



# Session #22: Sovereign Wealth Funds

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Aspects”

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# Outline

- What is a SWF and what is the rationale behind them?
- Objectives, governance, investment policy and reporting
- The Santiago principles
- Country examples: Norway and Timor-Leste
- Summary



# What is a Sovereign Wealth Fund?

- No universal definition, but often defined as “a state-owned pool of money created for **macroeconomic purposes**”.
- The revenues may origin from:
  - Natural Resources** (Norway, Chile, Timor-Leste, Botswana, Trinidad & Tobago, Abu Dhabi, Kuwait, Kazakhstan, Azerbaijan and Russia)
  - Other Fiscal Sources**, e.g. privatisation of public corporations, other sources of budget surpluses (Singapore, Korea, New Zealand and Australia), or
  - Excessive Foreign Reserves** (China)
- SWFs are holding, investing and managing assets in line with predetermined investment strategies, in order to achieve **financial objectives**.



# What is a Sovereign Wealth Fund?

- According to good international practice, SWFs mainly invest in **financial assets abroad**.
- Revenues typically derive from a country's **budgetary surplus** and are kept overseas to avoid any adverse impact on the domestic economy.
- Investments may preserve or increase the value of the funds through generation of **investment return**.
- The SWF is in most cases regarded as a stabilisation and savings vehicle, but some countries have also given it **domestic investment responsibilities** (e.g. Russia, Azerbaijan, Malaysia and Angola).



# SWF Key Information

- 74 SWFs worldwide: \$6.4 trillion under management
- 51 Natural Resource Funds: \$3.8 trillion under management

<b>Country</b>	<b>Type of fund</b>	<b>Size, billion</b>
Norway	Petroleum	\$838
Abu Dhabi	Petroleum	\$773
Saudi Arabia	Petroleum	\$676
China (CIC)	Non-commodity	\$575
China (SAFE)	Non-commodity	\$568
Kuwait	Petroleum	\$410
Hong Kong	Non-commodity	\$327
Singapore (GIC)	Non-commodity	\$320
Singapore (Temasek)	Non-commodity	\$173
Qatar	Petroleum	\$170
China	Non-commodity	\$161

Source: SWF Institute



# Why do most natural resource abundant countries have SWFs?

## 1. **Enable short and medium term stabilisation**

Separating natural resource revenues from public expenditures and insulating domestic economy from volatility.

Enables smoothing out expenditures over time.

## 2. **Provide for long term savings**

Ensuring future generations can benefit from mineral extraction.

## 3. **Sterilization**

Mitigating real appreciation of the currency and Dutch disease.

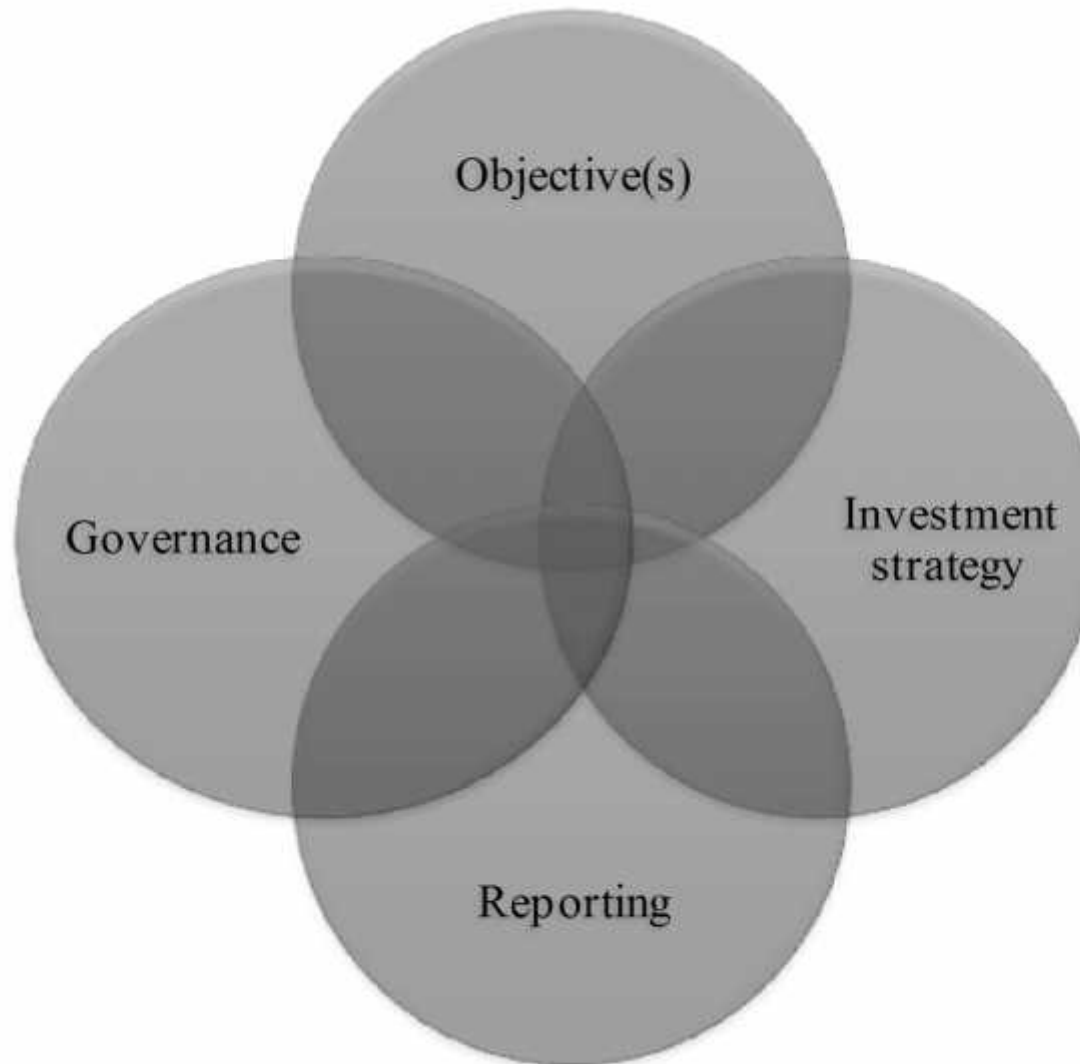
## 4. **Socio-economic development**

Improving infrastructure, health, education and promoting domestic economic growth.

