Ministry of Finance
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Date: 08.01.2018

Government Pension Fund Global – unlisted equity investments

In its letter of 29 June 2017, the Ministry asks Norges Bank to consider whether the investment universe for the fund should be expanded to include investments in unlisted equity. The Bank's assessments and recommendations are presented below.

The Bank has previously advised on unlisted equity, most recently in two letters dated 6 July 2010. The Bank recommended permitting such investments, but stressed that unlisted investments make different demands in terms of operational management to listed investments. At the Ministry's request, Norges Bank advised on a comprehensive framework for the fund's investments in its letter of 26 November 2015. The framework has subsequently been adjusted in the direction of the Bank's recommendations, with the fund's real estate investments being removed from the benchmark index from 1 January 2017 but remaining part of the investment universe. Responsibility for deciding how much and how the fund is to be invested in real estate has been transferred to the Bank subject to the overall restrictions in the mandate. The Ministry presumes that investments in unlisted equity should be regulated along the same lines. The Bank concurs. A broader investment universe will thus not automatically mean that the Bank actually invests the fund in unlisted equity.

In this letter, the Bank concentrates on the question of whether a broader investment universe might provide a basis for a portfolio with improved risk and return characteristics. How the Bank will approach these opportunities is a matter that the Bank will have to take a position on at a later date following further analyses and assessments. We begin by discussing the investment universe for equity. We then look at unlisted equity investments through and alongside private equity funds. We outline how the risk in unlisted equity investments can be governed in the management mandate, and provide some provisional assessments of how such investments might be implemented. We conclude by summarising the Bank's recommendations.

The equity investment universe

The investment universe for the fund's equity investments has been expanded gradually over time, from 21 developed markets in 1998 to 78 markets today. The original country list issued by the Ministry in 1998 has evolved into a general requirement for listing on a regulated and recognised marketplace.

When the fund began investing in equity in 1998, there was generally one single regulated and recognised marketplace in each country. Today, more than 150 marketplaces satisfy the mandate's criteria. The listing requirements vary between marketplaces. These differing requirements mean that listed companies do not necessarily have consistent characteristics along important dimensions such as the protection of minority interests and liquidity.

Stock exchanges play an important role in financial markets and help ensure that capital is allocated in a way that reflects the risk associated with different investments. In recent decades, we have observed that the number of listed companies appears to be in decline. In the US, the number of domestically listed companies has dropped almost 50 percent since the fund began investing in equity.[1] We find the same trend in the UK. Elsewhere in the world, the number of listed companies increased until 2011 but has since fallen slowly.[2]

The reasons for the decline in the number of listed companies in the US from its peak in 1996 are complex.[3] It cannot be explained by a general reduction in the number of companies, as the total number of companies in the US has increased over the same period. The number of new US companies choosing to go public, however, has decreased.[4] The companies that are listed appear to be somewhat older and larger than before. Over the past 20 years, delistings have outnumbered flotations.[5]

Many have seen this trend in the light of the cost of being listed, especially for smaller companies, having increased as a result of regulatory changes.[6] Another explanation may be that companies are choosing to merge with other companies rather than float, in order to benefit more quickly from economies of scale and new technology.[7] A third

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[1] The number of US listed companies peaked in 1996 and was down almost 50 percent by the end of 2016. Source: World Bank Development Indicators (data.worldbank.org).

[2] This trend towards growth flattening and reversing applies to the rest of the world taken as a whole. In European countries such as the Netherlands, Portugal, France and Belgium, we have seen the same trend as in the US and the UK, with a roughly 50 percent decline in the number of listed companies between 2000 and 2016. Source: World Bank Development Indicators.

[3] For more possible reasons for the decline in US listed companies, see Doidge, Karolyi and Stulz (2015), "The U.S. Listing Gap", NBER Working Paper 21181.

[4] Source: Jay Ritter's *Initial Public Offerings: Updated Statistics*, 8 August 2017.

