Norges Bank's letter of 5 February 2008 to the Ministry of Finance

The benchmark portfolio for the Government Pension Fund – Global

1. Background

In its letter dated 16 November 2007, the Ministry of Finance asked for input from Norges Bank for a fresh assessment of emerging equity markets in the benchmark portfolio for the Government Pension Fund – Global. The Ministry did not ask for an assessment of emerging fixed income markets, but we assume that this may become relevant later in 2008. Norges Bank was asked to focus on assessments of settlement and clearing systems and on issues related to corporate governance at companies registered in the relevant emerging equity markets.

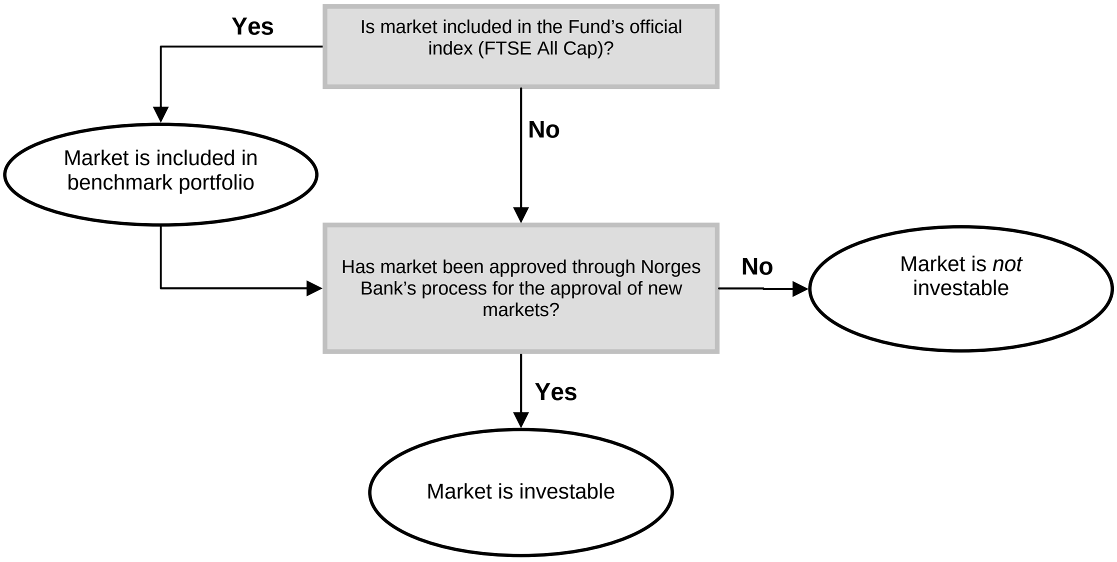
Emerging equity markets have been analysed in several letters from Norges Bank to the Ministry of Finance. The list of countries included in the equity benchmark portfolio now includes 27 countries, of which five are currently classified as emerging equity markets. The Ministry previously issued a list of countries over and above those in the benchmark portfolio in which the Fund could be invested. With effect from the summer of 2007, these guidelines were amended such that the Ministry now expects Norges Bank Investment Management (NBIM) to have established internal guidelines for the approval of new countries in the investment universe. To date, 11 countries outside the current benchmark portfolio have been approved.

The Ministry of Finance requires Norges Bank to prepare an overview of relevant issues related to valuation, performance measurement, and the management and control of risk for investments in each individual market and currency[1] before we invest in new countries. These assessments are to comply with the requirements set out in the Regulation and Guidelines, and they must also be documented. Enclosure 1 presents the factors assessed by NBIM before a country can be approved for inclusion in the investment universe.

2. Criteria for countries in the equity benchmark

Norges Bank has assessed the criteria for choosing countries documented in previous letters to the Ministry of Finance, and essentially recommends that these be retained by basing the benchmark portfolio on the FTSE Global All Cap Index. NBIM's approval process for new countries for equity investments must also be completed. This will ensure independent assessment of the individual country over and above the evaluation performed by FTSE. This also means that a situation could arise where a country included by FTSE does not pass NBIM's approval process, and so we will not invest in it. Norges Bank will then absorb this risk within the limit for tracking error. The diagram below illustrates this recommendation:

[1] See Report to the Storting No. 24 (2006-07) *On the Management of the Government Pension Fund in 2006*, pp. 64-65.



