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SOVEREIGN WEALTH FUNDS

A complete guide to state-owned investment funds

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Alberto Quadrio Curzio & Valeria Miceli

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Sovereign Wealth Funds

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Sovereign Wealth Funds

A complete guide to state-owned investment funds

by Alberto Quadrio Curzio and Valeria Miceli

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Introduction

What This Book Covers

This book is a thorough guide to sovereign wealth funds, an area of finance worth trillions of dollars, involving many of the world's governments, and affecting a wide array of sectors, but which – and not accidentally – often remains profoundly obscure.

Sovereign wealth funds (from here on SWFs) are state-owned investment vehicles that manage portfolios of financial activities. They are typically denominated in foreign currency deriving either from the sale of petroleum and other raw materials (commodity SWFs) or from other surpluses of the balance of payments (non-commodity SWFs).

From this common denominator, differences between funds can be outlined according to purpose, legal structure, strategy and source(s) of financing. This makes it possible to classify various types of SWFs: stabilisation funds, savings funds, reserve funds, development funds, and pension reserve funds without explicit pension liabilities.

The main players in this scenario amongst emerging countries are the Persian Gulf states, China, Singapore, Russia and Libya, and, amongst developed nations, Norway.

In 2009 there were 53 SWFs in the world, with total assets of between US$3,200 billion and US$3,800 billion. These are highly respectable numbers, especially if one considers that they are concentrated in the hands of just a few large operators. The ten largest SWFs hold 74% of total assets held by all SWFs. Since most of the assets managed by SWFs (almost 80% of the total) belong to emerging countries, while only 18% (in terms of asset size) belong to full democracies (according to *The Economist* Intelligence Unit's index of democracy), it is understandable how worrying their investments have been to recipient countries, especially considering how opaque and inscrutable many can be. Indeed, SWFs are equally a political as well as a financial concern. Since they are an expression of a new state capitalism, they are suspected, rightly or wrongly, of representing interests that go beyond their avowed goal of profit maximisation. As yet, though, no empirical evidence has been produced to substantiate such anxieties.

First ignored, then viewed as "barbarians at the gate"[1], and finally considered as lenders of last resort for the shaky financial sector, the image of SWFs has constantly changed, and they have had to quickly adapt to changing circumstances.

Since the beginning of the 21st century, SWFs have grown in number and size. With the price of petroleum rising constantly up until mid-2008, Asian countries' exports and surpluses also growing steadily, and the persistence of worldwide financial imbalances between countries that consume too much and save too little (the United States) and other countries that consume too little and save too much (China), it is not surprising that SWFs transformed into overactive financial giants in global markets, especially in the years 2007 and 2008. Their increasing role in financial markets – along with their opaque approach, the entry into the game of economic and political heavyweights such as China and Russia, and apprehensions about the shift of financial power which SWFs therefore symbolise – all contributed to their growing importance and visibility. They captured the concerned attention of institutional players (national and supranational), and of public opinion in Western democracies as well as in their own countries.

During 2007-2008, called upon by Western governments and institutions, they initially helped both their public image and the struggling economies of Western nations by contributing to recapitalise their crisis-stricken banks and by investing in important but troubled financial companies. Then from September 2008 – with losses accumulated mainly from these financial shareholdings, the fall in the price of oil, the shrinking of Asian exporters' current account surpluses and the need to provide support to domestic economies – SWFs underwent a phase of retrenchment. It was only in the second half of 2009, having adjusted targets and strategies to the changed financial scenario, that they re-entered the stage, proving to be major players in international financial markets.

The purpose of this book is to present a comprehensive survey of these increasingly important institutions. The Italian edition of the book was published in 2009 by il Mulino with the title «I fondi sovrani». The present English edition is broader and more detailed than the Italian one, not only because so much has changed in the intervening year, but also because we have had the opportunity to take into account even more of the growing academic literature on the subject.

Structure of the Book

After a brief historical digression bringing us up to the present (Chapter 1), this book focuses firstly on the fundamental issue of defining SWFs (Chapter 2). After this, we identify the actors involved, before classifying them and studying their main characteristics. In Chapter 3 we have chosen a few of the most representative SWFs based on the size of their assets, and examine in detail their history, purposes, organisation, portfolios and transparency.

