FUTURE OF SOVEREIGN WEALTH FUNDS IN THE GLOBAL FINANCIAL SYSTEM.

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ملخص:
تحلل هذه الورقة آثار الأزمة الاقتصادية العالمية الأخيرة على صناديق الثروة السيادية منذ منتصف عام 2007 ، شهدت صناديق الثروة السيادية خسائر كبيرة في محفظتها الاستثمارية ، انخفاضا في تدفقات الأموال، ومراقبة دقيقة من طرف حكوماتها . وقد استخدمت صناديق الثروة السيادية في الكثير من البرامج الاستقرارية دات الطابع السيادي و ساعدت في تمويل البنوك الغربية التي كانت تعاني من اضطرابات نتيجة الازمة المالية.

تم الاتفاق بين صناديق الثروة السيادية وصندوق النقد الدولي على مجموعة من الممارسات المعروفة باسم مبادئ سانتياغو الشئ الدي ساعدها في تقصير نسبيا المدة زمنية لاستثمارتها و حيازاتها على نسبة معتبرة من السيولة ،اضافة الى تحسيين إدارتها التي اصبحت باكثر شفافية ، مما ادى الى تحسن مؤقت في وضعيتها، الشئ الدي ساعدها في الحصول على حصص مسيطرة في الشركات الغربية الكبرى ، و تنسيق جيد مع مستثمرين جدد اضافة لصناديق سيادية أخرى . هذه التغييرات، إلى جانب حالة الاسواق العالمية ساعدت الصناديق الثروة السيادية في احتيازها على مكانة عالمية جيدة يؤهلها للقيام بدور أكثر بروزا في التمويل العالمي.
على الرغم من أن الأزمة المالية العالمية الأخيرة قد اثرت سلبيا على معظم الصناديق الثروة السيادية الى ان هده الاخيرة قد عرفت تدقيق وفحص متزايد من طرف الحكومات والصحافة ، يمكنها من استخلاص العديد من الدروس المستفادة من خلال هده الأزمة، هده الاخيرة عززت الاثر الايجابي للصناديق الثروة السيادية ، فهي الان في وضع جيد يؤهلها لتنفيذ أهدافها المعلنة و المتمثلة في: زيادة ثروة البلدان لأجيال المستقبل ، تحقيق الاستقرار في البلدان المالكة لتصدي لاي ازمة اقتصادية في المستقبل، و المساعدة في تعزيز المزايا التي يمكن لن يتحلى البلد من خلال الاستثمارات الاستراتيجية و عمليات الاستحواذ التي يقوم بها الصندوق.

Abstract:

This paper analyses the effects of the recent global economic crisis upon sovereign wealth funds (SWFs). Since mid-2007, SWFs have experienced significant portfolio losses, a decline in fund inflows, and enhanced scrutiny from their own governments. SWFs have been utilised for sovereign stabilisation programs and have helped finance troubled Western banks.

SWFs and the IMF have also created a set of best practices known as the Santiago Principles. From these developments, many SWFs have moved to relatively shorter investment time horizons and more liquid holdings, revamped their transparency and management, experienced a temporary improvement in their images, begun to hold controlling stakes in major Western corporations, and have improved their coordination with institutional investors and other SWFs. Going forward, these changes, alongside the relatively strong post-crisis asset position held by SWFs in comparison to other asset vehicles, make SWFs well-positioned to play an even more prominent role in global finance.

Much like other asset classes and sectors of the global economy, the recent global financial crisis was a painful yet transformative time for sovereign wealth funds (SWFs). Alongside most pension, mutual and private equity funds, SWFs endured heavy losses between mid-2007 and early 2009, inviting a wave of criticism and scrutiny from their own governments not seen by most SWFs since their inception.

Although the recent global turmoil has left most funds with less capital for investment and has put many SWFs under increased scrutiny from governments and the press, many of the lessons learned from the crisis have also strengthened SWFs. SWFs are now well-positioned to carry out their stated goals: growing a country's wealth for future generations, stabilising a country during economic shocks, and helping enhance a country's comparative advantages through strategic investments and acquisitions. On the other hand, some of the events associated with the global crisis may have taught SWFs and their sovereigns the wrong lessons.

I- Emergence factors and evolution of sovereign funds:

While there is not a precise definition of SWFs, Borgne and Medas provide a comprehensive overview. In their article, the authors define SWFs as vehicles to manage public funds, predominantly engaged in cross-border investments seeking a higher risk-return combination than the one offered by safer investments like government bonds[1]. SWFs obtain their capital mainly from current account surpluses and excess foreign exchange reserves, and are typically controlled by their governments.

There are two general types of SWFs: commodity and noncommodity[2]. Commodity SWFs are funded by oil or commodity export revenues, and noncommodity. SWFs are funded by transfers from official foreign exchange reserves. According to Butt et al., SWFs belong to a continuum of government-owned investment vehicles that include central banks, sovereign stabilization funds, sovereign saving funds, government investment corporations, and government-owned enterprises[3].

SWFs include the following variations: sovereign stabilization funds (designed to stabilize revenue), sovereign saving funds (to act as intergenerational funds), and government investment corporations (to invest in riskier assets like corporate bonds, common stocks, and real estate).

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[1] Borgne, E., & Medas, P. (2007). Sovereign wealth funds in the Pacific island countries: Macro-fiscal linkages. IMF Working Paper. Retrieved from www.imf.org/external/pubs/ft/wp/2007/wp07297.pdf.

[2] Kimmitt, R. (2008, January/February). Public footprints in privatemarkets. *Foreign Affairs*, pp. 119–130.

[3] Butt, S., Shivdasani, A., Stendevad, C., & Wyman, A. (2008). Sovereign wealth funds: A growing global force in corporate finance. *Journal of Applied Corporate Finance*, 20, 73–83

Although SWFs belong to their respective governments, an SWF is neither managed like a central bank nor does it form part of a country's foreign exchange reserves. Unlike a central bank, SWFs do not have the day-to-day responsibility for maintaining the stability of the national currency and money supply. And unlike an official foreign exchange reserve, SWFs are not held in foreign currencies. Further, compared to either central banks or an official foreign exchange reserve, SWFs are able to lengthen their investment horizons, assume greater risk, and seek higher returns despite the fact that they are investing state funds.

It is difficult to generalize SWFs as a class. For example,while the majority is owned by national governments, there are also those that are owned by local governments like provinces, emirates, and states (such as in Canada, the United Arab Emirates, and the United States, respectively).

Some are managed semi-independently-that is, the government appoints a board to oversee the operations of the SWF (for example, the Australian Government Future Fund)-while others are managed directly by their Ministry of Finance (for example, Indonesia's Pusat Investasi Pemerintah). There are also those that are managed by their central banks (for example, Kazakhstan National Fund and Nigeria—Excess Crude Account). A few SWFs are under the direct control of their head of state (for example, the State Oil Fund of the Republic of Azerbaijan and Venezuela's Fund for Investment of Macroeconomic Stabilization). Some SWFs are set up as a private company under the Companies Act, wholly owned by the government (for example, the Government of Singapore Investment Corporation).

