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Santiago Compliance Index 2014

Assessing the Governance Arrangements and Financial Disclosure Policies of Global Sovereign Wealth Funds

Fund-specific assessments that provide the basis for the ratings documented in this report can be obtained from GeoEconomica.

Sven Behrendt

Managing Director
GeoEconomica
Tel.: +41 (0)22 341 47 78
sven.behrendt@geoeconomica.com

Assessing the commitment of global sovereign wealth funds to the Santiago Principles

The Generally Accepted Principles and Practices (GAPP) for sovereign wealth funds (SWFs), also known as the “Santiago Principles”, are a voluntary code that commits SWFs to a set of generic good governance and financial disclosure standards. As of October 2014, 31 SWFs, with combined assets under management (AUM) of roughly US\$4 trillion, have pledged commitment to the Principles.

The Santiago Principles (the Principles) are anchored in the obligation for its signatories to publicly disclose relevant financial information and governance frameworks, as specified further in the 24 individual Principles. Created in 2008 by the independent International Working Group of Sovereign Wealth Funds, the Principles are designed to contribute to building global market confidence in the financial and economic orientation of internationally operating SWFs.

The Santiago Compliance Index 2014 (SCI) represents GeoEconomica’s judgement on the degree to which individual SWFs had implemented the Principles’ standards as of October 2014. The SCI is based on fund-specific assessments of governance arrangements and financial disclosure policies across the 24 Principles. It is built on the assumption that SWFs should not only pledge their commitment to higher governance and transparency standards by endorsing the Principles, but also publicly disclose relevant information that allows third parties to independently verify the quality of their commitments.

We conclude that the commitment of the SWF industry to the substance of the Santiago Principles is still uneven. A substantial number of SWFs have governance arrangements and financial disclosure policies that are in line with the standards set by Principles. At the same time, numerous funds, most notably from the Gulf region, still need to substantially advance their financial disclosure policies and become more transparent about governance arrangements. Their enhanced commitment to the Principles, in the form of more proactive disclosure policies, is essential to maintaining the legitimacy of the Principles themselves.

The Santiago Compliance Index 2014

Fund	Rating
Fully compliant	
Petroleum Fund of Timor-Leste	A
PRF / ESSF (Chile)	A
Future Fund (Australia)	A-
New Zealand Superannuation Fund	A-
Government Pension Fund Global (Norway)	A-
Heritage & Stabilisation Fund (Trinidad & Tobago)	A-
Alaska Permanent Fund	A-
Heritage Fund (Alberta/Canada)	A-
Broadly compliant	
State Oil Fund of Azerbaijan	B+
Pula Fund (Botswana)	B+
Nigeria Sovereign Investment Authority	B+
JSC National Investment Corp. (Kazakhstan)	B
Korea Investment Corporation	B
Temasek Holdings (Singapore)	B
Reserve / National Wealth Funds (Russia)	B-
Fundo Soberano de Angola	B-
Partially compliant	
China Investment Corporation	C+
Abu Dhabi Investment Authority	C+
GIC Private Limited (Singapore)	C+
Khazanah Nasional Berhad (Malaysia)	C+
National Development Fund (Iran)	C+
Russian Direct Investment Fund	C
Kuwait Investment Authority	C
Libya Investment Authority	C
Non-compliant	
Qatar Investment Authority	D
Not rated	
National Pensions Reserve Fund (Ireland)	X
JSC Samruk - Kazyna (Kazakhstan)	X
Fondo Strategico Italiano	X
Oil Revenues Stabilization Fund (Mexico)	X

Nine SWFs fully compliant with the Principles

We rate SWFs as *fully compliant* with the Santiago Principles if their governance, transparency, accountability arrangements and disclosure practices in our view correspond with the disclosure obligations and substance of the Principles. This also includes disclosure of a convincing self-assessment of compliance with the Principles. The SWFs we consider to be fully compliant include the Petroleum Fund of Timor-Leste, Chile's Pension Reserve Fund and the Economic and Social Stabilization Fund, Australia's Future Fund, the New Zealand Superannuation Fund, Norway's Government Pension Fund Global, Trinidad and Tobago's Heritage and Stabilisation Fund, the Alaska Permanent Fund, and Alberta's Heritage Fund. These funds represent AUM of roughly US\$1.1 trillion.

