



## About the IFSWF Membership

The IFSWF is a diverse group of sovereign wealth funds from every inhabited continent. They have varied economic roles and mandates.

Our members define themselves as:

*“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”

Sources of wealth for IFSWF members, 2018

Fiscal Surplus



Natural Resources Revenue



Government-owned companies



SOVEREIGN WEALTH FUND OBJECTIVES

## **Savings funds**

Savings funds are sometimes referred to as intergenerational savings funds because they have decades-long investment horizons. The world's oldest SWF, the Kuwait Investment Authority (KIA), is a good example.

Savings funds are often set up by commodity-rich countries to save a portion of their resource wealth for the future. Oil, gas and precious-metal reserves are finite: one day they will run out. There is also a risk that these resources will become stranded assets as climate-change regulation and the rise of green-energy alternatives render hydrocarbon extraction uneconomic.

But by using their SWFs to convert today's resource wealth into renewable financial assets, governments can share the windfalls with the generations of tomorrow. By investing overseas, savings funds in commodity-rich countries can also help prevent Dutch Disease, whereby a surge in commodity exports leads to a sharp rise in foreign-exchange inflows, generating inflationary pressures and damaging the competitiveness of other economic sectors.

Some savings funds are designed to nance future liabilities. Pension reserve funds, such as Australia's Future Fund, the New Zealand Superannuation Fund and Chile's Pension Reserve Fund, typically invest to build capital that will help defray their sponsoring government's future pension obligations. Unlike orthodox pension funds, the assets they manage remain the property of the government and no individual has any claim on them. As a result, these funds can remain, long-term investors, even as they are drawn upon.

### **Case Study: The New Zealand Superannuation Fund (NZSF)**

The New Zealand government created NZSF (also known as NZ Super) in 2001 to build savings to defray future pensions costs. As is the case in many countries, such costs are likely to rise as the population ages; as the number of older citizens increases, the number of taxpayers relative to the number of retirees falls.

The NZSF is managed by the Guardians of New Zealand Superannuation, a Crown entity which is empowered to make investment decisions independent of the government. The Guardians invest government contributions, along with the returns generated by these investments, to grow the capital of the fund. Withdrawals are due to begin in the mid-2030s.

As a long-term investor, NZSF can devote a relatively large proportion of its portfolio to private-market assets, taking advantage of the illiquidity premium available on such investments. For example, the fund invests in global forestry assets, transport infrastructure and real estate.

The Guardians use a reference portfolio as a benchmark against which to measure the performance of NZSF and the value added by its various active investment strategies. The reference portfolio is comprised of passive, low-cost, listed investments, split between global equities (80%) and fixed income (20%).

As of 31 March 2018, the Guardians allocated 66% of the fund's NZ\$37.8 billion (\$27.4 billion) portfolio to global equities, 13% to global fixed-income and other public market investments, 4% to domestic equities and 17% to alternative investments such as infrastructure, private debt and property.

## **Stabilisation funds**

Stabilisation funds are designed as pools of capital which governments can draw on to smooth the budget. Often, commodity-rich nations create these funds to manage revenue streams; the fund will save some of the proceeds from large influxes of revenue and pay out when commodity receipts fall below a specified amount.

Stabilisation funds can thus help mitigate the resource curse, an economic phenomenon whereby commodity-rich countries tend to experience slower growth than comparable countries that lack such wealth. The resource curse occurs partly because energy prices are volatile. When prices are high, governments usually increase spending; when they are low, governments must tighten their belts. These fluctuations exacerbate the economic cycle.

By helping to smooth out commodity revenues, stabilisation funds can help governments avoid extreme peaks and troughs in the cycle. These funds are also used to help stabilise the value of the country's currency during macroeconomic shocks. For this reason, stabilisation funds tend to hold a large proportion of their assets in liquid investments so that they have access to capital at short notice.

#### Case study: Economic and Social Stabilisation Fund of Chile (ESSF)

The Chilean government established ESSF in 2007. ESSF superseded an older fund called the Copper Stabilisation Fund, which the government had used to save a portion of its revenues from copper exports. The ESSF inherited much of its \$2.6 billion in start-up capital from this older vehicle.

The timing was propitious. Only a year after the fund was created, the financial crisis hit, reducing demand for commodities. By drawing on the fund's capital, the government could support the Chilean economy without issuing more debt. This is one reason Chile fared better than its Latin American peers during the crash (Chile's GDP growth declined by 1% in 2008; by contrast, Mexico's fell by 4.7%).

ESSF works in tandem with another SWF, the Pension Reserve Fund, in Chile's fiscal setup. According to Chile's Fiscal Responsibility Law, ESSF receives an amount equal to the government's annual surplus once contributions to the Pension Reserve Fund and the Central Bank of Chile have been deducted. As of end-March 2018, the fund held \$14.9 billion in assets.

As a stabilisation fund, ESSF needs to keep the bulk of its portfolio in liquid securities that can be accessed at short notice. As of 31 March 2018, ESSF held 33.4% of its portfolio in money-market assets; 55.2% in sovereign bonds; 8% in developed-market equities; and the rest in inflation-linked bonds.

### **Strategic funds**

Since the global financial crisis, there has been a marked change in how governments use their liquid and illiquid assets. With interest rates at record lows and global economic growth sluggish, the appeal of traditional savings and stabilisation funds has diminished. Instead, many states have created development funds that form part of their domestic economic policies.

