Enhancing the Transparency Dialogue in the "Santiago Principles" for Sovereign Wealth Funds

Adam D. Dixon[*]

I. INTRODUCTION

One outcome of the global financial crisis spurred by the collapse of Lehman Brothers in the summer of 2007 was that it quieted the criticism surrounding the growth of sovereign wealth funds (SWFs).[1] In the years preceding the crisis, Western politicians raised concerns that these state-owned investment funds could be used, in effect, as political machines underwriting any number of state interests—from bankrolling mercantilist industrial policies, to gaining access to natural resources, critical infrastructure, and new technology.[2] Unlike the ideal private investor, who is constrained by a profit motive, SWFs were not seen as financial institutions pursuing purely commercial objectives and risk-adjusted financial returns.[3] Therefore, SWFs were viewed in a very different light when compared to other correspondingly large beneficiary institutions, such as public pension funds.[4] As creatures of the state, SWFs were seen by some as a threat to liberal free-market capitalism with the potential to undercut the functional efficiency of markets.[5] The

---

[*] Senior lecturer in Economic Geography, School of Geographical Sciences, University of Bristol, U.K.

1. *See generally* Eric Langland, *Misplaced Fears Put to Rest: Financial Crisis Reveals the True Motives of Sovereign Wealth Funds*, 18 TUL. J. INT'L & COMP. L. 263 (2009). For background information on SWFs and definitional issues, see Ashby H. B. Monk, *Recasting the Sovereign Wealth Fund Debate: Trust, Legitimacy, and Governance*, 14 NEW POL. ECON. 451 (2009). For a comprehensive legal treatment of international and bilateral regulation of SWFs, see FABIO BASSAN, THE LAW OF SOVEREIGN WEALTH FUNDS (2011).

2. *See* Ronald J. Gilson & Curtis J. Milhaupt, *Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism*, 60 STAN. L. REV. 1345, 1361–62 (2008).

3. *See* BASSAN, *supra* note 1, at 10–13.

4. *See* Larry Catá Backer, *Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State-Owned Enterprises, and the Chinese Experience*, 19 TRANSNAT'L L. & CONTEMP. PROBS. 3, 24–33, 48–58 (2010); Larry Catá Backer, *Sovereign Wealth Funds As Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investment*, 41 GEO. J. INT'L L. 425, 436–50 (2009).

5. *See generally* Roland Beck & Michael Fidora, *The Impact of Sovereign Wealth Funds on Global Financial Markets*, 43 INTERECONOMICS 349 (2008).

growing presence of SWFs—coinciding in particular with China's rise to prominence in the global economy and the general unease this created for Western powers—was consequently an issue of national security, both political and economic.[6]

This growing apprehension surrounding SWFs came to a head in 2006 with the Dubai Ports World (DP World) controversy. Even though DP World—a state-owned infrastructure operator from the United Arab Emirates—was not an SWF in form and function, the case provided a potential opportunity for proponents of SWF investment, and foreign investment in general, to overcome the criticism and skepticism.[7] In 2006, DP World purchased U.K.-based ports operator Peninsular and Oriental Steam Navigation Company (P&O), which had contracts to operate a number of U.S. ports, but did not own the ports themselves.[8] Even though the United States Committee on Foreign Investment authorized the deal in 2005, several members of the U.S. Congress, namely New York Senator Charles Schumer and Representative Peter T. King, raised concerns about the national security implications of the deal.[9] Because DP World was a state-owned firm from the Middle East, DP World arguably fell victim to the "war on terrorism" political rhetoric and xenophobic mistrust. Not interested in the negative publicity and the prospect of a congressional bill to impede the transaction, DP World divested P&O's U.S. ports operations.[10]

The financial crisis ultimately caused Western governments to welcome SWF investment as a way to put a floor under collapsing markets and to provide a set of voluntary principles that would underwrite SWFs' claim to legitimacy in the international community. In the autumn of 2007, then-U.S. Treasury Secretary Henry Paulson, in conjunction with the International Monetary Fund, convened the International Working Group of SWFs (IWG) to draft a set of generally accepted principles and

6. *See* EDWIN M. TRUMAN, SOVEREIGN WEALTH FUNDS: THREAT OR SALVATION? 40–45 (2010).

7. *See* Justin O'Brien, *Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds*, 42 INT'L LAW. 1231, 1243 (2008).

8. Paul Rose, *Sovereign Wealth Fund Investment in the Shadow of Regulation and Politics*, 40 GEO. J. INT'L L. 1207, 1229 (2009) [hereinafter Rose, *Sovereign Wealth*]; Paul Rose, *Sovereigns As Shareholders*, 87 N.C. L. REV. 83, 115 (2008) [hereinafter Rose, *Sovereigns As Shareholders*].