## 5. **Ring-fencing**

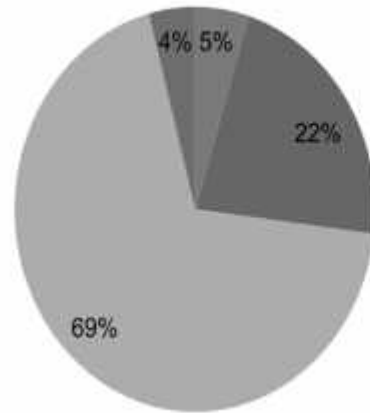
A special treatment of mineral revenues as they are a national endowment and exhaustible.

# Main Elements of SWF Policy

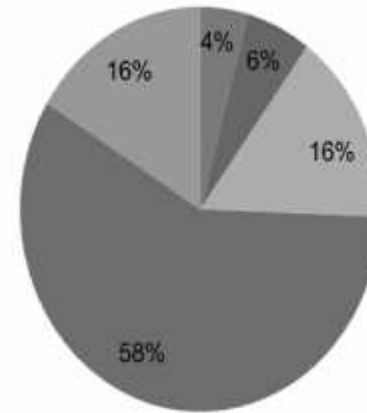


# SWF Objectives

Stabilization Funds

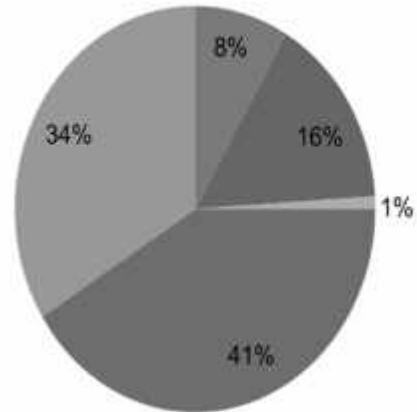


Saving Funds

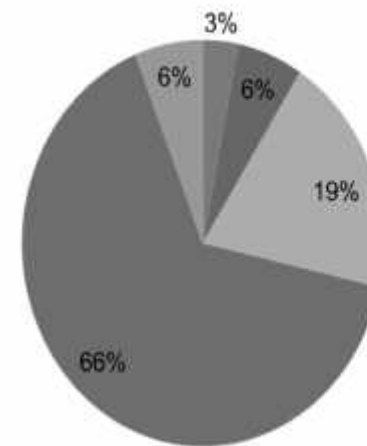


- Cash
- Other fixed income
- Sovereign fixed income
- Equities
- Others

Pension Reserve Funds

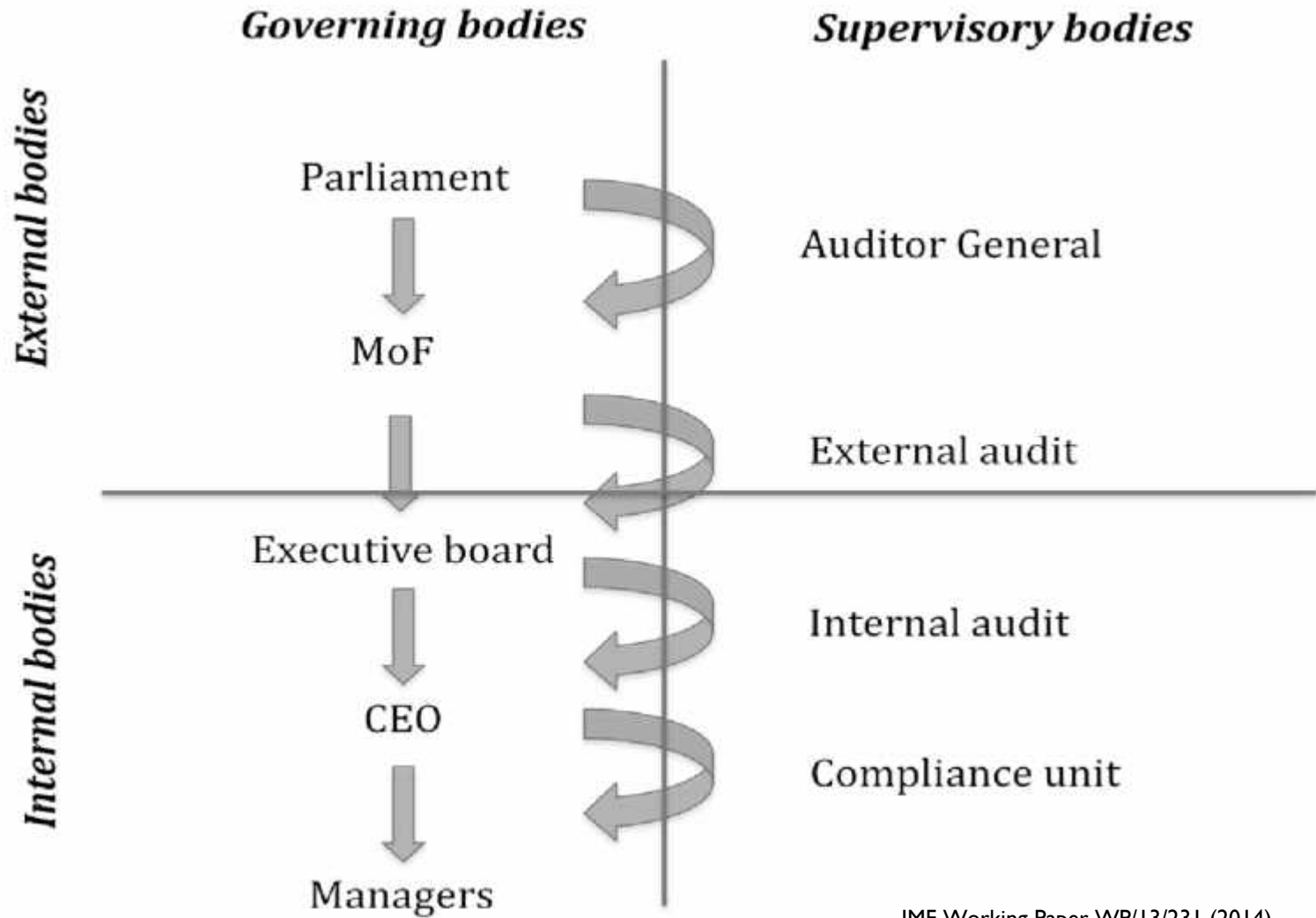


Reserve Investment Funds





# SWF Governance





# SWF Reporting

- **Internal reporting** an important part of the governance structure.
- **External reporting** ensures transparency and accountability.
  - Monthly, quarterly and annual disclosure of revenues received, transfers and withdrawals, investment performance etc.
  - Disclosure of audited financial statements
  - Publication of advice provided by Advisory Boards
- **Oversight bodies** ensure adequate checks and balances
  - Auditor General
  - Independent auditors
  - Consultative Councils/Public Interest and Accountability Committees



# SWF Investment Policy

- The principle of diversification
- The relationship between expected risk and return
- Defining the appropriate asset allocation depends on the risk bearing capacity
- The risk appetite should determine the asset allocation:
  - Cash
  - Fixed income/bonds
  - Equities
  - Alternative investments
- Investments in the international financial market vs. domestic investments
- Who should determine what?
- Transparency



# The Santiago Principles

- Santiago Principles = Generally Accepted Principles and Practices (GAPP) for SWFs.
- Adopted by 26 SWFs, from 23 countries, in 2008 in Santiago, Chile.
- The SWFs signed off on the Santiago Principles represented roughly US\$3.2 billion in assets under management in 2008.
- Comprise 24 individual principles and sub principles about good practices in SWF management.



