Appendix 2: Sovereign Wealth Funds

As discussed in earlier reports, an increasing number of countries have recently established, or are considering establishing, Sovereign Wealth Funds (SWFs). Private sector estimates suggest that SWF assets under management currently range from US$2-3 trillion. In the September 2008 *World Economic Outlook*, the IMF forecasts foreign assets under the management of SWFs will exceed $7–11 trillion by 2013.

The Department of the Treasury, in coordination with other U.S. Government agencies and multilateral institutions, has been working to shape an appropriate international policy response to financial market and investment issues raised by SWFs. This Appendix highlights important policy achievements since our last report in May 2008.

The International Working Group of SWFs

On April 30-May 1, 2008, representatives from more than 20 SWF countries met at the IMF in Washington, D.C. and formed the International Working Group of Sovereign Wealth Funds (IWG).[1] The IMF co-chaired the group and served as Secretariat throughout the drafting process. The IWG held two additional meetings, one in Singapore in July and the other in Santiago, Chile in early-September, where the IWG reached agreement on a set of voluntary principles and practices for SWFs. The IWG engaged countries that receive SWF investment throughout the process, and included the Organization for Economic Cooperation and Development (OECD) as a Permanent Observer.

Generally Accepted Principles and Practices ("GAPP" or "Santiago Principles")

The IWG publicly released the Generally Accepted Principles and Practices for Sovereign Wealth Funds (GAPP, or "the Santiago Principles")[2] on October 11, 2008, less than six months from the time the first IWG meeting was convened.[3] The Santiago Principles comprise 24 principles and supporting commentary to guide SWFs in establishing sound institutional and operational practices. These are divided into three separate chapters: (1) Legal Framework, Objectives, and Coordination with Macroeconomic Policies; (2) Institutional Framework and Governance Structure; and (3) Investment and Risk Management Framework.

The Santiago Principles respond directly to the key macroeconomic, financial market, and investment issues raised by the rapid growth in the size and number of SWFs.

- First, the Principles emphasize that SWF operations should be consistent with a sound macroeconomic policy framework to address the concern that the formation of SWFs may perpetuate undesirable underlying macroeconomic and financial policies.

---

[1] IWG member countries are: Australia, Azerbaijan, Bahrain, Botswana, Canada, Chile, China, Equatorial Guinea, Iran, Ireland, Korea, Kuwait, Libya, Mexico, New Zealand, Norway, Qatar, Russia, Singapore, Timor-Leste, Trinidad & Tobago, the United Arab Emirates, and the United States. Oman, Saudi Arabia, and Vietnam; the OECD and the World Bank participate as permanent observers.

[2] The U.S. was represented in the IWG by Michael Burns, Executive Director of the Alaska Permanent Fund Corporation, and Robert Kaproth from the U.S. Treasury Department. Recipient countries, including the United States, commented on the draft GAPP and participated in select sessions at IWG meetings.

[3] http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf

- Second, as the Principles are adopted, they will lead to greater SWF disclosure of financial information, which will help reduce uncertainty and potential volatility in financial markets. Major SWFs have already begun to improve their information disclosure practices. The Government of Singapore Investment Corporation (GIC) released its first public report in September on how it manages the Government's portfolio, including key information on its governance framework, investment processes, asset mix, and long-term returns. The Abu Dhabi Investment Authority (ADIA) has disclosed its broad asset allocation and is engaged in an on-going process to enhance disclosure in other areas.
- Third, the Santiago Principles contain important commitments to allay concerns that SWF investments may be politically motivated, emphasizing that SWFs should: invest on economic and financial, rather than political, grounds; establish operational independence to protect investment decisions from political interference; and disclose investment policies, including policies for voting publicly-traded equity shares.

The Santiago Principles' effectiveness in helping to reduce protectionist pressures and contribute to global financial stability depends on their widespread adoption by SWFs. We expect the combination of SWF ownership over the Principles, peer pressure, and moral suasion will lead to a high rate of implementation. We will continue to encourage implementation of the Principles in our bilateral dialogue with SWF country authorities.

The IWG has established a "Formation Committee" to convert the IWG into an international standing group of SWFs. The Committee comprises IWG members from Australia, Botswana, Chile, China, Kuwait, Qatar, Singapore, Trinidad and Tobago, UAE, and the United States. The resulting standing group is expected to meet periodically to consider proposals for further work. Two proposals for future work by the Standing Group are particularly important:

1) **Review and implementation of the Principles**: The Standing Group should consider ways to report on implementation of the Principles by SWFs, in a way that avoids prejudicing views on individual fund implementation. Reporting on SWFs' overall progress on implementation will help to demonstrate the positive shift in SWF practices.

2) **Creation of a mechanism for aggregate data reporting**: While some information is better disclosed at the individual fund level, provision of aggregate data would give market participants, policy makers and regulators a better sense of the scale of public sector participation in financial markets and cross-border capital flows, while protecting sensitive, fund-specific information.

OECD Investment Committee Work

In response to a rise in investment protectionist sentiment and the need to maintain open markets, a complementary dialogue has been underway in the OECD Investment Committee on investment policy toward SWF investments, building on the OECD's project on Freedom of Investment, National Security, and "Strategic" Industries. The United States, along with other OECD member countries, urged the OECD to identify best practices for countries that receive foreign government-controlled investment, including from SWFs. On April 9, 2008, as an initial step, the OECD published an OECD Investment Committee report on "Sovereign Wealth Funds and Recipient Country Policies." The report provides guidance for recipient country policies toward SWF investment, drawing on key OECD investment policy principles of transparency, predictability, proportionality, and accountability. OECD Ministers endorsed this report in June. On October 8, the OECD Investment Committee held further discussions on the principle of accountability and endorsed creation of an enhanced peer review mechanism to monitor and apply peer pressure where countries fall short in living up to these principles. The OECD will release a final report in early 2009 that will include investment policy best practices for countries that receive SWF investment.