The countries which, based on this recommendation, are to be included in the current benchmark portfolio amount to just over 5 per cent of the current benchmark portfolio for equities. Norges Bank is of the opinion that such a procedure will be appropriate to ensure adequate evaluation before the Fund is invested in a new market.

Unlike in previous recommendations, Norges Bank does *not* recommend retaining the criterion that a new country must make a meaningful contribution to risk and returns. Investments in companies registered in emerging economies have traditionally been associated with greater volatility than in developed markets. This is an additional risk for which investors are normally rewarded with a higher expected return. However, Norges Bank believes that, if account is taken of correlation in volatility, and of the fact that emerging markets make up a relatively small part of the proposed benchmark universe, it cannot be argued definitively that they will make a "meaningful contribution to risk". At the same time, it is not unlikely that this situation will change over time, as emerging economies are experiencing stronger growth than developed economies. It therefore seems inappropriate to exclude emerging countries from the equity benchmark portfolio on the grounds that they would currently contribute only marginally to the benchmark portfolio's risk and return characteristics. Through its continuous assessment of the world's equity markets, NBIM will be free to decide which markets it actually invests in, and with which weights it invests within the limit for active risk.[2] In all circumstances, it is desirable to have as broad a benchmark index as possible.

In the following, we will discuss matters related to the recommendation that the equity benchmark be based primarily on the FTSE index. NBIM will also impose the additional condition that a country must be approved through NBIM's country approval process. Issues related to corporate governance and to settlement and clearing systems are given particular attention. We believe that the methodology behind the FTSE Global All Cap Index could provide an appropriate objective framework for the inclusion of emerging equity markets in the Fund's benchmark portfolio. Section 3 reports on the implications of this criterion.

[2] Maximum expected tracking error of 1.5 per cent.

NBIM conducts a thorough approval process before a new country is permitted. At present, only three of the markets in question have not already been approved for the Fund's investment universe. However, NBIM has begun the approval process for these markets too. Section 4 presents NBIM's approval process for new countries in the equity investment universe.

A transition to basing the Fund's benchmark index on the FTSE Global All Cap's current country list would mean expanding it to include another 19 emerging markets. Norges Bank has obtained information from external sources and performed analyses which support this recommendation. This material is summarised in Section 5 together with assessments of corporate governance issues and the impact of new markets on the Fund's risk and return characteristics. Section 6 summarises the matters discussed in the letter.

3. *FTSE Global All Cap as a benchmark for the Fund's equity investments*

The official benchmark index for the equity portion of the Government Pension Fund – Global is composed of the FTSE Global All Cap regional indices. FTSE has been used as index supplier since the Fund first began investing in equities in 1998. FTSE is an independent index supplier. Investors worldwide have invested very considerable sums in equity markets with FTSE indices as their benchmark. As a result, FTSE's methodology attracts considerable attention in financial markets. This being the case, FTSE works continuously on evaluating which countries are to be included in its equity indices.

FTSE operates with three categories of country in its indices: Developed, Advanced Emerging and Secondary Emerging. An annual review process ensures that these categories always reflect real market conditions in the individual countries.[3] Countries which do not fall into any of these three categories are deemed uninvestable in the light of the criteria for the individual marketplace. For the record, it should be noted that other index suppliers do also have indices covering this category of market (frontier markets). These are typically small and illiquid with poor market functionality even by the standards of emerging markets.

FTSE attaches importance to gross national income per capita and market capitalisation in its assessment of the individual countries to be included in the index. In addition, FTSE attaches importance to four key areas, which are divided in turn into various criteria. These four main areas are[4]:

- Market and regulatory environment
- Custody and settlement
- Dealing landscape
- Derivatives market

[3] See Enclosure 2 for the criteria which must be met in each particular category.
[4] Enclosure 2 presents the actual evaluation matrices showing both the criteria used and the results for the individual country.

The factors prioritised by FTSE in its classification of markets will generally also be covered by the process established by NBIM for the approval of new countries for the Fund. NBIM's process will naturally include more criteria of an operational nature to ensure manageable processing of all investments in its systems for risk and performance measurement. NBIM's approval process is presented in Section 4 below.