Next, all SWFs do not invest in the same way. While some invest primarily in their local economy (for example, Khazanah Nasional BHD in Malaysia), others invest predominantly abroad (for example, the China Investment Corporation). There are SWFs that invest conservatively in safe assets like government bonds, and there are also those that undertake riskier investments through participation in joint ventures and/or private-equity deals and/or buyouts (for example, Abu Dhabi Investment Authority, Abu Dhabi's Mubadala Development Company, and the China Investment Corporation). A few SWFs invest as pension funds in the sense that they are set up to facilitate government savings necessary to meet public pension expenditure (for example, the Government Pension Fund-Global of Norway). While some governments establish only one such fund, others establish a family of those funds (for example, the United Arab Emirates).Therefore, SWFs differ in their objectives, the way they are managed, and their investment approaches.

Kuwait pioneered the establishment of SWFs, launching its SWF in 1953 . Among the older and largest is Singapore's Temasak Holding which was created in 1974. Alaska established its SWF in 1976 while Abu Dhabi investment Authority, the largest SWF, was also launched in 1976 (see Table1).

In Table 1 we can observe that a larger proportion of SWFs were established in recent years. This extraordinary growth in the number of SWFs has been the result of the rapid accumulation of foreign assets in some countries Among some of the largest SWFs is the China Investment Corporation (CIC) which was established in 2007 and holds US$200 billion. China has accumulated surpluses from exports sales revenue. Given that China has reserves of US$1.5trillion, it is likely that the CIC will increase its assets.

Table 1: The 20 Largest Sovereign Wealth Funds

Name of Funds	Year founded	Source	Billion US$
Abu Dhabi Investment Authority	1976	Oil	875
Singapore Investment Corporation	1981	Non-commodity	330
Norway Government Pension Fund-Global	1990	Oil	322
Saudi Arabia Various Funds	n/a	Oil	300
Kuwait Invetsment Authority	1953	Oil	250
China Investment Corporation	2007	Non-commodity	200
Hong Kong Monetary Authority Investment Portafolio	1998	Non-commodity	140
Stabilisation Fund of the Russian Federation	2003	Oil	127
China Investment Company	2003	Non-commodity	100
Singapore Temasek Holdings	1974	Non-commodity	108
Australia Government Future Fund	2004	Non-commodity	50
Libya Reserve Fund	n/a	Oil	50
Qatar Investment Authority	2000	Oil	40
US Alaska Permanent Fund	1976	Oil	40
Brunei Investment Agency	1983	Oil	35
Ireland National Pension Funds	2001	Non-commodity	29
Algeria Revenue Regulation Fund	n/a	Oil	43
South Korea Investment Corporation	2006	Non-commodity	20
Malaysia Khazanah Nasional	1993	Non-commodity	18
Kazakhstan National Oil Fund	2000	Oil, gas and metals	18

Source: Deutsche Bank Research, "Sovereign Wealth Funds, State Investment on the Rise", September, 2007

Currently, there are about 73 SWFs held by 44 countries with assets that range from US$20 million to US$6.2 trillion at the end of 2013. About 40 percent of total SWFs have originated from accumulated current accounts surpluses of non-commodity sources and about the same percentage are held by Asian and Pacific countries. However, oil producing countries remain the largest holders of SWFs (see Table 1). The accumulation of large current accounts surpluses has been a trend observed in a number of countries; remarkably the majority of these countries are emerging and developing nations, the rapid growth in the number of SWFs and the establishment of large SWFs by China and Russia has provoked concern and anxiety in some western countries Although the Anglo-Saxon governments were receptive of SWF investment other western countries voiced strong apprehension based on the prospect that SWFs could be used to seize control of strategic companies in sensitive sectors for their own political purposes The argument of financial protectionism became an issue for the International Financial Institutions

Given the significance of the possible impact that protectionism could have in the global economy, the International Monetary Fund (IMF) called states to a dialogue in October 2007 . Twenty-six countries that hold SWFs voluntarily played a role in the creation of an institutional framework around the governance and investment operations of these funds. A year later, the General Accepted Principles and Practices (GAPP) - Santiago Principles were launched with the aim of fostering trust and confidence among recipient and investor countries. These principles aim to support a healthy global economy with a financial system based on free flows of capital that complies with applicable regulatory requirements and transparent management. The purpose of the GAPP is to reflect appropriate governance and accountability of investment. The GAPP consists of 24 principles that cover four key areas:

1) Legal and institutional framework
2) Objectives and coordination on macroeconomic principles
3) Governance structure and code of conduct
4) Risk management framework

The launch of the GAPP is expected to dispel some of the prevailing apprehension about SWFs. It is expected that the Santiago Principles will support further investment by these well-established institutional investors and continue to contribute to the economy of recipient countries. SWFs are long-term investors.

It is widely acknowledge that long-term investment is one of the best methods of economic development. Long-term investments endure business cycles, convey diversity to the markets and provide support during economic volatility. The Santiago Principles therefore facilitate a platform for a more efficient flow of foreign direct investment.

II- Geographical and sectoral trends of sovereign funds investment :

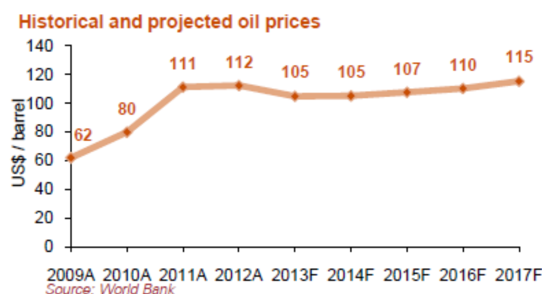
The global SWFs currently control an aggregate of approximately US$6.2 trillion in assets under management (AUM). Of this amount, the GCC SWFs (most notably ADIA, currently the world's second largest SWF behind the Norway Government Pension Fund) account for approximately 30% of global SWFs by AUM.

Top 10 Global Sovereign Wealth Funds (AUM)

No	Country	Sovereign Wealth Fund	AUM (US$ billion)
1	Norway	Government Pension Fund	716
2	UAE	Abu Dhabi Investment Authority ("ADIA")	627
3	China	SAFE Investment Company	568
4	KSA	SAMA Foreign Holdings	533
5	China	China Investment Corporation	482
6	China - Hong Kong	Hong Kong Monetary Authority Investment Portfolio	299
7	Kuwait	Kuwait Investment Authority ("KIA")	296
8	Singapore	Government of Singapore Investment Corporation	248
9	Russia	National Welfare Fund	176
10	China	National Social Security Fund	161

Source: SWF Institute as at March 2013

Like the rest of the world, the Middle East was impacted by the global financial crisis which saw SWFs in the region curb their investment activity, and in many cases, reset their investment strategies altogether. While recent years will be remembered for the financial crisis, the impact on SWFs in the oil rich countries was partly mitigated by the increase in the price of oil (often trading well in excess of US$100 per barrel since 2011). Therefore, as the economic world crawls out of the economic slowdown, these organisations appear to be in the best position to take advantage of the recovery in the global markets.



There is no doubt that, as liquidity tightened in the West thanks largely to the lingering impact of the financial crisis and, more recently, the Euro zone sovereign debt crisis, Middle Eastern SWFs' influence on the global economy has grown. Now, more than ever, these SWFs are viewed by the West as a vitally important source of capital.

However, despite this fact, SWFs in the Middle East appear to be viewing the West with caution and, as a result, have invested less internationally than they have done in the past. Whether this is due to international forces, such as the Euro zone debt crisis, or as a result of local factors, such as the Arab Spring, it is becoming evident that SWFs are redirecting a portion of their funds from international investments back into the Middle East.