9. *See* David S. Cloud & David E. Sanger, *Dubai Company Delays New Role at Six U.S. Ports*, N.Y. TIMES (Feb. 24, 2006), http://www.nytimes.com/2006/02/24/politics/24ports.html?pagewanted=all&_r=0.

10. For a more detailed discussion on the DP World controversy, see generally *supra* note 8 and accompanying text.

practices.[11] These principles are referred to as the "Santiago Principles."[12] The implicit objective of these twenty-four voluntary principles is to promote greater transparency and disclosure among the SWF community and mollify skepticism surrounding their commercial orientation.[13] The Santiago Principles were designed to affirm the legitimacy of SWFs and define the discourse surrounding their global expansion as institutional investors in global capital markets in pursuit of risk-adjusted financial returns.[14] Ultimately, the development of the Santiago Principles was a means of defining SWFs—not as creatures of mercantilist *realpolitik*, but as benign pools of capital, like other conventional beneficiary institutions (e.g., supplementary occupational pension funds), contributing to the depth and efficiency of global financial markets.[15]

Taken together, the activities of SWFs do appear to be benign. They may still be creatures of the state, but most appear to be chasing risk-adjusted returns instead of keeping with the skeptics' preconceived notion of SWFs as political machines.[16] This does not mean that SWFs are not being used to further economic policy goals that are ultimately in the interest of the state and national economy. For example, many SWFs from the Gulf States are actively used to further industrial development of their economies beyond natural resource extraction.[17] Furthermore, the activities of some countries, namely China, are still a cause for concern in some quarters.[18] But even in the case of China, it is not the actions of

---

11. INT'L WORKING GRP. OF SOVEREIGN WEALTH FUNDS, SOVEREIGN WEALTH FUNDS: GENERALLY ACCEPTED PRINCIPLES AND PRACTICES "SANTIAGO PRINCIPLES" 1, 7 (2008), *available at* http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf.

12. *See id.* at 1. The International Working Group (IWG) of Sovereign Wealth Funds was established at a meeting of twenty-six countries with SWFs, including the United States, on April 30 to May 1, 2008, in Washington, D.C. *Id.* For more on the development of the Santiago Principles, see generally Joseph J. Norton, *The "Santiago Principles" and the International Forum of Sovereign Wealth Funds: Evolving Components of the New Bretton Woods II Post-Global Financial Crisis Architecture and Another Example of Ad Hoc Global Administrative Networking and Related "Soft" Rulemaking?*, 29 REV. BANKING & FIN. L. 465 (2010); Joseph J. Norton, *The 'Santiago Principles' for Sovereign Wealth Funds: A Case Study on International Financial Standard-Setting Processes*, 13 J. INT'L ECON. L. 645 (2010) [hereinafter Norton, *A Case Study*].

13. *See generally* Ashby H. B. Monk, *Recasting the Sovereign Wealth Fund Debate: Trust, Legitimacy, and Governance*, 14 NEW POL. ECON. 451 (2009).

14. *See* Norton, *A Case Study*, *supra* note 12, at 652.

15. *See id.*

16. *See generally* Jonathan Kirshner, *Sovereign Wealth Funds and National Security: The Dog that Will Refuse to Bark*, 14 GEOPOLITICS 305 (2009).

17. *See* Daniel Haberly, *Strategic Sovereign Wealth Fund Investment and the New Alliance Capitalism: A Network Mapping Investigation*, 43 ENV'T & PLAN. 1833 (2011); *see generally* ADAM D. DIXON & ASHBY H. B. MONK, WHAT ROLE FOR SOVEREIGN WEALTH FUNDS IN AFRICA'S DEVELOPMENT? (2011), *available at* http://www.cgdev.org/doc/Initiatives/Oil2Cash/Final_Formatted_Monk_and_Dixon_SWF_10.11.pdf.

18. *See* George Gilligan & Megan Bowman, *State Capital: Global and Australian Perspectives*, 37 SEATTLE U. L. REV. 597 (2014).

the China Investment Corporation or its other sovereign funds, but rather the international expansion of its state-owned enterprises that draws the most skepticism.[19] Notwithstanding the relatively benign conduct of SWFs, the Santiago Principles have not, arguably, led to increased transparency. Compliance with the Santiago Principles has been slow and incomplete.[20] This underlines the inherent political nature of SWFs, as they reflect the norms and conventions of their sponsors in regard to transparency.[21]

Like any voluntary standard, compliance relies on the goodwill of the organization, and ultimately, the organization's sponsor. Compliance is further complicated when there are varied interpretations as to the standard requirements. What is needed, as I argue in the remainder of this short essay, is an explicit treatment of transparency in its different forms such that SWFs, their sponsors, and external analysts have a discursive device for evaluating and communicating when and why (and why they think) certain nondisclosures are legitimate, or more importantly, when and why transparency in one domain may diminish the significance of disclosure in other areas, thus reducing the significance of nondisclosure in those areas. The aim, then, is to encourage dialogue, in conjunction with the Santiago Principles, on nondisclosure as doing so leads, in my view, to increased transparency overall. Said slightly differently, dialogue on nondisclosure is, in itself, a form of transparency.