FTSE conducts an annual review of country classifications and announces any changes more than six months in advance. FTSE announced the results of its most recent annual review of country classifications on 20 September 2007.[5] Once the changes decided on have been implemented, the FTSE Global All Cap Index will include 47 countries[6] with the following classification:

- 24 countries classified as Developed
- 7 countries classified as Advanced Emerging
- 16 countries classified as Secondary Emerging

Countries in the FTSE Global All Cap Index (excluding Norway)

Developed	Advanced Emerging	Secondary Emerging
Australia	Brazil	**Argentina**
Belgium/Luxembourg	Mexico	**Chile**
Canada	**Poland****	***Colombia***
Denmark	South Africa	**Egypt**
Finland	South Korea	**Philippines**
France	Taiwan	**India**
Greece	**Hungary****	**Indonesia**
Hong Kong		**China**
Ireland		**Malaysia**
Israel*		***Morocco***
Italy		***Pakistan***
Japan		**Peru**
Netherlands		**Russia**
New Zealand		**Thailand**
Portugal		**Czech Republic**
Singapore		**Turkey**
Spain		
UK		
Switzerland		
Sweden		
Germany		
US		
Austria		

*Upgraded to Developed from June 2008
**Upgraded to Advanced Emerging from June 2008

The 19 countries not currently included in the Government Pension Fund – Global's benchmark portfolio are shown in bold type in the table above. Of these 19 countries,

[5] FTSE also publishes a watch list. At present, Chinese A-shares are on this list for possible reclassification as Secondary Emerging. Both South Korea and Taiwan are on watch for possible upgrade to Developed status. When it comes to possible downgrades, Greece is on watch for possible reclassification as Advanced Emerging, while Pakistan is on watch for exclusion from the FTSE Global All Cap Index.
[6] Luxembourg has been merged with Belgium in line with FTSE practice.

there are three (Colombia, Morocco and Pakistan) which, as at January 2008, have not been through NBIM's process for the approval of new countries for the investment universe.

Chinese H-shares (Hong Kong) are included in the current benchmark index for the Fund. Chinese B-shares are also permitted in the Fund's investment universe. The market for Chinese B-shares is included in the FTSE Global All Cap Index, but Chinese A-shares are not. In 2006, Norges Bank was awarded the status of Qualified Foreign Institutional Investor (QFII) by the Chinese authorities, which is a condition for being able to invest in Chinese A-shares. Such investments also require the award of an investment quota from the State Administration of Foreign Exchange (SAFE). It is not yet clear when Norges Bank will be awarded such a quota.

Norges Bank recommends that the benchmark portfolio for the Fund's equity investments should, in the first instance, include all of the countries included in the FTSE Global All Cap Index (other than Norway) for as long as this is the Fund's official benchmark index. This will ensure a process of continuous evaluation of how the individual markets are developing in terms of investability for a fund such as the Government Pension Fund – Global. By using FTSE's indices, the benchmark portfolio already follows FTSE's methodology when it comes to the inclusion of individual companies and the classification of these companies (by sector and size, for example), and it seems natural to use this approach for permitted markets as well.

4. NBIM's process for the approval of new countries in the equity investment universe

Norges Bank is proposing that inclusion of a country in the FTSE Global All Cap Index is necessary and sufficient for that country to be included in the Government Pension Fund – Global's benchmark portfolio. However, NBIM will also perform an independent evaluation of a country's suitability in terms of having markets which are open to foreign investors, legislation which protects investors' rights, and settlement systems which meet various minimum requirements. Furthermore, NBIM's process for the approval of new countries in the equity investment universe must ensure the readiness of all internal systems and procedures.

As mentioned above, NBIM has approved all bar three (Colombia, Morocco and Pakistan)[7] of the countries which are currently included in the FTSE Global All Cap Index but not in the Fund's proposed benchmark portfolio. This means that they have been evaluated using NBIM's process for the approval of new countries. A new country is approved by the Executive Director of NBIM once the individual areas for review have been approved by the relevant departmental managers. The areas reviewed in this process can be divided into the following main categories:

- Summary and main conclusions
- Market regulation, documentation requirements and trade flows
- Data availability
- Requirements for investment guidelines

[7] However, the approval process for these countries is currently under way.

- Transaction execution, costs and taxes
- Settlement and custody
- Performance measurement and accounting
- Administration of investments
- Risk management and reporting
- Implementation plan
- Evaluation and approval

As part of this approval process, NBIM obtains information about the market in question from a number of external sources. This includes a description of local market regulation and assessments of the quality of settlement and custody systems. An approval document is prepared for each individual market. The approval process normally takes one to two months.

