Sovereign Development Funds

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Shanthi Divakaran
Senior Financial Sector Specialist
Finance and Markets Global Practice, World Bank Group
(On behalf of Investment Funds Group)

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Sovereign Development Funds (SDFs) have emerged as a relatively new player within global financial architecture

- **Governments increasingly using investment fund model to advance a policy/development agenda, typically by channeling investment into strategic sectors e.g.. infrastructure, SMEs**
  - Sovereign Development Funds (SDFs) are sovereign investment agencies set up to achieve development objectives
  - Within this space, there are funds that may 1) seek co-investment; 2) can be set up by sovereigns/supra sovereigns/IFIs; 3) are not necessarily restricted to investing within sovereign boundaries;
  - ~30+ SDFs set up since 2005
- **Why now?**
  - Limited fiscal space for government, combined with the need to invest in key sectors
  - Countries with high domestic investment needs want to take advantage of potential high returns in domestic markets.
  - Increase in global AUM signal potential for co investment with private sector

This presentation draws on a WB Policy Research Working Paper 7851, co-authored by Havard Halland, Michel Noel, Silvana Tordo, Jacob Kloper-Owens "Strategic Investment Funds: Opportunities and Challenges" October 2016

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Despite commonalities, SDFs are heterogeneous in almost all respects

- **Heterogeneity**
  - Source of funding: fiscal surplus, privatization proceeds, pension fund surplus, govt borrowing , receipts from commodity exports, IFI investments etc.
  - Ownership: Sovereign or Supra Sovereign (e.g. GEEREF)
  - Policy goals: Economic development through SMEs/infrastructure; Facilitate SOE reforms; Attract co-investment; Diversify away from oil & gas reliance
  - Invested sectors: Often infrastructure, but also Real estate, Tourism, Agribusiness, Finl Services etc.
  - Return expectations: Market; Below market

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Global Examples of SDFs

- **Philippines Investment Alliance for Infrastructure (2012)**
  - **$625mn**, with capital from Philippines Govt Service Insurance System Fund (GSIS): 64% and Netherlands Algemene Pensioen Groep (24%)
  - Invests in greenfield and brownfield infrastructure in the Philippines
- **FONSIS (Senegal) (2011)**
  - **~$760mn**; state budget
  - Investments to stimulate economic growth and job creation, Infrastructure, SMEs (invested in VC which funds SMEs).
- **Ireland Strategic Investment Fund (2014)**
  - **$8bn**, sourced by share of assets from National Pension reserve Fund
  - Investments to promote Irish economy through equity, infrastructure, PE
- **Khazanah Nasional (Malaysia) (1993)**
  - **$40bn+,** sourced by govt share of privatized national agencies; issues Islamic bonds
  - Investments to promote devpt of strategic industries and for long-term economic interests
- **Global Energy Efficiency and Renewable Energy Fund (GEEREF) (2008)**
  - **Euro 222mn** (Germany, Norway, private funds)
  - Provides risk capital for energy efficient & renewable energy projects in developing countries (Asia, Africa, Latin America)

SDFs represent a useful tool for development, with potential benefits for both government and private sector

- **Government perspective**
  - Attract private co-investment, thus leveraging public sector investment
    - » At the fund level
    - » At the project level (particularly for infrastructure)
  - Catalyze capital flows to priority sectors of national/regional economies
  - Build govt capacity as professional investors
  - Bring specialized/ sector-specific expertise to structure/ finance investments
- **Private investor perspective**
  - Ability to realize returns through access to investment opportunities (e.g. through project origination) with government partnership
  - Provide co-investors a degree of implicit political / regulatory risk insurance
  - Leveraging government capital

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But governments must also be attuned to challenges when setting up SDFs

- **If double bottom line, governments must be able to <u>maximize policy objective while minimizing risk to commercial orientation</u> (capital, returns, and the integrity of investments)**
  - *If policy objectives prioritized* over commercial objectives, funding could go towards politically motivated projects
  - *If commercial incentives overly prioritized*, risk of crowing out private investors
  - Separate legal entity of fund many not always translate to operational independence
  - Investors may not be attracted because of low returns

- **M<u>ultiple entry points in the design, structure and governance arrangements</u> of SIFs that must address these challenges and seek to mitigate risk**
  - Clear articulation of mandate
  - Investment policy (defines goals, risk tolerance, liquidity requirements)
  - Fund model and structure
  - Co investors
  - Fund management
  - Governance arrangements, public disclosures, transparency
  - Performance measures/ benchmarks for financial and policy objectives
  - Incentives for private investors

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