

Conference - Universite' Paris Nanterre

Sovereign Wealth Funds: an opportunity properly managed?

SWFs and sustainability, in a time of volatility, risk and uncertainty.

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The research main topics are:

- *What Sovereign Wealth Funds (SWFs) are?*
- *Why SWFs are important?*
- *How can a SWF better perform and support sustainable development?*
- *How can a SWF better redistribute revenues?*





The research main topic is:

To demonstrate how SWFs' good governance is not only promoted and measured by SWFs' Governance independency and ability to seek exclusively for economic return without political interference but, on the contrary, by endorsing a political agenda focused on the promotion of domestic sustainable development and the spread of best practices and ethical guidelines both for long term investors and the companies they invest in.





What Sovereign Wealth Funds (SWFs) are?



Definitions of SWFs 2005 – 2008



International Working Group
of Sovereign Wealth Funds

- *Andrew Rozanov (2005)*
- *U.S. Department of Treasury (2007)*
- *International Monetary Fund (2008)*
- *Blundell-Wignell et al. (2008)*
- *Council on Foreign Relations: Teslik (2008)*



The Santiago Principles definition of SWFs (2008)

“...special purpose investment vehicle created and owned by the general government for macroeconomic 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.

... 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.”

The Santiago Principles (2008)



Clark, Dixon and Monk definition of SWFs 2013

«SWFs are government-owned and controlled (directly and indirectly) investment funds that have no outside beneficiaries or liabilities (beyond the government or the citizenry in abstract) and invest their assets, either in the short or long term, according to the interests and objectives of the sovereign sponsor.»



Definition of Sustainability and Shareholders



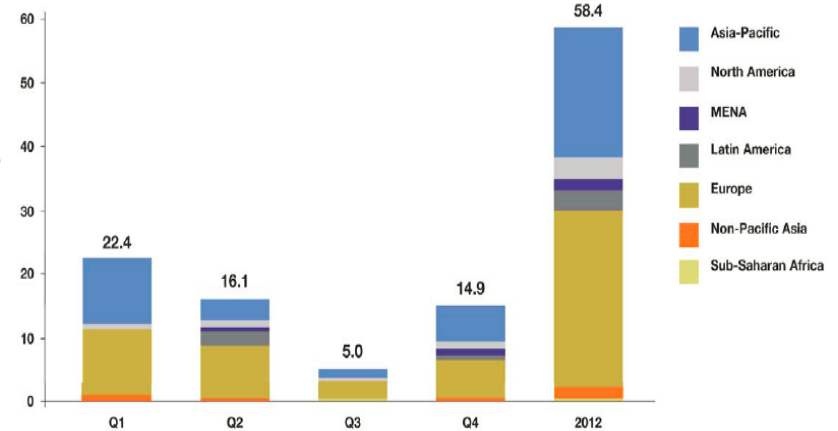
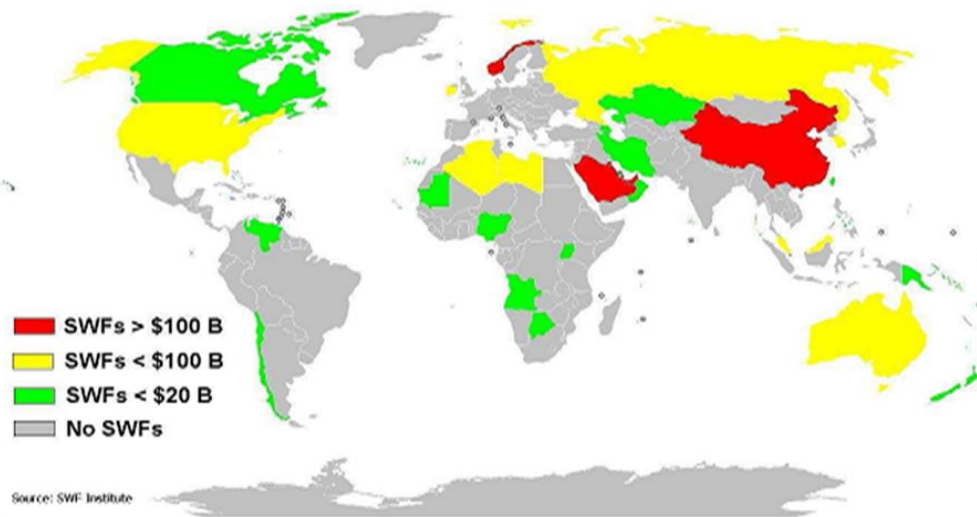
International Working Group
of Sovereign Wealth Funds

- *The capacity of SWFs to meet their objectives and, as well, their shareholders requests, expectations and rights.*
- *The effective ability of SWFs to contribute to the Sustainable development of the Sponsor Countries.*

- ♦ *Citizens of the Sponsor Countries;*
- ♦ *Future Generations;*
- ♦ *Governments;*
- ♦ *Others.*



Where SWFs are active?