5. *Assessment of other factors*

Macroeconomic and political conditions
Previous letters from Norges Bank about new countries in the benchmark portfolio have also discussed matters related to macroeconomic and political stability. However, there has been no definition of what requirements the individual markets must meet in order to be included in the Fund's benchmark portfolio. Norges Bank assumes that the Ministry of Finance itself will assess the level of importance to be attached to these factors when defining the equity benchmark for the Government Pension Fund – Global. We refer to the information on potential sources and indicators in this area presented in previous correspondence. Otherwise, we would stress that an evaluation of macroeconomic and political conditions will typically be an integral part of any investment decision.

Size and liquidity
Previous letters have discussed matters related to new countries in the benchmark portfolio having to be of a certain size. This has been justified by operational factors and the fact that small markets will contribute only marginally to diversifying the Fund. After more than a decade of global equity management, Norges Bank believes that it is not necessary to restrict the number of countries in the benchmark portfolio on these grounds. Norges Bank also believes that small markets should not be excluded on the basis of limited diversification characteristics. It seems more appropriate to base the benchmark portfolio on the markets included at any given time in the FTSE Global All Cap Index.

The liquidity of each individual market is assessed continuously by NBIM and is an integral part of its investment philosophy for generating the maximum possible return on its investments. Of the new markets not already approved for the Fund's investment universe through the process for the approval of new countries, there are four which, based on FTSE's criteria, are not as liquid as the others: Argentina, Colombia, Peru and Morocco. With the current investment strategy, these countries will make up less than 0.2 per cent of the Fund's overall benchmark portfolio. Furthermore, their market capitalisation is concentrated between a relatively small number of companies. NBIM will therefore be able to take the time it takes to establish the desired weight in these companies without this impacting appreciably on the level of tracking error.

Settlement systems
For a global investor, it is very important to assess the quality of settlement systems and the safeguards provided by financial markets legislation in each country. The markets must also meet certain requirements to be included in the investment universe. Generally speaking, settlement risk is higher in emerging markets than in developed markets. Furthermore, the legal framework in emerging markets is typically less adequate. This is quite clear from the assessment performed by FTSE (see Enclosure 2).

Norges Bank has obtained up-to-date updated assessments from the evaluation systems of its two global custodians: JPMorgan Chase (JPM)[8] and Citibank[9]. These institutions' operations give them an in-depth insight into the settlement systems in each individual country. When these institutions assess the risk associated with settlement and clearing systems in a particular country, they often start from established best practice standards based on SEC (Rule 17f-7) or BIS requirements. The table below shows how each of the 19 new markets are rated by JPM and Citibank:

[8] This score is an average of JPM's assessment of eight factors: trade matching, settlement type, securities type, depository, failure provisions, settlement cycle, regulatory oversight, and securities legal framework, where 1 is best and 3 is worst.
[9] This score is based on the SEC's requirements for an eligible securities depository (Rule 17f-7). Definitions:
1= Depositories have well-established and tested functions, often with tangible central bank/government support. Potential issues in evaluation factors are few, if any, and do not present cause for concern.
2= Depositories have acceptable measures in place for the factors evaluated, but may present one or more shortcomings that highlight a need for improvement in relation to the evaluation criteria. In some cases, a specific risk is balanced by better than average evaluations of other relevant factors.
3= Depositories exhibit above-average risk conditions in one or more evaluation factors. Investors are left relatively unprotected. The likelihood of depository performance issues is uncomfortably high; mechanisms to contain their effects may be inadequate.

Market	FTSE classification	JPM classification	Citibank classification
Argentina	Secondary Emerging	1.6	3
Chile	Secondary Emerging	1.4	1
Colombia	Secondary Emerging	2.1	2
Egypt	Secondary Emerging	2.0	2
Philippines	Secondary Emerging	2.0	2
India	Secondary Emerging	1.8	2
Indonesia	Secondary Emerging	1.5	3
Israel	Developed	2.0	2
China	Secondary Emerging	1.6	2
Malaysia	Secondary Emerging	2.0	2
Morocco	Secondary Emerging	1.6	2
Pakistan	Secondary Emerging	2.5	3
Peru	Secondary Emerging	1.8	2
Poland	Advanced Emerging	1.6	1
Russia	Secondary Emerging	2.9	2
Thailand	Secondary Emerging	1.6	2
Czech Republic	Secondary Emerging	1.8	2
Turkey	Secondary Emerging	1.5	3
Hungary	Advanced Emerging	1.4	1

