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# SOVEREIGN WEALTH FUNDS

*An Ethical Perspective*

**Authors** Christoph Stückelberger / Deon Rossouw / Sofie Geerts  
Pascale Chavaz / Namhla Xinwa



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# TABLE OF CONTENTS

<b>Table of Figures .....</b>	<b>7</b>
<b>Acronyms and Abbreviations.....</b>	<b>8</b>
<b>Preface .....</b>	<b>11</b>
<b>1 Introduction and Mapping of Sovereign Wealth Funds .....</b>	<b>13</b>
1.1 Introduction .....	13
1.2 Mapping of all SWFs.....	18
<b>2 Controversies of Sovereign Wealth Funds .....</b>	<b>29</b>
2.1 Economic Debate.....	29
2.2 Social Debate .....	36
2.3 Environmental Debate .....	41
2.4 Governance and Transparency Debate.....	45
2.5 Political Debate.....	50
2.6 Summary of Controversies.....	56
<b>3 Stakeholders in the Sovereign Wealth Funds Discourse .....</b>	<b>61</b>
<b>4 Overview of Standards for Sovereign Wealth Funds .....</b>	<b>69</b>
4.1 Introduction .....	69
4.2 The Santiago Principles .....	70
4.3 OECD Guidance to Recipient Countries .....	73
4.4 EU Communication – A Common European Approach to Sovereign Wealth Funds.....	74

4.5 Other Guidelines Applicable to SWFs.....	75
4.6 Transparency Indices for SWFs.....	82
4.7 Governance of Ethics in SWFs.....	88
4.8 Conclusion .....	95
<b>5 Ethical Criteria and Conclusion.....</b>	<b>99</b>
5.1 Ethical Criteria from Core Values .....	99
5.2 Value Judgment with EESGP Criteria and Conclusions..	102
5.3 Recommendations.....	108
<b>6 Draft Ethics Charter – English and Portuguese Versions .....</b>	<b>111</b>
6.1 Draft Ethics Charter of Fundo Soberano de Angola (FSDEA).....	111
<b>7 References.....</b>	<b>117</b>
<b>8 Annexures.....</b>	<b>131</b>
Annexure 1: Santiago Principles.....	131
Annexure 2: OECD.....	137
Annexure 3: EU Communication – A Common European Approach to Sovereign Wealth Funds. ....	145
Annexure 4: Global Compact .....	147
Annexure 5: United Nations Principles for Responsible Investment (UNPRI) .....	149
Annexure 6: Transparency Indices .....	152



# TABLE OF FIGURES

<i>Figure 1: Assets under management by origin (2014)</i> .....	15
<i>Figure 2: Year of establishment and number of existing SWFs</i> .....	20
<i>Figure 3: Assets under management by region</i> .....	22
<i>Figure 4: Assets under management by country</i> .....	23
<i>Figure 5: Number of SWFs by region</i> .....	23
<i>Figure 6: Number of SWFs by country</i> .....	24
<i>Figure 7: Ten largest assets under management by country</i> .....	25
<i>Figure 8: Democracy Index score by country (2013)</i> .....	25
<i>Figure 9: Largest SWFs (&gt;100 billion US\$ AUM)</i> .....	26
<i>Figure 10: Map of SWFs role-players</i> .....	67
<i>Figure 11a*: Comparison of scores in three transparency indices</i> .....	83
<i>Figure 11b: Comparison of scores in three transparency indices</i> .....	84
<i>Figure 12: Number of UNPRI and GAPP (Santiago Principles) signatories by region</i> .....	90
<i>Figure 13: Percentage of SWFs meeting ethical criteria, by region</i> .....	91
<i>Figure 14: SWFs global AUM meeting ethical criteria</i> .....	92
<i>Figure 15: Percentage of SWFs meeting ethical criteria, by origin</i> .....	93
<i>Figure 16: SWFs meeting no explicit ethical criteria, by region</i> .....	94
<i>Figure 17: Percentage of IFSWF (non-) members meeting ethical criteria</i> .....	95

## Tables

<i>Table 1a: Stakeholder Analysis</i> .....	65
<i>Table 1b: Stakeholder Analysis</i> .....	66

## ACRONYMS AND ABBREVIATIONS

<b>ADIA</b>	Abu Dhabi Investment Authority
<b>AFF</b>	Future Fund (Australia)
<b>AHSTF</b>	Alberta's Heritage Savings Trust Fund (Canada)
<b>APF</b>	Alaska Permanent Fund
<b>AUM</b>	Assets under management
<b>CIC</b>	China Investment Corporation
<b>(E)ESG(P)</b>	(Economic,) environmental, social and corporate governance (and political)
<b>EU</b>	European Union
<b>FFG</b>	Fund for Future Generations (Equatorial Guinea)
<b>FSDEA</b>	Fundo Soberano de Angola
<b>GIC</b>	Government of Singapore Investment Corporation
<b>GPIF</b>	Government Pension Fund – Global
<b>HKMA</b>	Hong Kong Monetary Authority Investment Portfolio
<b>HSF</b>	Heritage and Stabilization Fund (Trinidad and Tobago)
<b>ICD</b>	Investment Corporation of Dubai
<b>IMF</b>	International Monetary Fund
<b>ISF</b>	Italian Strategic Fund
<b>ISIF</b>	Ireland Strategic Investment Fund
<b>KIA</b>	Kuwait Investment Authority
<b>KIC</b>	Korean Investment Corporation
<b>KNB</b>	Khazanah Nasional Berhad (Malaysia)
<b>LIA</b>	Libyan Investment Authority
<b>MENA</b>	Middle East and North Africa
<b>MHC</b>	Mumtalakat Holding Company (Bahrain)
<b>NDF</b>	National Development Fund (Iran)
<b>NFHR</b>	National Fund for Hydrocarbon Reserve (Mauritania)
<b>NIC</b>	National Investment Corporation (Kazakhstan)
<b>NSIA</b>	Nigeria Sovereign Investment Authority

<b>NSSF</b>	National Social Security Fund (China)
<b>NWF</b>	Russian National Wealth Fund
<b>NZSF</b>	New Zealand Superannuation Fund
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>ORSFM</b>	Oil Revenues Stabilization Fund of Mexico
<b>PF</b>	Pula Fund (Botswana)
<b>PRF</b>	Pension Reserve Fund (Chile)
<b>QIA</b>	Qatar Investment Authority
<b>RDIF</b>	Russian Direct Investment Fund
<b>RRF</b>	Russian Reserve Fund
<b>SAFE</b>	State Administration of Foreign Exchange Investment Company (China)
<b>SAMA</b>	Saudi Arabian Monetary Agency Foreign Holdings
<b>SESF</b>	Social and Economic Stabilization Fund (Chile)
<b>S-K JSC</b>	Samruk-Kazyna JSC (Kazakhstan)
<b>SOF</b>	State Oil Fund of Azerbaijan
<b>SWF</b>	Sovereign wealth fund
<b>TH</b>	Temasek Holdings (Singapore)
<b>TLPF</b>	Timor-Leste Petroleum Fund
<b>USA</b>	United States of America
<b>WTO</b>	World Trade Organisation



# PREFACE

Sovereign wealth funds (SWFs), state-owned independent investment vehicles, have been increasingly growing in number during the last decades and are fast growing in assets and therefore in influence on global markets. The study shows that the credibility of the Sovereign Wealth Funds would be strengthened with additional ethical standards as these funds in many countries are subject to controversies. Against this background, the Board of Directors of FSDEA decided in 2014 to commission this project for a report on ethical perspectives of sovereign wealth funds and for an ethics charter of sovereign wealth funds in order to:

1. analyse SWFs on their role in finance, economy and society and their ethical standards and codes;
2. propose an Ethics Charter; and
3. start a dialogue with other SWFs in Africa and globally on such an ethics charter.

FSDEA asked the *African Innovation Foundation* (AIF) to conceptualize the project. The implementing partner is the Global Ethics Network *Globethics.net Foundation* based in Geneva, and with 155'000 registered participants in over 200 countries and territories.

This report is the result for the first step of the project.

*Globethics.net* set up a team of experienced experts and researchers for this report, composed of:

- Prof. Dr. Christoph Stückelberger, Founder and Executive Director of *Globethics.net*, Professor of Ethics at the University of Basel, specialized in economic ethics, environmental ethics and political ethics.

## *12 Sovereign Wealth Funds: An Ethical Perspective*

- Prof. Dr. Deon Rossouw, CEO of the *Ethics Institute South Africa* (EthicsSA) in Pretoria/South Africa, specialized in business ethics, accounting ethics, governance and ethics. Extraordinary Professor at *University of Stellenbosch*, member of the *King IV Committee on Governance for South Africa*, and former President of the *International Society of Business, Economics and Ethics*.
- Dr. Sofie Geerts, Senior Research Associate of *EthicsSA*, with a PhD in Development Economics.
- Pascale Chavaz, Project Officer of *Globethics.net*, specialist in Applied Ethics with research experience on Socially Responsible Investing (SRI).
- Namhla Xinwa, Research Assistant of *EthicsSA*, Economist.

The authors are very thankful to the Fundo Soberano de Angola FSDEA for this initiative to strengthen ethical perspectives in policies and governance of sovereign wealth funds. May the report contribute to the discussion and to solutions.

# INTRODUCTION AND MAPPING OF SOVEREIGN WEALTH FUNDS

## 1.1 Introduction

“Sovereign Wealth Funds (SWFs) are independent government run investment vehicles that manage state-owned assets and are managed separately from the official budget and reserves of a country” (IWG 2008). This is the definition used by the International Working Group of Sovereign Wealth Funds (IWG), and the most widely accepted definition. Mthuli Neube from the *African Developing Bank*, in this regard, suggests that SWFs of African countries should have three purposes: (a) funding national infrastructure projects, (b) making provision for future generations, and (c) supporting current spending by the government. However, various other definitions are used by academics, politicians, economists, etc. as was pointed out by Capapé and Guerrero (2013) in their paper called “More layers than an onion: looking for a definition of SWFs”.

When considering how to define sovereign wealth funds, there are two characteristics common to all. Firstly the fact that they are owned by governments, and secondly that they are investment funds.<sup>1</sup> There is no agreement on the other characteristics used in definitions, such as: SWFs

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<sup>1</sup> With this in mind, it should be noted that central banks might have the same investment policies and governance issues than SWFs, even if they don't pursue the same objectives.

have an international investment portfolio (not always, but this is often the case); SWFs do not have pension (or other direct) liabilities (like dividends); SWFs are independent, meaning that they are managed with the sole purpose of generating profit; SWFs have a defined purpose; SWFs invest for the longer-term; and SWFs only have financial objectives. In the current study, the IWG definition is used for reference with the only exception that funds which only invest domestically are also taken into consideration, whereas these are excluded from the IWG definition (El Kharouf et al. 2010, Van der Zee 2012).

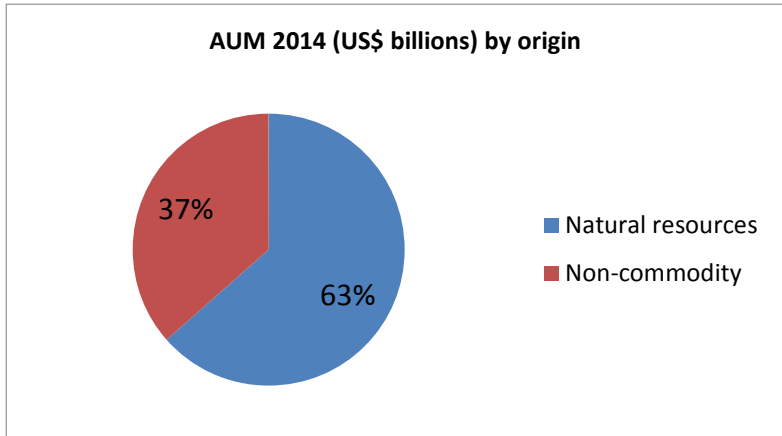
SWFs are a form of ‘new state capitalism’ to achieve financial efficiency and political pursuits. Most often SWFs are founded by governments with surplus funds which, for a variety of reasons, prefer to invest the surplus, rather than just save or spend it. Most SWFs (68 out of 96 funds, 71% of all SWFs) are owned by countries with large mineral reserves (like oil, gas and minerals) that, when commodity prices are high, obtain large amounts of revenue. Since these reserves are non-renewable, there is a need to generate long-term value and build wealth for future generations. However, there are also non-commodity based SWFs<sup>2</sup> (28 funds, 29% of all SWFs) which are funded by government bonds, foreign exchange reserves or revenues from state-owned enterprises (Capapé and Guerrero 2013, Balding 2012, Aguilera et al. 2015). In terms of assets under management (AUM), commodity funds represent 63% of the total amount in 2014, as Figure 1 illustrates.

---

<sup>2</sup> For example, Ireland established a SWF in 2001 to meet future costs of the ageing population. Each year, the government allocates 1% of GNP of the country to the SWF (Knowledge Development 2012).



*Figure 1: Assets under management by origin (2014)*



Hence, the purpose of creating SWFs is to address specific economic problems, such as the following:

1. *Stabilisation of the domestic economy.* An unstable economy leads to uncertainty and difficult planning and decision-making processes. When there is excess volatility in revenues or exports, fiscal surpluses or foreign exchange reserves, SWFs can be used to stabilise the economy (Capapé and Guerrero 2013). Singapore and China, for example, created their SWFs from foreign exchange reserves because they wanted to avoid injecting too much cash in the economy at one time, which can lead to inflation and a reduction in economic growth (Balding 2012).
2. *Diversification of the economy.* Many commodity rich countries are dependent on their commodities as main export product. As commodities are a finite resource, the economy has to diversify to be able to survive when commodities are depleted. In addition, a very prominent commodity-based economy reduces the competitiveness of the overall economy and prohibits the development of other industries. This phenomenon is called the

‘Dutch disease’<sup>3</sup>. The Gulf States were from an early stage aware of this problem and SWFs were partly created as vehicles to diversify the economy, and were complemented by supporting policies and actions (El Kharouf et al. 2010). To a certain extent, some of the Gulf States have succeeded in creating alternative economies (like travel and tourism, real estate, knowledge economy), but not yet to a sufficient extent (Hvidt 2013). Also Balding (2012) indicates that so far, not one commodity dependent country succeeded in diversifying its economy sufficiently away from commodities.

3. *Funding social and economic development in the domestic economy.* This can also be seen as ‘diversification of the economy’. As El-Kharouf (2010) indicates, SWFs can be valuable for diversification only when they invest locally. Especially domestic economic development (excluding the commodity sector) could be a major objective of a SWF. The majority of SWFs do invest locally, however in most instances the majority of assets are invested abroad. Some SWFs only invest abroad (like the Ghana Petroleum Funds), while others deliberately invest all of their assets domestically to stimulate the economy, like the *Banque Publique d’Investissement* from France (BPI) or the *Nigeria Investment Fund*<sup>4</sup>. Other SWFs partly have a domestic investment function like *Temasek* from Singapore, *New Zealand Superannuation Fund* (NZSF), the

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<sup>3</sup> The ‘Dutch disease’ refers to the crisis that erupted in the Netherlands in the 1960s when oil was discovered in the North Sea and consequently the Dutch economy was flooded with foreign currency. The Dutch currency became stronger and stronger which caused the rest of the Dutch export economy to become uncompetitive as the domestic economy had to pay higher prices for imported products and services (Triki and Faye 2011, The Economist 2013, Balding 2012). To avoid this ‘Dutch disease’, the economy needs to be diversified.

<sup>4</sup> The *Nigeria Investment Fund* is one of three funds managed by the *Nigeria Sovereign Investment Authority* (NSIA).

*Fundo Soberano de Angola* (FSDEA), *Samruk-Kazyna* from Kazakhstan or the *Palestine Investment Fund* (PIF) (Gelb et al. 2014) and others.

4. *Saving for future generations when commodity reserves are depleted* (Investopedia 2013). These reserves can be used to fund for example the government budget when revenues from commodity export no longer exist.
5. *Earning greater returns than on foreign exchange reserves*. Investing revenue from commodity exports, can lead to higher returns (The Economist 2013). Some countries, like China, have now so many reserves that they have more than enough to protect them against shocks. They just invest their revenue for a higher return.
6. *Repaying external debt or balancing the government budget*. This does not happen often, but there are cases where it happened. Nigeria, for example, withdrew 17 billion USD from its SWF over a period of two years to balance its budget and repay external debt. Also Mauritania and Algeria used their funds – respectively the *National Fund for Hydrocarbon Reserves* (NFHR) and the *Revenue Regulation Fund* (RRF) – to repay public debt and fund fiscal deficits (Triki and Faye 2011). In Quebec, Canada, the *Generations Fund* was created with the specific purpose to reduce public debt (Finances Québec 2006).
7. *Obtaining access to markets, ideas and technology* (The Economist, 2008). *Investment Corporation of Dubai* (ICD), for example, recently invested in *Dangote Cement*, Africa's largest cement producer based in Nigeria, in an attempt to get an entry into Africa. The CEO of the fund said that this investment was “a gateway to Africa” and was intended “to kick-start its investment into Africa” (Maritz 2014). *Qatar Investment Authority* (QIA)

invested in Siemens “to facilitate technology transfer” (Santiso 2013).

## 1.2 Mapping of All SWFs

As we see above, it can be difficult to come to a singular definition of what qualifies as a SWF. Furthermore, this study found that the available data on SWFs are often contradictory, but also difficult – when not impossible – to find. In this regard, identifying assets under management (AUM) over time and the purposes of funds were particularly challenging, as well as identifying legal structures, governance structures, and precise origins of non-commodity funds.<sup>5</sup> A good example of conflicting information is the *Hong-Kong Monetary Authority* (HKMA) Investment Portfolio, which current AUM are valued at an estimated 400.2 US\$ billion by the *Sovereign Wealth Fund Institute*, and at 65.1 US\$ billion by the *Sovereign Wealth Centre*. This is the largest discrepancy observed, but this demonstrates the widely varying estimates of AUM, especially with regard to historical data.

Other difficulties relate to certain funds being replaced, split or merged over time. This lack of clarity leads to widely divergent claims about SWFs. Amongst other examples, the *Ghana Petroleum Funds* (GPF) include both the *Ghana Heritage Fund* and the *Ghana Stabilisation Fund*, and the *Excess Crude Account* from Nigeria was replaced by the *Nigeria Sovereign Investment Authority* in 2010. The current state of three funds is uncertain: it cannot be clearly stated

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<sup>5</sup> Regarding the total AUM, Capapé and Guerrero give an interesting example: “Estimates range from \$2.7tn (GeoEconomica, 2012); \$2.19tn (Sovereign Investment Lab at University of Bocconi, 2011); \$3.2tn (Truman, 2011); \$4.6tn (Prequin, 2012); \$4.8tn (theCityUK, 2012); \$4.9tn (ESADEgeo et ESADE Business School, 2012), up to the 5.3tn estimated by Sovereign Wealth Fund Institute (2013)” (Capapé and Guerrero 2013). Regarding governance structures, Van der Zee’s analysis describes governance structures of 42% of all SWFs taken into consideration as “unclear” (Van der Zee 2012).

whether the *Reserve Fund for Oil* in Angola, the *Fund for Future Generations* from the Democratic Republic of the Congo, or the *Fonds de stabilisation des recettes budgétaires* in Equatorial Guinea still exist.<sup>6</sup> These funds were therefore not included in our statistical analysis.

In order to avoid situations in which we may have several, yet conflicting, sources of information concerning the same SWFs, we decided to prioritize the statistics published in the funds' own annual reports. In cases where these were not available, we referred to secondary or tertiary sources. Furthermore, only SWFs operating at the time of the writing of this report were taken into consideration, irrespective of whether they had replaced another former fund or not. For example, the *Government Petroleum Fund* established in 1990 by Norway became the *Government Pension Fund – Global* (GPFG) in 2006. In this case, GPFG was not considered as established in the 1990s, but in the 2000s.

The following analysis gives an overview of all SWFs as they were at the end of 2014. The assets under management (AUM) are presented in US billion dollars.

The first two SWFs were created by the State of Texas in the 19<sup>th</sup> century to fund public education from another source than public taxes: the *Permanent School Fund* (PSF, 1854) and the *Permanent University Fund* (PUF, 1876). It was not until the 1950s that new funds were created, starting with the *Kuwait Investment Authority* (KIA) in 1953. Slowly other states followed, usually oil producers with large reserves. The first non-commodity ever established is the *Taiwan National Stabilisation Fund* (NSF) in 1973.

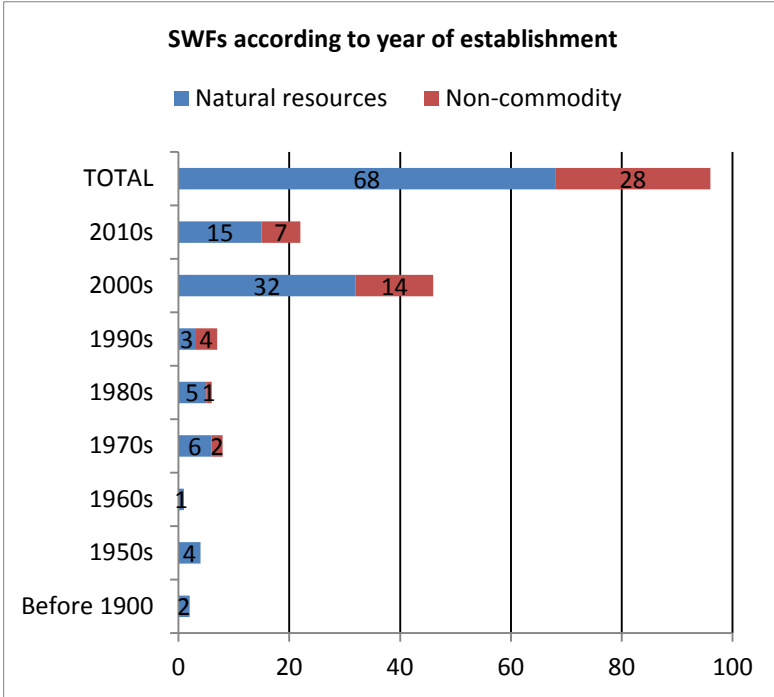
Since 2000, there has been a substantial increase in the creation of new SWFs, as 46 new funds were established between 2000 and 2009. The total amount of active SWFs now currently stands at 96, meaning that the number of SWFs has more than doubled in 9 years. Figure 2

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<sup>6</sup> It should be noted that those three countries have other existing funds.

compares the number of SWFs established during each decade, and their origin (commodity or non-commodity).

Figure 2: Year of establishment and number of existing SWFs



The rapid increase in the establishment of SWFs since 2000 could be attributed to rising commodity prices, which led to massive accumulation of foreign exchange for states, as well as to two trends in the global political economy since 2007 (Truman 2010). Firstly, due to the financial crisis, the importance of the state in managing the economy deepened, and secondly, the centre of economic and financial power is slowly moving from the European Union (EU) and United States of America (USA) to other countries. Countries, like China and Saudi Arabia, with consistently growing financial power which are able to

invest large amounts of money in SWFs – money that traditional economies in Europe and the USA do not have.

Additionally the most recent financial crisis showed that the *International Monetary Fund* (IMF) could not prohibit large meltdowns or even government failures, as was the case in Greece. Trust in the IMF has thus decreased, and many countries have realised that they should independently build sufficient reserves in case of future economic crises (Kalter and Schena 2012). Since 2010, the rate at which new SWFs are founded has decreased, but is still higher than before the 2000s.

The aggregate size of SWFs has been growing rapidly over the last few years. Estimations vary considerably, depending on how SWFs are defined. Considering the 96 SWFs included in this analysis, the total AUM was US\$ 6,4 trillion in 2014. This is a significant amount, representing 8,7%<sup>7</sup> of global financial trade.