Generally speaking, the most common changes within the region can be seen in local wage inflation and increases in major local infrastructure spend evident in Qatar as the country gears up for the FIFA World Cup in 2022, and in Abu Dhabi as it seeks to grow into a major global financial centre and true global city (Abu Dhabi's 2030 vision).

Looking forward, 2013 is set to be an extremely active year for SWFs in the region. Many funds have increased their headcount significantly during 2011 and 2012 and have strengthened their in house capabilities. While distressed periods are typically times when oil rich SWFs have taken advantage of 'opportunities' to acquire trophy assets in the West, we expect there to remain a heightened sense of caution. Western governments and organisations looking for capital from the Middle East need to adapt and demonstrate a deep understanding of what is driving the thinking of SWFs in the region, and be dedicated to making a long term commitment to building relationships that add value to their investment policy.

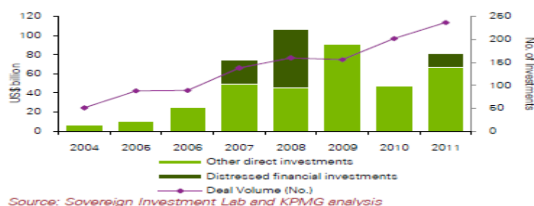
III- Global trends in sovereign investing[4]:

There is considerable diversity within the sovereign investment fund community in terms of size, investment strategy, investment management outsourcing and operating structure. As such comparisons between funds are not always relevant and broad trends within the industry can be obscured. We thought it might be useful to explore two of the key trends we see in the industry, the move toward direct investment or other forms of investment over which more control is exercised and the upgrading of risk and control environment, and share some thoughts on where these trends may be headed in the future, the following ideas could easily be criticized.

-Direct investment

We believe we are seeing an accelerating trend toward direct investment or strategies that offer the investor a greater level of control or influence over investment strategy. For the purposes of this discussion we shall define direct investment in quite a broad sense to include direct investment, co-investment alongside another investor such as a property company and investments made via structures over which the investor has a degree of discretion such as certain 'managed account' arrangements with private equity fund managers.

This may appear surprising to some and is certainly contrary, in capital terms at least, to what data providers are telling us.



Source: Sovereign Investment Lab and KPMG analysis

4 Emerging trends in the Sovereign Wealth Fund landscape Middle East, KPMG reporting team , May 2013

Examining the data a little deeper reveals a different picture as we would argue that distressed investments made in domestic banks during the financial crisis were largely politically driven and investments in distressed global international financial institutions one-off and opportunistic in nature. Eliminating these investments from the capital deployed statistics reveals a trend line more aligned with the broad upward trend in the numbers of direct investments made.

We should also bear in mind that data providers have to rely on publically disclosed data that we believe only captures a small proportion of direct investments. Clearly it is impossible to speculate about the actual level of direct investment but we would think it is likely to be a multiple of the above reported numbers given the aggregate asset base of SWFs is circa five and a half trillion dollars. We therefore need to rely on more anecdotal sources of information to support this rationale.

We believe there are some themes we are seeing in the market that support this view. Firstly we are seeing a number of funds hiring investment and investment management professionals to increase their capacity to evaluate direct investment and co-investment opportunities typically in asset classes that lend themselves to direct investment such real estate and private equity (ironically the fact that these people are available is for some part down to the global financial crisis). In parallel with this we have noted some funds appearing to alter their asset allocation to provide these new resources with capital. That said it is still relatively rare to see SWFs take control positions in companies and actively manage the underlying assets outside the real estate sector and the holding of nationalised assets.

We are also seeing some patterns of investment that suggests SWFs want to manage their investment strategies more actively, and potentially increase their opportunity for direct co-investment. This is particularly noticeable in private equity with managed accounts and the investments we have seen in private equity management companies.

Managed accounts, whilst not direct investment , do give investors a greater input into investment strategy particularly in the case of Private Equity houses operating multiple strategies. We have also seen a number of SWFs take stakes in management companies of private equity funds. Many commentators believe a component for the rationale of these investments is a closer alignment with the Private Equity (PE) fund allowing better access to direct co-investment opportunities alongside the private equity fund.

Looking to the future where can we expect these trends to go? Our view is that we are unlikely to see large scale adoption of the full private equity model in terms of SWFs taking control positions and participating in the management of assets. This is probably a step too far in terms complexity and we would question whether there would be large scale appetite for SWF capital on these terms. We do see further growth in direct passively managed minority investments, JVs and co-investment in infrastructure and private equity alongside existing real estate strategies. One area we might also anticipate some development may be increasing direct investment in corporate debt instruments. Given the current low yield environment in gilts, a tainted CDO market, one could see circumstances where participation in debt structures financing buyouts would be attractive, however, this vision can be criticized.

-Upgrading of risk and control environments

Many funds are relatively young organisations and many more have gone through periods of high growth and a considerable deepening in their levels of complexity as asset bases have diversified into more asset classes and these new asset classes tend to have higher levels of sophistication and complexity. Often back and middle offices and control and governance structures have not kept up with this rapid change. For some, shortfalls were exposed by the global financial crisis. We have seen a number of SWFs starting to address these issues. Clearly different funds have different priorities but some of the issues we see being addressed include:

- Upgrading of risk management in terms of increasing the level and quality of manpower, more sophisticated systems and formalising reporting
- Re-engineering of reporting systems particularly in the area of investment monitoring
- Development of more sophisticated treasury functions
- Formalisation of the control environment and procedures
- Development or enhancement of the ESG agenda looking forward, work being done here is likely to leave the SWF community more robust, efficient and better able to deal with market traumas in the future.

VI- Role of sovereign funds in the global financial system during financial crisis of 2007:

In the fall of 2007, as the global financial crisis gained momentum, views about SWFs moderated somewhat. In the fourth quarter of that year and the first quarter of 2008, several SWFs invested substantial amounts in Western financial institutions that were under financial stress. Their actions were motivated by the potential for financial rewards, but they also generated political side benefits: sovereign wealth funds to the rescue! For example, on August 21, 2007, during the month that the financial crisis broke, Steven R. Weisman in the New York Times quoted US Treasury Secretary Henry M. Paulson, Jr. as saying: “I'd like nothing more than to get more of that money.” Weisman also reported a view that in a future global crisis, and perhaps even during the crisis unfolding at the time, the US Treasury secretary might be wise to place calls to SWF managers as well as to central bankers and finance ministers around the world in an effort to manage the financial crisis[5].

The perception of SWFs as saviours of the Western financial system was as exaggerated as that of the SWF as threats that preceded the financial crisis. The new perception was based upon a flawed, partial-equilibrium understanding of SWF investment practices and balance sheets. In managing their portfolios, SWFs may buy government or corporate securities, invest in hedge funds, buy real estate, buy stocks of commodities, or purchase stakes in financial institutions. SWFs have to invest in some asset and generally do not hold substantial proportions of their portfolios in low-yielding cash investments. The particular governments, corporations, hedge funds, real estate developers, commodity producers, or financial institutions benefit financially from the SWFs' investments via access to funds in large volume often for a price. However, other governments and potential recipients of SWF investments, at most, benefit indirectly[6].

To the extent that the SWF disinvests from some assets to make new investments, the issuers of the assets from which the SWF disinvests are net losers. SWFs were not positioned in 2007 to save everyone.