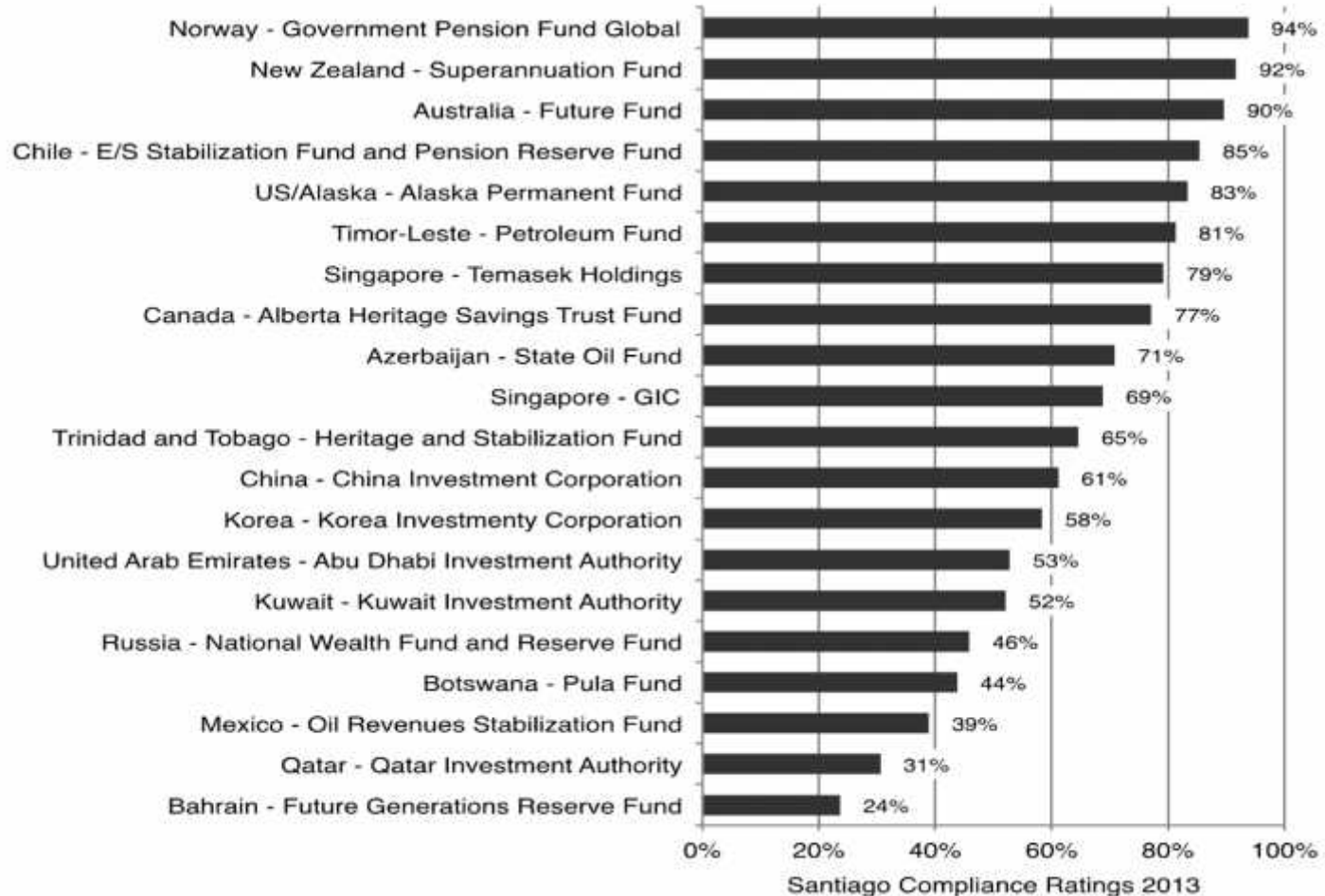
# The Santiago Principles

- Clear and publicly disclosed information about policies, rules, procedures or arrangements with regard to funding, withdrawal, and spending operations.
- Clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the Fund management.
- Timely reporting in accordance with recognized international standards and national accounting standards and public disclosure of financial information.