Figures 3 to 6 illustrate the regional distribution of SWFs with regard to their assets and numbers. The Asia-Pacific region leads the way with 40% of all AUM, mainly through non-commodity funds from China (6 SWFs; 22% of all AUM; ranking as 1<sup>st</sup> all countries) and from Singapore (2 SWFs; 7,8% of all AUM; 5<sup>th</sup> of all countries). The Middle East and North Africa (MENA) region follows with 34% of all AUM, almost exclusively through commodity funds, as only Palestine in this region has a non-commodity fund. United Arab Emirates (7 SWFs; 15% of all AUM; ranking 2<sup>nd</sup> of all countries) own the largest number of SWFs, followed by Saudi Arabia (2 SWFs; 12% of all AUM; ranking 4<sup>th</sup> of all countries), Kuwait (1 SWF; 6,4% of all AUM; ranking 6<sup>th</sup> of all countries) and Qatar (1 SWF; 3,2% of all AUM; ranking 7<sup>th</sup> of all countries). The substantial presence of Europe (18%) in these charts is due to Norway, which owns the largest fund (2 SWFs; 14% of all AUM; 3<sup>rd</sup> of all countries) and Russia (3 SWFs; 2,9% of all AUM; 8<sup>th</sup> of all

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<sup>7</sup> This percentage was calculated using the total AUM of SWFs in 2014 (US\$ 6449 billion) and the 2014 global AUM (74 trillion, Figure provided by the *Sovereign Wealth Fund Institute*).

countries). Like Central Asia, North America owns 6% of all AUM, despite 13 SWFs being shared between the United-States (10 SWFs; 2,1% of all AUM; ranking 10<sup>th</sup> of all countries) and Canada. Latin America (lead by Venezuela, Chile and Falkland Islands) and Sub-Saharan Africa combined (lead by Botswana, Angola, Zimbabwe and Mauritius) share 2% of all AUM.

*Figure 3: Assets under management by region*

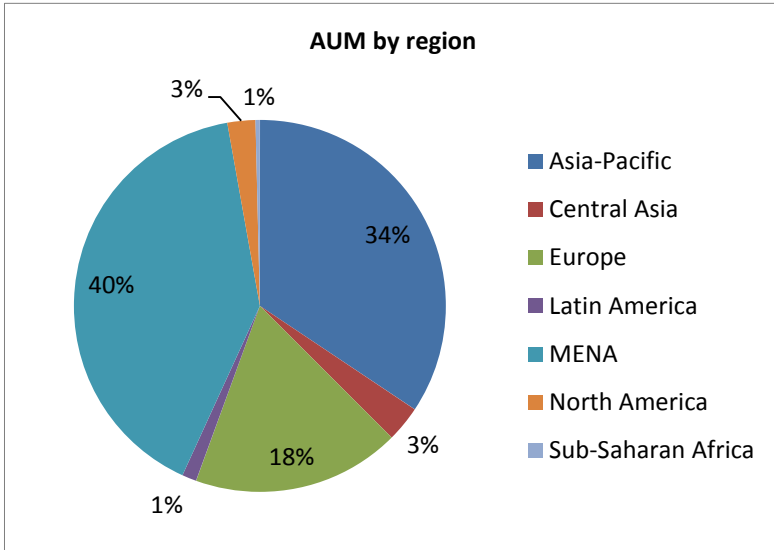




Figure 4: Assets under management by country<sup>8</sup>

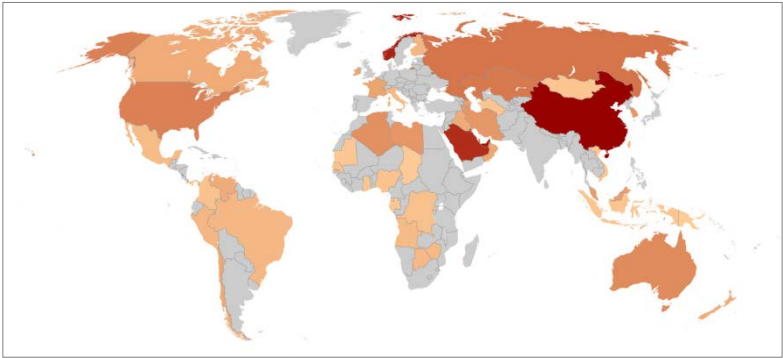
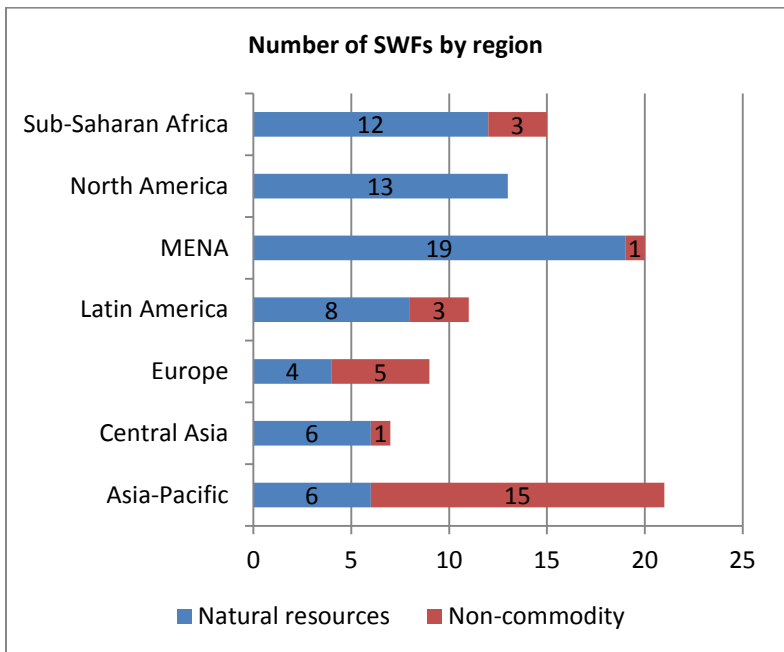


Figure 5: Number of SWFs by region



<sup>8</sup> Darker colours correspond to largest AUM.

Figure 6: Number of SWFs by country<sup>9</sup>

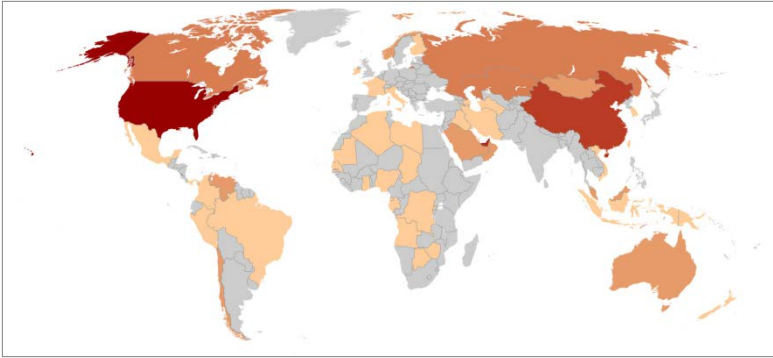


Figure 7 represents the ten countries with the greatest number of AUM. China is far ahead (US\$ 1424 billion), followed by United Arab Emirates (US\$ 977 billion), Norway (US\$ 903 billion), Saudi Arabia (US\$ 755 billion), Singapore (US\$ 503 billion) and Kuwait (US\$ 410 billion). Qatar, Russia, Kazakhstan and USA follow, with AUM below US\$ 200 billion each. It is worth mentioning that many of these countries are oil exporters, with the exception of China and Singapore. These ten countries represent 10% of all SWFs, but 89% of all AUM.

This chart also highlights the fact that authoritarian regimes are well represented in this top 10 list. Seven of these countries do not exceed a score of 4 out of 10 on the Democracy Index<sup>10</sup>, with only Norway, Singapore and the United-States that have higher scores, as illustrated in Figure 8 below. The Corruption Perceptions Index<sup>11</sup> demonstrates the same tendency, with scores lower than 50/100 for five of them (Qatar being unrated).

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<sup>9</sup> Darker colours correspond to largest number of SWFs.

<sup>10</sup> The Democracy Index was created by the Economist Intelligence Unit (EIU) in 2006. It scores the state of democracy of 167 countries. ([www.eiu.com/](http://www.eiu.com/))

<sup>11</sup> Since 1995, Transparency International scores countries every year (174 countries in 2014) on perceptions of public sector corruption. ([www.transparency.org/research/cpi/](http://www.transparency.org/research/cpi/)) The 2014 scores for these 10 countries are as follows. China: 36; United Arab Emirates: 70; Norway: 86; Saudi Arabia: 49; Singapore: 84; Kuwait: 44; Russia: 27; Kazakhstan: 29; USA: 74.

Figure 7: Ten largest assets under management by country

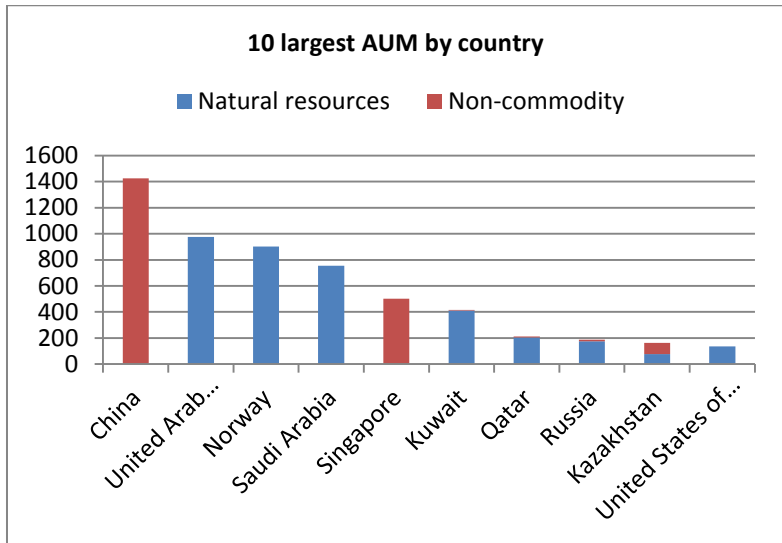
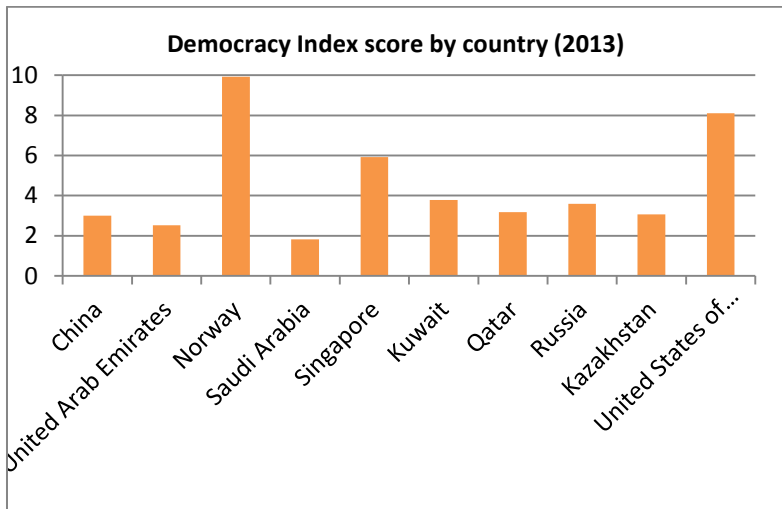


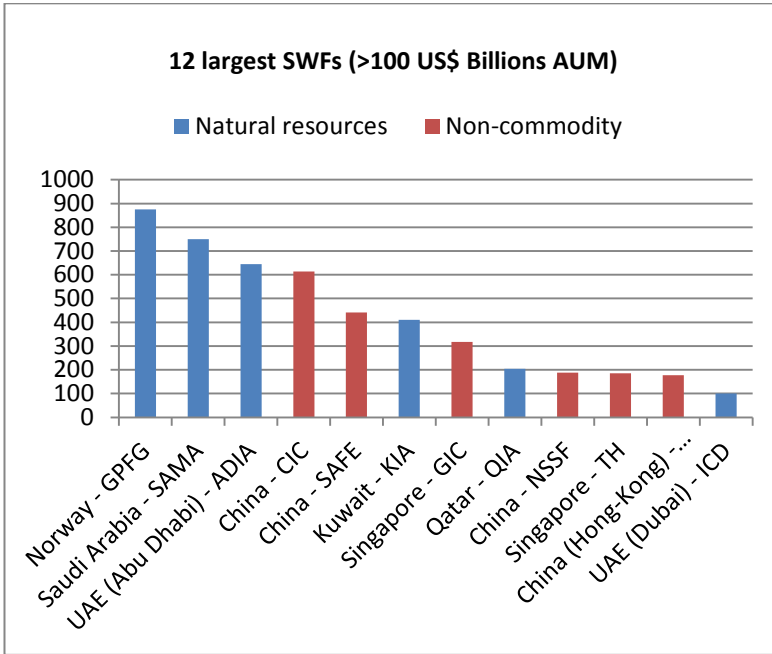
Figure 8: Democracy Index score by country (2013)



76% of the total AUM is concentrated in the 12 largest funds, as indicated in Figure 9. The *Government Pension Fund – Norway* (GPFN)

is the largest, with US \$875,2 billion, followed by *Saudi Arabian Monetary Agency Foreign Holdings* (SAMA, US\$ 749,5 billion), *Abu Dhabi Investment Authority* (ADIA, US\$ 644.5 billion) and *China Investment Corporation* (CIC, US\$ 614 billion). Four of these twelve largest funds are based in China, two in Singapore, and two in the United Arab Emirates.

*Figure 9: Largest SWFs (>100 billion US\$ AUM)*



Finally, it should be pointed out that 23 countries or sub-national governments<sup>12</sup> are currently considering the possibility of establishing a

<sup>12</sup> Bolivia, Canada: Saskatchewan, Colombia, Georgia, Guatemala, India, Israel, Japan, Kenya, Lebanon, Liberia, Morocco, Mozambique, Namibia, Philippines, Sierra Leone, Slovenia, South Africa, Tanzania, Tunisia, Uganda, United-States: West Virginia, and Zambia. The SWF of Papua New Guinea is considered as already existing in this study, now that the Parliament has approved it: <http://pidp.eastwestcenter.org/pireport/2015/February/02-20-01.htm>.

SWF. Nine amongst these are from the Sub-Saharan region, with the other regions more or less equally represented. (Santiso, 2014)

The sheer size of SWFs, the rise in the number of SWFs since 2000, the fact that most SWFs originate from the Middle East and so-called developing countries, and the perceived lack of transparency and accountability of SWFs lead to numerous debates about SWFs. The next section of the report will specifically look at the controversies surrounding SWFs regarding their economic, environmental, social, governance and political impact.



## CONTROVERSIES OF SOVEREIGN WEALTH FUNDS

SWFs have the potential to make a substantial positive impact on the lives of current and future generations. Nevertheless, there are a number of concerns raised by their existence<sup>13</sup>, and certain controversies concerning the way in which these funds operate. In this chapter the controversies surrounding SWFs that have emerged in the literature will be systematically examined and discussed. These controversies revolve around the economic, social, environmental, governance and political potential or real impact of SWFs.

### 2.1 Economic Debate

From the early 1980s, the *Washington Consensus*<sup>14</sup> stressed that the role of the state in the economy should be minimal. Proponents of the *Washington Consensus*, like Margaret Thatcher and Ronald Reagan, managed to spread it on a global scale with the result that these ideas were followed in many countries and by international financial

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<sup>13</sup> To determine whether a SWF should be created or not actually is the very first political, economic and ethical question. Also in countries like Switzerland the question regularly comes up if the country should have an SWF or not.

<sup>14</sup> The *Washington Consensus* is a set of economic policies aiming for neoliberal reform of the economy. The policies were driven by the US, the IMF and the World Bank. The policies included, amongst others, reduction of public expenditure, financial liberalisation, trade liberalisation, reducing import barriers, privatisation of state enterprises and deregulation of the economy.

institutions. However, it became clear in the 1990s that leaving the economy to the market alone was not the solution; in fact, the inaction of governments could worsen the state of the economy. Hence the *post-Washington Consensus* recognised again the role that the state should play in monitoring the market and in intervening when the market can cause potential harm.

Even with the dawn of the *post-Washington Consensus* the essence of the global economy and most national economies still remained market liberalism, which advocated for a reduced role of the state in the economy in order to stimulate global trade. Having too many rules was seen as detrimental to the development of global trade, which in turn would prohibit creation of wealth and jobs. The economic crisis of 2008 brought the hegemony of neoliberal economic ideas to an end. It led to the recognition that the state should play a role in the economy. The financial sector acted irresponsibly and exploited the lack of stringent regulation to increase their profits until the economic bubble imploded.

Since then there has been worldwide recognition that the state and other multilateral institutions have an important role to play in managing the economy, wherever and whenever necessary, to prevent future harm to the economy (Geerts 2014). Gerard Lyons, Chief Economist at Standard Chartered Bank, now speaks of the *Beijing Consensus*, referring to the Chinese economy where the government is tightly controlling the economy, which replaces the *post-Washington Consensus* (Lyons, no date).

It is against this background that many states created SWFs in the past decade. States started thinking about the future and their capacity to steer the economy to avoid economic problems. Balding (2012) claims that in principle SWFs were created to address specific economic problems, not to obtain financial or political power, though opinions on this differ.



In many cases, SWFs invest their money abroad in traditionally stable assets (from large reputable companies or bonds from stable governments), in a diversified way, and for the longer term. They invest in different regions, sectors, risk profiles and asset classes, just like traditional institutional investors. However, 80% of the total publicly reported investment in 2012 was concentrated in four sectors: financial services, real estate, commodities, and infrastructure (Santiso 2013, Aguilera et al. 2015).

According to Santiso's report (2013), during 2012 most SWF investments were made in Europe with the UK receiving the most investments, followed by the US. More recently, SWFs have begun investing more in consumer-orientated industries in emerging markets, however only in the industrial leaders in these emerging markets. Since SWF investments are long-term investments, a large amount of funds is involved and there are relatively few liabilities, a SWF can utilize higher risk investment strategies (The Economist 2013, Investopedia 2013, Capapé and Guerrero 2013).

Balding (2012) indicates that the track record of investments made by individual SWFs are mixed, which is normal and comparable to other investment funds. However shareholder value can increase by up to 15% when an SWF is involved, as SWFs are seen as reliable, and oriented towards long-term investments. This is also why SWFs are attractive to investors and assets that need capital. They can provide the required capital, and so become an important source of financing (Investopedia 2013). It should also be noted that long-term performance of SWFs worsens when politicians are involved in SWF management (Aguilera et al. 2015). The capital invested by SWFs can also be used to increase global wealth by using the SWF of one country to invest in another country which needs capital for budget deficits or development.

While the public announcement of an investment made by a SWF can create a positive, but short-term effect on the stock exchange,

investments made by SWFs are a stabilising factor for the companies and economies they invest in. Additionally the country receiving the investment from a SWF benefits as its market gets a boost; this was the case in the EU where large investments by SWFs increased the demand for the euro, supporting the currency domestically and internationally (Balding 2012, Knowledge Development 2012, Barbieri 2009).

During the financial crisis which erupted in 2008, SWFs rescued a number of European and American companies from bankruptcy. The bankruptcy of a large company like *Citigroup*, for example, would have had a devastating impact on many individuals, businesses, state clients and investors of the bank. Investments by SWFs in these failing western companies during the financial crisis not only saved the financial market from more trouble, but also made a positive contribution to the national economies of the USA and Europe (Balding 2012, Debatewise). Due to the enormous amounts of capital available in SWFs, they can come to the rescue of companies, and even troubled economies. This is a major advantage of the existence of SWFs that should not be underestimated.

SWFs also help developing countries to grow and fight poverty. Non-African SWFs have made substantial investments on the African continent for the purpose of development (Capapé 2012). For example, in 2011 the *China Investment Corporation* (CIC) invested in *Shanduka Group*, a South African group which invests in financial services, real estate, and energy, amongst others. Currently, the sectors in Africa that have received the most investment from SWFs are real estate and hotels. Also SWFs from developing countries, mostly in Africa, can stimulate economic development. Capapé (2012) and Triki & Faye (2011) say that Africa's economy is largely based on commodities and the export thereof, and hence African governments are ideally placed to start SWFs. Some African countries have also done so by investing their oil revenue like Libya and Algeria have, and more recently Ghana and Angola. Income from trading in commodities needs to be managed well,

and SWFs could play a role in this regard. In the past, Africa often suffered from recessions when commodity prices fell as African economies were so dependent on them. SWFs could assist African countries in investing for the future so that budget deficits can be reduced when they occur, and the economy can be diversified so that there is less dependency on commodities. SWFs in Africa can invest in infrastructure, for example, and local companies outside the commodities industry. Lyons even calls the funds of Angola and Nigeria ‘Sovereign Development Funds’ instead of Sovereign Wealth Funds due to the huge potential for development that these funds present for their respective countries (Capapé 2012, Lyons).

Even though this opportunity exists for African SWFs, Triki and Faye (2011) however remark that if one looks at the actual investments being made by African SWFs, they rather prefer to invest abroad. Although this demonstrates that theory and practice are not yet aligned, it seems very plausible that African governments would want to use SWFs to invest more in their own domestic economies for developmental reasons. Few funds invest in their national economies, but – as pointed out in the introduction – there are exceptions like CIC that invests 50% of its funds in the domestic economy, as well as *Temasek*, one of the SWFs from Singapore (Balding 2012). The *Fundo Soberano de Angola* (FSDEA) stated their intention to mainly invest in Africa, while the *Sovereign Wealth Fund Institute* currently estimates 40% of their assets are invested in Angola.

SWFs also invest to gain access to certain markets or sectors. This kind of investment is not only for financial gain, but to gain strategic access to a specific market or region. Santiso (2013) even says that SWFs mostly have dual financial and strategic objectives. India and China, for example, have invested in commodities in other regions to gain influence and access. *Temasek* aspires to make their country the liquid natural gas hub in Asia in order to reduce its dependence on

Indonesia and Malaysia in this regard. Consequently, *Temasek* invested in *Repsol*, a Spanish company with a significant stake in liquid natural gas to gain access to the necessary technology and to diversify its supplier base. The number of investments in this sector has increased by 90% in 2012, because the countries behind SWFs see these kinds of investment as necessary for any expected returns to be above average. Technological innovation is seen as the main driver for development, and required for facilitating knowledge transfers to their home countries (Santiso 2013, Aguilera et al. 2015).

The Chinese SWFs invest only in a select number of industries that the Chinese government deems important for the development of the country, namely natural resources, energy, materials and financial markets. *Qatar Investment Authority* (QIA) bought 3% of *Siemens* to facilitate technology knowledge transfer. Other SWFs have invested in agricultural land (mostly in Africa) and in firms that produce food on the acquired land. Due to these investments, they can assist in providing food security to their own people (Knowledge Development 2012). However, investing in land in developing countries is seen as a controversial practice, which is explained further below.

The first disadvantage is market distortion. The fact that SWFs rescued companies during the financial crisis is perceived by some critics as wrong, because these failed companies should have been allowed to disappear. That is basic capitalist logic, according to Larry Summers, former U.S. Treasury Secretary (Clarke 2013). DeMaura says that “the market should remain the driver of innovation and competition, not governments with funding” (Clarke 2013).

A second disadvantage is increased financial and economic protectionism. Investments by SWFs in American companies, for example, run the risk of not being approved by the *Committee on Foreign Investment in the United States* (CFIUS), created under the *Foreign Investment and National Security Act*, for fear of interference

with national interests. The executive powers in the USA even have a veto right to block any foreign investment, if it is deemed to be in contradiction with national security. Also the UK called upon the principle of national interest to keep *Kuwait Investment Authority* (KIA) from buying a substantial share in *BP* (Balding 2012). All states try to protect their economy from foreign possible threats where and when possible. Protectionism has been an issue over centuries and is still one today.

Currently, international trade rules – from the *World Trade Organisation* (WTO) – only allow protectionism for certain products or markets or for certain periods of time. However, this does not mean that states always refrain from protectionist measures. In fact, investments by SWFs were used in certain recipient countries to justify more protectionist measures (El Kharouf et al. 2010).

A third disadvantage is that due to the size of SWFs and the large investments or disinvestments that they can make, SWFs may have a negative impact on market stability (Balding 2012, Triki and Faye 2011). For example, large investments in recipient assets can lead to speculation bubbles, or if a SWF moves part of its investments from one sector to another, this can affect the whole market or a specific sector in a negative way.

To summarise, SWFs can make a very valuable contribution to financial markets and economies. The alleged economic disadvantages noted above rather seem to be more academic than real. Firstly, foreign investment is in principle welcomed by any country, and hence, refusing investments from SWFs based on a fear of interference with national interest is detrimental for the domestic and global economy and against WTO rules<sup>15</sup>. Barbieri (2009) states that refusing SWF investment offers is self-defeating, as they deprive the market of capital needed for

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<sup>15</sup> WTO provisions explicitly referring to investments are in place, drawing on the Trade Related Investment Measures (TRIMs) and the General Agreement on Tariffs in Services (GATS) (Barbieri 2009).

investment in companies and the financial market. In addition, there is no evidence that investments by SWFs have led to widespread protectionism so far (Clarke 2013, Triki and Faye 2011).

