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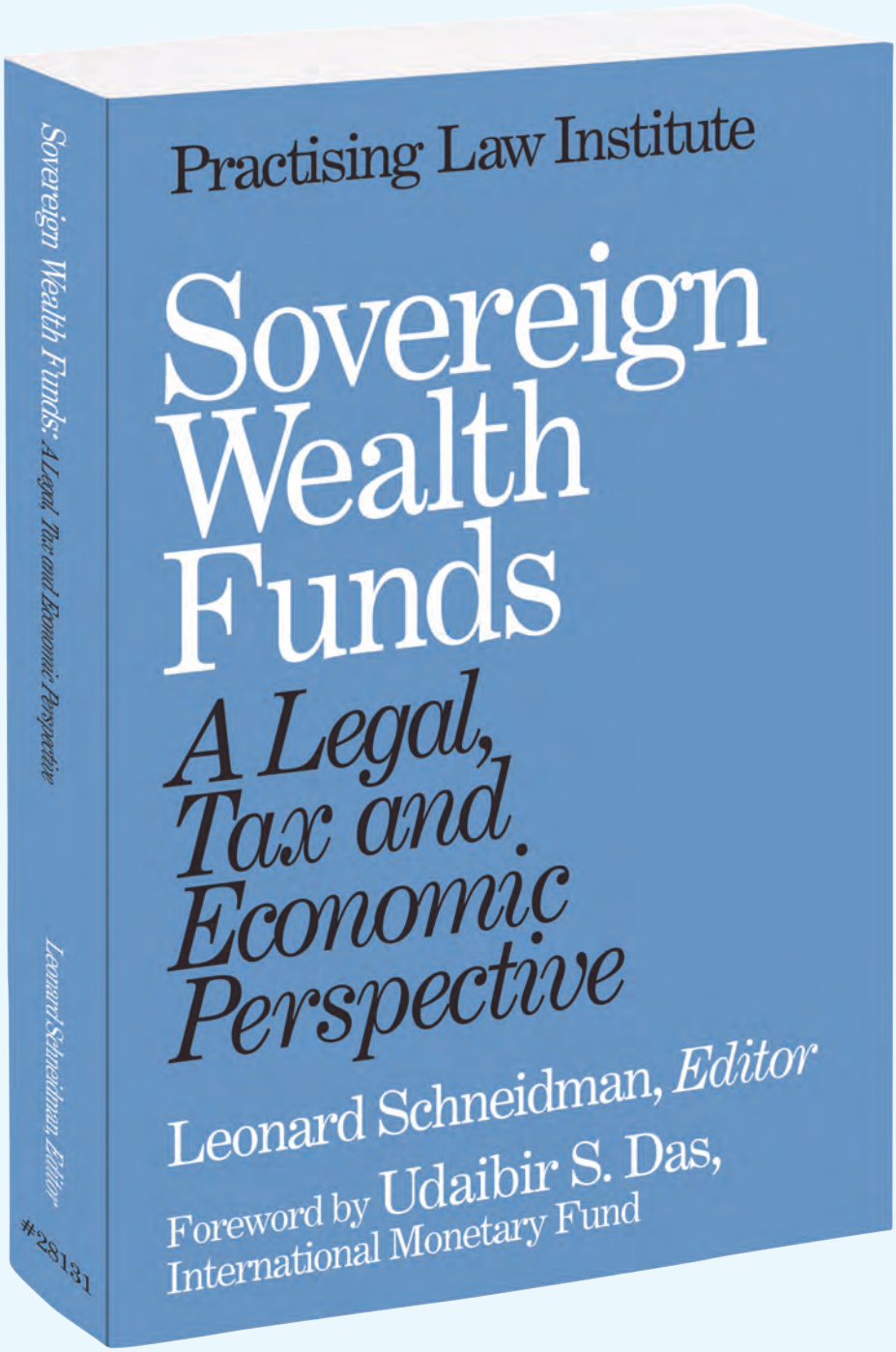

Chapter 2

Regulation in the United States*

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§ 2:1 Introduction

There is no comprehensive system of regulation that specifically targets sovereign wealth funds (SWFs), despite the increased publicity about SWF investment in the United States. The United States primarily uses a patchwork of regulations that limits and restricts foreign investment in certain industries and provides for the suspension or prohibition of general foreign investment that may be deemed harm-

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ful to national security. The general aim of the various regulations is the protection of U.S. national security interests. In addition, an investment by a SWF will be subject to the U.S. President's power to prohibit foreign investment, after a review and recommendation by the Committee on Foreign Investment in the United States (CFIUS). This chapter will briefly discuss industry-specific foreign investment regulations before turning to the basic structure and process of the CFIUS review.

§ 2:2 Industry-Specific Restrictions on Foreign Investment in General

There are a variety of restrictions, regulations, and disclosures mandated by law in certain sectors for reasons of national security. Depending on the industry and the regulations, there are laws that limit foreign investment, restrict the activities of foreign-owned assets, and require disclosure when there is foreign investment. Although there are several such regulations, one exemplifying restriction is that no entity that the Nuclear Energy Commission knows or believes "is owned, controlled, or dominated by an alien, a foreign corporation, or a foreign government" may obtain an atomic energy license.[1] Generally, a SWF would be subject to these restrictions as it is usually owned or controlled by a foreign government.

Another example is the International Emergency Economic Powers Act (IEEPA),[2] which provides the President with the authority to prohibit certain transactions with foreign persons as he or she sees fit. However, in order to exercise this authority, there must be "an unusual and extraordinary threat with respect to which a national emergency has been declared."[3] Barring an extraordinary threat that leads to the declaration of a national emergency, SWFs should not be concerned with the restrictive potential of the IEEPA.

The above examples briefly illustrate the patchwork of regulations that limit and restrict foreign investment in specific industries—specifically with respect to the protection of national security—and

1. 42 U.S.C. § 2133(d) (2006).
2. International Emergency Economic Powers Act, 50 U.S.C. §§ 1701–07.
3. 50 U.S.C. app. §§ 1701–02 (2006).

especially in the oil, energy, transportation, and communication industries. Recently, however, CFIUS has grown into a larger and more significant role in dealing with foreign investment, partially filling the void left by the industry-specific restrictions on foreign investment.

§ 2:3 The Committee on Foreign Investment in the United States

§ 2:3.1 Generally

CFIUS is the leading governmental entity that deals with foreign investment today. CFIUS has the authority to review pending or completed foreign transactions for potential harm to U.S. national security, and to subsequently recommend that the President prohibit or suspend such transactions. As concerns about foreign investment in the United States have grown over the years, CFIUS has seen its powers correspondingly expanded as it has assumed a larger role in the review process. As a result, the CFIUS review process may pose a significant and potentially burdensome hurdle for foreign investors, including SWFs, looking to invest in the United States.

§ 2:3.2 Background

CFIUS was created in 1975 by President Gerald Ford to monitor the impact of foreign investment in the United States and to coordinate the implementation of U.S. policy with regard to foreign investment. Amid concerns about increased foreign investment in the United States and fears of Japanese acquisitions of U.S. companies, in 1988 Congress passed the Exon-Florio Amendment to the Defense Production Act of 1950 (the "Act"),[4] authorizing the President to block any foreign investment that, after review, was deemed to be harmful to national security. Later in 1988, President Ronald Reagan delegated the review process to CFIUS.

In recent years, the controversy over DP World's acquisition of the Peninsular and Oriental Navigation Company ("P&O"), which operated several major U.S. port facilities, led to further amendments to

4. Exon-Florio Amendment, 50 U.S.C. app. 2170 (1988).

the Act. In March 2006, DP World, a subsidiary of Dubai World (a holding company owned by the United Arab Emirates government of Dubai), purchased P&O. CFIUS reviewed the transaction and approved it, but members of Congress expressed their opposition to the deal amid concerns about potential dangers to national security if a foreign state-owned company controlled U.S. ports. The intense focus given to this transaction by Congress and the American public compelled DP World to sell off its stake in P&O to American International Group. Upset by CFIUS's approval of the transaction, Congress subsequently passed the Foreign Investment and National Security Act of 2007 (FINSA),[5] further amending the Act to increase Congressional oversight of the review process and to reduce CFIUS discretion in the review process.

As amended, the Act authorizes the President to suspend or prohibit a foreign merger, acquisition, or takeover of a U.S. company that is considered harmful to national security.[6] CFIUS, chaired by the head of the U.S. Department of Treasury, is made up of at least eight other members, including the heads of the Department of Justice, Department of Homeland Security, Department of Commerce, Department of Defense, Department of State, Department of Energy, Office of the U.S. Trade Representative, and the Office of Science and Technology Policy.[7] The two principal purposes of the Act and the regulations promulgated thereunder are to authorize the President to suspend or prohibit any covered transaction that could threaten national security and to authorize CFIUS to mitigate any national security threat arising out of a covered transaction.[8]

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5. Foreign Investment and National Security Act of 2007, Pub. L. No. 110-49, 121 Stat. 246 (July 26, 2007).
6. 31 C.F.R. § 800.101 (2009).
7. U.S. Department of the Treasury, Composition of CFIUS, *available at* www.treas.gov/offices/international-affairs/cfius/members.shtml (last visited June 11, 2009).
8. 31 C.F.R. § 800.101 (2009).

§ 2:4 CFIUS Review Process

§ 2:4.1 Chronology of a CFIUS Review

The basic chronology of a CFIUS review consists of a voluntary notice or unilateral initiation by CFIUS or one of its members, a thirty-day review, a forty-five-day investigation, if necessary, and a report to the President if CFIUS recommends that the transaction be suspended or prohibited. Figure 2-1 on the next page illustrates the chronological breakdown of the CFIUS review process.

§ 2:4.2 Starting the CFIUS Review Process

There are two ways that the CFIUS review process may be initiated: through a voluntary filing or involuntary initiation.

[A] Voluntary Notice

The first way to initiate a review is by filing a voluntary notice with CFIUS. CFIUS encourages parties to consult with them before filing a notice and, when appropriate, to file a draft notice or other documents to help CFIUS understand the transaction. Consultation and filing of draft notices has an added benefit in that it also provides an opportunity for CFIUS to request additional information that it would like to receive in the formal voluntary notice.[9] Pre-filing consultations and documents are encouraged to assist CFIUS in addressing issues as efficiently as possible and are "particularly helpful where a party to the transaction has not previously prepared a notice for submission to [CFIUS] or where a transaction is unusually complex."[10]

There are numerous items required in the voluntary notice to CFIUS, including:

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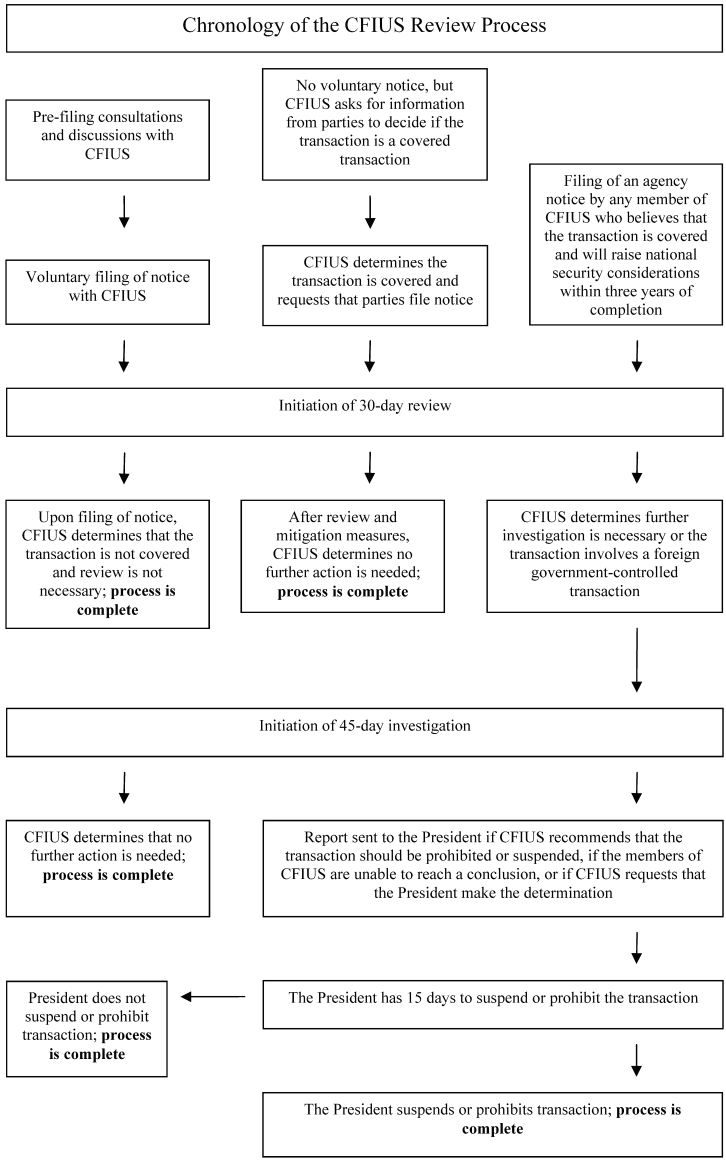
9. 31 C.F.R. § 800.401 (2009).
10. Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons, 73 Fed. Reg. 70,702, 70,711 (Nov. 21, 2008) (codified at 31 C.F.R. pt. 800).

Figure 2-1
Chronology of the CFIUS Review Process



(i) a summary of the essentials of the transaction;

(ii) the business activities of the U.S. business that is the subject of the transaction;

(iii) recent contracts of the U.S. business with federal government agencies involving classified information or classified technology, or with agencies that may have national defense, homeland security, or other national security responsibilities; and

(iv) the plans of the foreign acquirer for the U.S. business.[11]

CFIUS also has found that some information not required by the regulations may be helpful in facilitating the review process, including:

(i) whether the U.S. business develops or provides cyber systems, products, or services;

(ii) whether the U.S. business processes natural resources and materials or produces and transports energy, and the amount processed, produced, or transported annually; and

(iii) a discussion of the business rationale for the transaction.[12]

After the filing of a voluntary notice, if CFIUS determines that the transaction is not a covered transaction and is not subject to the Act, it will notify the parties and the process will be concluded. Once CFIUS informs the parties that the transaction is not subject to review, the President cannot exercise his power to suspend or prohibit the transaction. A voluntary filing, in and of itself, is not an admission that the transaction is a covered transaction.[13]

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11. 31 C.F.R. § 800.402 (2009).
12. U.S. Department of the Treasury, Office of Investment Security, Committee on Foreign Investment in the United States (CFIUS): Frequently Asked Questions, *available at* www.treas.gov/offices/international-affairs/cfius/faqs.shtml.
13. 31 C.F.R. § 800.403(c) (2009); 31 C.F.R. § 800.601(a)(1) (2009); Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons, 73 Fed. Reg. at 70,712.

[B] Involuntary Initiation

CFIUS may unilaterally initiate the review of a transaction in one of two ways. If CFIUS believes that a transaction for which no voluntary notice has been made may be a covered transaction and may raise national security considerations, it may ask that the parties involved provide the information necessary to determine whether such transaction is a covered transaction. If CFIUS then determines that the transaction is covered, it may ask for the parties to file a notice. Alternatively, if a member of CFIUS has reason to believe that a transaction is a covered transaction and may raise national security considerations, such member has the authority to file an agency notice, which initiates the review process.[14] In the event that an agency notice is filed, no initial action is required to be taken by the parties and no voluntary notice is required to be filed.

§ 2:4.3 Examination of Covered Transactions

CFIUS's specific mandate is two-fold. CFIUS must examine whether a "covered transaction" is made by or with any "foreign person" and could result in foreign control of a U.S. business and, additionally, whether there is credible evidence to support a belief that any foreign person exercising control of the newly acquired U.S. business might take action that threatens to impair U.S. national security. CFIUS must also determine whether any laws or regulations already exist that provide adequate and appropriate authority to protect U.S. national security, circumventing the need to prohibit the transaction through the CFIUS review process.[15]

The CFIUS review process only encompasses those transactions that are deemed to be "covered transactions." Pursuant to the Act, a covered transaction includes:

(i) a transaction that results in control of a U.S. business by a foreign person;

(ii) a transaction in which a foreign person conveys its control of a U.S. business to another foreign person;

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14. 31 C.F.R. § 800.401 (2009).
15. 31 C.F.R. § 800.501 (2009).

(iii) a transaction that results in the control by a foreign person of any part of an entity or of assets that constitute a U.S. business; and

(iv) a joint venture in which the parties enter into a contractual or other similar arrangement, including an agreement on the establishment of a new entity, but only if one or more of the parties contributes a U.S. business and a foreign person could control that U.S. business by means of the joint venture.[16]

A transaction cannot be a covered transaction for purposes of the Act unless it involves a "foreign person." A "foreign person," for the purposes of the CFIUS review, is any foreign national, foreign government, or foreign entity, or any entity over which control is exercised or exercisable by a foreign national, foreign government, or foreign entity.[17] A "foreign entity" is "any branch, partnership, group or subgroup, association, estate, trust, corporation, or division of a corporation, or organization organized under the laws of a foreign state if either its principal place of business is outside the United States or its equity securities are primarily traded on one or more foreign exchanges."[18] If the majority of the equity interest in a foreign entity as defined above is ultimately owned by U.S. nationals, the entity would not be considered a foreign entity.[19]

Although the Act is aimed at all forms of foreign control of U.S. businesses and not specifically directed at SWF investment, the Treasury Department notes that "the fact that a transaction is a foreign government-controlled transaction does not, in itself, mean that it poses national security risk."[20] When it looks at foreign government-controlled transactions, CFIUS considers, among other relevant factors, the extent to which investment management policies of the investor require investment decisions to be based solely on commercial

16. 31 C.F.R. § 800.301(a)–(d) (2009).
17. 31 C.F.R. § 800.216 (2009).
18. 31 C.F.R. § 800.212 (2009).
19. 31 C.F.R. § 800.212 (2009).
20. Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. at 74,571.

grounds, the degree to which management and decisions are exercised independently from the controlling government, the degree of transparency and disclosure of the purpose, investment objectives, institutional arrangements, and financial information of the investor, and the degree to which the investor complies with regulatory and disclosure requirements of countries in which they invest.[21]

If a transaction involves a foreign person, such foreign person must be in a position to obtain control of the U.S. business in order for the transaction to be a covered transaction. On November 14, 2008, the Treasury Department issued final regulations governing CFIUS, in which, among other things, the concept of "control" was clarified. According to these regulations, CFIUS will employ a functional test in determining control, rather than a bright-line test. Control in the CFIUS context is generally defined as "the power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity." Some of these important matters include the reorganization, merger, or dissolution of the entity; major expenditures or investments; and the entry into, termination, or non-fulfillment of significant contracts.[22]

The Treasury Department clarified that a variety of factors, such as ownership structure, ownership percentage, and ability to influence rather than control a U.S. business, will be considered in determining whether "control" exists for purposes of CFIUS review. For example, if the transaction results in the foreign person or entity holding 10% or less of the outstanding voting interests of the U.S. business, and the transaction is solely for the purpose of making a passive investment, then the foreign person would not control the U.S. business and therefore the transaction would not be a covered transaction. A passive investment is an investment where the person holding or acquiring the interest does not plan or intend to exercise control, does not possess or develop any purpose other than for a passive investment,

21. *Id.* at 74,751.
22. 31 C.F.R. § 800.204(a) (2009).

and does not take any action inconsistent with holding or acquiring such interests solely for the purpose of a passive investment.[23]

Further, CFIUS may give greater scrutiny to a covered transaction if such transaction involves "critical infrastructure." "Critical infrastructure" is generally defined in the Act and is meant to be determined on a case-by-case basis.[24] Critical infrastructure, according to the Act, is a system or asset that is so important to the United States that its destruction or incapacitation would have a debilitating effect on U.S. national security.[25] The Treasury Department noted that CFIUS considers the particular assets involved in a given transaction, rather than classifying entire groups or types of assets as "critical infrastructure" in general. Again, as with the determination of what constitutes a "covered transaction," there is no bright-line test employed by CFIUS, but rather an analysis of a variety of factors in order to determine what constitutes "critical infrastructure."

§ 2:4.4 The Thirty-Day Review Period

Once a notice has been filed and a transaction has been deemed to be a covered transaction, the CFIUS national security review process begins, and this review must take place in the ensuing thirty days. For each covered transaction and its subsequent review, the Secretary of the Treasury designates one or more of the members of CFIUS as the lead agency or agencies for the committee (the "Lead Agency"). The Lead Agency has the primary responsibility for the activity for which it has been appointed, including all or part of a review, an investigation, or the negotiation or monitoring of a mitigation agreement.[26]

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23. 31 C.F.R. § 800.302(b) (2009); 31 C.F.R. § 800.223 (2009).
24. Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons, 73 Fed. Reg. at 70,708.
25. 31 C.F.R. § 800.208 (2009).
26. 31 C.F.R. § 800.502 (2009); 50 U.S.C. app. § 2170(k)(5) (2009); 31 C.F.R. § 800.218 (2009). During the review, CFIUS, or a lead agency on behalf of the Committee, may "negotiate, enter into or impose, and enforce any agreement or condition with any party to the covered transaction in order to mitigate any threat to the national security of the United States" due to the transaction. 50 U.S.C. app. § 2170(l) (2009). Any such mitigation agreement or condition must be a product of a risk-based analysis of the threat to national security conducted by CFIUS. 50 U.S.C. app. § 2170(l) (2009).