The importance of SWFs on international financial markets leads us in Chapter 4 to study their investment strategies, with the help of various academic studies, so as to be able to quantify their impact on financial markets. At least for now, empirical evidence seems to suggest that stabilising factors outweigh the negative ones, even if this evidence is not univocal and further research is required.

In Chapter 5 we deal with the feared intertwining of economics and politics in SWFs and the possible geopolitical consequences of their rise. There is widespread belief that transparency and good governance are the keys to alleviating fear and keeping markets open. But measuring the transparency of each SWF presents us with the worrying fact that the largest SWFs are on average the least transparent, and the least transparent SWFs are typically based in non-democratic countries. Of course, when dealing with transparency and good governance, two aspects cannot be forgotten, and in this chapter will not be. Firstly transparency and good governance must be assessed not only from Western countries' point of view, but also from the perspective of the citizens of the countries owning the SWFs, the final owners of their wealth. Secondly, in the plea for transparency, all the actors involved in financial markets must be treated according to the same principles.

Various governments – including those of the United States, Germany and France – have discussed and in some cases taken action to limit foreign direct investment by SWFs. International institutions, however, have tried to formulate a multilateral framework for the issue. The approach of individual countries, and the European Commission, will be examined in Chapter 6, and that of the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) in Chapter 7.

Who This Book is For

This book adopts a careful empirical approach to an area hitherto mired in obscurity and suspicion, and attempts to clarify and synthesise all that can be known about a very complex matter. It should therefore prove of use to a wide audience. This will range from economic and financial operators, to academic scholars and policymakers.

As will become clear in the course of this book, no cartoon villain or hero will in fact materialise. SWFs are neither enemies nor saviours. They are simply investors with a marked and lasting influence on financial markets. Being familiar with them is crucial to understanding their behaviour, as well as rendering them responsible actors in more efficiently-regulated markets and a broader integrated world economy.

* * *

This new edition of the book is the joint work of the two authors, who have joint responsibility for the contents. Valeria Miceli has entirely written Chapters 3, 4 (as in the Italian edition) and this version of Chapter 5. These chapters have been significantly expanded in this English edition.

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This study was undertaken by the authors at the Centro di Ricerche in Analisi Economica ed Economia Internazionale (Centre for Research in Economic Analysis and International Economic Development), also known as CRANEC, at the Catholic University of Milan.

Milan
15 February 2010

1.

How and When Sovereign Wealth Funds Came About

The history of sovereign wealth funds can be divided into four phases, beginning in 1953. In that year, the first authority that foreshadowed a SWF was founded: the Kuwait Investment Authority (KIA). From then on, SWFs, new entities in finance and the world economy, grew and spread throughout various countries. SWFs were to assume three basic features: they originated from foreign currency surpluses; they were owned and managed by sovereign states or their emanations; and they were financially earmarked mainly for extra-national purposes.

According to analysis by Griffith and Ocampo[2], the accumulation of foreign-exchange assets and the subsequent decision to establish a SWF is typically based on four types of motives:

1. 'wealth substitution' or transforming natural resources into financial assets
2. 'resilient surplus', in case of long-lasting current account surpluses that cannot be corrected in the short-run by exchange-rate appreciation
3. 'counter-cyclicality', to absorb temporary current account surpluses and/or booming commodity prices
4. 'self-insurance', associated with reducing the risks of pro-cyclical capital flows.

The last two strategies, even if rational from the point of view of the individual country, help fuel global imbalances and the consequent instability of the world economy. As we will see, in each of the phases in the development of SWFs, the above motives have had different relative importance. This has given rise to different types of SWFs in terms of origin, nature and purpose, and consequently in their investment strategies.

The initial phase that started in 1953 intensified in the 1970s, with the start-up of several SWFs in countries with surpluses from oil exports (which grew with the increase in the price of crude oil, and continued until the first half of the 1990s). In this period, the motives for creating most of the funds were wealth substitution and counter-cyclicality.

The second phase began in the late 1990s and ended in 2004. In addition to the oil SWFs, there were growing numbers of SWFs emerging from Asian countries, which benefited from enormous trade-balance surpluses from exports of manufactured goods. By accumulating and managing currency reserves, these SWFs pursued a strategy of covering the risks from the kinds of financial and currency crises which had characterised their recent past (self-insurance).

The third phase covered the recent years from 2005 to 2008, when the term ‘sovereign wealth funds’ was first coined and SWFs came to the attention of the broader public (and not just financial operators). In this phase we also saw a change in the attitude of countries receiving SWF investment: from caution if not hostility towards SWFs, to appreciation as lenders of last resort able to help them resist banking and financial turmoil.

