Background

The Government Pension Fund Global (GPFG) stems from accumulated revenues from the extraction of oil and gas on the Norwegian continental shelf. The Fund serves as a tool to support long-term considerations in the spending of oil and gas revenues, as well as a long-term savings vehicle. The market value of the Fund was 7,867 billion kroner (approximately 917 billion USD) at the end of March 2017.

The governance framework of the GPFG is marked by a clear division of roles and responsibilities. The Ministry of Finance holds the formal responsibility for the management of the Fund, whereas the operational management is carried out by Norges Bank (the central bank of Norway). All significant changes to the GPFG's investment strategy are presented to Parliament before implementation.

Norges Bank manages the GPFG in accordance with a management mandate issued by the Ministry of Finance. The mandate sets out the general principles and regulations for Norges Bank's management of the Fund. The mandate expresses the Fund's investment strategy, including provisions on the composition of the benchmark index, risk limits, reporting and responsible management.

The GPFG is invested in listed equity, fixed income and unlisted real estate outside of Norway. The Fund's investment objective is to achieve the highest possible return, given an acceptable level of risk. The Fund's investment strategy has been developed gradually over time based on assessments of expected risk and return, the Fund's purpose and distinctive characteristics, and views on the functioning of international capital markets.

Over time the risk-taking and investment universe of the GPFG has been expanded, both with regards to the size of the equity share, the number of countries the Fund is invested in, and more asset classes and financial instruments. The Fund's current benchmark consists of 62.5 per cent equities and 37.5 per cent fixed income, and is based on broad, global indices from leading index providers.[1] Recently it has been decided to increase the equity allocation to 70 per cent. This increase will be implemented gradually over time.

Within specified risk limits set out in the management mandate, Norges Bank can deviate from the Fund's benchmark, including by investing in unlisted real estate. The principal risk limit is a tracking error limit of 1.25 percentage points. The regulation of unlisted real estate investments means that the scope and composition of such investments are decided by Norges Bank, within the risk limits set by the Ministry of Finance. The regulation of unlisted real estate includes an upper limit of such investments of 7 per cent of the GPFG. At the end of March 2017, about 2.5 per cent of the Fund was invested in unlisted real estate.

Norges Bank is in general not permitted to invest the GPFG in unlisted companies in sectors other than real estate. Norges Bank may, however, invest the Fund in unlisted companies where the company board has expressed an intention to seek listing on a regulated and recognized marketplace.

The Ministry of Finance aims to assess whether Norges Bank should be allowed to invest the GPFG in unlisted companies on a more general basis. The assessment will not include

[1] The benchmark is based on indices from FTSE (equities) and Bloomberg Barclays (fixed income). The benchmark's geographical composition is based on market weights for equities and corporate bonds, and GDP weights for government bonds.

unlisted infrastructure, which it has been decided not to open for at this stage. The Ministry has in particular noted that unlisted infrastructure investments are subject to greater political, reputational and regulatory risks, and that the Fund might not have a comparative advantage for taking on such risks.

As part of the decision basis for whether the Ministry of Finance should open up for investments in unlisted companies on a more general basis, an expert group is appointed to address unlisted equity investments. In addition, Norges Bank will be asked to give its advice on unlisted equity investments by December 10, 2017.

Mandate for the expert group addressing unlisted equity investments in the GPFG

The group shall prepare a public report on unlisted equity investments within all sectors, excluding unlisted real estate and infrastructure respectively, by December 22, 2017. The report shall address the following issues:

1. **An examination of the global market for unlisted equity investments that would be investable for the GPFG,** including:
    - Descriptions and assessments of the investable market for unlisted equity for the GPFG, including private equity funds, such as seed capital, venture capital and leveraged buy-out funds, other fund structures, and direct investments in unlisted companies with or without the use of joint ventures and partners.
    - An assessment of to which extent equity investments in unlisted companies represent systematic different investment opportunities in terms of expected risk and return compared to listed companies and companies that seek an initial public offering (IPO), e.g. due to differences in technology or different sector compositions.
    - An assessment of possible structural developments over time in the way companies are funded, including to which extent companies tend to be more mature when seeking an IPO, and if the share of companies seeking IPOs have fallen over time. The assessment should address any differences across regions and countries.

2. **An examination of expected returns, risks and costs for unlisted equity investments,** including:
    - An assessment of historical and expected returns, risks and costs for unlisted equity investments. The analysis should distinguish between returns due to systematic and other risk exposure. Assessments of expected returns should take into account Norges Bank's ability to obtain comparative advantages and skills within unlisted equity investments.
    - A description of any non-financial risks that are distinctive for unlisted equity investments, including operational and reputational risk, and an assessment of the governance needed to manage and control such risks.

3. **An examination of the characteristics and management of unlisted equity investments,** including:
    - A description of the comparative (dis)advantages and skills an investment manager may have or develop within unlisted equity investments. The description should discuss both operational and fund selection skills.

- An assessment of to which extent Norges Bank may have or be expected to develop such characteristics and skills, given the size and other characteristics of the GPFG and its governance structure.
- An assessment of possible changes needed in an investment management organization in order to successfully substitute listed for unlisted equity investments.

4. **An assessment of whether certain parts of the investable market for unlisted equity would suit the GPFG well, given the size, horizon, and political anchoring of the Fund, and which would not.** With regards to investments that are found to be possibly well suited for the GPFG, the assessment should include:
    - Expected value added in terms of risk and return.
    - How, in brief and general terms, the investment mandate to Norges Bank could be amended to allow for such investments, including the need to impose special reporting requirements and how risk and return could be measured and evaluated.