Within twenty days of the start of the review, the Director of National Intelligence must undertake and deliver to CFIUS a thorough analysis of any threat to U.S. national security posed by the covered transaction under review.[27]

The national security risk assessment conducted by CFIUS is based on the information provided by the parties in the notice, public sources, and the threat assessment prepared by the Director of National Intelligence.[28] National security, however, is not defined in the rules or regulations, and is meant to be reviewed on a case-by-case basis.[29] Despite the lack of a concrete definition, there are certain known factors that CFIUS takes into account when reviewing a transaction to determine if it would impair U.S. national security. Some of these factors include:

(i) the foreign control of domestic industries and commercial activity as it affects U.S. capability to meet the requirements of national security;

(ii) the potential effects of the transaction on U.S. international technological leadership in areas affecting U.S. national security;

(iii) the potential national security-related effects on U.S. critical infrastructure, including major energy assets;

(iv) whether the covered transaction is a foreign government-controlled transaction; and

(v) any other factors as the President or CFIUS may determine to be appropriate.[30]

If, at the end of the thirty-day review period, CFIUS determines that no further investigation is needed, the process is concluded and written notice will be sent to the parties to this effect. Once CFIUS

27. 50 U.S.C. app. § 2170(b)(4) (2009).
28. Department of the Treasury, Office of Investment Security, Guidance Concerning the National Security Review Conducted by the Committee on Foreign Investment in the United States, 73 Fed. Reg. 74,567, 74,569 (Dec. 8, 2008).
29. Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons, 73 Fed. Reg. at 70,705.
30. 50 U.S.C. app. § 2170(f) (2009).

has decided that no further action is needed, the President cannot then exercise his authority to suspend or prohibit the transaction. If no investigation is necessary, a senior-level official of the Treasury Department and of the Lead Agency must certify to Congress that, on the basis of the review, the transaction will not harm U.S. national security.[31]

§ 2:4.5 The Forty-Five-Day Investigation

If, at the end of the thirty-day review period, a member of CFIUS believes that the transaction (i) threatens to impair U.S. national security and that threat has not been resolved or mitigated; (ii) is a foreign government-controlled transaction; (iii) results in foreign control over critical infrastructure that could impair national security and it has not been mitigated; or (iv) warrants further investigation, and the Lead Agency concurs in this assessment,[32] then an additional forty-five-day investigation is required. The forty-five-day investigation focuses on the same factors as the thirty-day review.

An investigation of a foreign government-controlled transaction, or a transaction regarding critical infrastructure, can be waived if the Secretary of the Treasury and the head of the Lead Agency both determine, on the basis of the initial review, that the transaction will not harm U.S. national security.[33] If the investigation is waived, a senior-level official of the Treasury Department and of the Lead Agency must certify to Congress that, on the basis of the review, the transaction will not harm U.S. national security.[34]

If, at the end of the forty-five-day investigation, CFIUS determines that no further action is needed, no report is sent to the President. Instead, the investigation is concluded and the parties will be informed of the decision in writing. If no report is sent and CFIUS's review is concluded, the transaction cannot be blocked by the President.[35]

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31. 31 C.F.R. § 800.504 (2009); 31 C.F.R. § 800.601(a)(2) (2009); 31 C.F.R. § 800.503(c) (2009).
32. 31 C.F.R. § 800.503(a) (2009).
33. 50 U.S.C. app. § 2170(b)(2)(D) (2009).
34. 31 C.F.R. § 800.503(c) (2009).
35. 31 C.F.R. § 800.506(d) (2009); 31 C.F.R. § 800.601 (2009).

However, CFIUS may send a report to the President if it recommends that the transaction should be prohibited or suspended, if the members of CFIUS are unable to reach a conclusion, or if CFIUS requests that the President make a determination. The President has the authority to suspend or prohibit any transaction with foreign persons within fifteen days of receipt of the CFIUS report.

The CFIUS review process is slightly more straightforward for SWF investments. As discussed above, a SWF may voluntarily submit a notice or a review could be involuntarily initiated by CFIUS. In either case, the forty-five-day investigatory period will be triggered since an investment by a SWF constitutes a foreign government-controlled transaction. However, the preferred course may be to submit a voluntary notice—of 404 notices from 2006 to 2008, only thirty-six have required the forty-five-day investigation and only two have then resulted in presidential action.[36]

§ 2:4.6 Potential Issues in the CFIUS Review Process

Over the last few years, several transactions have raised public concerns that compelled the parties involved to reconsider investing in the United States. As seen by the controversy surrounding DP World's acquisition of P&O, foreign investments in the United States may elicit adverse media attention, which then may prevent or impede the successful completion of a given transaction. The eventual failure of DP World's purchase of U.S. ports was not a unique case; in 2005, China National Offshore Oil Corporation called off its attempted purchase of Unocal Corporation due to political tensions. In 2006, the Israeli company Check Point Software Technologies ended its attempt to purchase Sourcefire, a security software maker, citing the complexity of the CFIUS review process. More recently, the DP World incident only has increased the attention on CFIUS and foreign in-

36. 31 C.F.R. § 800.506 (2009); 50 U.S.C. app. § 2170(d) (2006); U.S. Department of the Treasury, Covered Transactions, Withdrawals, and Presidential Decisions: 2006–2008, *available at* www.treas.gov/offices/international-affairs/cfius/docs/Covered-Transactions_2006-2008.pdf (last visited June 11, 2009).

vestments in the United States, leaving foreign investors concerned about potential negative publicity and any backlash that may endanger U.S. transactions.

Another area of potential concern for foreign entities seeking to invest in the United States is the potential disclosure of information provided by the parties to the transaction regarding the transaction or the parties themselves. At the completion of the thirty-day review, a certified notice with a description of the actions taken by CFIUS and the determinative factors in the related decisions must be sent to various members of Congress, including, among others, the Senate Majority and Minority leaders, the Speaker and Minority leader of the House of Representatives, and the chair and ranking member of the Senate Committee on Banking, Housing, and Urban Affairs and of any other Senate committee that has oversight over the Lead Agency.[37] Likewise, this same information must be disclosed in a certified report at the conclusion of the forty-five-day investigation.[38]

The disclosure of information to CFIUS is a potential area of concern for two reasons. First, the success of a transaction often depends on the correct timing of disclosure of the activity to the public and the media. If certain information is disclosed to CFIUS, or if a potential transaction receives attention due to a voluntary notice filing, and this information is then subsequently disseminated prior to the consummation of a transaction, it could negatively impact the prospects for successfully completing the transaction as negotiated. Additionally, disclosure of information to CFIUS may be a concern for an investor who is not public, and does not want their investment structure or financial condition to be publicly available. The desire for privacy of information by SWFs, in particular, has recently come into conflict with the increased call for transparency by recipient countries.

While there is nothing preventing the disclosure of information to either House of Congress or any authorized committee or subcommittee of Congress, the Act contains certain confidentiality provisions that state that any information or documentary material filed with CFIUS is exempt from the requirements of public disclosure of information by U.S. government agencies.[39] Additionally, none of the in-

37. 50 U.S.C. app. § 2170(b)(3) (2009).
38. *Id.*
39. 31 C.F.R. § 800.702 (2009).

formation may be made available to the public, except as may be relevant to any administrative or judicial action or proceeding.[40] The prohibited disclosure of information or material that is filed with CFIUS is punishable by fines and, in certain circumstances, imprisonment.[41]

Lastly, potential investors in the United States must be aware that there are penalties for various violations of the CFIUS laws and regulations. Making a material misstatement or omission, whether intentionally or through gross negligence, or making a false certification may give rise to liability to the United States for a maximum civil penalty of $250,000 per violation. A violation of a material provision of a mitigation agreement, or material condition imposed for mitigation, may give rise to liability to the United States for either a maximum of $250,000 per violation or the value of the transaction, whichever is greater. The penalties under the regulations are to be imposed by the members of CFIUS and may be recovered in a civil action in federal district court.[42]

Issues arise on both sides of the CFIUS review process, from U.S. authorities seeking to protect national security, to foreign investors concerned about the level of public disclosure and the scrutiny they may undergo. The increased international attention to SWFs has led not only to a desire for more stringent review in the United States, but also to a push to establish best practices and standards for SWF investments.

40. *Id. See also* 50 U.S.C. app. § 2170(c) (2009).
41. 31 C.F.R. § 800.702(d) (2009).
42. 31 C.F.R. § 800.801(a)–(b) (2009); 31 C.F.R. § 800.801(d)–(f) (2009).

Chapter 3

U.S. and International Best Practices*

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§ 3:1 Overview
§ 3:2 Recipient Country Concerns
§ 3:3 SWF Concerns
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§ 3:5 OECD SWFs and Recipient Country Policies
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Appendix 3A OECD Declaration on SWFs and Recipient Country Policies
Appendix 3B SWFs Generally Accepted Principles and Practices

§ 3:1 Overview

The increasing size, visibility, and investments of sovereign wealth funds (SWFs) in recent years have led to various concerns by both the recipient countries of such investments and by the SWFs making such investments. The global recession has undeniably tempered many of these concerns, as the rate of investment and the targets of such investments has shifted. However, this delay follows an intense period in which SWFs, recipient countries, and international organizations concerned with the investment practices of SWFs worked to address these various concerns through the establishment of best practices when undertaking such investments. This chapter will discuss the concerns relating to SWF investment by both the recipient countries

* The following Curtis lawyers were instrumental in the preparation of this chapter: Bradley Doline and H. Michael Zografakis. The author thanks them for their invaluable assistance.

receiving such investments and the SWFs making such investments, before focusing on the best practices established by the U.S. Department of Treasury, the Organization for Economic Cooperation and Development (OECD), and an International Monetary Fund (IMF)-initiated working group on SWFs.

§ 3:2 Recipient Country Concerns

As discussed in the previous chapter, several controversies surrounding SWF investment developed in recent years as the level of SWF investment increased. The controversy surrounding DP World's acquisition of Peninsular and Oriental Navigation Company ("P&O") was, at least in part, based on the reluctance of the United States to allow a foreign entity to control an asset as vital to industry as the port system. More specifically, many constituencies in the United States were concerned that the investment objectives in connection with this investment could be driven by a variety of factors that potentially could expose the United States economically, politically, or otherwise. The investment objectives of SWFs, along with the lack of transparency in many sovereign investment entities, and the potential effects an investment by a SWF may have on the domestic economy, are concerns that have risen to the forefront in discussions regarding SWF investment practices in recent years.

Recipient countries of SWF investment are primarily concerned with the motivations behind such investment. The nature of SWFs, as investment vehicles owned and operated by governmental bodies, creates a potential conflict with respect to the treatment of an investment by those who influence its direction. Recipient countries may be concerned that an investment by a foreign entity is driven not by economic factors, but instead by political factors. Often, this issue arises when a foreign entity wishes to invest in an industry that the recipient country considers to be a vital industry for purposes of that country's domestic security, which potentially could expose such recipient country's domestic security. Normally, investments are made for purely economic reasons. However, the ownership of SWFs may create a tension between the economic realities of an investment and the potentially political background and objectives of those controlling such investment.

This issue is further compounded by the lack of transparency in many SWFs—specifically, the lack of transparency surrounding decision-making authority. For recipient countries, whether an investment is made in what a recipient country may deem to be a "vital" industry or otherwise, the idea that the ultimate source of decision-making authority is unknown can be an unsettling proposition. Without understanding who has the authority to make decisions in an organization, it is difficult to reconcile the true aims and objectives of that organization.

In addition, the lack of transparency can contribute to uncertainty in the marketplace, an issue that has risen to the forefront in light of the global recession. Recipient countries, and their respective markets, may find it difficult to evaluate the value of a given investment and the underlying asset without access to specific information regarding the performance of an investment and the financial health of the organization making such investment. As a result, there is greater potential for statistical distortion—a potentially market destabilizing effect. For these reasons, the lack of transparency of SWFs and their investments is a significant cause of the reluctance of recipient countries to accept such investments.

If a SWF stays on the sidelines in a given investment, in essence, foregoing what is often the right of a significant investor to have a voice in the corporate governance of the business in which the investment is made, then there is generally less concern by the recipient country. However, if a SWF more actively exercises its right to a representative corporate voice, then the issue of transparency and the recipient country's reconciliation with the objectives of the SWF is more likely to arise. Many SWFs have, in fact, become more active investors for a variety of reasons, such as to gain specific knowledge of (i) a given industry, (ii) sophisticated financial instruments and investing in general, or (iii) the corporate governance that goes along with such investments. Depending on how developed the recipient country's laws are with respect to business entities, a lack of transparency by an investing SWF that controls a board of directors or that has a significant influence on a company may unsettle investors and potentially create interruptions in such company's business. The corporate governance laws of many countries have trended towards openness in order to ensure that full information is available for the market to evaluate a company and its controlling persons; it is with

regard to this issue that a SWF's investment could come under additional scrutiny.

Many of the issues that recipient countries of SWF investments may have focus on transparency, or the traditional lack thereof, of SWFs. Whether driven by politics or economics, these concerns have been raised and discussed in recent years, due to the increased investment activity of SWFs. Concurrent with the exploration of these concerns, however, many SWFs have taken a proactive approach in alleviating these issues and addressing certain internal matters of concern, which may have further positive benefits.

§ 3:3 SWF Concerns

The shift in the approach of recipient countries to investments by SWFs has also caused the SWFs making such investments to reevaluate their goals and focus their attention on protecting not only their investments, but also their ability to make such investments. As their level of sophistication has risen, commensurate with their increased investment activity, many SWFs have taken a more proactive approach to their internal organization in an effort to ensure that any potential investments may be facilitated more easily and maintained more efficiently. The main areas of SWFs that have seen significant improvement over the last decade are: (i) in the definition of their investment objectives, (ii) in their governance, and (iii) in their transparency both within and vis-à-vis governmental entities.

Some SWFs have made a concerted effort to define their investment objectives, through the establishment of clear investment policies, in order to alleviate some concerns of recipient countries. In addition, some SWFs have started to disclose more information about their respective asset allocations to further increase the awareness of their investment objectives. This step, however, has not gained significant popularity and, it may be argued, may actually weaken the position of SWFs at the negotiating table. Generally, the establishment of a clear investment policy was an element of SWF investing that was viewed as a purely internal matter. However, the external benefits of clearly defining these policies has become more apparent to SWFs. The gradual shift away from viewing investment objectives as a purely internal matter is a product, in part, of the call by recipient countries for more information about the investments, and the goals of such in-

vestments, being made by SWFs in their respective countries. For a SWF that has an established investment policy, there is tangible evidence that such SWF can use such policy in order to support the basis for their investment and defend against any external scrutiny by a recipient country.

Another area that has become a focus for SWFs is the governance structure of such funds. Traditionally, there has not been a formal structure by which SWFs were governed; of course, by their very nature SWFs may be set up in any manner that they so choose. However, as SWFs have interacted with other institutions and have been exposed to best practices throughout the financial industry, many SWFs have restructured their vehicles to better conform to such best practices. In addition to the operational efficiencies that result from imposing a clear legal structure, many SWFs have had the added benefit of further alleviating concerns that a recipient country may have with respect to the flow of funds in a sovereign institution. The implementation of a clear legal structure provides a framework that potential recipients of an investment may understand in order to determine who has the ultimate decision-making authority. Inextricably linked with this concept is the idea that, as a result, the investment objectives of a SWF may be better gauged by recipient countries. Again, for SWFs that are looking to take an active approach to investing, the benefits of creating a governance structure that is consistent with other vehicles of the same type not only has internal benefits, but external benefits as well.

Finally, the overriding theme of both the establishment of clear investment objectives and the imposition of a clear governance structure is the idea of transparency. The call for greater transparency of SWFs has been echoed by many organizations as well as governments of recipient countries of SWF investment. As a result, SWFs have recognized that the opening up of certain decision-making processes, and the source of their funds, greatly reduces the questions that may arise in connection with any potential investments. The transparency of SWFs often has a domestic benefit as well; if a SWF is transparent about how investment decisions are made and by whom, it allows for greater coordination between domestic fiscal and monetary authorities. Since many SWFs have grown to significant size relative to their respective home countries' economies, the investments that the funds make can have a significant impact on their respective domestic mar-

kets. This transparency further assists those foreign analysts that are charged with assessing the financial health and stability of nations that maintain SWFs, creating an additional spillover benefit for such SWFs.

The concerns of both recipient countries of SWF investments, as well as the SWFs making such investments, have been brought to the forefront in recent years in connection with the rise of their investment activities. The concerns discussed above provide a framework by which several entities, both governmental and non-governmental, have been able to assess their relative positions and take significant steps towards improving the investment climate and ensuring a more free flow of capital.

§ 3:4 Joint Statement of Principles for SWF Investment

On March 20, 2008, officials from the U.S. Department of the Treasury, the governments of Singapore and Abu Dhabi, and SWFs Abu Dhabi Investment Authority and Government of Singapore Investment Corporation met to discuss issues surrounding SWFs, recipient country inward investment regimes, and efforts to develop best practices.[1] Following the meeting, the participants released a joint statement outlining certain policy principles intended to further their "common interest in an open and stable international financial system."[2]

The policy principles established for investing SWFs are:

(i) basing investment decisions solely on commercial grounds and not the geopolitical goals of the controlling government;

(ii) increasing information disclosure, in areas such as purpose, investment objectives, and financial information, to help reduce uncertainty in financial markets and build trust in recipient countries;

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1. Press Release, U.S. Department of the Treasury, Treasury Reaches Agreement on Principles for SWF Investment with Singapore and Abu Dhabi (Mar. 20, 2008), *available at* www.ustreas.gov/press/releases/hp881.htm (last visited Mar. 11, 2010).
2. *Id.*

(iii) implementing strong governance structures, internal controls, and operational and risk management systems;

(iv) promoting fair competition between funds and the private sector; and

(v) respecting host-country rules by complying with all applicable regulatory and disclosure requirements of the countries in which they invest.[3]

The policy principles established for recipient countries are:

(i) prohibiting the implementation of protectionist barriers to portfolio or foreign direct investment;

(ii) ensuring predictable investment frameworks accompanied by inward investment rules that are publicly available, clear, predictable, and supported by a consistent rule of law;

(iii) preventing discrimination among investors; and

(iv) respecting investor decisions by being as unintrusive as possible and ensuring that limitations imposed on investments for national security reasons are proportional to actual risks raised by the transaction.[4]

The policy principles released by the participants were intended to further the efforts of the OECD and the IMF in "develop[ing] voluntary best practices for [SWFs] and inward investments regimes for government-controlled investment in recipient countries."[5] The nations participating in the joint statement believed that "international agreement on a set of voluntary best practices will create a strong incentive among [SWFs] and investment-recipient countries to hold themselves to high standards."[6] After the release of this joint statement, the OECD and IMF released their own set of policies and procedures in the spring and fall of 2008, respectively.

3. *Id.*
4. *Id.*
5. *Id.*
6. *Id.*

§ 3:5 OECD SWFs and Recipient Country Policies

In the fall of 2007, the G7 Finance Ministers and other members of the OECD requested that the OECD Investment Committee (the "Investment Committee") develop guidance for recipient countries' policies toward investment by SWFs. This request was addressed as part of the OECD's ongoing project on Freedom of Investment, National Security and "Strategic Industries" (FOI), which was launched in 2006 in light of the rise in investment protectionism and to maintain open markets. The Investment Committee delivered its report on "Sovereign Wealth Funds (SWFs) and Recipient Country Policies" to the G7 Finance Ministers on April 4, 2008 (the "Report").