SWF investments in Western financial institutions soured as the financial crisis deepened in the fall of 2008 and winter of 2009. Along with other global investors, SWFs saw reductions in the mark-to-market value of their portfolios on the order of 20 to 30 percent. Their managers were heavily criticized for investment decisions that, with the benefit of hindsight, were seen as

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[5] Steven R. Weisman, “A Fear of Foreign Investments,”
New York Times, August 21, 2007. Weisman became editorial director and public policy fellow at the Peterson Institute for In-
ternational Economics in July 2008.

[6] For example, they may benefit from the stability that a specific SWF investment in one financial institution brings to the financial system as a whole

unwise. SWFs in 2007 and 2008 proved to be neither an unqualified threat nor an unqualified salvation for anyone involved.

Meanwhile, the SWFs' continued and still-rapid growth raised issues that were not going away. They remained controversial and contentious in North America and Europe, and numerous suggestions were made to regulate SWF investments or refine existing regulations as they applied to such investments by foreign governments. As researchers and analysts explored the SWF phenomenon, policymakers in North America and Europe discovered that their own countries had SWFs too, often operating at the sub national level, such as Alaska's Permanent Fund, as well as the functional equivalent of SWFs in the form of government pension funds[7].

Both types of governmental investment vehicles diversify their investments globally. Moreover, in the United States, observers are familiar with large government pension funds that use their financial muscle to achieve political objectives, often under the guise of ethical investment policies. Meanwhile, policymakers in non-Western countries with SWFs became concerned that jurisdictions would erect barriers to SWF investments. The associated tensions led to more finger pointing.

Response to Sovereign Wealth Funds As is appropriate and desirable when international controversies emerge, responsible policymakers sought multilateral solutions and, to that end,

the involvement of multilateral institutions—the International Monetary

Fund (IMF), World Bank, and OECD. Outside observers, suggested the development of a voluntary code of conduct or set of standards or best practices for SWFs[8].

This suggestion was initially resisted by officials of some of the countries that would be affected. They argued that hedge funds, private equity firms, and other large pools of capital were not subject to international standards. The arguments from the countries with SWFs were somewhat undercut by the fact that authorities in the United States, United Kingdom, and other jurisdictions were moving at the same time to promote the establishment of standards or codes of conduct for such private investment vehicles. Standards were emerging for all the big money players.

Some also argued that the public sector should set a strong example for the private sector in demonstrating accountability and transparency. The fact that this argument took time to catch on reflected the reality that the many countries that are home to SWFs have diverse and differing political and cultural histories. Their funds were established to serve a wide range of economic and financial policy objectives derived from their own unique circumstances. They did not from the start perceive themselves as part of a coherent group, let alone one that could benefit from self regulation. Moreover, the countries that were home to SWFs were legitimately seeking a quid pro quo in the form of a commitment from countries receiving their investments not to subject SWF investments to special restrictions or higher standards.

In October 2007, the Peterson Institute for International Economics released prototype of an international standard for SWF accountability and transparency in the form of an SWF scoreboard[9].

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7 Policymakers in countries with large foreign exchange reserves, such as Japan, India, and Brazil, also began to think about setting up SWFs. Brazil subsequently has done so

8 Edwin M. Truman, "What Should the Fund's Role Be Now?" Remarks at the Bretton Woods Committee 2007 Annual Meeting, June 12, 2007, available at www.piie.com (accessed on July 12, 2010).

9 . See Edwin M. Truman, "Sovereign Wealth Fund Acquisitions and Other Foreign Government Investments in the United States," testimony before the US Senate Committee on Banking, Housing, and Urban Affairs, November 14, 2007

In April 2008, a refined and updated SWF scoreboard was released in the form of a blueprint for SWF best practices (Truman 2008a). The blueprint was designed to prod and inform the multilateral, collaborative project that became the International Working Group of Sovereign Wealth Funds (known as the IWG), which was about to be established under the aegis of the IMF. The first meeting of the IWG was on May 1, 2008.

The IWG completed its work in September 2008 and the result of its effort was a set of Generally Accepted Principles and Practices of SWFs(known as the Santiago Principles or the GAPP). The release of the Santiago Principles in October 2008 was drowned out by the cascading crescendos of the global economic and financial crisis.

In parallel with the IMF-facilitated process, during 2007–08 many of the countries that are recipients of SWF investments, as well as those that are home to SWFs, met under the aegis of the OECD to reexamine the issues raised by international investments by governments or government controlled entities. This examination concluded that there was no case for establishing a new, separate regulatory framework for SWF investments.

Members of the OECD in effect recommitted themselves to the existing framework of OECD codes and declarations governing foreign government investments. Nevertheless, over the past several years the authorities in a number of OECD countries, including the United States, have implemented, and in a few cases established for the first time, regimes governing foreign investments in their countries that, in their practical application, raise the potential bar for such investments. Countries with SWFs are justified in their concern that the quid pro quo for greater accountability and transparency by SWFs has not been delivered.

All the multilateral activity addressed, but hardly dispensed with, the SWF challenge. The funds continue to raise a host of economic, financial, and political issues, which is why they are both fascinating and contentious, attracting observers and scholars in many disciplines and with many different perspectives. Everyone has an opinion and gets into the act.

V-Impact of Sovereign Wealth Funds on Global Financial Markets :

Sovereign Wealth Funds have grown to be major players in the global financial system, which has already begun adjusting to their emergence. So what are their implications? One can look at this from numerous angles; ours (what we suggest) will be to reflect on the phenomenon of SWFs in terms of their impact on global financial markets and on the main actors and constituencies affected by their investments.

- The SWFs themselves
- The SWFs‘ owners
- The recipient countries of SWFs‘ investments (the likelihood that they will feed protectionist sentiment)
- The multilateral regulatory and oversight institutions
- Other financial institutions
- The recipient companies of SWFs‘ investments
- World-financial markets (in terms of their impact on economies and markets around the world)

Based on our research each of these groups has interests and concerns that will have to be weighed and balanced in order to come up with an optimal formula to all.

As of today, frictions are arising among several of these constituencies. They relate to such issues as opaqueness and regulation of SWFs.

Even if more than 50 funds all around the world are described as SWFs, each and every one of them has its own history, mandate, purpose, size, source of funding, structure, transparency and asset allocation. However, they all share some common points:

- SWFs like to be seen as large private funds or as renowned public pension funds. That is, they seek higher-risk adjusted returns on their investments, leading positions in the most interesting transactions and attracting the market's best talents and ideas. Mainly, they wish to compete without disadvantage against other constituencies of global markets.

- They give a big importance to their privacy and independence.

- Another general characteristic is that most funds seek to be discreet in their investments and do their best to stay away from political tumults.

They also usually stand by calls for greater transparency and/or regulation. Jesse Wang, the chief risk officer of China's CIC, for example, claims that his fund is similar to other foreign public pension funds or college pension funds, "adopting a diversified, long-term and passive investment strategy". Nevertheless, the remarkable growth of SWFs and the diversification of their portfolios have shed the spotlight on them. Even if they want to play the role of quiet investors, their newfound visibility prevents them from doing so.

- Age and sophistication of individual SWFs are key factors that have some bearing on their investment policies. Newly established funds from emerging countries, such as Libya or the Central Asian Republics, tend to be occupied in basic matters as finding the optimal scheme to manage themselves while catching up with mature, sophisticated investors. Older SWFs such as KIA, ADIA, or Temasek serve as models to the newer, less reputable funds. Considering their experience and sophistication, the .old hands. among SWFs are purely focused on returns, market positioning, and supervising outsourced tasks.