II. ENHANCING THE TRANSPARENCY DIALOGUE

In previous work, I, along with Ashby Monk, considered a simple conceptual framework to parse out different types of transparency in the constitution and operation of sovereign funds. In that work, we distinguished five areas of sovereign fund transparency: (1) political; (2) procedural; (3) policy; (4) operational; and (5) performance.[22] This concep-

---

19. *See id.*

20. *See generally* Sarah Bagnall & Edward M. Truman, *IFSWF Report on Compliance With the Santiago Principles: Admirable But Flawed Transparency*, PETERSON INST. INT'L ECON. (Aug. 2011), http://www.piie.com/publications/pb/pb11-14.pdf.

21. *See generally* GORDON L. CLARK ET AL., SOVEREIGN WEALTH FUNDS: LEGITIMACY, GOVERNANCE AND GLOBAL POWER (2013); Adam D. Dixon & Ashby H. B. Monk, *Rethinking the Sovereign in Sovereign Wealth Funds*, 37 TRANSACTIONS INST. BRIT. GEOGRAPHERS 104 (2012); Kyle Hatton & Katharina Pistor, *Maximizing Autonomy in the Shadow of Great Powers: The Political Economy of Sovereign Wealth Funds*, 50 COLUM. J. TRANSNAT'L L. 1 (2012).

22. *See* Adam D. Dixon & Ashby H. B. Monk, *Reconciling Transparency and Long-Term Investing Within Sovereign Funds*, 2 J. SUSTAINABLE FIN. & INVESTMENT 275, 281 (2012), *available at* http://www.tandfonline.com/doi/pdf/10.1080/20430795.2012.703126. The conceptual framework offered by Dixon and Monk is inspired by the framework developed for central bank transparency offered by Petra Geraats. *See* Petra M. Geraats, *Central Bank Transparency*, 112 ECON. J. 532 (2002).

tual framework mirrors many of the elements of the Santiago Principles. As such, it can be seen as an extension of the Santiago Principles, providing a somewhat different, and in some ways more explicit, language for exploring transparency and non-transparency.[23]

Our impetus for devising this conceptual framework was the emerging concern that public disclosure among the SWF community could potentially undermine long-term investment strategy. This concern is based on the assumption that a long-term investment strategy is likely to face increased criticism (primarily domestic) as a consequence of poor short-term market performance during periods of market volatility. Put simply, by disclosing performance metrics on a regular basis over the short run, the investment focus of the fund would potentially become concentrated on short-term performance to the detriment of higher long-term investment returns.[24] But performance is just one area of transparency. Nondisclosure in this area may be perfectly acceptable for some SWFs as a means of focusing the investment policy on the long term. The problem, however, is when arguably legitimate nondisclosure extends, purposefully or not, into nondisclosure of another area that may be deemed illegitimate.

The view taken here is that transparency is increased in the aggregate even if an SWF and its sponsor disclose only a rationale for maintaining nondisclosure in certain areas.[25] And in those areas where nondisclosure is upheld, increased disclosure in other areas may provide functionally equivalent information. The persistence of nondisclosure among some (if not many) of the signatories of the Santiago Principles suggests that there is no global consensus as to what constitutes transparency in relation to the operation of an SWF.[26] Western countries and multilateral organizations may attempt to coerce state sponsors of SWFs (who are unaccustomed to transparency in the governance of state institutions) to become more transparent, but coercion may be resisted and

---

23. The Santiago Principles are divided into three sections: (1) legal framework, objectives, and coordination with macroeconomic policies; (2) institutional framework and governance structure; and (3) investment and risk management framework. *See* Dixon & Monk, *supra* note 22, at 278. There are clear complementarities with the framework presented here, but the overlap and order is not complete. Overlap is most clear in the first section, which complements political transparency.

24. *See IFSWF Members' Experiences in the Application of the Santiago Principles*, INT'L FORUM SOVERIGN WEALTH FUNDS, 34–37 (July 7, 2011), http://www.ifswf.org/pst/stp070 711.pdf.