[5] Source: Doidge, Karolyi and Stulz (2015).

[6] See, for example, Gao, Ritter and Zhu (2013), "Where Have All the IPOs Gone?", *Journal of Financial and Quantitative Analysis* 48(6),1663-1692, and Doidge, Karolyi and Stulz (2015).

[7] Source: Gao, Ritter and Zhu (2013).

explanation may be the emergence of alternative providers of long-term risk capital, such as sovereign wealth funds, institutional investors and private equity funds.

The Bank is currently allowed to invest in unlisted companies where the board has expressed an intention to seek a listing (pre-IPOs). However, we have found that the boards of unlisted companies will often consider various alternatives to listing, and that this is reflected in board resolutions. The Bank's pre-IPO investments are currently regulated in the mandate in the same way as the fund's listed equity investments. In this respect, the regulation of unlisted equity investments differs from the regulation of the fund's unlisted real estate investments. The mandate permits unlisted real estate investments to be made through separate legal entities, in different types of financial instruments, and with ownership stakes in excess of 10 percent. We have found that it is important for the risk associated with such investments to be anchored in every part of the governance structure. The Bank has made little use of the option of investing in pre-IPO companies.

The Ministry asks the Bank to consider what investment opportunities might be available to the fund given a general licence to invest in unlisted companies, compared to today's mandate. Exact data on the combined value of companies in private ownership are not available. Many unlisted companies are small and impossible for the fund to invest in. The ratio between listed and unlisted companies varies from country to country and over time.

Unlisted equity investments form part of the portfolios of all of the investors that the fund is normally measured against, such as other sovereign wealth funds. At the end of 2016, investors in this group had invested an average of around 8.5 percent of their capital in unlisted equity, up from around 4 percent in 2000.[8] Investments in unlisted equity can be made either indirectly, through private equity funds and funds-of-funds, or directly. Direct investments can be made either alone or alongside other investors. The Bank does not consider the fund to be especially well-positioned at present to taking large stakes in unlisted companies on its own.

In the rest of this letter, the discussion will concentrate on indirect investments through private equity funds and co-investments made alongside such funds. These are the strategies in the unlisted equity market where we have access to data of sufficient quality, and also where large parts of institutional investors' capital is currently allocated.

Investments in and alongside private equity funds

Private equity funds invest in unlisted companies with the aim of selling them on at a later date.[9] Many of these companies are never listed as independent companies either before or after being owned by a private equity fund. At the end of June 2016, private

[8] *Equity Investments in Unlisted Companies*, McKinsey & Company, Report to the Norwegian Ministry of Finance, November 2017.

[9] The information in this part of the letter is based on data from Preqin unless otherwise specified.

equity funds had almost 2,500 billion dollars under management. By way of comparison, the value of the FTSE Global All Cap index was then 51,000 billion dollars. Private equity funds' assets were thus equivalent to around 5 percent of the value of this broad global equity index. The ratio between private equity funds' assets and the value of the FTSE Global All Cap has been relatively stable since the financial crisis.

The assets managed by private equity funds can be broken down between buyout funds, venture funds, growth funds and other types of fund. Buyout funds managed 60 percent of the total. These funds normally acquire a controlling interest in the companies they invest in, and take an active role in running them. During the time that they are owned by the buyout fund, these companies often undergo extensive restructuring. Venture funds are the other main group of funds, accounting for around 20 percent of total assets under management. These funds normally take smaller positions in relatively young companies with the potential for rapid growth. Growth funds currently manage around 10 percent of the total and operate in the space between venture funds and buyout funds, generally investing in established companies that need capital to finance further growth.

There is an active secondary market for interests in private equity funds. Sales of these interests are often motivated by changes of strategy. Investors who are forced to sell their interests quickly will often have to sell them at a discount to their estimated value at the time of sale. This discount varies over time, between fund types and between managers.