- Operations in host countries conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which

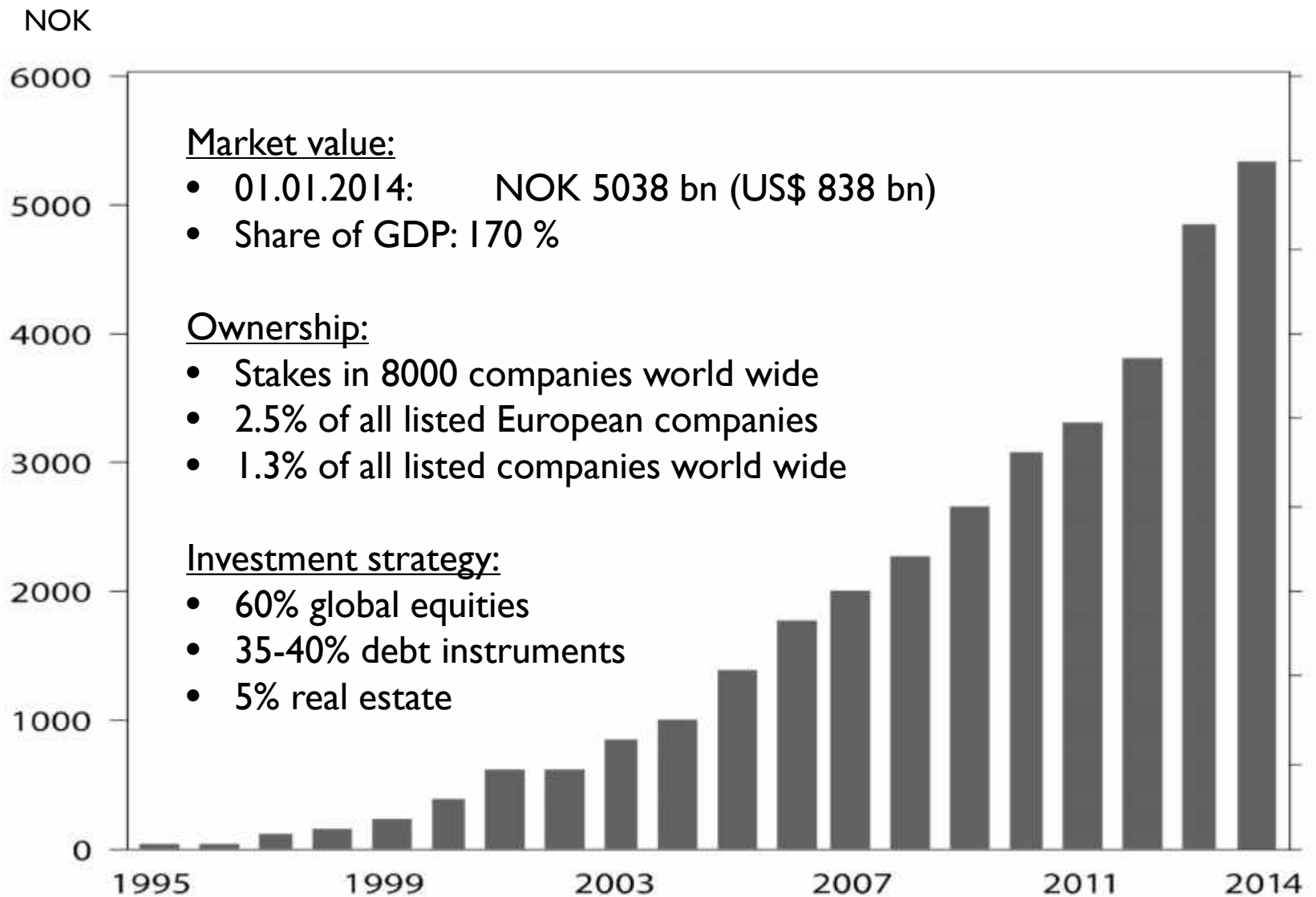
# The Santiago Compliance Index



## Santiago Compliance Index 2013



# Norway: Gov. Pension Fund Global (GPFG)



Source: Ministry of Finance

# Norway: A clear Governance Structure

Norwegian Parliament (Stortinget)

Government  
Pension Fund Act



National Budget  
Annual Report

Ministry of Finance

Management  
mandate  
(risks mgmt, reporting  
and responsible inv.)