25. Whether the framework here will work and by whom is an empirical question. Hence, the claim here regarding workability is only hypothetical. For a discussion on the importance of analyzing the effectiveness and outcomes of transparency policies, see generally ARCHON FUNG ET AL., FULL DISCLOSURE: THE PERILS AND PROMISE OF TRANSPARENCY (2007).

26. *See generally* BAGNALL & TRUMAN, *supra* note 20.

may ultimately be unsuccessful.[27] Keep in mind, however, that with the Kuwait Declaration of April 6, 2009, the IWG–SWF was succeeded by the International Forum of Sovereign Wealth Funds (IFSWF), whose purpose is to "meet, exchange views on issues of common interest, and facilitate an understanding of the Santiago Principles and SWF activities."[28] The Santiago Principles may have been written, but the dialogue surrounding implementation continues. The issue of how SWFs are, or can be, transparent is thus an ongoing discussion.

Table 1 (see below) provides a brief look at the objectives of each form of transparency and the methods used. The following subsections describe each area of transparency in more detail. Note that the treatment of these areas of transparency and the potential methods used in this essay are not exhaustive. Hence, I am not providing a ranking system.[29] The reason I have not chosen to rank funds or quantify transparency in each category is that transparency is a social construction—there are likely to be differing views as to what constitutes transparency and what information must be disclosed in order for an organization to be considered transparent. Furthermore, it is not clear that a relative ranking of SWF transparency will motivate increased transparency.[30] Again, the aim of the conceptual framework is to promote dialogue on the logic and rationale of nondisclosure, while also examining whether disclosure of certain information negates the significance of information not disclosed.

---

27. All SWFs face some form of accountability that results in disclosure. For example, fundamental to securities regulations in developed markets is the requirement that share ownership be disclosed once a particular threshold (e.g., 10%) has been breached. For more on SWF accountability, see Anna Gelpern, *Sovereignty, Accountability, and the Wealth Fund Governance Conundrum*, 1 ASIAN J. INT'L L. 289 (2011). Gelpern maps four categories of demands on SWFs: public internal accountability, private internal accountability, public external accountability, and private external accountability. *Id.* at 295–307. The former two relate to domestic accountability issues, while the latter two pertain to international and bilateral norms. *See id.* The aim of the categorization is to understand whom an SWF answers to so that it is possible to determine to whom they should answer, while finding ways to resolve conflicts among an SWF's constituencies. *See* Dixon & Monk, *supra* note 21.

28. *"Kuwait Declaration": Establishment of the International Forum of Sovereign Wealth Funds*, INT'L WORKING GRP. SOVEREIGN WEALTH FUNDS (Apr. 6, 2009), http://www.iwg-swf.org/mis/kuwaitdec.htm. The IFSWF has met annually since its inception.

29. Like the index devised by Edward Truman. *See* EDWARD M. TRUMAN, A BLUEPRINT FOR SOVEREIGN WEALTH FUND BEST PRACTICES (2008). There are important similarities between the elements that comprise Truman's index and the framework discussed here. Whereas Truman aims to promote ideal "best practices," that is not our aim. This is not to detract from the promotion of best practices, as the framework here is ultimately about promoting more transparency. The difference is that I do not begin from an a priori set of best practices. Rather, the approach taken here recognizes the geopolitical reality that states will have varying views and interpretations regarding transparency.

30. For a criticism of the contemporary enthusiasm for transparency indexes, see David Heald, *Varieties of Transparency, in* TRANSPARENCY: THE KEY TO BETTER GOVERNANCE? 23 (Christopher Hood & David Heald eds., 2006).

This may be unsatisfying for transparency advocates, but it is a geopolitical reality.[31]

Table 1: Framing Transparency

Form of Transparency	Objectives	Methods
Political	To clarify the policy goals of the SWF	Mission statement
	To clarify the relationship of the SWF vis-à-vis the state	Legal framework
Procedural	To clarify the governance architecture of the SWF	Board selection procedure (incl. requisite qualifications)
		Internal and external delegation procedures
		Corporate engagement procedures
Policy	To clarify the rules and objectives imposed on decision-makers in implementing an investment mandate	Disclosure of investment beliefs and strategic vision
		Corporate engagement policy
Operational	To clarify the way an investment strategy is implemented and by whom	Disclosure of internal and external mandates
		Disclosure of asset allocation, specific investments, and intended holding periods
		Corporate engagement actions
Performance	To clarify the investment outcomes achieved by the fund	Short and long-term performance metrics
	To clarify how investment outcomes serve policy goals	External audits
		Qualitative assessment of investment activities
		Qualitative assessment of organizational culture and effectiveness

A. Political Transparency

Political transparency refers to the exogenous rules and regulations underpinning the fund's operations. The objectives here are twofold: On the one hand, this form of transparency is about clarifying the objectives of the SWF in relation to a policy goal or set of policy goals. Such goals can range from saving for future generations to limiting the effects of Dutch disease.[32] The primary method of disclosure is a mission statement

31. *See generally* THE RIGHT TO KNOW: TRANSPARENCY FOR AN OPEN WORLD (Ann Florini ed., 2007).