The Investment Committee found that SWFs bring benefits to home and host countries, and that existing OECD investment instruments are "well suited to develop guidance for countries receiving investments from [SWFs]."[7] The Investment Committee believes that the OECD's existing investment instruments contain the fundamental principles for recipient country policies needed for the required guidance. The key OECD investment instruments are the OECD Code of Liberalisation of Capital Movements and the OECD Declaration on International Investment and Multinational Enterprises of 1976 (together, the "Instruments"). Generally, the Instruments express a common understanding of fair treatment of foreign investors, commit adhering governments to build this fair treatment into their investment policies, and provide for the periodic review of an adhering government's observance of these commitments by their peers.[8] The Instruments embody the following principles that are applicable to the policies of recipient countries: (i) non-discrimination (foreign investors are to be treated not less favorably than domestic investors in like situations); (ii) transparency (information on restrictions on foreign investment should be comprehensive and accessible to everyone); (iii) progressive liberalization (members commit to the gradual elimination of restrictions on capital movements across their countries); (iv) "standstill" (members commit to not introducing new restrictions); and (v) unilateral liberalization (members also commit to al-

7. OECD, SWFs and Recipient Country Policies (Apr. 4, 2008), *available at* www.oecd.org/dataoecd/34/9/40408735.pdf (last visited Mar. 11, 2010).
8. *Id.*

lowing all other members to benefit from the liberalization measures they take and not to condition them on liberalization measures taken by other countries).[9]

The Report also indicated that participants in the FOI project agreed on a number of key principles that should guide governments in the design and implementation of measures intended to address national security concerns in the context of foreign investment.[10] While investments controlled by foreign governments can raise national security concerns, OECD members agreed that the national security clause of the Instruments should not be a cover for protectionist policies. Among other agenda items, the FOI sought to develop broad practices and principles for recipient country policies toward SWFs that would address legitimate national security concerns while preserving and broadening the international investment system. The agreed-upon principles, which include transparency, predictability, proportionality, and accountability, are relevant both broadly and to addressing national security concerns that arise in the context of SWF investments. Participants in the FOI agreed on the following guidance for investment policy measures designed to safeguard national security, which is applicable to host countries receiving investments from SWFs:

- **Non-discrimination.** Governments should be guided by the principle of non-discrimination and should rely on measures of general application that treat similarly situated investors in a similar fashion.
- **Transparency/predictability.** While sensitive information should remain confidential, regulatory objectives and practices should be made as transparent as possible in order to increase the predictability of outcomes. In order to further transparency and predictability, (i) laws should be codified and published in a convenient and readily available form; (ii) interested parties should receive prior notification when a government plans to change its investment policies; (iii) interested parties should be consulted by a government when it

9. *Id.*
10. *Id.*

is considering changing its investment policies; (iv) when reviewing procedures for foreign investments, strict time limits should be applied, commercially sensitive information should be protected and the procedure itself should be conducted in a fair and predictable fashion; and (v) investment policy actions should be adequately disclosed by governments, but commercially sensitive and classified information should be protected from any such disclosure.

- **Regulatory proportionality.** Investment restrictions or transaction conditions should be limited to only what is needed to protect national security, and they should be avoided altogether when other measures exist that are adequate and appropriate to address a national security concern. In order to foster the concept of regulatory proportionality: (i) in determining what is necessary to protect its national security, each country should use risk assessment techniques that are rigorous and reflect its circumstances, institutions and resources; (ii) investment restrictions should be narrowly focused on national security concerns; (iii) security-related investment measures should be designed to benefit from adequate national security expertise and expertise in weighing the implications of actions relating to the benefits of open investment policies and the impact of restrictions; (iv) the scope of restrictive investment measures, if any, should be limited to the specific risks posed by specific investment proposals; and (v) when other policies fail to eliminate security-related concerns, restrictive investment measures may be used as a last resort.
- **Accountability.** In order to ensure accountability of the authorities implementing these investment policy measures, host countries should consider introducing procedures for parliamentary oversight, judicial review, periodic assessments, and requiring that decisions to block an investment are taken at a high level of government.[11]

The Report was welcomed and discussed at the OECD Ministerial Council Meeting held in June 2008. On the basis of the Report, the

11. *Id.*

Ministers of the OECD countries endorsed a set of policy principles for countries receiving SWF investments that were adopted by the Ministers on June 5, 2008 in the OECD Declaration on SWFs and Recipient Country Policies (the "Declaration," see Appendix 3A).[12] The principles adopted in the Declaration reflect long-standing OECD commitments to promote an open global investment environment, and are consistent with OECD countries' rights and obligations under the Instruments. The principles set forth in the Declaration, which reflect the basic tenets of the principles set forth in the Instruments and the Report, are:

(i) recipient countries should not erect protectionist barriers to foreign investment;

(ii) recipient countries should not discriminate among investors in like circumstances and any additional investment restrictions only should be considered when generally applied policies fail to address legitimate national security concerns; and

(iii) where such national security concerns do arise, the investment safeguards implemented by recipient countries should be transparent and predictable, proportionately applied, and subject to accountability in their application.[13]

The OECD presented the Declaration, the Instruments, the Reports, and the FOI process in a message delivered to the International Monetary and Financial Committee, a policy-guiding committee of the Board of Governors of the IMF, on October 11, 2008. When taken together with the International Working Group of SWFs' Generally Accepted Principles and Practices (the "GAPP," see Appendix 3B), the OECD believes that its "guidance to recipient countries and the GAPP for [SWFs will] provide the international community with a robust framework for promoting mutual trust and confidence and reaping the full benefits of [SWFs] for home and host countries."[14]

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12. OECD, OECD Declaration on SWFs and Recipient Country Policies (June 5, 2008), *available at* www.olis.oecd.org/olis/2008doc.nsf/LinkTo/NT000032DE/$FILE/JT03247225.PDF (last visited Mar. 11, 2010).
13. *Id.*
14. OECD, Message by the OECD Secretary-General to the International Monetary and Financial Committee (Oct. 11, 2008), *available at* www.oecd.org/dataoecd/0/23/41456730.pdf (last visited Mar. 11, 2010).

§ 3:6 International Working Group of SWFs

On October 11, 2008, the International Working Group of SWFs (IWG) presented the GAPP, otherwise known as the "Santiago Principles," to the International Monetary and Financial Committee. The IWG was established on May 1, 2008 at a meeting of countries with SWFs with the objective "to draft a common set of voluntary principles that would promote a clearer understanding of the institutional framework, governance and investment operations of SWFs and would support the maintenance of an open and stable investment climate globally."[15]

The Santiago Principles represent a collaborative effort by SWFs across advanced, emerging, and developing country economies to set out a comprehensive framework and provide a clearer understanding of the operations of SWFs.[16] The IWG published the Santiago Principles with the belief that it "will in both home and recipient countries improve the understanding of the objectives, structures, and governance arrangements of [SWFs]; enhance the understanding of [SWFs] as economically and financially oriented entities; and help maintain an open and stable investment climate."[17]

In establishing a set of generally accepted principles and practices that reflect the general investment practices and objectives of SWFs, the Santiago Principles center around the following key areas: (i) legal framework, objectives, and coordination with macroeconomic policies; (ii) institutional framework and governance structure; and (iii) investment and risk management framework.[18] Furthermore, the Santiago Principles are guided by the overall objectives of implementing a transparent and sound governance structure, ensuring compliance with applicable regulatory and disclosure requirements in recip-

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15. Press Release No. 08/06, International Working Group of SWFs, International Working Group of SWFs Presents the "Santiago Principles" to the International Monetary and Financial Committee (Oct. 11, 2008), *available at* www.iwg-swf.org/pr/swfpr0806.htm (last visited Mar. 11, 2010).
16. *Id.*
17. *Id.*
18. International Working Group on SWFs, SWFs Generally Accepted Principles and Practices: "Santiago Principles" (Oct. 2008), *available at* www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf (last visited Mar. 11, 2010). *See* Appendix 3B.

ient countries, ensuring investments are based on commercial objectives, and helping maintain a stable and free-flowing global financial system.[19]

The Santiago Principles consist of twenty-four voluntary principles and related explanatory material. Some of the more salient principles and practices, each of which is implemented on a voluntary basis and is subject to home country laws, regulations, requirements, and obligations, include the following:

- **GAPP Principle 2.** *The policy purpose of the SWF should be clearly defined and publicly disclosed.* A clearly defined and publicly disclosed policy purpose will help a SWF develop appropriate investment strategies, ensure that a SWF's operational management conducts itself professionally, and ensure that investments are undertaken without any geopolitical agenda of the government sponsor.
- **GAPP Principle 6.** *The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.* In order to ensure that a SWF's investment decisions and operations are based on commercial considerations rather than political considerations, its operational management should be conducted on an independent basis and should be clearly delineated in its legal framework.
- **GAPP Principle 15.** *SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.* With respect to its investment activities in a host country, a SWF should abide by any national securities laws or anti-monopoly rules, provide disclosure to local regulators upon request, be subject to local regulators, and comply with all applicable tax rules. However, it is expected that a host country will not subject the SWF to any requirement or regulatory action greater than what a similarly situated investor would be subject to.

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19. *Id.*

- **GAPP Principle 16.** *The governance framework and objective, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.* This Principle would help to promote a clear understanding of what a SWF seeks to achieve, which may help reassure a recipient country's concern that investments made by a SWF are based on commercial considerations and employ sound operational controls and risk management systems.
- **GAPP Principle 17.** *Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.* The disclosures promoted by this Principle along with disclosure of certain items specified in other Principles are intended to contribute to stabilizing international financial markets and enhancing trust in recipient countries.
- **GAPP Principle 20.** *The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.* The purpose of this Principle is to promote fair competition and to prevent a SWF from using its government's privileged access to market sensitive information to put itself in a more advantageous position.[20]

While the IWG believes that the Santiago Principles represent a framework that properly reflects appropriate governance and accountability arrangements as well as the conduct of investment practices by SWFs, it also recognizes that several aspects could benefit from further study and work, especially as the macroeconomic and financial stability implications of SWF investments change and their practices develop. To that end, the IWG announced on April 6, 2009 the establishment of the International Forum of SWFs (the "Forum"). Established pursuant to the "Kuwait Declaration," the purpose of the Forum is to meet at least annually to exchange views on issues of common interest and to facilitate an understanding of the Santiago

20. *Id.*

Principles and SWF activities.[21] Through its work, the Forum aims to contribute to the development and maintenance of an open and stable investment environment, and to further the guiding objectives of the Santiago Principles.[22]

As the OECD, the IMF, and their respective members continue to work towards developing a set of best practices and principles to address the concerns of recipient countries and SWFs, the Report and the GAPP have greatly helped in allaying these concerns and fostering a sense of trust and understanding between recipient countries and SWFs. While it is difficult to gauge the full impact of the Report and the GAPP on the activities of SWFs and recipient countries, due in large part to the global financial crisis that has negatively affected the foreign investment activities of several SWFs, the Report and the GAPP have created the foundation for an environment in which SWFs and recipient countries work in concert rather than in opposition to each other. As a sense of normalcy returns to the global financial markets, the Report and the GAPP will provide a framework that will help to foster mutually beneficial situations where SWFs enjoy fair treatment in the markets of recipient countries and these countries can resist the pressures to take protectionist actions against them.

21. International Working Group of SWFs, "Kuwait Declaration": Establishment of the International Forum of SWF (Apr. 6, 2009), *available at* www.iwg-swf.org/mis/kuwaitdec.htm (last visited on Mar. 11, 2010).
22. *Id.*

Appendix 3A

OECD Declaration on SWFs and Recipient Country Policies

Unclassified C/MIN(2008)8/FINAL

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development 05-Jun-2008

English/French

COUNCIL

C/MIN(2008)8/FINAL
Unclassified

Meeting of the Council at Ministerial Level, 4-5 June 2008

OECD DECLARATION ON SOVEREIGN WEALTH FUNDS AND RECIPIENT COUNTRY POLICIES

(Adopted by Ministers of OECD countries at the Council at Ministerial level, on 5 June 2008)

JT03247225

Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format

English/French

C/MIN(2008)8/FINAL

At the OECD Ministerial Council Meeting on 4-5 June in Paris Ministers of OECD countries*

- Welcomed the constructive contribution that Sovereign Wealth Funds (SWFs) make to the economic development of home and host countries. To date they have been reliable, long-term, commercially-driven investors and a force for global financial stability.

- Recognised that if SWF investments were motivated by political rather than commercial objectives, they could be a source of concern, and that legitimate national security concerns could arise.

- Welcomed international discussions involving SWFs, their governments and recipient governments. These increase understanding, contribute to mutual trust and confidence, and help avoid protectionist responses that could undermine economic growth and development.

- Noted that the home countries of SWFs and SWFs themselves can enhance confidence by taking steps to strengthen transparency and governance in the SWFs.

- Supported the work of the IMF on best practices for SWFs as an essential contribution and the continuing coordination between the OECD and the IMF.

- Noted that the OECD for its part has been working on best practices for recipient countries. Together the IMF and OECD will help preserve and expand an open international investment environment for SWFs while safeguarding essential security interests.

- Welcomed the Report by the OECD Investment Committee on SWFs and Recipient Country Policies, which reflects inputs from both OECD and emerging economies, and looked forward to future work, including peer monitoring of policy developments and broader consideration of foreign-government controlled investments.

- Based on this Report, Ministers endorsed the following policy principles for countries receiving SWF investments. These principles reflect long-standing OECD commitments that promote an open global investment environment. They are consistent with OECD countries' rights and obligations under the OECD investment instruments.

  - Recipient countries should not erect protectionist barriers to foreign investment.

  - Recipient countries should not discriminate among investors in like circumstances. Any additional investment restrictions in recipient countries should only be considered when policies of general application to both foreign and domestic investors are inadequate to address legitimate national security concerns.

  - Where such national security concerns do arise, investment safeguards by recipient countries should be:

    - transparent and predictable,

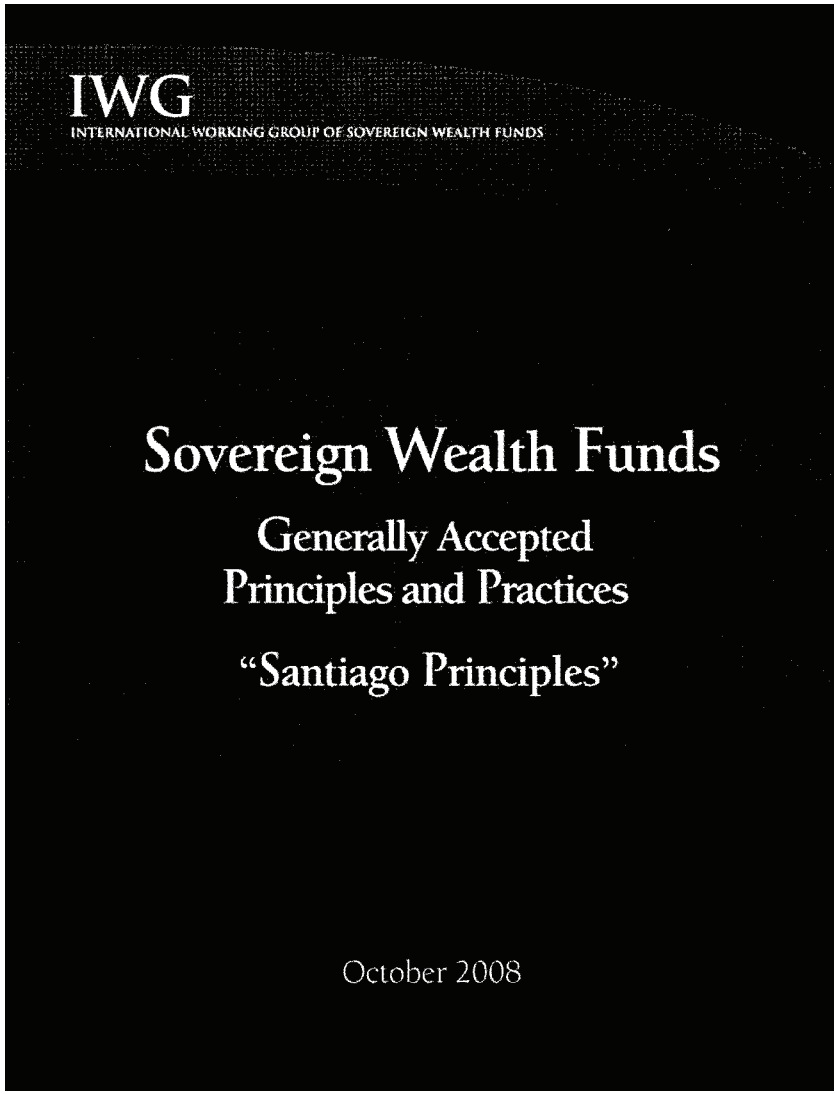
    - proportional to clearly-identified national security risks, and

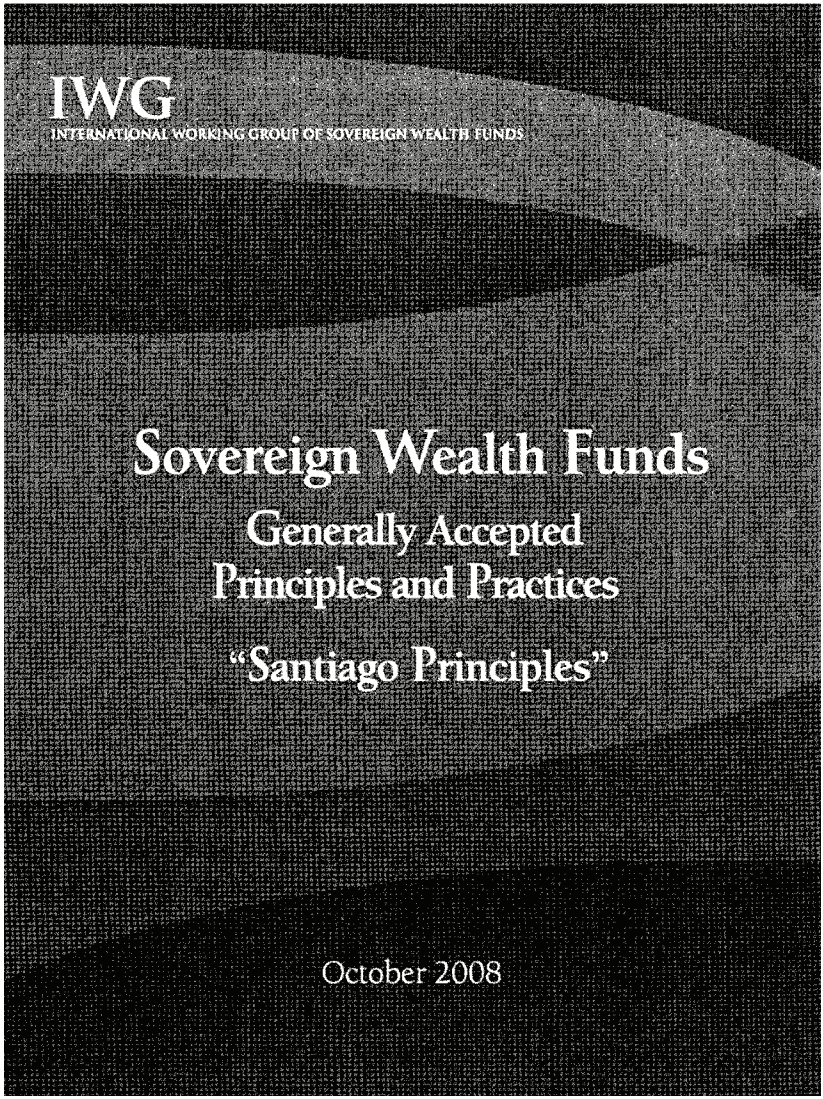
    - subject to accountability in their application.

* Ministers of Chile, Estonia and Slovenia adhered to this Declaration in the name of their government on 5 June 2008.

Appendix 3B

SWFs Generally Accepted Principles and Practices—"Santiago Principles"




IWG
INTERNATIONAL WORKING GROUP OF SOVEREIGN WEALTH FUNDS
Sovereign Wealth Funds
Generally Accepted
Principles and Practices
"Santiago Principles"
October 2008

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Abbreviations and Acronyms

ADIA	Abu Dhabi Investment Authority
CEO	Chief executive officer
CIC	China Investment Corporation
GAPP	Generally accepted principles and practices
GIC	Government of Singapore Investment Corporation
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IWG	International Working Group of Sovereign Wealth Funds
KIA	Kuwait Investment Authority
KIC	Korea Investment Cooperation
LIA	Libyan Investment Authority
OECD	Organization for Economic Cooperation and Development
QIA	Qatar Investment Authority
SOE	State-owned enterprise
SWF	Sovereign wealth fund
UAE	United Arab Emirates

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Introduction

Sovereign wealth funds (SWFs) have recently been recognized as well-established institutional investors and important participants in the international monetary and financial system. This was highlighted by the International Monetary and Financial Committee (IMFC) when, in October 2007, it expressed the need for further analysis of key issues for investors and recipients of SWF flows, including a dialogue on identifying best practices.[1]

The International Working Group of Sovereign Wealth Funds (IWG) was established at a meeting of countries with SWFs on April 30–May 1, 2008, in Washington, D.C. In the meeting, it was agreed that the IWG would initiate the process, facilitated and coordinated by the International Monetary Fund (IMF). Hamad Al Hurr Al Suwaidi, Undersecretary of Abu Dhabi Finance Department, and Jaime Caruana, Director of the Monetary and Capital Markets Department of the IMF, were selected to co-chair the IWG.

The IWG comprises 26 IMF member countries with SWFs.[2] The IWG met on three occasions—in Washington, D.C., Singapore, and Santiago (Chile)—to identify and draft a set of generally accepted principles and practices (GAPP) that properly reflects their investment practices and objectives, and agreed on the Santiago Principles at its third meeting. A subgroup of the IWG—chaired by David Murray, Chairman of the Australian Future Fund Board of Guardians—was also formed to carry forward the technical drafting work. The drafting group met on three occasions—in Oslo (Norway), Singapore, and Santiago—to draft the GAPP. In carrying out its work, the IWG used the findings of the IMF-commissioned voluntary SWF Survey[3] on current structures and practices, and drew from

[1]The IMFC is a committee of the Board of Governors of the International Monetary Fund (IMF), comprising representatives—typically ministers of finance and central bank governors—of all 185 IMF member countries.

