systems for central banking and investment management are discussed in more detail in sections 9 and 10 respectively.

Risk management is integrated into operational management, and importance is attached to striking a balance between objectives, risks and control procedures for the Bank's key processes. Underlying frameworks and processes have been established in the organisation for the identification of significant risks, assessment of risk-reducing control measures and reporting. Functions have also been established to ensure compliance with laws, regulations and internal rules. Significant risks are also followed up through Internal Audit's work, which is reported to the Executive Board. When entering into agreements on outsourcing services, the Bank insists on the right of access to the supplier's risk management and internal control system.

THE SUPERVISORY COUNCIL'S GENERAL OVERSIGHT

In 2011 the Supervisory Council considered a number of matters as part of its supervision of the Executive Board's overall management and control of Norges Bank's operations. These included:

- Principles for the management of security, contingency planning and crisis management at Norges Bank
- Norges Bank's plans and budgets for 2011 and 2012, including assessments of operational risk and action plans
- 2011 report on operations
- 2011 threat assessment for Norges Bank
- The Executive Board's audit plan (plan for Internal Audit's work)
- General assessment of internal controls and risk management
- Annual report from Internal Audit
- Norges Bank's annual report and financial statements
- Ethical principles for Norges Bank's employees
- 2011 personnel policy report
- Revised mandate for the Executive Board's Audit Committee
- Follow-up of the audit report from Deloitte AS
- Annual report and accounts for Norges Bank's pension fund

The Council receives the Executive Board's audit plan and audit reports from Internal Audit for information. It has also become an established practice for the Council to receive an annual statement from the Audit Committee's chairman on the Committee's activities.

The Supervisory Council's supervision has provided documentation that the Executive Board has implemented processes to update the overall management and control system. In addition, the Council has had it documented, through material from the Executive Board and statements from the Central Bank Governor, that the Board regularly

follows up targets, action plans, internal control and the risk situation on the basis of this system.

The Council's consideration of specific matters relating to the Bank's operations in general is presented below.

SPECIFIC MATTERS

COMPLIANCE WITH THE REGULATION ON RISK MANAGEMENT AND INTERNAL CONTROL AT NORGES BANK

The Ministry of Finance has issued a regulation on risk management and internal control at Norges Bank (the Internal Control Regulation), which entered into force on 1 January 2010 and supplements the Norges Bank Act's rules on the responsibility of the Executive Board and the Central Bank Governor for the management and control of the Bank's operations. In accordance with the Regulation, the Executive Board has drawn up general principles for risk management at Norges Bank and more detailed risk management principles for central banking and investment management respectively.

The Regulation requires the Executive Board to present a general assessment of internal control and the risk situation to the Supervisory Council at least once a year. In 2011 the Bank worked on strengthening its control environment and management structure, including its systematic approach to operational risk management and compliance with the Internal Control Regulation. A systematic structure for annual and periodic operational reporting and reporting on internal control and risk management by the operational units and Internal Audit has been established. The Executive Board considers the risk situation in central banking to be acceptable, and operational risk at NBIM to be within the set tolerance limits.

In the opinion of the Supervisory Council, compliance with the requirements of the Internal Control Regulation has been documented. In its future work, the Council will keep abreast of the Executive Board's follow-up of risk reduction measures.

SECURITY AND CONTINGENCY PLANNING

Security and contingency planning are a priority area at Norges Bank. The consequences of any incidents can be serious. The Executive Board has drawn up principles and general guidelines for security, contingency planning and crisis management at Norges Bank, including NBIM. The principles take account of, among others, the requirements of the Security Act, the Document Security Instructions, the Personal Data Act, the Working Environment Act and new public guidelines and standards for security. Various aspects of security – such as information, asset, cash and personal security – are covered by the guidelines. The Supervisory Council has reviewed and taken note of these principles.

Norges Bank performs regular threat assessments of factors that could affect the security and interests of the Bank and its employees nationally and internationally. These threat assessments are reported to the Executive Board, and the Supervisory Council was kept abreast of these assessments and related actions in 2011. A special update was given on the Bank's handling of the situation following the events of 22 July 2011 and the Bank's subsequent follow-up work.

The supervision of this area in 2011 supports the Council's view that Norges Bank gives work on security and contingency planning high priority. The supervision plan for 2012 includes a review and assessment of the Bank's processes in this area.



SECTION 9

SUPERVISION OF CENTRAL BANKING ACTIVITIES

ESTABLISHED MANAGEMENT AND CONTROL STRUCTURE

Central banking activities comprise the core areas of monetary policy and financial stability as well as administration. Line management is the key management principle. On the basis of principles, strategies and limits adopted by the Executive Board, the Central Bank Governor issues supplementary guidelines and action plans for the Bank's areas. All line managers have clearly defined responsibilities and authority, which include planning, implementation and reporting on activities and the use of resources. The management principles also cover risk assessments, internal controls and monitoring compliance.

The administration area is responsible for staff and support functions and for the systems and shared processes for risk management and control. There are also a number of bank-wide functions that include responsibilities and duties relating to NBIM.

Semi-annual and annual operational reports are prepared for the Executive Board on the status of action plans, risk management and internal controls in the central banking area.