The financial crisis beginning in 2007 opened a fourth phase that was still underway in 2010. In this phase, SWFs have had to come to terms with significant losses, and financial markets in difficulty everywhere. This has caused their investment activity to substantially contract. Only since the second half of 2009 have they really returned to the fray, with targets and strategies adjusted to the changed financial scene. They have proven, so far, to now be major players in international financial markets, willing to behave responsibly and cooperatively.

From 1953 to the Mid-1990s: Unknown Actors

This first phase has two milestones. The initial one came in 1953 with the establishment of the Kuwait Investment Board, which then became the Kuwait Investment Authority (KIA). This was actually not a real SWF, but an authority, according to the criteria listed in Chapter 2. Nevertheless, KIA was in substance a SWF, because its specific purpose was to invest surpluses derived from oil revenues so as to reduce Kuwait’s dependence on exhaustible fossil reserves, thus lessening the effects of price oscillation. Thus oil revenues were converted into financial investments; mostly fixed-interest, low-risk securities.

The second SWF, established with a specific legal status, was created by the British colonial administration of the Gilbert Islands in 1956, to capitalise on the revenues from phosphate by investing them in diversified shareholdings. The Revenue Equalization Reserve Fund was and is certainly not comparable in size to those generated by oil revenues or other revenues mentioned later. But compared to the size of the economy of its host (now the Republic of Kiribati), the stock of assets accumulated by this SWF is in the present-day three times greater than their GDP.

In the 1970s the rise in the price of oil from under US$5 a barrel to more than US$35 in 1980, the year after the Khomeini revolution, made it possible for exporting countries to rapidly accumulate enormous financial wealth. These revenues were partly spent domestically, with the resulting push of domestic inflation. Consequently oil revenues were increasingly allocated to foreign direct investment. We can see in this accumulation of foreign assets and the subsequent decision to establish SWFs with them, the prevalence of wealth substitution and counter-cyclical motives. The purpose indeed was to create diversified sources of income other than oil, in order to counterbalance the depletion of this raw material and its price fluctuation, but also to protect domestic wellbeing. An additional motive might have been political, too, as governments in emerging oil-exporting countries often need to maintain control of wealth in order to strengthen their internal political power as well as gain support from developed countries interested in receiving petro-dollar investment.

Various countries, in particular the members of the Gulf Cooperation Council (GCC), launched new SWFs: the United Arab Emirates (UAE) established the Abu Dhabi Investment Authority in 1976, and in the same year Kuwait founded another fund, the Future Generations Fund, which was managed by KIA.

Even in developed countries, the increase in oil prices and prices of raw materials in the early 1970s brought about the launch of two oil-based SWFs in 1976: the Alaska Permanent Fund Corporation in the United States, and Alberta's Heritage Fund in Canada.

In this phase, another type of SWF was also established: the non-commodity SWF. In 1974 the Singapore government founded Temasek Holdings, while in 1981 the Government of Singapore Investment Corporation (GIC) was also set up. Both fitted into Singapore's growth strategy, as a city-state with too small a domestic market to generate sufficient consumption and investment demand to use its currency and fiscal surpluses. Of a similar nature, Malaysia's Khazanah Nasional Berhad was set up several years later in 1993.

The 1980s and 1990s featured two large-scale international dynamics which affected SWFs: a fall in the price of oil in the 1980s and the wave of growing globalisation in the 1990s.

The oil price fell below US$20 a barrel in the mid-1980s, staying below this level until the end of the 1990s except for a price upsurge during the Iraqi invasion of Kuwait. These downward price fluctuations reinforced the belief of governments running SWFs that their income should not depend solely on oil and natural gas. This meant reinforcing the counter-cyclical component at the base of the decision to establish SWFs. Thus other SWFs were launched, including the State General Reserve Fund of Oman in 1980, and, in 1981, the Libyan Arab Foreign Investment Company, fuelled by proceeds from natural gas fields discovered in the 1970s and 1980s. In 1983, the Brunei Investment Agency was established, and in 1984 so too was the Abu Dhabi International Petroleum Investment Company.