In our view, the only shortcoming in most cases remains the often imprecise self-assessment of the implementation of the Principles. In some cases, we also find that the government (the fund's owner), rather than the SWF itself, should assume reporting obligations referenced in the Principles. In such cases, more conclusive guidance from the government about the location of information would improve a fund's performance on transparency. These shortcomings, however, are balanced by otherwise sufficiently developed governance and financial disclosure policies.

Nine SWFs broadly compliant with the Principles

We rate SWFs as *broadly compliant* with the Santiago Principles if their governance, transparency, accountability arrangements and disclosure practices in our view correspond broadly with the disclosure obligations and substance of the Principles. Assessments identify minor shortcomings in the disclosure practice and/or minor deviations from the Principles' substance. Applying B+, B and B- ratings allows a higher degree of granularity and differentiation across SWFs.

The SWFs we consider as broadly compliant with the Principles include the State Oil Fund of Azerbaijan, Botswana's Pula Fund, the Nigeria Sovereign Investment Authority, the Kazakh JSC National Investment Corporation, the Korea

Investment Corporation, Singapore's Temasek Holdings, the Russian Reserve Fund and the National Wealth Fund, and the Fundo Soberano de Angola. The group of broadly compliant SWFs represents US\$475 billion in AUM.

The shortcomings we identify in the broadly compliant category concern elements, referenced by the Principles, that are more technical, such as an inconclusive description of a fund's approach to risk management, insufficient information on its approach to executing shareholder rights or on arrangements that prevent it from benefitting from privileged information or inappropriate influence by the broader government in competing with private entities. We note that in some cases, the owner has specific competencies that might have consequences for operational fund management. Though these competencies might rest on solid legal or regulatory foundations, some funds rated "broadly compliant" do not conclusively disclose on an annual basis how these play out in practice.

Eight SWFs partially compliant with the Principles

We rate SWFs as *partially compliant* with the Santiago Principles if their governance, transparency, accountability arrangements and disclosure practices in our view correspond only partially with the disclosure obligations and substance of the Principles. Assessments identify gaps that substantially compromise compliance with the Principles. Applying C+, C and C- ratings allows a higher degree of granularity and differentiation across SWFs.

The SWFs we consider as partially compliant with the Principles include the China Investment Corporation, the Abu Dhabi Investment Authority, Singapore's GIC Private Limited, Malaysia's Khazanah Nasional Berhad, Iran's National Development Fund, the Russian Direct Investment Fund, the Kuwait Investment Authority, and the Libya Investment Authority. The group of partially compliant SWFs represents US\$2.1 trillion in AUM.

Partially compliant funds disclose enough information about themselves to allow the construction of a consistent narrative of their policy purpose and objectives, the broader lines of their governance arrangements and some meaningful financial information. At the same time, partially

compliant funds do not disclose robust financial information, such as an audited income statement and balance sheet, conclusive information about funding and withdrawal arrangements, rates of returns, or performance benchmarks. They also provide limited access to their legal foundation, bylaws or other constitutive documents as well as management agreements that would specify the return objectives, investment policies and competencies of the operational asset manager. The partially compliant funds' self-assessments of the implementation of the Santiago Principles are often fragmented, if they are disclosed at all.

SWFs not compliant with the Principles

We rate SWFs as *non-compliant* with the Santiago Principles if their governance, transparency, accountability arrangements and disclosure practice in our view are deficient across most areas covered by the Principles. We note that, for now, only the governance and financial disclosure policies of the Qatar Investment Authority (QIA) do not comply with the Principles. We continue to argue that a stronger commitment by QIA to a proactive disclosure policy would enhance the overall legitimacy of the Principles.

Four SWFs not rated

We exclude SWFs from our ratings whose disclosure policies do not allow us to conduct a meaningful assessment, whose mandates are in the process of major revisions, or whose political institutions lack the capacity to formulate a consistent policy direction and/or to provide for meaningful supervisory arrangements as of September 2014.