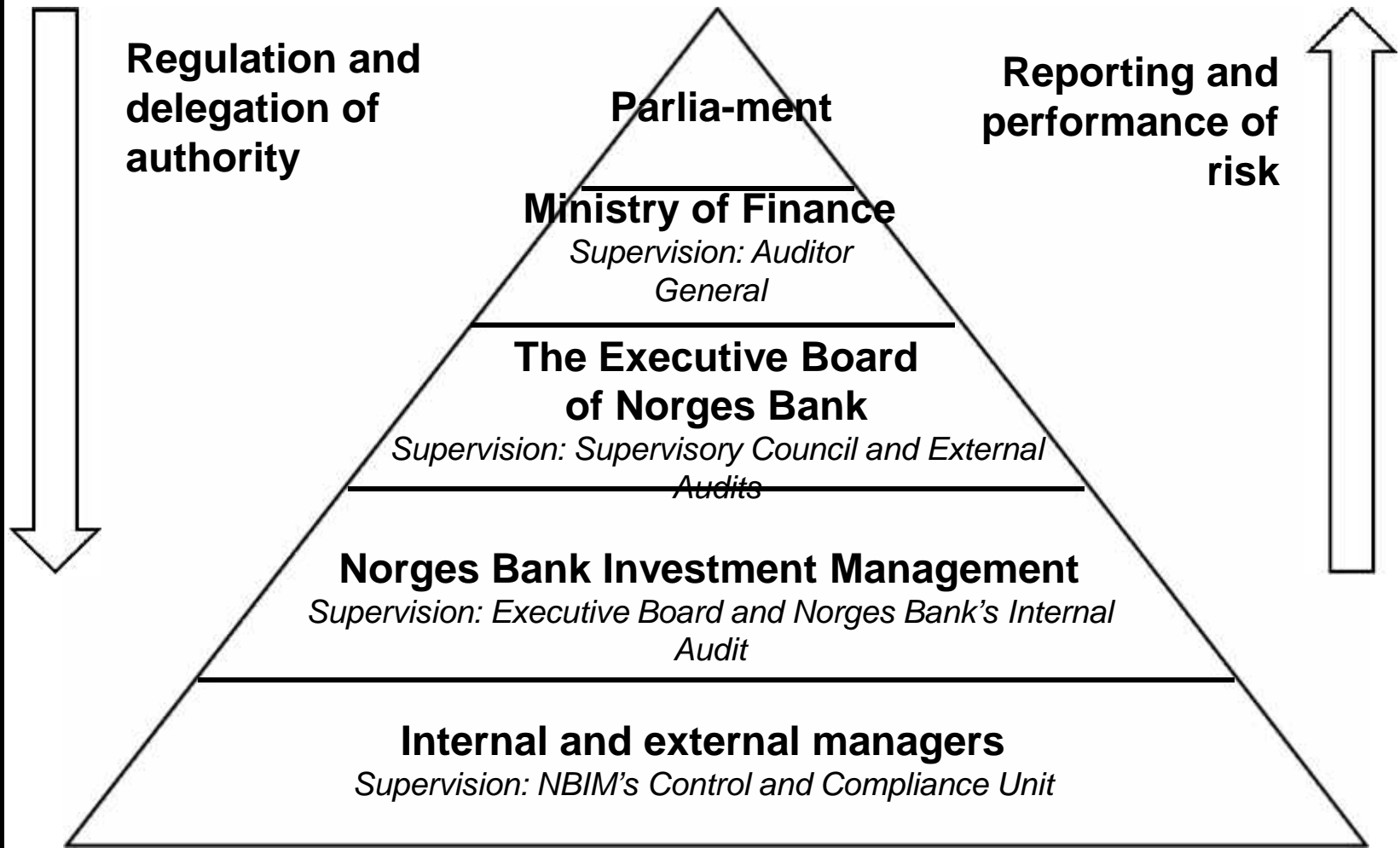


Quarterly & Annual  
Reports  
Investment Strategy  
Advice

