

The role of sovereign wealth funds in the national economy

International Symposium Financing for Development, 22 November 2018

What is a sovereign wealth fund?

"Special-purpose investment funds or arrangements that are 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 that include investing in foreign financial assets."

- Sovereign Wealth Funds Generally Accepted Principles and Practices, "The Santiago Principles"

But what does this actually mean?

Types of sovereign wealth fund

SWFs are a extremely diverse group of investors. There are three main types and hybrid funds.



Savings

- Natural-resource revenue savings
- Foreign-exchange diversification
- Pension reserve



Stabilisation

- Exchange-rate stabilisation
- Smoothing government spending across the commodity cycle



Strategic

- Stewarding state-owned enterprises to create national & regional champions
- Enhancing local stock-market liquidity (IPOs, investing in local funds)
- Promoting economic development by investing in strategic sectors
- Attracting long-term foreign direct investment as a promoter or partner

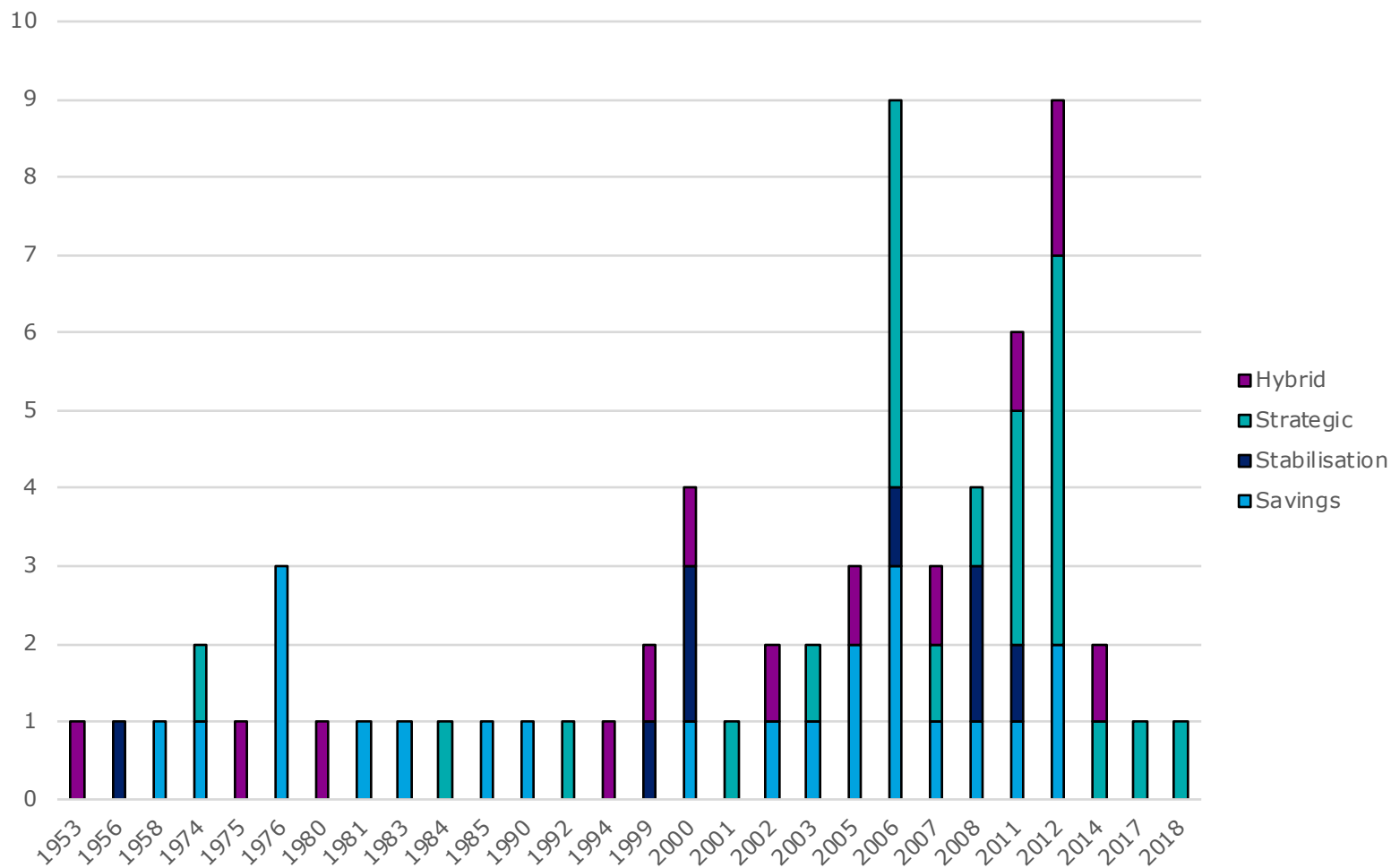


Hybrid

- Savings and stabilisation
- Savings and strategic
- Savings, stabilisation and strategic ("Triple S")