The SWFs not rated in the SCI 2014 include the National Pensions Reserve Fund, which the Irish Government seeks to reorient from a long-term pension fund to a fund focused on domestic investments. The disclosure policies of JSC Samruk-Kazyna, Fondo Strategico Italiano and the Oil Revenues Stabilization Fund (of Mexico) do not allow us to conduct an assessment of their compliance with the Principles.

Conclusions

The SCI 2014 arrives at the following broad conclusions about funds rated as fully compliant with the Principles: They demonstrate that their management is operationally independent from the owner. They conclusively demonstrate their financial and economic orientation or, alternatively, provide definitive information about other considerations (not economic or financial) that drive their investment policies. As a result, they contribute actively to building the confidence of financial market participants, regulators and other stakeholders in SWFs.

SWFs that are broadly or partially compliant with the Principles demonstrate the operational independence of both their management and their economic and financial orientations, but only to a relative degree. As such, they make an inconsistent contribution to building confidence in the SWF industry.

Funds rated as non-compliant with the Principles do not demonstrate the operational independence of either their management or their economic and financial orientations, and therefore do not contribute to building confidence in the SWF industry in line with the aspirations formulated by the Principles.

We would like to stress an important point about our conclusions, anchored in the term “demonstrate”. We do not conclude that SWFs with less favourable ratings necessarily pursue investment policies driven by other than financial and economic considerations, and we do not conclude that their operational management is necessarily spurred by policy directions provided by their governments. We only conclude that SWFs with low compliance ratings do not *demonstrate* the operational independence of fund management or the economic and financial orientation of investment policies, as the Principles suggest. In other words, based on publicly accessible documentation, the SCI cannot ascertain the independence of operational fund management or the financial and economic orientation of funds that, based on our assessment, do not fully comply with the Principles.

The Santiago Principles

The Santiago Principles are an innovative form of global governance: they hold government-owned or related entities from developed and emerging economies, accountable to the same set of standards. Given the fluid interpretation of the Principles' substance and meaning, we offer the following set of pointers – derived from our own interpretations – that provided guidance to our assessments and ratings.

1. The Principles as a social licence to operate

The Santiago Principles are a voluntary code and as such do not constitute a legal instrument. Instead they set a standard around which expectations about SWFs, held by other market participants, regulators and stakeholders, are formed. The Principles are based on the conviction that the SWFs committed to them would solely pursue financial-return objectives or, alternatively, declare what other considerations drive their investment policies. In addition, the Principles' standards are designed to provide checks and balances that prevent political interference, as SWFs allocate capital across global markets. In return, the Principles expect that other actors, in particular countries that potentially receive SWF-sponsored investments, will display greater confidence in the funds' economic and financial orientation, and will not discriminate in any form against them. As such, the Principles are positioned as a social licence to operate, allowing SWFs to freely engage in global markets.

Different schools of thought exist on how to obtain that licence to operate. One argues that, by merely ratifying the Principles, an SWF sufficiently demonstrates its commitment to their material content, thus acquiring and benefitting from the Principles' licence to operate.

Another school of thought suggests that whilst formal commitment is necessary, it is not sufficient. Rather, SWFs have to pursue a proactive disclosure policy, in line with the Principles' standards. The Principles themselves support that position, suggesting that the governance framework and objectives, as well as the manner in which an SWF's management is operationally independent from the owner, should be publicly

disclosed (Principle 16). Moreover, relevant financial information should be available publicly to demonstrate an SWF's economic and financial orientation (Principle 17), which contributes to stability in international financial markets and enhances trust in recipient countries.

Yet another school of thought argues that an independent verification mechanism needs to complement commitment, disclosure and reporting practices, though the Principles leave it formally to the individual SWF to conduct third-party reviews and disclose their results (Principle 24). Independent verification allows the international community to form an opinion on the extent to which an SWF abides by the Principles and, as a consequence, to decide on the role it assigns to the SWF in international affairs. The SCI shall contribute to forming that opinion by independently assessing and rating SWFs' disclosure policies against the Principles.