Types of company

Private equity funds invested a total of 450 billion dollars in different companies in 2016.[10] Almost 70 percent of these investments were made by buyout funds. Studies of buyout funds show that they often invest in small and medium-sized companies with moderate profitability and high book-to-market ratios.[11] Venture funds account for a small share of investments by value, but a high share of the total number of investments.

Buyout funds invest in both privately owned companies and listed companies which they then take private. Transactions of the latter type have decreased markedly over the past 20 years and accounted for less than 20 percent of the value of buyout funds' investments in 2016. Overall, we find that private equity funds invest relatively more in sectors such as consumer services, health care and information technology, and

[10] This excludes investments financed through co-investments and other types of structure. By way of comparison, the value of global IPOs in 2017 was an estimated 190 billion dollars, up 40 percent on 2016, making it the most active year for global IPOs since 2007. Source: *EY Global IPO Trends*.

[11] Source: Stafford (2015), "Replicating Private Equity with Value Investing, Homemade Leverage, and Hold-to-Maturity Accounting", Harvard Business School Working Paper 16-081.

relatively less in sectors such as finance.[12] There are therefore sectoral differences between the listed and unlisted markets.[13]

More than half of buyout funds' exits take the form of a trade sale, in other words a sale to another company, often in the same industry. IPOs are chosen in only 10 percent of cases. These are thus not necessarily the same companies that the Bank is currently permitted to invest in through the mandate for pre-IPO investments. With venture funds, trade sales again account for the bulk of exits, with IPOs chosen in only around 10 percent of cases. The ratio between trade sales and IPOs has been relatively stable over the past decade for both buyout and venture funds.

Returns, financial risk and liquidity

On average, investments in private equity funds will be less liquid than listed equity. Private equity funds will often also choose to use a substantial amount of debt to make their investments. These factors mean that investors demand a higher expected rate of return to invest through a private equity fund.

In Report to the Storting No. 15 (2010-2011), the Ministry wrote: "Investments in private equity are associated with higher risk than listed shares, and should therefore generate a higher return. Historical return figures indicate that this has not been the case." More recent studies of historical returns, based on higher-quality data, paint a more positive picture.[14] These studies show that investments in private equity funds and other fund structures have, on average, produced a return after costs that is slightly higher than that on a broad portfolio of listed equity, even when adjusted for differences in market risk (beta). This excess return over the listed market does, however, seem to have narrowed slightly in recent years. This has been interpreted as a sign that competition between funds has increased, and that the market has become more mature.[15] Whether investors have, on average, been adequately compensated for bearing the risk associated with these investments is still being debated.

Returns can vary considerably between funds and between the investments that the funds make. The difference between the returns on the best and worst funds are relatively large, but smaller than a decade ago. A good return on one fund is not necessarily a guarantee of a good return on the next fund from the same manager.[16] Investors need to put time and resources into analysing the investment strategy of the funds they are considering investing in, and need to have skills in manager evaluation.

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[12] Based on data from Hamilton Lane's database.

[13] As with the public market, the private equity market is dominated by US funds, which account for around 50 percent of the total. The differences in sector distribution can therefore be explained only to a limited extent by differences in geographical composition.

[14] See, for example, Harris, Jenkinson and Kaplan (2016), "How Do Private Equity Investments Perform Compared to Public Equity?", *Journal of Investment Management* 14(3), 1-24.

[15] See, for example, Braun, Jenkinson and Stoff (2017), "How Persistent is Private Equity Performance? Evidence from Deal-Level Data", *Journal of Financial Economics* 123(2), 273-291.

[16] See, for example, Harris, Jenkinson and Stucke (2014), "Private Equity Performance: What Do We Know?", *Journal of Finance* 69(5), 1851-1882.

This evaluation needs to include more than just an analysis of historical return performance.