32. "Dutch disease" is the coexistence within the traded goods sector of booming and lagging subsectors. The booming sector is usually the extractive sector, which contributes to upward pressure on the value of the national currency on foreign exchange markets. The traded manufacturing sector becomes less competitive on global markets as a consequence. The non-extractive sectors are furthermore under pressure as a larger proportion of economic resources flow to the extractive sec-

and a description of the legislative foundations of the fund. A clearly defined purpose is important, as it sets the basis for how an SWF should operate as an investment institution. An organization charged with providing a buffer fund in the event of fiscal distress should operate and invest differently from a fund that is charged with facilitating local economic development or a fund that seeks to achieve at or above market returns over the long-term. If an SWF appears to diverge from its specific policy objective, there may be cause for concern for those who are skeptical of the SWF's intentions.

Political transparency, on the other hand, is about clarifying the relationship vis-à-vis the SWF and the state sponsor. The method of disclosure here could be a description of the institutional arrangements (formal or otherwise) guiding the interaction between the fund and the sponsor. Examples of institutional arrangements include the frequency of reporting and ministerial or political representation on the board. Understanding these arrangements is very important for determining the intent of an SWF. If, for example, a state sponsor proclaims the independence of an SWF, yet the degrees of separation between political authority and day-to-day investment decision making appear small, a skeptical outsider may have reason to suspect an underlying political motive that diverges from the stated policy goals of the SWF. However, this does not mean that in the case where an SWF is independent from the state sponsor that the state sponsor should be absent from setting broader investment goals or ensuring that the SWF abides by its mandate.

B. Procedural Transparency

Procedural transparency refers to how decisions are made, and by whom, throughout the process of achieving an SWF's intended mission and policy goals. The objective here is to clarify the governance architecture and the investment decision-making process. Disclosure includes information on how the board is chosen, arrangements regarding board tenure, and how authority is delegated inside and outside of the fund—such as to the designation to an investment committee, the selection of external managers, or the hiring of internal staff. Understanding how the leadership of the fund is chosen and how authority is delegated provides

---

tor. Consequently, economic growth and development is asymmetric, which may be detrimental to the economy and society over the medium and long runs, as natural resources are extinguished or as prices collapse. Economies, in effect, become dependent on the extractive sector for growth and welfare. *See generally* W. M. Corden, *Booming Sector and Dutch Disease Economics: Survey and Consolidation*, 36 OXFORD ECON. PAPERS 359 (1984) (U.K.); W. Max Corden & J. Peter Neary, *Booming Sector and De-Industrialisation in a Small Open Economy*, 92 ECON. J. 825 (1982) (Gr. Brit).

crucial insight into the intended behavior of the SWF. If, for example, board selection is purely a political exercise where board members are selected based on political relationships and not domain-specific expertise, it is difficult for the state sponsor and the SWF to claim independence from political meddling, even if such interference is nonexistent. Again, this does not mean that state representatives cannot be members of the board; however, if a board lacks members with independent authority and domain-specific expertise, the skeptical outsider may be more likely to infer that the SWF has political intentions.

Likewise, where assets are not managed in-house, disclosing how the SWF selects external managers provides valuable information. The delegation of external mandates through a competitive and transparent bid process goes a long way in revealing whether an SWF has political or purely financial motivations. This logic holds equally where in-house management is preferred. A board and a sponsor concerned with limiting any semblance of political meddling would likely grant significant independence to internal asset managers and investment committees in the day-to-day operation of the SWF and the selection of specific investments.

C. Policy Transparency

Policy transparency refers to the rules and objectives that the fund imposes on its own operations and personnel in implementing investments. The objective of this form of transparency is to provide clarification regarding an SWF's investment beliefs and guiding principles.[33] Knowledge regarding investment beliefs provides valuable information on an SWF's intent. If a statement of investment beliefs is grounded in Modern Portfolio Theory[34] and the Efficient Markets Hypothesis,[35] which would suggest that the SWF follows a passive investment strate-

---

33. There is a growing interest in defining and disclosing investment beliefs among some of the largest public and multiemployer pension funds. For discussions, see generally KEES KOEDIJK & ALFRED SLAGER, INVESTMENT BELIEFS: A POSITIVE APPROACH TO INSTITUTIONAL INVESTING (2011) (U.K.); KEITH P. AMBACHTSHEER, PENSION REVOLUTION: A SOLUTION TO THE PENSIONS CRISIS (2007).