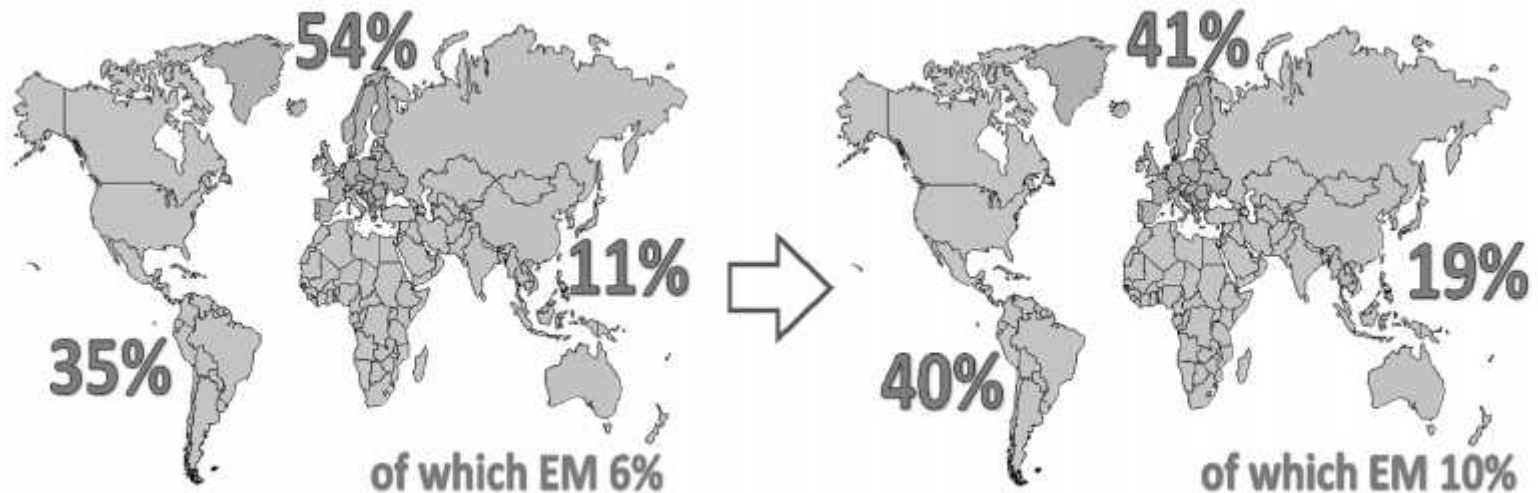
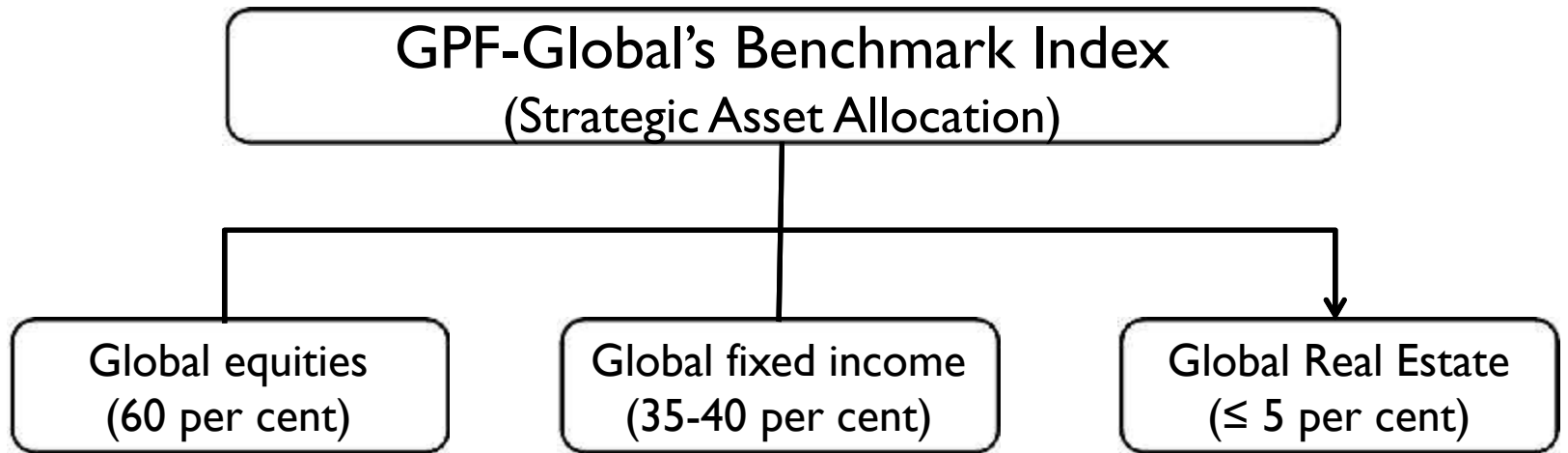
Norges Bank (NBIM)