Secondly, SWFs have not yet led to destabilisation of markets. Indeed they have large amounts of money to spend, but the size of the fund is actually a limiting factor for SWFs as it is more difficult to quickly change investment strategy or buy or sell shares compared to smaller investment funds. All changes should go slow as otherwise, due to the large amounts involved; the financial markets would be distorted, which could also be detrimental for SWFs themselves. In addition, SWFs mostly limit the amount of shares they obtain in a company to ensure that their influence on the company stays limited (e.g. the *Government Pension Fund – Global* (GPFG) from Norway only obtains shares of companies up to 2,5%). In addition, research also indicates that SWFs do not cause more volatility for financial markets than other investment vehicles, and currently, SWFs transactions are not more than 2-10%<sup>16</sup> of the traded finance on a global scale respectively of the AUM.

## 2.2 Social Debate

SWFs are created by governments to manage assets, on behalf of their citizens. Hence, SWFs could be expected to invest their capital for the benefit of their citizens, and citizens have the right to keep their governments accountable for how these funds are managed, at least in theory. Aguilera et al. say that SWFs have a fiduciary duty to the state, and ultimately to its citizens. In practice the situation is somewhat different.

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<sup>16</sup> 2% (Balding 2012, Debatewise); 8,7% according to our calculation (cf. note 7).

The Editors of *Ethics & International Affairs* (2014) and Balding (2012) mention that few governments actually ask themselves the question of whether it is legitimate to use commodities and public money to create a SWF, to invest public money for the sake of future generations, or to address economic problems. In Norway, for example, the Parliament decides where the funds of the SWF should be invested in, and according to what rules and regulations. However, in the majority of countries it is governments or public officials, who are not necessarily democratically elected, that make investment decisions, and often do not even inform their citizens of the existence of the SWF (Knowledge Development 2012).

In principle citizens of a country should have a say in what happens to the commodities that belong to the country, and the revenue obtained by extracting and selling it. For the majority of SWFs it is not clear whether citizens have any say in the matter. This is an important factor to look at, as citizens might ask how investment decisions are being made. A good example is *the Alaska Permanent Fund* (APF) that consulted citizens on whether they wish to abolish the fund and receive their per capita share of its assets, or whether they prefer to retain the fund. The majority of Alaskans wished to retain the fund as a resource for future generations. In the end it was not the government but Alaskans who decided on the future and strategy of their SWF (The Editors of *Ethics & International Affairs* 2014).

Related to this, Cummine (2011) questioned why SWFs are not distributing returns from the fund directly to its citizens. Only the APF issues 'dividends' on an annual basis, paying out a certain amount to its citizens, based on the profit that the fund made. However it seems that other SWFs are not really keen to do the same. Firstly, SWFs managers and governments argue that issuing dividends to citizens runs counter to the core purpose of the SWF, namely saving money for the future (for example to stabilise the economy, or to reduce budget deficits). If

dividends would be issued, it might be that too much capital enters the market and that there will be inflation, which is one of the economic problems that a SWF wants to prohibit. If dividends were issued, citizens might consume the amount they receive, thus reducing the amount that could be invested to ensure future returns. The idea being that the larger the capital sum to be invested, the higher the return will be.

Additionally, a SWF is a national fund and individual citizens are not the owners of it. Even though individuals might benefit from the fund, it is not a given that this should happen by paying out dividends. The SWF contains ‘common wealth’, which are long-term national savings. This argument is often reflected in the founding documents of SWFs. The question is thus whether citizens of a country with a SWF do not have a right to benefit from the fund, within their lifetime, especially in developing countries, which have larger number of impoverished persons? Cummine (2011) suspects that the refusal of most SWFs to issue dividends might be the consequence of a desire by SWF managers to preserve maximum control over the fund, because issuing dividends is likely to heighten citizen awareness of the existence of the fund and its activities.

Balding (2012) mentions that SWFs should serve its citizens as this would give SWFs more legitimacy. SWFs can do this by investing domestically or by being willing to take a lower financial return on their investment in order to gain a higher social return. An example would be investing in a local industry which is not yet profitable, but that has high potential for creating jobs. This is exactly the role that capital could play in developing a country. In practice, very few SWFs have a clear policy on how much of the income should be used for which purpose. Income from SWFs can be used for different purposes, like funding development, putting aside a part for future generations, balancing the government budget, etc. The Nigerian Government, for example,



withdrew US\$ 17 billion from the US\$ 20 billion it had in its SWF between 2008 and 2010 to pay external debt and balance the budget as there was no clear policy on what the SWF should be used for. Thus, besides the financial return, a SWF could also look at the ‘social return’ when making investment decisions.

In a number of countries, like Singapore, Norway and the United Arab Emirates, SWFs contribute to the national social protection framework. Invested funds are used in health, education and the social security system. Although the SWFs do not have direct liabilities (like monthly pay-outs to beneficiaries) the income from investments is used by these governments to add to the health, education and social welfare budget.

Triki and Faye (2011) and Balding (2012) mention that SWFs are potential solutions for development in Africa. Despite their potential for domestic economic development, many African SWFs invest outside Africa, mostly in stable economies and not in their own domestic economies as mentioned in 2.1. above. However, there are exceptions like the *Libyan Investment Authority* (LIA) which invested heavily in Africa (data from 2011) in the past three decades with only about 25% being invested outside Africa. African SWFs currently tend to use their capital too much for stabilisation and macroeconomic purposes, and not for infrastructure development, or investments in health and education or other development spending. African SWFs could also play a role to lobby international investors to invest in local companies, or to start new companies in Africa by providing an amount of the required capital. However, this is also a government responsibility. Foreign SWFs could also invest in Africa to spur development (Triki and Faye, 2011).

Lastly, The Editors of *Ethics & International Affairs* (2014) argue that SWFs, due to their global scale and large resources should contribute to global justice by refusing to invest in countries and companies with a bad reputation, and try to influence other investors to

not do so either. SWFs should strive towards a fair and equal distribution of benefits, and by doing so set an example for solving growing inequality problem.

SWFs are currently not taxed by their home countries while other institutional investors are often taxed, which gives SWFs a commercial advantage over other institutional investors from the home country. Recipient countries sometimes tax SWFs, but in many instances, SWFs are exempt from taxation as they have the status of a foreign government (which is in principle not taxed). In the US for example, foreign investors (SWFs or not) are not taxed on capital gains. It would be fair if applicable tax laws, in home countries and recipient countries, would also be applied to SWFs. (Balding 2012, Knoll 2009). It has even been suggested that SWFs should pay taxes on their transactions – a sort of global tax – and that this money should then be used to solve global problems of injustice, like poverty (Armstrong 2015).

Managing the massive amounts of money accumulated in a SWF, requires specialized knowledge and skills. The U.S. Treasury said in 2008 that “SWF managers demonstrate a clear lack of knowledge about sovereign wealth funds, operations and their own sophistication”. Research from Balding (2012) however indicates that this is certainly not the case and that SWFs have worked with some of the world’s most talented asset managers and that countries are aware of the importance of managing such enormous amounts of money. It could be that the U.S. Treasury said this to promote American asset managers for the funds so that the USA would have larger control over SWFs, however this is mere speculation. Santiso (2013) also reports that since 2009, SWFs make more investments themselves and less through external asset managers. This trend started after the financial crisis which resulted in the fact that external fund managers are less trusted and because they charged high fees, however being unable to shield the funds against losses. SWFs now often have their own internal management teams,

who have greater control over SWFs than in the past. This has also resulted in the fact that SWFs have become more professional, as quality staff is used, which contributes to the reputation of SWFs (Aguilera et al. 2015).

In conclusion, the social value of SWFs lies in the fact that huge amount of funds could be available for current development as well as for future generations. However, the potential value for citizens will only be unlocked if they are aware of the existence of the SWF(s) of their country, have a say in its investment objectives, and benefit from it in some way.

## **2.3 Environmental Debate**

SWFs can influence the behaviour of companies and governments in which they invest by, for example, refraining from investing in companies that harm the environment. The GPFG from Norway tries to influence the environmental responsibility of companies. The fund has an Ethical Council which advises the fund investors on the environmental, social and governance (ESG) performance of companies. The Ethical Council can also propose to disinvest from companies, however the ultimate decision lies with the Ministry of Finance.<sup>17</sup> The fund has an ethical investment strategy, outlining which companies the fund cannot invest in.

In 2011, under pressure from environmental NGOs, the fund decided to disinvest from all companies that were involved in palm oil production that causes deforestation, threatening biodiversity. The 2012 annual report indicated that it disinvested from 23 companies involved

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<sup>17</sup> GPFG not only has guidelines on the environment, but also on social issues and governance. In addition, the fund automatically excludes investments in the production or distribution of weapons, or in the tobacco industry. Full guidelines can be consulted on the website of the Norway Ministry of Finance at [www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics\\_council/ethical-guidelines.html?id=425277](http://www.regjeringen.no/en/sub/styrer-rad-utvalg/ethics_council/ethical-guidelines.html?id=425277).

with palm oil. The fund also disinvested from Freeport McMoran due to their mining activities and the negative consequences thereof on the environment. They also disinvested from Wal-Mart due to labour issues. In addition, the Norwegian Prime Minister announced in March 2014 that the fund would invest in renewable energy in an effort to cut greenhouse gas emissions and address climate change – to the value of US\$ 8 billion. Climate change activists believed the announcement by the Prime Minister did not go far enough. They also criticised GPFPG for continuing to invest in fossil fuel (Wood and Rimmer 2014).

GPFPG not only disinvests, but also engages with companies to determine whether they are willing to address the fund's concerns. In this way, its investment strategy is pushing companies to improve their environmental (and also social and governance) behaviour. However, Norway is neither actively identifying violators of environmental and social standards, nor trying to influence them. Their approach is more ad-hoc and so they are more likely to engage with companies that they are already invested in whenever these companies get embroiled in specific environmental or labour controversies.

The *New Zealand Superannuation Fund* (NZSF) also demonstrates its concern for the environment. They specifically wish to invest in climate change initiatives. The *China Investment Corporation* (CIC) has invested in renewable energy companies, but rather ad-hoc and not because they have a climate change policy or strategy. However, these examples of responsible investing are a start. In fact, all SWFs could play a more active role by disinvesting from companies that are involved in environmental controversies, or by actively investing in companies that produce renewable energy. More SWFs could follow Norway's example and push companies to take into account environmental and climate change issues. However, besides the above examples, SWFs do not show much interest in addressing environmental problems (The Economist 2013, Balding 2012, Etifor).

Goeconomica (2014b) indicated that recently climate activists have targeted SWFs as possible financiers of so-called ‘climate finance’, which refers to finance that is needed to deal with climate change like climate change mitigation or adaptation projects. While the need for dealing with climate change has been recognised by many countries, most have not made any financial commitments. The problem that Goeconomica points out is that so far, SWFs have not been really interested in climate and environmental problems, except for GPFG and NZSF (as mentioned above).

The possible risk that climate change poses for long-term investments has not yet been sufficiently recognised by SWFs (and also not by many other institutional investors<sup>18</sup>). Figueres (Goeconomica 2014b) from the *Intergovernmental Panel on Climate Change* said in January 2014 that “institutional investors who ignore climate change are blatantly in breach of their fiduciary duty to their owners”. It can be argued that SWFs which have the objective of safeguarding funds for future generations also have the moral responsibility to ensure that these future generations will be able to live sustainably on our planet.

In this regard, it is worth highlighting that ‘future generations’ are usually not well-defined. How many generations should be considered by these funds? Is this a mid-term or long-term vision? The answer probably has an impact on investment policies. For example, SWFs which take a long-term view of ‘future generations’ cannot avoid environmental issues. They probably could not invest in nuclear energy considering the long-term risks thereof and the related decommissioning costs. A reflection on the meaning of ‘future generation’ is therefore

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<sup>18</sup> There are exceptions like the *Rockefeller Fund* that announced in September 2014 that they would start disinvesting from fossil fuels because of climate change concerns. This is remarkable as the Rockefeller family made its money by founding the *Standard Oil Company*, which operated the biggest oil refineries in the US. Also the *World Council of Churches* announced their disinvestment from fossil fuels (Goldenberg 2014).

needed to guide SWFs' investment policies and help them to be more transparent towards stakeholders.

One of the controversial environmental (and social) problems that haunt SWFs is land acquisition. In this context, land acquisition refers to the purchase or lease of land from mostly poorer developing countries by wealthy, food-insecure nations and private investors in order to produce food security for their respective countries (Sindayigaya 2012). The reason for land acquisition being so controversial is the fact that it can worsen food security in host countries, increase the price of food, and potentially can also deprive local farmers and people of land. There is also a large environmental issue due to the fact that this land is often used for crop farming, which is mostly monoculture, water-intensive and requires a lot of pesticides. This leads to degradation of the soil, depletion of water resources, air pollution, erosion and reduced biodiversity. Governments of host countries welcome the renewed interest from foreign investors in agriculture and often gladly give them access to large pieces of land for crop production. These governments are not always aware of the above possible negative impacts and they do not ask their citizens whether they approve of these arrangements. In some instances local farmers and people are displaced to make way for foreign investors who have invested in the land.

Why is there a renewed interest in investing in land? Firstly, the global food crisis of 2008 made countries that import most of their food realize that investing in food security for its citizens in times of crisis is a necessity. The food crisis substantially increased food prices to the extent that it became very expensive for certain countries to import food, and for their citizens to buy it. A second reason for the interest in land is energy security as increasingly bio-fuels are used to replace fossil fuels. The EU has set specific targets for the bio-fuel that should be used by each member state by 2020. Soya, the ingredient mostly used for bio-fuel is grown on large pieces of land, outside Europe. Due to the

increasing demand for bio-fuel, investors are eager to invest in farmland producing soya for bio-fuel. Furthermore, land is also seen as a rather safe investment (Sindayigaya 2012). It is not clear to what extent SWFs are involved in land acquisition, but it is sure that they are involved. *Qatar Investment Authority* (QIA) has reportedly invested in Kenya to get access to 40 000 hectares of farmland. *Libyan Investment Authority* (LIA) acquired 100 000 hectares in Mali for rice production (Sindayigaya 2012). *Kuwait Investment Authority* (KIA) has invested in poultry farms in Morocco, Yemen and Egypt (GRAIN 2008).

The above environmental concerns should be taken in mind by SWF investors when making investment decisions. However, this is also applicable to other institutional investors. In addition, SWFs could play an important role in urging companies to have more regard for the environment by not investing in companies which are involved in environmental degradation.

## **2.4 Governance and Transparency Debate**

The Economist (2008) stated that “sovereign wealth funds are as hard to grasp as shadows”. Zeigler (2014) added that “SWFs are not necessarily as transparent as non-governmental international financial institutions, and thus present a transparency gap”. Balding (2012) alleged that the funds lacking in transparency are often owned by undemocratic governments or countries which are perceived to be ‘less friendly’ towards the West. Since the increase in the number of SWFs since 2000, more and more calls were made to improve their governance. SWFs are instruments of sovereign states, however a lot of their investments are made globally. Regulation thus needs to be done on a global scale, but there are clear limitations to such regulation due to the autonomy of sovereign states. For the most part, international organizations – like IMF, EU and the *Organisation for Economic Co-operation and Development* (OECD) – have their hands tied and can

only offer guidelines like the ones described in chapter 4 below. On the other hand, recipient countries of SWF investments have the power to dictate what happens within their countries. So the strength of the governance within countries tends to be the strongest mechanism for determining the extent to which SWFs can wield power globally. Hence, SWFs have to adhere to international financial laws (OECD and IMF), WTO rules of trade, and the laws of countries where they invest in.

There are a number of ‘Transparency Indices’, which are rankings of the transparency of a number of SWFs. The mere fact that they exist is a proof that there is some unease about the governance and transparency of SWFs. Also, the transparency indices are compiled by academic institutes or research centers located in the West, where a level of transparency is required that is not necessarily required in other parts of the globe. The three SWFs transparency indices, namely the *Truman Index*, the *Linaburg-Maduell Transparency Index* and the *Santiago Compliance Index* are described in detail in chapter 4 below.

Geeconomica (2014d) states that SWFs are run in line with a country’s political institutions and their way of decision-making. In principle, SWFs are only required to report to their respective governments. The government could then opt to report about the SWF to the general public, but is not obliged to do so. The fact that SWFs are often managed outside the normal financial management institutions of a country contributes to the perception that they are operating outside the law and in secret (Capapé and Guerrero 2013). Balding (2012) asserts that many SWFs are bound to fiscal rules which determine what capital would flow into and out of the fund. However, even if these rules exist, they are not necessarily made public. SWFs could be expected to report to their citizens as they are public funds, and therefore citizens have the right to know what is happening with the funds. SWFs should adhere to at least some minimal level of disclosure (Balding 2012).



African, Middle Eastern and some Asian SWFs are immediately regarded with suspicion due to the reputation of their governments in terms of standards of governance, transparency and democratic principles. Research from Geoeconomica (2014d) indicates that supervisory boards of SWFs in democratic countries consist of independently appointed directors, while in one-party states, strict monarchies, and guided democracies, the directors are often members of an executive branch of government (Capapé 2012, Triki and Faye 2011, Geoeconomica 2014d). The perception of SWFs in these latter categories of countries tends to be negative, or at least suspicious, due to the governance reputation of these countries. The fact that executive government members are overseeing SWFs does not help. Aguilera et al. (2015) also state that the long-term performance of SWFs worsens when politicians are involved in its management and that these SWFs sometimes struggle to keep up with the performance of peer institutional investors, probably due to political interference.

A similar situation prevails in Middle Eastern SWFs and to some extent in some Asian SWFs as they have a long history of not disclosing information. The *State Oil Fund of Azerbaijan* (SOF), for example, is headed by the President of the country and the management of the fund is accountable directly to the President, who also determines policy directions of the fund (Geoeconomica 2014d). CIC is not transparent about its financial data. They do make financial reports publicly available, but a closer look reveals that the data are inaccurate and flawed by serious inconsistencies. The fund was established in 2007 with a capital of 200 billion US\$. The financial report indicated that it earned 6.8% on registered capital however the balance sheet shows that the capital at the end of 2008 was 298 billion US\$, an increase of almost 50% and not 6.8% (Santiso 2013).

It is crucial for both the country and its SWF to be perceived as trustworthy and transparent, as investors tend to only invest when they

are comfortable with the standards of governance and transparency of a country. Political stability is also an important consideration, as investors want to be assured that their money is safe and that common rules of trade and investment apply.

On the other hand there are, especially recently, more voices that indicate that there is increasing transparency from SWFs. *Abu Dhabi Investment Authority* (ADIA), for example, has been releasing an annual report since 2009 which indicates its investment strategies and governance structure. KIA has an independent Board of Directors composed of private sector representatives (Santiso 2013). And the recently established FSDEA has a website in English which provides information about composition of the board, purpose of the fund, financial data and even a code of conduct. Some SWFs also want to curb the criticism and show that they are legitimate investors, and are hence increasing transparency and are investing in such a way that demands increasing respect from the international community (Aguilera et al. 2015). An interesting comment was made by Marcelo Giugale, a World Bank economist who said that if a country sets up a SWF, it is a huge signal of discipline (Canuto and Halland 2014). Santiso (2013) also mentions in his report that since 2012, SWFs are more visible and transparent due to increased public demands, also from the domestic population, for transparency.

In addition, research reports indicate that the investment patterns of SWFs are mostly apolitical and profit orientated (Balding 2012). Transparency indices, like the ones mentioned above, indicate that more than half of SWFs are considered as transparent. Kratsas and Truby (2015) point out that too much transparency might endanger SWFs' competitiveness compared to other investment vehicles. Balding (2012) also mentions that there is a risk associated with too frequent disclosures on investment returns, as other investors could copy the strategy of the fund, and in this way gain access to certain investment opportunities.

KIA, for example, reports according to very strict rules, the *Korea Investment Corporation* (KIC) only releases its annual results after quite some delay, and *Temasek* maintains some degree of strategic ambiguity to deter foreign actors from launching speculative attacks on the local currency (Goeconomica 2014c).

Calls for more transparency should thus be balanced against prudent regulatory measures. Some of the reporting demands directed at SWFs even exceed the ones required from other institutional investors. The rules should be the same for all investors in order to create a level playing field. GPFG, for example, is very transparent and discloses a lot of information, but the Norwegian fund managers also confirm that in future, the levels of transparency might decrease if there would be a need to protect their investment strategy (Balding 2012). Another argument raised by Balding is that transparency rules and reports do not necessarily do any good. He cites the example of the 2008 financial crisis, which occurred despite extensive reporting. If reports are not carefully scrutinised and if they do not contain relevant information, they might serve very little purpose.

Lastly, Balding (2012) indicates that all SWFs also invest in ‘public markets’ when investing abroad. They consequently invest in international financial markets, which are transparent. So even if SWFs do not want to reveal information on certain holdings and policies, it is possible to find this information when they invest abroad. This means that there is an increased degree of transparency. SWFs have to adhere not only to WTO rules but also to rules and laws related to investment in the countries they invest in.

To conclude, the issues of governance and transparency in SWFs are certainly the most debated ones. Even though non-binding governance guidelines exist and transparency indices related to SWFs are regularly published, SWFs neither necessarily comply with these voluntary governance guidelines, nor are they necessarily committed to score well

in these transparency indices. Each SWF has its own governance rules, depending on their founding documents, the rule of law in their home country, and the domestic and international pressure to be more transparent.

## 2.5 Political Debate

Balding (2012) indicates that SWFs occupy an inherently political space while attempting to invest apolitically. Balding interviewed 40 fund managers for his book *SWFs: The New Intersection of Money and Politics*, and all of them acknowledged in some way “the unique political natures and pressures of their funds”. Public money that is used to buy private interests in other countries is a controversial issue from the start, especially because countries with SWFs are mostly non-Western, with political values that are not always endorsed by the West (Debatewise).

When SWFs from China and Abu Dhabi bought out *Citibank* (for US\$ 14.5 billion) and *Merrill Lynch* (for US\$ 6.6 billion) in 2008, fear was raised that SWFs could be used by foreign governments to control western companies. There were concerns that there might be a political agenda behind these transactions because why else would these countries want to invest in failing companies and economies (Santiso 2013, Capapé and Guerrero 2013)? In 2007 the U.S. Congress blocked the sale of *Unocal*, a Californian oil company, because they did not want China to acquire a company that held ‘strategic assets’. Once a fund owns shares of a company, they receive voting and decision-making power in that company at shareholder meetings. SWFs could in this way acquire substantial control over companies, if they buy the necessary share. The question was raised whether the purpose of the SWFs investing in, for example large western banks, would be for the sake of investing for a profit, or whether it is for legally obtaining access to critical information.

There was also a fear that access to certain information, or just owning shares, would be used by countries to obtain political objectives. What would for example happen if the USA take sides in a conflict between China and Taiwan, and China would threaten to shut *Citibank* down? Or assume that Venezuela had bought *Alcoa* (an aluminium smelter) and then decided to close down all smelters in the USA and open new ones in South America because Venezuela is hostile towards the USA? Many Americans would lose their jobs and it would have a devastating impact on the USA economy (The Economist 2008). In Canada, the government rejected the sale of a division of *Manitoba Telecom* to an Egyptian company because of national security concerns such as that data in the possession of *Manitoba Telecom* could fall in the hands of fundamentalist Muslim groups in Egypt (Investopedia 2013). These examples illustrate the concern that SWFs might have political objectives, which could override financial objectives.

Another political concern raised at about the same time was that SWFs would obtain too much political influence in international economic affairs due to their large size. Firstly, SWFs could contribute to more volatile financial markets (see also above under economic debate), or they could influence policy making. Most SWFs are established by middle-income countries, often with the intention to increase their financial muscle and widen their influence in international politics. Ownership of capital is seen as an important determinant of power (Goeconomica 2014d). Santiso (2013) also indicates the rising trend of more 'South to South' investment, where SWFs play a large role. Capital flows are changing and SWFs are increasingly investing in other emerging markets and their own domestic economies, giving them more financial power.

A third political concern raised was that a SWF could be taken over by a government itself (political takeover), or a state-owned enterprise and in this way put the SWF's investments in danger. There is little

proof off a full takeover by a government or state-owned enterprise; there are only two known examples where a SWF fund was taken over by politicians (Capapé 2012). The *Oil Revenue Management Plan* from Chad was created in 1999 as a condition imposed by the IMF to manage its income from oil, however the fund was soon taken over by the political authorities and was never used as it was intended to.<sup>19</sup> In Equatorial Guinea, the fund was created in 2002 to assist with the development of the country, however it is opaque and closely tied to the ruling family (Capapé 2012).