34. MPT is theory of asset allocation whereby it is possible to maximize the expected return of the portfolio given a certain amount of portfolio risk. The aim is to select a set of assets that collectively has a lower level of risk than any individual asset. *See generally* Harry Markowitz, *Portfolio Selection*, 7 J. FIN. 77 (1952).

35. According to EMH, financial markets are informationally efficient. Consequently, it is impossible to consistently achieve risk-adjusted returns in excess of the market. *See generally* Eugune F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970).

gy[36] and holds a diversified portfolio, but the SWF is seen to be making large investments in a small selection of firms, skeptics are likely to see reasons for concern. But, if an SWF's investment beliefs go against convention, preferring instead smaller and more targeted investments that can be monitored more easily, the SWF's behavior would not be out of the ordinary.

For an SWF and sponsor not accustomed to complete transparency, a detailed set of investment beliefs—one that provides information on how the SWF views investment opportunities and the SWF's geographic distribution—provides an external analyst important information that can be cross-referenced with other available information. For example, if information regarding investments is revealed that diverges from the stated investment beliefs, some may assume that the SWF has alternative intentions as an SWF is unlikely to keep evidence of a large deal undisclosed indefinitely.

In this area of transparency, an SWF may also provide information regarding the circumstances under which the SWF will engage its investment entities. Some SWFs may view corporate engagement as best left to others, choosing instead to simply exit the investment. This is the most likely case for SWFs concerned with the political ramifications of corporate engagement (particularly of foreign firms), as it could easily be labeled as political intervention by a foreign government. For other SWFs, particularly those that can demonstrate the extent of the SWF's independence from direct political influence, corporate engagement may be a crucial part of its investment beliefs.[37] An argument can be made that ownership entails certain rights and responsibilities. Exercising voice instead of exit may be more preferable for the long-term institutional investor.[38]

---

36. In contrast to active management where investors try to beat the market through stock selection, the passive investor focuses on achieving risk-adjusted market returns at the lowest possible costs, usually by constructing a portfolio that tracks an externally specified index (e.g., S&P 500). *See generally* JOHN Y. CAMPBELL & LUIS M. VICEIRA, STRATEGIC ASSET ALLOCATION: PORTFOLIO CHOICE FOR LONG-TERM INVESTORS (2002).

37. For example, Norges Bank Investment Management, the organization charged with managing Norway's SWF Government Pension Fund-Global, has begun to increasingly engage the leadership of the companies it invests in. This is seen as one of its long-term fiduciary responsibilities, given that on average it owns 2.5% of the companies in which it invests. *See* Richard Milne, *Norway Wealth Fund Focuses On Corporate Engagement*, FIN. TIMES, Apr. 25, 2013.

38. *See generally* STEPHEN DAVIS ET AL., THE NEW CAPITALISTS: HOW CITIZEN INVESTORS ARE RESHAPING THE CORPORATE AGENDA (2006); TESSA HEBB, NO SMALL CHANGE: PENSION FUNDS AND CORPORATE ENGAGEMENT (2008); Gordon L. Clark & Tessa Hebb, *Pension Fund Corporate Engagement: The Fifth Stage of Capitalism*, 59 REL. INDUSTRIELLES/INDUS. REL. 142 (2004) (Can.); *see also* JOHN KAY, THE KAY REVIEW OF UK EQUITY MARKETS AND LONG-TERM DECISION-MAKING (2012), *available at* http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf.

D. Operational Transparency

Operational transparency refers to the way the investment strategy, underpinned by investment beliefs, is implemented and by whom. The objective here is to describe the ways in which the fund seeks to put policies into action, such as how the fund plans to access financial markets, certain industries, and geographies. The most transparent method for disclosure is regular and detailed provision of information on asset allocation, specific investments, and intended holding periods. Ultimately, operational transparency is about clarifying what an SWF is actually doing. For some SWFs, provision of such details may not be forthcoming. For others, it may be forthcoming, but not on a regular basis for fear of undermining a particular investment or investment strategy.[39] This may, however, foster skepticism. Although not a perfect substitute, an SWF may instead provide detailed information about the managers that have been selected, the scope of their investment mandates, and the ongoing monitoring of these investment relationships. It may also provide information on how internal teams have been constructed. This can be seen as providing somewhat of a proxy for asset allocation. Finally, where an SWF participates in corporate engagement, operational transparency entails disclosure of such actions and the reasons for those actions, if that action has not already been publicized, as is likely to be the case.