[2]IWG member countries are Australia, Azerbaijan, Bahrain, Botswana, Canada, Chile, China, Equatorial Guinea, Islamic Republic of Iran, Ireland, Korea, Kuwait, Libya, Mexico, New Zealand, Norway, Qatar, Russia, Singapore, Timor-Leste, Trinidad and Tobago, the United Arab Emirates, and the United States. Permanent observers of the IWG are Oman, Saudi Arabia, Vietnam, the OECD, and the World Bank. For a complete set of countries and associated representatives, see Appendix II.

[3]See *Sovereign Wealth Funds: A Survey of Current Institutional and Operational Practices*. Available via the Internet: www.iwg-swf.org/pub.htm.

related international principles and practices that have already gained wide acceptance in related areas.

The IWG also benefited from input from a number of recipient countries—Australia, Brazil, Canada, France, Germany, India, Italy, Japan, South Africa, Spain, the United Kingdom, and the United States—as well as from the European Commission,[4] the OECD, and the World Bank. The IMF facilitated and coordinated the IWG's work, and acted as the IWG secretariat (see Appendix II)

[4]At the IWG, the European Commission is acting on behalf of the European Union, as agreed by the European Council on March 14, 2008.

Hamad Al Hurr Al Suwaidi
IWG Co-Chair and Undersecretary,
Abu Dhabi Finance Department

Jaime Caruana
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Monetary and Capital Markets Department
International Monetary Fund

October 2008

Santiago Principles: Objective and Purpose

Sovereign wealth funds (SWFs) are special-purpose investment funds or arrangements that are owned by the general government.[5,6] Created by the general government for macro-economic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies that include investing in foreign financial assets.[7] SWFs have diverse legal, institutional, and governance structures. They are a heterogeneous group, comprising fiscal stabilization funds, savings funds, reserve investment corporations, development funds, and pension reserve funds without explicit pension liabilities. Appendix I discusses the definition of an SWF in more detail, and Appendix III contains short descriptions of SWFs in the International Working Group of Sovereign Wealth Funds (IWG).

As well-established institutional investors, SWFs have been undertaking cross-border investing for many years. Their investments have helped promote growth, prosperity, and economic development in capital-exporting and -receiving countries. In their home countries, SWFs are institutions of central importance in helping to improve the management of public finances and achieve macroeconomic stability, and in supporting high-quality growth. SWFs also bring substantial benefits to the global markets. Their ability in many circumstances to take a long-term view in their investments and ride out business cycles brings important diversity to the global financial markets, which can be extremely beneficial, particularly during periods of financial turmoil or macroeconomic stress.

Recently the rapid accumulation of foreign assets in some countries has resulted in the growing number and size of SWFs. Various projections suggest that their presence in international capital markets is set to increase further. As a result of the SWFs' increasing level of assets invested in public and private equity holdings, they are exercising greater influence on corporate governance practices.[8]

[5]General government includes both central government and subnational government.

[6]These exclude, *inter alia*, foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, state-owned enterprises (SOEs) in the traditional sense, government-employee pension funds, or assets managed for the benefit of individuals.

[7]SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.

[8]Although SWFs may still be relatively small in comparison with total global financial assets, they are significant relative to both mature market stock market capitalization and emerging market economies' debt and capital markets. According to market sources, the estimated size of SWFs is US$2–$3 trillion, while according to the IMF *Global Financial Stability Report*, October 2007, page 139, total global financial assets are estimated at US$190 trillion, mature market stock market capitalization at US$39.2 trillion, and emerging market economies' debt and capital markets at US$17.8 trillion.

The IWG recognizes that SWF investments are both beneficial and critical to international markets. For that purpose, it will be important to continue to demonstrate—to home and recipient countries, and the international financial markets—that the SWF arrangements are properly set up and investments are made on an economic and financial basis. The generally accepted principles and practices (GAPP), therefore, is underpinned by the following guiding objectives for SWFs:

i. To help maintain a stable global financial system and free flow of capital and investment;

ii. To comply with all applicable regulatory and disclosure requirements in the countries in which they invest;

iii. To invest on the basis of economic and financial risk and return-related considerations; and

iv. To have in place a transparent and sound governance structure that provides for adequate operational controls, risk management, and accountability.

Purpose

The purpose of the GAPP is to identify a framework of generally accepted principles and practices that properly reflect appropriate governance and accountability arrangements as well as the conduct of investment practices by SWFs on a prudent and sound basis. Elements of the GAPP have been drawn from a review of existing SWF practices used in a number of countries and a distillation of principles and practices applicable to SWF activities that are already in use in other international fora (see reference list on page 49). Making the GAPP known will help to increase understanding of SWFs to home and recipient countries and the international financial markets. The GAPP also seeks to ensure that through the pursuit of these principles and practices, SWFs continue to bring economic and financial benefits to home countries, recipient countries, and the international financial system.

The GAPP aims at supporting the institutional framework, governance, and investment operations of SWFs that are guided by their policy purpose and objectives, and consistent with a sound macroeconomic policy framework. Publication of the GAPP should help improve understanding of SWFs as economically and financially oriented entities in both the home and recipient countries. This understanding aims to contribute to the stability of the global financial system, reduce protectionist pressures, and help maintain an open and stable investment climate. The GAPP would also enable SWFs, especially newly established ones, to develop, review, or strengthen their organization, policies, and investment practices.[9]

To ensure success of the GAPP, a constructive and collaborative response from the recipient countries will be essential. The IWG is of the view that the GAPP, together with the OECD's guidance for recipient countries,[10] will help achieve the shared goal of maintaining a stable and open investment environment. Increased transparency—both by the SWFs on their structure and

[9]It is understood that application of some or all of the GAPP may not be relevant or appropriate to the extent of SWFs' domestic assets.

[10]The OECD Investment Committee has adopted a report on recipient country policies in relation to SWFs, which was endorsed by OECD ministers in early June 2008. See OECD Investment Committee Report, April 4, 2008: "The OECD will continue its work on how governments can maintain their commitment to open international investment policies—including for SWFs—while also protecting essential security interests. The resulting framework will foster mutually-beneficial situations where SWFs enjoy fair treatment in the markets of recipient countries and these countries can confidently resist protectionism pressures."

operations, and by recipient countries on their investment screening processes and equal treatment of investors—is one of the key factors in achieving this shared goal.

Nature

The GAPP is a voluntary set of principles and practices that the members of the IWG support and either have implemented or aspire to implement. The GAPP denotes general practices and principles, which are potentially achievable by countries at all levels of economic development. The GAPP is subject to provisions of intergovernmental agreements, and legal and regulatory requirements. Thus, the implementation of each principle of the GAPP is subject to applicable home country laws.

The principles and practices laid out in the GAPP, along with their explanatory notes, can be expected to guide existing and future SWFs in various aspects of their activities—most importantly investing professionally in accordance with their investment policy objectives—and to help inform any associated legal and institutional reform. As investment institutions, SWFs operate on a good faith basis, and invest on the basis of economic and financial risk and return-related considerations. In doing so, they comply with applicable regulatory and disclosure requirements in their home countries and in the countries in which they invest.

Structure

The GAPP covers practices and principles in three key areas. These include (i) legal framework, objectives, and coordination with macroeconomic policies; (ii) institutional framework and governance structure; and (iii) investment and risk management framework. Sound practices and principles in the first area underpin a robust institutional framework and governance structure of the SWF, and facilitate formulation of appropriate investment strategies consistent with the SWF's stated policy objectives. A sound governance structure that separates the functions of the owner, governing body(ies), and management facilitates operational independence in the management of the SWF to pursue investment decisions and investment operations free of political influence. A clear investment policy shows an SWF's commitment to a disciplined investment plan and practices. Also, a reliable risk management framework promotes the soundness of its investment operations and accountability.

This document consists of three parts—the GAPP (Part I); a discussion of the GAPP, where each GAPP principle and subprinciple has an accompanying explanatory note that provides the underlying rationale and objective for the principle in question, together with examples on how the principle has been implemented in some countries (Part II); and appendix and reference material, including a definition of SWFs, background information of SWFs represented in the IWG, and references to professional literature and other international standards and codes, parts of which are applicable to SWFs (Part III).

Implementation and Review

The IWG recognizes the evolving nature of international capital flows, and the fact that some SWFs are still in the process of establishing their operations. Other forms of sovereign investment arrangements may still emerge. Therefore, especially for newer SWFs, the implementation of the GAPP (e.g., GAPPs 17 and 22) may be challenging and require an appropriate transitional period. For example, under GAPP 17, it is recognized that some newly established SWFs may require time to reach their desired long-term asset allocation and related performance standards and to be able to disclose the relevant information indicated in this principle. For these SWFs, there are different time frames in which this can be completed, reflecting the different investment objectives, strategies, and time horizons implied by the particular

strategic asset allocation strategy. For others, which may already be following well-established practices, the GAPP may be considered as setting a minimum standard. However, the GAPP is formulated broadly enough so that underlying principles and practices can be accommodated in different institutional, constitutional, and legal settings existing in various countries.

The IWG also recognizes that several aspects of the GAPP could benefit from further study and work, such as those relating to the provision of comprehensive and reliable information about past, present, and future activities of an SWF, and potential risks to investment operations and SWF balance sheets. Likewise, as the macroeconomic and financial stability implications of SWF investments change and SWF practices develop, some aspects of the GAPP may need re-examination. Continuing coordination and consultation at the international level also could be desirable on issues of common interest to the SWFs.

To facilitate this, the IWG has agreed to explore the establishment of a standing group of SWFs. This group would be able to keep the GAPP under review, as appropriate, and facilitate the dissemination, proper understanding, and implementation of the GAPP. The standing group also would provide SWFs with a continuing forum for exchanging ideas and views among themselves and with recipient countries. The group could also examine ways through which aggregated information on SWF operations could be periodically collected, made available, and explained.

Generally Accepted Principles and Practices (GAPP)—Santiago Principles

In furtherance of the "Objective and Purpose," the IWG members either have implemented or intend to implement the following principles and practices, on a voluntary basis, *each of which is subject to* home country laws, regulations, requirements and obligations. This paragraph is an integral part of the GAPP.

GAPP 1. Principle
The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).

GAPP 1.1. Subprinciple. The legal framework for the SWF should ensure legal soundness of the SWF and its transactions.

GAPP 1.2. Subprinciple. The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed.

GAPP 2. Principle
The policy purpose of the SWF should be clearly defined and publicly disclosed.

GAPP 3. Principle
Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

GAPP 4. Principle
There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal, and spending operations.

GAPP 4.1. Subprinciple. The source of SWF funding should be publicly disclosed.

GAPP 4.2. Subprinciple. The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.

GAPP 5. Principle
The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

GAPP 6. Principle
The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.

GAPP 7. Principle
The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.

GAPP 8. Principle
The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.

GAPP 9. Principle
The operational management of the SWF should implement the SWF's strategies in an

independent manner and in accordance with clearly defined responsibilities.

GAPP 10. Principle
The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.

GAPP 11. Principle
An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

GAPP 12. Principle
The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.

GAPP 13. Principle
Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management, and staff.

GAPP 14. Principle
Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.

GAPP 15. Principle
SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

GAPP 16. Principle
The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.

GAPP 17. Principle
Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

GAPP 18. Principle
The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.

GAPP 18.1. Subprinciple. The investment policy should guide the SWF's financial risk exposures and the possible use of leverage.

GAPP 18.2. Subprinciple. The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.

GAPP 18.3. Subprinciple. A description of the investment policy of the SWF should be publicly disclosed.

GAPP 19. Principle
The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

GAPP 19.1. Subprinciple. If investment decisions are subject to *other than* economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.

GAPP 19.2. Subprinciple. The management of an SWF's assets should be consistent with what is generally accepted as sound asset management principles.

GAPP 20. Principle
The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

GAPP 21. Principle
SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

GAPP 22. Principle
The SWF should have a framework that identifies, assesses, and manages the risks of its operations.

GAPP 22.1. Subprinciple. The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning, and an independent audit function.

GAPP 22.2. Subprinciple. The general approach to the SWF's risk management framework should be publicly disclosed.

GAPP 23. Principle
The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

GAPP 24. Principle
A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.

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Discussion of the GAPP—Santiago Principles

In furtherance of the "Objective and Purpose," the IWG members either have implemented or intend to implement the following principles and practices, on a voluntary basis, *each of which is subject to* home country laws, regulations, requirements, and obligations. This paragraph is an integral part of the GAPP.

A. Legal Framework, Objectives, and Coordination with Macroeconomic Policies

Legal basis and form

GAPP 1. Principle
The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).[11]

Explanation and commentary

A sound legal framework underpins a robust institutional and governance structure of the SWF and a clear delineation of responsibilities between the SWF and other governmental entities. This framework facilitates the formulation and implementation of appropriate objectives and investment policies, and is necessary for an SWF to operate effectively to achieve its stated purpose.

[11]See also GAPPs 6 and 16.

The legal framework of an SWF generally follows one of three approaches. The *first* type of SWFs is established as a separate legal identity with full capacity to act and governed by a specific constitutive law (e.g., Kuwait, Korea, Qatar, and United Arab Emirates (Abu Dhabi Investment Authority, ADIA)). Such SWFs are legal identities under public law. The *second* category of SWFs takes the form of a state-owned corporation (e.g., Singapore's Temasek and Government of Singapore Investment Corporation (GIC),[12] or China's China Investment Corporation (CIC)). Although these corporations typically are governed by general company law, other SWF-specific laws may also apply. The *third* category of SWFs is constituted by a pool of assets without a separate legal identity. The pool of assets is owned by the state or the central bank (e.g., Botswana, Canada (Alberta), Chile, and Norway). In these cases, legislation typically sets out specific rules governing the asset pool. Provided that the overall legal framework is sound, each of these structures can be employed to meet the requirements laid down in this Principle.

GAPP 1.1. Subprinciple. **The legal framework for the SWF should ensure legal soundness of the SWF and its transactions.**

[12]GIC is a corporation that is wholly owned by the government of Singapore and manages Singapore's foreign reserves. The government is the owner of the reserves. However, Temasek—which also is wholly owned by the Government as its sole shareholder—is the legal owner of its assets.

Explanation and commentary

This general principle has several implications. First, the establishment of the SWF should be clearly authorized under domestic law. Second, the legal structure should include a clear mandate for the manager to invest the SWF's assets and conduct all related transactions. Third, irrespective of the particular legal structure of an SWF, the beneficial and legal owners of the SWF's assets should be legally clear. Such clarity contributes to accountability in the home country, and is often required under the recipient countries' regulations.

GAPP 1.2. Subprinciple. **The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed.**

Explanation and commentary

Disclosure of the legal basis and structure of the SWF enhances the public understanding and confidence in the mandate to manage public monies. Clarity and disclosure of the legal relationship between the SWF and other state bodies (such as the central bank, development banks, other state-owned corporations and enterprises) contributes to a better understanding of the mandated responsibilities of the SWF vis-à-vis other government bodies, and of the SWF's institutional set-up and organization structures to ensure that it is managed professionally.

There are several ways in which the legal basis and structure of SWFs are disclosed. For SWFs that do not have a legal identity, their legal basis and structure is typically described in the provisions of publicly available legislation.[13] The legal structure of SWFs that have a legal identity with capacity to act under public law is disclosed through the generally available constitutive laws of the SWF. Lastly, SWFs that are constituted as state-owned companies are normally governed by the country's company law (as well as other laws regulating private and public companies).[14] In addition, some SWFs disclose key features of their corporate structure on their websites (e.g., Australia, Canada (Alberta), Korea, Kuwait, New Zealand, and Singapore).

Objectives and macroeconomic linkages

GAPP 2. Principle
The policy purpose of the SWF should be clearly defined and publicly disclosed.

Explanation and commentary

A clearly defined policy purpose facilitates formulation of appropriate investment strategies based on economic and financial objectives (see also GAPP 19). The pursuit of any other types of objectives should be narrowly defined and mandated explicitly. A clearly defined policy purpose will also ensure that the operational management of the SWF will conduct itself professionally and ensure that the SWF undertakes investments without any intention or obligation to fulfill, directly or indirectly, any geopolitical agenda of the government. Public disclosure of the SWF's policy purpose provides a better understanding of what the SWF seeks to achieve and whether its behavior is consistent with the specified purpose.

SWFs are created by governments for a variety of policy purposes such as (i) stabilization funds (e.g., Russia, Chile, and Mexico), where the primary objective is to insulate the budget and the economy against commodity price swings; (ii) savings funds for future generations (e.g., Libya and Kuwait), which aim to convert non-renewable assets

[13]For example, the SWF in Botswana was created by a provision in the Bank of Botswana Act; the Alberta Heritage Fund was established by the Alberta Heritage Savings Trust Fund Act; and the Norwegian Government Pension Fund was established by Government Pension Fund Law.

[14]These laws could require disclosure of key information on the SWF's structure in a corporate registry that may be open to the public.

into a more diversified portfolio of assets to meet public sector superannuation liabilities in the future and mitigate the possible Dutch disease[15] effects of spending resource revenue; and (iii) reserve investment corporations (e.g., Korea, and Singapore's GIC), whose assets or assets under management, to some extent, are still counted as reserve assets,[16] and are established to increase the return on reserves. These purposes or objectives may be multiple, overlapping, or changing over time.[17]

The SWF's policy purpose guides its investment policy and asset management strategy. For instance, stabilization funds, which serve short- to medium-term objectives, usually have shorter investment horizons. By contrast, savings funds, which have longer-term objectives, typically aim at generating higher returns over a long time horizon. SWFs whose objective is to hedge against country-specific risks may hold assets with negative correlation to the country's major exports to offset terms-of-trade shocks. Many SWFs only invest abroad, thus illustrating how the SWF's purpose can affect its investment policy.

[15]Dutch disease refers to the situation where a boom in a commodity sector of the economy could lead to a loss of competitiveness for other sectors in this economy.

[16]Reserve assets consist of those external assets that are readily available to and controlled by monetary authorities for direct financing of payments imbalances, for indirectly regulating the magnitude of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes (see IMF, *1993 Balance of Payments Manual*, page 97). Underlying the concept of reserve assets are the notions of "control," and "availability for use," by the monetary authorities.

[17]For example, in some countries (e.g., Botswana and Russia) stabilization funds have evolved into funds with a savings objective, as accumulated reserves increasingly have exceeded the amounts needed for short-term fiscal stabilization.

GAPP 3. Principle
Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

Explanation and commentary

Since SWFs are often created for macroeconomic purposes, their operations should support and be consistent with a sound overall macroeconomic policy framework. The SWF's operations can have a significant impact on public finances, monetary conditions, the balance of payments, and the overall sovereign balance sheet. Thus, operations of the SWF that have significant macroeconomic implications should be executed in coordination and consultation with the competent domestic authorities. For instance, transactions that involve an exchange between domestic and foreign currencies by an SWF may affect monetary conditions, the exchange rate, and domestic demand conditions.

Funding and withdrawal rules

GAPP 4. Principle
There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal, and spending operations on behalf of the government.

Explanation and commentary

Policies, rules, procedures, or arrangements for the SWF's funding, withdrawal, and spending operations on behalf of the government should be clearly set out and be consistent with the policy purpose of the SWF. This could be in the relevant legislation, charter, or other constitutive documents. Such a system helps provide a clear basis for deriving the expected time horizon and efficient investment policy for the savings,

and promotes macroeconomic stability and accountability. Funding and withdrawal rules are specific to the type of SWF. Fiscal stabilization funds are typically funded from revenue contingent deposit rules (e.g., exceeding a revenue or commodity price reference level), and their withdrawal rules are crafted to finance specific budget deficits or are set in motion by triggers such as a fall in a commodity price below a specified level.[18] Savings funds are typically funded by government budget surpluses, while the budget's expenditure path takes into account the long-term expected returns from the SWF.[19] Some SWFs keep their capital and returns, while others pay out targeted annual dividends.

GAPP 4.1. Subprinciple. **The source of SWF funding should be publicly disclosed.**

Explanation and commentary

Public disclosure of the source of an SWF's funding facilitates a better understanding of the uses of public monies, thereby promoting accountability. Many SWFs are funded out of mineral royalties (principally oil), while the remainder are funded from privatization receipts, general fiscal surpluses, and balance of payments surpluses and foreign exchange intervention. Returns on SWF investments also contribute to the buildup of assets under management. In a few cases, divestment proceeds and borrowing from markets have also played a role in asset accumulation. The extent to which the SWF's assets are also classified as international reserves should be clarified.