THE SUPERVISORY COUNCIL'S GENERAL OVERSIGHT

In its supervision, the Supervisory Council has attached importance to ensuring that the Executive Board sets the premises for central banking activities and systematically follows up results, risks, compliance, incidents and action plans. The Council has considered the following matters which provide a broad insight into the basis and development of supervision of the Executive Board's management and control of central banking in 2011:

- Strategic plan for central banking for 2011–2013
- The Executive Board's investment mandate for the management of Norges Bank's foreign exchange reserves
- Overall annual assessment of internal controls and the risk situation in central banking
- Operational reports for central banking activities
- Annual and quarterly reports on the management of Norges Bank's money market portfolio
- Financial stability reports
- Monetary policy reports
- Semi-annual and annual reports on notes and coins
- Annual report on payment systems
- Annual report on Norges Bank's settlement system and collateral for banks' lending
- Reports from Internal Audit

As part of its supervisory work, the Supervisory Council has received documentation that the Executive Board and the central banking area regularly assess the management framework and systematically follow up the area's risk management and results. The Executive Board also reports on any undesirable incidents and the Bank's handling of these incidents to the Supervisory Council during the year. The Council is positive about how this is also happening in the general operational reporting.

The Council has noted the central banking area's assessments of the need for the clarification of roles and responsibilities for risk management in bank-wide processes, and steps have been taken to strengthen compliance work. The Council has also noted the development work under way on management processes and the reorganisation of central banking in 2012.

The Council's consideration of specific matters in the central banking area is presented below.

SPECIFIC MATTERS

GOVERNMENT DEPOSITS AT NORGES BANK

Central government deposits at Norges Bank totalled NOK 82bn at the end of 2011, and interest of NOK 2bn was paid.

An agreement has been reached between the Ministry of Finance and the Bank on the operation and management of the government's accounts at the Bank. As part of central government's financial management, a group account system has been set up where deposits from the Treasury at Norges Bank are the top level. Under the agreement, the Bank's work is to be performed in accordance with the Norges Bank Act, the rules governing financial management in the central government sector and the guidelines for settlement accounts in the group account system.

The agreement also requires an independent audit or control body to submit an annual assurance statement to the Ministry on the Bank's compliance with specific requirements in the agreement. This statement includes assessments of control procedures relating to the agreement's security and contingency planning requirements.

The Office of the Supervisory Council issued an unqualified statement for 2011. The Council has taken note of this statement and submitted it to the Ministry.

NORGES BANK'S ROLE AND RESPONSIBILITIES IN WORK ON MONETARY POLICY AND FINANCIAL STABILITY

The review of the Executive Board's minutes gives the Supervisory Council a broad overview of matters considered by the Executive Board in the areas of monetary policy and financial stability. In the light of the deterioration in the global economy in the second half of 2011, a new practice was established whereby the Central Bank Governor gives a briefing at each meeting of the Supervisory Council. These briefings provided the Supervisory Council with regular information about the economic situation and the challenges for financial stability. Informa-

tion was provided on the Bank's analyses, instruments and contingency plans for countering financial turmoil.

The Supervisory Council performed an assessment in 2011 of its consideration of Norges Bank's monetary policy reports, which are published three times a year. The main purpose and content of these reports mean that they fall outside the Council's immediate supervisory responsibilities, but the reports provide a good insight into the Bank's core area and technical challenges. As a result of this assessment, the Council has received the monetary policy reports for information since autumn 2011. A similar assessment has been performed for the Bank's financial stability reports, which are published twice a year.

Topical issues reported and elaborated on at meetings or seminars in 2011 included the response to the financial crisis, global developments, and the processes leading to the Executive Board's interest rate forecasts and decisions. The Council considered a report from Internal Audit to the Executive Board on the management and organisation as well as the administration and use of models in working processes in the monetary policy area.

All in all, these reports and briefings in the areas of monetary policy and financial stability provide a sound basis for the Supervisory Council's supervision of the Bank's operations in these areas.

NOTES AND COINS

Norges Bank is responsible for issuing notes and coins. This involves deciding on their face value and design. The Bank is also responsible for ensuring that society has access to and the necessary confidence in cash as a means of payment, and for promoting an efficient overall payment system. The Bank's duties and responsibilities in the notes and coins area have traditionally been given high priority by the Supervisory Council given the considerable inherent risk of irregularities and the low tolerance for errors. The Bank has outsourced central bank depot services to NOKAS AS.

The Supervisory Council receives the Bank's reports on notes and coins, which the Executive Board considers semi-annually.

Internal Audit has submitted a report to the Executive Board on the processes for the supply of notes and coins to the market, which has been considered by the Supervisory Council.

The Office of the Supervisory Council performs fixed annual supervisory tasks in this area. In 2011 it also performed a review and assessment of security in the processes for the destruction of banknotes by NOKAS AS on behalf of the Bank. As far as is known, Norges Bank is the only central bank to have outsourced this aspect of cash management. The main conclusion from the review was that the Bank has adequate control in this area through extensive agreements and close monitoring.