There are also many examples of domestic political interference in SWFs. It is unclear, for example, how closely the royal families and politicians of Saudi-Arabia and Abu Dhabi are involved in their SWFs (Balding 2012). At home, SWFs could be ‘directed’ to invest in domestic companies which are owned by political actors or well-connected persons. Due to their large size, SWFs have mostly a large influence at home, in terms of decision-making in economic and financial policy. Politicians might decide to use the fund for political ends, just because they can, or they could change its investment strategy to serve their interests or just because the government thinks it is the right thing to do. The Muslim government of Kuwait, for example, interfered in KIA in 1985 when the fund wanted to invest in an Irish brewery. The government found this incompatible with the traditional values of the country and blocked the investment (Balding 2012). Another example is the *Saudi Arabian Monetary Agency Foreign Holdings* (SAMA), which has to follow Islamic financial principles and has to ensure that each investment they make is Shariah compliant (Santiso 2013). Also the Russian government uses their SWFs as they please. They frequently use them for funding budget deficits, or during

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<sup>19</sup> Since 2006, Chad has a new SWF, the *Fonds de stabilisation des recettes budgétaires*, but little information about it is available.

2013, to support the Ukrainian Government in their political battle (Goeconomica 2014d, Balding 2012).

SWFs can also be used to influence their domestic economies, especially in developing countries. In Singapore, for example, *Temasek* has a stake in almost every domestic company. CIC invests a significant part of its assets in the domestic economy (Chinese banks, Chinese investment firms and development banks) to keep political control over these sectors (Santiso 2013) and over the domestic economy. Also for very clear political reasons governments might opt to start a SWF to strengthen the national identity or for the sake of consolidating the power of the ruling politicians (Goeconomica 2014d).

Lastly, there is also the possibility of investment manipulation on the domestic level, as certain asset managers might have access to privileged information if they are connected to the ‘right’ politicians. This creates an uneven playing field. Investment manipulation is less likely when investing abroad as SWFs then also have to adhere to international and national trade and financial rules, and SWF managers would then only have access to the same information as other investors (Balding 2012).

SWFs do influence domestic financial and economic affairs, but not often international affairs. To date, different sources (The Economist 2008, Balding 2012, Knowledge Development 2012, Santiso 2013, and Kratsas and Truby 2015) indicate that there is no hard proof that SWFs have abused their power and are intentionally making investment decisions that are not driven mainly by financial market considerations. There is little evidence that SWFs are investing abroad for political reasons (to direct international economic policy, gain access to sensitive data or to control foreign companies) and hence all the above political concerns should be considered as concerns harbored by mostly western governments (Balding 2012, Santiso 2013). However, SWFs sometimes make strategic investment decisions, for example to gain access to

markets, to know-how and technology, to establish certain relations, to foster national security or to secure resources. So non-financial considerations are sometimes taken into account when investments are made, but they are not political. SWFs remain public entities which can be used 'as an arm of the state' to pursue certain goals through investment (Aguilera et al. 2015).

Western governments often judge foreign investment according to which country is investing. Countries that are perceived as friendly or culturally similar are welcomed and seldom questioned. Countries that are perceived as a threat or as unfriendly are not welcomed and are viewed with suspicion. China for example, which in the last decades became more powerful both in economic and political terms, is regarded as a threat. The above example of CIC investing in American financial institutions was heavily debated, but investments made by the GPFG in the same banks were never questioned. The same goes for the investments by foreign governments in American bonds. Japan did this to a great extent, which was not originally seen as a problem. But when China started doing the same, it created a fuss.

Western governments tend to politicize possible investments from certain SWFs. Balding (2012) finds it short-sighted to decline investments by SWFs from countries seen as a possible threat or unfriendly. He questions whether governments that want to obtain certain national security information from other countries would do that by trying to invest in 'strategic assets' in the hope of obtaining this information. There are far more efficient and cheaper means of obtaining such information like espionage or hacking computers.

Balding (2012) further points out that governments all over the world have always lobbied and negotiated for their own domestic companies. They would sponsor trade missions to other countries in an attempt to attract foreign investment for their domestic economies. Governments normally do not object to foreign investment, but when it



comes from certain SWFs there are concerns. In addition, governments have also other financial means to their disposal, besides SWFs, which could be used to invest in foreign companies should they wish to do so. Consequently, the claim by the USA, Canada and Europe that SWFs could be a threat for national interest is based on fear that SWF home countries might obtain too much power over their domestic affairs. Their concern is fed by the fact that most SWFs are from countries outside of Europe and North America.

An interesting trend, indicated by Balding (2012) and Aguilera et al. (2015), is that SWFs could invest, not to abuse their power, but to improve relationships. SWFs invest often in countries with which they have rather poor relationships. So the investment by China and the United Arab Emirates in American banks in 2008 could be seen as an attempt to improve the relations between these countries and the USA. Balding says that if this indeed happens, that is not a problem as countries with a SWF have not yet abused any power; they just use SWFs as a tool for better political relations. In this light, the ethical investment strategy of GPFG can be seen as politically motivated since it is the Parliament and elected politicians that decide on the investment strategy and include or exclude investments in certain companies and countries based on ethical guidelines (e.g. they do not invest in companies that produce weapons, or disrespect the environment as indicated above). So Norway uses GPFG to advance its values-based foreign policy. Norway has never been criticized for including non-financial criteria in its investment strategy (Balding 2012, Knowledge Development 2012, Geoeconomica 2014d).

In conclusion it can be said that SWFs are to some extent inherently political vehicles. Geoeconomica (2014d) stated that SWFs should be more straightforward and open about the political forces that influence their behaviour. Political interests interfere with fund management so it is better to acknowledge that and be transparent about it. The fact that

SWFs are accountable to governments and citizens, rather than shareholders, makes them political vehicles from the start. Also Santiso (2013) indicates that even though SWFs are created as independent vehicles, they never escape from politics. The Chinese SWFs, for example, are inherently political due to the governing system of the country (tight control of the Chinese government, especially in terms of financial and investment policy). Nothing happens without government approval, certainly not large investments. The investment decisions of the fund are also driven by the wishes of Beijing. The government has stressed the importance of the energy, technology, financial and natural resources sectors as vital sectors for Chinese development, and it is exactly in these sectors that the SWF has invested. The wisdom of these investment decisions are questionable because these four sectors are volatile and hence risky, which confirms that the investments in these sectors are not merely for financial reasons, but politically motivated.

To summarise, SWFs are inherently political however SWFs should ensure that they are autonomous, meaning that there should not be unjustified meddling in the affairs of the SWF which are not in line with the purpose and governance rules of the SWF. And as long as the investment decisions of a SWF are commercially motivated, with the aim of earning a return on investment, the fact that SWFs are state-owned should not be a problem. As Kratsas and Truby (2015) write, “[SWFs] mere government status should not be enough to ground theoretical and unclear concerns about national security and political interference.”

## **2.6 Summary of Controversies**

There are several *economic advantages* to the investments made by SWFs; for example, they are often seen as maintaining a long-term perspective, so even when public announcements are made on SWF investments there are short-term but real positive effects in the economy.

Furthermore, these investments are themselves stabilizing forces, as we saw in the 2008 financial crisis where many Western companies were rescued from bankruptcy by SWFs. And this stabilizing force is often as well to fight chronic economic issues, such as poverty in developing countries.

*Economic disadvantages* associated with SWFs are the fact that SWFs can cause distortion and instability in the market. Market distortion relates to the fact that SWFs can intervene in markets when they are not supposed to, and market instability is due to the large funds available to SWFs. Companies, or even whole sectors, can become instable when large amounts of money are shifted in this way. Investments by SWFs could also lead to increased financial and economic protectionism by recipient states which fear that investments made by SWFs could interfere with national interests.

*Social advantages* of SWFs lie in the size of the funds which are available for investing in the development of present and future generations. Although there is a distance between the average home country citizen and the SWF, these funds still provide opportunity for domestic investments and social programmes supported by the SWF.

*Social disadvantages:* The citizens of a home country often have no opportunity to contribute to how the SWF is managed, and current generations do not necessarily benefit from the SWF of their country, however the SWF is funded by commodities or funds accumulated during their lifetime. How current generations can benefit is another issue adding to the controversy: by investing in current education? Or health services? Or by issuing dividends? As such the conceived legitimacy of SWFs might be controversial and further worsened by the fact that SWFs are often managed by non-elected managers. Also, SWFs are often not taxed by their home countries, while other institutional investors are taxed, creating an uneven playing field. Even abroad, SWFs are often not taxed on capital gains.

*Environmental advantages:* By positive or negative environmental selection criteria for investments (choosing to invest, not to invest, or to cease investing), in certain companies, SWFs can influence environmental policies of companies. Just as SWFs have the power to stabilize economies or companies, they can destabilize companies in order to provide a disincentive against company practices that are detrimental to the environment.

*Environmental disadvantages:* However, some SWFs are criticised of their involvement in land grabbing which is seen as controversial due to the environmental, but also social, negative consequences of it. In addition, SWFs do not always consider the environment when making investment decisions.

*Governance advantages:* In terms of governance, while SWFs are the instruments of sovereign states, each state can influence to what extent funds from other countries can invest in their own country, forcing foreign funds to adhere not only to the laws within the state they are investing, but also to international financial laws and WTO rules of trade. Additionally, the relatively recent development of transparency indices indicates that there is an active desire for SWFs to become more transparent,

*Governance disadvantages:* On the other hand, SWFs are still often accused of not being transparent and not adhering to good governance rules. The fact that SWFs are often managed outside the normal financial management institutions of a country contributes to the perception that they are operating outside the law and in secret. Some SWFs also publish limited information. The way an SWF is governed is closely associated with the standards of governance and principles of the home countries: the fact or perception that many home countries of SWFs are having non-democratic regimes fuels this suspicion.

*Political debate:* Because of the stabilizing power of SWFs that was mentioned before, SWFs can have political impacts on the relations

between states. This is a recent trend, where we have seen countries like China and the United Arab Emirates investing in American banks. While it is contended that this might also be an attempt to further gather information, it has been argued that given the amount of funds involved in such investments, that it is too inefficient to be considered as merely a means to access information. However SWFs are sometimes accused of making investments due to political objectives such as increasing influence in a company, a country, or on an international level. Finally, SWFs can potentially be taken over by the government of the home country, meaning that a country would then be the one investing, and the fund is no longer an SWF. Domestically some SWFs are criticised of being political by making investment decisions that only benefit e.g. the ruling elite.



## **STAKEHOLDERS IN THE SOVEREIGN WEALTH FUNDS DISCOURSE**

An analysis was made of the different stakeholders involved in the discourse on SWFs. The identified stakeholders were categorized in terms of their *interest* in SWFs, *attitudes* toward them, and level of *influence* on the SWF discourse.

Interest levels in SWFs indicate the stance and involvement of each stakeholder in the discourse. Attitudes toward SWFs go beyond whether stakeholders are pro- or anti-SWFs and assess the extent to which they focus on economic, environmental, social, governance and political (EESGP) implications. Levels of influence assesses the extent of resources, strategic control of resources, level of negotiating power, inter-linkages, level of knowledge and skills, and political power of stakeholders to influence the global discourse on SWFs.

The identified stakeholders are investors, socially responsible investors, academics and think tanks, international organisations, beneficiaries (citizens in the home country), NGOs, home countries, and recipient countries. Each stakeholder is given a rating which corresponds with a score for both attitude as influence: high positive (3), moderate positive (2), low positive (1), neutral (0), low negative (-1), moderate negative (-2) and high negative (-3). Depending on the scores for attitude and influence, each stakeholder is given a position on the map (Figure 10 below). The higher the score, the more influence the

stakeholder has on the SWF, and the more positive its attitude is towards SWFs.

Table 1 and Figure 10 (below) indicate that the home countries of SWFs and investors have the most positive attitude towards SWFs and have the most influence over them. This is not surprising as home countries are responsible for establishing SWFs and can determine its investment strategy. Investors see the financial and economic opportunities that SWFs could bring. Not surprisingly, investors which do not consider EESGP factors when making investment decisions tend to be positive when it comes to environmental, social, governance and political issues related to SWFs as they tend to focus only on financial returns. Investors that manage SWFs can obviously influence its investment strategy and are having hence a moderate high influence.

Home countries should take non-financial considerations into account when making investment decisions. Some home countries consider the environment when making investment decisions (like Norway, China, New-Zealand) or invest in socially related matters like education, health and social security, although the majority of SWFs do not. In terms of governance and transparency, obviously home countries try to defend the governance practices of their SWFs, but there are conflicting opinions in this regard, as explained above.

Another important stakeholder are the beneficiaries of SWFs in their home countries, or citizens. They might have a different attitude towards SWFs than their government. As described under the social debate, beneficiaries are not necessarily involved in the decision-making about their SWF and do not necessarily benefit from it. However, beneficiaries could have a large influence as they can question what happens with national reserves. Citizens are an important stakeholder for SWF managers and home countries to keep in mind, because if they are dissatisfied it could create a public outcry sooner or later. Hence,



beneficiaries are low positive about the existence of SWFs, and their influence on SWFs, with some exceptions, has remained low.

Socially Responsible Investors, however, take a less positive view of SWFs as they do have high regard for the environmental, social and governance (ESG) impacts of investments. Hence, the attitude of these investors towards SWFs is less positive compared to traditional investors as most SWFs do not take ESG issues into consideration. It is not clear whether socially responsible investors are involved in management SWFs, hence their influence is considered to be low.

Recipient countries also have a large influence on SWFs, but their attitude tends to be more ambiguous. As indicated above, there have been allegations of poor governance and political interference, but then the investments by SWFs in, mostly, northern countries (EU and USA) are mostly welcomed. They bring capital, which is vitally needed by recipient countries. Hence, the overall attitude towards SWFs is low negative. These recipient countries do however try to influence the behaviour of SWFs through various means. A powerful mechanism for influencing foreign SWFs is to convince not only the IMF, but also the OECD, to look into the governance of SWFs, and hence their influence is deemed high. It is important for SWFs to not neglect the opinion of recipient countries as they have the power to refuse investment from a SWF in their respective countries.

International organisations, like the IMF, OECD, UN or international fora like OMFIF, have a positive attitude towards SWFs, however there are mostly concerns in terms of governance and possible political interference. Hence, they do try to engage with home countries and succeeded in bringing them together to develop the Santiago Principles, amongst others. Their influence is deemed moderate high. However, there are restrictions in terms of the level of influence these international bodies can have.

Lastly, think tanks, academics and NGOs are also stakeholders with an interest in SWFs. Many academics have studied SWFs and their approach to EESGP issues. The research conducted thus far is fragmented. Academics are not necessarily pro- or anti-SWFs. In general they welcome them but do identify issues that can potentially cause, for example, economic problems, undue political interference, a lack of transparency, social controversies, and environmental degradation.

It is due to the latter that NGOs choose to target their work on SWFs that have, or continue to, invest in companies involved in controversies related to the environment, social or governance issues. These NGOs do not exclusively focus target SWFs, but also other investors (there are currently no NGOs which specifically investigate SWFs). The overall influence of think tanks, academics and NGOs on the SWFs discourse is rather low.

Table 1a: Stakeholder Analysis

Stakeholders	Interests	Attitudes				Overall Attitude	Influence	
		Economic	Environmental	Social	Governance	Political	Level of influence	
Investors*	Handle SWF accounts. Focused on making profit	High positive	High positive	High positive	High positive	High positive	Moderate high	Strong inter-linkages through global economy. Highly skilled, resourced and knowledgeable. Highly competitive in attempts to get SWF accounts. Can influence investment patterns of SWFs.
Socially Responsible Investors*	Could handle SWF accounts but no information available if this is actually the case.	High positive	Low negative	Low negative	Low positive	Low positive	Low	In principle positive towards SWFs but Socially Responsible investors will take environmental, social and governance issues into account when making investment decisions. There is however no information on whether SRI investors are involved in the SWF market, hence there influence is deemed low.
Academics/ Think Tanks	Academic think-tanks and tertiary institutions. Authors on SWF related issues.	High positive	Low negative	Low positive	Low positive	Low positive	Low	Tend to be single actors. Fragmented but can prove powerful when interlinked in cause e.g. on Land Policy initiative (related to land grabbing). More influential when not fragmented. Tend to be focused on diverse range of issues.
International Institutions/ Organisations	Set regulations such as IFSWF, OECD, UN, EU, IMF, WTO, OMFIF	High positive	Low negative	High positive	Moderate positive	Moderate negative	Moderate high	Tend to engage with SWFs and try to regulate them on an international scale, highly resourced and influenced by mostly western countries.

\*Table continues on next page

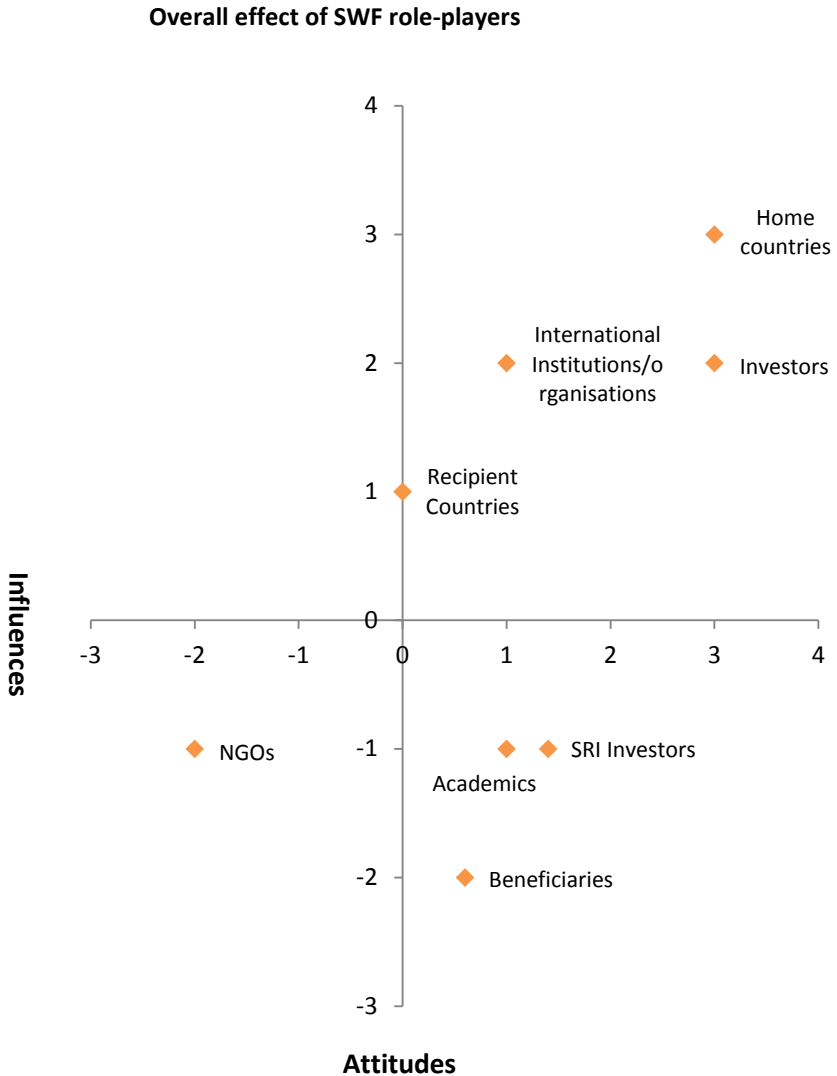
Table 1b: Stakeholder Analysis

Beneficiaries (domestic)	The citizens of the countries with SWFs	Moderate positive	Low positive	Moderate positive	Low negative	Low negative	Low positive	Moderate low	Depending on the level of democracy and civil mobilisation of SWF home country. Tend to be less included in decision-making and also less empowered in southern countries and Middle East, where most SWFs originate.
NGOs	Civil Society and International NGOs	Moderate Negative	Moderate Negative	Moderate negative	Moderate Negative	Moderate Negative	Moderate Negative	Low	Very organised and have good international linkages for mobilisation. Do not target SWFs specifically, but rather causes like environmental impact of large dams; land grabbing etc.
Home Countries	Countries that have a SWF	High positive	High positive	High positive	High positive	High positive	High positive	Very high	The governments that establish SWFs and decide on its investment strategy.
Recipient Countries	Countries that SWF invest in.	Moderate positive	Low positive	Low positive	High negative	High negative	Low Negative	High	There seems to be a North vs. South control issue. Highly resourced and strong control, but difficult to interfere in domestic affairs of other countries.

\*‘Investors’ refers to individuals or companies that invest money on behalf of SWFs. SWFs themselves are not considered investors’ in this stakeholder table (SWFs are considered under home countries

Table 1 portrays the influence and attitude of the different stakeholders towards SWFs. The X-axis represents the attitude of the role-player and the Y-axis the influence of the role-player.

Figure 10: Map of SWFs role-players





## OVERVIEW OF STANDARDS FOR SOVEREIGN WEALTH FUNDS

### 4.1 Introduction

Like other market players, and, as shown throughout this analysis, SWFs raise concerns in terms of their economic, environmental, social, governance and political (EESGP) implications. In addition to national and international regulations which SWFs have to comply with, there is also an expectation that they should abide by a number of non-binding guidelines, codes or principles. Currently there are three such voluntary standards that apply specifically to SWFs, all of which were released in 2008.

The best-known guidance standard that applies to SWFs are the *Generally Accepted Principles and Practices for SWFs* (GAPP), also known as the *Santiago Principles*. These principles were designed to define more precisely what a SWF is, to allay scepticism surrounding their commercial orientation (and thus avoid protectionism), and to promote greater transparency, disclosure and independence. The second standard is *Guidance to Recipient Countries* from the OECD that has the purpose of preserving and expanding an open international investment environment for SWFs. The Secretary-General for the OECD, Angel Gurría, stated at the time that “taken together, OECD guidance to recipient countries and the GAPP for SWFs provide the international community with a robust framework for promoting mutual trust and

confidence and reaping the full benefits of SWFs for home and host countries” (OECD 2008). The third set of principles that directly targets SWFs was proposed by the Commission of the European Communities within a communication aiming to promote “a common response to the challenges posed by SWFs” (Commission of the European Communities, 2008). There are various other related standards and regulations aimed at investors in general, of which the *United Nations Principles on Responsible Investment* (UNPRI) is the best-known. There are also more general standards that apply to business in general, such as the *United Nations Global Compact*. These standards will be briefly discussed below (part 4.2). They are also attached as annexures to this report.

Through research carried out on all websites of existing SWFs, an analysis on their ethical governance is made in part 4.3. Six ethical criteria were selected (including codes of ethics, values statement, extra-financial criteria, shareholder activism, etc.) and cross-checked with basic data on the funds (regions, origins, numbers, AUM, etc.) to get a new overview on SWFs and their commitments to ethics, transparency and responsibility.

## 4.2 The Santiago Principles

In 2008, on the request of developed nations, the IMF called all countries with at least one established SWF together to discuss and develop guidelines on how these funds should be governed. The IMF coordinated a process to identify and draft *Generally Accepted Principles and Practices* (GAPP), also known as the *Santiago Principles*. A total of 23 countries<sup>20</sup> collaborated in the *International*

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<sup>20</sup> The IWG member states were Australia, Azerbaijan, Bahrain, Botswana, Canada, Chile, China, Equatorial Guinea, Iran, Ireland, Kuwait, Libya, Mexico, New Zealand, Norway, Qatar, Russia, Singapore, South-Korea Timor-Leste, Trinidad and Tobago, the United Arab Emirates, and the United States. Oman,



*Working Group of Sovereign Wealth Funds* (IWG) in 2008 and drafted the principles, with support from the IMF. The *Santiago Principles* are a voluntary set of governance guidelines, which IWG member states implement or aspire to implement. When the Principles were finalized, IWG member states formally established the *International Forum of Sovereign Wealth Funds* (IFSWF) through the *Kuwait Declaration* (2009), in order to exchange ideas and views related to SWFs and the application of the GAPP. IFSWF then technically replaced IWG.<sup>21</sup> The Declaration explicitly states that “the Forum will not be a formal supranational authority and its work shall not carry any legal force”, which confirms the voluntary nature of the *Santiago Principles* (Barbieri 2009).

These principles require SWFs to include information on the legal framework of the SWF, objectives, alignment with macroeconomic policies, institutional framework, governance structure, and investment and risk management framework (IWG 2008), but there is no explicit mention of SRI considerations. Following Kratsas and Truby (2015), it is interesting to note that they are not utopian principles, but a set of already existing best practices. The main values underpinning the *Santiago Principles* are transparency and independence. The *Santiago Principles* are listed in Annexure 1 of this report.

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Saudi Arabia, Vietnam, the OECD and the World Bank were permanent observers.