GAPP 4.2. Subprinciple. **The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.**

Explanation and commentary

SWFs should aim at generating returns based on economic and financial considerations and, in general, engage directly in spending only for their own operating expenses. Instead of undertaking general government expenditure, withdrawals may be made from the SWF to the national budget, from which expenditure is made according to national priorities or specific earmarks (e.g., Singapore[20]). Making withdrawals within the budget framework will ensure consistency with macroeconomic policies, and the same applies to SWF spending on general government tasks.[21] The nation's budget documentation should also explain the contribution made by the SWF to the government's fiscal and monetary objectives.[22]

Statistics compilation and reporting

GAPP 5. Principle
The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

[18]In Kuwait, a predetermined part of oil revenues is deposited in the SWF. In Chile, accumulation (and withdrawal) is based on a reference copper price determined annually by the authorities.

[19]For example, Norway's SWF receives the net central government receipts from petroleum activities and transfers to the budget the amounts needed to finance the non-oil deficit. Therefore, the net allocation to the SWF reflects the budget's overall balance.

[20]The Constitution of the Republic of Singapore provides that part of the investment income on Singapore's reserves can be used to support spending on the government budget.

[21]In Russia, withdrawals are approved by the federal budget laws.

[22]Some SWFs (e.g., in Libya) may be set up to directly finance domestic infrastructure investments or other public goods or services.

Explanation and commentary

Policymakers in general rely on macroeconomic data sets that are accurately compiled and disseminated by the national agencies (such as the national statistical office, and the statistics departments in the central bank and ministry of finance). The absence of economic data in national macroeconomic data sets of national accounts and fiscal, monetary, and external sector statistics can hinder economic analysis and potentially mislead data users. The importance of SWFs underlines the need for their activities to be captured in relevant macroeconomic data sets. Cooperation in data reporting primarily involves the owner, or—depending on national arrangement—the SWF, transmitting timely SWF data of good quality and relevant scope to the appropriate national agencies, using modalities of data transmission agreed with those national agencies. The data should be treated with customary confidentiality by the national agencies as set out in the statistical law/regulation(s). Adding a description of key features of the statistics supplied ("metadata") facilitates their correct interpretation.

B. Institutional Framework and Governance Structure

Governance framework

GAPP 6. Principle
The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.[23]

Explanation and commentary

Regardless of the specific governance framework, the SWF's operational management should be conducted on an independent basis to ensure its investment decisions and operations are based on economic and financial considerations consistent with its investment policy and objectives, in effect free of political influence or interference.

The governance structure should be set out in the SWF's legal framework, for example, in the relevant legislation, charter or other constitutive documents. It should ensure appropriate and effective division of oversight, decision making, and operational responsibilities.[24] A number of SWFs, which are established as separate legal entities (e.g., Qatar, UAE (ADIA), Australia, and Singapore's Temasek and GIC), have a governance structure that clearly differentiates an owner, a governing body,[25] and management of the SWF. Where SWFs are established as pools of assets without separate legal personality (e.g., Chile, Canada (Alberta), Mexico, Norway, Russia, Timor-Leste, and Trinidad and Tobago), the owner may exercise the functions of the governing body(ies) through one or more of its organizational units (e.g., a ministry, a parliamentary committee, etc.). In such cases it is important that there be a clear distinction between the owner/governing body(ies) and the agency responsible for the operational management of the SWF. For example, the operational management of the SWF could be delegated to an independent entity, such as the central bank (e.g., Chile, Norway, Timor-Leste, and Trinidad and Tobago) or a separate statutory agency (e.g., Canada (Alberta)).

GAPP 7. Principle
The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.

[23]See also GAPPs 1, 10, 16, and 19.

[24]Relevant guidance includes the OECD Principles of Corporate Governance.

[25]See GAPP 8 for a definition of the governing body.

Explanation and commentary

The owner[26] has two important roles. First, the owner determines the SWF's objectives. These include the broad policy purposes of the SWF and the investment mandate and acceptable levels of risk consistent with it. In some cases, the role of the owner is to determine objectives consistent with relevant statutory provisions; in other cases, these matters are determined by the owner without detailed legislative guidance or constraints. Second, the owner exercises its oversight responsibility in accordance with the legal structure of the SWF. For that purpose, there should be adequate reporting systems in place that give the owner a true picture of the SWF's performance, financial situation, and risk management practices in order to allow the owner to effectively oversee the SWF's performance (see also GAPP 23). In addition to these two roles, particularly in cases where the SWF is a separate legal entity, the owner generally appoints the members of the SWF's governing body(ies), the procedures and competency requirements for which should be well-structured and transparent.

GAPP 8. Principle
The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.

Explanation and commentary

The governing body(ies) of the SWF sets the strategy and policies aimed at achieving the SWF's objectives and is ultimately responsible for the SWF's performance. In addition, its mandate may also include (i) deciding how to implement such strategies; (ii) delegating responsibilities and setting up committees as deemed necessary;[27] and (iii) especially where the SWF is a separate legal entity, appointing and removing the SWF management (including the CEO and/or the managers). The governing body(ies) can take the form of a board of directors or trustees (e.g., Australia, China, Singapore's Temasek and GIC, UAE (ADIA), and Trinidad and Tobago), or a committee or commission (e.g., Ireland and Korea). In some cases, such as where the SWF is a pool of assets, the governing body(ies) may be, for example, (a unit in) the ministry of finance (e.g., Canada (Alberta), Norway, Mexico, Russia, and Timor-Leste) and/or be represented by the governing body(ies) of the central bank (e.g., Botswana).

The governing body(ies) should be structured so that it is able to exercise effective, independent, and objective judgment in respect of its responsibilities. It is important to establish a clear policy of a minimum standard of competency for governing body members—and members of the governing body committees, as the case may be—for them to perform their functions. A remuneration scheme that attracts and maintains qualified professionals fosters the established objectives of the SWF. As applicable, the governing body's roles and responsibilities, as well as the number of its members and their appointment, terms of office, and procedures for removal, should be clearly specified in the relevant legislation, charter, or other constitutive documents. Furthermore, the governing body's roles and responsibilities should be made publicly available.

GAPP 9. Principle
The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.

[26]The owner refers to the government as the beneficial and/or the legal owner of the SWF, or assets managed by the SWF, depending on the legal structure of the SWF (see GAPP 1).

[27]For example, these could include an Audit Committee and an Investment Committee.

Explanation and commentary

The management of the SWF responsible for its day-to-day operations should have the authority to make individual investment decisions, as well as to make operational decisions relating to staffing and financial management (subject to strategic direction from and accountability to the owner or the governing body(ies)). The operational management of the SWF should act in the best interest of the SWF, and its responsibilities should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreements.

To enhance confidence in recipient countries, it is important that managers' individual investment decisions to implement the SWF's defined strategy be protected from undue and direct political interference and influence. As owner, the role of the government is to determine the broad policy objectives of the SWF, but not to intervene in decisions relating to particular investments. A range of mechanisms could be employed to ensure the operational independence of the SWF's management:

i. vesting responsibility for the SWF's management in a separate entity headed by a governing body with clearly defined responsibility for implementing the broad investment mandate established by the government;

ii. providing extensive powers to the chief executive and senior managers where the SWF's governing body(ies) is not independent;

iii. vesting responsibility for operational management in the hands of the central bank or statutory agency; or

iv. contracting out responsibility for making individual investment decisions to external service providers on a fee-for-service basis.

One or more of the above mechanisms could be adopted, or the owner or the governing body(ies) should demonstrate that the operational independence of the SWF's management is preserved.

Accountability

GAPP 10. Principle
The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.

Explanation and commentary

It is important that there are in place accountability arrangements for the owner, the governing body(ies), and the operational management, as applicable, which are commensurate with their respective defined responsibilities. The owner is accountable, for example, to the legislature (as is the case in Botswana, Canada (Alberta), Chile, Mexico, Norway, Russia, Timor-Leste, and Trinidad and Tobago) or the public, for the SWF's approved objectives. In cases of SWFs established as separate legal entities, the governing body(ies) is accountable to the owner, and management is accountable to the governing body(ies) for the SWF's operations, including its investment performance. In cases of SWFs without separate legal identity, the entity responsible for operational management is accountable to the owner.

Access to accurate, timely, and relevant information is essential to an effective accountability framework. In addition, developing appropriate evaluation methods could facilitate the monitoring by owners and governing body(ies), or both as the case may be, of the performance of SWF managers in achieving their objectives (see also GAPP 23).

GAPP 11. Principle
An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

Explanation and commentary

The annual report and the financial statements should present the performance of the SWF's assets and liabilities and be based on a reliable and consistent accounting system. This is important to ensure that information about investments and performance is clear, fair, accurate, and comparable for accountability reasons. It is also important that the financial statements include information on contingent liabilities and off-balance sheet transactions, as applicable. In most cases, the financial statements are prepared according to international financial reporting standards (e.g., Azerbaijan, Botswana, Timor-Leste, Trinidad and Tobago, and UAE (ADIA)) or equivalent national accounting standards (e.g., Australia, China, Korea, New Zealand, and Singapore).[28]

GAPP 12. Principle
The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.

Explanation and commentary

The SWF's activities, finances, accounting and operational systems, and controls should be internally audited on a regular basis, as applicable. The audit procedures should be open for review. The internal audit process should be independent of the SWF's operational management and result in periodic internal audit reports, which could be presented to the owner or the governing body(ies) (or a committee thereof).

The SWF's financial statements should be subject to an annual independent external audit in line with international standards, or equivalent national auditing standards, so as to provide assurance that the financial statements fairly represent the financial position and performance of the SWF in all material respects. Information on accounting policies and any qualification to the statements should be an integral part of the financial statements. The external audit report prepared by an independent commercial auditor should be submitted to the owner or the governing body(ies) (or a committee thereof). In some instances, an external audit report may also be prepared by an independent statutory auditor. The external auditor should be subject to strict qualification and suitability standards, and the selection process for commercial auditor should be transparent, independent, and free from political interference (for example, consistent with the International Federation of Accountants Code of Ethics).[29]

Assurances of integrity of operations

GAPP 13. Principle
Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management, and staff.

Explanation and commentary

To ensure the soundness and integrity of the SWF's operations, members of the governing body(ies), managers, and staff should be appropriately qualified and well-trained, and should be subject to minimum professional standards. To the extent applicable, the governing body(ies) should require establishment of a code of conduct for all members of the governing body(ies), management, and staff, including compliance programs. Furthermore, members of the governing body(ies), managers, and staff should be subject to conflicts of interest guidelines, and rules. These codes, guidelines, and rules are critical in ensuring a high level of integrity and professionalism. In addition, adequate legal protection for members of the governing body(ies), management, and staff (such as customary provision of

[28]See www.IFRS.com.

[29]See IFAC, 2005, *Code of Ethics for Professional Accountants.*

indemnification and insurance where applicable) furthers the good-faith conduct of their official duties. In cases where the SWF is a pool of assets, professional and ethical standards should apply to staff employed by the entity(ies) involved in the operational management of the SWF.

GAPP 14. Principle
Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.

Explanation and commentary

To ensure good governance and efficient use of resources, it is important that the SWF, its owners, or the entities in charge of the SWF's operational management establish clear rules and procedures for dealing with third parties (e.g., commercial fund managers and custodians, or external service providers).

GAPP 15. Principle
SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

Explanation and commentary

It is essential that the SWF respect host country rules and comply with all applicable laws and regulations of host countries in which SWF operations are conducted. Information with respect to the SWF's operations or activities within a given jurisdiction should be disclosed to the relevant regulators in such jurisdictions in compliance with applicable laws and regulations, including in connection with investigations or any other regulatory actions initiated by securities regulators or other relevant authorities. In particular, the SWF should (i) abide by any national securities laws, including disclosure requirements and market integrity rules addressing insider trading and market manipulation; (ii) provide disclosure to local regulators, upon request and in confidence, of financial and non-financial information as required by applicable laws and regulation; (iii) where required by applicable law or regulation, be subject to local regulators, and cooperate with investigations and comply with regulatory actions initiated by local regulators or other relevant authorities; (iv) abide by any anti-monopoly rules; and (v) comply with all applicable tax rules. The SWF expects that host countries would not subject the SWF to any requirement, obligation, restriction, or regulatory action exceeding that to which other investors in similar circumstances may be subject.

GAPP 16. Principle
The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.

Explanation and commentary

Public disclosure of the objectives and governance framework of the SWF promotes a clear understanding of what the SWF seeks to achieve and of the division of responsibilities to provide assurance that investment decisions are made on an independent basis without political interference. Such public disclosure would support the maintenance of an open and stable investment climate. In particular, it can assist in reassuring recipient countries that SWF investments are based on economic and financial considerations and employ sound operational controls and risk management systems.[30]

[30]For example, in Australia and Ireland, the SWFs disclose this information in annual reports, media releases, and on their websites. In Azerbaijan, the SWF responds to freedom of information requests and publishes information on its website, while SWFs in UAE (ADIA) and Singapore publish their objectives and governance structure on their websites.

GAPP 17. Principle
Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

Explanation and commentary

The financial information referred to in this principle would normally be asset allocation, benchmarks where relevant, and rates of return over appropriate historical periods consistent with investment horizons. Disclosure of these items will help to give guidance on risk appetite. These disclosures taken together with the disclosure of other items specified in the GAPP (particularly GAPPs 2, 4, 18.3, and 21) aim at meeting the intent of the GAPP to contribute to stability in international financial markets and enhance trust in recipient countries.

C. Investment and Risk Management Framework

Investment policy

GAPP 18. Principle
The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.

Explanation and commentary

The investment policy should set out how to achieve the SWF's defined objectives using the investment strategy as set by its owner or its governing body(ies). By defining the investment policy, the SWF commits to a disciplined investment plan. The investment policy also guides the SWF in implementing activities consistent with the approved investment objectives and strategies, and risk tolerance,[31] as well as its investment monitoring procedures. Although there is no set formula that suits all situations, the investment policy, including the strategic asset allocation, should draw upon appropriate portfolio management principles.

The strategic asset allocation is typically embodied in a benchmark portfolio,[32] and determined by the SWF's policy purpose, liability profile, horizon over which expected returns and risk are defined, and characteristics of different asset classes.[33] The investment policy normally defines permissible asset classes and gives guidance on concentration risk with regard to individual holdings, liquidity, and geographical and sectoral concentration. In line with the policy purpose of the SWF, the strategic asset allocation may set certain investment parameters, for example, exclusively investing in foreign assets. In addition, the strategic asset allocation may consider the SWF's investments in conjunction with other assets or liabilities of the country, resulting in, for example, investing in assets negatively correlated with the country's natural resources.

As the parameters and assumptions underlying the SWF's investment policy—including its strategic asset allocation—change over time, a periodic review is needed (e.g., as

[31]Risk tolerance refers to an investor's willingness and ability to handle declines in the value of his/her portfolio. For example, it can be expressed as the degree of uncertainty that an investor can accept with regard to a negative change in the value of the portfolio.

[32]A benchmark portfolio is a reference portfolio or an index constructed on the basis of the investment policy. It serves as a basis for comparison of the performance of the actual portfolio.

[33]Asset class refers to a group of securities that exhibit similar characteristics, and behave similarly in the financial market. Examples of asset classes include stocks, bonds, and real estate.

is currently done by SWFs in Australia, New Zealand, and Singapore).

GAPP 18.1. Subprinciple. **The investment policy should guide the SWF's financial risk exposures and the possible use of leverage.**

Explanation and commentary

Exposures to financial risks (including market, credit, and liquidity risks), the use of derivatives, and leverage[34] commensurate with the SWF's investment horizon and risk-bearing capacity are key determinants of its ability to meet its investment objectives and contribute to financial market stability. Such exposures and the use of derivatives and leverage should be well understood, and measured and managed appropriately (see GAPP 22).

Derivatives are useful in SWFs' operations—some may use them only for hedging purposes, whereas others also use them for active position taking. While SWFs typically do not use much leverage, this is often an integral part of an SWF's investment, risk management, and cash management frameworks. It may show up in a variety of forms, including traditional borrowing to finance investments, use of futures and options contracts, interest rate and currency swaps, repos, and buy/sell-back operations. In addition, leverage is an integral part of investing in certain asset classes such as "alternative investments" and real estate (including from a rate of return and from a tax perspective, where appropriate).

GAPP 18.2. Subprinciple. **The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.**

Explanation and commentary

In addition to internal managers, SWFs may allocate part of their assets to one or more external institutions for investment management. An SWF may use external managers because they may (i) have skills and established systems for undertaking investment activities in specialized instruments and markets for which the SWF does not have a capability; and (ii) assist SWFs in managing or reducing the costs of maintaining an asset management operation in a particular market or instrument. In these and similar circumstances, SWFs carefully select reputable and creditworthy investment managers and enter into written investment management agreements. Such agreements typically provide for (i) specification of an investment mandate; (ii) an agreed understanding of expected performance and investment risk—including tracking errors—reports, and fees; and (iii) where appropriate, a clear undertaking by the investment manager of any promised particular investment methodology or a team to whom historical performance may have been attributed.

GAPP 18.3. Subprinciple. **A description of the investment policy of the SWF should be publicly disclosed.**

Explanation and commentary

The description could include qualitative statements on the investment style (e.g., active/passive, financial/strategic) or investment themes, the investment objectives, the investment horizon, and the strategic asset allocation. These disclosures, together with the disclosure of relevant financial information as described in GAPP 17, should give an indication of risk appetite and exposure. In addition, the SWF may describe the use of leverage in its portfolio or disclose other meaningful measures of financial risk exposure.

[34]Leverage is using borrowed funds or debt in such a way that the potential positive or negative outcome is magnified and/or enhanced.

GAPP 19. Principle
The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

Explanation and commentary

It is a core principle that SWFs' overarching objective is to maximize risk-adjusted financial returns, given the risk tolerance level of the owner. SWFs' investment decisions and activities, therefore, should be guided by and be consistent with this objective.

GAPP 19.1. Subprinciple. **If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.**

Explanation and commentary

Some SWFs may exclude certain investments for various reasons, including legally binding international sanctions and social, ethical, or religious reasons (e.g., Kuwait, New Zealand, and Norway). More broadly, some SWFs may address social, environmental, or other factors in their investment policy. If so, these reasons and factors should be publicly disclosed.

GAPP 19.2. Subprinciple. **The management of an SWF's assets should be consistent with what is generally accepted as sound asset management principles.**

Explanation and commentary

The SWF should manage its assets and discharge its other duties with care, skill, and diligence. The same applies to delegating authority and in selecting and supervising investment managers. Sound asset management also requires that each investment be considered in the context of the overall portfolio, and not in isolation only, and as part of an overall investment strategy that incorporates risk and return reasonably suitable to the SWF's approved investment policy and objectives. Fees and costs incurred in performance of its investment activities should be reasonable in amount, and the process of authorization and incurrence, and amounts paid, should be transparent to its owner or its governing body(ies) and follow clear rules and procedures, and be subject to ethics rules (see GAPP 14).

GAPP 20. Principle
The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

Explanation and commentary

This principle promotes the fair competition of SWFs with private entities. For example, SWFs should not seek advantages such as those arising from privileged access to market sensitive information.[35]

GAPP 21. Principle
SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments.[36] The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

Explanation and commentary

SWFs' demonstrated ability to contribute to the stability of global financial markets results in part from their ability to invest on a long-term, patient basis. The exercise of voting

[35]However, recipient countries may grant to SWFs certain privileges based on their governmental status, such as sovereign immunity and sovereign tax treatment.

[36]See GAPP 15.

rights is seen to be important by some SWFs for their capacity to hold assets and preserve value rather than becoming a forced seller and, by definition, a shorter-term investor. The exercise of ownership rights is also seen by some SWFs as a mechanism for keeping the management of a company accountable to the shareholders, and thus contributing to good corporate governance and a sound allocation of resources.

To dispel concerns about potential noneconomic or nonfinancial objectives, SWFs should disclose *ex ante* whether and how they exercise their voting rights. This could include, for example, a public statement that their voting is guided by the objective to protect the financial interests of the SWF. In addition, SWFs should disclose their general approach to board representation. When SWFs have board representation, their directors will perform the applicable fiduciary duties of directors, including representation of the collective interest of all shareholders.

To demonstrate that their voting decisions continue to be based on economic and financial criteria, SWFs could also make appropriate *ex post* disclosures.

Risk management and performance measurement

GAPP 22. Principle
The SWF should have a framework that identifies, assesses, and manages the risks of its operations.

Explanation and commentary

It is important for the SWF to have a strong risk management[37] culture, where senior management is engaged in crafting and enforcing risk management processes, and a well-functioning risk management framework to ensure that it is able to identify, assess, and manage its risks to protect its assets and stay within the tolerance levels as set in the investment policy. Adherence to high standards in risk management with sound operational controls and systems will also help achieve the aim of preserving international financial stability as well as maintaining a stable, transparent, and open investment environment.

The risks that SWFs face in their investment operations can be classified into four broad categories: financial, operational, regulatory, and reputational risks. The main financial risks are market risk (e.g., interest rate, foreign currency, equity and commodity price risks), credit risk (e.g., issuer, counterparty, and settlement risks), and liquidity risk. The main operational risks[38] include people risk (incompetence and fraud), business continuity risk, process risk, technology risk, and legal risk. The main regulatory risk stems from changes in the laws and regulations governing the operation of SWFs in countries of origin as well as recipient countries, or from changes in the application of such laws and regulations. Reputational risk is the potential that negative publicity regarding an SWF's business practices, whether true or untrue, may cause a decline in investment returns, costly litigation, or loss of counterparties, or impair the home country government's international standing.