Both JPM and Citibank give markets a score from 1 to 3, where 1 is best. Based on JPM's criteria, only three markets score less than 2: Colombia, Pakistan and Russia. Citibank finds that Argentina, Indonesia, Pakistan and Turkey are the countries in the FTSE Global All Cap universe with the weakest settlement systems. These three countries perform much better in JPM's classification, which takes account of a somewhat broader set of criteria. It should be stressed that this type of evaluation is relatively subjective and liable to change. The underlying trend is towards better and more secure settlement systems in the individual markets, because this promotes larger capital inflows and so a better basis for economic growth. Norges Bank therefore believes that the sum of the continuous evaluation and monitoring achieved through the proposed criteria for countries in the benchmark portfolio, and the objectives and other control measures on the part of the portfolio manager, is sufficient for there not to be a need to establish a minimum requirement for the settlement system in each individual market.

Requirements for financial markets legislation

Besides the assessments performed by FTSE, Norges Bank has carried out an independent assessment of financial markets legislation in all of the markets in question. A summary of key features in areas such as market structure, market regulation, tax system and supervisory arrangements in each country can be found in Enclosure 3. Norges Bank has not, in this context, performed a separate evaluation of potential aspects of reputational risk due to investment in particular countries. Information about such matters will be available from sources such as Transparency International if the Ministry of Finance wishes to prioritise this in its assessment.

In short, all markets have established a body of legislation which regulates key aspects of the financial market, as well as supervisory arrangements which ensure monitoring of markets and market players in a way which is considered adequate for NBIM to invest in these markets. This material therefore largely confirms the assessments performed by FTSE – and this further supports the recommendation to include these markets in the benchmark portfolio.

In line with the established procedure, NBIM will perform a separate process for the approval of each individual country in connection with investment being permitted in new markets. This process will also cover the countries already included in the benchmark portfolio. Besides the information which has been produced (see Enclosure 3), this process will involve thorough assessment of all factors mentioned in Section 4 of this letter.

Corporate governance issues
The Ministry of Finance has also asked Norges Bank to report specifically on corporate governance issues.

NBIM exercises ownership rights for the Government Pension Fund – Global and Norges Bank's foreign exchange reserves. As the basis for this work, we analyse companies' governance structure, protection of shareholder rights, observance of human rights, environmental issues and other matters related to their activities which impact on the sustainability of both the companies and the portfolio.

We would point out that a country assessment already takes into account a number of governance criteria, such as the existence of a well-functioning market, settlement systems, political and macroeconomic stability, and legal safeguards when investing in the market. In addition, corporate governance issues in emerging markets will more naturally form part of the individual portfolio manager's risk assessments at company and sector level than of an assessment of whether or not to invest in the market at all.

Norges Bank believes that corporate governance criteria should not be a deciding factor in whether or not markets are included in the investment universe or the benchmark portfolio. We are of the opinion that good corporate governance can best be promoted through presence and engagement, and that this will mainly concern company-specific matters. Nor, in practice, has corporate governance been a criterion to date in the exclusion of markets from the investment universe or the benchmark portfolio.

If corporate governance is to be a factor, the challenge will be deciding which criteria are to be assessed, and what standards a country's rules must meet for them to be deemed adequate. If we are in a position to establish such standards, it has to be assumed that several countries which have already been approved, both within and outside the current benchmark portfolio, may be less functional than the potential new countries. In addition, individual companies' articles of association may ensure standards of corporate governance which exceed the requirements of the country's legislation, in which case a country-based assessment will be of little relevance. It would be unfortunate to have to exclude a potential investment in a company with articles of association which afford adequate protection of shareholder rights simply because the company is registered in a country with an inadequate regulatory framework.

There is the same challenge when it comes to matters of human rights and the environment. A limit would need to be established for what is defined as inadequate environmental regulation. Human rights are a well-known quantity, but there would still be a need to define the degree to which a country must respect them. If such questions and standards are to be assessed, this could come into conflict with the situation in countries already included in the investment universe and the benchmark portfolio. In addition, such issues will often be linked to sectors and companies rather than countries in general. A country-based assessment will therefore be inappropriate. It can also be added that, in today's global market, breaches of human rights, environmental regulations and anti-corruption rules will often take place in countries other than the one in which a company is registered. Again, a country-based approval process could prevent investment in companies with adequate governance.