<sup>21</sup> Today, the IFSWF member list includes also SWFs from Angola, Italy, Kazakhstan, Malaysia and Nigeria. The whole list of is as follows: Angola (FSDEA), Australia (AFF), Azerbaijan (SOF), Bahrain (MHC), Botswana (PF), Canada – Alberta (AHSTF), Chile (PRF & SESF), China (CIC), Equatorial Guinea (FFG), Iran (NDF), Ireland (ISIF), Italy (ISF), Kazakhstan (NIC & S-K JSC), Kuwait (KIA), Libya (LIA), Malaysia (KNB), Mexico (ORSFM), New Zealand (NZSF), Nigeria (NSIA), Norway (GPF), Qatar (QIA), Russia (RDIF, RRF & NWF), Singapore (TH & GIC), South Korea (KIC), Timor-Leste (TLPF), Trinidad and Tobago (HSF), UAE – Abu Dhabi (ADIA), and USA – Alaska (APF).

Adherence to the *Santiago Principles* is voluntary and there is no enforcement mechanism. Each country decides whether it wishes to adhere to and implement them, and determines the extent to which it is willing to do so. Kratsas and Truby (2015) are in favour of a model of self-regulation and therefore support this supranational regulatory framework involving the participation of the SWFs. They state that “Even now, GAPP offer possibly the most effective route towards reducing the costs due to SWFs and silencing their critics, and together, reducing protectionist measures.” Bagnall and Truman (2013) claim that “IFSOF appears to have been broadly, but not universally, successful in raising global standards of transparency and accountability of SWFs” and that “[...] progress among non-members lags substantially behind progress among members”. On the other hand, Sauvart et al. (2012) affirm that “despite the international welcome, the Santiago Principles are generally recognized as de minimis requirements in their scope and nature”. According to Dixon (2014), “compliance with the Santiago Principles has been slow and incomplete”<sup>22</sup>. Behrendt (2010) considers their implementation as “sluggish”, which risks devaluing the Principles whereas the commitment of the members SWFs is “an important test for the viability of new forms of global governance”. Bagnall and Truman (2013) also point out that the *Santiago Principles* are “not rigorous enough as outsiders would prefer” and are “not explicit about what information should be publicly disclosed.”<sup>23</sup>

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<sup>22</sup> In this regard, Dixon also refers to Bagnall and Truman (2011).

<sup>23</sup> For example: “[...] the Santiago Principles do not call for SWFs to disclose their size [...] They are silent about the need to distinguish between SWF and international reserves [...] They do not call for disclosure of the currency composition of investments [...] They are silent on providing information on specific investments [...] And they do not advocate that SWFs audits be published.” (Bagnall and Truman, 2013)

A ‘Transparency Index’ that rates SWFs adherence to Santiago Principles is released from time to time as described in part 4.6 of this chapter.

### 4.3 OECD Guidance to Recipient Countries

The OECD Investment Committee developed the *Guidance to Recipient Countries* as an integral part of the *Freedom of Investment, National Security and Strategic Industries* Project. This guidance forms part of the document called *Sovereign Wealth Funds and Recipient Countries – Working together to maintain and expand freedom of investment*<sup>24</sup> (available in Annexure 2 of this report). It contains three main parts: a *Declaration on Sovereign Wealth Funds and Recipient Country Policies*<sup>25</sup>, *The General Investment Policy Principles*<sup>26</sup>, and the *Guidelines for Recipient Country Investment Policies Relating to National Security*<sup>27</sup>. The accompanying *Ministers’ Declaration* affirms the commitment of OECD members’ to defend an open environment for investment by SWFs, but also to preserve national security. This document focuses on freedom of investment and its key values are liberalisation, non-discrimination, and transparency.

The *Declaration on Sovereign Wealth Funds and Recipient Country Policies* promotes peer surveillance of countries to avoid protectionist behaviour against SWFs. It specifies that recipient countries of SWF investments should avoid protectionist measures based on national security concerns. If such concerns exist, recipient countries should, amongst others, carefully consider the investment in a transparent way, proportional to clearly identified risks for national security.

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<sup>24</sup> Available at: [www.oecd.org/investment/investment-policy/41456730.pdf](http://www.oecd.org/investment/investment-policy/41456730.pdf)

<sup>25</sup> Available at: [www.oecd.org/daf/inv/investment-policy/41816692.pdf](http://www.oecd.org/daf/inv/investment-policy/41816692.pdf)

<sup>26</sup> Available at: [www.oecd.org/daf/inv/investment-policy/41811096.pdf](http://www.oecd.org/daf/inv/investment-policy/41811096.pdf)

<sup>27</sup> Available at: [www.oecd.org/daf/inv/investment-policy/43384486.pdf](http://www.oecd.org/daf/inv/investment-policy/43384486.pdf)

*The General Investment Policy Principles* give prominent place to those of the *Code of Liberalisation of Capital Movements*<sup>28</sup> and the *Declaration on International Investment and Multinational Enterprises*<sup>29</sup>, both of which discussed below. They re-affirm long-standing OECD investment principles of non-discrimination against foreign investors, transparency on restrictions on foreign investment, progressive and unilateral liberalisation, and finally “standstill”, which means that “members commit to not introducing new restrictions” (OECD 2008).

Finally, the *Guidelines for Recipient Country Investment Policies Relating to National Security* focus on non-discrimination, transparency/predictability, regulatory proportionality and accountability. These guidelines are also non-binding (OECD 2008).

#### **4.4 EU Communication – A Common European approach to Sovereign Wealth Funds**

The European Union issued a communication in 2008<sup>30</sup> on how EU member states should deal with SWFs. Compared to the United-States, the European Union has shown greater interest in SWFs investments, following its traditional openness to foreign investments: “as the world’s leading trader and the largest source as well as the largest destination of foreign direct investments, the EU is a major beneficiary of an open world economic system. It is committed to ensuring that its markets remain open for investment.” (Commission of the European Communities, 2008). Investments by SWFs in the EU are subject to the same rules and controls as any other form of investment. The Common

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<sup>28</sup> Available at: [www.oecd.org/daf/inv/investment-policy/CapitalMovements\\_WebEnglish.pdf](http://www.oecd.org/daf/inv/investment-policy/CapitalMovements_WebEnglish.pdf)

<sup>29</sup> Available at: [www.oecd.org/daf/inv/mne/48004323.pdf](http://www.oecd.org/daf/inv/mne/48004323.pdf)

<sup>30</sup> Available at: [ec.europa.eu/internal\\_market/finances/docs/sovereign\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/sovereign_en.pdf)

EU approach to the treatment of SWFs as investors is based on five principles (the full text can be found in Annexure 3 of this report):

- Commitment to an open investment environment.
- Support of multilateral work with regard to SWFs, in particular from the IMF and the OECD.
- Use of existing instruments related to investments.
- Respect of European Community (EC) Treaty obligations and international commitments: the EU and its member states will act according to the Principles of the EC Treaty and abide by international obligations of the EU.
- Proportionality and transparency when dealing with investment decisions.

The communication is directed to EU member states and is non-binding. However, all EU member states should adhere to existing EU legislation, treaties, guidelines, etc. (Commission of the European Communities, 2008).

## 4.5 Other Guidelines Applicable to SWFs

### 4.5.1 IMF Guidelines

Besides the Santiago Principles, the IMF has additional guidelines that are also relevant to SWFs although they are not specifically targeting them. Many of these guidelines focus on transparency, such as the *Code of Good Practices on Transparency and Financial Policies*<sup>31</sup> (1999), which is dedicated to central banks and other financial agencies. It parallels the *Code of Good Practices on Fiscal Transparency*<sup>32</sup> (1998, revised in 2007) that targets the public sector as a whole. The *Manual on*

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<sup>31</sup> Available at: [www.imf.org/external/np/mae/mft/code/eng/code2e.pdf](http://www.imf.org/external/np/mae/mft/code/eng/code2e.pdf)

<sup>32</sup> Available at: <https://www.imf.org/external/np/pp/2007/eng/051507c.pdf>

*Fiscal Transparency*<sup>33</sup> (1998, revised in 2007) expands and explains the pillars and principles of this Code; and the *Guide on Resource Revenue Transparency*<sup>34</sup> (2005, revised in 2007) supplements the Code and Manual by addressing the specific problems faced by resource rich countries.

The IMF also promotes standards on data integrity, quality and dissemination. The *Funds Data Standards Initiatives*<sup>35</sup> (1996, revised in 2012) consists of the *Special Data Dissemination Standards* (SDDS) and the *General Data Dissemination System* (GDDS). These standards “enhance the availability of timely and comprehensive statistics, which contributes to the pursuit of sound macroeconomic policies and efficient functioning of financial markets” (IMF 2015). The *Data Quality Assessment Framework*<sup>36</sup> (DQAF, 2003, revised in 2012) grew out of the latter two standards, incorporating the good practices articulated therein. It is the result of intensive consultation and it covers the prerequisites of quality, assurances of integrity, methodological soundness, accuracy, reliability, and serviceability.

The IMF also established the *Guidelines for Foreign Exchange Reserve Management*<sup>37</sup> (GFERM, 2001, revised in 2013) to help increase countries’ resilience to shocks through good reserve management practices. Similarly, the *Guidelines for Public Debt Management*<sup>38</sup> (2001, revised in 2014) also intend to reduce countries’ vulnerability by strengthening the quality of their public debt management. Apart from transparency and accountability, the main values promoted by those guidelines are stability, longevity, prudence and quality.

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<sup>33</sup> Available at: [www.imf.org/external/np/pp/2007/eng/051507m.pdf](http://www.imf.org/external/np/pp/2007/eng/051507m.pdf)

<sup>34</sup> Available at: <https://www.imf.org/external/np/pp/2007/eng/101907g.pdf>

<sup>35</sup> Available at: [www.imf.org/external/np/exr/facts/data.htm](http://www.imf.org/external/np/exr/facts/data.htm)

<sup>36</sup> Available at: [dsbb.imf.org/pages/dqrs/DQAF.aspx](http://dsbb.imf.org/pages/dqrs/DQAF.aspx)

<sup>37</sup> Available at: <https://www.imf.org/external/np/pp/eng/2013/020113.pdf>

<sup>38</sup> Available at: [www.imf.org/external/np/pp/eng/2014/040114.pdf](http://www.imf.org/external/np/pp/eng/2014/040114.pdf)

In an attempt to facilitate the implementation of standards, the IMF launched the *Standards and Codes Initiative* in 1999 to strengthen the international financial architecture. The *Reports on the Observance of Standards and Codes* (ROSCs) that emanate as a result of this initiative are available online.<sup>39</sup>

#### 4.5.2 OECD Guidelines

Beside the *Guidance to Recipient Countries*, there are also other regulations from the OECD that are relevant to SWFs. As previously mentioned, the *Code of Liberalisation of Capital Movements*<sup>40</sup> (1961, revised in 2013), and the *Declaration on International Investment and Multinational Enterprises*<sup>41</sup> (1976, revised in 2011), inspired the Principles included in the *Guidance to Recipient Countries*. The Code has assisted countries in progressively removing barriers to the movement of capital, “while providing flexibility to cope with situations of economic and financial instability” (OECD 2013). The *Declaration on International Investment and Multinational Enterprises* included into the *Guidelines for Multinational Enterprises*<sup>42</sup> constitutes a policy commitment “to provide an open and transparent environment for international investment and to encourage the positive contribution multinational enterprises can make to economic and social progress.”<sup>43</sup>

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<sup>39</sup> Available at: [www.imf.org/external/NP/rosc/rosc.aspx](http://www.imf.org/external/NP/rosc/rosc.aspx)

<sup>40</sup> Cf. note 29.

<sup>41</sup> Cf. note 30.

<sup>42</sup> Available at: [www.oecd.org/daf/inv/mne/48004323.pdf](http://www.oecd.org/daf/inv/mne/48004323.pdf). It “contains recommendations in areas such as disclosure, employment and industrial relations, the environment, combating bribery, consumer interests, science and technology, competition and taxation.” (MBIM, 2006, retrieved 24 Feb. 15. Available at: [www.nbim.no/en/transparency/features/2011-and-older/2006/corporate-governance-and-ethics-/](http://www.nbim.no/en/transparency/features/2011-and-older/2006/corporate-governance-and-ethics-/))

<sup>43</sup> OECD, [www.oecd.org/investment/investment-policy/oecddeclarationanddecisions.htm](http://www.oecd.org/investment/investment-policy/oecddeclarationanddecisions.htm), retrieved 24 Feb. 15.

Other OECD documents that might be relevant to SWFs are the *Principles of Corporate Governance*<sup>44</sup> (1999, revised in 2004), the *Guidelines on Corporate Governance of State-Owned Enterprises*<sup>45</sup> (2005), the *Guidelines for Pension Fund Governance*<sup>46</sup> (2009) and the *Harnessing Freedom of Investment for Green Growth*<sup>47</sup> (2011).

#### 4.5.3 United Nations Guidelines

The *Global Compact* was launched in 2000 by the United Nations to encourage socially and environmentally responsible corporate citizenship. Its main objective is to call upon businesses to “embrace, support and enact” a set of principles<sup>48</sup> (available in Annexure 4) relating to human rights, labour standards, environmental responsibility, and anti-corruption. These principles are based on a number of international declarations and conventions. Member companies (several thousand at present) commit themselves to improve in each of the above mentioned areas and to submit an annual ‘Communication on Progress’ (COP).

The *Global Compact* is a founding member of the *Principles for Responsible Investment* (UNPRI) along with the *Finance Initiative of United Nations Environment Programme* (UNEP). Published in 2006, these principles address the lack of definition and norms related to responsible investment. They mainly encourage institutional investors to consider ESG factors in their investment practices. At the end of 2014, more than 1300 organizations (including investment institutions and service providers) had signed up the UNPRI. There are no minimum

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<sup>44</sup> Available at: [www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf](http://www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf)

<sup>45</sup> Available at: [www.oecd.org/corporate/ca/corporategovernanceofstateownedenterprises/34803211.pdf](http://www.oecd.org/corporate/ca/corporategovernanceofstateownedenterprises/34803211.pdf)

<sup>46</sup> Available at: [www.oecd.org/pensions/private-pensions/34799965.pdf](http://www.oecd.org/pensions/private-pensions/34799965.pdf)

<sup>47</sup> Available at: [www.oecd.org/daf/inv/internationalinvestmentagreements/47721398.pdf](http://www.oecd.org/daf/inv/internationalinvestmentagreements/47721398.pdf)

<sup>48</sup> Available at: <https://www.unglobalcompact.org/what-is-gc/mission/principles>.



entry requirements, but signatories have to report on the implementation of the Principles through the annual reporting and assessment process. If this requirement is not fulfilled, the signatory is publicly delisted from the UNPRI Initiative.

The *Guiding Principles on Business and Human Rights*<sup>49</sup>, informally called the *Ruggie Principles*, were endorsed in 2011 by the *United Nations Human Rights Council* (UNHRC). They are a global standard directed at States and companies to “clarify their duties and responsibilities to protect and respect human rights in the context of business activities and to ensure access to an effective remedy for individuals and groups affected by such activities” (OHCHR, 2014). These principles are based on three pillars: the state duty to protect human rights, the corporate responsibility to respect human rights, and access to remedy for victims of human rights abuses.

The *UNEP Statement by Financial Institutions on the Environment and Sustainable Development*<sup>50</sup> was finalized in 2011 by the *UNEP Finance Initiative*, which describes its mission as “[bringing] about systemic change in finance to support a sustainable world, and is highlighted in its motto, changing finance, financing change.”<sup>51</sup> It contains three main parts: commitment to sustainable development, sustainability management, as well as public awareness and communication.

In December 2014, the *UNEP Finance Initiative* also launched the *Human Rights Guidance Tool for the Financial Sector*. It is described as an “online signposting tool providing information on human risks for financial institutions”<sup>52</sup>, which gathers background information on

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<sup>49</sup> Available at: [www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR\\_EN.pdf](http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf)

<sup>50</sup> Available at: [www.unepfi.org/about/statements/fi/](http://www.unepfi.org/about/statements/fi/)

<sup>51</sup> UNEP FI, [www.unepfi.org/about/](http://www.unepfi.org/about/) (Retrieved 23 Feb. 15)

<sup>52</sup> UNEP FI, [www.unepfi.org/humanrightstoolkit/index.php](http://www.unepfi.org/humanrightstoolkit/index.php) (Retrieved 13 Jul. 15)

human rights and the related laws, conventions and other standards or initiatives, as well as raising key questions and key issues relating to different sectors and topics.

#### **4.5.4 Reporting Standards**

There are many standards on reporting, and they all share the purpose of making information available and comparable for stakeholders of the reporting entities.

The *Global Reporting Initiative* (GRI) produces the best-known standards for sustainability reporting: the most recent version is the *G4 Sustainability Reporting Guidelines*<sup>53</sup>. They offer an international reporting framework for all organizations – regardless of its size or location – for the disclosure of EESG performance. An Implementation Manual accompanies this reporting framework.

The GRI supports The *International Integrated Reporting Council*<sup>54</sup> (IIRC), which launched its Framework for integrated reporting<sup>55</sup> (<IR>) in 2013. This new approach to corporate reporting focuses on value creation. The *Guiding Principles* of the integrated reporting framework include strategic focus and future orientation, connectivity of information, stakeholder relationships, materiality, conciseness, reliability and completeness, as well as consistency and comparability.

The *Chartered Financial Analyst Institute* (CFA Institute) introduced the *Global Investment Performance Standards*<sup>56</sup> (GIPS) in 1999. This standard urges investment managers to present and publish their performance in an internationally recognized form, in order to allow for comparison, and to strengthen professionalism.

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<sup>53</sup> Available at: <https://www.globalreporting.org/resource/library/GRIG4-Part1-Reporting-Principles-and-Standard-Disclosures.pdf>

<sup>54</sup> Known as the ‘International Integrated Reported Committee’ until 2011.

<sup>55</sup> Available at: [www.theiirc.org/wp-content/uploads/2013/12/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf](http://www.theiirc.org/wp-content/uploads/2013/12/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf)

<sup>56</sup> Available at: [www.cfapubs.org/doi/pdf/10.2469/ccb.v2010.n5.1](http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2010.n5.1). They were revised in 2010.

The *International Financial Reporting Standards*<sup>57</sup> (IFRS) issued by the *International Accounting Standards Board* (IASB) were designed to harmonize accounting standards on an international level and are progressively replacing numerous national standards.

Similarly, the *International Public Sector Accounting Standards* (IPSAS) developed by the *International Public Sector Accounting Standards Board* (IPSASB) applies to governments or any other public entity. They aim “to enhance the quality, consistency, and transparency of public sector financial reporting worldwide”.<sup>58</sup>

#### 4.5.5 Other Guidelines

The *World Trade Organisation* (WTO) has a number of trade agreements in place, which all member states have to adhere to. There are specific agreements related to investments, drawing on the *Trade-Related Investment Measures*<sup>59</sup> (TRIMs) and the *General Agreement on Tariffs in Services*<sup>60</sup> (GATS) (Barbieri 2009). Most countries are members of the WTO and so SWFs fall under WTO agreements when trading internationally. GATS provides specifications on how SWFs should be administered and how disputes arising should be dealt with. Due to this dispute mechanism, the WTO agreements are seen as more powerful than the IMF guidelines (Mattoo and Subramanian 2008).

The *International Social Security Association* (ISSA) issued *Guidelines on Investment of Social Security Funds*<sup>61</sup> in 2013 to assist member organisations with their investment policies and their governance.

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<sup>57</sup> Available at: [www.ifrs.org/IFRSs/Pages/IFRS.aspx](http://www.ifrs.org/IFRSs/Pages/IFRS.aspx). They were named ‘International Accounting Standards’ (IAS) until 2001.

<sup>58</sup> IPSASB, [www.ifac.org/public-sector](http://www.ifac.org/public-sector) (retrieved 23 Feb. 15)

<sup>59</sup> Available at: [https://www.wto.org/english/docs\\_e/legal\\_e/18-trims.pdf](https://www.wto.org/english/docs_e/legal_e/18-trims.pdf)

<sup>60</sup> Available at: [https://www.wto.org/english/docs\\_e/legal\\_e/26-gats.pdf](https://www.wto.org/english/docs_e/legal_e/26-gats.pdf)

<sup>61</sup> Available at: [www.issa.int/excellence/guidelines/investment](http://www.issa.int/excellence/guidelines/investment)

The *Collevecchio Declaration on Financial Institutions and Sustainability*<sup>62</sup> (2003) calls on financial institutions to embrace six commitments, namely sustainability, “do not harm”, responsibility, accountability, transparency, as well as sustainable markets and governance.

The *International Organization of Securities Commissions* (IOSCO) is recognized as the global standard setter for the securities sector. The document *Development and Regulation of Institutional Investors in Emerging Markets*<sup>63</sup> was published in 2012 to help emerging markets policy makers and regulators to both develop and regulate institutional investors.

Finally, the *United Nations Conference on Trade and Development* (UNCTAD) is currently working on the theme of *FDI, Tax and Development*, aiming to provide a foundation for the ongoing debate in the international community on tax avoidance. Its newly released working paper *FDI, Tax and Development: The fiscal role of multinational enterprises: towards guidelines for Coherent International Tax and Investment Policies* is available online.<sup>64</sup>

## 4.6 Transparency Indices for SWFs

There are three indices that rate the transparency of SWFs, viz., the *Truman Index*, the *Linaburg-Maduell Transparency Index*, and the *Santiago Principles Index*, all of which are briefly described below. However, it is worth noting that there are differences in the way SWFs

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<sup>62</sup> Available at:

[www.banktrack.org/download/collevecchio\\_declaration\\_2/0\\_030401\\_-collevecchio\\_declaration.pdf](http://www.banktrack.org/download/collevecchio_declaration_2/0_030401_-collevecchio_declaration.pdf)

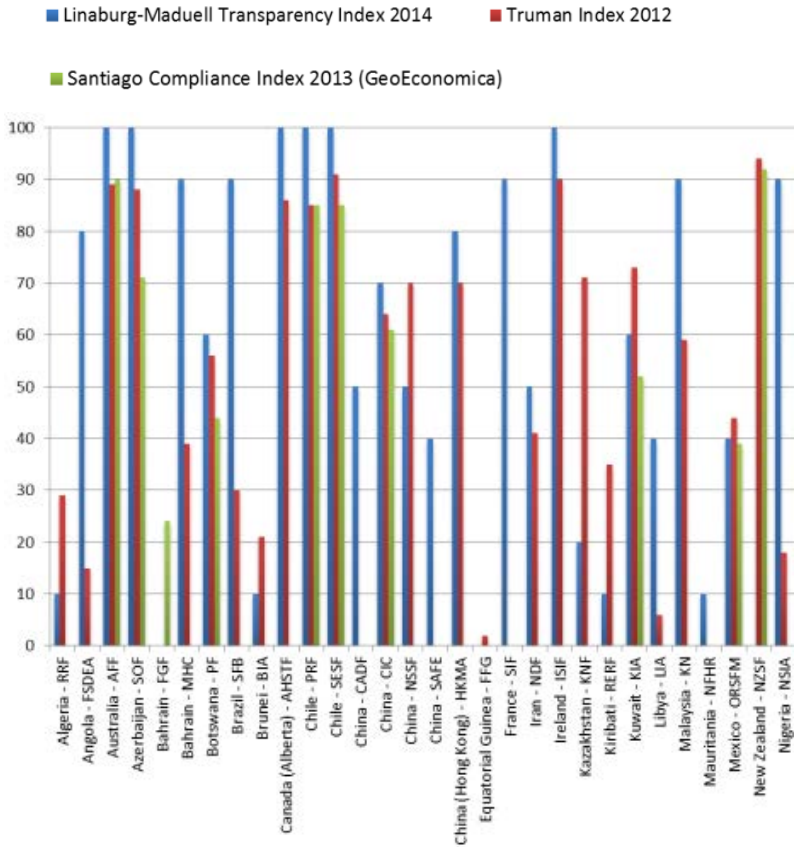
<sup>63</sup> Cf. recommendations in Chapter 4:

[www.iosco.org/library/pubdocs/pdf/IOSCOPD384.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD384.pdf)

<sup>64</sup> Available at: <http://www.tralac.org/images/docs/7262/fdi-tax-and-development-unctad-working-paper-march-2015.pdf>

are ranked in these indices, which is evident in the differences between the scores received according to each index.