GAPP 22.1. Subprinciple. **The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct,**

[37]Risk management is the process of identifying the desired level of risk, measuring the current level of risk, monitoring the new actual level of risk, and taking actions that bring the actual level of risk to be aligned with the desired level of risk.

[38]Operational risks are the risk of loss from failures in a company's systems and procedures or events completely outside of the control of the organization.

business continuity planning, and an independent audit function.

Explanation and commentary

The measurement and management of financial risks is typically done by using quantitative methodologies and models. To complement these models and to mitigate "model risk," stress tests[39] should regularly be conducted to evaluate the potential effects of macroeconomic and financial variables or shocks.

To assess, manage, or mitigate operational risks, there should be an established and documented framework that has clear lines of responsibility, segregation of duties,[40] and reliable control mechanisms. Codes of conduct and recruitment policies are important to ensure the professional and ethical behavior of staff involved in the SWF's operations. To ensure that the SWF can continue operating in case of a technology breakdown or natural disaster, contingency planning, including alternative sites of operation, is an important part of the framework.

In mitigating regulatory and reputational risks, it is important to have systems to track current regulatory and legal requirements in each recipient country that the SWF invests in. Impact assessment of any forthcoming changes in the regulatory environment should be conducted regularly. To satisfy the owner and the governing body(ies) that risks in the SWF are managed properly, the risk management framework should be subject to a regular independent audit.

[39]A stress test is a simulation technique used on investment portfolios to determine the financial outcome in different scenarios.

[40]The lines of responsibilities and segregation of duties should be clear both at the operational level (e.g., among the front, middle, and back offices) and at the senior management committee level (e.g., between the Investment Committee and the Risk Management Committee).

GAPP 22.2. Subprinciple. **The general approach to the SWF's risk management framework should be publicly disclosed.**

Explanation and commentary

Public disclosure of the SWF's general approach to its risk management policies and key actions related to governance and the soundness of its operations reassures that the SWF, its governing body(ies), or management adheres to a high standard of managing operational, regulatory, and reputational risks. However, there are certain elements of the risk management framework (such as information about the alternative sites of operation) that are considered to be sensitive information and should not be disclosed. Adherence to high standards, including transparent operational control and risk management systems, together with a constructive engagement by recipient countries, will help achieve the aim of maintaining a stable, transparent, and open investment environment.

GAPP 23. Principle
The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

Explanation and commentary

Accurate and consistent measurement and reporting of investments and investment performance enables the managers of an SWF to make well-informed judgments about their investments. Reliable performance measurement is also important for back-testing of risk measurement models. For the owners and the governing body(ies), this is crucial for assessing how well managers are keeping to their defined objectives. Users of statistics based on the valuation of assets also need to be assured of the sound measurement of the underlying data.

Investment benchmarks are an important tool for assessing performance and monitoring the

accountability of SWFs. If benchmarks are used, performance assessment and accountability will, *inter alia*, occur through the comparison of performance of the actual portfolio relative to the benchmark portfolio.

GAPP implementation

GAPP 24. Principle
A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.

Explanation and commentary

It is desirable for each SWF or its owner or governing body(ies) on behalf of the SWF to use the GAPP to review the SWF's existing arrangements and assess its ongoing implementation on a regular basis, with the results reported to its owner or governing body(ies). The implementation can be verified through self-assessment performed by the SWF along with its owner, or other mechanisms such as third-party verification as determined by the SWF or its owner or governing body(ies). The owner or the governing body(ies) may choose to publicly disclose the assessment to the extent it believes such disclosure is consistent with applicable laws and/or regulations and may contribute to stability in international financial markets and enhance trust in recipient countries.

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Appendices and References

Appendix I. Defining Sovereign Wealth Funds

1. SWFs are defined as follows:

2. *SWFs are defined as special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.*

3. This definition excludes, *inter alia*, foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, operations of state-owned enterprises in the traditional sense, government-employee pension funds, or assets managed for the benefit of individuals.

4. *Three key elements* define an SWF:

- Ownership: SWFs are *owned* by the *general government*, which includes both central government and subnational governments.[41]
- Investments: The investment strategies include investments in *foreign financial assets*, so it excludes those funds that solely invest in domestic assets.
- Purposes and Objectives: Established by the general government for macroeconomic purposes, SWFs are created to invest government funds to achieve *financial objectives*, and (may) have liabilities that are only broadly defined, thus allowing SWFs to employ a wide range of investment strategies with a medium- to long-term timescale. SWFs are created to serve a different objective than, for example, reserve portfolios held *only* for traditional balance of payments purposes. While SWFs may include reserve assets, the intention is not to regard all reserve assets as SWFs.[42]

Furthermore, the reference in the definition that SWFs are "commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports" reflects both the traditional background to the creation of SWFs—the revenues received from mineral wealth—and the more recent approach of transferring "excess reserves."

[41]Note that the use of the word *arrangements* as an alternative to *funds* allows for a flexible interpretation of the legal arrangement through which the assets can be invested. SWFs vary in their institutional arrangements, and the way they are recorded in the macroeconomic accounts may differ depending on their individual circumstances. See also the IMF's *Government Finance Statistics Manual*, 2001.

[42]Likewise, the intention is not to exclude all assets on the books of central banks: SWFs can be on the books of central banks if they also are held for purposes other than balance of payments purposes (e.g., as intergenerational wealth transfer).

Appendix II. List of IWG Members and Recipient Countries That Participated in the IWG Meetings

A. List of IWG Countries, SWFs, and Institutions

Countries and Their SWFs
Australia: Australian Future Fund
Azerbaijan: State Oil Fund
Bahrain: Reserve Fund for Strategic Projects
Botswana: Pula Fund
Canada: Alberta Heritage Savings Trust Fund
Chile: Economic and Social Stabilization Fund / Pension Reserve Fund
China: China Investment Corporation
Equatorial Guinea: Fund for Future Generations
Islamic Republic of Iran: Oil Stabilization Fund
Ireland: National Pensions Reserve Fund
Korea: Korea Investment Corporation
Kuwait: Kuwait Investment Authority
Libya: Libyan Investment Authority
Mexico: Oil Stabilization Fund
New Zealand: Superannuation Fund
Norway: Government Pension Fund
Qatar: Qatar Investment Authority
Russia: Reserve Fund / National Wealth Fund
Singapore: Temasek Holdings Pte Ltd / Government of Singapore Investment Corporation Pte Ltd
Timor-Leste: Petroleum Fund of Timor-Leste
Trinidad and Tobago: Heritage and Stabilization Fund
United Arab Emirates: Abu Dhabi Investment Authority
United States: Alaska Permanent Fund

Permanent Observers to the IWG
Oman: State General Reserve Fund
Saudi Arabia: Saudi Arabian Monetary Agency
Vietnam: State Capital Investment Corporation
Organization for Economic Cooperation and Development
World Bank

IWG Secretariat
International Monetary Fund

B. Representatives from the IWG Countries, SWFs, and Institutions

Co-Chairs
Hamad Al Hurr Al Suwaidi
Abu Dhabi Finance Department
Jaime Caruana
International Monetary Fund

Member Countries
AUSTRALIA
Ian Beckett
The Treasury
Felicity McNeill
Department of Finance and Deregulation
David Murray (Chair, IWG Drafting Group)
Australian Future Fund

AZERBAIJAN
Ruslan Alakbarov
State Oil Fund of the Republic of Azerbaijan
Azer Mursagulov
Ministry of Finance

KINGDOM OF BAHRAIN
Mohamed Mubarak Al Sulaity
Ministry of Finance
Yousif Abdulla Humood
Ministry of Finance
Talal M. Kazim
Ministry of Finance

BOTSWANA
Linah K. Mohohlo
Bank of Botswana
Oduetse A. Motshidisi
Bank of Botswana

CANADA
Arvind Bhatia
Department of Finance
Wayne Foster
Department of Finance
Rod Matheson
Alberta Finance and Enterprise

CHILE
Amelia Huerta Bertrand
Ministry of Finance
Eric Parrado
Ministry of Finance

Juan Carlos Piantini
Central Bank of Chile
Patricio Sepulveda
Ministry of Finance

CHINA
Wang Jianxi
China Investment Corporation
Wang Shuilin
China Investment Corporation
Zhang Hong
China Investment Corporation
Wu Xueling
China Investment Corporation
Liu Haoling
China Investment Corporation

ISLAMIC REPUBLIC OF IRAN
Abdelali Jbili
International Monetary Fund
Jafar Mojarrad
International Monetary Fund

IRELAND
Eileen Fitzpatrick
National Treasury Management Agency
Dermot Keane
Department of Finance

KOREA
Yi Tae Kim
Ministry of Strategy and Finance
Byunghoon Nam
Ministry of Strategy and Finance
Jeyoon Shin
Ministry of Strategy and Finance
Ik Ho Suh
Korea Investment Corporation

KUWAIT
Bader Mohammad Al-Sa'ad
Kuwait Investment Authority
Mahmoud Ahmed Mahmoud
Kuwait Investment Authority
Nadeya Mohamed
World Bank

LIBYA
Mohamed H. Layas
Libyan Investment Authority

MEXICO
José Gabriel Cuadra García
Banco de México
Alfonso Guerra
International Monetary Fund
Gerardo Rodríguez
Ministry of Finance
Marco Oviedo
Ministry of Finance

NEW ZEALAND
Yuong Ha
International Monetary Fund
Brian McCulloch
New Zealand Treasury
Adrian Orr
New Zealand Superannuation Fund

NORWAY
Thomas Ekeli
Ministry of Finance
Ola Peter Krohn Gjessing
Norges Bank Investment Management
Martin Skancke
Ministry of Finance

QATAR
Ahmed M. Al-Sayed
Qatar Investment Authority
Tariq M. Muslih
Qatar Investment Authority
Kenneth Shen
Qatar Investment Authority

RUSSIA
Peter Kazakevitch
Ministry of Finance
Roman Shiyko
Ministry of Finance
Yulia Snizhkova
Bank of Russia

SINGAPORE
Vivien Chen
Government of Singapore Investment Corporation
Hasan Jafri
Temasek Holdings
Laurence Lien
Ministry of Finance

Siong Guan Lim
Government of Singapore Investment Corporation
Ashok Srinivasan
Temasek Holdings

TIMOR-LESTE
Abraão F. De Vasconselos
Banking and Payments Authority
Emilia Pires
Ministry of Finance

TRINIDAD AND TOBAGO
Allison Lewis
Ministry of Finance
Ewart S. Williams
Central Bank of Trinidad and Tobago

UNITED ARAB EMIRATES
William J. Brown
Abu Dhabi Investment Authority
Euart Glendinning
Abu Dhabi Investment Authority
Saeed R. Al-Hajeri
Abu Dhabi Investment Authority
Robert E.B. Peake
Abu Dhabi Investment Authority

UNITED STATES
Michael J. Burns
Alaska Permanent Fund Corporation
Robert Kaproth
U.S. Department of the Treasury

Permanent Observers
OMAN
Ghalib Al Busaidy
State General Reserve Fund
Rashid Al Khaifi
Ministry of Finance

SAUDI ARABIA
Muhammad Al-Jasser
Saudi Arabian Monetary Agency
Khaled Akhattaf
Saudi Arabian Monetary Agency
Ahmed Al-Kholifey
Saudi Arabian Monetary Agency
Ahmed A. Al Nassar
International Monetary Fund
Saad M. Al Nefaee
International Monetary Fund

OECD
Kathryn Gordon
Pierre Poret

WORLD BANK
Alex Berg
Jennifer Johnson-Calari
Sudhir Rajkumar
Isabelle Strauss-Kahn

International Monetary Fund (IWG Secretariat)
Wouter Bossu
Norma Cayo
Udaibir S. Das (Head of IWG Secretariat)
Antonio Galicia-Escotto
Robert Heath
David J. V. Hofman
Francine Koch
Peter Kunzel
Thomas Laryea
Ross Leckow
Laura Lipscomb
Yan Liu
Yinqiu Lu
Adnan Mazarei
Christian B. Mulder
William Murray
Michael Papaioannou
Iva Petrova
Jukka Pihlman
Jon Shields
Alison Stuart
Amadou Nicolas Racine Sy
Mauricio Villafuerte

C. Recipient Country Representatives Who Participated in the IWG Meetings

EUROPEAN COMMISSION
Marco Buti
Moreno Bertoldi
Klaus Regling
Francisco Caballero-Sanz

AUSTRALIA
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Appendix III. Background Information on IWG Member Countries' SWFs

(The listing is alphabetically ordered according to country names. The information contained relates to the position as of end-July 2008.)

Australia: The Future Fund

Goals and objectives

The Future Fund Act 2006 (the Act) commenced on April 3, 2006, and established the Future Fund Special Account (the Fund Account), the Future Fund Board of Guardians (the Board) and the Future Fund Management Agency (the Agency), collectively referred to as the Future Fund. The object of the Act is to strengthen the Commonwealth's long-term financial position.

The Future Fund will make provision for unfunded superannuation liabilities that will become payable during a period when an aging population is likely to place significant pressure on the Commonwealth's finances. The legislation quarantines the Fund, the balance of the Fund Account and other investments, for the ultimate purpose of paying unfunded superannuation liabilities and expenses associated with the investment and administration of both the Board of Guardians, and by direct transfer from the administered funds, the expenses of the Future Fund Management Agency.

How the fund is managed

The Future Fund is controlled by an independent Board of Guardians that is collectively responsible for the investment decisions of the fund and is accountable to the Australian Government for the safekeeping and performance of fund assets. The Future Fund Management Agency is responsible for the development of recommendations to the Board on appropriate investment strategies and for the implementation of these strategies. The functions of both the Board of Guardians and the Future Fund Management Agency are set out in the Future Fund Act. The Board of Guardians reports annually to the Australian Parliament on all aspects of the Fund's performance, and the Fund is subject to independent external audit by the Australian National Audit Office. At June 30, 2008, the assets of the Future Fund portfolio were valued at A$64.18 billion.

In the 2008–09 budget, the Australian Government announced that the Future Fund Board of Guardians and Management Agency would be given additional responsibility for managing the investment of three additional specific purpose funds that the government proposes to establish to support expenditure on education, health, and infrastructure.

Azerbaijan: The State Oil Fund of the Republic of Azerbaijan

The State Oil Fund of the Republic of Azerbaijan (SOFAZ) was established in accordance with the Decree of the President of the Republic of Azerbaijan No. 240 dated December 29, 1999.

Goals and objectives

SOFAZ is an organization whereby oil- and natural gas-related windfalls of Azerbaijan are accumulated and efficiently managed for the benefit of the country and its present and future generations.

How the fund is managed

SOFAZ has a three-tier management structure, with the President of the Republic of Azerbaijan being a supreme governing and reporting authority for the Fund. Activities of the Fund in the field of managing and spending assets of the Fund are overseen by a Supervisory Board, composed of representatives of various government authorities, two Members of Parliament nominated by the Speaker of Parliament and community-based institutions.

Administrative and operational management of the Fund is vested with the Executive Director, appointed by and accountable to the President of the Republic of Azerbaijan.

The Fund publishes quarterly reports on its financial position in major newspapers of the country. These reports, as well as annual reports together with audited financial statements and the report of independent auditors (Deloitte), are available at the SOFAZ's website (www.oilfund.az/en). In addition to reports to the president of the country and the Supervisory Board, the Fund regularly reports to the Parliamentary Chamber of Accounts (the supreme audit institution of the country), Ministries of Finance and Economic Development, and the State Committee for Statistics.

Relations between fund and budget

The Fund may finance only projects that are included in the Public Investment Programme, which is to be submitted to the Parliament together with the annual consolidated budget. SOFAZ's primary expenditure items are directed to the financing of projects aimed at the socio-economic development of the country, as well as the important infrastructure projects.

Bahrain: The Future Generations Reserve Fund

The Future Generations Reserve Fund (FGF) of Bahrain was established with a Royal Decree issued on July 17, 2006.

Source and purpose of the FGF

The FGF's purpose is to strengthen Bahrain's long-term fiscal management and help preserve the hydrocarbon wealth. The FGF

receives, in monthly payments, part of the oil income accruing from higher than budgeted oil prices.

Institutional framework

The FGF is owned by the Government of Bahrain and managed by the Ministry of Finance. Its governance framework includes a Board of Directors and a head of the Investment, Operations, and Administrational team.

Accounting and reporting

The FGF's activities are audited internally by an Audit Directorate, and its financial statements are subject to an external audit by an independent commercial auditor.

Investment and risk management

The FGF invests only in liquid instruments with the aim of preserving its capital. The risk management framework encompasses a range of financial risks, including interest rate, liquidity, currency, and credits risks.

As a newly established SWF, the FGF's policies and procedures of operation are still in the process of development.

Botswana: The Pula Fund

The Pula Fund was established in 1993 under the Bank of Botswana Act (CAP 55:01).

Source of funds

The Pula Fund is a long-term fund and forms part of the overall foreign exchange reserves. The accumulation of foreign exchange reserves stems from the general trend of surpluses in the balance of payments, which were based mainly on the export of diamonds.

Ownership of the Pula Fund

The Pula Fund is accounted for in the balance sheet of Bank of Botswana. Through budget surpluses, the Government has accumulated cash balances with the Bank of Botswana. The balances with the Bank of Botswana are transformed into direct government ownership of part of the Pula Fund. Currently, the Government's share of the Pula Fund is about two-thirds, while the remainder is owned by the Bank.

Investment policy and asset allocation

The Pula Fund, being a part of the foreign exchange reserves, is exclusively invested in foreign currency denominated assets. The investment objectives are based on the maintenance of the purchasing power of the reserves and maximizing returns within acceptable risk parameters. The strategic asset allocation includes public equity and fixed income instruments in industrialized economies.

Assets under management

At the end of 2007 the Pula Fund amounted to US$6.6 billion, equivalent to 56 percent of GDP and 18 months of import cover. The Pula Fund accounted for 68 percent of the total foreign exchange reserves.

Reporting of Pula Fund activities

The financial and investment activities of the Pula Fund are reported in the financial statements of the Bank. Annual financial statements are audited by external auditors and submitted to the Minister of Finance and Development Planning, for submission to Parliament.

Canada (Alberta): The Heritage Savings Trust Fund

The Alberta Heritage Savings Trust Fund (Heritage Fund) was created in 1976 with the passage of the Alberta Heritage Savings Trust Fund Act.

Goals and objectives

The Heritage Fund was established as a means of saving a portion of the royalty and other revenues that the Province of Alberta receives from the production of its oil and natural gas resources. Initially the Fund received annual transfers of non-renewable resource revenues from the Province and retained its investment income. Since 1982 the investment income from the Fund has been transferred to the

Province's General Revenue Fund and is used to help pay for government programs and services. Automatic annual transfers of revenues into the Fund stopped in 1987. Since that time the Fund has grown through regular inflation-proofing and capital additions made by the government from time to time, primarily from budgetary surpluses.

Assets and income of the Heritage Fund are fully consolidated with the assets and revenue of the Province. As of March 31, 2008, the assets in the fund are approximately Can$17 billion.

On January 1, 1997, a new *Alberta Heritage Savings Trust Fund Act* was passed. This Act sets out the current structure and investment framework for the Fund. The Fund is managed as an endowment fund with the goal to maximize long-term returns at a prudent level of risk. The Fund is not to be used for economic development or social investment purposes.

Investment policy

Under the legislation, the provincial Minister of Finance is assigned responsibility for the Fund and its investments. The Minister is required to adhere to investment policies that a reasonable and prudent person would apply in respect of a portfolio of investments to avoid undue risk of loss and obtain a reasonable return. The Minister must report on the performance of the Fund quarterly within 60 days of the end of the quarter and make public the Annual Report within 90 days of the end of the fiscal year. A three-year business plan is prepared and published annually as part of the provincial budget.

The Fund consists of investments in bonds, public and private equities, hedge funds, derivatives, real estate, and other real asset investments such as infrastructure and timberlands. The current allocations are approximately 32 percent to cash and fixed income, 46 percent to Canadian and global equity, 11 percent to real estate, and 11 percent to alternative investments. The assets of the Heritage Fund are globally diversified.

Governance arrangement

The Minister must report on the performance of the Fund quarterly within 60 days of the end of the quarter and make public the Annual Report within 90 days of the end of the fiscal year. A three-year Business Plan is prepared and published annually as part of the provincial budget.

The legislation also creates the Standing Committee on the Alberta Heritage Savings Trust Fund, which is a committee of the Alberta Legislature with members from all major parties of the legislature. The Standing Committee reviews and approves the Business Plan and Annual Report of the Fund, receives regular reports on the performance of the Fund, and conducts public meetings on an annual basis in different locations in the Province. The purpose of these meetings is to update Albertans on the investment activities and results of the Fund. The Auditor General of Alberta is the auditor of the Heritage Fund.