- Sovereign owners' identity is another particularity common to all SWFs.

Given that they all aim to serve their owners' interest, SWFs choose the investment strategy that best suits these interests. Thus SWFs from developing countries could tend to take lower levels of risks in their investments than SWFs from .wealthy countries.. Given that SWFs belong to citizens, in low income countries there may be a greater need for prudence.

Beyond commonalities, an important matter remains unsettled; it concerns SWFs management style (active vs. passive) in the companies in which they invest.

This issue has no clear or right answer. During the current financial crisis, SWFs made huge investments in many distressed banks without asking board seats or imposing their conditions on the financial institutions management. This move can perhaps tone down public apprehension about their motivation but it deprives SWFs from the glamorous role of .shareholder activist. and hence, questions the long term impact of those investments on recipient companies. Indeed, in corporate finance theory, the presence of a passive cash-loaded stakeholder may not be good for long-term corporate health according to Andrew L. Friedman, Samantha Miles in .Stakeholders, Theory and Practice.. Hitting the right note will be crucial. Figures 3 and 4 show the geographical distribution of SWFs investments between OECD countries, BRIC countries and Non-OECD (excluding BRIC) countries by number of deals and by USD value.

Figure 3: Number of Deals by Region (Total of 785 Deals)

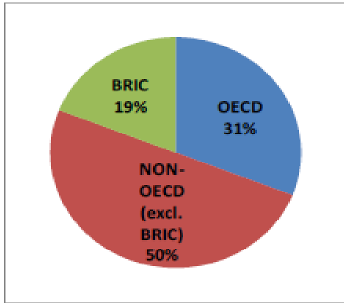
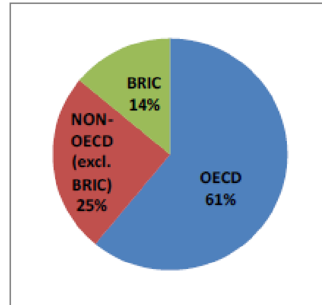


Figure 4: Value of Deals by Region (Total of $ 250 Billion)



Sources: www.worldbank.org seen on May 2013

-Firms Considering Investments by SWFs.

*** Benefits for Recipient Firms and their Stakeholders**

Companies subject to SWFs investments have various interests that could be in line with the funds - or at odds with them.

Companies' management usually favors the entry to capital of long-term, passive investors who very rarely try to interfere in corporate strategy or to disinvest their stake. As a matter of fact, institutional investors, especially those with a long-term investment horizon, are generally greeted with open arms on equity markets. Firms seeking to have a stable capital base may find in SWFs a very thought after shareholder.

A possible explanation is that in many instances SWFs have proven to be loyal and undisturbing investors. This is particularly the case of KIA which continues to be a low-profile and dependable investor in its holdings around the globe. This feature was very well exemplified by its management of its minority stake in Daimler-Benz.

KIA is the single largest shareholder of the German automobile maker with a 7.1 percent stake. Daimler-Benz acquired Chrysler in 1998 as part of its ambition to become an internationally integrated car manufacturer. In 2007, faced with the evidence that Daimler had not been properly integrated with the American automobile producer, Chrysler was spun-out. This sudden divestiture that follows a failed business operation could have driven KIA to adjust its holding but it didn't and refrained from intervening. Such examples are encouraging for recipient companies

As Howard Socol, CEO of Barney's, declares after the acquisition of his company by Dubai's Istithmar in 2007, "This transaction further enhances our ability to develop our brand and grow our business."

For the companies being purchased, capital inflows can be a net positive situation. More capital means more money for research and development, more money for investments and more money to pay salaries. Especially, this means lower urgency to have recourse to financial debt, with equity (or its derivatives) emerging as a substitute for indebtedness especially in times of weak liquidity on credit markets. This also implies an ease of pressures on management for debt amortization.

Finally, having a SWF as stakeholder – in whichever way - could turn out to be beneficial for accessing foreign markets, in terms of facilitating the entry or softening regulatory stringency and abbreviate delays.

To illustrate this last positive effect for recipient companies we recall the case of China who many believe will try to leverage foreign entrance to its own market with its own incursions into foreign territories. Following, the China Development Bank's acquisition of 3.1 percent of

Barclays, the target‘s chief executive John Varley acknowledged that the transaction would open the Chinese retail market to its bank. This access would have been otherwise difficult. And it is no coincidence that its is Blackstone that provided advisory services for this deal

given the PE group‘s relation with China‘s SWF CIC (who controls a 10 percent stake in it). In autumn of 2007, Blackstone bought a 20 percent stake in China National Bluestar Corp, a large Chinese chemical products manufacturer.

***Threats and Letdowns for Recipient Firms and their Stakeholders**

Every single advantage of the above mentioned has nevertheless its downsides.

To begin with other stakeholders with shorter investment frames could prefer other shareholders to be more aggressive and implicated in fixing high criteria for

management performance.

Moreover, as several observers have rightly indicated SWFs do not need to assign two directors to the board to exude influence when they control 10 percent of a firm. This is the case of Saudi‘s Prince Walid Bin Talal, who though not represented on Citigroup‘s board has had a significant command over the bank‘s

key strategic decisions, as evidenced by his not so invisible hand on the dismissal of chief executive officer and chairman Charles Prince III in November of 2007.

Also recalling the Isthismar – Barney‘s case outlined above, if Mr. Socol praised the deal as it happened, he later resigned because what have been rumored as sharp differences with the company‘s new owners over strategy especially plans for overseas expansion. Mr. Socol disagreed with the aggressive timetable put in place, according to close source he believed that Barney‘s new owners had "plans to grow helter-skelter in a bunch of countries.. In this way, Isthismar lost a veteran of retail business and struggled for six months to name a new CEO at Barneys to the point that some believed that it had developed a case of .buyer‘s remorse..

Also, a sovereign investment in a firm may complicate the entry to countries that have a tense relation with the SWFs‘ owners. This narrows the possibilities to attract new investments from some new countries or new investors. It could also hamper plans to engage in certain politically controversial sectors or complicate a company‘s external growth through mergers and acquisitions. Lastly, firms are usually aware of the public relations damages and implications of a foreign investors connection to their capital, whether a SWF or any other government owned entity.

Therefore, boards of directors and top executives of firms in which SWFs invest should work on understanding the intentions and strategic drivers of SWFs as well as all the threats they carry. The outer shell of those new liquidity providers with enormous resources is undoubtedly appealing, especially that these suppliers appear to be patient, long-term investors who rarely interfere in governance or management. But any corporation considering a liquidity injection from a SWF should check elements with a more careful and dubious eye in order to assess the genuineness of these appearances and their viability over time if conditions came to alter.

Accepting the entry of a SWF in its capital base should not be problematic if managed well. The most important point is to listen and try to address the concerns of the other shareholders, of the media, and of the other participants of the international financial system.

-Other Financial Institutions

Other financial institutions consist mainly of financial services firms, asset managers, various types of funds, and private institutional investors. Of course, these players perceive the rise of SWFs through the lens of their own interests.

SWFs may be competitors, but also potential partners, co-investors, or clients. As a matter of fact, other financial institutions perceive SWFs equally as a source of opportunities as a source of threats.