SWFs are mainly concentrated in the emerging countries of Asia, Middle East and Africa. Countries that are asking for more decision-making power corresponding to their economic power in the international organizations.

SWFs investments are directed mainly towards Europe, Asia and North America



What SWFs could also be?

- *ASIA: SWFs are the reaction to the 1997 Asian crisis and the recognition among emergencies countries that self-insurance was preferable to IMF conditionality and the associated loss of sovereignty.*
- *GULF: SWF is an institution used to provide long-term assurance to domestic sovereignty. The legitimacy of these SWFs is a function of its utility to the ruling elite through its contribution to stability and support to the power of the regime. (KIA) (BIA)*
- *China/Support the Go Global Political Agenda: SWFs often can be used as a tool for guarantee access to raw materials.*
- *Protection of the domestic interests: Some countries create SWFs in order to protect and support the domestic economic and the competitiveness of the strategic local firms.*
- *SWFs are the “natural institutional blueprint for more active management of excess reserves” (Park 2008, 2)*



SWFs Main Objectives

- ***Stabilization Funds:*** *Stabilization vs Volatility (Dutch Disease, inflation, etc.)*
- ***Saving Funds:*** *Transformation of non renewable resources into wealth for future generations*
- ***Pension Reserve Funds:*** *meeting future deficits of the social security system*
- ***Development Funds:*** *Support of Development (Infrastructure, Renewable Energy, Education)*
- ***Diversification Funds:*** *Diversification plus employment*
- ***Multiple and specific goals Funds:*** *Empowerment of the private sector*





Why Sovereign Wealth Funds are important?

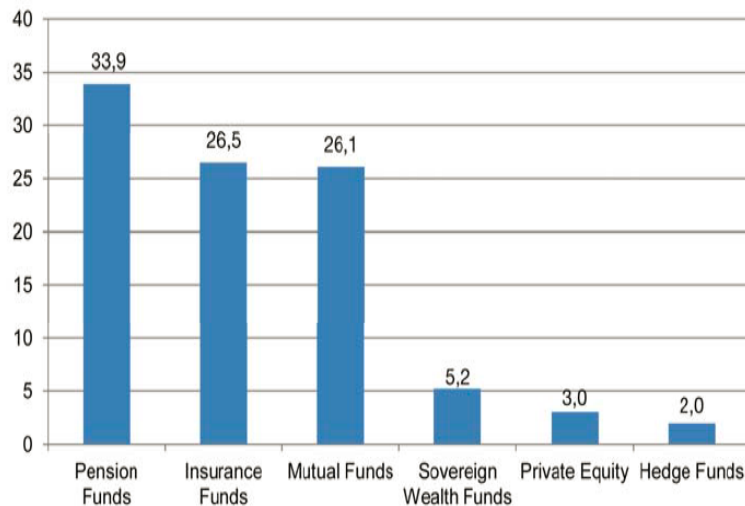


Why Sovereign Wealth Funds?

...SWFs represent important financial and political actors on the global scenario and are becoming increasingly fundamental in the international monetary and financial system

...with an **AUM of nearly \$ 6 trillion**, are the world's fourth financial power but they are concentrated in a much smaller number of subjects

