

**Testimony of Gerard Lyons, PhD, Chief Economist and Group  
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**before the**

**Committee on Foreign Affairs, U.S. House of Representatives**

**regarding**

**The Rise of Sovereign Wealth Funds: Impacts on U.S. Foreign  
Policy and Economic Interests**

**Wednesday 21<sup>st</sup> May, 2008, Washington D.C.**

## 1. Oral testimony and overview

Chairman Berman, Ranking Member Ros-Lehtinen and members of the Committee, I appreciate the opportunity to testify here before you on the rise of Sovereign Wealth Funds and the impact on US foreign policy and economic interests. I will offer brief oral testimony and respectfully request that my complete written statement be entered into the record. That written statement is a short background paper that looks at Sovereign Wealth Funds (SWFs) in terms of the context surrounding them, issues they raise and the implications. In the brief time we have this morning I would like to make some specific points directly linked to the topic of today's session, namely the implications for US foreign policy and economic interests.

SWFs are not new. Some of the oldest funds have been around for half a century. Many SWFs have a long history of investment without problems. Thus it is important to take a balanced perspective of SWFs, and for many people SWFs are not a concern. However, as these funds increase in size, importance and economic impact, many issues arise that need to be considered. I would like to highlight three broad areas.

First, in macro-economic terms

I believe SWFs should be seen in the context of a significant change in the world economy, whereby emerging countries are seeing a rise in their economic and financial power; whilst high commodity prices and China's exchange rate policy are important contributory factors to the growing size of SWFs.

Another aspect of this shift in the global economy is rising intra-regional trade within Asia, largely because of the opening up of China, and increasing inter-regional trade between Asia and other regions such as Africa, Latin America, the Middle-East. This includes increased flows of goods, commodities, people, remittances and increased capital flows. These new trade corridors need to be taken into account when one views the likely future role of SWFs. I would expect SWFs to allocate an increased amount of their future investment to emerging economies and, in all probability, away from the dollar. And, if recent experience with SWFs is a guide, we should expect to see governments playing an increasing role in future business flows.

One way to view SWFs is a reflection of imbalances in the world economy. This imbalance has seen a sizeable US trade deficit and flows of capital from the East to the West. A correction of this imbalance is underway. From a US perspective this is already evident in terms of a period of weaker, below trend growth and a weak dollar. For the rest of the world there is a need for steady growth in other major economies such as Europe and Japan and, equally importantly, the need for surplus economies in the Middle East and across Asia to switch their savings into increased domestic demand at home. This will require a number of factors, including deeper and broader financial markets across economies in regions such as Asia and the Middle East. Although this is happening in some countries, it needs to occur on a broader scale. In the case of China, as part of this financial development there is a case for arguing that their currency should appreciate at a faster pace.

Second, State Capitalism and the role of governments

In my view, it is what I call State Capitalism that should concern us, rather than SWFs themselves. State Capitalism is the rising role of government ownership and management of international assets. Indeed, the important issue regarding SWFs is not that these are foreign but that they are government owned. Many countries in the West, including the US and UK, have no problem with foreign investment. Indeed both have a long history of welcoming such inward foreign investment. Government controlled funds are different from private sector flows, acting in the interests of a state, on behalf of its people, rather than a company or individual investors. This raises at least the question of how these funds might seek to use their investments and the leverage they bring. It is important to stress that there are some generic issues. Many of the concerns are not, strictly speaking, just about SWFs but are often more about government controlled companies, particularly in countries such as Russia and China.

I think it is important that the government and business in the US – and indeed in other Western economies - need to have complete confidence in the robustness of their present legal, competition and regulatory set-up to cope with any issues arising from SWFs. Just as the UK needs to be able to safeguard British interests, so too must the US safeguard American interests, and both countries must ensure they remain open to investment and provide input into the current multilateral approaches being adopted by both the International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD).

When one views the role of government alongside the matter of energy security there are wider issues that need to be considered. This is perhaps best highlighted by the increased flows between China and Africa, where China's interest in Africa has helped to correct perceptions of the chronic undervaluation of African assets. This raises the possibility of sizeable capital inflows to developing countries, on a scale that would dwarf traditional reliance on aid flows. The OECD has made this point, highlighting that, "If SWFs chose to allocate 10 per cent of their portfolio to emerging and developing economies over the next decade, this could generate inflows of \$1,400 billion, more than all OECD countries' aid to developing economies put together." The developmental impact, allowing for much more rapid progress, would be huge. But the nature of the new economic engagement must also be closely monitored. Vulnerable states, in need of quick financing, with no access to international capital markets and the investor scrutiny that results from such access, may build up debt at a rapid and unsustainable pace. Even more worrying, with little experience in dealing with SWFs, or with government controlled firms, they may not pay much attention to what is required of them in return.