***Threats and Concerns**

The concerns of other financial institutions mirror the various roles that SWFs have come to play. Indeed, SWFs have an edge compared to the private sector and this edge could be summarized in two main points:

- The first one would be the access to private information gathered by the security services and intelligence agencies of the owning government. This information is clearly not available to private investors.

- The second one would be the idea that a SWF, being backed by a government or a sovereign entity, can benefit from low financing rates and that again is not the case of private investors.

The growth of the SWFs is another concern. The dynamics of supply and demand advocates that a flood of new money may drive up asset prices and drive down risk premiums. The small size of SWFs relative to other financial players in the global economy mitigates this effect, though it may be pronounced in some geographies and sectors.

Many financiers think that managerial talent is lacking in several of the recently created SWFs and thus could occasion mistakes that resound over the whole financial system. Ultimately, this concern will diminish as more SWFs become more sophisticated and knowledgeable investors — but that prospect also raises its own competitive concerns, as there will be intensifying competition for talents and deal flow.

Another potentially harmful impact concerns specifically the private equity sector.

Some believe that the emergence of SWFs could remove one of the pillars of this industry. As a matter of fact, the private equity surge over the last decade has been analyzed by some scholars as an attempt to arbitrage away the overvaluation of fixed income instruments relatively to equity instruments. This situation is said to be the consequence of the prevalent investment of central banks in debt as opposed to equity.

By bringing in debt relative to equity, the private equity groups helped deal with that imbalance. Given, the instauration of SWFs and the resulting shift from secure, liquid investments by central banks to more risky, .speculative. ones a major pillar of the private equity industry could thus be eliminated.

Finally, it would be predictable if calls for increased transparency of SWFs be followed by similar calls for other financial players, like hedge funds and investment banks. In this way, the call would be symmetrical: the entire financial system should be transparent. Financial

institutions must prepare themselves for such an alternative and determine which information they‘re willing to share and which they‘re not.

***Opportunities and Mutual Interests**

Notwithstanding the risks and anxieties summarized above, the emergence of SWFs affects positively other financial constituencies of world capital markets, in particular investment banks and asset management firms.

The asset management industry had so long been refused access to foreign exchange reserve management, which was handled solely by central banks. The outsourcing of funds by SWFs to external managers would drive up demand for investment banking services, such as trading and purchase of equities and fixed income, consulting and valuation advice. Corporate finance departments of major European and American banks are exerting extra efforts and resources to work with SWFs on their asset management, with Morgan Stanley, JPMorgan and Merrill Lynch having created internal dedicated teams for SWFs advisory.

In order to have an approximate idea of the potential gains for other financial institutions we examine two studies recently carried out. The first one performed by Morgan Stanley guesstimates that close to US$200 billion could be annually outsourced in the coming four years while SWFs carry on with their size expansion. Merrill Lynch estimates (under certain assumptions) that between $4 and $8 billion would be generated in incremental annual revenue for global asset managers.

Thus, SWFs can jointly engender an upwelling in global asset supply, as financial institutions would be incited to structure new products to meet the demand of these institutions with very deep pockets. Asset classes that attract most SWFs are local government debt, emerging market corporate debt and the asset management industry.

Knowing that they might invest in the same companies as the SWFs, the financial institutions are eager to have additional information about those funds, how they think and where they are looking to invest, by sector, geography, and level of economic development. This information is a highly valuable competitive intelligence that could support pre-emptive moves and/or positioning from the financial institutions. “In the future,” says David Rubenstein, founder of the Carlyle Group, “sovereign wealth funds and private equity firms are likely to pursue large investment opportunities through joint ventures.”

IV-The geopolitical role of SWFs and industrialized nations feared[10]:

Sovereign wealth funds from resource-rich countries controlling more than $500bn of assets operate with no disclosure, limiting their accountability and increasing the risk of corruption, a leading transparency watch dog has said.

The Revenue Watch Institute, a New York-based group backed by charitable foundations and rich-country governments, published research showing that eight large funds, including the investment authorities of Qatar, Kuwait and Libya, disclosed no details at all about their assets, transactions or investments. Those eight funds are estimated to have assets worth $539bn.

Other funds, including Saudi Arabia’s, which controls an estimated $530bn, and Nigeria’s, have little disclosure or political accountability.

Daniel Kaufmann, president of Revenue Watch, said sovereign funds built up using revenues from natural resource production were “one of the areas of greatest opacity” associated with the oil, gas and mining industries.

[10] TheCityUK, FINANCIAL MARKETS SERIES, SOVEREIGNWEALTH FUNDS MARCH 2013.

He added that while international efforts to improve disclosure of natural resources payments had made progress in recent years, "on this issue we are really in the Dark Ages".

He was speaking as Revenue Watch released a study assessing 58 resource-rich countries on the governance of their oil, gas and mining industries, which rated only 11 as "satisfactory" overall. Countries were scored on criteria including disclosure of financial information, laws that support transparency and fair competition, and frameworks to allow accountability and fight corruption.

The highest standards were found in Norway, which is widely seen as a model for effective management of natural resource wealth, closely followed by the US and then the UK.

Several emerging economies also scored "satisfactory" grades, including Brazil, Mexico, Chile and Colombia.

The worst rated were Iran, Qatar, Libya, Equatorial Guinea, Turkmenistan and Myanmar.

Revenue Watch argues that better oversight and use of oil, gas and mineral revenues would transform the lives of a billion people in resource-rich countries with poor governance.

The UK, which holds the rotating presidency of the G8 leading economies this year, is pushing for an agreement on increased transparency in resource industries.

Rules mandating greater disclosure by oil and mining companies have been adopted in the EU and proposed in the US, although those regulations have been challenged in court by the American Petroleum Institute, the industry group.

Transparency among sovereign wealth funds has made less progress. The leading funds agreed a voluntary code of conduct in 2008, but Mr Kaufmann said there were no real incentives for them to improve their transparency.

He added that poor governance at these funds could have a "contagion effect", encouraging bad practices in the countries in which they invested.

Although Norway's oil fund, the world's largest, ranks highest for governance, Revenue Watch also gave high ratings to the sovereign funds of Trinidad and Tobago, Bahrain, Chile, East Timor and Mexico.

IIV -Sovereign funds trends under recovery from the financial crisis[11]:

Sovereign wealth funds are a permanent, prominent feature of the inter-national financial landscape. As countries become wealthier, and governments expand their responsibilities for the long-term welfare of their citizens, it is highly likely that those citizens will look to their governments to help manage their countries' financial wealth, including wealth associated with natural resources, for themselves and for future generations.

These trends are not set in stone. Responsibility could devolve back onto the citizens themselves, but that is less likely. Moreover, as societies become wealthier, the scale of government involvement in managing their wealth will increase, even if, contrary to recent trends, it does so less than proportionately.

Despite the potential setback to international financial integration as a consequence of the global economic and financial crisis of 2007–09, the financial case for globalizing the allocation of all forms of financial investment via diversification remains overwhelming. Thus, three trends interact to suggest that SWFs are here to stay: the expanding wealth of all societies, growing involvement of governments in managing that wealth, and increasing recognition of the benefits of international portfolio diversification. At the same time, SWFs are instruments of "big money," and big money is distrusted whether in the hands of governments, banks, hedge funds, or other private investment vehicles.

[11] TheCityUK, FINANCIAL MARKETS SERIES, SOVEREIGNWEALTH FUNDS MARCH 2013.