2. Interpretations guiding Santiago compliance assessments

We stress that SWF compliance assessments and the resulting SCI are based on publicly accessible and relevant legislation, charters and other constitutive documents or management agreements as provided by SWFs and their owners. The choice of data reflects our independent view of the timeliness, coverage, accuracy, credibility and usability of available information. Individual assessments will be modified if relevant fund-specific, official information becomes accessible. Fund-specific assessments and associated ratings cannot represent any assurance of action and follow-through by the respective fund of the Principles' material obligations. The assessments are based on the assumption that publicly available official documentation provides adequate representation of SWFs' de facto governance arrangements, operations and financial conduct.

The deliberate focus on publicly available documentation might also cause a discrepancy between Santiago compliance as perceived by outside observers and that perceived by fund owners and managers with insider knowledge. We therefore acknowledge that fund-specific governance arrangements and financial conduct might be of higher quality than those reflected in our assessment documents. Again, we stress that

our assessments are based on publicly available information and, thus, are subject to the quality of a fund's disclosure policy. A less favourable assessment, it should be underlined, does not suggest that a fund does not employ reasonable governance arrangements or does not operate according to sound financial considerations; it merely conveys that such actions cannot be ascertained based on publicly available documentation.

3. Assumptions

Assessments are also based on our reading of the Principles suggesting that SWFs are obliged to provide disclosure across the entire set of Principles. We note that, whilst not every Principle is not complemented by an explicit obligation for public disclosure, Principle 16 states that the "governance framework and objectives [...] should be publicly disclosed". In addition, Principle 17 declares that "relevant financial information regarding the SWF should be publicly disclosed [...]". A governance framework, in our view, is composed of a fund's institutions and the structure determining their relationships. That interpretation is confirmed by the annotation's section of the Principles on "Institutional Framework and Governance Structure", which covers Principles 6 to 17 and thus calls for disclosure for each. We also assume that the disclosure obligation of Principle 17 materially covers Principle 23. Of those remaining, only Principles 3, 5, 20, and 24 do not explicitly request disclosure. Except for Principle 24, they are all fairly technical in nature. We assume the disclosure obligation also to cover these given the Principles' general thrust to increase overall transparency, international best practices, and the Principles' broad coverage of an SWF's governance framework.

The Santiago Principles provide considerable latitude for interpreting the material obligations they place on each signatory. The assessments are therefore necessarily guided by GeoEconomica's interpretation of the Principles, which is also informed by the best-practice applications of the Principles. The methodology and performance indicators used for the assessments are available at www.geoeconomica.com.

We also appreciate that SWFs exist to serve diverging purposes, such as reserve management,

fiscal stabilisation, long-term savings, pension reserve management or strategic development objectives. They therefore have diverging investment objectives and policies, driving specific risk-return profiles and asset allocations set by fund-specific governance arrangements. Our assessments are based on the assumption that the Principles provide a framework generic enough to accommodate these differences. Moreover, we acknowledge that SWFs are owned by countries with very different political institutions and regulatory traditions, and take note of possible tensions between the standards set by the Principles and domestic-level constitutional, legal and/or regulatory obligations. We find that all SWF governance arrangements carry the DNA of their sovereign owners' political institutions. However, we assume that each individual signatory has evaluated to what degree, if any, the Principles might conflict with other obligations.

In that context, it is important to note that the assessment and rating process incorporates the "comply or explain" standard, set out by the UK Corporate Governance Code. Signatories to the Principles who choose not to comply with one or several of them, or who do not follow the guidance appended to the Principles (also because the Principles might conflict with other legal or regulatory obligations), may wish to provide meaningful explanations and clarification. In these cases, the assessment evaluates the conclusiveness of these explanations.

SWFs may or may not choose to comment on preliminary conclusions reached during the evaluation process.

Specific themes

Beyond formal assessments, the Santiago Principles allow the distillation of specific themes that emerge from the comparative analysis of the SWFs that endorsed them. We touch briefly on the following five themes:

1. Assets of SWFs committed to the Santiago Principles have grown by over 80 percent from 2008 to 2014

The Principles' relevance as an important regulatory instrument has certainly increased in line with the SWF industry's transformation from a peripheral to a central player in global financial affairs. The combined asset value of the original signatories was roughly US\$2.2 trillion in 2008. Today, sovereign asset managers pledging commitment to the Principles represent more than \$4 trillion in AUM, invested across the entire spectrum of asset classes, and translating into 81 percent growth from 2008 to 2014, or an annualised growth rate of 13.5 percent. Though the size of the SWF industry is well short of the 2015 mark of US\$12 trillion suggested by commentators in 2007, growth has been substantial, accelerating the industry's migration from the periphery to the centre of global finance.