MANDATE AND GUIDELINES FOR NORGES BANK'S FOREIGN EXCHANGE RESERVES

Norges Bank's international reserves consist of foreign exchange reserves and claims on the International Monetary Fund (IMF). The foreign exchange reserves are to be available for intervention in the foreign exchange market in connection with the implementation of monetary policy or to promote financial stability.

The reserves are divided into a short-term money market portfolio managed by Norges Bank Monetary Policy and a long-term portfolio and a buffer portfolio managed by NBIM. Net foreign exchange reserves totalled NOK 262bn at the end of 2011: NOK 35bn in the money market portfolio, NOK 224bn in the long-term portfolio and NOK 3bn in the buffer portfolio.

Quarterly and annual reports on these portfolios supplemented with statements from the Bank have been considered by the Supervisory Council. As part of its supervision, the composition and risk profile of the foreign exchange reserves were assessed together with a description of the Executive Board's adjustments to the mandate and guidelines for the management of the foreign exchange reserves following the financial crisis in 2008. The Central Bank Governor's briefings on developments in the economic situation in Norway and abroad included an account of the effects on the Norwegian economy and Norges Bank's contingency planning. The Bank's adjustments to its foreign exchange reserves and management framework were also discussed.

The Executive Board has drawn up principles and frameworks intended in part to meet the central bank's need for liquidity.

The aforementioned assessment and the Governor's briefings show that the Executive Board regularly assessed the mandate and guidelines for the foreign exchange reserves and oversees their management through quarterly reporting.

This topic will continue to have high priority in the Supervisory Council's future work.

SECTION 10

SUPERVISION OF INVESTMENT MANAGEMENT ACTIVITIES

ESTABLISHED MANAGEMENT AND CONTROL STRUCTURE

The Executive Board introduced a revised policy document structure at NBIM in 2011. As part of this, principles for organisation and management at NBIM were drawn up, and the job description and investment mandate for the Executive Director of NBIM were updated.

Line management is the key management principle. This is formalised through a management framework established by the Executive Director of NBIM and also includes the structure for risk management and internal control. Besides the operational units, NBIM has established control functions to monitor and follow up operational risks and compliance with laws, regulations and internal rules.

Norges Bank has a large and complex investment management operation, and there will always be an inherent risk of operational errors and incidents. Operational errors could lead to direct financial losses or gains, and loss of reputation. The Executive Board set a tolerance limit for operational risk at NBIM in 2010, namely there must be less than a 20 per cent probability of unwanted operational events resulting in gains and losses totalling NOK 500m or more in any 12-month period.

The Executive Board receives monthly overviews and quarterly reports on developments in risks and returns. There are also quarterly reports on operational risk management and compliance with mandates and other rules. Significant breaches of the mandate for the management of the Government Pension Fund Global and other relevant operational incidents are reported to the Ministry of Finance. Any breaches of the Ministry's guidelines are also mentioned in the public quarterly and annual reports for the Fund.

THE SUPERVISORY COUNCIL'S GENERAL OVERSIGHT

In its supervision, the Supervisory Council ensures that the Executive Board sets the premises for investment management and systematically follows up results, risks, compliance, incidents and action plans. The Council considered many matters which together provide a good insight into developments and form a sound basis for the supervision of the Executive Board's management and control of investment management in 2011:

- Strategic plan for NBIM 2011-2013
- Update of the Executive Board's investment mandate and the job description for the Executive Director of NBIM
- The Executive Board's principles for risk management at NBIM
- Setting of operational risk tolerance for NBIM's activities
- Expectations documents for active ownership
- Rules on remuneration arrangements for NBIM employees
- Operational reports for NBIM
- Annual report on operational risk management and internal control at NBIM
- Public quarterly and annual reports on the Government Pension Fund Global
- Public quarterly and annual reports on the foreign exchange reserves
- Quarterly reports on risks and returns for the Government Pension Fund Global and the foreign exchange reserves
- Quarterly reports on operational risk management, internal control and compliance
- Reports from Internal Audit

The turmoil in global capital markets made its mark on investment management in 2011. The Council was kept updated through quarterly reports and supplementary statements on the substantial fluctuations in equity and

fixed-income markets, NBIM's assessments, and the Executive Board's follow-up of risks and returns.

The Council noted that the level of operational risk in 2011 was low relative to the Executive Board's tolerance limit. Fewer operational errors at suppliers, faults in IT systems and internal manual errors were reported than in previous years. The Council also took note of the assessments of exposure and operational risks relating to the extensive and complex processes and IT systems at NBIM and its service providers, as well as the work under way on monitoring and reducing operational risk levels.

As part of its supervisory work, the Supervisory Council received documentation that the Executive Board and NBIM regularly assess the management framework and systematically follow up NBIM's results, risks and incidents.

The Council's consideration of specific matters in the investment management area is presented below.

SPECIFIC MATTERS

NEW MANDATE FROM THE MINISTRY OF FINANCE FOR THE MANAGEMENT OF THE GOVERNMENT PENSION FUND GLOBAL

The new Mandate for the Management of the Government Pension Fund Global entered into force on 1 January 2011. The Executive Board has followed up the new mandate from the Ministry of Finance by issuing internal supplementary guidelines and policy documents for Norges Bank's management of the Fund.