SWFs are not the only mechanisms through which governments actively manage the wealth of their countries on behalf of their citizens. Government pension funds are essentially the same as SWFs except where they are invested solely in government paper or the beneficiaries make the investment choices. However, governments have other mechanisms at their disposal. They generally manage their international reserves more conservatively, and manage other government-owned or controlled financial or non financial institutions with greater attention to return and less attention to risk, than in the case of SWFs. However, such generalizations can be deceiving because distinctions between these three broad types of governmental financial activity are blurred. Specifics depend on the country and its culture, history, political structure, and economic and financial circumstances. The potential for institutional or regulatory arbitrage is a significant concern in the future. For some countries, a standard such as the Santiago Principles increases the incentive to establish government-controlled investment pools that fall outside the definition of SWFs used by the IFSWF.[12]

Setting aside those complications, and concentrating for the moment on SWFs themselves, distrust of these funds has been substantially defused since they burst into the global consciousness five years ago. The general public and its political representatives know more about what SWFs are and what they are not.

The growth of SWFs slowed with the diminished external surpluses that feed some of the funds, the reduced rate of accumulation of reserves by most countries, and the financial losses that many SWFs suffered during the global economic and financial crisis. This has helped to temper, but again not to eliminate, some of the exaggerated fears promulgated under the heading of state capitalism operating through the channel of SWFs. On the other hand, the philosophical, political, and economic contest between the traditional model of mature industrial economies, with their reliance on markets, and state capitalism, with its appeal to power and nationalism, is far from settled in many emerging-market economies in particular.

The economic and financial threats to both SWF home and host countries that some observers saw in their activities also have not generally materialized. We summarized those concerns under five headings: (1) mismanagement of SWF investments; (2) pursuit of political or

economic power objectives; (3) exacerbation of financial protectionism;

(4) contribution to financial market turmoil and uncertainty; and (5) conflicts of interest, in particular between home and host countries. Nevertheless, as with much about the complex world today, it is impossible to remove these potential concerns from the economic, financial, and political landscape.

One important contribution to clarifying the role and responsibilities of SWFs and institutionalizing their participation in the international financial system has been the promulgation of the Santiago Principles for such funds. As shown , the Santiago Principles conform broadly to the structure of the SWF scoreboard presented already . Moreover, over the past several years the ratings on that scoreboard have significantly improved for a number of SWFs. Nevertheless, the Santiago Principles should be made more comprehensive and robust, and the record of compliance with them by the major SWFs must continue to improve.

The SWF scoreboard and the Santiago Principles are built on the concept of accountability and transparency both to citizens of the home country as well as to citizens and governments of host countries.

[12] Abdullah Al-Hassan, Michael Papaioannou, Martin Skancke, and Cheng Chih Sung ,Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management, working paper, Monetary and Capital Markets Department, 2013-12-08

This approach reduces the risk of mismanagement of SWF investments. The structure of most SWFs, along with their transparency, if practiced, also reduces the possibility that a country will use the funds as a mechanism to pursue economic power objectives. On the other side, with less of a perceived threat, host countries should be less inclined to resort to financial protectionism to guard against such risks. Similarly, financial market participants should be reassured if SWFs adhere to a high degree of accountability and transparency regarding their activities and business practices. All of this should build trust and reduce the scope for conflicts of interest for each SWF and between the home and host country of those funds' investments.

On the side of the host countries, their collective and individual actions over the past several years have been less than impressive. Collectively, the members of the OECD have agreed that a separate regime for SWF investments in their economies is not required. Instead, existing codes and standards governing government investments should be sufficient. Unfortunately, the OECD members did not take advantage of their review of policies in this area to strengthen their openness to government investments. Perhaps, this was inevitable given the increased involvement of the governments of many countries that are not members of the OECD in international investment activities. It is a point of tension that these non member countries have not participated in writing the rules of the OECD, which until its recent expansion was an exclusive group of mature industrial countries. This change in the landscape also helps to explain, if not to excuse, the tendency of many individual OECD countries to establish, clarify, or otherwise tighten their policies on foreign direct investment, particularly when that investment involves governmental entities, including but not even primarily SWFs.

On the one hand, SWFs are more trusted than five years ago; on the other, concerns about investment by SWFs and other governmental entities, while somewhat reduced, have not been eliminated. These concerns have been reinforced by the tendency of SWFs to partner with other investors, thus perhaps disguising their intentions. Such partnering by SWFs is of greater concern when it takes the form of co-investment with another state-owned enterprise and involves sensitive sectors such as natural resources or strategic sectors such as electronics.

Thus, policymakers in countries that are home to SWFs should not declare victory. What is required to build on the progress that has been made? I recommend action in four areas: an upgrade of the Santiago Principles and compliance with them; greater reciprocal responsibility by host countries to SWF investments; improvements in related data collection

and disclosure; and pursuit of a comprehensive framework governing all forms of government investment as the ultimate goal.

Upgrading the Santiago Principles Using the framework of the IFSWF, countries with SWFs must be diligent in promoting adherence to the Santiago Principles, upgrading the ratings of their funds on those principles, and enhancing the principles so that they conform more closely to the SWF scoreboard. Unless sustained progress in this area is achieved, observers in countries receiving SWF investments will be justified in their cynicism about the process that led to the promulgation of the Santiago Principles. I expect continued progress, but I am prepared to be disappointed.

The IFSWF should be diligent in encouraging all countries with large SWFs to join the IFSWF and adhere to the Santiago Principles. Economies with estimated total assets of more than $25 billion in their SWF that are not members of the IFSWF are Hong Kong, Algeria, Brunei Darussalam, Kazakhstan, and Malaysia—in order of the size of their funds. In addition, Saudi Arabia has a large investment portfolio that is often viewed as similar to an SWF. Saudi Arabia, which was an observer in the IWG that produced the Santiago Principles, should clarify the management of its portfolio of foreign assets and conform their management to international norms of disclosure. Finally, major SWF countries with multiple funds, including the United

States and the United Arab Emirates, should ensure that each of their funds complies with the Santiago Principles.

Going forward, as part of the IFSWF's peer review processes that body must actively consider improvements in the Santiago Principles, which are only a good first start toward meeting the standards outlined in the SWF scoreboard presented already. As noted, for only 17 of the 25 principles where there is an overlap with the elements in the SWF scoreboard do the Santiago Principles explicitly require public disclosure of compliance with the principle. Given that many of the funds of member countries of the IFSWF already publicly disclose how they implement the eight other principles, there is no reason why the Santiago Principles should not recommend public disclosure of how an SWF complies with a principle that has already been established.

The most important of the principles where public disclosure should be recommended is the release of the SWF's annual report. This is the easiest path to increased accountability and transparency. The vast majority of funds do so already.

The next most important elements for which public disclosure should be made explicit are those covering independent audits of the funds. The Santiago Principles endorse the principle of independent audits, but they are silent about public disclosure, one of the eight elements of the SWF scoreboard not included in the principles.

The Santiago Principles should also embrace the public disclosure of mandates given to outside managers rather than just calling for a description of the extent and nature of such mandates. This is important to limit opportunities for corruption and conflicts of interest.

The Santiago Principles should incorporate the public disclosure of how the operation of the funds is integrated with the fiscal and monetary policies of the government. This is crucial to the goal of not undermining macroeconomic stability of the home country[13].