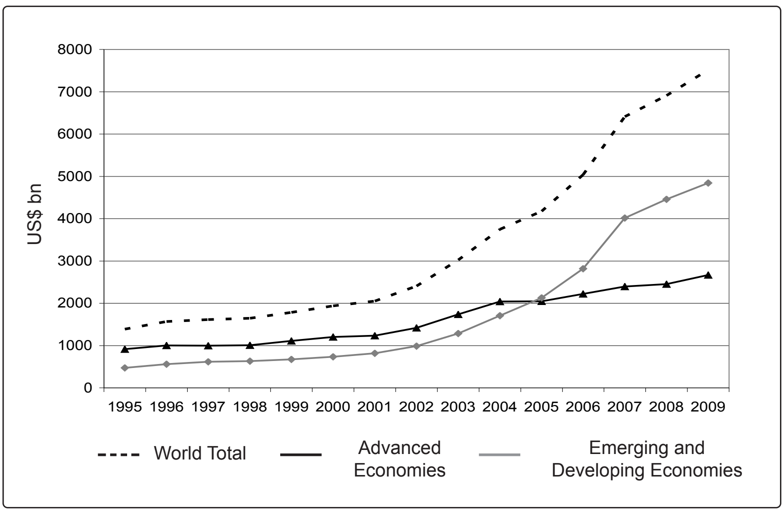
The advent of globalisation contributed significantly to the growth of SWFs, facilitating the international movement of capital and direct investment abroad. The year 1990 was the second great milestone in the initial phase of SWF history, with the establishment of the Norwegian Government Pension Fund, currently the second-largest SWF in the world. This initiative must be seen as an answer to the needs of wealth substitution and counter-cyclicality, as well as an attempt to avoid 'Dutch disease'. (Dutch disease being the fate which befell a Holland briefly rich with North Sea natural gas in the 1960s. The currency of the commodity-rich nation rose too far, distorting the economy.) Indeed, in the case of an advanced country like Norway, it makes economic sense to prefer long-term savings to domestic spending on internal investment.

During this first period, spanning more than 40 years, 16 SWFs (refer to the classification provided in Chapter 2) were established. Their investment strategies remained conservative and prudent with portfolios largely composed of low-yield, mainly US government securities. In this period they sought and maintained a very low profile. As a consequence they were almost unknown even to the financial community.

From the Late '90s to 2004: Emerging From Anonymity

Emerging countries' impressive accumulation of foreign exchange reserves was a characteristic phenomenon of the first decade of the 2000s. Following the currency crisis that hit emerging economies in the 1990s (particularly in the latter half of the decade), many countries, and especially those hardest hit, proceeded to systematically accumulate reserves well in excess of short-term external liabilities (the level suggested by the so-called Guidotti-Greenspan rule).

Figure 1 – Total foreign exchange holdings in US$ billion (1995 to third quarter 2009)



Source: Our elaboration on IMF, Currency Composition of Official Foreign Exchange Reserves (COFER) Database, accessed February 2010.

Self-insurance is one of the most commonly accepted explanations of why developing countries decide to hold an excessive level of foreign reserves with all the costs this choice implies[3]. Another possible explanation is mercantilism (fostering export competitiveness). For some countries the rationale of hoarding reserves stems from an aggregation of several motives: in the aftermath of the East Asian crisis self-insurance dominated, while after 2000 other motives must also be taken into account[4].

Just after the various financial crises of the late '90s, emerging countries, facing growing financial instability in a more interconnected world, rationally decided to self-insure themselves to avoid having to resort to the IMF with its principle of conditionality, thus minimising the risks and associated costs of future crises. Excess reserves may therefore be correlated with the volatility of capital flows and eventually to the level of a country's financial openness. Obstfeld et al[5] have conducted an empirical study that clearly shows a statistical and economically significant correlation of reserve levels with financial openness and financial development, especially in the years after the Asian crises. Indeed, countries that gradually liberalised capital markets have been less exposed to financial crises. If hoarding reserves is a rational answer from an individual country's point of view, however, from the collective point of view this strategy appears dangerous, since it contributes to feeding global imbalances, with some countries accumulating large debts and others accumulating excessive currency-exchange surpluses.

Since this huge level of reserves generates two types of costs both in terms of lower yields and the sterilisation necessary to avoid inflation, the debate in economic literature is open as to why countries choose to self-insure themselves instead of closing capital markets. The answer according to Rodrik[6] is that closing to financial liberalisation is difficult due to interest-group pressure and the practical difficulty nowadays of controlling and preventing massive capital outflows.

