



Overview 2016

The Pension Fund for State Employees (LSR)
The Pension Fund for Nurses (LH)

Appendix – LSR & LH

Role of the funds

The principal role of the Pension Fund for State Employees (LSR) and the Pension Fund for Nurses (LH) is to pay pensions to its members upon retirement and throughout their lives and to ensure their families with a pension following a loss of income due to an impaired ability to work or due to death. The funds receive contributions and invest them in order to meet their liability regarding old-age pension, disability pension, spouse's pension and children's

allowance. Furthermore, the funds grant loans against a mortgage to fund members and accept and invest voluntary pension savings. In 2016, LSR and LH had a total of 30,589 active members and 20,682 members received pensions and other benefits. The funds pay over one-third of all pensions and benefits paid by Icelandic pension funds. LSR operates in three divisions, divisions A and B, and a division for voluntary pension savings. All divisions have the same board but are financially separated from each other. LSR and LH

operate in close cooperation and share facilities and staff members.

Investment policy for LSR & LH

The investment policy is as shown below. It is reviewed at least once a year considering changes in market situations, laws and regulations. LSR and LH follow a strategic asset allocation policy that targets the percentage to be invested in each asset class.

| | Division A | | | Division B | | | Division LH | | |
|--|------------|------------|------------|------------|------------|------------|-------------|------------|------------|
| | Policy | Variation | | Policy | Variation | | Policy | Variation | |
| Cash | 2% | 0% | 10% | 3% | 0% | 10% | 3% | 0% | 10% |
| Bonds | 53% | 40% | 70% | 52% | 30% | 65% | 52% | 30% | 65% |
| Government bonds | 28% | 15% | 45% | 29% | 20% | 40% | 32% | 20% | 40% |
| Municipal bonds | 3% | 0% | 10% | 4% | 0% | 10% | 4% | 0% | 10% |
| Financial Institution bonds | 4% | 0% | 10% | 3% | 0% | 10% | 5% | 0% | 10% |
| Mortgage bonds | 13% | 5% | 25% | 10% | 5% | 20% | 5% | 0% | 10% |
| Other bonds | 5% | 0% | 10% | 6% | 0% | 10% | 6% | 0% | 10% |
| Equities | 41% | 20% | 50% | 42% | 25% | 55% | 42% | 25% | 55% |
| Domestic equities | 14% | 5% | 25% | 7% | 5% | 15% | 7% | 5% | 15% |
| Foreign equities | 27% | 10% | 40% | 35% | 20% | 50% | 35% | 20% | 50% |
| Other investments | 4% | 0% | 10% | 3% | 0% | 10% | 3% | 0% | 10% |
| Purchase and management of residential property | 0% | 0% | 1% | 0% | 0% | 1% | 0% | 0% | 1% |
| Total foreign investments | 32% | 20% | 45% | 39% | 20% | 50% | 39% | 20% | 50% |



Investments

Total net investments in the year 2016 were 36 billion ISK. The funds invested 19.6 billion ISK in bonds, 6.9 billion ISK in domestic equities and 12 billion ISK in foreign equities. Last year, net distributions from private equity and real estate funds were 2.5 billion ISK.

Net investments 2016

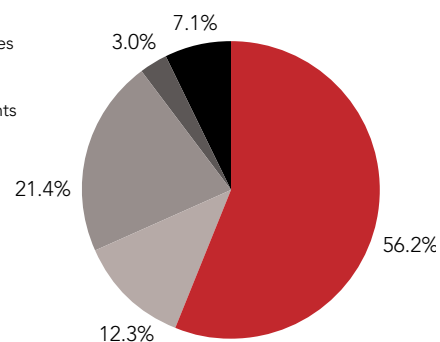
| (m. ISK) | LSR | LH | Total |
|-----------------------------|----------------|--------------|----------------|
| Government bonds | (11,551) | (225) | (11,776) |
| Municipal bonds | 2,043 | 0 | 2,043 |
| Financial Institution bonds | 11,782 | 181 | 11,963 |
| Member loans | 14,447 | (114) | 14,333 |
| Domestic bond funds | (2,895) | 0 | (2,895) |
| Bonds | 19,661 | -84 | 19,577 |
| Domestic equities | 6,763 | 121 | 6,885 |
| Foreign equities | 12,039 | (42) | 11,996 |
| Equities | 18,802 | 79 | 18,881 |
| Private equity | (2,081) | (245) | -2,325 |
| Real estate | (122) | (10) | (133) |
| Other investments | (2,203) | (255) | (2,458) |
| Total | 36.260 | -260 | 36.000 |

Total assets

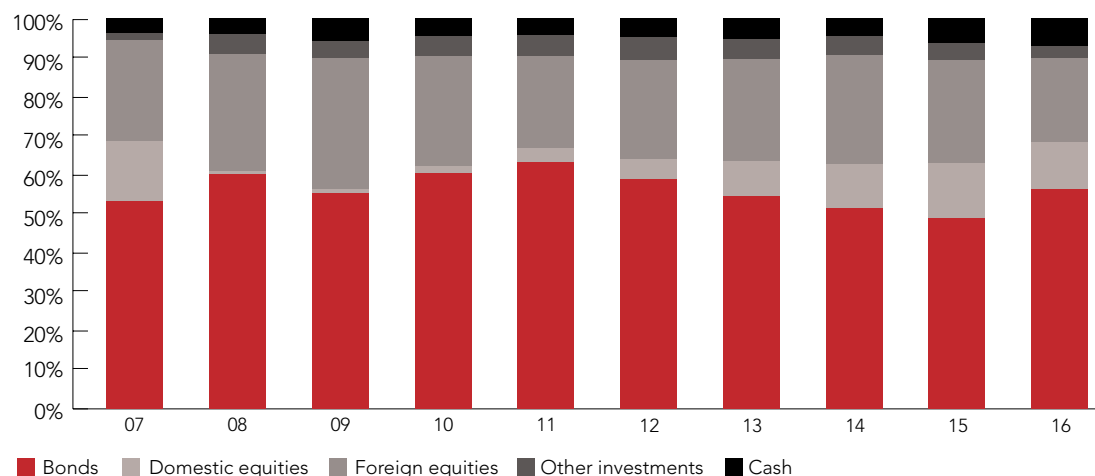
In the year-end 2016 total assets in securities amounted to 742.2 billion ISK. Assets in bonds amounted to 417.2 billion ISK or 56.2% compared to 49% in the year-end 2015. Assets in domestic equities were 91.2 billion ISK or 12.3% of total assets compared to 14.1% in 2015. Assets in foreign equities were 159.1 billion ISK or 21.4% compared to 26.4% in 2015. Total assets in private equity and real estate funds were 22.4 billion ISK or 3% compared to 4.4% last year. Cash and deposits amounted to 52.4 billion ISK in the year-end or 7.1% of total assets.