Internal Audit conducted an evaluation for the Executive Board in 2011 of whether NBIM's policy documents meet the requirements of the mandate from the Ministry and the guidelines set by the Board. A summary of the report was considered by the Council.

The compliance function at NBIM has systems for detecting and following up any breaches of guidelines. Besides

compliance with the Ministry's mandate, this follow-up work covers internal guidelines and external rules. Monthly and quarterly reports are produced for the Executive Board. The Board forwards quarterly reports on compliance and operational incidents to the Supervisory Council. Significant breaches of the guidelines for the management of the Fund are reported to the Ministry in line with an established procedure. The Bank has gradually increased the level of official reporting on compliance in the quarterly and annual reports for the Fund. Compliance with the Executive Board's internal guidelines is also reported on here.

Internal Audit has performed an evaluation of the quarterly compliance report. The Supervisory Council has considered the report from the evaluation.

The Office of the Supervisory Council holds regular meetings with NBIM's control and compliance departments. These meetings include a review of the status of the follow-up of the Ministry's guidelines and internal guidelines. The Council has considered an assessment of the Executive Board's implementation and follow-up of the new mandate from the Ministry of Finance in 2011 following a review by the Office of the Supervisory Council.

All in all, the Supervisory Council has received adequate documentation and confirmation that the Executive Board has implemented and followed up the new mandate for the management of the Fund. The Supervisory Council did not receive any reports of significant breaches of the mandate in 2011.

COUNTERPARTY RISK

In 2009 the Supervisory Council decided on a programme of assurance engagements focusing on operational risk management in the management of the Government Pension Fund Global. The projects are being carried out by Deloitte AS in conjunction with the Office of the Supervisory Council. The programme was drawn up in consultation with the Ministry of Finance. Four of the

projects were carried out in 2009/2010 and discussed in the Supervisory Council's report to the Storting for 2010.

Programme for assurance engagements concerning operational risk management in the management of the Government Pension Fund Global – projects and timing:

- Organisation structure and management controls – 2009
- Operational risk and internal control – 2009
- Monitoring external managers – 2010
- Capital inflows and exposure to the chosen benchmark portfolio – 2010
- Framework for assessment of counterparty risk – 2011
- Risk management in relation to active management

In 2011 the Council commissioned Deloitte AS to perform an assurance review and assessment of NBIM's system for risk management and control of counterparty risk. This is the risk of loss due to a counterparty defaulting on its obligations before final settlement, and Norges Bank therefore not receiving the agreed payment in cash or securities. This risk may also arise in connection with defaults on bank deposits, or partners in real estate investments not fulfilling their contractual obligations.

The basis for the assessments in the review was measurement criteria derived from international standards and practical experience from similar operations. The report concluded that the system for risk management and control of counterparty risk has essentially been designed and implemented in line with the measurement criteria. The report was considered by the Council in December 2011 and made public in connection with its submission to the Ministry of Finance.

EXTERNAL MANAGEMENT

2010 saw considerable attention being given to Norges Bank's use of external managers and payment of performance fees. The Council discussed the auditing and supervisory work carried out extensively in its report to the Storting for 2010. The report reached the following conclusion: *"Fees of this magnitude seem high. In its supervision the Supervisory Council considered the matter in relation to the return generated and compared this with the Ministry of Finance's guidelines for the management of the Government Pension Fund Global. On this basis the Council can confirm that the audit and supervisory reviews in 2009 and 2010 did not reveal any lapse or breach of the Ministry of Finance's rules or any errors in the reporting. The Council has received an independent assurance statement that Norges Bank has designed and implemented processes for the management and control of external managers in line with relevant standards."*

Norges Bank conducted a process in 2010 and 2011 where a ceiling for the payment of fees was inserted into the contracts with each external manager. The Ministry of Finance has added a provision governing this to the mandate for the Government Pension Fund Global, as announced in the government's report to the Storting on the management of the Fund in 2010. The Bank's internal guidelines have been formulated with a concrete ceiling on annual payments per mandate of USD 25m. The Office of the Supervisory Council and the external auditor have received documentation and performed tests confirming that this ceiling for the calculation of fees has been implemented. The highest payment in 2011 was USD 19m.

External management was scaled back during the year from 9.2 per cent of assets under management for the Fund to 4.4 per cent. Performance fees to external managers totalled NOK 546m in 2011, against NOK 986m in 2010. The decrease in fees can be explained by strategic changes and generally weaker returns from the managers.

The Council has monitored developments in external management and fees through its consideration of quarterly reports, semi-annual accounts and budgets. Supplementary statements have been given by the Bank at meetings of the Council. In the opinion of the Supervisory Council, Norges Bank has introduced a fee structure for external managers that complies with the Ministry of Finance's mandate.

TRANSPARENCY IN THE MANAGEMENT OF THE GOVERNMENT PENSION FUND GLOBAL

The management of the Government Pension Fund Global attracts considerable public interest, and there is both a requirement and an expectation that Norges Bank will maintain a high level of openness to the extent permitted by responsible implementation of the management of the Fund. This is also clear from the Storting's consideration of matters concerning the Fund, and from the Ministry of Finance's management mandate. The Supervisory Council has stressed the importance of transparency in its consideration of matters concerning NBIM and the Fund.