# Norway: Regulation, Supervision and Reporting



# Norway: GPFG's Investment Strategy

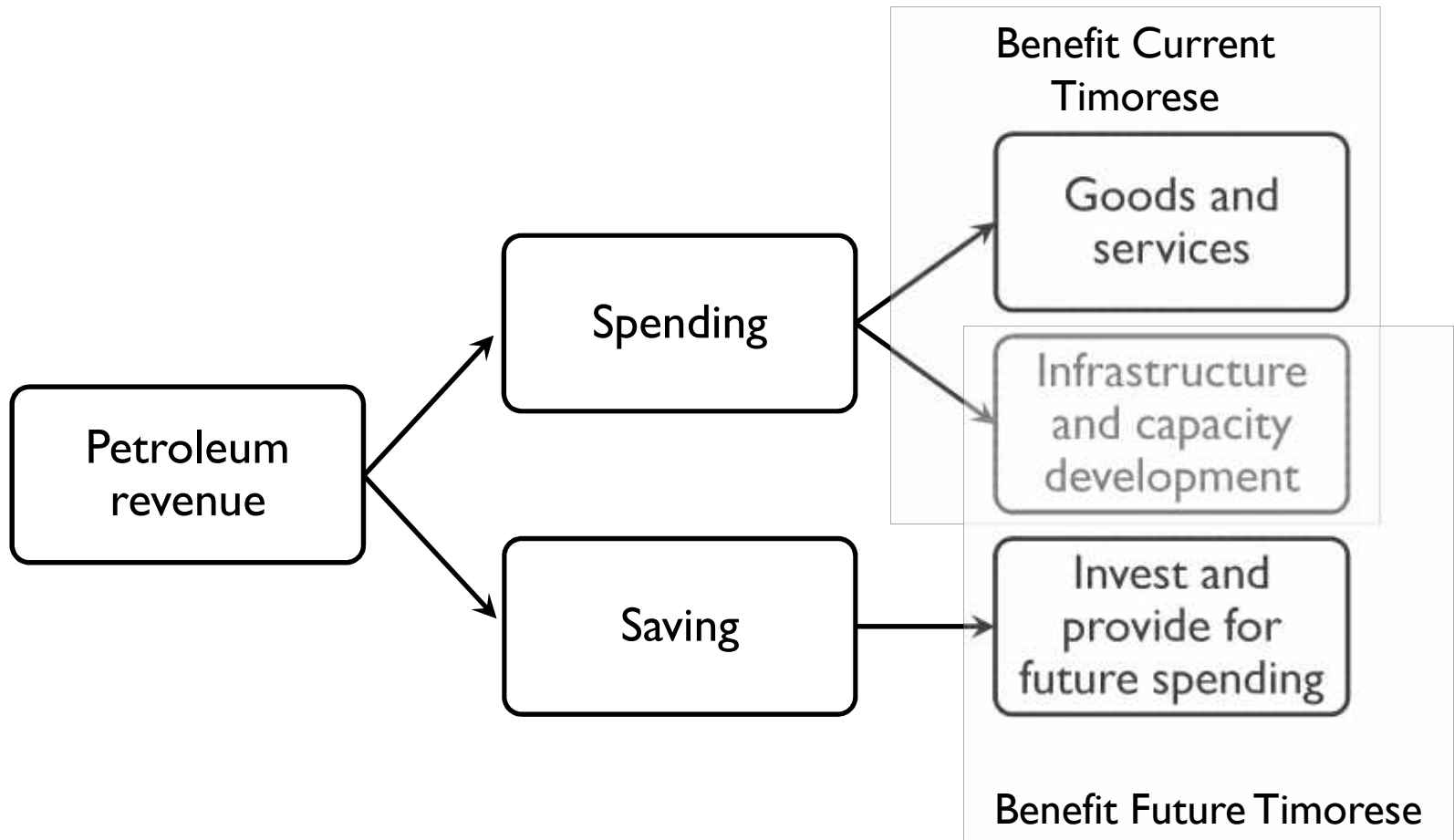


# Timor-Leste: The Petroleum Fund's main Goal

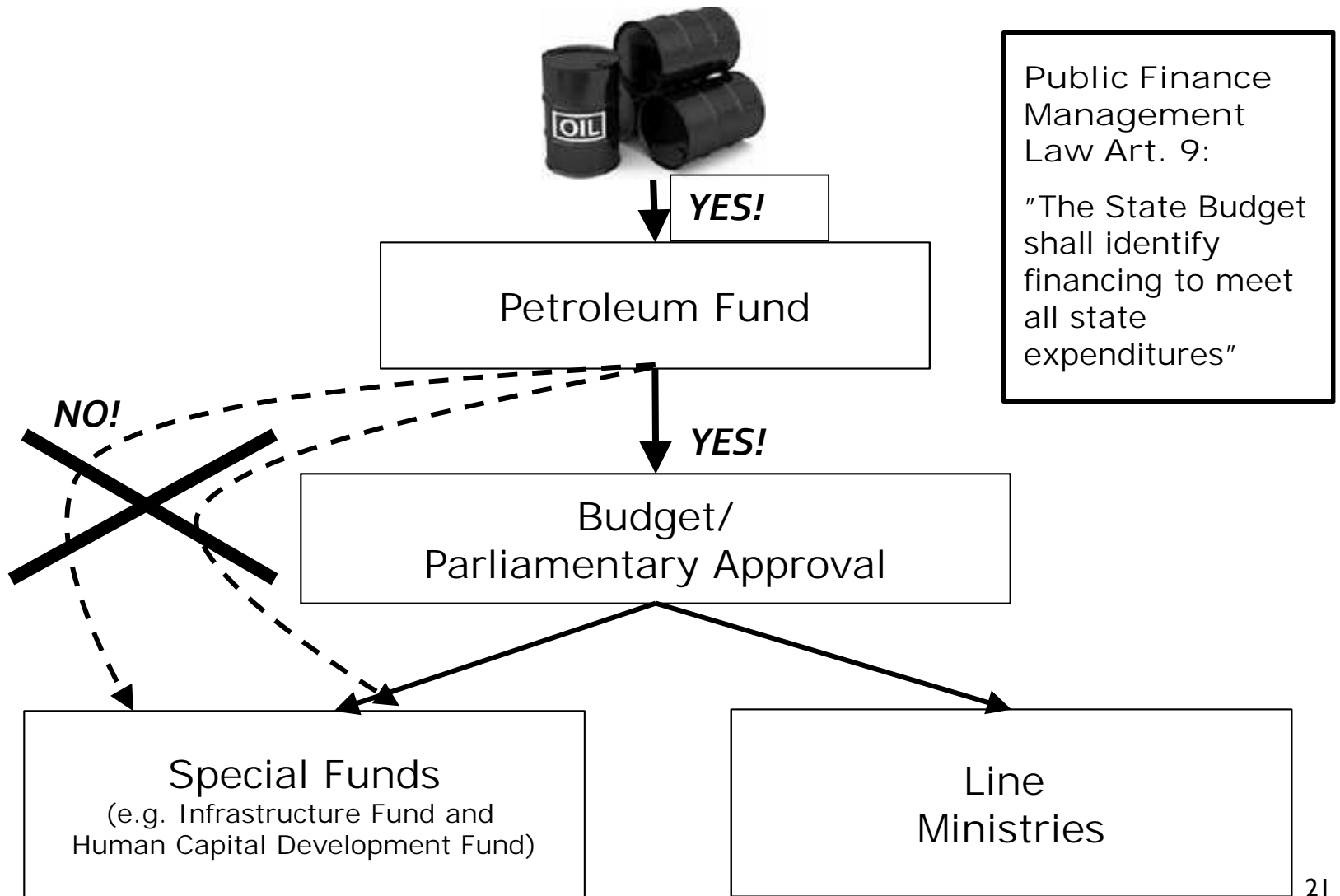


The Petroleum Fund shall contribute to a wise management of the petroleum resources for **the benefit of both current and future generations**. The Petroleum Fund shall be a tool that contributes to sound fiscal policy, where appropriate consideration and weight is given to the long-term interests of Timor-Leste's citizens.