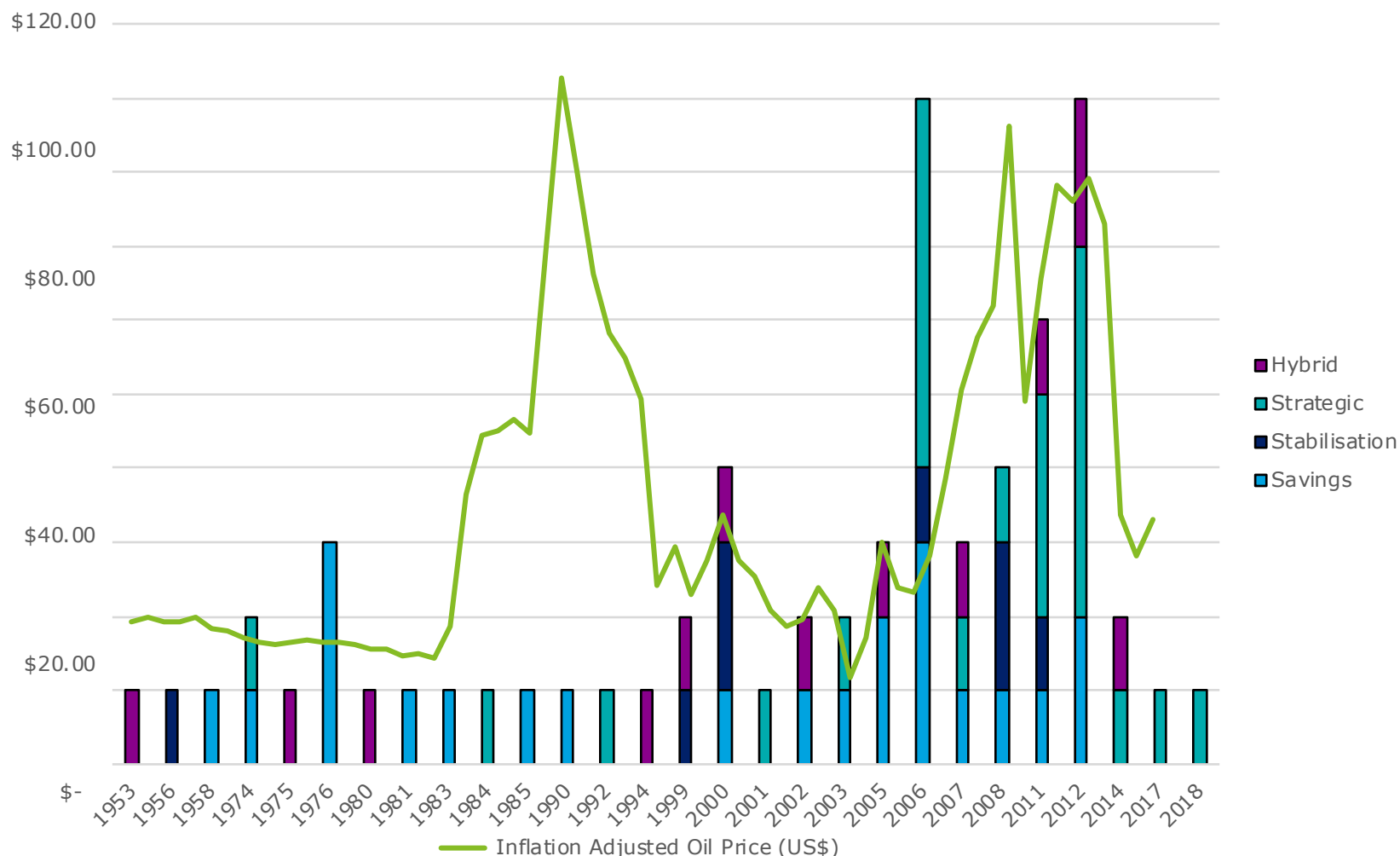
The evolution of sovereign wealth funds

Originally created for stabilisation or savings, more SWFs are being created for strategic purposes.