The importance of transparency is also set out in NBIM's strategy, which was approved by the Executive Board and presented to the Council in 2011. NBIM must address the needs of many different domestic and foreign stakeholders in its communications. The Council has noted that the communication strategy is attaching increasing importance to Norwegian target groups.

The adaptation of quarterly and annual reports to new accounting rules, IFRS standards and a new mandate in 2011 led to an increased volume of public information about the management of the Fund. The volume of information made available on NBIM's website¹² is also considerable, including constantly updated information on the size of the Fund. The structure and content of NBIM's policy documents were also published in 2011. The Council has noted that the Fund performs well in both national and international comparisons.

The information publicly available on the management of the Fund and Norges Bank's implementation of the management task have undergone considerable change. All in all, the Supervisory Council is of the opinion that the information provides a good insight into the portfolio and how the management task has been performed. The level of information and transparency concerning the management of the Fund must nevertheless be regularly assessed.

The Bank has developed a high degree of openness in its external reporting of incidents and operational risk management, and the Council looks positively on this. The Council will continue to pay attention to the Bank's openness about its management of the Fund in 2012.

PERFORMANCE-BASED PAY

The Council's report for 2010 discussed a review of the design and implementation of NBIM's system for performance-based pay. The review concluded with a positive assessment of the Bank's design and oversight of the system.

The Ministry of Finance's regulation on remuneration at financial institutions has been applied to the management of the Government Pension Fund Global, with appropriate adjustments. The new mandate for the management of the Fund contains guidelines and limits for the remuneration system. The system is to help promote and incentivise good management and control of risk in investment management, prevent excessive risk-taking and help avoid conflicts of interest. On the basis of this, the Executive Board issued new guidelines for remuneration at NBIM in spring 2011. The Council has been given an account of the updates in the new rules.

The Office of the Supervisory Council and the external auditor have performed concrete tests confirming the implementation of the new rules. The Council confirms that NBIM has implemented a remuneration system which complies with the mandate for the management of the Fund.

12 www.nbim.no.

REAL ESTATE INVESTMENTS

In March 2010 Norges Bank was awarded a mandate to invest up to 5 per cent of the Government Pension Fund Global's portfolio in real estate outside Norway through a corresponding reduction in its allocation to bonds, previously 40 per cent.

The Council has been kept abreast of the status of the start-up of real estate investments. The previously agreed purchase of 25 per cent of The Crown Estate's portfolio of properties on Regent Street in London was finalised in spring 2011. The Bank also entered into a partnership with units of the listed French insurance company AXA Group SA during the year, through which the Fund owns 50 per cent of various properties and property companies in and around Paris. The Fund's real estate investments consisted of a portfolio of interests in 114 buildings at the end of 2011 and accounted for approximately 0.3 per cent of total assets under management.

Real estate investments are held through subsidiaries of Norges Bank for commercial, liability and tax reasons. This structure was discussed in the government's reports to the Storting on the Government Pension Fund for 2010 and 2011 and is regulated by the management mandate¹³. Besides setting up companies for the individual investments, Norges Bank created the holding company NBIM S.à r.l. in Luxembourg in 2011 as a platform for the Fund's real estate investments, primarily in mainland Europe. The corporate structure is illustrated in Figure 6¹⁴, cf. the more detailed description in the annual report on the management of the Fund in 2011. Investments will be made through the holding company, which will have

stakes in other companies investing directly or indirectly in properties.

The Bank carried out an extensive process throughout 2011 and early 2012 to design and implement a business model and a management and control framework for these corporate structures. The Council has considered the matter on several occasions. Two independent external legal opinions have been obtained on the Supervisory Council's role and responsibilities under the Norges Bank Act regarding the implementation and supervision of real estate investments through foreign subsidiaries. The legal issue has been particularly relevant for companies such as NBIM S.à r.l.

The opinions were available in January 2012 and clarify that under section 8a of the Norges Bank Act the Council has the authority to approve the creation of such companies on the proposal of the Executive Board. The Council is also to supervise these companies. Against this background, the Executive Board has, at the Council's request, adjusted the corporate documents and the framework for management and control in line with the provisions of the Norges Bank Act and made preparations for the formal approval of the operations of NBIM S.à r.l.