Large investors will often have better opportunities and better abilities to co-invest alongside private equity funds. Investors are not normally charged management fees for these co-investments.[17] Several studies indicate that investors with large sums invested in unlisted equity have achieved slightly higher returns after costs than investors with only small sums invested.[18] Lower management costs as a result of better negotiating power and more resources to conduct thorough due diligence have been mooted as possible explanations.

Regulation of risk

In its letter of 29 June, the Ministry writes that it will consider how unlisted equity investments should be regulated in the management mandate. As a starting point, the Ministry presumes that there should not be a separate allocation to unlisted equity investments, but that any such investments will be made within the Bank's permitted scope for deviation from the benchmark index.

As outlined by the Ministry in its letter of 29 June, unlisted equity should not be treated as a separate asset class but as part of the opportunity set for equity investments in general. In the same way as for unlisted real estate, the Ministry could set an upper limit on how much of the fund may be invested in unlisted equity. The fund is now large in relation to the investable market. At the same time, there is reason to believe that external management organisations' capacity to handle larger allocations has increased in recent years, due partly to growth in alternative co-operative arrangements such as strategic partnerships and separate accounts.[19] If the fund's stake in this "market" were to be roughly the same as the fund's average stake in the companies included in the fund's benchmark index for equity, this would indicate that the limit should be set at around 4 percent of the fund, or 6 percent of the equity portfolio.[20] The Ministry could also choose to set a lower limit. It will in any case take a long time to build up a portfolio.

The relative risk associated with the fund's unlisted real estate investments is currently calculated on the basis of a representative time series from an external service provider, cf. the Bank's letters of 10 October and 15 December 2016. The Bank's external service provider could also supply the same type of time series for unlisted equity. We would

[17] See, for example, Braun, Jenkinson and Schemmerl (2017), "Adverse Selection and the Performance of Private Equity Co-investments", working paper, version dated April 2017.

[18] See, for example, Da Rin and Phalippou (2016), "The Importance of Size in Private Equity: Evidence from a Survey of Limited Partners", *Journal of Financial Intermediation* 31, 64-76.

[19] According to Bain & Company's *Global Private Equity Report 2017*, separate accounts account for 6 percent of the capital raised by alternative investment funds in 2016, up from 2.5 percent in 2006.

[20] In this calculation, we have used Preqin's figures for assets under management in private equity funds as an estimate of the unlisted market. This has to be seen as a conservative estimate.

then be able to use processes and systems that are already established. Alternatively, the Bank could calculate a time series itself using data for comparable listed equity.

The Ministry also writes that it will consider supplementary risk limits to capture risks not normally captured by the calculation of relative volatility. Any investment needs to be preceded by thorough due diligence. The aim of this review should be to map all relevant investment risks and operational, or non-financial, risks. The risk factors identified in the due diligence need to be monitored, managed and reported on regularly. Assessments of potential reputational consequences form part of the Bank's due diligence on investments.

For the fund's investments in unlisted real estate, the Ministry has permitted investments to be made through separate legal entities, with ownership stakes in excess of 10 percent, and in different types of financial instrument. The Ministry should consider applying these special mandate provisions to any investments the fund is permitted to make in unlisted equity. This goes particularly for the fund's scope to invest through separate legal entities in order to protect the Bank's balance sheet. There will be a need for this even when investing indirectly through funds.

Unlisted investments are generally less liquid than listed investments. The Executive Board currently sets a limit for liquidity risk in the fund. Even if unlisted equity investments are permitted, most of the fund will still be invested in listed equity and tradable debt instruments. The Bank does not therefore see a need for new provisions to regulate liquidity risk in the management of the fund.

The Ministry should instruct the Executive Board to set additional risk limits for the fund's investments in unlisted equity. In the first instance, it may be appropriate for the Executive Board to be asked to set limits for how much of the fund may be invested in different strategies (e.g. private equity funds and co-investments), the maximum holding in underlying companies, maximum leverage in co-investments, and how much of the fund may be managed by an external manager. The Executive Board could provide additional guidance on investments in unlisted equity in the strategic plans drawn up for Norges Bank Investment Management, and in the investment mandate issued to the CEO of Norges Bank Investment Management.