The Fund's investments are managed by the Alberta Investment Management Corporation (AIMCo). AIMCo is wholly owned by the Province and was established by statute in 2008 to manage all the government's investments including the Heritage Fund. AIMCo is governed by a Board of Directors and is operationally independent from the government.

Chile: Fiscal Responsibility Funds

Goals and objectives

The purpose of the fiscal policy is to contribute to macroeconomic stability and provide public assets increasing opportunities and social protection to Chileans. As of 2001, the fiscal policy has been guided by the structural rule. The structural balance concept reflects the trend in the financial situation of the central government. Thus, the effects of cyclical fluctuations in economic activity, the copper price, and other factors of a similar nature are excluded. In this way, public spending is dissociated from the cyclical evolution of the structural revenue track

record. This helps to avoid drastic adjustments in public spending in face of adverse economic effects in boom times, when the Government receives substantial transitory revenues.

In line with the implementation of a fiscal policy ensuring sustainability of public spending over time, a Fiscal Responsibility Law was enacted in September 2006. This law created the Pension Reserve Fund (PRF) and the Economic and Social Stability Fund (ESSF). As regards the PRF, the purpose is to supplement the financing of future pension contingencies. On the other hand, the main objectives of the ESSF are to finance potential fiscal deficits and amortize the public debt.

The Fiscal Responsibility Law establishes rules for the creation and accumulation of the Funds and raises the possibility of capitalizing the Central Bank of Chile (CBC). In accordance with the law, the PRF increases each year by a minimum amount equivalent to 0.2 percent of the gross domestic product (GDP) of the previous year. If the actual fiscal surplus exceeds 0.2 percent of GDP, the PRF receives a contribution up to a maximum of 0.5 percent of GDP. The law provides that the Government will be able to make capital contributions to the CBC in an annual amount equivalent to the balance resulting from subtracting the contribution to the PRF from the actual surplus. However, the annual contribution may not exceed 0.5 percent of GDP of the previous year. Lastly, the ESSF will get the remaining balance resulting from subtracting from the actual surplus the contributions to the PRF and to the CBC.

Institutional arrangement

The institutional arrangement of the two Funds is clearly defined in the law and additional regulations. To carry out the investment policy for the Funds, the Ministry of Finance appointed the CBC as the government agent to act on behalf and in the name of the Government to manage and invest the Funds' resources. The CBC must follow specific guidelines issued by the Ministry of Finance. These guidelines establish the requirements and conditions to be applied for the correct and complete execution of the functions assigned to the CBC in its capacity of government agent.

The Fiscal Responsibility Law established that the Minister of Finance must be assisted by a Financial Committee to decide on the financial investment of the Funds' resources and define the necessary guidelines for implementation thereof. In compliance with this provision, on December 23, 2006, the Minister of Finance announced the creation of the Funds and the setting up of a private advisory committee, composed of professionals with extensive experience in economic and financial fields.

Investment policy

The Funds' initial investment policy includes the same asset classes as the investment portfolio of the international reserves managed by the CBC. As of March 2007, investments include only short-term and low-risk financial instruments. In fact, 30 percent of the portfolio is invested in monetary market instruments, 66.5 percent in sovereign bonds, and 3.5 percent in inflation-indexed sovereign bonds.

At the end of 2008, the investment policy will include additional asset classes. The Financial Committee recommended that the Funds' new structure will include 15 percent in equities, 20 percent in corporate fixed-income, 45 percent in sovereign bonds, 15 percent in inflation-indexed bonds, and 5 percent in liquid assets. In this context, the recommendations presented by the Committee—and accepted by the Ministry of Finance—seek to maximize the Funds' return subject to an acceptable risk level. This new investment structure implies a greater investment diversification than the present one, and is more in line with the Funds' objectives.

As of June 2008, the ESSF and PRF reached US$18.8 billion and US$2.5 billion, respectively.

China: China Investment Corporation

Incorporation and purpose

China Investment Corporation (CIC) was established on September 29, 2007, by the Chinese government in compliance with the Company Law of the People's Republic of China. It is wholly owned by the Chinese government and has its own corporate entity status. The purpose of the CIC is to maximize return at acceptable risk tolerance and improve the corporate governance of key state-owned financial institutions.

Source of funds

CIC's capital is funded through issuing special treasury bonds. With the approval of the Standing Committee of the 10th National People's Congress, the Ministry of Finance issued Y1.55 trillion special treasury bonds and used raised funds to purchase foreign reserves (US$200 billion) to be injected into CIC as its registered equity capital. CIC has to pay dividends to the State Council as its owner, to cover the cost of these special treasury bonds.

Governance arrangements

As required by the Company Law, CIC has been working on its internal institutional setting and governance structure. It has established a Board of Directors, Supervisory Board, and management team. The appointment and dismissal of Board directors should be approved by the State Council. The chairman and vice chairman of the Board are appointed by the State Council. CIC's development strategies and operational and investment guidelines are determined by the Board of Directors. Responsibilities and accountabilities within the CIC, across departments and desks, are clearly defined.

Reporting and auditing

CIC's implementing performance and accounting are reported to the Board, and are subject to the scrutiny by the Supervisory Board. The Internal Audit Department carries out independent audits. The audit reports shall be approved by the Chairman of the Supervisory Board. CIC is subject to financial supervision by the Ministry of Finance and periodic external auditing by the National Audit Office.

Investment objectives and risk management

CIC's investment objectives are first, to invest in a diversified portfolio of overseas financial instruments, to maximize long-term returns on CIC's capital; and second, to recapitalize domestic financial institutions as a shareholder abiding by relevant laws in order to maintain and increase the value of state-owned financial assets in its wholly owned subsidiary—Central Huijin.

CIC focuses its overseas investment mainly on equity, fixed-income, and alternative assets. CIC will allocate assets prudently and effectively at acceptable risk tolerance.

CIC has established its preliminary system of investment decision-making, internal control, and risk monitoring and management. CIC has established a risk management structure in order to ensure legitimate, compliant, sound, and prudent operation.

Ireland: The National Pensions Reserve Fund

The National Pensions Reserve Fund (NPRF) was established on April 2, 2001, under the National Pensions Reserve Fund Act 2000. The purpose of the Fund is to meet as much as possible of the cost to the state of social welfare and public service pensions to be paid from 2025 until at least 2055. The Act provided for the establishment of the NPRF Commission to control the investment of the Fund, the appointment of the National Treasury Management Agency (NTMA) as Manager and annual contributions of 1 percent of GNP to the Fund. The latest projections are for public pensions expenditure (social welfare and public service) to increase from around 5 percent of GDP in 2007 to some 7.6 percent in 2025 and 13 percent by mid-century.

NPRF Commission

Under the NPRF Act, the NPRF Commission controls and manages the NPRF. There are seven members, appointed by the Minister on the basis that "they have acquired substantial expertise and experience at senior level" in a range of areas prescribed in the Act. The Commission has discretionary authority to determine the Fund's investment strategy, within a statutory investment mandate of maximizing the investment return subject to an acceptable level of risk. This framework gives the Commission the freedom to develop, outside of the political process, a long-term investment strategy primarily based on a diversified portfolio of real assets. The Commission publishes a statutory annual report including its portfolio of investments. It also publishes quarterly performance statements on a non-statutory basis. The Fund accounts are audited by the Comptroller and Auditor General (Public Auditor) and are laid before both Houses of the Oireachtas (Parliament). The Chairperson of the Commission and the Chief Executive of the Manager can be called upon to give evidence to the Committee of Public Accounts.

The Act provides that 1 percent of GNP is to be paid from the Exchequer into the Fund each year. This contribution can be increased (but not decreased) by a Dáil (Lower House of Parliament) resolution. In addition, €6.5 billion, representing the proceeds of the sale of Telecom Éireann and contributions in respect of 1999 and 2000 were paid into the Fund on its inception.

Assets and Investments

The total state contribution to the Fund at end-2007 was €15.2 billion. The 2008 budget provision is €1.69 billion. The value of the NPRF at end-2007 was €21.15 billion. The Fund is within the General Government sector for statistical purposes.

Investment policy and strategy

The NPRF is obliged by the Act to secure the optimal total financial return available at a level of risk acceptable to it. The only constraints on its investment are that it may not invest in Irish Government securities or acquire a controlling interest in a company. The Commission's investment strategy is founded on the expectation that equities and other real assets will outperform financial assets over the long term despite swings over short time periods. The Fund's long-term investment horizon (no drawdown for at least 17 years) and strong cash flow mean that it can also exploit the additional return and diversification benefits available from holding less liquid assets such as property and private equity. The NPRF Commission is a signatory to the UN Principles for Responsible Investment and the Carbon Disclosure Project.

Korea: Korea Investment Corporation

Goal and objective

Korea Investment Corporation (KIC) was established in July 2005 under the KIC Act. It was launched with a mandate to manage public funds entrusted by the government and the Bank of Korea, by investing in a variety of financial assets in the international financial markets.

How the fund is managed

KIC has adopted a governance structure with the Steering Committee as the highest governing body in order to ensure autonomy and independent operation. The Steering Committee is currently composed of nine members including the committee chairman. Committee members include six professionals from the private sector, the CEO of KIC, and the heads of trust institutions that have entrusted assets exceeding one trillion won, namely the Minister of Strategy and Finance and the Governor of the Bank of Korea. Six private sector members, who are nominated by the Civil Member Candidate Nomination Committee and appointed by the President of Korea, serve two-year terms. The Chairman of the Steering Committee is elected from among the private sector members.

Assets and investment policy

Initially entrusted to manage US$20 billion for the Bank of Korea and the Ministry of Strategy and Finance, KIC has, through the end of 2007, invested US$14.8 billion of the whole entrusted amount. The asset classes that KIC may invest in include securities (stocks and bonds), foreign exchanges, and derivatives, as defined under the KIC Act. At present, KIC invests in asset classes that are specified in the investment management agreements between KIC and its clients.

KIC reports on its business activities to the National Assembly in accordance with the National Assembly Act and the Act on the Inspection and Investigation of State Administration, and is subject to annual inspections conducted by the National Assembly.

Kuwait: Kuwait Investment Authority

History and origins

The Kuwait Investment Authority (KIA) is the oldest sovereign wealth fund in the world. KIA traces its roots to the Kuwait Investment Board, which was established in 1953, eight years before Kuwait's independence.

In 1982, KIA was established to take over the responsibility of managing the assets of Kuwait from the Ministry of Finance. Today, the KIA manages two main funds: the General Reserve Fund (GRF) and the Future Generations Fund (FGF). The KIA may also manage any other funds entrusted to it by the Minister of Finance. The KIA is an asset manager, and does not own any of the assets it manages, all of which are owned by the State of Kuwait.

Investment philosophy

KIA's mission is to achieve a long-term investment return on the financial reserves entrusted by the State of Kuwait to the Kuwait Investment Authority by providing an alternative to oil reserves.

KIA's objectives are threefold: (1) KIA aims to achieve a rate of return on its investment that, on a three-year rolling average, exceeds composite benchmarks by designing and maintaining an uncorrelated asset allocation, consistent with mandated return and risk objectives; (2) KIA endeavors to be a world class investment management organization committed to continuous improvement in the way it conducts business; and (3) KIA is committed to the excellence of the private sector in Kuwait, while ensuring that it does not compete with or substitute for it in any field.

Source of funds

KIA is responsible for the management and administration of Kuwait's General Reserve Fund (GRF) and its Future Generations Fund (FGF), as well as all other funds entrusted to it by the Minister of Finance for and on behalf of the State of Kuwait. The GRF is the repository of all of the State of Kuwait's oil revenues and income earned from GRF investments. The FGF was established in 1976 with 50 percent of the GRF balance, and each year 10 percent of all state revenues, including revenues of the GRF, are transferred to the FGF. KIA manages FGF assets for the benefit of future generations, permitting oil assets to be diversified into long-term financial investments.

Structure and governance

KIA is an independent public authority managed by its Board of Directors, the majority of whom must be from the private sector. The Managing Director is appointed by the Board of Directors from the private sector representatives. An Executive Committee of the Board is responsible for monitoring KIA's activities.

Independent audits and review

KIA's accounts are reviewed, audited, and approved by two of the world's leading external audit firms. In addition, KIA is required by law to submit semi-annual statements of its assets under management to the independent State Audit Bureau; KIA presents an annual statement of its accounts to the Council of Ministers (Kuwait's

Cabinet); the KIA presents an annual statement of its accounts to the National Assembly (Kuwait's Parliament); and the KIA appears before various committees at Parliament on a periodic basis to discuss KIA's performance. KIA's Board of Directors has an Audit Committee, with members from the private sector representative of the Board.

Risk management

KIA's performance and risk management systems are the responsibility of KIA's Risk and Performance Unit, which reports directly to the Managing Director. The Risk and Performance Unit is responsible for conducting performance and risk analysis, identifying and communicating performance and risk issues to senior management, developing an understanding of performance and risk within KIA's investment sectors, and investigating data irregularities.

Libya: The Libyan Investment Authority

> *"The Libyan Investment Authority is committed to managing and developing the funds entrusted to it by employing the highest level of financial expertise to invest across a range of international markets and asset classes."*
>
> **Executive Director, Mohamed H. Layas**

Goals and objectives

The Libyan Investment Authority (LIA) was established in December 2006 and started operations in June 2007. It is mandated to manage the financial assets allocated to it by the State. The intention is to build a high quality and well-diversified investment portfolio in order to create a sustainable source of revenue, with a view to reducing dependency on oil.

Headquartered in Tripoli, the LIA has the authority, infrastructure, and depth in resources to enable it to achieve its mandate: to be recognized as a world-class provider of investment management for the benefit of the Libyan state and the long-term future and well-being of its citizens.

Source of funds

The LIA funds consolidated pre-existing funds such as the Libyan Foreign Investment Company, the Libyan African Investment Portfolio and Oilinvest Company. Oil revenues in excess of budgeted amounts are transferred to the LIA.

Today it is estimated that the LIA's fund is worth US$50 billion. The state will increase the funds entrusted to the LIA to US$70 billion before the end of 2008.

How the fund is managed

The fund invests in assets on a commercial basis mostly abroad through reputable international managers. The LIA may, however, make direct investments domestically or internally through joint-ventures or with national or international strategic partners. These are likely to be in sectors and industries that are of critical importance to Libya's development.

Its organizational structure is being developed with assistance from international consultants. Its board of trustees includes the Prime Minister (Chairman), the Governor of the Central Bank, and the Minister of Planning, and its board of directors includes the Executive Director of the LIA, the Deputy Executive Director, and five Libyan investment professionals. The board of directors is advised by a committee of international financial experts.

An international consulting firm is helping the LIA develop a process for selecting and evaluating reputable investment managers for different asset classes.

Reporting and transparency

LIA intends to meet high transparency standards and a new decree in 2008 requires that LIA publish annual reports on its website in both English and Arabic.

Mexico: Oil Revenues Stabilization Fund of Mexico

Goal and objectives

In 2000, the Oil Revenues Stabilization Fund was constituted with a risk management purpose in response to the observed oil price decreases that led to unplanned budget cuts in the late 1990s. The objective of the Fund is to lessen the effects on public finances of changes in the level of oil revenues derived from sudden variations in international oil prices.

Sources of funds

The Fund's inflow comes from a special levy on oil revenues and 40 percent of excess revenues, when the observed oil price is higher than the one set in the budget. Also, it has an upper limit defined by the level of oil production platform.

The resources of the Fund are used to compensate for a decrease in estimated income from the levies of the related fiscal year derived from a lower observed oil price, using up to 50 percent of the accumulated resources at the end of the previous the fiscal year for that purpose. The operation of the Fund and the allocation of resources are audited by the Superior Auditor of the Federation, and reports are sent to Congress on a quarterly basis.

Investment policy

The investment policy of the Fund is set by a Technical Committee, which aims at an adequate level of liquidity required for the purpose of the Fund and a reasonable rate of return with a minimum risk level. The Technical Committee is composed of representatives of the Ministry of Finance.

New Zealand: The New Zealand Superannuation Fund

Goals, objectives, and investments

The New Zealand Superannuation Fund was established under the New Zealand Superannuation and Retirement Income Act 2001. It is a Crown-owned fund financed by capital contributions from the Government, to assist future governments to meet the cost of providing retirement income to New Zealanders.

An aging population means the cost of providing New Zealand superannuation is expected to double over the next 50 years. To prepare for this, the Government plans to allocate around NZ$1.5 billion a year to the Fund over the next 20 years while the cost of superannuation is relatively low. In the meantime, the Fund will invest the money on a prudent but commercial basis. As the cost of superannuation escalates, the Government will progressively draw on the Fund to help smooth the impact on its finances.

The Fund commenced investing at the end of September 2003. As of May 31, 2008, the value of the Fund was NZ$14.7 billion. The Fund is expected to grow to around NZ$109 billion by 2025, making it one of the largest funds in Australasia.

The Fund is governed by a separate Crown entity called the Guardians of New Zealand Superannuation (Guardians). This entity is overseen by a Board selected by the Minister of Finance for their skills and experience.

While accountable to the Crown, the Guardians operate at arm's length from the Crown. The Guardians are charged with managing and administering the Fund's assets in a prudent, commercial manner.

How the fund is managed

The Guardians must manage the Fund in a manner consistent with best-practice management portfolio, maximizing return without undue risk to the Fund as a whole, and avoiding prejudice to New Zealand's reputation as a responsible member of the world community. They are required to publish an annual Statement of Intent setting out their organizational objectives for the following three years and their Annual Report must measure performance against those objectives. In addition they are required to prepare, keep updated, and publish a

Statement of Investment Policies, Standards and Procedures. Each of those public documents, together with more information about the Guardians and the Fund, can be found on the Fund's website, www.nzsuperfund.co.nz.

Norway: Government Pension Fund

Incorporation and objectives

The Government Pension Fund was established by the Pension Fund Act in 2006 to support the long-term management of petroleum revenues and facilitate the government's accumulation of financial assets in order to help cope with large, future financial commitments associated with an ageing population. The Fund consists of the Government Pension Fund – Global (formerly known as the Petroleum Fund, established in 1990) and the Government Pension Fund – Norway (formerly known as Folketrygdfondet, established in 1967).

The Pension Fund – Global's inflow consists of all state petroleum revenues, net financial transactions related to petroleum activities, as well as the return on the Fund's investments. The outflow from the Fund is the sum needed to cover the non-oil budget deficit. The Fund is thus fully integrated with the state budget and net allocations to the Fund reflect the total budget surplus (including petroleum revenues). Fiscal policy, which regulates the outflow from the Fund, is anchored in a guideline where the structural, non-oil budget deficit shall over time correspond to the real return on the Fund, estimated at 4 percent.

Investment policy

The Fund is invested globally in a large number of financial instruments in order to get a broad diversification and achieve good investment returns with moderate financial risk. The Fund is a pure financial investor with a diversified portfolio of minority holdings in a wide range of companies. The Fund's strategic benchmark portfolio consists of 60 percent equities, 35 percent fixed income instruments, and 5 percent real estate investments (in process of being established).

Governance arrangement

The governance structure of the Fund is marked by a clear division of responsibilities between the political authorities and the operational management. Under the Pension Fund Act, the Ministry of Finance is the formal owner of the Fund. The Ministry has formulated the investment strategy by setting a benchmark with risk limits. Within these limits, there is full delegation of operational management to Norges Bank. The Bank manages parts of the funds internally, while parts are managed by external managers appointed by the Bank on a commercial basis. As formal owner of the assets, Norges Bank is also charged with exercising the Fund's ownership rights.

Ethical guidelines

The Fund has a set of ethical guidelines that are based on two elements: to ensure that a reasonable portion of the country's petroleum wealth benefits future generations, and to not make investments which constitute an unacceptable risk that the Fund may contribute to unethical acts or omissions. To implement the ethical guidelines, the following mechanisms are employed: (i) achieve high returns subject to moderate risk; (ii) exercise the ownership rights associated with the equity holdings (done by Norges Bank); and (iii) exclude some companies from the investment universe (decided by the Ministry based on advice from Council on Ethics).

Accountability

The management of the Fund is characterized by a high degree of transparency and disclosure of information. The Ministry reports to Parliament and the public on all important matters relating to the Fund. Norges Bank publishes quarterly reports on the management of the Fund, as well as an annual report and an annual listing of all investments. At the end of 2007, the Fund's

value stood at NOK 2,019 billion, or US$373 billion.

The Government Pension Fund – Norway originates primarily from surpluses in the national insurance accounts from the introduction of the National Insurance Scheme in 1967 and until the late 1970s. The return on the assets is added to the Fund. There are no transfers between the fiscal budget and the Fund, nor are there any transfers of capital between the Pension Fund – Global and the Pension Fund – Norway. Equities account for 60 percent and fixed income instruments for 40 percent of the Pension Fund – Norway's strategic benchmark, with 85 percent allocated to Norway and the remaining 15 percent to Denmark, Finland, and Sweden. The governance structure and transparency arrangements are similar to that of the Pension Fund – Global. The Ministry of Finance represents the owner and sets the benchmark with risk limits, while there is full delegation of operational management of the Pension Fund – Norway to the state-owned asset manager Folketrygdfondet. At the end of 2007, the Fund's value stood at NOK 117 billion, or US$21 billion.