These funds follow the lead of two well-established South-East Asian SWFs, Singapore's Temasek Holdings and Malaysia's Khazanah Nasional. These funds acquire stakes in companies in strategic industries to nurture their development, promoting the growth of the wider economy and realising financial returns. Temasek and Khazanah have also been able to build portfolios of overseas assets from the proceeds of the realisation of some of their major investments, as well as using the dividends and other cash distributions they receive from their portfolio companies.

The Irish Strategic Investment Fund (ISIF) neatly illustrates how these vehicles differ from traditional savings funds. ISIF has a mandate to invest on a commercial basis to support economic activity and employment in Ireland in targeted economic sectors. The fund's recent activity includes the launch of an infrastructure development plan to finance student accommodation across Ireland and a €100 million (\$107 million) fund that will offer loans to Irish milk producers.

Strategic funds can promote the domestic economy in a variety of ways. They may provide financing to early-stage companies in strategic industries, or buy long-term stakes to facilitate the development of more mature firms. Some, like Kazakhstan's Samruk-Kazyna, are active managers of their portfolio companies, aiming to upgrade their operations and profitability with a view to privatisation.

Some strategic funds will make direct investments in critical infrastructure projects, occasionally using their local expertise to leverage co-investments from peer institutions.

#### Case study: Russian Direct Investment Fund (RDIF)

Founded in 2011, RDIF co-invests in Russian projects with expected attractive returns on investment and economic benefits to the country. It also allocates a small proportion of its assets to overseas investments alongside foreign partners.

Unusually, RDIF is designed to work in tandem with top global investors, including SWFs, acting as a catalyst for direct investment in Russia. To this end, RDIF has formed partnerships with over 20 international institutions. Several of RDIF's investment partners automatically participate in all its deals.

In 2012, RDIF partnered with the China Investment Corporation (CIC) to create the Russia-China Investment Fund, a vehicle that invests primarily in the Russian economy, with each party allocating \$1 billion to the vehicle. RDIF also has similar agreements in place with the Kuwait Investment Authority, Mubadala Investment Company, Qatar Investment Authority, Caisse des Dépôts, CDP Equity, the Korea Investment Corporation, and the Public Investment Fund of Saudi Arabia, among others.

RDIF often makes direct investments alongside more than one international partner at a time. Over 30 deals have been closed across a wide range of sectors in the five years of RDIF's investment activity, with a proportion of funds attracted from partners per each rouble invested by RDIF totalling 9 to 1.

This co-investment model enables RDIF to amplify the economic impact of its investments. As of the end of 2017, RDIF has invested 100 billion roubles (\$1.8 billion) of Russian government capital while over RUB 1.1 trillion came from its co-investors, partners and banks. RDIF has also established joint investment platforms with a total value of more than \$30 billion through partnerships with leading international investors.

### **Multiple Objectives**

Not every SWF has a single objective. Many funds combine two or more of the functions listed above, mixing stabilisation, savings and development.

While these hybrid funds arise all over the world and include the China Investment Corporation, the Trinidad and Tobago Heritage and Stabilisation Fund, and the State Oil Fund of Azerbaijan, they are particularly common in developing economies in sub-Saharan Africa. Many of these nations created their SWFs following the commodity super-cycle of the 2000s, which led to a boom in resource revenues.

Locking away capital for future generations is clearly inappropriate for countries with high levels of poverty or pressing infrastructure-development needs. For this reason, African countries have created innovative SWF structures that often integrate sub-portfolios dedicated to discrete objectives.

For example, the Fundo Soberano de Angola allocates a third of its portfolio to international securities such as Treasury bonds and developed-market equities, and the remainder of its assets to private-equity investments in Angola and elsewhere in sub-Saharan Africa to support "socioeconomic development".

Similarly, Botswana uses its Pula Fund, sub-Saharan Africa's oldest SWF, for a combination of savings, stabilisation and development.

#### Case study: Nigeria Sovereign Investment Authority (NSIA)

In 2004, Nigeria created a fund called the Excess Crude Account (ECA), designed to manage its oil revenues for both savings and stabilisation purposes. As oil prices surged during the 2000s, ECA collected a large proportion of the government's revenues. But ECA also had a poorly-defined legal mandate, which meant its savings were subject to wrangles between the federal government and state governors.

In 2012 Nigeria launched a new SWF, NSIA, to rectify these problems. NSIA has a clearer and more-legally rigorous mandate than ECA: it is divided into separate, ring-fenced pools of capital, each of which has a different objective: a Future Generations Fund, an Infrastructure Fund and a Stabilisation Fund.

As of end-2016, the most recent date at which the NSIA disclosed the composition of its investment portfolio, the Future Generations Fund was 43% in cash, 53% in public- and private-equity strategies, with the remainder of the portfolio allocated to commodities and other diversifiers. The Stabilisation Fund also allocates a portion of its capital to absolute-return fixed-income managers (36%) but devotes its portfolio to more-liquid assets such as short-duration Treasury bonds (29%) and time deposits (47%).

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. For example, NSIA collaborated with construction firm Julius Berger Nigeria to help finance a new bridge over the Niger River connecting the cities of Asaba and Onitsha. The Infrastructure Fund has also made investments in telecommunications and healthcare.