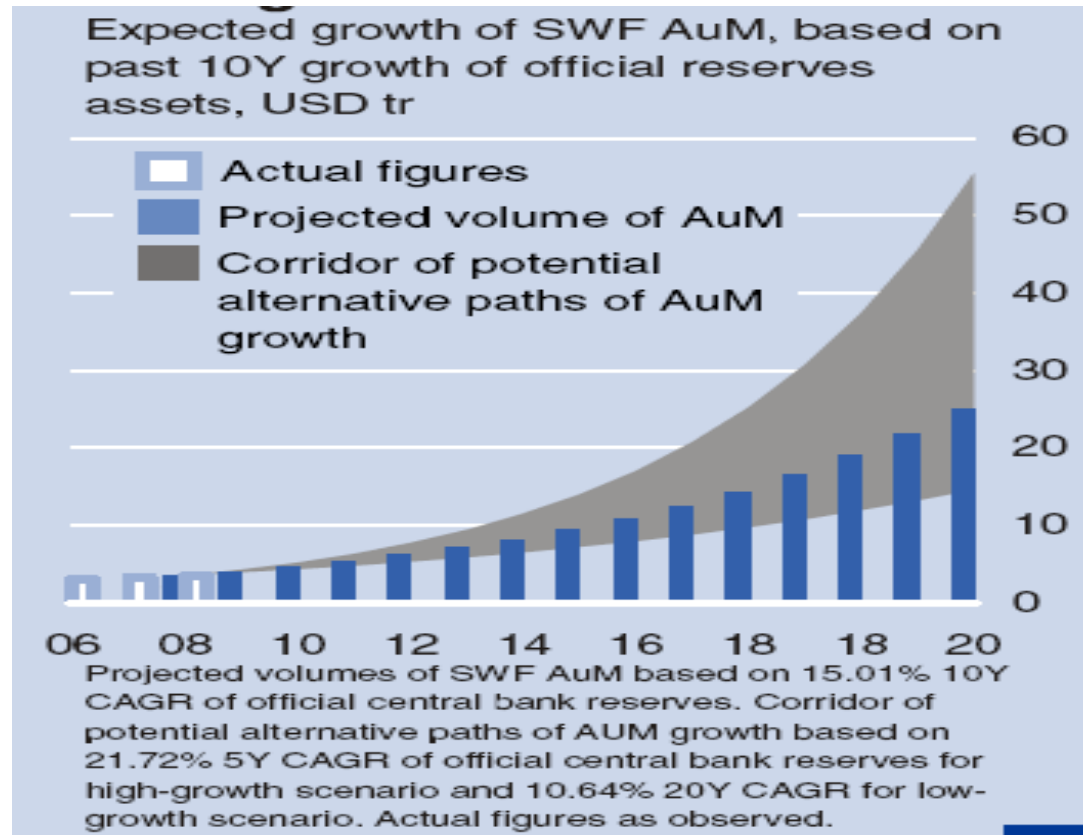
Global AUM (US\$trn, 2012)



Source: CityUk



Why Sovereign Wealth Funds?



...their AUM is expected to **duplicate** in less than 10 years.



The role of SWFs in the Financial Sector

- The sovereign fund of Qatar, QIA, is the second largest shareholder of Credit Suisse with a stake of 6.2%. In 2010 acquired 5% of Banco Santander Brazil.
- Aabar Luxembourg S.A.R.L. (Luxembourg Fund controlled by Aabar Investments of Abu Dhabi holds the 6,501% of Unicredit.
- The Sovereign Fund of Kuwait holds shares of Citigroup (USA) and Merrill Lynch (USA).
- The most prestigious banks in the USA and UK have China, Singapore, Kuwait and Abu Dhabi as their main shareholders.



Why SWFs?

- SWFs represent the next installment of capitalist development following Clark's pension funds capitalism. (Clark, Dixon and Monk)
- Volatile financial markets and speculative excess has seen the reemergence of states as important arbiters of the prospects and redirection of capitalist economies.
- SWFs offer States an opportunity to reassert national sovereignty and authority over financial globalization in ways that preserve local differentiation, autonomy, and indeed, sovereignty. (Helleiner 2009 mod).
- Furthermore the raising of SWFs well represents the increase of importance of finance over the real economy in the global economy.
- SWFs demonstrate that the power of financial markets now extends to state agencies, from representative democracies to authoritarian regimes.



SWFs International Benefits

SWFs bring important benefits to global capital markets in terms of:

- Liquidity injection in the international financial markets;
- Possibility of counter-cyclical investments;
- Markets' stabilization through long term investments;
- Financial assets allocation ;



SWFs could support domestic sustainable development through:

- The increase of the national ranking in terms of Human Development Index;
- The improvement of transparency through the implementation of best practices and good governance;
- The reduction of corruption and the reduction of poverty through an appropriate redistribution of incomes;
- The increase of employment in terms qualitative and quantitative terms;
- A favorable element for the increase of the national credit rating;
- The stabilization and diversification of the economy;
- The development of Infrastructure and of the Private Sector;
- **The import of know-how and the transfer of knowledge.**



SWFs International Benefits

SWFs bring important benefits to global capital markets in terms of:

- The promotion both at the domestic and international level of best practices and ethical values that contribute to the good governance and the transparency and sustainability of other Sovereign Wealth Funds and the companies they invest in;
- Enhancement of transparency and public scrutiny, limitation of discretionary control, and support to public promotion of long-term savings of resource revenues;
- SWFs can also directly dedicate part of their portfolio to social investments.