The challenge associated with the exercise of ownership rights has been emphasised in previous correspondence on the inclusion of emerging markets in the Government Pension Fund – Global. NBIM already has access to the necessary information on all of the companies in the FTSE index. Even though the number of companies in the benchmark will grow by around 850, this is a relatively modest increase compared to the increase of around 4,500 companies resulting from the expansion of the equity benchmark to include the small-cap segment. Norges Bank believes that the proposed expansion as such is manageable within its current active ownership set-up. It therefore seems inappropriate to look more closely at corporate governance issues at country level at this stage.

Risk and returns
Emerging markets account for a relatively small part of the overall market capitalisation of global equity markets, and the impact on a fund such as the Government Pension Fund – Global will therefore be limited. This section analyses the risk and return characteristics of the equity benchmark portfolio resulting from the inclusion of emerging markets. This analysis uses historical return series for the FTSE All World Developed, FTSE All World Advanced Emerging and FTSE All World Secondary Emerging Indices[10]. The data run from 1994 to December 2007, and the US dollar has been used as base currency. Continuous rebalancing to the specified weights in the different markets is assumed. The weights used are based on market capitalisation in December 2007, adjusted for strategic weights. There is a 10 per cent weighting of emerging markets (5 per cent FTSE All World Advanced Emerging and 5 per cent FTSE All World Secondary Emerging) and a 90 per cent weighting of developed markets.

As can be seen from the table below, emerging markets were consistently more volatile than developed markets. Over the period as a whole, the risk in emerging markets, as expressed by the annual standard deviation, was 32 per cent higher than in developed markets. If we look at the different sub-periods, volatility in emerging markets was significantly higher in two and marginally higher in one.

[10] Medium- and large-cap companies are included, while small-cap companies are excluded. Small-cap companies accounted for about 12 per cent of the FTSE Global All Cap Index in December 2007. This is not believed to affect the conclusion from this analysis significantly, as the distribution between the different sizes of company is relatively similar in all three country categories.

	Emerging markets	Developed markets
Entire period	17.1%	13.0%
January 1994 to December 1998	17.9%	11.1%
January 1999 to December 2003	16.6%	16.2%
January 2004 to December 2007	16.6%	10.2%

Table 1: Annualised volatilities based on daily returns

Over the period 1994-2007 as a whole, the return on emerging markets was slightly lower than on developed markets. Closer analysis reveals that Advanced Emerging markets generated a slightly higher return than developed markets, and Secondary Emerging markets a slightly lower return.

	Geometrical return		Arithmetical return	
	Emerging markets	Developed markets	Emerging markets	Developed markets
Entire period	9.0%	9.7%	8.6%	9.2%
January 1994 to December 1998	-9.3%	16.1%	-9.7%	14.9%
January 1999 to December 2003	16.8%	3.1%	13.0%	2.6%
January 2004 to December 2007	25.9%	10.5%	31.0%	13.3%

Table 2: Annualised returns

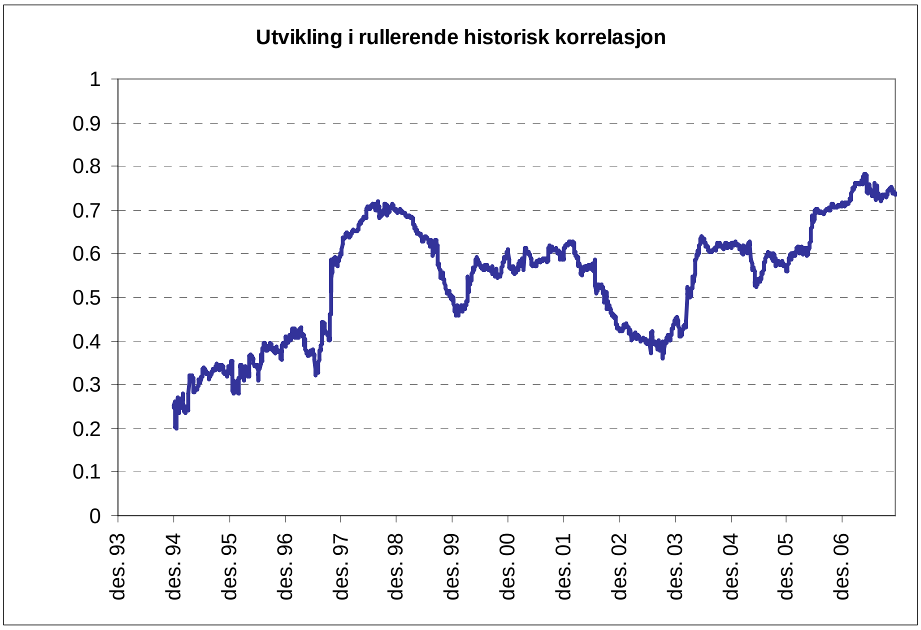
If we look at the different sub-periods, emerging markets produced a significantly lower return in the first period, but significantly higher returns in the other two.