The mandate's restrictions on the fund's investments in unlisted real estate could be a good starting point for the regulation of investments in unlisted equity.

Implementation

The Ministry asks a number of questions about how the Bank envisages implementing investments in unlisted equity. The Bank will need to decide on these questions at a later date. If the Ministry decides to permit such investments, there will be a need for further analyses and assessments before the Bank actually makes the decision to invest.

Investing with others
To begin with, the Bank will consider investing in or alongside private equity funds. Such a strategy will require the Bank to have good manager evaluation skills.

Since 1998, the Bank has built up broad expertise in evaluating investment managers. The results of external equity management after costs have been good. We will be able to build on experience and processes from this external management, with the necessary adjustments to take account of the differences between listed and unlisted investments. The Bank currently uses external managers for the fund's equity investments in emerging markets, small companies in developed markets, and environment-related mandates. These are markets and segments where there is a need for specialist expertise, and where we do not consider it appropriate to have all of the necessary expertise in-house. These same requirements will to some extent apply to investments in unlisted equity.

A number of studies have shown that risks and returns in unlisted equity are driven by some of the same factors that drive risks and returns in listed equity.[21] The Bank will be able to manage the general market and currency risk associated with unlisted equity investments by making adjustments to other parts of the portfolio. An investment in a private equity fund in the US could be financed through a combination of selling US equity and buying US bonds. The combination of selling equity and buying bonds reflects how investments in private equity funds normally have slightly higher levels of debt than the average for listed equity. This type of financing solution will help ensure that the total risk in the fund adequately reflects the total risk in the benchmark index. The Bank currently manages the market and currency risk in the fund's unlisted real estate investments along the same lines.

Investing cost-effectively
If the Ministry permits unlisted equity investments, we will give priority to establishing cost-effective solutions. The need for new staff will probably be limited at first, as the Bank anticipates starting off by considering investments through private equity funds. It is, however, reasonable to expect total management costs to rise slightly, because the direct management costs for unlisted investments are generally higher than the equivalent costs for listed investments. When investing in funds, we have to expect to pay both a fixed management fee and a variable performance fee. The management mandate currently requires the Bank's agreements with external managers to include a cap on total fees to external managers. Consideration will need to be given to whether this requirement can be adapted to investments in private equity funds.

Co-investments will contribute to lower average management costs than if the fund's investments in unlisted equity are exclusively in private equity funds. Investors are not

[21] See, for example, Bass, Gladstone and Ang (2017), "Total Portfolio Factor, Not Just Asset, Allocation", *Journal of Portfolio Management* 43(5), 38-53.

normally charged management costs for this kind of investments. Co-investments will, however, require rather more staff, as well as expertise in assessing the underlying company investments. Through its licence to invest in pre-IPO companies, the Bank has already amassed competence that we can build on. When it comes to the question of board representation at the companies invested in by the consortium, the Bank believes that it will be most natural to assign this responsibility to the Bank's partners.

Unlisted investments are more complex operationally than listed investments, and do not benefit from continuous market pricing in a regulated marketplace. The resulting practical challenges will to some extent be the same regardless of the type of unlisted investment. In areas such as the drafting of partnership agreements, valuation, accounting, risk management and reporting, we will be able to draw on experience from real estate management. This is in line with the Ministry's assertion in Report to the Storting No. 15 (2010-2011) that it would be best to build experience in unlisted real estate investments before also permitting other types of unlisted investment. Unlisted equity investments within the constraints outlined in this letter will probably not serve to increase the complexity of management significantly beyond that which already follows from parts of the fund being invested in unlisted real estate.