SWFs that promote social investments:

- Azerbaijan State Oil Fund - Sofaz (Baku Pipeline and social projects)
- Fundo Soberano de Angola – FSDEA(3.5% of portfolio for social projects)
- Texas Permanent School Fund
- The New Mexico land grant fund
- Alberta's Heritage Fund
- The Government Pension Fund – Global– Norway (gender empower related)
- Kuwait Investment Authority KIA - (economic infrastructure in third world countries)
- New Zealand Superannuation Fund - New Zealand (Enviroment)



How SWFs promote social investments?

Sector	Fund	Projects
Infrastructure	Azerbaijan, State Oil Fund	Water Supply (Oguz-Qabala-Baku water supply system) Irrigation System(Reconstruction of the Samur-Absheron irrigation system) Railway (Financing of the Baku-Tibilisi-Kars railway)
Education system	Angola, Fundo Soberano de Angola	Don Bosco Schools, multi-year project, that encourages computer-based learning in traditional classrooms at an early age.
Renewable Energy	UAE, Mubadala	Masdar Capital, seeks to build a portfolio of the world's most promising renewable energy and clean technology companies.
Private Sector	Kuwait, Kuwait Investment Authority KIA	Promoting the excellence of the private sector in Kuwait while ensuring that it does not compete with or act as substitute for it in any field.





How can SWFs promote sustainable development?



From Transparency to Sustainability

Transparency is a critical part of sustainability:

The need for a SWFs greater transparency is common both for sponsor countries and host countries.

Present themselves to the public opinion as profit driven financial institutions pursuing goals that are far from being political or strategic

*In order to present SWFs investments benefits with the effects of creating a **friendly environment for their investments**, avoiding the rise of protectionist sanctions and fostering better performances.*



SWFs' transparency index

- Linaburg-Maduell

- Analysis of satisfaction of ten fundamental principles by the SWFs

- Kaufmann, Kraay and Mastruzzi (KKM)