At the same time, the wealth managed by sovereign asset managers is still highly concentrated. The 10 largest SWFs control roughly 86 percent of the industry's total asset base. Moreover, the top three funds – Norway's Government Pension Fund Global, China Investment Corporation and the Abu Dhabi Investment Authority (ADIA) – control an estimated US\$2 trillion, or almost half of SWF assets under management.

The most relevant growth driver over the past years has certainly been the continuously high prices of natural resources, which led to substantial government contributions to SWF funding. Many natural-resource-endowed countries were able to keep public expenditure in check, at least to a degree that allowed them to transfer excess revenues for their sovereign asset managers to look after. Whether that trend will continue is an open question, however. Public demand for increased public investment and spending is growing, and fiscal policies remain on an

expansionary footing. Downward pressure on global oil and gas prices, driven in part by the US shale gas revolution, and a more fragile outlook for the global economy are denting government revenues.

Global Sovereign Wealth Funds: Assets under Management, 2014

Fund	AUM in US\$ billion*
Government Pension Fund Global (Norway)	841
China Investment Corporation	653
Abu Dhabi Investment Authority**	589
Kuwait Investment Authority**	386
GIC Private Limited (Singapore)**	315
Qatar Investment Authority**	304
Temasek Holdings (Singapore)	178
Reserve / National Wealth Funds (Russia)	173
Future Fund (Australia)	92
JSC Samruk - Kazyna (Kazakhstan)	90
Korea Investment Corp. (Republic of Korea)	72
Libya Investment Authority	66
National Development Fund (Iran)	65
Alaska Permanent Fund	50
Khazanah Nasional (Malaysia)	41
State Oil Fund of Azerbaijan	36
National Pensions Reserve Fund (Ireland)	26
New Zealand Superannuation Fund	21
PRF / ESSF (Chile)	21
Heritage Fund (Alberta/CA)	16
Petroleum Fund of Timor-Leste	15
Russian Direct Investment Fund	10
Fondo Strategico Italiano	6
Heritage & Stab. Fund (Trinidad & Tobago)	6
Fundo Soberano de Angola	5
JSC National Investment Corp. (Kazakhstan)	5
Pula Fund (Botswana)	5
Oil Revenues Stabilization Fund (Mexico)	4
Nigeria Sovereign Investment Authority	1
Total	4,092

* Latest available figures rounded to full US\$ billion

** Sovereign Wealth Center; Institute of International Finance; and other estimates

A second growth factor has been the increasing asset valuations, in particular over the past two years, that SWFs have substantially benefitted from, despite the volatilities of the global financial

markets. They have been able to ride out bear markets due to their long-term investment horizon. Also, most SWFs were able to consistently beat their respective performance benchmarks, driven in part by higher-quality asset management capabilities.

Third, SWFs have increased in sheer numbers. Setting up an SWF has become a common tool of economic policy for countries endowed with substantial natural resources. This phenomenon has played out most actively in commodity-rich Africa. The strong legitimacy of proactively managing sovereign wealth has been good news for Africa at large, anchoring economic policy in more prudent fiscal management and providing some impetus for accelerated institution and capacity building.

Despite the risks to industry growth, the more central position of SWFs makes the Santiago Principles increasingly relevant for the global financial system and global economy at large. The Principles serve not only as a frame of reference for self-regulating sovereign wealth managers, but also as a best practice for financial and economic actors in other domains and industries that aspire to self-regulate their business conduct, based on an innovative form of collective action.

2. The Santiago Principles are good news for resource-rich Africa

The concept of SWFs and reference to the Principles should be good news for good governance in Africa. The resource-rich continent has seen significant growth rates over the past few years, driven as well by substantial commodity incomes. This has prompted African governments to consider setting up SWFs to save some income and to distribute it more equally across current and future generations, and/or to establish financial buffers that ensure less volatile fiscal policies, should commodity revenues decline for cyclical or other reasons.