Safeguarding ownership interests
Norges Bank is a responsible investor and makes active use of its voting rights. When investing through private equity funds, the Bank will not have voting rights in the unlisted companies these funds invest in. The Bank will, however, have a certain influence over investment strategy and corporate governance as one of the group of investors that own the fund. With co-investments, investors' voting rights are regulated in shareholder agreements. Investors who contribute capital will normally invest in line with the lead investor and will be able to exercise the voting rights carried by their shares in accordance with the terms of the shareholder agreements. It will be important to ensure that the fund's ownership interests are at least as well protected as they would be in a comparable listed company, and that investments are carried out in a way that protects the Bank's balance sheet.

Unlisted equity investments will expose the fund to non-financial risks. When investing in funds, these risks will in the first instance relate to the actual management company, its employees and its processes, including those for managing environmental, social and governance risks. The Bank will need to conduct thorough evaluations and will be able to build on existing processes, in particular our experience from external equity management.[22] As part of these evaluations, we meet representatives from various parts of the management organisation, both investment personnel and support staff. This internal review is supplemented with a report from an external consultant. The process for selecting and evaluating external managers has been tested over many years and

[22] See http://www.nbim.no/en/the-fund/governance-model/policies/operational-risk-management/ for general guidelines on the management of operational risk.

has been regularly fine-tuned. With co-investments, the Bank will need not only to evaluate the private equity fund but also to conduct a broad risk assessment of the unlisted company that is the candidate for investment.

Responsible investment

Responsible investment is an integral part of our management of the fund. The Bank's principles for responsible investment are based partly on the OECD's Principles of Corporate Governance and Guidelines for Multinational Enterprises. These documents do not distinguish between listed and unlisted companies.

The fund may not be invested in companies that, on the recommendation of the Council on Ethics, the Bank has excluded from the fund's investment universe under the guidelines for observation and exclusion. Excluded companies could be handled through special agreements.[23] The mandate for the Council on Ethics does not currently distinguish between listed and unlisted companies. Were the Council on Ethics to recommend excluding an unlisted company in which the fund is invested directly or indirectly, the Bank would make the decision in line with the guidelines and conduct any divestment from the company or fund as cost-effectively as possible. Any such divestment can be expected to take rather longer, on average, than divestments from listed companies.

Most private equity funds are organised as limited partnerships under local law, often in low-tax countries. With this corporate form, the private equity fund itself is not taxed on investment income. Instead, investors are treated as though they held the shares directly and are taxed where they are resident. This follows from the corporate form, not the jurisdiction. Our expectations of companies when it comes to tax and transparency are set out in Norges Bank Investment Management's expectations document of April 2017. These expectations are not affected by whether a company is listed or unlisted.

If the Ministry decides to permit investments in unlisted equity, it will be natural to retain the mandate requirement that the fund may only be invested in unlisted companies and fund structures in countries with which Norway has a tax treaty or in countries from which Norway can request tax information under other international agreements. When investing in funds, this requirement will apply to the private equity fund and not to the underlying companies invested in. As far as the Bank has been able to ascertain, investments in unlisted equity will not present any significant new tax challenges and could be made in a way that does not have tax implications for the fund's other investments.

Private equity funds have been accused of investing in a way that results in a social cost in the form of lost jobs and unsustainable business models. Were this to be the case, investing alongside a private equity fund could have reputational consequences for the

[23] This is standard practice for investments in private equity funds. Excluded companies can be handled through "side letters" between individual investors and the manager.

Bank and for the fund. Studies of the conduct of private equity funds do not, however, provide support for claims that these funds as a group behave in such a way. Private equity funds create value at the companies they invest in, in both the short and the long term.[24] As with listed investments, however, there will always be some players whose business practices fall short of the Bank's expectations. The potential reputational consequences need to be assessed ahead of each investment.

Transparency

The Bank attaches great importance to openness about the management of the fund. Less information is publicly available on unlisted companies than on listed companies, although the amount of information has increased in recent years. In the fund's unlisted real estate investments, our experience has been that we have good access to information as an investor, and we publish an extensive report on the fund's unlisted real estate investments each year.