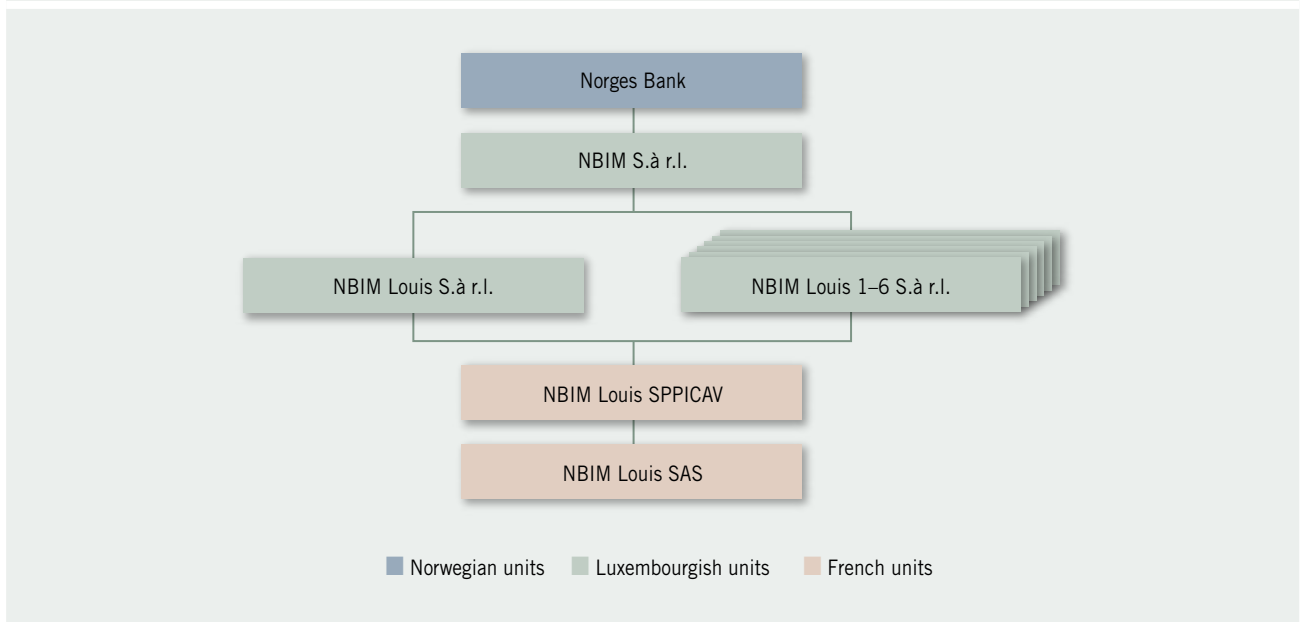
The Council has approved the proposal from the Executive Board concerning the operations of the company. The Council has laid down special guidelines for the creation and supervision of subsidiaries in accordance with the provisions of the Norges Bank Act. For example, there is a requirement that the Bank's external auditor is also the auditor of Norges Bank's subsidiaries.

In the opinion of the Supervisory Council, this process has established a robust framework for building up real estate investments further and for the management and control of the foreign corporate structures. This framework will need to be developed as these investments grow. Real estate investments will remain a priority area for the Council's supervision in future.

¹³ Section 4-3 (3): "The Bank may make investments in the real estate portfolio through Norwegian or other legal entities."

¹⁴ a) SPICCAV = Société de Placement à Prépondérance Immobilière à Capital Variable (SPPICAV). An unlisted, regulated investment vehicle.
b) SAS = Société par Actions Simplifiée. This company is party to the agreement with AXA and has lawful title to 50 per cent of the underlying assets in the form of properties and property companies.

FIGURE 6 CORPORATE STRUCTURE FOR REAL ESTATE INVESTMENTS IN MAINLAND EUROPE



SECTION 11

NORGES BANK'S BUDGET AND FINANCIAL STATEMENTS

ESTABLISHED BUDGETING AND ACCOUNTING PROCESSES

In accordance with the Norges Bank Act, each year the Executive Board prepares a proposed budget for Norges Bank for approval by the Supervisory Council. The Board's proposed budget is supported with risk assessments and action plans. The budget process complies with the Bank's budget rules as approved by the Supervisory Council and the supplementary provisions and guidelines issued by the Central Bank Governor. The Council's budget decision covers expenditure on ordinary operations and the number of full-time equivalent employees for the Bank's two areas. Investments are approved individually. The budget for central banking is largely a fixed budget, whereas the budget for NBIM is based on performance. The Council may issue special authorisations or additional allocations over and above the budget adopted. The budget is followed up by the Executive Board through semi-annual operational reporting. The budget adopted each year is communicated to the Ministry of Finance.

Under the mandate for the management of the Government Pension Fund Global, the Ministry of Finance sets a limit each year for the fee covering Norges Bank's direct and indirect management costs. The limit each year is based on estimates of costs in Norges Bank's budget. Performance fees for external managers are also covered.

Each year the Executive Board produces an annual report and annual financial statements. The annual financial statements are adopted by the Supervisory Council. The annual report, the audited annual financial statements, the auditor's 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.

OVERSIGHT OF EXPENDITURE AND DECISION ON NORGES BANK'S BUDGET

The Supervisory Council followed up the Bank's expenditure in 2011 by considering semi-annual reports and internal accounts. The internal accounts showed that expenditure was within the approved budget. The Supervisory Council notes that the internal accounts for 2011 and the budget for 2012 show a downward trend in costs relative to assets under management for the Government Pension Fund Global. The net reduction in costs is due partly to a large part of management having been brought in-house, resulting in reduced use of external managers and some economies of scale. On the other hand, growth in the workforce and the Fund led to higher wage, transaction and settlement costs.