In the face of the significant costs entailed in maintaining huge reserves, several emerging countries decided to allocate part of their currency reserves to new investment vehicles able to prefer yields over liquidity. Thus the Chinese SAFE Investment Company was established in 1997 and the Hong Kong Monetary Authority Investment Portfolio in 1998. Following the same logic, the Korea Investment Corporation was created in 2005.

While some Asian countries which accumulated huge currency reserves only recently set up SWFs with modest asset levels compared to the size of their respective reserves, the Middle Eastern countries and other oil- and gas-exporting countries chose the opposite strategy. They chose to invest their wealth mainly in other investment vehicles including sovereign funds, to the detriment of their currency reserves.

At the same time, growing demand in emerging economies, especially Asian ones, pushed up oil prices from less than US$20 a barrel at the end of the 1990s to almost US$40 in 2004. Oil-exporting countries, including those of the GCC, benefited from this significant increase in the price of oil and gas, pouring revenues into funding their SWFs. This time, these countries were determined to avoid the waste and inefficiency that characterised what happened to the oil windfalls of the '70s and decided to transfer part of this windfall to SWFs. At the turn of the century the number of SWFs grew substantially; between 1998 and 2004 15 SWFs were established. Most of them were commodity based. The Iranian Oil Stabilization Fund and Azerbaijan's State Oil Fund were both set up in 1999, the Algerian Revenue Regulation Fund and Kazakhstan's National Fund in 2000, Abu Dhabi's Mubadala in 2002 and Istithmar World (owned by Dubai World) in 2003. In 2004 Nigeria's Excess Crude Account and Russia's Stabilization Fund of the Russian Federation (oil-based) were set up.

In 2003 the New Zealand Superannuation Fund was created. In this case the rationale was different and was related to the need to meet this government's future liabilities for the payment of pensions in an ageing society. The same rationale was at the base of the establishment, in the following phase in 2006, of the Australian Government Future Fund.

At the end of this period the total assets held by SWFs were estimated at US$895 billion, according to Rozanov[7].

From 2005 to Mid-2008: Emerging Overactive Giants

In this period SWFs entered the limelight of world news, and caught the interested and concerned attention of institutional players (national and supranational) and public opinion in Western democracies. There was a growing realisation of the influence these players could have on global markets as major investors. Overall reactions were quite troubled; one critic viewed them as "barbarians at the gate"[8], ready to take control of Western interests.

In 2005 the expression *sovereign wealth funds* was coined by Andrew Rozanov[9] of State Street Global Advisors. This designated investment entities, different from public pension funds and currency reserves, that have among their objectives coverage from excess volatility of energy raw-material revenues, accumulation of wealth for future generations, and economic and social development. Rozanov recognised that many of these funds were not new, but their increasing numbers throughout the world and the rapid growth of their assets justified specific attention. His article marked the starting point of a growing interest on the part of operators and scholars, which led to a proliferation of research on the topic. Whereas researchers took some time to acknowledge their significance, though, banks and financial market players were quicker.

There are several causes for the growing importance, sudden visibility and global relevance of SWFs in this phase.

1. The considerable growth of their assets following the increase in the price of oil (and of natural gas and raw materials), which rose from US$60 a barrel in August 2005 to US$147 on July 11 2008, as well as the emerging exporting markets' growing accumulation of significant currency reserves, a trend which had already begun in the preceding phase.
2. The increase in the number of SWFs, with a concentrated group taking shape in emerging markets. In this period 19 SWFs out of 53 were established. To cite the most important in terms of asset size: China Investment Corporation in 2007; the two Russian funds in 2008 deriving from the split of their forerunner, the Stabilization Fund of the Russian Federation; the Libyan Investment Authority in 2006; Qatar Investment Authority in 2005; the Investment Corporation of Dubai in 2006; Korea Investment Corporation in 2005; Bahrain

Mumtalakat in 2006 and the Chilean Economic and Social Stabilization Fund in 2007.