For long, the Pula Fund, created to preserve part of Botswana's income from diamond exports for future generations, was the only African SWF to actively endorse the Principles (aside from Equatorial Guinea's dysfunctional Fund for Future Generations). In June 2014, the Nigeria Sovereign Investment Authority (NSIA) endorsed the Principles, followed by the Fondo Soberano de

Angola (FSDEA), endorsing them in August. Both Funds have made explicit commitments to implementing the Principles.

The NSIA Act obliges the NSIA to "implement best practices with respect to management independence and accountability, corporate governance, transparency and reporting on performance", with due regard as appropriate for the Principles (Art. 4[2d]). It also requires the NSIA to "develop policies and procedures for communicating its investment objectives in a manner generally consistent with the guiding objectives underpinning the Santiago Principles" (Art. 49). The Annex to Decree No. 108/13, approving the management regulations of the FSDEA, states that the Santiago Principles will be implemented in the Fund's organisational, judicial and operational aspects within the first three years of operation (Art. 6).

However, the current set-up of governance arrangements will challenge the aspiration to align their policies with the Principles. We note, for example, the substantial powers of the President of the Republic of Angola, who is given the authority to approve the FSDEA's investment policy, activity plans, annual and multiyear budgets, management reports, financial statements, annual investment strategy and staffing policy, as well as management regulations or internal regulations. Whilst FSDEA provides the President with substantial and centralised authority, which is unusual when compared with the governance arrangements of most other SWFs, NSIA's Governing Council brings together a hugely diverse set of representatives from the federal and state governments, the private sector, academia and civil society tasked with providing advice and general counsel to NSIA's officers and its Board. Although the Council's composition shows a high degree of inclusiveness, with a diverse representation of executive government entities and other stakeholders, we believe it will be challenged to assume a role aligned with the Principles' governance standards.

These examples suggest that the design of national political institutions strongly resonate in the governance arrangements of SWFs, not only but also in the African context. Possible deviations of governance arrangements need to be reconciled with the Principles' request for meaningful government supervision and the independence of operational fund management.

3. SWFs from the Arab world are lagging behind in public disclosure policies

Clearly, the four SWFs from the Arab world that have endorsed the Principles – Abu Dhabi Investment Authority (ADIA), Kuwait Investment Authority (KIA), Qatar Investment Authority (QIA) and Libya Investment Authority (LIA) – lag behind in their public disclosure policies. This should be a major concern, as their conservative commitment erodes the Principles' legitimacy, which itself is further stressed by the funds' relative weight in the SWF industry, with combined AUM of roughly US\$1.3 trillion, according to the Sovereign Wealth Center – or more than 30 percent of the assets held by SWFs committed to the Principles.

We note that none of the four funds maintain qualitatively robust public financial disclosure practices, such as publicly disclosing audited income statements or balance sheets, robust disclosure of funding and withdrawal arrangements, or disclosure of meaningful financial performance indicators. They also largely fail to provide robust and verifiable narratives of their governance arrangements based on relevant legislation, charters and other constitutive documents or management agreements. This prevents outside observers from coming to an informed conclusion about the operational independence of the funds' management.

After ratification of the Principles, we note that ADIA began publishing an annual review, and has also provided a self-assessment of its implementation of the Principles. However, this documentation is insufficient to obtain a more favourable compliance rating. We observe that KIA is legally prevented from disclosing information about its financial conduct to the public. Though we apply the “comply or explain” approach in assessments, we consider KIA’s disclosure policy as not developed enough to more than make up for the significant financial disclosure deficit caused by its domestic legal obligations. As for LIA, its disclosure policy is for the time being only rudimentarily developed. And, as far as we can see, QIA has yet to take any meaningful steps to meet some of the Principles' basic disclosure standards.

We conclude that for the time being, Arab SWFs have demonstrated neither their managements' operational independence nor their economic and financial orientation, and therefore have not

contributed to building confidence in the SWF industry in line with the Principles' aspirations. Again, this is not to say that Arab SWFs might not otherwise maintain stable governance arrangements fundamentally aligned with their governments' policy objectives, or invest based on a sound investment policy driven by financial and economic considerations. Rather, our findings cannot ascertain the independence of these funds' operational management, or their financial and economic orientation. A convincing narrative, reconciling the conservative position of Arab SWFs on public disclosure with an otherwise favourably evolving global public disclosure environment, is certainly needed to maintain the Principles' legitimacy.