Reporting on the fund's unlisted equity investments would be designed in a way that helps outsiders assess the performance. Access to information and our right to share this information with others are factors that can be prioritised when drafting the agreements we enter into. Unlisted equity's contribution to our overall excess return could be reported on separately. Returns on unlisted equity investments should be compared with relevant return metrics, but should also take account of the fact that the return on investments in a fund may be uncertain until the last of the fund's investments is realised.

In line with established practice for the fund's unlisted real estate investments, management costs could be reported in such a way that they can be compared with those for the fund's listed investments. An overview of partners and external managers should be included in the annual reporting, and holdings of unlisted investments should form part of the holding lists published each year.

Gradual approach

It will be natural for the Bank to approach investment opportunities and build expertise gradually. The strategy for the fund's unlisted investments will evolve over time and will be adjusted in the light of experience. Priority will be given to areas where the expertise we build up can be expected to have positive knock-on effects on other parts of the fund's management. By working with venture funds, for example, we might gain insights into new technology which could have consequences for the fund's other investments in the longer term. This might apply particularly to the fund's environment-related mandates, which invest in sectors undergoing rapid technological development.

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[24] See, for example, Bernstein, Lerner, Sorensen and Strømberg (2016), "Private Equity and Industry Performance", *Management Science* 63(4), 1198-1213, and Achraya, Gottschalg, Hahn and Kehoe (2013), "Corporate Governance and Value Creation: Evidence from Private Equity", *Review of Financial Studies* 26(2), 368-402.

If the fund is allowed to invest in unlisted equity, investing in and alongside private equity funds would appear to be the most relevant options for the Bank to consider.

Overall assessment
The fund's size, long-term horizon and limited liquidity needs may make it well-suited to investing in unlisted equity. A broader investment universe may also enable the fund to be invested in different types of company to those that are available in the public equity market. Based on historical data, investing in unlisted equities can also be expected to generate a slightly higher return after costs than listed equity investments. For a large, global equity investor such as the fund, the difference between listed and unlisted companies appears to be somewhat less distinct than before. The Bank also has extensive manager evaluation skills, practical experience from unlisted real estate investments, and experience of managing the total risk in the portfolio within a comprehensive framework. In addition, unlisted investments may have positive spill-over effects on other parts of the fund's management.

Unlisted investments do not benefit from continuous pricing in a regulated marketplace. Less information is publicly available. This means that the management and reporting of risk will need to be conducted in a slightly different way to listed investments. The type of risk that these challenges present is difficult to quantify, but it is important that these risks are anchored and understood in all parts of the management structure. Direct management costs are higher for unlisted investments. It may also take time for these investments to show concrete results, and it may be somewhat harder to evaluate our management performance.

On balance, Norges Bank believes that the risk associated with unlisted equity investments could be adequately constrained in the management mandate. Investments in unlisted equity lie closer to the Bank's existing investment activities than was the case when the Ministry first permitted investments in unlisted real estate. Unlisted equity investments within the constraints outlined in this letter will probably not serve to increase the complexity of management significantly beyond that which already follows from parts of the fund being invested in unlisted real estate. The Bank's recommendation is that the Ministry permits investments in unlisted equity in its definition of the investment universe.

If the Ministry does permit unlisted equity investments, the Bank will approach investment opportunities and build expertise gradually, invest via and alongside others in a responsible manner that safeguards the fund's ownership interests, and share relevant information with the public. The detailed investment strategy will be determined by the Executive Board at a later date, based on further analyses of investment opportunities given a general licence to make unlisted investments. The Bank will invest only if we believe there is reason to expect these investments to help improve the trade-off between risk and return in the fund as a whole. A broader investment universe will thus not automatically mean that the Bank actually invests the fund in unlisted equity.

Yours faithfully

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