3. The activism of SWFs in terms of international investment, particularly accentuated from the beginning of 2007 to mid-2008, with two-thirds of all transactions undertaken by SWFs registered in the period 1995 to mid-2008[10]. The increasing average size of the deals, and the astonishing total amount invested in this period, contributed to rising concern.
4. The shift from west to east and from developed to emerging countries in the geoeconomic and political global balance of power.
5. The tendency of SWFs to maintain secrets. Their opacity has in fact been one of the reasons for major concern.
6. The entry into the game of Russian and Chinese SWFs. Since these funds belong to non-democratic, non-allied world powers, they triggered particular worries of a geopolitical nature in the US and Europe.
7. The fact that SWFs represent a form of state capitalism in which decision-making mechanisms and investment time-horizons are different from those of the dominant (prior to the crisis) laissez-faire economic policies. As anyone knows, the excesses of freeing the market from rules has lost much credibility over the last two years, generating a revival of governments' economic role in developed countries as well.

Along with these factors, we should also consider two macro trends which characterise the destination of investments by SWFs.

One trend is geoeconomic in nature: the SWFs which first invested mainly in Asia turned towards the European Union and the United States. In dollars, from 1994 to 2004, SWFs invested just under US$15 billion in Asia and less than US$1 billion elsewhere. In 2008, up until October only US$3.5 billion was destined for Asia, US$11 billion to the EU, US$30 billion to the United States and US$1.5 billion to other countries. This shift also explains why, especially in 2007, SWFs leapt to the attention of the European Union and the United States: in less than two years, about US$26 billion was invested in the EU, and US$64 billion in the United States[11].

The other macro trend is sectoral, with the distinct preference of SWFs in 2007 and 2008 for the banking and financial sector. In just the first quarter of 2008, SWFs spent US$58 billion in Western financial institutions[12]. For the whole year, investments in the financial sector represented 96% of the total value. The surge of the financial sector is a recent phenomenon: in 2006 this sector attracted less than one fifth of SWF investment and still less in previous years. There are various reasons for sectoral imbalance in the activity of SWFs: expectations of formidable profits following those the sector had generated in the years 2000-2006; reputedly cheap share prices in 2007 and 2008 (in fact the market value of many large banks fell by 20-60% in just 18 months); the sector's strategic role; and pressures from Western institutions and financial operators to bail-out Western banks.

This table lists the main investments by SWFs in Western banks in the period 2006 to mid-2008.

Table 1 – Main investments in Western banks (2006 to mid-2008)

Date	SWF	Target	Value ($ million)
27 Mar 2006	Temasek	Standard Chartered	4,000
06 Oct 2006	Istithmar	Standard Chartered	1,000
23 Jul 2007	Temasek	Barclays	2,000
27 Nov 2007	ADIA	Citigroup	7,500
10 Dec 2007	GIC	UBS	9,760
19 Dec 2007	CIC	Morgan Stanley	5,000
27 Dec 2007	Temasek	Merrill Lynch	4,400
15 Jan 2008	GIC	Citigroup	6,880
15 Jan 2008	KIC	Merrill Lynch	2,000
15 Jan 2008	KIA	Merrill Lynch	2,000
16 Jan 2008	KIA	Citigroup	3,000
28 Jan 2008	QIA	Credit Suisse	3,000
8 Feb 2008	GIC	UBS	14,400
25 Jun 2008	QIA	Barclays	3,500
27 Jul 2008	Temasek	Merrill Lynch	3,400

Source: Bortolotti, Fotak, Megginson and Miracky (2009); Financial Times.

Finally, we should also consider the behaviour of the institutional, national and supranational recipients of SWFs. There are three distinct trends in this regard.

The first emerged in 2007, when various governments expressed concern and caution about SWF investments, specifically their investments in strategically sensitive companies. Several developed countries introduced or revitalised prudential regulations. There are at least two reasons for this reaction: the need to have transparent, market-driven investors; and for political reasons, since many SWFs are established in non-democratic countries.

The second trend took shape in the second half of 2008 as the financial crisis progressed. At this point the desire emerged in various countries to have SWFs as investors: to this end, heads of governments and ministries sent missions to countries with SWFs to incentivise these investments. From "barbarians" they became lenders of last resort for the shaky financial sector. Given their orientation to long-term instead of short-term capital gains, they initially helped mitigate the crisis of international financial markets, contributing to recapitalising Western banks in particular.

The third trend, which overlapped time-wise with the previous two, regarded international institutions and the European Union. In 2008 the European Commission set down guidelines for SWFs. Then the IMF, in agreement with the SWFs, launched voluntary regulations (the so-called Generally Accepted Principles and Practices (GAPP) or Santiago Principles, which we will discuss in greater detail in the last chapter) to ensure that the funds operated as fair market players.