Qatar: Qatar Investment Authority

Establishment and ownership

Qatar Investment Authority (QIA) was established in 2005 by virtue of the Emiri Decision No (22) of 2005 as an independent government investment institution and went into operation in early 2006.

QIA is wholly owned and subject to supervision by the Government of the State of Qatar and pursuant to Article (2) of QIA's constituent instrument, namely said Emiri Decision, QIA has a legal personality and a budget, both of which are independent of those of the Government of the State of Qatar. Said provisions together with other provisions of the above-mentioned Decision as well as those of other Emiri Decisions and QIA Board resolutions provide for separation of roles and responsibilities among the owner, the governing entity, and the management.

According to its constitutive instrument, QIA's objectives are to develop, invest, and manage the state reserve funds and other property assigned to it by the Government via the Supreme Council of Economic Affairs and Investments. The above mentioned Emiri Decision endowed QIA with required capacity, powers, and competences to act in fulfilling its statutory mandate and achieve its objectives.

Governing body

QIA's Board of Directors is the supreme body, having full control over its affairs and the discharge of its business. The Board consists of a Chairman, a Vice Chairman, and a number of members who are appointed in accordance with said Emiri Decision. QIA's Board meets regularly and as required, for setting out and review of QIA's strategic policy in accordance with the objectives provided for in its constitutive instrument. QIA's Board does not normally engage itself in the decisions relating to day-to-day business, as those are assigned by the Emiri Decision to the Chief Executive Officer and the management.

Management

QIA's Chief Executive Officer is responsible for the internal control of QIA, management of its affairs, and the implementation of its general policy. To carry out these functions, he is assisted by a management team including an investment committee and business departments, covering, *inter alia*, direct investment in real estate and private equity, supported by internal audit, legal, administration, and finance departments. In addition to the existing regulations, policies, and procedures, QIA is currently engaging a number of specialist companies to update the same and prepare comprehensive systems and sets of manuals involving codes, policies, and procedures pertaining to corporate governance, code of conduct, legal policies,

investment approval process, risk management and investment strategy, operations, and the like.

Russia: Reserve Fund and National Wealth Fund of the Russian Federation

Incorporation and objectives

The Reserve Fund (RF) and National Wealth Fund (NWF) were established in accordance with the amendments to the Budget Code, the federal law of the Russian Federation, approved in 2007. The initial transfers to the RF and NWF were executed on January 30, 2008, from the Stabilization Fund of the Russian Federation, whereupon it ceased to exist. As of that date the size of the RF and NWF totaled US$125.40 billion and US$31.98 billion, respectively. As of August 1, 2008, the RF totaled US$129.68 billion and the NWF totaled US$32.69 billion.

The objective of the RF is to ensure that the federal budget expenses are financed and the federal budget balance is maintained. In case the amount of oil and gas revenues is not sufficient for the budget purposes, an additional amount could be withdrawn from the RF. The RF could also be used for early state foreign debt repayment in compliance with the federal budget law for the corresponding fiscal year. Actually the RF has replaced the Stabilization Fund. The amount of the RF is limited to 10 percent of GDP. That means that this sum is sufficient to meet future budget obligations in case of unfavorable conditions for a period of at least three years.

The objectives of the NWF are to co-finance voluntary pension savings of the Russian citizens and to maintain the budget balance of the Pension Fund of the Russian Federation. The NWF assets could not be used for any other purposes.

Accumulation

The budget proceeds from the mineral extraction tax and export duties on oil, gas, and oil products are accounted separately from other proceeds to the budget. As the oil and gas proceeds are withdrawn from the budget the artificial budget deficit appears. This calculated non-oil deficit should be covered by the transfer, which amount is pegged to GDP: 6.1 percent in 2008, 5.5 percent in 2009, 4.5 percent in 2010, and 3.7 percent from 2011. The oil and gas proceeds in excess of the transfer are to be channeled to the RF until its amount reaches 10 percent of GDP. If after all there is an excessive amount of oil and gas revenues, then it will be channeled to the NWF.

Governance structure

The Ministry of Finance of the Russian Federation manages the RF and NWF. Some functions of asset management of the RF might be delegated to the Central Bank of the Russian Federation (Bank of Russia) in accordance with agreement with the Ministry of Finance. As for the NWF, some functions of asset management might be delegated to the Bank of Russia or specialized financial institutions (external managers).

Investment policy

The primary investment objective of the RF and NWF is to ensure safety of the assets and stable level of return.

The RF assets are to be invested in foreign currency and the following asset classes, nominated in foreign currency:

- foreign debt securities issued by foreign governments;
- foreign debt securities issued by foreign agencies and central banks;
- foreign debt securities of international financial institutions;
- deposits in foreign banks and credit organizations; and
- deposits and account balances with the Bank of Russia.

The NWF assets are to be invested in financial instruments eligible for the RF and also in:

- fixed income securities and equities of legal entities;
- shares in investment funds; and
- deposits in Russian banks and credit organizations.

Currency composition for both Funds stayed the same as it was for the Stabilization Fund: USD–45 percent, EUR–45 percent, GBP–10 percent.

Current asset allocation for the RF and NWF is the following:

- foreign debt securities issued by foreign governments–80 percent;
- foreign debt securities issued by foreign agencies and central banks–15 percent;
- foreign debt securities of international financial institutions–5 percent

The issuer shall have a long-term credit rating not lower than AA-level.

The investment horizon is limited by minimum maturity for debt securities of three months and maximum maturity of three years for debt securities nominated in USD and EUR, and five years for debt securities nominated in GBP.

Currently the RF and NWF are not invested in eligible assets directly and external managers are not used. The Ministry of Finance places both Funds on the banking accounts in the Bank of Russia in USD, EUR, and GBP. Under the banking account agreement, the Bank of Russia should pay the Ministry interest equal to the performance of the total return indices, composed from the eligible asset classes in accordance with the requirements mentioned above.

At present, the NWF assets should be invested in the same financial instruments as RF. The reason is that investments in corporate securities require development of necessary legal and technical infrastructure. In accordance with instructions from the Government of the Russian Federation the Ministry of Finance is drafting proposals on the NWF's organizational framework and investment strategy.

Reporting and audit

RF and NWF have separate Federal Treasury accounts with the Bank of Russia. The Ministry of Finance should report every quarter to the Government on accumulation, investment, and spending of the capital of both Funds as a part of the Ministry's report on budget execution. In turn, the Government should report quarterly on the same items to the both chambers of the Russian Parliament—the Federal Assembly of the Russian Federation (the State Duma and the Federation Council). At the beginning of every month, the Ministry of Finance should publish a report in the mass media on the accumulation, spending, balance, and investment operations of the RF and NWF.

The accumulation, spending, and investment operations of the RF and NWF are audited annually by the Accounts Chamber of the Russian Federation, an independent statutory auditor, established by the Federal Assembly of the Russian Federation.

Singapore: Government of Singapore Investment Corporation Pte Ltd

Incorporation

The Government of Singapore Investment Corporation Pte Ltd (GIC) was incorporated in 1981 under the Singapore Companies Act and is wholly owned by the Government of Singapore. The Government, through its Investment Mandate to GIC, has authorized GIC as its agent to manage Singapore's foreign reserves. The government is the owner of the reserves.

Source and purpose of funds

The sources of the Government's funds are its accumulated national savings and sustained balance of payments surpluses. GIC's mission is to preserve and enhance the purchasing power of these reserves, which may be called upon during times of crisis. The returns on

the investment of these reserves also contribute toward the Government's budgetary needs.

Governance

The Ministry of Finance, as representative of the Government in dealing with GIC, provides GIC with an investment mandate that sets out the investment objective, time horizon, risk parameters, and investment guidelines for managing the portfolio. The Government does not direct or interfere in GIC's investment decisions.

The Government ensures that a competent board of directors is in place and holds the GIC Board accountable for its overall portfolio performance. GIC is additionally accountable to an independent Elected President of Singapore,[43] who is empowered under the Constitution of Singapore to provide a custodial role over the country's reserves. The President also has to concur with any appointment or removal of directors from the GIC Board, to ensure that each director is a person with integrity and competence.

The GIC Board sets the asset allocation policy and reviews the performance of the portfolio. The GIC management executes the investment strategies and is responsible for all investment transactions. It has full autonomy on where and how to invest the portfolio within the asset allocation approved by the Board. Three asset management subsidiaries—GIC Asset Management Pte Ltd, GIC Real Estate Pte Ltd, and GIC Special Investments Pte Ltd—are responsible for investing the portfolio in the asset classes under their charge and within the guidelines set out in the Investment Mandate.

[43]The President cannot hold other constitutional office nor may he be a member of any political party. He is also required under his oath of office to discharge his functions without regard to any previous affiliation with any political party.

Reporting and audit

GIC reports to the Accountant General's department of the Ministry of Finance on a monthly and quarterly basis, with detailed information on the performance, risk, and distribution of the portfolio. Once a year, GIC management meets the ministry formally to review the risk and performance of the portfolio in the preceding financial year. The Government portfolio is audited annually by the Auditor-General of Singapore, who is appointed by the elected President of Singapore.

Investment and risk management

GIC invests only for financial returns. GIC invests in equities, fixed income, foreign exchange, commodities, money markets, alternative investments, real estate, and private equity. With a network of eight offices in key financial capitals around the world, it invests in more than 40 markets worldwide and in a variety of investments and securities.

Risk management and control forms a critical part of the company's investment management activities. It protects the portfolio against catastrophic losses. The company places great emphasis on risk awareness and a strong governance framework run by people of high integrity. The risk management framework includes policies which cover a wide spectrum of risks such as credit risks, market risks, operational risks, counterparty risks, and legal and regulatory risks.

Detailed information on GIC's governance framework, investment processes, asset mix, and long-term returns are available at www.gic.com.sg.

Singapore: Temasek Holdings (Private) Limited

Incorporation and purpose

Temasek Holdings (Private) Limited (Temasek) was incorporated in 1974 under the Singapore Companies Act and is wholly

owned by the Government of Singapore. Then, Temasek was established to hold and manage investments in companies previously held directly by the Singapore Government. The Government transferred these investments to Temasek in order for them to be managed on a commercial basis as a company and to focus on its responsibilities of policy making for the economy. Today, Temasek's mission is to create and maximize sustainable shareholder value as an active investor and shareholder of successful enterprises.

Source of funds

Temasek is an investment company that owns and manages its assets. Temasek's investments are funded through dividends received from its portfolio companies, divestment proceeds, commercial borrowings, a maiden Yankee bond issue in 2005 and occasional capital injections from its shareholder, the Singapore Government. Temasek does not manage Singapore's foreign exchange reserves. Temasek has a corporate credit rating of AAA/Aaa by Standard & Poor's and Moody's, respectively.

Governance

Temasek is an autonomously managed and professional investment house guided by an independent board. A majority of Temasek's directors are from the private sector. Temasek's investment, divestment, and other operational decisions are made by the Board and management, independent of the Singapore Government.

The Singapore Government ensures that a competent board of directors is in place and holds them accountable. Temasek is additionally accountable to an independent Elected President of Singapore, who is empowered under the Constitution of Singapore to provide a custodial role over the country's reserves. The President also has to concur with any appointment or removal of directors from the Temasek Board, to ensure that each director is a person with integrity and competence.

Reporting and audit

Temasek provides annual statutory financial statements audited by an international audit firm, as well as periodic updates, to the Singapore Ministry of Finance, with detailed information on the performance and risk. Temasek pays dividends to its shareholder regularly, and like other commercial companies, Temasek pays taxes wherever it operates.

Investment and risk management

Temasek has flexible investment horizons and the option of taking concentrated positions or remaining in cash. Its four investment themes—"Transforming economies," "Thriving middle class," "Deepening comparative advantages," and "Emerging champions"—serve as its guiding principles. Temasek's portfolio stands at S$185 billion and is spread across Singapore, the rest of Asia, and the OECD markets.

Temasek is an investor in diverse industries covering banking and financial services, real estate, transportation and logistics, infrastructure, telecommunications and media, bioscience and healthcare, education, consumer and lifestyle, energy and resources, engineering, and technology.

Inclusive of dividends distributed, and net of any new capital, Temasek's total shareholder return is more than 18 percent compounded annually since inception.

Companies in its portfolio are managed by their respective management, and guided and supervised by their respective boards. Temasek does not direct the commercial or operational decisions of its portfolio companies, but holds their respective boards accountable for the financial performance of their companies. It will exercise its shareholder rights, including voting, to protect its commercial interests.

Temasek has a multinational staff of some 350 and international offices in China, India, Brazil, and Vietnam, and a compensation framework aligned toward sustainable long-term value creation.

Temasek's risk-management framework covers strategic issues, including funding liquidity risk and structured foreign exchange risk; financial risks such as investment risks, market risks, and credit risk; and operational risks.

Detailed information on Temasek's financial performance, investments, governance framework, compensation, risk management, and community engagements are published for the public in the annual *Temasek Review*, available at www.temasekholdings.com.sg.

Timor-Leste: Timor-Leste Petroleum Fund

The Republic of Timor-Leste established a Petroleum Fund in 2005 under the Petroleum Fund Law 09/2005. The Petroleum Fund shall contribute to a prudent and transparent management of the petroleum resources for the benefit of both current and future generations and sound fiscal policy. According to the law, the Government is the overall manager of the Fund, while the Banking and Payments Authority (BPA) is the operational manager.

As of June 30, 2008, the Petroleum Fund's balance was US$3.2 billion and the monthly revenues to the Fund are currently estimated at approximately US$200 million. Based on prudent assumptions, the Fund's closing balances at year-end 2008 and 2010 are estimated at US$3.3 billion and US$5.8 billion, respectively.

The Petroleum Fund Law requires that not less than 90 percent of the portfolio be invested in debt instruments and deposits denominated in U.S. dollars. Not more than 10 percent of the portfolio may be invested in other financial instruments, provided that the instruments are issued abroad, are liquid and transparent, and are traded in a financial market of the highest regulatory standard.

The current investment mandate defined in the Management Agreement between the Ministry of Finance and the BPA is to invest the portfolio in debt instruments issued by the United States and other qualifying sovereign governments. The performance is measured against the benchmark Merrill Lynch 0–5-year government bond index. So far, the investments have only taken place in U.S. government bonds.

The Government is responsible for establishing the overall policies and guidelines for the investment of the capital of the Fund, within the framework of the current Petroleum Fund Law, including the specific asset allocation strategy, the investment mandate given to the operational manager, comprising an overall mandate and eventually any subsidiary mandates to external and/or internal managers, with such benchmarks, financial targets, performance and risk measures as may be necessary to convey the Ministry of Finance's intentions to the BPA for the investment and anticipated return on the Fund.

Taking into account the size of the Petroleum Fund and the fact that the balance of the Fund is growing rapidly, the Government is reviewing the current legal framework, including the investment strategy and eligible instruments, with the aim of diversifying the portfolio into other asset classes, currencies, and regions than the current law permits, subject to certain risk limits.

Trinidad and Tobago: The Heritage and Stabilization Fund

Establishment

The Heritage and Stabilization Fund (HSF) was established in March 2007 by an Act of Parliament, Act 6 of 2007.

Source of funds

The HSF is a long-term fund that has two distinct elements: a stabilization component to insulate fiscal policy from fluctuations in energy sector revenues, and a savings component for future generations. More emphasis will be placed on the savings component of this Fund. The accumulation of foreign exchange in the Fund derives from the proceeds of exports of oil and natural gas.

The Fund is separate from the overall foreign exchange reserves of Trinidad and Tobago.

Ownership of the fund

The HSF is owned by the Government of Trinidad and Tobago and managed by an independent board, composed of one representative each from the Ministry of Finance and the Central Bank and three representatives from the private sector. The Board delegates operational management to the Central Bank of Trinidad and Tobago and the Bank uses external fund managers to manage part of the portfolio.

Assets under management

As of August 23, 2008, the HSF amounted to US$2,400 million.

Investment policy and asset allocation

The HSF is invested exclusively in foreign currency denominated assets with a medium- to long-term focus. The Board decides on the investment objectives of the Fund, on strategic asset allocations, and on the benchmark portfolio. The Bank manages the Fund to achieve a target rate of return. The Fund is to be invested in fixed income securities and equities.

Report of the HSF activities

The Central Bank reports on a quarterly basis to the Board of the HSF, while the Board reports to the Minister of Finance annually. The Minister of Finance reports to Parliament on an annual basis after an independent audit by the Auditor General.

Relations between the HSF and the budget

The Act requires that 60 percent of the excess tax revenue from oil and gas (the difference between the actual and the budget estimate) be transferred into the HSF on an annual basis. The oil and gas prices to be used for the budget estimate take into account the recent price history as well as projected prices obtained from defined international sources.

United Arab Emirates: Abu Dhabi Investment Authority

Ownership

Abu Dhabi Investment Authority (ADIA) is a public institution established in 1976 by the Government of the Emirate of Abu Dhabi as an independent government investment institution. ADIA replaced the Financial Investments Board created in 1967 (part of the then Abu Dhabi Ministry of Finance).

ADIA is wholly owned and subject to supervision by the Abu Dhabi Government and has an independent legal identity with full capacity to act in fulfilling its statutory mandate and objectives. ADIA's current constitutive document is Law No. (5) of 1981 Concerning the Re-organization of the Abu Dhabi Investment Authority. Law No. (5) provides separation of roles and responsibilities among the owner, the governing entity, and the management.

ADIA's Law (5) objective is "to receive funds of the Government of Abu Dhabi allocated for investment, and invest and reinvest those funds in the public interest of the Emirate in such a way so as to make available the necessary financial resources to secure and maintain the future welfare of the Emirate."

Abu Dhabi is one of seven Emirates comprising the sovereign federal state of the United Arab Emirates (UAE or Union). Each Emirate exercises sovereignty over all matters that are not within the assigned jurisdiction of the Union government. In particular, under the UAE Constitution, the natural resources and wealth in each Emirate is the public property of that Emirate. Consequently, the natural resources and wealth of Abu Dhabi are considered essential to the economic prosperity, well-being, and security of its citizens.

Governing body

ADIA's Board of Directors is the supreme body having absolute control over its affairs and the discharge of its business. The Board is composed of a Chairman, Vice Chairman,

Managing Director, and other Board members, all of whom are senior Government officials appointed by a Decree of the Ruler of the Emirate. ADIA's Board of Directors meets periodically as required for establishment and review of ADIA's strategic policy in accordance with Law (5) objectives and its oversight of ADIA. ADIA's Board does not normally involve itself in ADIA's investment and operational decisions, as the Managing Director is assigned these responsibilities by Law (5).

Management

ADIA's Managing Director is the chief executive responsible for the implementation of its policy, the management of its affairs, and the legal representative of ADIA in its relationship with third parties. The Managing Director is vested by Law (5) with financial independence and various powers, including the power to take decisions in respect of investment proposals following review and analysis in context of the policies approved by the Board within the Law's objectives. Thus, ADIA's management has operational independence from general government.

ADIA's Managing Director is assisted by the Investment Committee established pursuant to Law (5), which is composed mainly of the heads of the several investment departments. The Investment Committee assists the Managing Director in the performance of his duties and provides advice in respect of ADIA's investments and the management and coordination of ADIA's affairs and activities. The Investment Committee is supported by a number of advisory committees: the Strategy Committee, the Administration Committee, and the Guidelines Committee. The Managing Director is also supported by the Strategy Unit, Evaluation and Follow-up Department, Internal Audit Department, and Legal Division.

United States of America: Alaska Permanent Fund Corporation

The Alaska Permanent Fund was created by the people of Alaska in 1976 to save a portion of the state's oil revenue for the future. The Fund is currently worth about US$37 billion.

In 1980, the Alaska State Legislature created the Alaska Permanent Fund Corporation to manage the investments of the Permanent Fund outside of the State Treasury. The investments are guided by a six-member board of trustees, appointed by the Governor.

The Trustees have maintained a conservative asset mix over the years. The current asset allocation includes 53 percent in U.S., non-U.S., and global equities, 22 percent in U.S. and non-U.S. fixed income, and 10 percent in real estate. The Fund also has allocations of 6 percent to private equity, 6 percent to absolute return strategy investments, and 3 percent to infrastructure investments.

The Permanent Fund is made up of two parts: reserved (principal) and unreserved assets. The Constitution does not allow the reserved portion of the Fund to be spent. The Alaska State Legislature may spend the unreserved part of the Fund as it chooses.

Prior to 2005, the Legislature had only used the earnings of the Fund for one purpose: the Permanent Fund Dividend program (administered by the Department of Revenue). This program annually distributes a portion of the unreserved assets to every eligible Alaskan. These dividends have ranged from US$331 in 1984 to US$1,964 in 2000. In the fall of 2008, dividends of approximately US$2,000 will be paid to more than 600,000 Alaskans.

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