The correlation between the two types of market varied during the period.

Entire period	0.51
January 1994 to December 1998	0.37
January 1999 to December 2003	0.52
January 2004 to December 2007	0.78

Table 3: Correlation between return on emerging and developed markets based on daily price observations

Over the period as a whole, the correlation was 0.51. This is a low level, resulting in a good diversification effect at portfolio level. Although the volatility in emerging markets was significantly higher than in developed markets during the period, the risk in the benchmark index would not have increased had emerging markets been included. This applies both to the period as a whole and to the first two sub-periods. In the final sub-period (January 2004 to December 2007), the volatility of the benchmark index would have increased had emerging markets been included. The chart below suggests that the correlation between developed and emerging markets is increasing.



Rolling historical correlation

The table below shows the estimated annual volatility for a benchmark index which also includes emerging markets.

	Emerging markets	Developed markets	"New" portfolio
Entire period	17.1%	13.0%	12.8%
January 1994 to December 1998	17.9%	11.1%	11.0%
January 1999 to December 2003	16.6%	16.2%	15.9%
January 2004 to December 2007	16.6%	10.2%	10.3%

Table 4: Annualised volatilities based on daily returns

All forward-looking statements are subject to considerable uncertainty, but there are probably grounds to attach more importance to the latest data as a guide to future developments. Increased globalisation, growing similarities in industrial structure between emerging and developed markets, and the development of adequate settlement systems and legal frameworks could lead to a higher level of correlation. However, there will still be diversification effects from emerging markets which can be exploited to achieve a favourable risk-adjusted return. Based on historical data, a portfolio of both developed and emerging markets will be less volatile than a portfolio consisting solely of developed markets. Both the weighting of emerging markets and the diversification effect mean that their inclusion will have only marginal effects on the portfolio's risk profile.

6. Recommendation

Norges Bank recommends that the benchmark portfolio for equities in the Government Pension Fund – Global be expanded to include all of the countries classified at any given time as Developed, Advanced Emerging or Secondary Emerging in the FTSE Global All Cap Index. The Bank is of the opinion that the assessments performed by FTSE when classifying markets is robust and sufficient for these countries to be included in the benchmark portfolio for the Fund. Drawing on the index supplier's established annual review processes will simplify and improve the monitoring and maintenance of approved countries. The criteria used by FTSE are transparent and are considered by Norges Bank to be sufficient for classifying markets' suitability for international investors. Changes in the indices are announced in good time in order to minimise market impact.

At the same time, Norges Bank recommends that the current requirements for an adequate approval process for all new countries before investment is made in a new market be retained. Besides an additional independent assessment of many important criteria already covered by FTSE, this process ensures that NBIM has procedures, processes and systems which can handle these equity investments satisfactorily. Norges Bank has paid particular attention to settlement and clearing systems and to issues related to market regulation and financial markets legislation in its assessment of the criteria for the inclusion of emerging markets in the Government Pension Fund – Global's equity benchmark portfolio.

The inclusion of emerging markets in the benchmark portfolio will not affect the Fund's risk and return characteristics to any significant degree. This is due to their relatively low weight in the benchmark portfolio and some diversification gains. However, there is reason to believe that, in time, emerging markets will account for a more significant share of the equity market universe, and it may therefore be appropriate for the Fund to have exposure to these markets at as early a stage as possible. As part of its everyday management activities, NBIM will make a number of judgements in order to replicate the benchmark index. These judgements concern, among other things, transaction costs, settlement risk, legal risk, macroeconomic conditions, and the degree to which deviations from the benchmark portfolio will help to exploit the limit for active risk.

Yours faithfully

Svein Gjedrem

Yngve Slyngstad

<u>Enclosures</u>

1. NBIM's process for the approval of new countries
2. FTSE's country evaluation matrices
3. Summary of market regulation in each of the 19 new countries