One issue not fully covered in the present approach is that of intellectual property. If a SWF acquired a minority stake, such intellectual property may not be lost, but it could with a majority stake. But even then, how could safeguarding intellectual property be enforced, particularly where the people in any company may be a key part of that skills advantage? Moreover, if a fund owned the company or was the majority investor then it would be entitled to the intellectual property, and the innovator would be rewarded, whilst the country of the SWF benefits from the knowledge. The issue this raises may be more to do with the need for a level playing field, and the need to remove restrictions in a SWF's own market. This issue, moreover, also needs to be seen in the context where there is a general assumption that as the world economy changes, it is economies in the West that will gain from being knowledge based economies. That cannot be taken for granted, as there is every reason to believe that economies around the world, including those that

have SWFs, will be keen to move up the value added curve very quickly. Ensuring enforceable global standards on patents and intellectual property appears an important aspect of this debate.

Third, a Code of Conduct for SWFs

In its Statement at the October 2007 IMF, the G7 said that they see, “merit in identifying best practices for SWFs in such areas as institutional structure, risk management, transparency and accountability.”

One can analyse SWFs in terms of their openness and transparency. Some funds, such as Norway, Temasek and Alaska, are open and transparent, providing detailed information on their size, returns and portfolio composition. In turn, some SWFs are very opaque. One can link this issue of openness and transparency into the wider debate over accountability, governance and their investment strategy. Because SWFs are government controlled an issue is whether their investments are commercially or strategically driven. The record to date is that investments appear largely commercially driven.

In a detailed analysis last summer, I suggested that in the future SWFs will take bigger financial stakes in equity and bond markets across emerging economies; to feed more money into alternative investments such as hedge funds and private equity; to boost strategic links with countries that have not shared fully in globalisation or which have been shunned by the West; and to take strategic stakes in sensitive areas within developed countries. My view of strategic stakes included securing intellectual property rights, or taking positions in key industries such as telecommunications, energy and the financial sector. The subprime crisis has, indeed, seen huge capital injections by SWFs into many western financial firms, but this has been generally welcomed, with such stakes preventing, or at least delaying, a consolidation of the financial sector. It has also prompted debate as to whether SWFs should take a more active role in poorly managed firms, or should continue to invest passively, often through third parties as they do at the moment.

In recent months SWFs have been more prepared to engage in discussion on these issues. This has been welcome. It is clear from much of that debate that SWFs do not wish to be discriminated against. That is fair. The feeling amongst many is that is that their record of being responsible and disciplined investors makes the case for increased regulation and for a Code of Conduct unnecessary.

It is hard to argue against an investment framework that is fair and commercially driven, with clear, predictable rules that apply to everyone. But, in my view, this does not argue against a Code of Conduct. Rather such a Code is there to reflect the growing scale of these funds and their increasing importance. And of course there may be the need for Codes to be introduced in other areas. Ideally this Code should be voluntary and should include: clarity over the motivation for the Code; the need for clarity of objectives and investment strategies; the need for best practice on corporate governance and on accountability and the need for greater transparency regarding transactions. The issue of enforceability also needs to be considered. Whilst secrecy in itself does not mean that a fund will be a bad investor, in a global financial environment where transparency and accountability are seen as important positives, such opaqueness should not be encouraged.

There is a need for common ground rules, best practice, and the need to promote an investment framework that is fair and commercially driven. Any constraints on SWFs should be based on an objective appraisal of facts within a stable framework of roles and processes. Yet, as long as investments by SWFs are made for commercial reasons and not for political purposes then these funds should be accepted.

Here follows the briefing paper on SWFs.

## **2. SWFs in context**

SWFs are not new, in fact the oldest dates from 1953. Given how old some of these funds are, one might ask, why all the recent fuss? There are a number of reasons. The number of countries with SWFs is increasing, the amounts at their disposal are rising and the possible investments are becoming more controversial. Moreover, to quote European Commissioner Peter Mandelson, "there is a heightened need for reassurance" when one considers that the biggest new funds are in countries such as Russia and China, countries that as he says are, "new investors, with huge reserves, backed by governments with mixed democratic credentials, substantial foreign policy projection and no track record as investors." Whereas, Mandelson goes on to say that he believes the risks are overstated and our ability to cope with them is likely understated, the main point is that there are risks.

There is an important aspect that needs to be addressed up front, and that is how one defines a SWF? The IMF recently noted twenty six different definitions. The key characteristic is that they are owned by a sovereign state. Exceptions being, sub-national level funds financed by foreign exchange assets, resulting from commodity exports, which allows one to include Alaska from the US or Alberta from Canada. They are not central banks and, in that respect, I would not include Saudi Arabia's funds managed by their central bank, although some others do. SWFs are not pension funds, unless financed by foreign exchange assets from commodity exports, such as Norway's Government Pension Fund.