# Timor-Leste: How does Petroleum Revenue benefit Timorese?



# Timor-Leste: No Off-budget Transfers



# Timor-Leste: Governance Structure

**Legislator:**

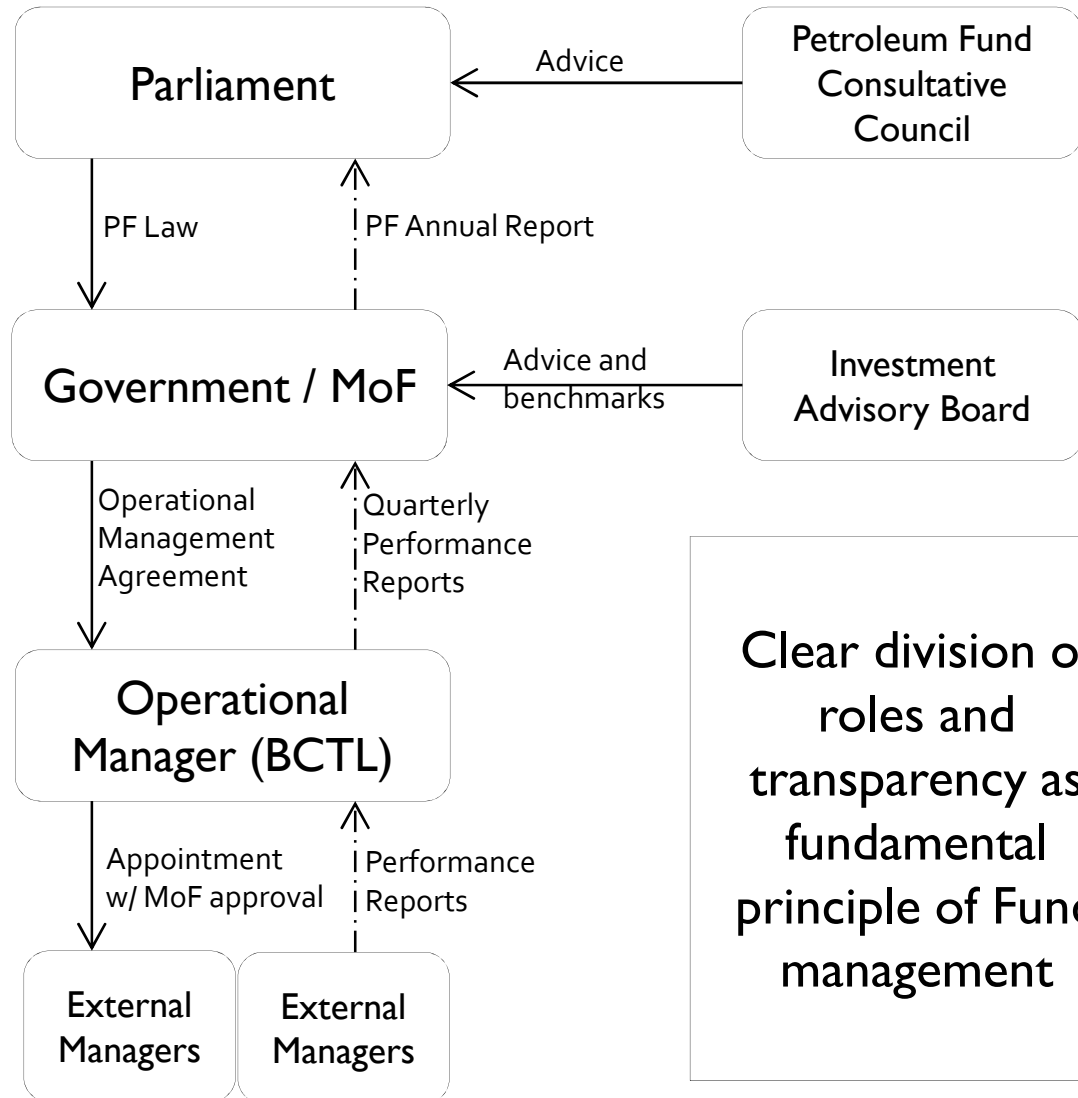
Petroleum Fund Law

**Executive:**

Formulate Investment policy  
Monitor management of the Fund

**Manager:**

Implement Investment policy



**Clear division of roles and transparency as fundamental principle of Fund management**



# Summary: Ingredients to Success

- The SWF must be a part of the overall macroeconomic framework and act in coordination with fiscal and monetary policies.
- Design and policies must comply with the SWF objective.
- A clear governance structure based on sound governance principles.
- Extensive provisions that cater for adequate regulation, supervision and reporting.
- Prudent investment strategy linked to long term aims and the country's risk-bearing capacity.



# Take Away Points

- Identify and articulate the SWF objective(s) before entering into the design phase.
- Ensure checks and balances and a sound governance structure is in place.
- Integrate the SWF into the macroeconomic and budget framework.
- Transparency matters.