Figure 11a\*: Comparison of scores in three transparency indices



\*Figure continues on next page

Figure 11b: Comparison of scores in three transparency indices

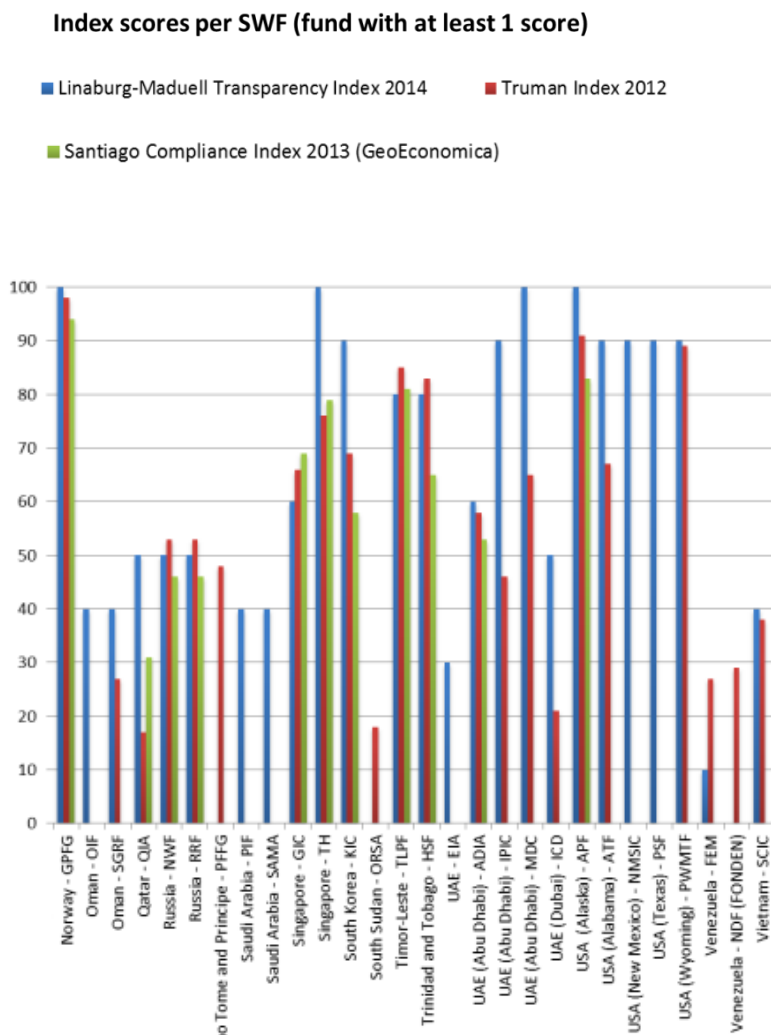


Figure 11 indicates that *Temasek Holdings* (TH) scores 100 in the *Linaburg-Maduell Transparency Index*, while it only scores 79 in the *Santiago Principles Index* and 76 in the *Truman Index*. The *Kuwait Investment Authority* (KIA) scores 73 in the *Truman Index*, while it only scores 60 in the *Linaburg-Maduell Index*, and 52 in the *Santiago Principles Index*. 19 SWFs have scores for all three indices, but a number of them are listed in only one or two of the three indices. In total, 58 SWFs are scored by at least one index.

The *Truman Index*, compiled from data by the *Peterson Institute* (from December 2013), indicates that the majority of SWFs (27 out of 47 funds) currently score above 50, with an overall average of 55. Such a score means that the structure, governance, transparency, accountability and behaviour of the fund is ‘fair’. Five SWFs score 90 or more: *Government Pension Fund – Global* from Norway (GPFG, 98), *New Zealand Superannuation Fund* (NZSF, 94), *Social and Economic Stabilization Fund* from Chile (SESF, 91), *Alaska Permanent Fund* (APF, 91) and *Ireland Strategic Investment Fund* (ISIF, 90). Six SWFs score less than 20: *Nigeria Sovereign Investment Authority* (NSIA, 18), *Oil Revenue Stabilization Account* from South Sudan (ORSA, 18), *Qatar Investment Authority* (QIA, 17), *Fundo Soberano de Angola* (FSDEA, 15), *Libyan Investment Authority* (LIA, 6) and *Fund for Future Generations* from Equatorial Guinea (FFG, 2). A list of all questions of the Truman Index can be found in Annexure 6. Bagnall and Truman (2013) noticed some improvements over time, mostly concerning the identification of holders of investment mandates, publication of public audits and publication of information on the returns of the funds. They conclude that the *Santiago Principles* have only limited influence on SWFs in countries such as Ghana, Qatar, Angola and Brazil.

The *Sovereign Wealth Fund Institute* also developed a transparency index, called the *Linaburg-Maduell Transparency Index*.<sup>65</sup> This index consists of 10 criteria (see Annexure 6) related to transparency. The last version of this rating (fourth quarter 2014) indicates that 36 out of 52 funds score 5 or more out of 10. Ten funds score 10 out of 10: *Future Fund from Australia* (AFF), *State Oil Fund of Azerbaijan* (SOF), *Alberta's Heritage Savings Trust Fund* from Canada (AHSTF), *Pension Reserve Fund and Social* (PRF) and *Economic Stabilization Fund* (SESF) from Chile, *Ireland Strategic Investment Fund* (ISIF), *Government Pension Fund – Global* (GPFG), *Temasek* (TH) from Singapore, *Mubadala Development Company* from Abu Dhabi (MDC) and *Alaska Permanent Fund* (APF). Five funds score 1: *Revenue Regulation Fund* from Algeria (RRF), *Brunei Investment Authority* (BIA), *Revenue Equalization Reserve Fund* from Kiribati (RERF), *National Fund for Hydrocarbon Reserves* from Mauritania (NFHR) and *Macroeconomic Stabilization Fund* from Venezuela (FEM). In order to aid the commensurability of the three different indices used in Figure 11, we have converted the base 10 index scores into base 100. For example, the *Saudi Arabian Monetary Agency Foreign Holdings*, with an original score of 4/10 in the *Linaburg-Maduell Transparency Index*, is listed here with a score of 40/100.

The *Santiago Compliance Index*, developed by Geoeconomica, rates SWFs against the *Santiago Principles*. Geoeconomica (2014a) points out that even though a SWF subscribes to the Principles, this does not mean that it is transparent and committed to good governance. The SWFs that score 80 or higher are considered fully compliant with the Principles. Such a score is held by the *Timor-Leste Petroleum Fund*

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<sup>65</sup> Bagnall and Truman (2013) are critical of this Index “for being superficial in some of its 10 elements (such as: Does the funds have a website?), not releasing the resulting scores for each element, and for combining many factors into some elements, such as portfolio value, returns, and management compensation, without providing any information about how the factors were weighted within each element.”



(TLPF, 81), APF (83), PRF and SSEF (85), AFF (90), NZSF (92) and GPFG (94). SWFs scoring between 50 and 79 show a fragmented commitment to the Principles and score well on some principles, but less so on others like independence of the operational management of the fund or financial disclosure policies. The SWFs that fall in the middle group of this index are: *Kuwait Investment Authority* (KIA, 52), *Abu Dhabi Investment Authority* (ADIA, 53), *Korea Investment Corporation* (KIC, 58), *China Investment Corporation* (CIC, 61), *Heritage and Stabilization Fund* from Timor-Leste (HSF, 65), *Government of Singapore Investment Corporation* (GIC, 69), *State Oil Fund of Azerbaijan* (SOF, 71) and *Temasek* (TH, 79). The non-compliant group consists of: *Future Generation Fund* from Bahrain (FGF, 24), *Qatar Investment Authority* (QIA, 31), *Oil Revenue Stabilization Fund* of Mexico (ORSFM, 39), *Pula Fund* from Botswana (PF, 44), as well as *National Wealth Fund* (NWF) and *Russian Reserve Fund* (RRF) with a score of 46.

Considering the average score of all indices – whether the fund is scored with one, two or three indices – we find eleven funds score 90 or more: *Strategic Investment Fund* from France (SIF, 90), *New Mexico State Investment Council* (NMSIC, 90), *Texas Permanent School Fund* (PSF, 90), PRF (90), APF (91), SESF (92), AFF (93), AHSTF (93), NZSF (93), ISIF (95) and GPFG (97). Five funds have an average score of less than 20: FFG (2), NFHR (10), BIA (15), ORSA (18) and FEM (18). Bagnall and Truman (2013) state that “in general, larger increases in scores were scored in the 2007-09 period, when the SWF issue was hot and pressure on SWFs to be more transparent and accountable was significant.”

## 4.7 Governance of Ethics in SWFs

The governance of ethics in SWFs refers to the measures that a SWF takes to ensure that its operations and investments are conducted in an ethical manner. We analysed the primary sources (e.g. websites and annual reports) of all SWFs against six criteria in order to gauge their level of governance of ethics. These six criteria are:

1. *VMV Statement: Does the SWF have a vision, mission and values statement?*

There is a statement of its mission/vision/values and/or principles that includes non-financial goals.

2. *Code of ethics: Does the SWF have a code of ethics?*

The SWF has or refers to<sup>66</sup> at least one code of ethics/conduct or other guidelines related to its internal functioning/governance, whether it is publicly available or not.

3. *External regulations: Is the SWF voluntarily subscribing to external regulation(s) –*

The SWF is member, signatory, or is officially committed to an ‘external’ (shared with other organizations) voluntary regulation (Santiago Principles, UNPRI, Carbon Disclosure Project, etc.).

4. *Governance of ethics: Does the SWF have a governance/management structure that attends to ethics?*

The SWF has an internal structure (board sub-committee, ethics committee, compliance department, etc.) specifically dedicated to the governance of ethics.

5. *Asset allocation: Does the SWF include non-financial considerations in its investment policy?*

Non-financial matters are considered in its investment policy.

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<sup>66</sup> For example, a SWF might refer to the code of ethics of its managing institution.

6. *Shareholder activism*: Does the SWF exercise its powers as a shareholder?

The SWF states that it does or might use its voting rights and/or might enter into dialogue with the companies it has shares in.

This analysis does not mean that an SWF without these ethical criteria is per se unethical, but it is not explicit and therefore difficult to measure.

It was decided to focus only on the official sources of SWFs (e.g. annual reports and websites) in order to avoid secondary interpretations of the governance of ethics of SWFs that might lead to biased perceptions of SWFs.

From our study, it is clear that the most subscribed to external regulations are the *Santiago Principles* (through membership of IFSWF) and the UNPRI (as signatories). As Figure 12 shows, the *Santiago Principles* are quite popular amongst SWFs, since more than one third of them are members of IFSWF (33 SWFs out of 96). Europe has the highest number with 6 IFSWF members out of 9 SWFs. At the other extreme, only 2 out of 13 SWFs in North America commit themselves to the *Santiago Principles*. Only very few funds, 5 in total, are signatories of the UNPRI.

Figure 12: Number of UNPRI and GAPP (Santiago Principles) signatories by region

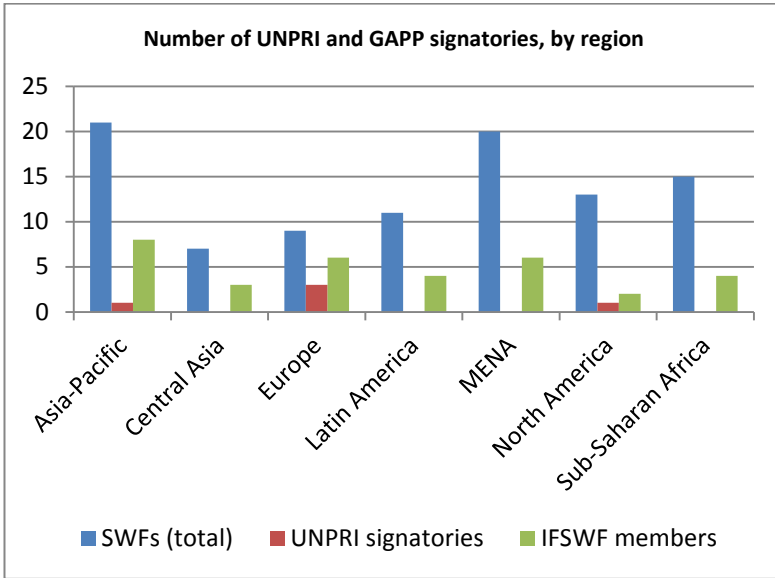


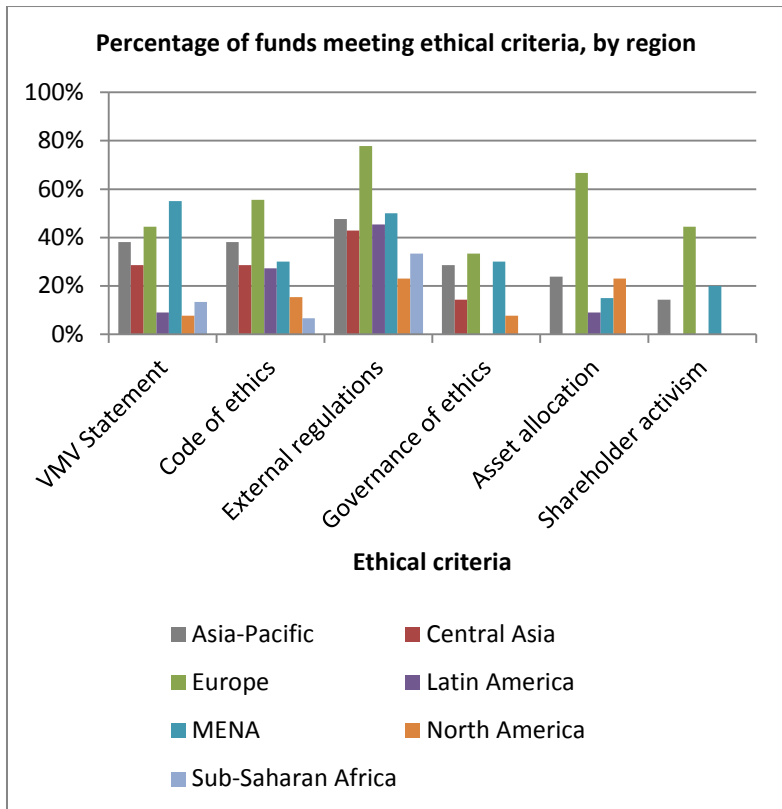
Figure 13 illustrates the percentage of SWFs meeting all the ethical criteria. ‘External regulations’ includes IFSWF members and UNPRI signatories, but also members of other responsible associations (Carbon Disclosure Project investor members, Long-Term Investors Club Member, etc.), or any SWF claiming to follow other voluntary regulations. ‘Asset allocation’ includes UNPRI signatories, but also any SWF claiming to include non-financial criteria in its investment policy.

European SWFs score above 50% on 3 criteria (code of ethics, external regulations and asset allocation) and not less than 33% on any of the 3 other ones. Its average score in all criteria is the highest, with 54%. MENA and Asia-Pacific follow with an average of 33% and 32%. MENA has a score of 50% or more on 2 criteria (mission, vision, values statement and external regulations) and not under 15% on any of the other criteria. Sub-Saharan Africa has the lowest average score of 9%,

with a maximum of 33% on only one criterion (external regulations) while scoring 0% on three further criteria (governance of ethics, asset allocation and shareholder activism).

Globally, 45% claim to subscribe to external regulations, 30% have a vision, mission and values statement, 28% have a code of ethics, 18% a governance structure dedicated to compliance and/or ethics, 19% include non-financial criteria, and only 11% declare being involved in shareholder activism.

Figure 13: Percentage of SWFs meeting ethical criteria, by region



Looking at AUM instead of total number of SWFs (Figure 14), statistics show more promising results, indicating that the largest SWFs are usually more responsible – or at least show better intentions – than smaller ones when it comes to the governance of ethics.

*Figure 14: SWFs global AUM meeting ethical criteria*

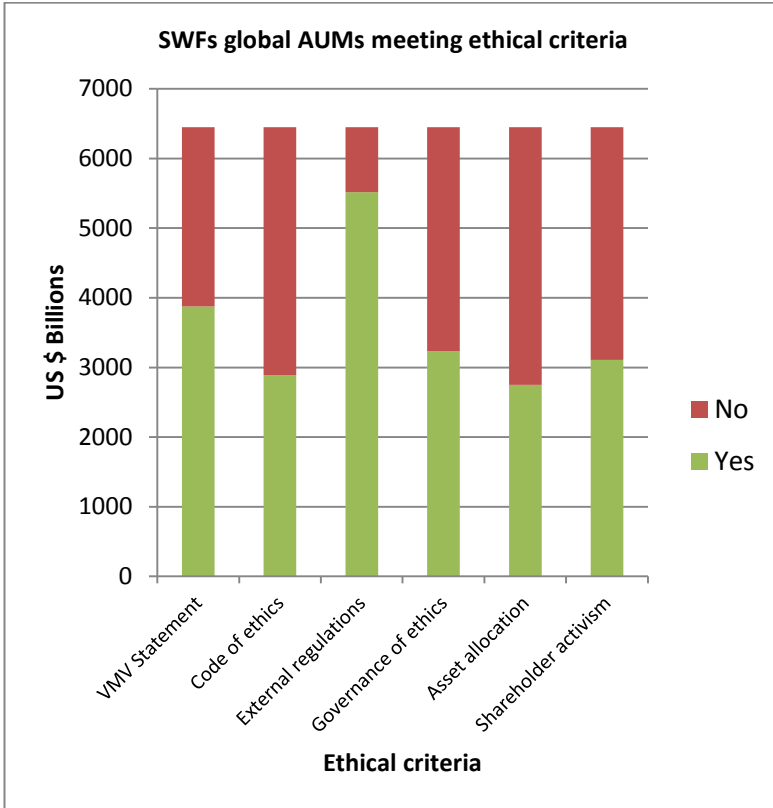
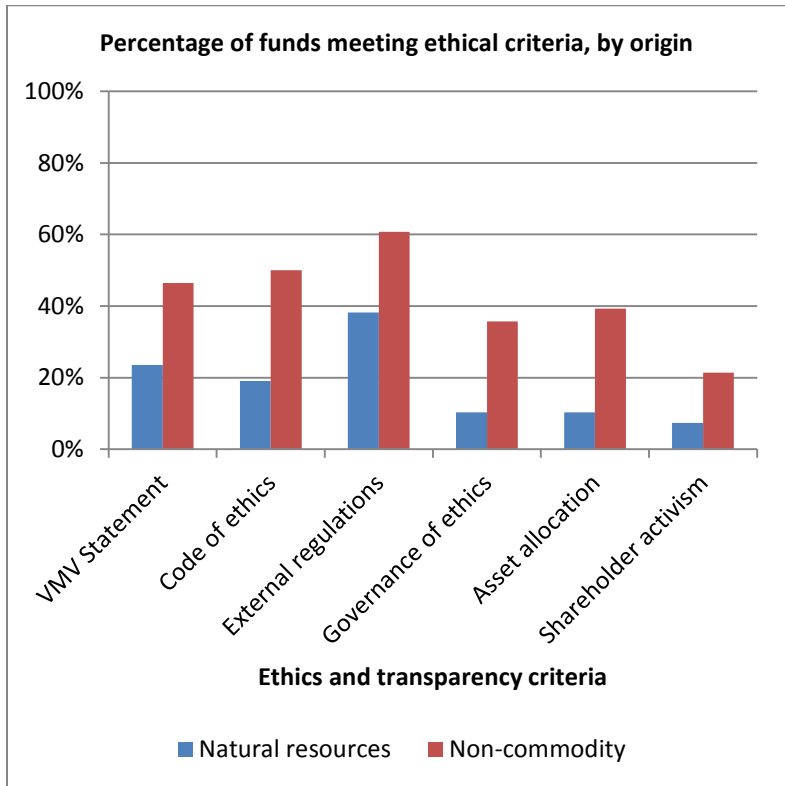


Figure 15 illustrates the significant difference between commodity and non-commodity SWFs regarding their performance on these ethical criteria. Except for ‘external regulations’<sup>67</sup>, non-commodity funds have always at least twice higher scores than commodity funds.

<sup>67</sup> 38% of commodity SWFs and 61% of non-commodity SWFs are positively rated on ‘external regulations’.

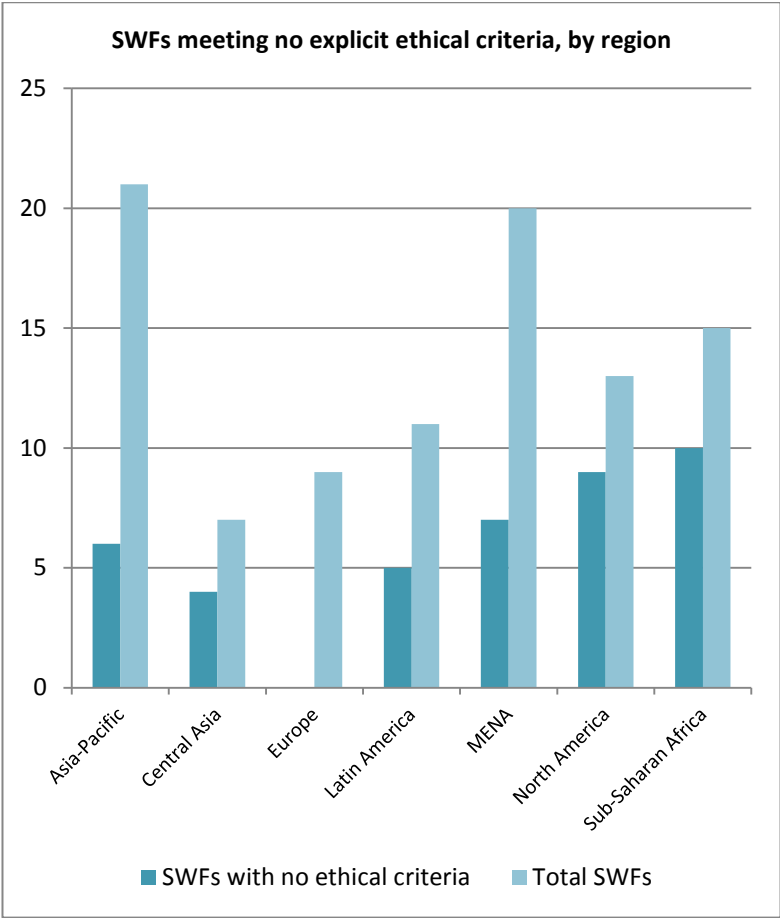
Figure 15: Percentage of SWFs meeting ethical criteria, by origin



Only two SWFs meet all 6 criteria: GPFG from Norway – which is also the largest SWF – and the *New Zealand Superannuation Fund* (NZSF).

On the other hand, 41 SWFs (43% of all SWFs) do not meet any of the ethical criteria assessed in this study. Figure 16 shows their regional distribution. Europe remains best in class with none of its nine SWFs entering this category, while North America (13 SWFs and 9 meeting no ethical criteria, 69%), Sub-Saharan Africa (15 SWFs and 10 meeting no ethical criteria, 67%) Central Asia (7 SWFs and 4 meeting no ethical criteria, 57%) have the lowest scores.

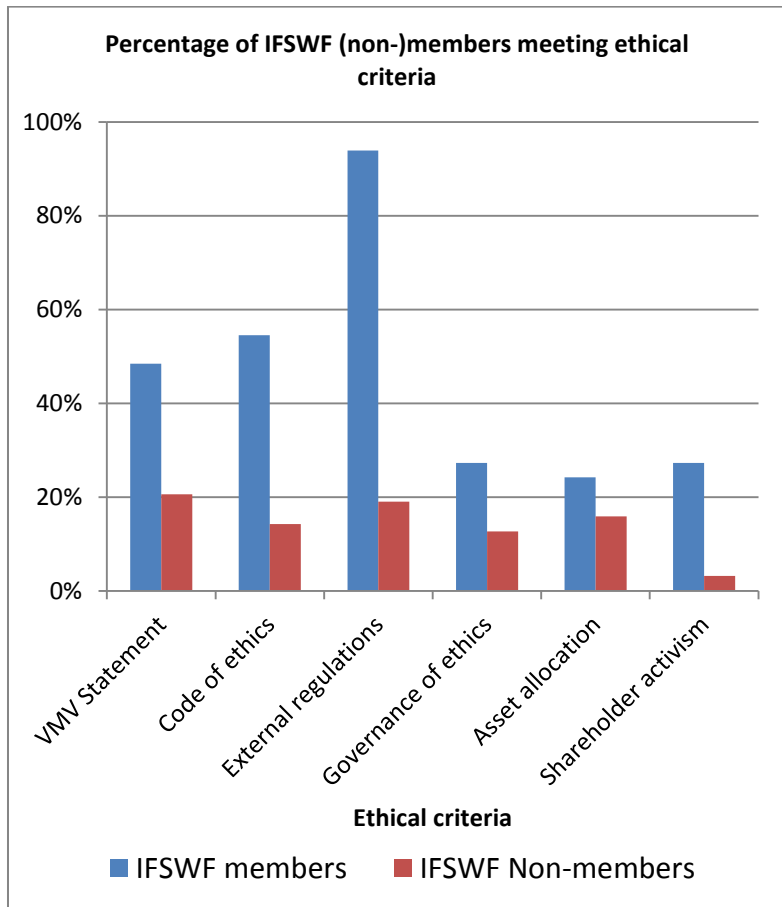
Figure 16: SWFs meeting no explicit ethical criteria, by region



Since the *Santiago Principles* is the standard to which most SWFs subscribe, it is particularly interesting to compare the scores of SWFs that subscribe to the Santiago Principles with those SWFs that do not subscribe to it. Figure 17 illustrates the differences between the IFSWF members and non-members, regarding the six ethical criteria. It clearly shows that IFSWF members outscore non-members on all criteria, even though ‘external regulations’ inherently include IFSWF members.