There are four main sources for where SWFs derive their funds: (a) revenue from commodities, with 16 of the largest 22 funds depending on commodity income; (b) foreign exchange reserves, particularly important for China's SWF; (c) investment income, which is very important for, for instance, Temasek; and (d) discretionary factors that may influence how much money governments allocate in the start-up phase.

The US Treasury, in their various comments on SWFs, tends to differentiate between SWFs funded by commodities and those funded by non-commodities and, in turn, has linked this to the different asset-liability structure of such funds. Also, the funding of SWFs from non-commodities can be linked to the debate about foreign exchange rates and, in particular, to intervention by China to keep its currency undervalued, whilst building up its foreign exchange reserves.

The size of SWFs is also an issue. In a detailed analysis carried out last summer, we estimated their size at \$2.3 trillion, but there is a wide range of opinion. Generally \$2-3 trillion is cited, although in an analysis in April 2008 by the London based International Financial Services (IFSL) put their size at \$3.3 trillion. Whether one views this as large or small depends on the benchmark, but they are getting bigger. This amount is small in one respect, representing 1.3% of global financial assets, but is sizeable in another respect, being larger than hedge funds, which are between \$1 trillion to \$1.5 trillion, although they

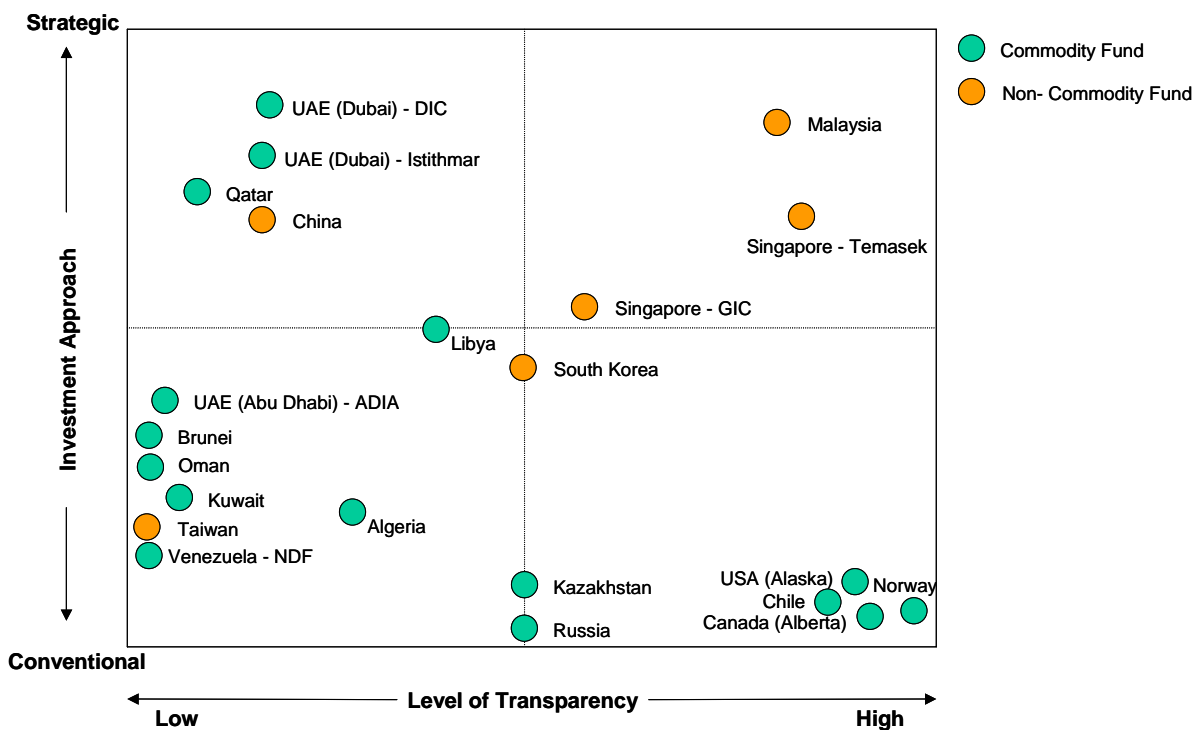
leverage up, and larger than private equity, at \$0.7 trillion to \$1.1 trillion. It is hard to gauge the future size of SWFs, but on current trends they could exceed foreign exchange reserves in five years or so and even reach \$13.4 trillion in a decade. However, an unwinding of global economic imbalances could, it is said, significantly reduce their future rate of growth. All things considered, it is hard to quantify the future scale of SWFs, but in qualitative terms they are likely to be sizeable.