From numbering 17 before 1997, in 2004 there were 34 SWFs and by 2008 there were 53. They went from the level of managed assets of US$500 billion in 1995 to nearly US$900 billion in 2004, and from there to an amount of total assets of between US$3,300 and US$4,000 billion (this figure fluctuates according to the estimates adopted) at the end of 2008[13].

From End-2008 Onwards: Reshaping Strategies

Since August-September 2008, the investment activity of SWFs has slowed for four reasons:

1. losses accumulated over the last year mainly from shareholdings in the US and European banking and financial sectors
2. the fall in the price of oil which went down from US$147 a barrel on July 11 2008 to US$40 a barrel at the end of December 2008, to recover to almost $80 by December 2009
3. the global recession, which contributed to shrinking Asian exporters' current account surpluses and levelling global imbalances
4. the risk in the home economies of SWFs due to the worldwide financial crisis.

The investments of SWFs in Citigroup, Barclays, Credit Suisse, UBS, Morgan Stanley and Merrill Lynch generated losses in value ranging between 60% and 90%[14]. These losses, mostly unrealised, were partially absorbed in 2009. Even if they have never been completely disclosed, according to some estimates they exceeded US$57 billion as of March 2009[15]. Thus the crisis hit SWFs very hard. They and the rest of the world discovered that they were not unbeatable, nor able to escape the financial storm.

In addition, SWFs were asked to provide support to domestic markets. Most countries in difficulty used their excess resources to tap budget deficits or provide stimulus packages, supporting domestic markets and institutions (Russia, Ireland, Kuwait, Qatar, UAE).

In 2009, the value of assets held by SWFs fluctuated, according to our estimates, between US$3,200 and US$3,800 billion.

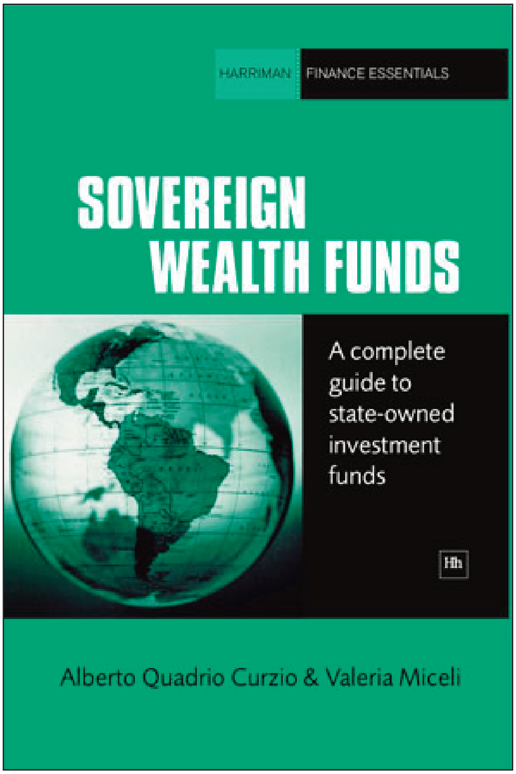
After a period of retrenchment and a slowdown of investment activity, SWFs like many other investors used this break to rethink the structure and allocation of their portfolios and to adapt investment strategies to the changed financial scenario. The possible long-term challenges entailed a review of reserve levels versus SWF assets, redefining the proper level of asset diversification, changes in risk-management policies and targets, and increased scope for more active corporate governance. Moreover the new investment strategies of SWFs had to take into account the long-term development needs of their own countries and regions, their economic diversification and technological progress. Indeed, SWFs are increasingly subject to the scrutiny of domestic public opinion.

The image of SWFs has constantly changed and they have had to quickly adapt to changing circumstances. They are not, as said, enemies or saviours; they are investors with a strong and lasting influence on financial markets. While it is legitimate to ask them to be more transparent, a symmetrical request must be addressed to other financial actors such as hedge funds, private equity and investment banks if the mistake of using double standards is to be avoided. After the adoption of the Santiago Principles and the establishment of the International Forum of Sovereign Wealth Funds (IFSWF), SWFs seem willing to assume the role of responsible investors more involved in shaping the financial and monetary global framework. This is good news for the international community.

Small Companies, Big Profits

A complete guide to state-owned investment funds

Alberto Quadrio Curzio & Valeria Miceli



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