Figure 17: Percentage of IFSWF (non-) members meeting ethical criteria



## 4.8 Conclusion

This chapter described the voluntary regulations for SWFs emanating from international financial institutions (IMF, OECD, EU), the United Nations (UNEP, UNHCR, WTO), and from other organizations in the third-sector. The fact that so many regulations and

indices exist – mostly having been developed since 2008 – shows a demand for SWFs to act transparently and responsibly.

Also, our analysis gives an overview of SWFs' current transparency and commitment to the governance of ethics. But as was previously noted, the scope of this analysis is mainly restricted to public claims and intentions rather than concrete facts. It would be interesting to compare these public claims and intentions with the actual practices of SWFs, but that is beyond the scope of this report.

Finally, the example of the Norwegian *Government Pension Fund – Global* (GPGF) is worth being given extra consideration, since it is often referred to as the most transparent and responsible fund. With the six ethical criteria from this study easily met and scores of 10/10, 98/100 and 94/100 to the *Linaburg-Maduell Index*, the *Truman Index* and the *Santiago Principles Index* respectively, it clearly shows the best overall results in the current evaluation.

The fund was created in 1990 to invest surplus wealth from the oil sector and was known as the 'Petroleum Fund' until 2006. In 2002, the government of Norway appointed a committee to develop ethical guidelines for the Fund's investments. The *Graver Report* was released in 2003, identifying principles on protection of the environment, human rights, labor standards as well as corporate governance standards. It also proposed two investment management instruments: shareholder activism and investment screening (Chesterman, 2008). In 2004, the Advisory Commission on International Law, responsible for Norway's compliance with international legislation, was replaced by the Council on Ethics. As Chesterman (2008) explains, "the focus of the Council's work is on avoiding the risk of doing the wrong thing rather than ensuring a desirable course of action is followed." Its formal mission is to give advice on whether investments in financial instruments issued by

specified issuers are inconsistent with the Fund's *Guidelines for observation and exclusion from the Government Pension Fund Global*<sup>68</sup>.

According to those guidelines, the negative screening is regulated as follows:

The Fund shall not be invested in companies which themselves or through entities they control:

1. produce weapons that violate fundamental humanitarian principles through their normal use;
2. produce tobacco;
3. sell weapons or military materiel to states that are subject to investment restrictions on government bonds as described in the management mandate for the Fund [...]

Companies may be put under observation or be excluded if there is an unacceptable risk that the company contributes to or is responsible for:

1. serious or systematic human rights violations, such as murder, torture, deprivation of liberty, forced labour and the worst forms of child labour;
2. serious violations of the rights of individuals in situations of war or conflict;
3. severe environmental damage;
4. gross corruption;
5. other particularly serious violations of fundamental ethical norms

This text gives some latitude to the Council, while remaining quite clear on its focuses for negative screening. The Council's recommendations are submitted to the Norwegian Ministry of Finance, which takes the final decisions. Norges Bank, the central bank of

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<sup>68</sup> Available at: <https://www.regjeringen.no/en/topics/the-economy/the-government-pension-fund/responsible-investments/guidelines-for-observation-and-exclusion/id594254/>

Norway, which administers the fund, provides a list of companies excluded from GPFG's portfolio, as well as of companies placed under observation.<sup>69</sup>

Regarding the shareholder activism, Norges Bank "is required to report on how it has acted as owner representative and explain how it has promoted "special interests relating to the long-term horizon and diversification of investments in accordance with" the guidelines on ownership" (Chesterman, 2008). Yet GPFG uses its voting rights and its right to information, and engages with companies to determine whether they are willing to address the fund's concerns in order to push companies to improve their environmental, social and governance behaviour. Amongst many other policies, GPFG follows the Policy on Conduct of Business from Norges Bank.<sup>70</sup>

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<sup>69</sup> It is available at: [www.nbim.no/en/responsibility/exclusion-of-companies/](http://www.nbim.no/en/responsibility/exclusion-of-companies/)

<sup>70</sup> Available at: [www.nbim.no/globalassets/documents/governance/policies/nbim-conduct-of-business-policy.pdf](http://www.nbim.no/globalassets/documents/governance/policies/nbim-conduct-of-business-policy.pdf)

## **ETHICAL CRITERIA AND CONCLUSION**

### **5.1 Ethical Criteria from Core Values**

This report offers a descriptive analysis of (a) the reality of SWFs, (b) the public perception of the financial, economic, social, environmental and political impact of SWFs, and (c) an overview and comparison of the existing standards and principles relevant for SWFs.

But this report is also an ethical assessment, and attempts to present the ethical arguments underpinning all SWFs. This was visible throughout the report, not only in the discussion of the controversies around SWFs, but also in the discussion of the ethical and governance standards relevant to SWFs. Ethical values provide the criteria for value-judgments on how ethical any individual SWF might be. These values also become the basis for the Ethics Charter of chapter 6.

Ethics means reflection on right and wrong. Ethical decision-making means to take decisions based on ethical values. Values-driven behaviour and action is different from, for example, purely power- or money-driven behaviour. Values-driven decisions are led by core values, and in order to implement them manifold resources are needed. Power, capital, human resources, natural resources, technology, innovation, and communication are important instruments and means in order to implement values. From an ethical standpoint these resources are not goals in themselves, but means to strengthen and implement core

values and convictions. Therefore power, money, technology and innovation are very important, even to SWFs, as a means of pursuing ethical goals.

Values are different in different cultures, religions, economic and political systems, and also in individual lives. But in the modern globalized and interconnected world many values are shared globally. The human rights declarations, the millennium development goals, the new sustainable development goals, etc., are based on broadly accepted core ethical values. These core ethical values also provide the basis for this ethical assessment.

*Core values* are criteria and benchmarks for individuals, institutions and societies. The following are core ethical values that can guide ethical thinking and behaviour:

*Responsibility* means being in a position of authority and therefore having a duty to make sure that certain things are done. Responsibility means to respond to the expectations and duties of those who entrusted the power to those with responsibility (e.g. the electorate to politicians, clients to banks). For example, a SWF invests and uses its capital in the interest of the people/country with a long term benefit. Responsibility is relevant for all sectors of society, in family, economy, politics, culture, religion, civil society, etc.

*Freedom* refers to the capacity to take control of life, unfold it in a responsible way, and develop innovative and sustainable solutions in society and to express own convictions in a fair way. Freedom is not only the *freedom from* restrictions, but also the *freedom to* access resources, to be able, and have the means, to implement set objectives.

*Independence* is a specific form of freedom. It describes the autonomy of decisions made independently from others. The sovereignty of states is an expression of their independence to build their societies according to their collective, independent will. A sovereign wealth fund is a fund of a sovereign state, and at the same time

independent in their investment policy. But in a global interconnected world, independence is always limited since sovereign entities are embedded in international standards, codes, conventions and regulations in order to foster international cooperation and peace.

*Community* means to embed, protect and strengthen individual lives in a community of human beings, even in communities with non-human beings. Individual freedoms should not destroy the community, and the community should not oppress the individual. SWFs stand in a direct relation to their respective home country communities, but are also (responsible) members of the world community. In a harmonious society freedom of the individual and the strength and order of the community balance one another.

*Fairness/Justice* means fair access to resources and chances needed to live a life in dignity. It means equality as in the equal rights of human beings as captured in the core of Human Rights, and in fair judicial systems and constitutional states.

*Peace* means absence of war, but even also a fair and non-violent way to settle conflicts and reach security. Security and peace are fruits of social justice and economic fairness. Investments can increase conflicts or strengthen peace.

*Sustainability* means a life of dignity for present generations without endangering a life of dignity for future generations. It means to act in a way which can be maintained in the long term. SWFs almost by definition are tasked with this long term perspective for societies.

In addition to core values, there are also *core virtues*. Virtues are attitudes or character traits that enable one to implement core ethical values. Only two are mentioned here which are of specific relevance for SWFs:

*Transparency* means acting with sufficient openness in disclosing information and in communication. Transparency is a precondition for accountability and trust. Transparency does not exclude confidentiality

in specific areas and time periods. The right balance of transparency and confidentiality builds trust. For SWFs transparency does not mean disclosing all information, but disclosing sufficient information to legitimate stakeholders to make sense of the decisions and actions of the SWF. The more globalized and mutually accountable the world economy and its financial sector are, the more transparent they are expected to be.

*Integrity* is the fruit and culmination of all the above values and virtues. Values-driven decisions and actions, honesty, transparency and accountability lead to integrity. An individual or an institution with integrity has a great reputation. This often leads to reduced reputation risks and transaction costs. It leads to long term recognition, sustainable reputation and long term benefit.

When the above values are applied to investing it is referred to as ‘Responsible Investing’. Responsible investments take these values and virtues into account in the investment criteria and policies and governance structures. Responsible investments reconcile and combine these values and virtues with the financial value and performance which is needed. “The value of values” (the annual motto of the *Global Ethics Forum* of *Globethics.net*) means that ethical values also create economic value.

## **5.2 Value Judgment with EESGP<sup>71</sup> Criteria and Conclusions**

SWFs are investment vehicles that can generate substantial *benefits for current and future generations*, but they also can and already did generate a fair amount of controversy. The exponential rise in the number of SWFs since the early 2000s was accompanied by a similar rise in suspicions around SWFs.

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<sup>71</sup> Economic, Environmental, Social, Governance and Political.



*On the economic side*, it is argued that SWFs could distort the market as they have the financial means to intervene when companies or countries are going bankrupt, and hence bail them out. Some would argue that the intervention of SWFs in these instances is welcomed, as otherwise these companies (e.g. like *Citibank* in 2008) would be gone causing unemployment, people losing their savings, etc. However, capitalists argue that the market should be left alone, and that states and SWFs should refrain from intervening. The controversy centers around the debate on the extent to which a state should intervene in its market. When an SWF makes an investment decision, it should follow all applicable laws and regulations and make a fair judgment whether it is wise to make the investment. If it is deemed wise to make the investment, SWFs should not be distracted by ideological debates concerning the state's involvement in the economy. Hence, this controversy is considered as irrelevant.

The fact that SWFs can cause *market instability* is true, but this has yet to occur. SWFs have large funds at their disposal, but the size can actually be a limiting factor for SWFs, as it limits the possible investment strategies available, compared to smaller investment funds. Additionally, SWFs often limit the amount of shares they obtain in a company to ensure that the risk and their influence on a company remains limited.

Investments made by SWFs could increase *protectionism* by recipient states, as there would be a fear for interference with issues of national interest. It seems that this argument was sometimes used by recipient states to refuse investments from SWFs. There is however no actual proof that SWFs try to make certain investments to gain strategic access to a company or a country to obtain influence. Protectionism is a phenomenon that has always been present, and states have regularly tried to protect their domestic economies from foreign intervention.

Investments by SWFs could be interpreted against this background. In principle, protectionism is forbidden by the WTO.

The fact that *citizens of the home country of a SWF* have little say in the management of a SWF is a potential danger. Citizens should be aware of the existence of the SWF(s) of their country, have a say in their investment objectives, and benefit from its profits in their own lifetime. This would increase the perceived legitimacy of a SWF in its own country. In terms of *taxation*, the same tax laws apply to all institutional investors, therefore also for SWFs, domestically and abroad. SWFs should not behave in an anti-competitive manner, but be an example to other investors and pay their required taxes.

As it is important for SWFs to invest for the sake of future generations, they should take the *environmental effects* such as *climate change* into serious consideration. SWFs have the moral responsibility to not only invest for future generations, but also to ensure that these future generations will be able to live a sustainable life on our planet. If our planet is gone in fifty years, all the investments made are useless. Furthermore, SWFs should influence the behaviour of other SWFs, companies and governments to consider the environment when making investments. In principle SWFs should refrain from investing in companies that harm the environment, or should at least stimulate these companies to become more environmentally friendly. SWFs could also finance sustainable climate projects like renewable energy projects.

The very fact that some SWFs are accused of not being transparent and of not adhering to *good governance* rules is a problem, even if it is just a question of the accusers' perception. It is crucial for both the home country and its SWF to be perceived as trustworthy and transparent, as investors only invest when they are comfortable with the standards of governance and transparency of a country. Investors want to be assured that their money is safe and that common rules of trade and investment will apply. This is equally relevant for companies and countries an SWF

wants to invest in. SWFs should look at the reporting standards that other institutional investors maintain, and commit to at least meeting that same standard of reporting, or even exceed it.

Additionally, to gain *domestic legitimacy*, it is important for a SWF to be transparent and open about the way the fund is governed. Citizens of a home country of a SWF should be able to trust the management of the SWF, and the information that is available concerning it. SWFs should adhere to local and international legislation, and its own founding documents. In addition, SWFs should develop and adhere to the voluntary standards of good governance, focusing on all fields of governance as well as ethics.

SWFs are to some extent *inherently political vehicles* because they are accountable to governments and citizens and not to shareholders. Home countries, recipient countries and companies should be aware of this, but it should not necessarily be a cause for concern. SWFs should be clear and open about the politics links or ties they have than can influence their behaviour. In addition, SWFs should avoid unjustified political meddling or influencing which are not in line with the purpose and the governance rules of the SWF. This should be clearly described in the founding documents of the SWF. In addition, recipient countries should not politicize any (possible) investments from a SWF. Investments are judged according to which home country is involved; if the home country is perceived as unfriendly or a threat, the investment is not welcomed. This is short-sighted and detrimental to economic development. Recipient countries hence have the moral responsibility to judge all investments in the same way, no matter the SWF's home country.

In addition the above-mentioned controversies, if SWFs are managed well, i.e. based on *values and ethical principles* as mentioned above, they are a major benefit to both home countries and for their foreign investment targets. SWFs often inject capital in financial markets in

Europe and the US, markets which desperately need more capital to ensure economic growth. Also for the home countries of SWFs, there are many benefits like the availability of capital for local economic development, the avoidance of economic malaise, and safeguarding of funds for the future generations.

*Are there ethical criteria for SWFs investment policies for the ratio between foreign and domestic investments?* It is a commonly held view that domestic investments are more risky than foreign investments, and SWFs traditionally and commonly invest in external assets “to respond to sterilization, stabilization, and risk/return objectives”, focusing on “nondomestic, high-return existing infrastructure and low-risk, new, bankable infrastructure projects in Europe and Asia” (Gelb et al., 2014). From an ethical point of view, it is certainly important for SWFs to be part of the global market in order to optimize return and diversify risks; but, they also have to consider investment needs within their own country, especially since traditional sources of financing are decreasing. Several resource-rich countries have established SWFs partly assuming the role of national investor (like Angola, Mongolia, Nigeria and Papua New Guinea) and others are about to. As Geld et al. (2014) show, many challenges come along with domestic investments. Chief amongst them is the risk of political interference and elite capture, the separation between SWFs’ activities and other government institutions with investment mandates and the consistency with macroeconomic stabilization policies.<sup>72</sup> But those risks should not lead to the conclusion that domestic investments should be avoided. They should rather be

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<sup>72</sup> Geld et al. add: “The SWF could also be used to bypass parliamentary scrutiny of spending, resulting in inefficient and fragmented public investment programs. [...] risks of wasteful expenditure, budget fragmentation, political capture, and lack of coordination with fiscal policy [...]”. Developing countries could also face the “lack of government capacity for project selection, appraisal, design and implementation; weak governance and regulatory frameworks; and lack of coordination among government entities, as well as political economy issues [...]”.

addressed, while SWFs accept a possible lower return in favor of large social and environmental benefits. To do so, in accordance with these authors, we suggest focusing on competitive as well as pooled investments, and building a strong corporate governance scheme including an independent board, professional staff, transparent reporting and independent audits. The international financial crises and turbulences have shown that domestic investments are not necessarily more risky or have with lower return than foreign investments and international markets. Furthermore, domestic investments can increase the acceptance and reputation of SWFs in the home country.

SWFs can even be more beneficial for home and recipient countries, and in fact for the world at large, if SWFs *would integrate ethical and sustainability issues in their investment processes*. There is a growing awareness that the inclusion of environmental, social and governance (ESG) criteria (which correspond to the core ethical values) in investment decisions can produce several benefits. A recent research report by *Arabesque* (Clark, et al., 2014) analysed all available statistical information to assess the benefits of integrating ESG criteria into the investment process, and also to determine whether such ESG integration results in positive or negative returns. The report indicates that investments that integrate ESG criteria have a competitive advantage and perform better because risks are better managed, operational processes are streamlined, and reputations are enhanced; both with internal and external stakeholders.

*External costs* (like fines, court cases) are also significantly reduced by respecting EESGP criteria. The credit ratings of companies with good ESG rating improve, and consequently it is easier for them to access capital, and the cost of accessing capital is also lower. Herwig Peeters, CEO of *Forum ETHIBEL*, indicates that funds that incorporate ESG criteria can be as profitable as non-ESG funds, given the same level of competence of the asset management team. Based on factual

observations (and not merely on backtracking exercises) these funds often outperform the market. Fund managers claim that the inclusion of ESG considerations in investment decisions lead to more comprehensive risk assessments and better investment decisions. The 'Quarterly Journal of Economics' (2003) found evidence already in 2003 that stocks of well-governed companies significantly outperform the performance of poorly governed companies. Van Liedekerke, et al. (2007) also indicated in a study that funds that incorporate ESG criteria have a similar financial performance as non-ESG funds.

In addition, *ESG factors are becoming more mainstream* in societies around the globe. Van Liedekerke indicates that a growing number of people find ESG criteria important. As the power of ordinary citizens across the world increase, they are likely to demand that business and investors incorporate ESG considerations in their decisions and behaviour. It is therefore in the best interest of investors and asset managers to include ESG criteria into their investment processes. The fact that SWFs are created to benefit a nation impose on them the responsibility to integrate ESG criteria in their investment processes.

### **5.3 Recommendations**

To ensure that SWFs make a positive contribution to their national, but also to the global community and are more explicit values-driven, we invite the Sovereign Wealth Funds to consider the following recommendations, that SWFs:

1. Adhere to best corporate governance practices and economic, environmental, social, governance and political (EESGP) principles which can positively influence the reputation or image of a country, especially if the country is often perceived negatively in terms of its institutional transparency and governance standards.

2. Include economic, environmental, social, governance and political (EESGP) considerations in their investment policies to ensure that they are responsible investors and responsible global citizens.
3. Ensure optimal independence from political interests. However, SWFs should acknowledge the fact that they are inherently political vehicles and be transparent about it. When certain investment decisions are taken because of political motives, these should be disclosed wherever possible.
4. Improve their global transparency by releasing annual integrated reports and collaborate in order to increase their positive impact.
5. Assume their potential of becoming a substantial asset for their respective nations by clearly and unambiguously stating in the founding document of the SWF the intended purpose and use of the fund.
6. Mainly invest within their home countries, especially if they are developing or emerging countries, in order to support their domestic investment needs and support their impact. This requires a continuous identification of related risks, commitment to the relevant standards, and acceptance of possibly lower financial returns in exchange for additional social and environmental benefits.
7. Actively counter negative perceptions about SWFs, especially in cases where they are governed according to best practice principles. Negative perceptions can severely harm investment strategies and returns.





## **DRAFT ETHICS CHARTER – ENGLISH AND PORTUGUESE VERSIONS**

### **Draft Ethics Charter for Sovereign Wealth Funds**

In order to give expression to the ethical values and virtues, as well as the recommendations outlined in the previous chapter, it is hereby suggested that SWFs adopt an ethics charter.

An ethics charter represents a foundational commitment to ethics. It serves as the ethical constitution of the SWF. As the ethical foundation (or constitution) of the SWF, all actions and decisions taken by the SWF should always be reconcilable with its ethics charter.

An ethics charter differs from a code of conduct. Codes of conduct prescribe specific actions that need to be followed or avoided by persons involved in the governance and management of an organization. It is thus meant to direct the behaviour of internal stakeholders as well as other stakeholders within the sphere of control or influence of the organisation.

The Ethics Charter for SWFs was deliberately designed in manner that would make it easy for any SWF to adopt it, in order to strengthen the ethical responsibility of SWFs both nationally and internationally. Global aspirational voluntary standards that have gained the most ground in recent years tend to be short and easy to recall. Two outstanding examples in this regard are the *United Nations Global Compact*, and the *United Nations Principles of Responsible Investment* (UNPRI). The experience gained from the success of such standards,

informed the design of the Ethics Charter for SWFs around the three basic ethical values of *Responsibility*, *Independence* and *Integrity* and in a format that is brief and easy to recall.

It would be possible (and also desirable) to develop over time some practical guidance to SWFs on what the adoption of this Ethics Charter implies in terms of governance and management of a SWF. This is however an evolutionary process in which other SWFs should preferably be invited to participate.

*Further explanations to the Charter will be added. Other additional background documents can be produced as needed.*

It is hereby proposed that the Ethics Charters for SWFs reads as follows:

## **Ethics Charter for SWFs**

The moral purpose of a SWF is to act in the best interest of the people for which the fund was created – whether current or future generations – and also as a responsible citizen of the world community.

Therefore, the SWF commits itself to use its ownership and influence to implement the following ethical values:

### **1. Responsibility**

#### **1.1. Economic Responsibility**

To ensure that our fund's financial performance contributes to the development of our national economy without causing detrimental market distortions or anti-competitive practices.

#### **1.2. Environmental Responsibility**

To consider the environmental impact of our investment decisions and to avoid investments that are detrimental to the sustainability of our country and the planet.

#### **1.3. Social Responsibility**

To balance the well-being of current generations with those of future generations and to refrain from harming people and communities through our investments decisions.

#### **1.4. Governance Responsibility**

To enhance the financial performance of our fund in a fair, accountable, accessible and transparent manner without compromising national or international laws and good governance principles.

### **2. Independence**

To act with independence of mind in fulfilling the legal mandate and moral purpose of the fund, and to prevent personal and political interests from interfering in decisions related to the fund.

### **3. Integrity**

To act with ethical integrity in pursuit of all our objectives and in the way we treat our staff and all our external stakeholders.

### **4. Sensitivity to the Local Values and Culture**

Be sensitive and take into account the global values and standards, as well as the values and traditions of the local context and culture.

## **Proposta de Carta de Ética para Fundos Soberanos**

A fim de dar expressão aos valores éticos e virtudes, bem com às recomendações feitas no capítulo anterior, sugere-se que os fundos soberanos (FS) adoptem carta de ética.

Uma carta de ética representa um compromisso de base com a ética. Ela serve como o alicerce ético do Fundo Soberano. Como alicerce ético do Fundo Soberano todas as acções e decisões tomadas pelo Fundo Soberano devem sempre ser reconciliáveis com a Carta de Ética.

Uma Carta de Ética difere de um código de conduta. Os Códigos de Conduta prescrevem acções específicas que precisam ser adoptadas, ou evitadas, pelas pessoas envolvidas na governação e gestão de uma organização. Assim, significa que os Códigos de Conduta servem para dirigir o comportamento das partes interessadas internas assim como das partes interessadas sob a esfera de controlo, ou influência, da organização.

A Carta de Ética para Fundos Soberanos foi deliberadamente esboçada de uma forma que pudesse facilitar que qualquer Fundo Soberano a possa adoptar, de forma a a influenciar a responsabilidade ética dos FSs tanto nacional como internacionalmente.

Os padrões globais aspiracionais, de carácter voluntário, que tiveram maior sucesso nos anos recentes tendem todos a ser breves e fáceis de recordar. Os dois mais destacados exemplos são o Compacto Global das Nações Unidas e os Princípios das Nações Unidas sobre o Investimento Responsável. A experiência adquirida do êxito de tais padrões influenciou a concepção da Carta de Ética para FSs em torno dos três valores éticos básicos de *Responsabilidade, Independência e Integridade* e num formato que é breve e fácil de recordar.

Seria possível (e também desejável) desenvolver, ao longo do tempo, alguma orientação prática aos Fundos Soberanos sobre o que implicaria a adopção de Cartas de Ética em termos de governação e gestão de um Fundo Soberano. Entretanto, trata-se de um processo evolutivo em que

outros Fundos Soberanos deveriam preferivelmente ser convidados a participar.