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Source: Inflationdata.com

Why SWFs for national development?

- Long term investor
- Crowd in private capital (infrastructure)
- Strengthen management of state owned enterprises (SOEs) and state assets
- Can direct investment into strategic sectors despite limited fiscal space



Major challenges for SWFs investing domestically

IFSWF members voluntarily apply the Santiago Principles: the accepted standard for sovereign fund governance, investment practice & risk management.

- Ownership of the assets
- Sources of the funds
- Governance structure
- Types of asset from the view of development
- Whether the mandate is to attract private capital
- Conflicts of interest/risks of domestic investment by public funds
- Sovereign funds competing for scarce public capital or crowding out private capital
- Conflicts or mis-alignments especially regarding economic development activity
- Politics accentuating risks



Key questions for SWFs focused on development?

- **Scope and mandate:**

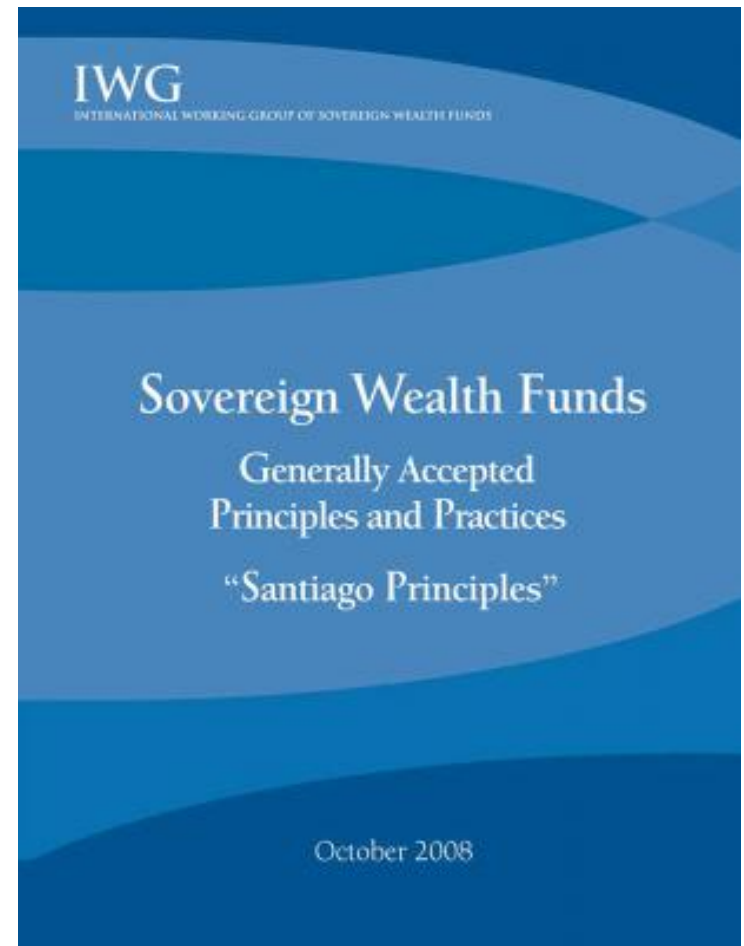
- How should mandates be formulated to address market failures and avoid market distortions?
- What important factors can help attract private capital into the SWF?
- Which ownership and legal structures are used to deliver SWF mandates? What are the advantages and disadvantages?

- **Fund independence**

- What governance arrangements can insulate the SWF from external influences that contradict the mandate of the fund?
- What type of decision processes allow for fund operational independence?

- **Double-bottom lines**

- When is a double bottom line appropriate?
- Is there a tradeoff between financial and economic returns? How is this managed?
- What are examples of key metrics used to measure the double bottom line? How can non-financial returns be measured?