4. Subprinciple 19.1: a back door?

As already noted, the Santiago Principles were mainly drafted to dispel concerns about the potential political orientation of SWF investment policies, as well as the political interference of government in operational fund management. That has been their general thrust over time. However, we note that the Principles leave a back door through which politics nevertheless can enter the scene.

Principle 19 declares that SWF investment decisions should aim to maximise risk-adjusted financial returns based on economic and financial grounds. However, Subprinciple 19.1 specifies as much as it suggests that if investment decisions "are subject to other than economic and financial considerations, these should be clearly set out in the investment policy of a fund and be publicly disclosed". The annotation to Subprinciple 19.1 is geared towards addressing social, ethical, environmental or religious aspects that might also inform a fund's investment policies. Subprinciple 19.1, however, does not limit non-financial and non-economic considerations to aspects that in the broadest sense could be aggregated to responsible investment principles. Instead it leaves the space for other political interests to affect investment policies under the condition that they be publicly disclosed.

To our knowledge, only a few cases arguably fall into that reporting category. Perhaps the most prominent is GIC Private Limited (GIC) from Singapore, whose assets, as declared by the country's Ministry of Finance, are part of

Singapore's strategic reserves and, as such, are a key defence for the country during crises. The Government of Singapore does not, therefore, disclose the size of GIC's assets – which, in turn, has substantial side effects on the remainder of its financial disclosure policy. In that line of reasoning, we conclude that Subprinciple 19.1 acknowledges that SWFs might be considered as active policy tools of government. At the same time, the Principle endorses such policy if it is publicly disclosed.

5. Minding the gap: coordination between fund management and government

The term *sovereign wealth fund* is often used generically to capture and describe all aspects of sovereign wealth management. On that aggregate level, it does not distinguish between the two core building blocks of SWF governance arrangements: the *asset owner*, in the form of the government setting the fund's objectives, and the *asset manager*, driving its operational management.

The main thrust of the Santiago Principles is to ensure that the asset manager executes its management obligations in line with the fund's objectives as set by the government, but remains otherwise beyond the government's reach, preventing political interests to interfere with fund management. At the same time, the Principles do stress that further lines of communication and coordination between the government and asset manager should be institutionalised. Principle 3 instructs SWFs to closely coordinate their activities with domestic fiscal and monetary authorities, in the event these activities have significant and direct domestic macroeconomic implications and an impact on public finances, monetary conditions, balance of payments or the overall sovereign balance sheet, amongst others. Principle 5 requires funds to report relevant statistical data pertaining to a fund to its owner for inclusion in macroeconomic data sets.

The results of our assessments indicate that most SWFs have substantial difficulty disclosing information about the inner workings of their engine rooms of policy coordination between the government and fund management (beyond the realm of Principle 7 mandating the owner [the government] to set the fund's objectives). Such difficulty is probably also driven by fear that disclosure would compromise their overall reputation and

compliance with the Principles. Perhaps the most illustrative examples are statements from ADIA, declaring that it carries out its investment programme independently and without reference to its owner, the Government of the Emirate of Abu Dhabi. Though one can legitimately assume that such declarations are intended to dispel concerns about potential political interference by the Government in the fund's asset management operations, it is not unreasonable to assume that the Government and ADIA's management must have mechanisms in place that synchronise the fund's investment operations with the Emirate's broader macroeconomic requirements – mechanisms that they should have and as endorsed by the Principles.

Policy coordination might also be required to meet the Principles' reporting obligations. In some cases, such obligations could reach beyond a specific fund's authority, and should be assumed by government. For example, Norway's Government Pension Fund Global does not report how the Fund's outflows are offset against inflows, but instead reports an aggregate figure (the net allocation). The Fund leaves it to Norway's national budget to provide more detailed information about in- and outflows in the form of net cash flow from petroleum activities and its non-oil deficit. Another example is Australia's Future Fund. According to the Australian Government Actuary's target asset level declarations, the Fund's target asset level for 2013-2014 was A\$119.4 billion. The Fund's value as of June 2014 was A\$101 billion. The target asset level represents the amount of monies expected to offset the present value of projected unfunded superannuation liabilities. We would assume that the discrepancy between the target asset level and the real value of the Fund's assets might constitute a point of concern and require the public disclosure of a conclusive narrative. The Future Fund's Board of Guardians, however, is not mandated to comment on the coverage of the Government's future liabilities.