Total assets 2016

- Bonds
- Domestic equities
- Foreign equities
- Other investments
- Cash



Changes in asset allocation 2007–2016



Total assets 2016

| (m. ISK) | | | | Proportion | | |
|-----------------------------|----------------|---------------|----------------|--------------|--------------|--------------|
| | LSR | LH | Total | LSR | LH | Total |
| Government bonds | 264,793 | 7,866 | 272,659 | 37.0% | 29.8% | 36.7% |
| Municipal bonds | 20,512 | 909 | 21,420 | 2.9% | 3.4% | 2.9% |
| Financial Institution bonds | 17,830 | 317 | 18,147 | 2.5% | 1.2% | 2.4% |
| Mortgage bonds | 467 | 0 | 467 | 0.1% | 0.0% | 0.1% |
| Member loans | 68,409 | 1,615 | 70,024 | 9.6% | 6.1% | 9.4% |
| Other bonds | 33,532 | 944 | 34,477 | 4.7% | 3.6% | 4.6% |
| Bonds | 405,542 | 11,651 | 417,193 | 56.7% | 44.1% | 56.2% |
| Domestic equities | 88,247 | 2,905 | 91,152 | 12.3% | 11.0% | 12.3% |
| Foreign equities | 149,414 | 9,641 | 159,055 | 20.9% | 36.5% | 21.4% |
| Equities | 237,661 | 12,545 | 250,207 | 33.2% | 47.5% | 33.7% |
| Private equity | 21,115 | 796 | 21,911 | 2.9% | 3.0% | 3.0% |
| Real estate | 474 | 35 | 509 | 0.1% | 0.1% | 0.1% |
| Other investments | 21,589 | 832 | 22,420 | 3.0% | 3.2% | 3.0% |
| Cash | 51,005 | 1,362 | 52,367 | 7.1% | 5.2% | 7.1% |
| Total | 715,797 | 26,390 | 742,187 | 100% | 100% | 100% |



Return and asset allocation

| | LSR | | LH | |
|--------------------------------|-------|-------|-------|-------|
| | 2016 | 2015 | 2016 | 2015 |
| Return | | | | |
| Nominal return | 3.0% | 8.7% | 1.4% | 7.4% |
| Net real return | 0.8% | 6.5% | -1.0% | 5.1% |
| Average 5 year net real return | 6.3% | 6.5% | 6.0% | 6.6% |
| Asset allocation | | | | |
| Cash | 7.1% | 6.1% | 5.2% | 6.5% |
| Bonds | 56.7% | 49.4% | 44.1% | 41.4% |
| Domestic equities | 12.3% | 14.3% | 11.0% | 9.9% |
| Foreign equities | 20.9% | 25.8% | 36.5% | 37.9% |
| Other investments | 3.0% | 4.4% | 3.2% | 4.3% |



Foreign equities

LSR and LH cooperate with external managers for investments and custody of foreign equities. For risk diversification purposes, investments are diversified between several managers with different investment styles and strategies. The external managers are listed in a table on this page.

Funds / Segregated portfolios (LSR & LH) 2016

| Segregated portfolios | m. ISK | % |
|-----------------------|---------------|--------------|
| Morgan Stanley | 10,283 | 5.8% |
| EFG Global Equity | 6,539 | 3.7% |
| ETF Credit Suisse | 4,969 | 2.8% |
| Total | 21,792 | 12.2% |

Foreign equities – Funds

| | | |
|-------------------------------|----------------|--------------|
| MFS FCP Global Equity | 27,858 | 15.6% |
| Vanguard Global Stock Index | 22,650 | 12.7% |
| Schroder Global Core | 15,638 | 8.8% |
| Schroder Global Quant Value | 11,319 | 6.3% |
| T. Rowe Price US Large Growth | 9,479 | 5.3% |
| Other funds | 50,319 | 28.2% |
| Total | 137,263 | 76.9% |

Private equity and real estate funds

| | | |
|---|---------------|--------------|
| Oberon Credit Investment Fund II | 1,952 | 1.1% |
| AIP Private Markets Fund VI LP | 1,580 | 0.9% |
| Schroder Private Equity III | 1,430 | 0.8% |
| Oberon Credit Investment Fund III | 1,331 | 0.7% |
| Morgan Stanley Emerging Private Markets | 1,327 | 0.7% |
| Other funds | 11,742 | 6.6% |
| Total | 19,360 | 10.9% |

| | | |
|--------------|----------------|---------------|
| Total | 178,415 | 100.0% |
|--------------|----------------|---------------|

The annual accounts of the funds



- ▶ The Pension Fund for State Employees (LSR)
- ▶ The Pension Fund for Nurses (LH)