*Uma explicação adicional à Carta será acrescentada. Outros documentos adicionais de fundo histórico e de apoio poderão ser produzidos conforme a necessidade.*

Desta forma, propõe-se que a Carta de Ética para Fundos Soberanos seja redigida da seguinte maneira:

### **Carta De Ética para Fundos Soberanos**

O propósito moral de um FS é agir no melhor interesse das pessoas para as quais o fundo foi criado – sejam elas da presente geração ou das gerações vindouras – e também como um cidadão responsável da comunidade global.

Portanto, o FS compromete-se com os seguintes valores éticos:

#### **1. Responsabilidade**

##### **1.1. Responsabilidade Económica**

- Assegurar que o desempenho financeiro do nosso fundo contribua para o desenvolvimento da nossa economia nacional sem causar distorções nos mercados ou práticas anti-competitivas.

##### **1.2. Responsabilidade Ambiental**

- Considerar o impacto ambiental das nossas decisões de investimento e evitar investimentos que são detrimenais à sustentabilidade do nosso país e do planeta.

##### **1.3. Responsabilidade Social**

- Equilibrar o bem-estar das gerações presentes com o das gerações vindouras e reprimir-se de prejudicar as pessoas e comunidades através das nossas decisões de investimento.

##### **1.4. Responsabilidade de Governação**

- Aumentar o desempenho financeiro do nosso fundo de uma forma justa, prestando contas, e de forma transparente sem comprometer as leis nacionais e internacionais nem os princípios de boa governação.

#### **2. Independência**

- Agir com independência mental no cumprimento do mandato legal e do propósito moral do fundo, e prevenir que interesses pessoais ou políticos interfiram nas decisões relacionadas com o fundo.

#### **3. Integridade**

Agir com integridade ética na perseguição de todos os nossos objectivos e na forma como tratamos os nossos colaboradores e todos as pessoas externas mas com um interesse na nossa acção.

#### **4. Sensibilidade para os Valores e Cultura**

Ser sensível e tomar em consideração os valores e padrões globais bem como os valores e tradições do contexto e cultura locais.

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## ANNEXURES

### **Annexure 1: Santiago Principles**

#### *GAPP 1. Principle*

The legal framework for the SWF should be sound and support its effective operation and the achievement of its staged objective(s).

- GAPP 1.1 Subprinciple The legal framework for the SZF should ensure the legal soundness of the SWF and its transactions
- GAPP 1.2 Subprinciple The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and the other state bodies, should be publicly disclosed.

#### *GAPP 2. Principle*

The policy purpose of the SWF should be clearly defined and publicly disclosed.

#### *GAPP 3. Principle*

Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

#### *GAPP 4. Principle*

There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal, and spending operations.

- GAPP 4.1 Subprinciple The source of SWF funding should be publicly disclosed.
- GAPP 4.2 Subprinciple The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.

*GAPP 5. Principle*

The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

*GAPP 6. Principle*

The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.

*GAPP 7. Principle*

The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.

*GAPP 8. Principle*

The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.

*GAPP 9. Principle*

The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.

*GAPP 10. Principle*

The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.

*GAPP 11. Principle*

An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

*GAPP 12. Principle*

The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.

*GAPP 13. Principle*

Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management, and staff.

*GAPP 14. Principle*

Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.

*GAPP 15. Principle*

SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

*GAPP 16. Principle*

The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.

*GAPP 17. Principle*

Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

*GAPP 18. Principle*

The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.

- GAPP 18.1 Subprinciple The investment policy should guide the SWF's financial risk exposures and the possible use of leverage.
- GAPP 18.2 Subprinciple The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.
- GAPP 18.3 Subprinciple A description of the investment policy of the SWF should be publicly disclosed.

*GAPP 19. Principle*

The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.

- GAPP 19.1 Subprinciple If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.



- GAPP 19.2 Subprinciple The management of a SWF's assets should be consistent with what is generally accepted as sound asset management principles.

*GAPP 20. Principle*

The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

*GAPP 21. Principle*

SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If a SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

*GAPP 22. Principle*

The SWF should have a framework that identifies, assesses, and manages the risks of its operations.

- GAPP 22.1 Subprinciple The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning, and an independent audit function.
- GAPP 22.2 Subprinciple The general approach to the SWF's risk management framework should be publicly disclosed.

*GAPP 23. Principle*

The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

*GAPP 24. Principle*

A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.

## **Annexure 2: OECD**

### **Sovereign Wealth Funds and Recipient Countries – Working together to maintain and expand freedom of investment (2008)**

#### *OECD Declaration on SWFs and Recipient Countries Policies*

At the OECD Ministerial Council Meeting on 4-5 June 2008 in Paris, Ministers of OECD countries

- Welcomed the constructive contribution that Sovereign Wealth Funds (SWFs) make to the economic development of home and host countries. To date they have been reliable, long-term, commercially-driven investors and a force for global financial stability.
- Recognised that if SWF investments were motivated by political rather than commercial objectives, they could be a source of concern, and that legitimate national security concerns could arise.
- Welcomed international discussions involving SWFs, their governments and recipient governments. These increase understanding, contribute to mutual trust and confidence, and help avoid protectionist responses that could undermine economic growth and development.
- Noted that the home countries of SWFs and SWFs themselves can enhance confidence by taking steps to strengthen transparency and governance in the SWFs.
- Supported the work of the IMF on best practices for SWFs as an essential contribution and the continuing coordination between the OECD and the IMF.
- Noted that the OECD for its part has been working on best practices for recipient countries. Together the IMF and OECD will help preserve and expand an open international investment

environment for SWFs while safeguarding essential security interests.

- Welcomed the Report by the OECD Investment Committee on SWFs and Recipient Country Policies, which reflects inputs from both OECD and emerging economies, and looked forward to future work, including peer monitoring of policy developments and broader consideration of foreign-government controlled investments.
- Based on this Report, Ministers endorsed the following policy principles for countries receiving SWF investments. These principles reflect long-standing OECD commitments that promote an open global investment environment. They are consistent with OECD countries' rights and obligations under the OECD investment instruments.
  - Recipient countries should not erect protectionist barriers to foreign investment.
  - Recipient countries should not discriminate among investors in like circumstances. Any additional investment restrictions in recipient countries should only be considered when policies of general application to both foreign and domestic investors are inadequate to address legitimate national security concerns.
  - Where such national security concerns do arise, investment safeguards by recipient countries should be:
    - transparent and predictable,
    - proportional to clearly-identified national security risks, and
    - subject to accountability in their application.

### ***OECD General Investment Policy Principles***

*The OECD general investment policy principles are established in the OECD Code of Liberalisation of Capital Movements, adopted by the OECD country governments in 1961, and the OECD Declaration on International Investment and Multinational Enterprises of 1976 as revised in 2000, adopted by forty-one OECD and non-OECD country governments. They apply to treatment of all foreign investors, including SWFs, and are as follows:*

- Non discrimination. Foreign investors are to be treated not less favourably than domestic investors in like situations. While the OECD instruments protect directly the investment freedoms of those SWFs established in OECD member countries, they also commit members to using their best endeavours to extend the benefits of liberalisation to all members of the International Monetary Fund. Experience has shown that, in practice, OECD governments nearly always adopt liberalisation measures without discriminating against non-OECD countries -- investors from non-member countries reap the same benefits of free market access as OECD residents. Outright discrimination against non-OECD based investors would be a major departure from OECD tradition.
- Transparency. Information on restrictions on foreign investment should be comprehensive and accessible to everyone.
- Progressive liberalisation. Members commit to the gradual elimination of restrictions on capital movements across their countries.
- “Standstill”. Members commit to not introducing new restrictions.
- Unilateral liberalisation. Members also commit to allowing all other members to benefit from the liberalisation measures they

take and not to condition them on liberalisation measures taken by other countries. Avoidance of reciprocity is an important OECD policy tradition. The OECD instruments are based on the philosophy that liberalisation is beneficial to all, especially the country which undertakes the liberalisation.

*OECD Guidelines for Recipient Countries Investment Policies  
Relating to National Security*

- *Non-discrimination* – Governments should be guided by the principle of non-discrimination. In general governments should rely on measures of general application which treat similarly situated investors in a similar fashion. Where such measures are deemed inadequate to protect national security, specific measures taken with respect to individual investments should be based on the specific circumstances of the individual investment which pose a risk to national security.
- *Transparency/predictability* – while it is in investors' and governments' interests to maintain confidentiality of sensitive information, regulatory objectives and practices should be made as transparent as possible so as to increase the predictability of outcomes.
  - Codification and publication. Primary and subordinate laws should be codified and made available to the public in a convenient form (e.g. in a public register; on internet). In particular, evaluation criteria used in reviews should be made available to the public.
  - Prior notification. Governments should take steps to notify interested parties about plans to change investment policies.

- Consultation. Governments should seek the views of interested parties when they are considering changing investment policies.
  - Procedural fairness and predictability. Strict time limits should be applied to review procedures for foreign investments. Commercially-sensitive information provided by the investor should be protected. Where possible, rules providing for approval of transactions if action is not taken to restrict or condition a transaction within a specified time frame should be considered.
  - Disclosure of investment policy actions is the first step in assuring accountability. Governments should ensure that they adequately disclose investment policy actions (e.g. through press releases, annual reports or reports to Parliament), while also protecting commercially-sensitive and classified information.
- *Regulatory proportionality* - Restrictions on investment, or conditions on transaction, should not be greater than needed to protect national security and they should be avoided when other existing measures are adequate and appropriate to address a national security concern.
    - Essential security concerns are self-judging. OECD investment instruments recognise that each country has a right to determine what is necessary to protect its national security. This determination should be made using risk assessment techniques that are rigorous and that reflect the country's circumstances, institutions and resources. The relationship between investment restrictions and the national security risks identified should be clear.

- Narrow focus. Investment restrictions should be narrowly focused on concerns related to national security.
  - Appropriate expertise. Security-related investment measures should be designed so that they benefit from adequate national security expertise as well as expertise necessary to weigh the implications of actions with respect to the benefits of open investment policies and the impact of restrictions.
  - Tailored responses. If used at all, restrictive investment measures should be tailored to the specific risks posed by specific investment proposals. This would include providing for policy measures (especially risk mitigation agreements) that address security concerns, but fall short of blocking investments.
  - Last resort. Restrictive investment measures should be used, if at all, as a last resort when other policies (e.g. sectoral licensing, competition policy, financial market regulations) cannot be used to eliminate security-related concerns.
- *Accountability* – procedures for internal government oversight, parliamentary oversight, judicial review, periodic regulatory impact assessments, and requirements that important decisions (including decisions to block an investment) should be taken at high government levels should be considered to ensure accountability of the implementing authorities.
    - Accountability to citizens. Authorities responsible for restrictive investment policy measures should be accountable to the citizens on whose behalf these measures are taken. Countries use a mix of political and judicial oversight mechanisms to preserve the neutrality and objectivity of the investment review process while



also assuring its political accountability. Measures to enhance the accountability of implementing authorities to Parliament should be considered (e.g. Parliamentary committee monitoring of policy implementation and answers or reports to Parliament that also protect sensitive commercial or security-related information).

- International accountability mechanisms. All countries share a collective interest in maintaining international investment policies that are open, legitimate and fair. Through various international standards, governments recognise this collective interest and agree to participate in related international accountability mechanisms (e.g. the OECD notification and peer review obligations in relation to restrictive investment policies). In particular, these help constrain domestic political pressures for restrictive and discriminatory policies. Recipient governments should participate in and support these mechanisms.
- Recourse for foreign investors. The possibility for foreign investors to seek review of decisions to restrict foreign investments through administrative procedures or before judicial or administrative courts can enhance accountability. However, some national constitutions' allocation of authority with respect to national security may place limits on the scope of authority of the courts. Moreover, judicial and administrative procedures can be costly and time-consuming for both recipient governments and investors, it is important to have mechanisms in place to ensure the effectiveness, integrity and objectivity of decisions so that recourse to such procedures is rare. The possibility of seeking redress should not hinder the

executive branch in fulfilling its responsibility to protect national security

- The ultimate authority for important decisions (e.g, to block foreign investments) should reside at a high political level. Such decisions require high-level involvement because they may restrict the free expression of property rights, a critical underpinning of market economies, and because they often require co-ordination among numerous government functions. The final decision to prohibit (or block) an investment should be taken at the level of heads of state or ministers.
- Effective public sector management. Broader public sector management systems help ensure that the political level officials and civil servants responsible for security-related investment policies face appropriate incentives and controls for ensuring that they exercise due care in carrying out their responsibilities and are free from corruption, undue influence and conflict of interest.

### **Annexure 3: EU Communication – A Common European approach to Sovereign Wealth Funds.**

*Principles for a common EU approach to the treatment of SWFs as investors.*

The common EU approach to the treatment of SWFs as investors should be based on the following principles:

- *Commitment to an open investment environment:* in line with the Lisbon Strategy for growth and jobs, the EU should reaffirm its commitment to open markets for foreign capital and to an investor-friendly investment climate. Any protectionist move or any move perceived as such may inspire third countries to follow suit and trigger a negative spiral of protectionism. The EU prospers from its openness to the rest of the world – and from its investments abroad – and hence would be among the first to suffer from a trend towards protectionism. At the same time, the EU should endeavour to open SWFs owners' countries to EU investors and secure a fair and equitable treatment for them, notably through FTA negotiations.
- *Support of multilateral work:* the EU should actively drive forward work carried out by international organisations, in particular the IMF and the OECD. The EU welcomes an open dialogue with SWFs owners and recognises the benefits of a global approach to a common framework for SWF investment.
- *Use of existing instruments:* the EU and the Member States already have specific instruments that enable them to formulate appropriate responses to risks or challenges raised by cross-border investments, including investments by SWFs, for reasons of public policy and public security.
- *Respect of EC Treaty obligations and international commitments:* the EU and its Member States will continue to act in a way fully

compatible with the principles laid down in the Treaty establishing the EC and with international obligations of the EU.

- *Proportionality and transparency*: measures taken for public interest reasons on investment should not go beyond what is necessary to achieve the justified goal, in line with the principle of proportionality, and the legal framework should be predictable and transparent.

These basic principles should define the common EU approach which should be proposed as the basis for an understanding between recipient countries on the treatment of SWFs investments. Transposed at international level, this common approach should draw on the above principles of openness to cross-border investments, preference for multilateral solutions, respect of existing international obligations, proportionality and predictability of rules.

## **Annexure 4: Global Compact**

The UN Global Compact's ten principles in the areas of human rights, labour, the environment and anti-corruption enjoy universal consensus and are derived from:

- The Universal Declaration of Human Rights
- The International Labour Organization's Declaration on Fundamental Principles and Rights at Work
- The Rio Declaration on Environment and Development
- The United Nations Convention Against Corruption

The UN Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment and anti-corruption:

### *Human Rights*

- Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and
- Principle 2: make sure that they are not complicit in human rights abuses.

### *Labour*

- Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
- Principle 4: the elimination of all forms of forced and compulsory labour;
- Principle 5: the effective abolition of child labour; and
- Principle 6: the elimination of discrimination in respect of employment and occupation.

### *Environment*

### *148 Sovereign Wealth Funds: An Ethical Perspective*

- Principle 7: Businesses should support a precautionary approach to environmental challenges;
- Principle 8: undertake initiatives to promote greater environmental responsibility; and
- Principle 9: encourage the development and diffusion of environmentally friendly technologies.

### *Anti-Corruption*

- Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

## **Annexure 5: United Nations Principles for Responsible Investment (UNPRI)**

*Principle 1:* We will incorporate ESG issues into investment analysis and decision-making processes.

Possible actions:

- Address ESG issues in investment policy statements.
- Support development of ESG-related tools, metrics, and analyses.
- Assess the capabilities of internal investment managers to incorporate ESG issues.
- Assess the capabilities of external investment managers to incorporate ESG issues.
- Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or rating companies) to integrate ESG factors into evolving research and analysis.
- Encourage academic and other research on this theme.
- Advocate ESG training for investment professionals.

*Principle 2:* We will be active owners and incorporate ESG issues into our ownership policies and practices.

Possible actions:

- Develop and disclose an active ownership policy consistent with the Principles.
- Exercise voting rights or monitor compliance with voting policy (if outsourced).
- Develop an engagement capability (either directly or through outsourcing).
- Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights).
- File shareholder resolutions consistent with long-term ESG considerations.

## *150 Sovereign Wealth Funds: An Ethical Perspective*

- Engage with companies on ESG issues.
- Participate in collaborative engagement initiatives.
- Ask investment managers to undertake and report on ESG-related engagement.

*Principle 3:* We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Possible actions:

- Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative).
- Ask for ESG issues to be integrated within annual financial reports.
- Ask for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact).
- Support shareholder initiatives and resolutions promoting ESG disclosure.

*Principle 4:* We will promote acceptance and implementation of the Principles within the investment industry.

Possible actions:

- Include Principles-related requirements in requests for proposals (RFPs).
- Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate).
- Communicate ESG expectations to investment service providers.
- Revisit relationships with service providers that fail to meet ESG expectations.
- Support the development of tools for benchmarking ESG integration.



- Support regulatory or policy developments that enable implementation of the Principles.

*Principle 5:* We will work together to enhance our effectiveness in implementing the Principles.

Possible actions:

- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning.
- Collectively address relevant emerging issues.
- Develop or support appropriate collaborative initiatives.

*Principle 6:* We will each report on our activities and progress towards implementing the Principles.

Possible actions:

- Disclose how ESG issues are integrated within investment practices.
- Disclose active ownership activities (voting, engagement, and/or policy dialogue).
- Disclose what is required from service providers in relation to the Principles
- Communicate with beneficiaries about ESG issues and the Principles.
- Report on progress and/or achievements relating to the Principles.
- Seek to determine the impact of the Principles.
- Make use of reporting to raise awareness among a broader group of stakeholders.

## **Annexure 6: Transparency Indices**

### ***Truman Index Peterson Institute***

- **STRUCTURE**

1. Is the SWF's objective clearly stated?
2. Is there a clear legal framework for the SWF?
3. Is the procedure for changing the structure of the SWF clear?
4. Is the overall investment strategy clearly stated?

#### *Fiscal Treatment*

5. Is the source of the SWF's funding clearly specified?
6. Is the nature of the subsequent use of the principal and earnings of the fund clearly specified?
7. Are the SWF's operations appropriately integrated with fiscal and monetary policies?
8. Is the SWF separate from the country's international reserves?

- **GOVERNANCE**

9. Is the role of the government in setting the investment strategy of the SWF clearly established?
10. Is the role of the governing body of the SWF clearly established?
11. Is the role of the managers in executing the investment strategy clearly established?
12. Are decisions on specific investments made by the managers?
13. Does the SWF have internal ethical standards for its management and staff?
14. Does the SWF have in place, and make publicly available, guidelines for corporate responsibility that it follows?
15. Does the SWF have ethical investment guidelines that it follows?

- TRANSPARENCY AND ACCOUNTABILITY

*Investment Strategy Implementation*

16. Do regular reports on investments by the SWF include information on the categories of investments?
17. Does the strategy use benchmarks?
18. Does the strategy use credit ratings?
19. Are the holders of investment mandates identified?

*Investment Activities*

20. Do regular reports on the investments by the SWF include the size of the fund?
21. Do regular reports on the investments by the SWF include information on its returns?
22. Do regular reports on the investments by the SWF include information on the geographic location of investments?
23. Do regular reports on the investments by the SWF include information on the specific investments?
24. Do regular reports on the investments by the SWF include information on the currency composition of investments?

*Reports*

25. Does the SWF provide at least an annual report on its activities and results?
26. Does the SWF provide quarterly reports?

*Audits*

27. Is the SWF subject to a regular annual audit?
28. Does the SWF publish promptly the audits of its operations and accounts?
29. Are the audits independent?

- BEHAVIOUR

30. Does the SWF have an operational risk management policy?

31. Does the SWF have a policy on the use of leverage?
32. Does the SWF have a policy on the use of derivatives?
33. Does the SWF have a guideline on the nature and speed of adjustment in its portfolio?

***Linaburg-Maduell Transparency Index***

1. The fund provides history including reason for creation, origins of wealth and government ownership structure
2. The fund provides up-to-date independently audited annual reports
3. The fund provides ownership percentage of company holdings, and geographic location of holdings
4. The fund provides total portfolio market value, returns and management compensation
5. The fund provides guidelines in reference to ethical standards, investment policies and enforcer of guidelines
6. The fund provides clear strategies and objectives
7. If applicable, the fund clearly identifies subsidiaries and contact information
8. If applicable, the fund identifies external managers
9. The fund manages its own web site
10. The fund provides main office location address and contact information such as telephone and fax

***Santiago Compliance Index***

Geoeconomica (2014a) provides the indicators used in order to rate the Santiago Principles:

<b>GAPP</b>	<b>Standard</b>	<b>Indicator</b>
GAPP 1	Legal framework	Legal basis and/or founding charter are disclosed.

GAPP 2	Policy purpose	The policy purpose of the fund is disclosed. Inconsistent policy purposes may receive a noncompliant rating as a consequence.
GAPP 3	Coordination with domestic fiscal and monetary authorities	Disclosure of processes that ensure coordination with domestic fiscal and monetary authorities. Alternatively, an explanation of why the fund's activities do not have significant direct domestic macroeconomic implications is required.
GAPP 4	Source of funding/ withdrawal and spending	Policies, rules, procedures or arrangements for the fund's funding, withdrawal and spending operations on behalf of the government should be clearly set out and consistent with the fund's policy purpose. Industry best practice also includes the annual reporting of the amount of inflows and withdrawals, if applicable.
GAPP 5	Statistical data reported to the owner	Description of procedures that ensure statistical data pertaining to the fund are reported on a timely basis to the owner.
GAPP 6	Governance framework	Holistic description of the fund's governance framework and identification of entities within that framework. Compliance with Principle 6 needs to be assessed in the context of Principles 7 to 9.
GAPP 7	Role of the owner	Disclosure of regulations that ensure the fund's owner sets the objectives, appoints the members of its governing body(ies) in accordance with clearly defined procedures, and exercises oversight over the SWF's operations.
GAPP 8	Role of the governing body(ies)	Disclosure of regulations that ensure the fund's governing body(ies) has(have) a clear mandate and adequate authority and competency to carry out its functions, including setting the fund's strategy and accountability arrangements.
GAPP 9	Operational management	Disclosure of regulations that provide the mandate for operational management, including reference to responsibilities and accountability arrangements.
GAPP 10	Accountability	Disclosure of accountability arrangements linking the fund to its political constituency and institutions.
GAPP 11	Annual report and accounting	Publication of annual reports and commitment to an international or national accounting standard.
GAPP 12	Auditing	Disclosure of audited financial statements.
GAPP 13	Professional and	Disclosure of professional and ethical standards.

## *156 Sovereign Wealth Funds: An Ethical Perspective*

### ethical standards

GAPP 14	Third parties	Disclosure of rules and procedures for dealing with third parties.
GAPP 15	Regulatory and disclosure requirements in host countries	Description of arrangements that ensure regulatory and disclosure requirements in host countries are complied with.
GAPP 16	Operational management independence	Disclosure of processes and policies that ensure operational management is independent from the owner of the fund.
GAPP 17	Disclosure of relevant financial information	Disclosure of asset allocation, benchmarks where relevant, rates of return over appropriate historical periods.
GAPP 18	Investment policy	Description of a conclusive investment policy.
GAPP 19	Disclosure of non-financial and economic considerations	Disclosure and discussion of factors beyond economic and financial considerations that drive investment decisions.
GAPP 20	Privileged information or inappropriate government influence	Disclosure of rules and regulations that prevent the fund from benefitting from privileged information or inappropriate government influence.
GAPP 21	Ownership rights	Adequate description of the approach to executing shareholder rights.
GAPP 22	Risk management framework	Description of the risk management framework.
GAPP 23	Investment performance and benchmarks	Disclosure of investment performance and performance benchmarks.
GAPP 24	Implementation of Santiago Principles	Description of the process to regularly review compliance with the Santiago Principles by or on behalf of the SWF. Disclosure of a Santiago compliance selfassessment.



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# Sovereign Wealth Funds

## *An Ethical Perspective*

In the past decade the number of Sovereign Wealth Funds (SWFs) has increased substantially. This development stands to act as a positive impact for posterity. However, the increase of SWFs is gaining much attention and raises concerns about the way in which these funds operate in the world of finance and on the global market. The study shows that the credibility of the Sovereign Wealth Funds would be strengthened with additional ethical standards as these funds in many countries are subject to controversies.

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