The Council has no special remarks on the Bank's reporting on its expenditure in 2011.

Norges Bank's budget for 2012 has been approved by the Council. During its consideration of the budget, the Council paid attention to relevant comparative data, such as forecasts for costs in the current year. The budget is affected by commercial factors and the continued rapid expansion of NBIM's activities. Importance was attached to the budget decision covering income and costs for the Bank's entire operations, broken down into central banking and NBIM.

The Ministry of Finance has set an upper limit for the fees for the management of the Government Pension Fund Global in 2012 of 9 basis points (0.09 per cent) of average assets under management. The limit in 2011 and previous years was 10 basis points (0.1 per cent).

SPECIFIC MATTERS IN 2011

THE BANK'S FINANCIAL MANAGEMENT

The Office of the Supervisory Council has performed a review of the Bank's financial management model with assistance from Deloitte AS. Relevant frameworks, processes and information provided to the Supervisory Council have been reviewed and assessed. The Bank's budget rules and limits for financial management have also been considered in relation to recognised standards and good practice.

The review confirms that financial management at Norges Bank is performed in accordance with applicable rules, and that the Bank has good control of its expenditure. A number of areas for improvement were nevertheless identified, relating partly to structures, standardisation and clarification of management principles.

The Council has decided to launch a process with the aim of issuing comprehensive new general financial rules for Norges Bank. The framework will take account of the distinguishing characteristics of and differences between central banking and investment management activities. The final rules will be drawn up with appropriate collaboration between the Supervisory Council and the Executive Board.

Developing these rules for the Bank's financial management will strengthen the Council's capacity to perform its supervision.

MANAGEMENT OF CONVERSION PROJECTS AT NORGES BANK

In the 2010 report the Supervisory Council presented its follow-up of the conversion of premises for rental to the financial supervisory authority Finanstilsynet and the management of future conversion projects. The Executive Board established a model for the management of conversion projects in 2010. NOKAS AS moved out of the Bank's premises towards the end of 2011, and a fresh process of converting and adapting the premises vacated has begun. Parts of the vacant premises will be let. The Council has been kept abreast of progress and costs in this work through the Bank's budget and expenditure reporting.

The Executive Board's management model will form the basis for the Supervisory Council's supervision of the implementation of planned conversion projects in 2012.

NORGES BANK'S FINANCIAL STATEMENTS FOR 2011

Norges Bank's financial statements for 2011 are the first to be prepared in accordance with the regulation on the annual financial statements of Norges Bank (the Annual Financial Statements Regulation). The Regulation contains supplementary provisions on the preparation of annual financial statements and annual reports in accordance with the Annual Accounts Act and International Financial Reporting Standards (IFRS) as endorsed by the EU. The Regulation also regulates the established practice of supplementary financial reporting for the Government Pension Fund Global being included as part of Norges Bank's annual financial statements and then being reproduced in the annual report on the management of the Fund.

Subsidiaries of Norges Bank that consist exclusively of investments as part of the management of the investment portfolio are included in the financial reporting.

Norges Bank's annual report and financial statements for 2011 and the auditor's report from Deloitte AS were considered at the Supervisory Council's meeting of 15 March 2012. The following decision was passed:

- *The Supervisory Council takes note of the Annual Report of the Executive Board for 2011.*
- *The Supervisory Council takes note of the auditor's report for Norges Bank for 2011.*
- *The Supervisory Council adopts Norges Bank's financial statements for 2011 with the following transfers and allocations:*
 - › *In connection with the introduction of IFRS, the sum of NOK 205m is to be transferred from "Other capital" to the Adjustment Fund.*
 - › *In accordance with the guidelines, the profit after other allocations of NOK 8 376m is to be transferred to the Adjustment Fund.*
 - › *There is no capital in the Transfer Fund and no transfers will therefore be made to the Treasury.*

At the same meeting, the Supervisory Council considered the annual report on the management of the Government Pension Fund Global in 2011 produced by the Executive Board. Deloitte AS has also issued an auditor's report on the consolidated financial reporting for the investment portfolio for the Government Pension Fund Global included in Norges Bank's annual financial statements. Both auditor's reports were unqualified.

Deloitte AS's audit plan for 2011 was considered by the Supervisory Council. In connection with the consideration of the annual financial statements and the auditor's report, the Council also received information from the auditor on significant matters relating to the year's audit. The Executive Board and Deloitte have confirmed that the Bank has initiated processes to follow up the comments in the audit report. Deloitte's report on the audit of the annual financial statements for 2010 was considered by the Supervisory Council in 2011, and its report on the audit of the annual financial statements for 2011 will be considered at a later date.

In the opinion of the Supervisory Council, financial reporting in accordance with the Annual Financial Statements Regulation and International Financial Reporting Standards has strengthened the presentation of the Bank's financial position, operations and results. Standardised reporting also means increased transparency and aids comparison between Norges Bank and its peers in other countries.

INTERIM REPORTING

The new Annual Financial Statements Regulation also regulates Norges Bank's quarterly reports for the Government Pension Fund Global. The Regulation states that the Executive Board is to present quarterly financial statements. The external auditor submits a report to the Supervisory Council in accordance with the international standard on reviews of interim financial information. The review reports submitted to the Supervisory Council in 2011 were unqualified. The Council considers the quarterly financial statements as part of its general supervisory activities.