E. Performance Transparency

Performance transparency refers to the investment outcomes achieved by the fund. The objective of this form of transparency is to shed light on whether an SWF is performing as designed, but more importantly, whether it is in keeping with its mission. While poor performance may point to an ineffective, inexperienced, and ill-resourced organization (among other potential problems), it may also point to investments made for political purposes or an organization that is subject to excessive political interference in its day-to-day operations.[40] Performance-exceeding market returns may also be an indicator of impropriety. However, an SWF that discloses a best-practice governance architecture, its investment beliefs, procedures for monitoring investment relationships, and how it maintains and motivates an expert staff, among other areas of disclosure discussed above, can more easily justify above average performance.

---

39. For example, if an SWF indicated its intended holding period for specific investments, other investors in the market may trade on that information and therefore undermine the SWF's expected returns from the investment.

40. Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 799–839 (1993).

The most obvious method for disclosing performance is providing information on returns set against some market benchmark, or absolute returns. The issue, however, is the frequency of such disclosure. For long-term investors, monthly and quarterly returns may seem inappropriate. Markets can be highly volatile in the short run, which can exaggerate good or bad performance. For an SWF trying to maintain a long-term investment strategy, poor performance in the short run, while possibly pointing to an ill-resourced and ill-managed organization, may give the organization's sponsors or its detractors reason to intervene in the SWF's operations. Such intervention may jeopardize the long-term strategy, or the threat of potential intervention could force the organization to have an overly short-term focus.

For a number of commentators, SWF officials, and SWF sponsors, the demand for short-term performance metrics is arguably the cause of so much short-termism in financial markets.[41] Hence, many SWFs choose not to produce performance metrics on a regular basis, if they produce them at all. For example, since 2010, the Singapore Government Investment Corporation has disclosed its real returns on five-year, ten-year, and twenty-year bases while producing increased information on its governance, investment policies, and operations.[42] This contrasts with the New Zealand Superannuation Fund (NZSF), which produces monthly performance metrics.[43] The NZSF combines this regular disclosure with active public engagement, going to great lengths to educate the public on how markets, particularly equity markets, are volatile in the short run, yet mean reverting over the long run.[44]

The case of the NZSF is compelling as it demonstrates that producing quantitative performance metrics is insufficient as a whole; an organization needs to provide further justification of its performance as a

41. For a general discussion on short-termism, see generally David Marginson & Laurie McAulay, *Exploring the Debate on Short-Termism: A Theoretical and Empirical Analysis*, 29 STRATEGIC MGMT. J. 273 (2008); Alfred Rappaport, *The Economics of Short-Term Performance Obsession*, 61 FIN. ANALYSTS J. 65 (2005).

42. *See* GOV'T OF SING. INV. CORP. PTE LTD, GIC REPORT ON THE MANAGEMENT OF THE GOVERNMENT'S PORTFOLIO FOR THE YEAR 2010/11, at 8 (2011), *available at* http://www.gic.com.sg/images/pdf/GIC_Report_2011.pdf.

43. *See generally* N.Z. SUPERANNUATION FUND, HOW WE INVEST (2012), *available at* http://www.nzsuperfund.co.nz/files/How%20We%20Invest.pdf.

44. *See* Dixon & Monk, *supra* note 22. For more detailed accounts of Singapore's sovereign wealth funds, see generally CLARK ET AL., *supra* note 21, at 86–104; Henry Wai-chung Yeung, *From National Development to Economic Diplomacy? Governing Singapore's Sovereign Wealth Funds*, 24 PAC. REV. 625 (2011). For further discussion on the governance of the New Zealand Superannuation Fund, see Benjamin J. Richardson, *Sovereign Wealth Funds and the Quest for Sustainability: Insights from Norway and New Zealand*, NORDIC J. COM. L, 2/2011 at 1, http://www.njcl.utu.fi/2_2011/benjamin_j_richardson.pdf (Fin.).

means of ensuring its legitimacy with the public.[45] Hence, other methods of performance disclosure can come through internal and external audits that may examine subjective criteria. These subjective reports could examine, for example, whether there is a self-reflexive learning culture within the organization and the board. Producing such performance reports is ultimately about reflecting the image of a professional financial institution, which is focused on achieving some risk-adjusted return in the pursuit of a legitimate policy goal established by the sponsor.