From these examples, we conclude that some aspects of SWF disclosure, as required by the Santiago Principles, might reside within the government's mandate. As such, governments may have to assume further responsibility to proactively disclose and address aspects that the Principles determine to be relevant.

6. Growth at the margins: sovereign development funds

We note that the growth of the SWF industry, as witnessed by membership in the International Forum of Sovereign Wealth Funds (IFSWF), an association of SWFs also designed to promote the Santiago Principles, has been driven as well by the emergence of what could be called sovereign development funds. The primary objective of these funds is to enhance the competitiveness of national economies by providing government-backed investment schemes that attract foreign direct investment. The most notable of these entities are the Russian Direct Investment Fund, Fondo Strategico Italiano, the future Ireland Strategic Investment Fund (after having absorbed the National Pensions Reserve Fund's resources), Fundo Soberano de Angola (to some degree), the National Development Fund of Iran, and others.

Although considerable value lies in the Principles extending their reach to sovereign development funds and obliging them to apply the Principles' generic standards, the dynamic application of a definition of what constitutes an SWF risks eroding conceptual boundaries. The Principles themselves suggest that SWFs are geared to pursue investment strategies focused on foreign financial assets, so funds solely invested in domestic assets from the SWF universe are excluded. We note that the mandates of sovereign development funds often include a reference to foreign financial investments; as such, they might formally qualify as SWFs. However, the overall objective of SWFs is conventionally assumed to be to operate mainly as the manager of the sovereign's financial assets abroad. As such, the inclusion of sovereign development funds in the SWF universe needs to be reconciled with the core definition of an SWF.

Concluding thoughts

The Santiago Principles represent an indispensable tool to decipher the fine print of the governance architecture and *raison d'être* of the world's SWFs. They enable a comparative approach to analysing SWFs, which allows greater understanding of the differences between them and appreciation of the industry's diversity. However, the Principles are drafted in a way that generally allows each of them to provide a narrative of compliance.

At the same time, the Principles create a sense of collective identity that sets SWFs apart from other players in the financial industry. And, indeed, fundamental conceptual differences exist between sovereign and private wealth managers. Sovereign wealth managers are accountable to the state and its citizens, and not to private shareholders; they advance the interests of the state, which uses them as instruments of public economic policy. Their beneficiaries are not private investors, but national citizens. As such, SWFs have no competitors, contrary to their private peers. Government has nowhere else to go than to its dedicated and legally endorsed asset manager.

Absent competitive forces between them, global SWFs are in the privileged position to develop deeper levels of coordination and eventual cooperation. This constitutes both a risk and an opportunity. The risk is that coordinated investment decisions might move and distort markets. Competition prevents private investors from sharing information with their peers; without such competition amongst SWFs, market relevant information might flow more easily between them. Given SWFs' ambitions to be recognised as ordinary market participants, the plausibility of that thesis should be further examined and, if confirmed, the necessary steps should be taken to ensure market-sensitive information does not travel.

But the absence of competition also constitutes an opportunity. As we have argued, SWFs exist to serve a distinct public policy purpose on the national level. Any effort to facilitate international coordination between them should correspondingly serve a distinct global public policy purpose, without compromising their *raison d'être* or financial return orientation. The industry's commitment to and full implementation of the Santiago Principles should provide confidence to other actors that the global SWF industry is indeed that stabilising force, with a credible licence to operate also in the global public policy space.

About

GeoEconomica is an independent macro-trend and political risk advisory and research firm. It monitors how macro trends and politics are moving markets.

Contact

GeoEconomica
Geneva Office
4, Chemin des Papillons
1216 Cointrin – Geneva
Switzerland
info@geoeconomica.com
Tel.: +41 (0)22 341 47 78

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