SECTION 12

ASSESSMENT OF THE EXECUTIVE BOARD'S MANAGEMENT AND CONTROL

The Council has received all of the information it has asked for.

The Supervisory Council is of the opinion that the Executive Board exercised satisfactory management and control of Norges Bank's operations in 2011 in accordance with the Norges Bank Act, the guidelines for the management of the Government Pension Fund Global and the Regulation on Risk Management and Internal Control at Norges Bank.

The supervision of the Bank's activities and compliance with the rules for its operations revealed no cause for special remarks under the Act.

The Supervisory Council has performed assessments of the framework for the creation, management and control of subsidiaries for real estate investments. The Executive Board has adjusted the framework in line with these assessments.



SECTION 13

PRIORITIES FOR FUTURE SUPERVISORY WORK

The Supervisory Council will constantly monitor and adjust its activities to developments in Norges Bank's regulatory framework, organisation and results. The priority for supervision is to monitor the Executive Board's processes for the management and control of significant risks, including incidents and other circumstances that may have a material impact on the Bank's operations and reputation. In its future work, the Council will keep abreast of the Executive Board's follow-up of risk reduction measures. Particular attention will be paid to the Bank's reporting on operational risk management and compliance with laws and other rules, including Internal Audit's organisation and work.

The Supervisory Council has approved a supervision plan for 2012 setting out its overall supervision and control tasks. The plan reflects the Council's assessment of risk and materiality, and the results of previous years' supervisory work. It also builds on the strategies and action plans for the Council and the Office of the Supervisory Council for the period 2010–2012.

Selected topics for reviews covering the whole of Norges Bank's activities include the development of frameworks for financial management and the Bank's security and contingency planning work.

The supervision of investment management will continue to have high priority. As part of the preparation of the supervision plan for 2012, there was a dialogue with the Ministry of Finance on future plans for the implementation of assurance projects. Two assurance projects are planned, covering the management and control framework for real estate investments and assessments of security in the IT infrastructure. Other priority areas for supervision will be the Bank's processes for responsible investment, openness in its public disclosures, and following up risks and returns.

In the light of the financial turmoil, the Supervisory Council will continue to monitor Norges Bank's contingency planning in relation to financial stability and the Executive Board's management of the foreign exchange reserves.

The Council and the Office of the Supervisory Council will update their strategy and action plans during the course of 2012 to ensure continuous improvement in their supervisory function.

APPENDIX

NORGES BANK'S SUPERVISORY COUNCIL 2012–2013

SUPERVISORY COUNCIL

Full members

Reidar Sandal, <i>chairman</i>	(2010–2013)
Frank Sve, <i>deputy chairman</i>	(2010–2013)
Tormod Andreassen	(2012–2015)
Vidar Bjørnstad	(2012–2015)
Eva Karin Gråberg	(2012–2015)
Runbjørg Bremset Hansen	(2012–2015)
Marianne Lie	(2010–2013)
Morten Lund	(2012–2015)
Monica Salthella	(2010–2013)
Tine Sundtoft	(2012–2015)
Synnøve Søndergaard	(2010–2013)
Ingebrigt S. Sørfonn	(2012–2015)
Erland Vestli	(2010–2013)
Randi Øverland	(2012–2015)
Reidar Åsgård	(2010–2013)

Permanent Committee

Reidar Sandal, <i>chairman</i>
Frank Sve, <i>deputy chairman</i>
Runbjørg Bremset Hansen
Monica Salthella
Reidar Åsgård

Alternates

Ola Røtvei	(2010–2013)
Tone T. Johansen	(2010–2013)
Beate Bø Nilsen	(2012–2015)
Hans Kolstad	(2012–2015)
Rita Lekang	(2012–2015)
Camilla Bakken Øvald	(2012–2015)
Lars Gjedebo	(2010–2013)
Torunn Hovde Kaasa	(2012–2015)
Lars Haakon Søraas	(2011–2013)
André Støylen	(2012–2015)
Britt Hildeng	(2010–2013)
Solveig Ege Tengedal	(2012–2015)
Jan Blomseth	(2010–2013)
Anne Grethe Kvernød	(2012–2015)
Kari-Anne Opsal	(2010–2013)

Eva Karin Gråberg
Erland Vestli
Morten Lund
Tormod Andreassen
Synnøve Søndergaard

Director of the Office of the Supervisory Council

Svenn Erik Forsstrøm

Norges Bank's Supervisory Council
Report for 2011

Issued by:

Norges Bank's Supervisory Council
Bankplassen 2
Postboks 1179 Sentrum
N-0107 Oslo
Tel: +47 22 31 60 00
www.norges-bank.no

Published:

27 March 2012

Layout and print:

07 Gruppen AS

Photos:

Monica Kvaale (pp. 4, 42)
Ståle Andersen (p. 12)
Espen Schive (pp. 24, 28)

ISBN 978-82-7553-681-3 (print edition)

ISBN 978-82-7553-680-6 (online edition)