In addition to calling for funds to have policies on leverage and the use of leverage, those policies should be made public. This is an important part of good risk management practices.

Finally, it is not enough that a fund declares that it has internal ethical standards as recommended by the Santiago Principles. The fund should also make those standards public.

With respect to the elements in the SWF scoreboard that were omitted from the Santiago Principles, the two most important of these, after the publication of independent audits, are disclosure of the size of the fund at least annually and establishment of a public policy on the speed of adjustment of the fund's portfolio. The first is widely practiced now and enhances the credibility of each fund's overall disclosure policy. The second would help provide greater confidence that the fund as a good public citizen is dedicated to minimizing market turmoil.

Augmented Reciprocal Responsibility My second recommendation is that countries receiving SWF investments should develop a mechanism, for example within the OECD Investment Committee, for deeper peer reviews of the adherence by OECD members to its codes and practices. These peer reviews should routinely involve nonmembers of the OECD, including representatives of the largest SWFs or their governments. They should also cover cases where investments have been disallowed because of exceptions to the principle of national treatment based on national security or broader economic or social criteria.

While sovereign governments must make their own decisions, consistent with their own laws and regulations, they should be held responsible to the broader community of governments as well as to official and private investors for justifying and defending their actions. Reciprocal responsibility on the part of host and home countries to SWF investments requires greater accountability and transparency by both groups of countries. The Santiago Principles are a step in this direction by the home countries, and the host countries should more fully reciprocate.

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[13] International Forum of Sovereign Wealth Funds www.ifswf.org

Improving Data Collection and Related Disclosures My third area of recommendations focuses on the principal reason why SWFs attract so much political attention: they are instruments of crossborder governmental investment activity. Government investors by their nature are faced with a different set of incentives than private investors.

In addition, their actions are interpreted as being politically motivated even when they are not. Moreover, to the extent that one vehicle of cross border investment, such as SWFs, comes under closer examination, governments have an incentive to shift to the use of other vehicles.

It is well known that the managers of the international reserves in a growing number of countries follow investment strategies similar to those of many SWFs. For example, the investments of China's State Administration of Foreign Exchange (SAFE) include those via the SAFE Invest-

ment Company said to have about $350 billion in assets under management. The SAFE Investment Company is sometimes classified as an SWF.

The Data Template on International Reserves and Foreign Currency Liquidity (IMF 2000), the international disclosure standard that covers some countries' international reserves, is less detailed and comprehensive than the Santiago Principles, and China in particular is not a participant. The Reserves Template, as the international standard is known, was designed to encourage countries to be more transparent and disciplined about their release of information about international reserves and to provide more confidence that those reserves were readily available to meet the country's international obligations. It was not designed to inform the public about investment strategies. For example, the Reserves Template does not distinguish between reserves held in securities in the form of bonds or equities, to say nothing of equity stakes that are significant and might be controlling.

A decade after the Reserves Template was agreed upon, its content should be updated to include more information on the nature of countries' reserve holdings, in particular when those holdings may be indistinguishable from the holdings of any country's or the same country's SWF. At the same time, countries that have large SWFs should be encouraged to adhere to the revised Reserves Template, starting with the United Arab Emirates, China, Kuwait, Libya, Qatar, and Algeria.

In addition, as recommended above, Saudi Arabia should become a full participant in the IFSWF as well as adhere to the Reserves Template. Adherence to the IMF's Special Data Dissemination Standard, which is voluntary, requires adherence to the Reserves Template, but not vice versa. One objective of this recommendation is to limit the scope for institutional or regulatory arbitrage as is already readily apparent in China.Each of these countries, with the exception of Algeria, is already a member of the IFSWF.

In the same spirit, countries should agree to a broader effort to record and track all forms of international investment by governments and government-owned or -controlled financial or nonfinancial institutions. The Sixth Balance of Payments and International Investment Position Manual (BPM6) (IMF 2009a) recognizes that some governments may create "special purpose government funds, usually called sovereign wealth funds."

The BPM6 focuses on whether the assets in such funds can be classified as reserve assets and suggests the application of the test of whether they are readily available to the monetary authorities and whether there is a liquid claim of a resident entity on a nonresident that is denominated in foreign currency. The BPM6 goes on to state with respect to such funds: "Some of these assets may be included in reserve assets or possibly in other functional categories. Where the funds are significant, the special purpose government fund's foreign assets not included in reserve assets can be shown separately as a supplementary item" (IMF 2009a, 130; emphasis added). One would hope that the international assets of SWFs would be included

somewhere in a country's international investment position. The quoted passage is less prescriptive than is desirable. In any case, the guidance does not indicate that SWF assets should be separately identified.

The approach of the BPM6 to the suggested treatment or nontreatment of SWF assets also is recommended for all international assets of governments with the exception of reserves. Those other assets are to be included in the category for the particular type of asset (securities, direct investment, etc.) rather than being shown separately, or in a supplemental item, as government assets. Where the amounts are significant, foreign government-owned assets and liabilities to foreign governments should be separately recorded and reported.

US statistical treatment of government assets and liabilities to foreign governments is somewhat more informative than is recommended by the BPM6. All US government assets are reported either as reserve assets or other US government assets. However, this treatment applies only to federal government assets and not to the general government category, which includes state and local governments. As reported , US state and local pension funds and SWFs hold substantial international assets more than $400 billion. On the liability side, the United States reports foreign official holdings by category of asset, such as US treasury securities, under the heading "foreign official assets in the United States."

The subcategory of "other foreign official assets" has grown quite rapidly recently and includes SWF holdings of assets other than US government securities or other liabilities reported by banks.

Again, this category generally does not include subnational government entities such as pension funds or nonpension SWFs. Thus, Australia's Future Fund is included, but the holdings of assets in the United States by the Canada Pension Plan or Alberta Heritage Savings Trust Fund are not.

One exception involves the United Arab Emirates, where eight of the nine UAE entities are included in the US Treasury's instructions for what is an official entity.

In light of the increased attention and concern about the international economic and financial role of governments, whether benign or as a manifestation of state capitalism with potential malign overtones, it would be appropriate for the home and host countries to have more comprehensive data on the international assets of governments on both the asset and liability side. This would help to further build trust in SWFs as well as in government investments in other forms, such as direct investment, in particular via mechanisms of institutional or regulatory arbitrage that seek to avoid the inconvenience of SWF reporting standards under the Santiago Principles.

A Comprehensive Investment Framework as the Ultimate Goal The recommendation on improved data and disclosure leads to my final recommendation: the development of a comprehensive framework governing all forms of government investment in other countries.

Perceptions of SWFs have been adversely affected by the international investment activities of other governmental entities, ranging from institutions managing international reserves to government-owned banks and nonfinancial institutions. If SWFs are to have a safe future, home and host governments should comprehensively approach the broader issues associated with capital flows and international investments by governments.

Preferably this activity would lead to an international investment treaty or at least a more comprehensive approach to governmental investment flows than today is the case. That broader approach should encompass the revision of the IMF's Articles of Agreement to square them with the positive and negative realities of international capital flows—in other words, revival of the capital account amendment proposal that was abandoned in 1997. The broader approach should also encompass standards governing both the behavior and treatment of government investments.

The standards could be developed under the aegis of the OECD as long as non-members were included in the process. If these standards were to be enforced, the WTO would be a logical place to lodge them because that organization has a proven track record on enforcing international agreements.

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