- Worldwide Governance Indicators developed

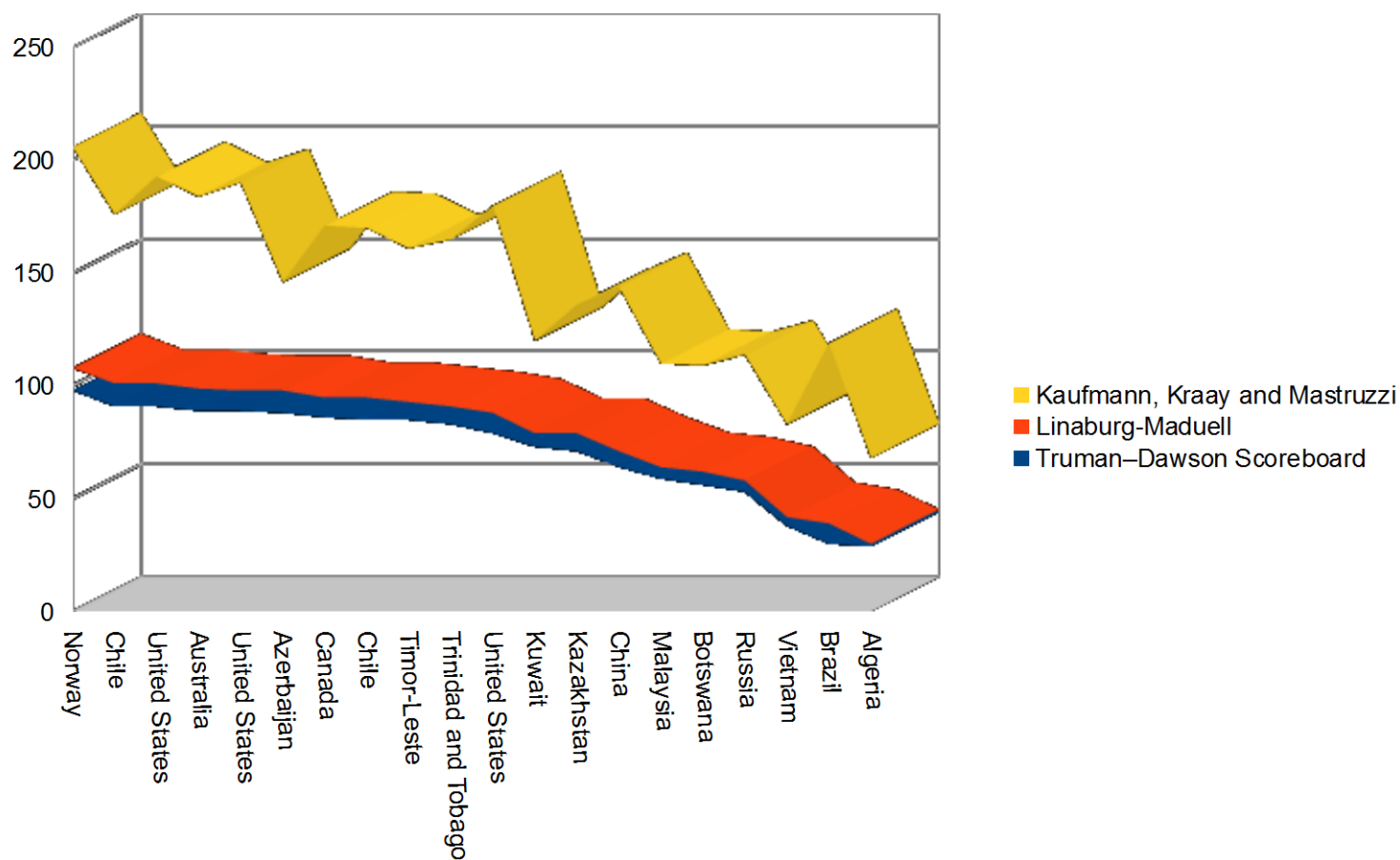
- Truman-Dawson

- Based on 33 evaluation indicators of adherence to behavioral norms considered optimal

- Santiago Principles - General Accepted Principles and Practice



Comparison of the three indexes results (Data 2012)



Elaboration by Elena Lanfranchi, Università degli Studi di Bergamo



How to assess SWFs Sustainability:

1. Governance

- Independency of the board from the political decision makers;
- The existence of:
 - ✓ a clear policy purpose;
 - ✓ a sound legal framework;
 - ✓ annual Audit, Reporting;
- Use of the best-practice portfolio management in order to avoid prejudicing the Sponsor Countries 'reputation';
- Others.



How to assess SWFs Sustainability:

2. Allocation of Portfolio

- Tolerance of risk in the strategic allocation of portfolio in terms of
 - ✓ Assets
 - ✓ Time horizon
 - ✓ Geographical area of investments and the related political, financial, legal risks.
- Co-Investment with
 - ✓ Other SWFs
 - ✓ International Financial Institutions
 - ✓ Others
- Driven Criteria:
 - ✓ Financial
 - ✓ Social
 - ✓ Strategic
 - ✓ Political



How to assess SWFs Sustainability:

3. Target Companies

Ethical guidelines for the evaluation of the target Companies

The Norwegian government pension funds global example

Exclusion related to the violations of:

- ✓ *Children's rights;*
- ✓ *Human rights;*
- ✓ *Climate change good policies;*
- ✓ *Water management good policies.*

And the presence of:

- ✓ Gross corruption;
- ✓ Severe environmental damage;
- ✓ Manufacturing and sales of weapons;
- ✓ Production of tobacco.



How to assess SWFs Sustainability:

3. Target Companies

Norway's Government Pension Global (GPFG) divested from:

- 23 palm oil producers companies linked to tropical deforestation (ASIA);
- Oil companies with operations in Equatorial Guinea accused of not using the massive oil in order to alleviate poverty

An another important element that the Norwegian SWF takes into serious consideration, is the level of efficacy in the accomplishment of the ethical guidelines by the companies the Fund invest in.



How to assess SWFs Sustainability:

3. Target Companies

Ethical guidelines for the evaluation of the target Companies

New Zealand Superannuation Fund Examples

Exclusion of companies that are directly involved in:

- ✓ *the manufacture of cluster munitions;*
- ✓ *the manufacture of anti-personnel mines;*
- ✓ *the manufacture of tobacco;*
- ✓ *the processing of whale meat.*

New Zealand Superannuation Fund responsible investment work programme is closely aligned to the United Nations' Principles for Responsible Investment (UNPRI).

The UNPRI is the internationally-accepted benchmark for how institutional investors should manage environmental, social and governance issues.





***How can SWFs distribute
revenues?***



Redistribution of revenues

Alaska Permanent Fund (APF) directly distributes profits to national citizens paying in cash.

Main benefits of the model:

- (i) transparency in the use of the SWF's resources ;*
- (ii) the accomplishment of the specific needs of each individual citizen.*

Main barriers to the implementation the model:

- (i) Anti-consumption objection;*
- (ii) Diluted returns objection;*
- (iii) Savings objection;*
- (iv) Technical concerns objection;*
- (v) Wrong timing due to the recent global financial crisis;*
- (vi) Institutional skepticism.*



Thank You!



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