III. CONCLUSION

Often underlying Western society's concern with the rise of SWFs, or for that matter, any accumulation of financial power by some public entity (e.g., a public-employee pension fund or a state-owned enterprise), is the intrinsic link these entities have with the state. There is a perception that this link is incompatible with free-market capitalism. If not always an explicit argument, skeptics fear that such state-sponsored entities, even if there is a high degree of organizational and political separation from the decision makers of these entities, will ultimately contravene "free" market process of exchange to the benefit of the political will. In a space that purportedly should be limited to only private actors, this interference is ultimately inefficient. By this logic, such entities contravene the "spirit of capitalism" and are thus seen as threatening.

Unfortunately, skeptics seem to forget or ignore that markets are inherently political: Throughout the history of capitalism and over the last 150 years, the state has had a key role in ensuring capitalist processes—whether explicitly or implicitly.[46] The state sets many of the "rules of the game" through regulation and is usually there to provide public goods to the economy that are necessary for the rest of the capitalist system to operate. No successful developed market economy is without a relatively strong state and strong institutions.[47] The global financial crisis of the last decade reminded us that even in the most so-called free markets, the state is always waiting in the shadows to rescue capitalism from its excesses and failures. The state is likely to continue to do so, even to the chagrin of free-market purists, because it has always done so. Most

45. *See generally* Mark C. Suchman, *Managing Legitimacy: Strategic and Institutional Approaches*, 20 ACAD. MGMT. REV. 571 (1995).

46. *See generally* IMMANUEL WALLERSTEIN, HISTORICAL CAPITALISM (1983).

47. *See generally* DARON ACEMOGLU & JAMES A. ROBINSON, WHY NATIONS FAIL: THE ORIGINS OF POWER, PROSPERITY, AND POVERTY (2012).

political leaders are unwilling to sit back and see what happens if action is not taken, even if the moral hazard is clear.[48]

Following the global financial collapse in September 2008, it was not uncommon to hear fearful pronouncements that capitalism could soon be replaced—that emerging markets that had embraced capitalism as a means to organize their economies over the last several decades would revert to their old ways. The specter of socialism was knocking on the door, or was it? Like most crises, many forget to remind themselves that capitalism has always oscillated between booms and busts (to varying degrees). However, this fear was not so much a fear of a return to socialism, but a fear of a return of the interventionist state and a state that controls the means of production.[49] Yet, if one is reminded that the state is a part of the process, even in the freest of markets, then a more visible state is not necessarily counterproductive to a properly functioning free market, or the continuing existence of one. The state may have to periodically show its face, but it is still firmly on the side of capitalism in almost all countries. That the majority of SWFs are in emerging markets is not just a product of global imbalances and high commodity prices over the last decade—it demonstrates the way that market capitalism has been embraced since the end of colonial rule and the collapse of the Iron Curtain. Since the crisis began, more and more countries have established or are in the process of establishing their own sovereign wealth funds.[50] Given that SWFs are by nature capitalist entities in pursuit of the profits of global capitalism, this development is further confirmation of market capitalism as a form of economic organization with states (not surprisingly) as leading supporters.

But, states are not all the same. States and their polities do not always share the same values or have the same political traditions—openness and transparency included. This is not, however, a state of affairs that is unchangeable. Economic and political globalization brings ideas and different traditions into contact, often engendering change in the process. Hence, sponsors of SWFs may not all agree on what constitutes transparency. This is clearly apparent given the arguably measured compliance with the Santiago Principles. Nonetheless, the appetite for and commitment to dialogue on transparency and other general issues related to sponsoring an SWF, fostered through the IFSWF, is clearly

48. Consider the massive bailout programs in advanced economies implemented in the midst of the financial crisis of 2008. *See generally* EMILIANO GROSSMAN & CORNELIA WOLL, SAVING THE BANKS: THE POLITICAL ECONOMY OF BAILOUTS (2013).

49. *See generally* IAN BREMMER, THE END OF THE FREE MARKET: WHO WINS THE WAR BETWEEN STATES AND CORPORATIONS? (2010); Gerard Lyons, *State Capitalism: The Rise of Sovereign Wealth Funds*, 7 J. MGMT. RES. 119 (2007).

50. *See* CLARK ET AL., *supra* note 21, at 1–12.

palpable. While not seeking to replace the Santiago Principles, the simple conceptual framework offered in this essay is a response and contribution to that commitment.

Assuming that some SWFs and their state sponsors will remain wedded to nondisclosure in certain areas, it does not mean that they will necessarily maintain nondisclosure in other areas, which may provide a partial substitute for certain nondisclosures. Complete transparency may be wanting for some, but in the aggregate, transparency is increased if dialogue on non-transparency and potential functional equivalencies is expanded. Again, the framework provided here is for discursive purposes, which may be used by SWFs, their sponsors, and external analysts in describing the intentions of an SWF and ultimately those of the sponsor.