Case Study – Nigeria Sovereign Investment Authority (NSIA)

Second bridge over the Niger River

- NSIA has three mandates:
 - Future Generations
 - Infrastructure
 - Economic Stabilisation
- The Infrastructure Fund is primarily run by an in-house team and invests domestically, in projects such as bridges and toll roads, alongside commercial partners.
- NSIA collaborated with Government and construction firm Julius Berger Nigeria to help finance a new bridge over the Niger River connecting the cities of Asaba and Onitsha.
- Infrastructure Fund has also co-created Africa's first infrastructure credit enhancement company.
 - Set up to provide credit enhancement for local currency bonds issued on domestic infrastructure projects; a first in Africa. The company is currently wholly funded by the NSIA and successfully closed its first deal in Q1 2018 with Viathan, a captive power company.



Appendix

History of the Santiago Principles

A decade ago, concerns arose in Europe and the US about the intentions of SWFs. The Santiago Principles were written to ensure the free-flow of capital.

November 2007

The IMF convenes a Roundtable of Sovereign Asset & Reserve Managers in Washington, DC to facilitate the exchange of ideas & experiences in asset and reserve management.

May 2008

International Working Group of Sovereign Wealth Funds is set up by 25 IMF member countries to work on voluntary principles that properly reflect SWF investment practices & objectives.

April 2009

The Working Group agrees a permanent structure as the IFSWF in Kuwait City. The IFSWF agrees contribute to an open investment environment, & facilitate exchange of views between SWFs.

March 2008

Sovereign Wealth Funds from Abu Dhabi and Singapore agree with the US Treasury to adhere to nine policy principles: five for SWFs; four for recipient countries.

October 2008

The Working Group & the IMF delivered a set of 24 Generally Agreed Principles & Practices in Santiago, Chile.

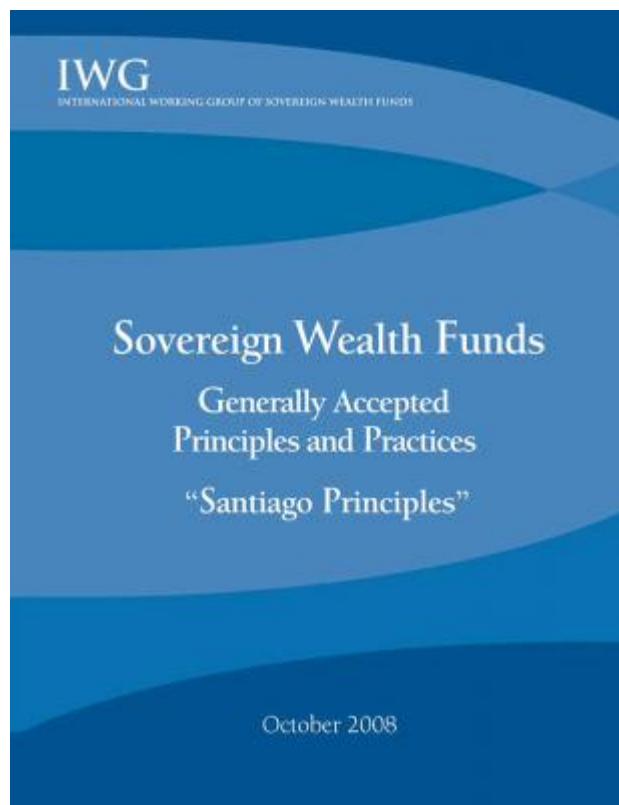
August 2014

IFSWF incorporates the Secretariat as an independent non-profit company in the City of London.

IFSWF welcomes its first new members.

The Santiago Principles

Published in October 2008, the 24 Santiago Principles cover fund objectives, institutional framework, and investment and risk management.



Generally Accepted Principles and Practices for Sovereign Wealth Funds ("Santiago Principles")

GAPPs split into three core pillars:

- **Pillar 1:** Legal Framework, Objectives, and Coordination with Macroeconomic Policies
- **Pillar 2:** Institutional Framework and Governance Structure
- **Pillar 3:** Investment and Risk Management Framework

What are the Santiago Principles?

By implementing the Santiago Principles, SWFs demonstrate their commitment to professional, independent, and commercially orientated investment management.

They are...

- ✓ Voluntary
- ✓ Self-assessed
- ✓ Subordinate to local law
- ✓ A principles-based approach to governance
- ✓ Adaptable to individual circumstances
- ✓ Professional credentials

They are not...

- ✗ Regulation
- ✗ Binding
- ✗ Prescriptive
- ✗ "Soft" law
- ✗ A rules-based approach to governance