In our analysis of SWFs we determined that there is also significant concentration amongst SWFs, with a Super Seven funds. Using the recent data from the ISFL, the size of these funds is now: Abu Dhabi Investment Authority (ADIA) (\$875 billion); Norway (\$396.5 billion); GIC of Singapore (\$330 billion); Kuwait (\$213 billion); China (\$200 billion); Russia (\$128 billion); and Temasek of Singapore (\$108 billion).

Overall the top ten SWFs are probably now around \$2.3 trillion. In terms of concentration this compares with: the top ten asset managers, \$13.4 trillion; the top ten central banks \$4.4 trillion; the top ten state pension funds \$2.9 trillion; the top ten corporate pension funds \$0.7 trillion; the top ten hedge funds around \$252 billion; and top ten private equity \$236 billion. One could also include wealthy individuals.

Another distinguishing characteristic is to define SWFs in terms of their openness and transparency. Some funds, such as Norway, Temasek and Alaska, are open and transparent, providing detailed information on their size, returns and portfolio composition. In turn, some SWFs are very opaque. One can link this issue of openness and transparency into the debate over accountability and governance. One could also try and differentiate between SWFs based on whether their investment strategy is commercially or strategically driven. Examples of conventional investors would be Chile, Russia, Kazakhstan or Norway, whilst strategic investors might include Malaysia or some of the Middle East funds. The following chart compares the major funds in terms of transparency and investment.

## **Chart 1: The Largest Sovereign Wealth Funds Overview of Investment Approach and Transparency**



Source: Standard Chartered and Oxford Analytica

Based on the main objective of each fund, the IMF has identified five types of SWFs: (a) stabilisation funds, whose aim is to insulate the economy and budget from swings in oil or commodity prices; (b) savings funds, aimed at converting non-renewable assets into a more diversified, longer-term portfolio; (c) reserve investment funds, whose aim is to increase the return on reserves; (d) development funds, that help fund or promote policies in the home country; (e) contingent pension reserve funds, that add towards funding pension liabilities. Yet, these need not be distinctive features of a SWF, and a fund may have multiple, overlapping objectives that change over time. Chairing a session on SWFs at an OECD conference at the end of March there was much suggestion from the funds present there that they would focus more on the development agenda in their own country in the future.

Deputy Secretary of Treasury, Robert Kimmitt, in a recent article on Foreign Affairs, has talked about how one would view SWFs alongside other government financial groups, and thus he has talked about this in terms of the four sovereigns: international reserves; public pension funds; state owned enterprises; and SWFs. McKinsey's, meanwhile, have talked about the new power brokers, including: SWFs alongside; foreign exchange reserves; hedge funds and private equity. SWFs are becoming more important, both in their own right, and in the context of the ever changing global financial environment.

### 3. The issues raised

A sound analysis and clear understanding is needed of all the issues raised by SWFs. The question that immediately arises is whether SWFs represent a real or a perceived threat?

If I take the UK's experience, it would suggest the threat is more perceived than real. The UK's experience shows few examples of actual problems with SWFs; one such concern was in 1988, when there were concerns that Kuwait, which then had a 22% stake in BP, would bid for the company – the fear being an OPEC state would buy a stake in a leading oil company. But even if there have been few actual threats, the UK like other countries still needs to safeguard against any perceived threats, as well as wider ranging issues emanating from SWFs. Indeed, it could be argued that increased attention on SWFs in recent months has led to the funds themselves being more aware of the need for increased transparency.

At the World Economic Forum meeting in Davos this January, in the public session on SWFs, the point was made that SWFs are being seen as guilty until proven innocent! Furthermore, one could argue that many SWFs have a long track record as good investors. And, throughout much of the emerging world, SWFs are seen as a force for good. There are many aspects to this debate.

In my view, the main issue is not that SWFs are foreign but that they are government controlled. This means these funds could play by different rules, with possible different outcomes to those that would happen in a purely commercial environment, with national interest taking precedence over shareholder value. This links into a number of areas:

- Fiduciary responsibility: as government controlled funds may not be driven by the same commercial considerations as private firms this raises many possible issues, of which corporate governance and the fiduciary responsibility to shareholders are key.
- Inefficient allocation of capital: could such funds lead to an inefficient allocation of capital, as they are not driven by the same near-term commercial pressures as private companies?
- Financial stability concerns: There seems to have been a shift in thinking on this in recent months. Previously, there were concerns about their impact on future financial stability because of potentially large, concentrated and often non-transparent positions in certain markets and asset classes. Previously, to minimise the impact of rumours and speculation disrupting financial stability, there appeared to be a desire for greater predictability regarding SWF activity, although in practice it is hard to see how this could be possible. The sub-prime crisis appears to have changed sentiment. The injection of capital by SWFs into Western financial firms has prevented, or at least delayed, the consolidation of the financial sector. This welcome injection led SWFs to be seen as a stabilising influence. As John Lipskey, the IMF's First Managing Director said, "From the viewpoint of international financial markets, SWFs can facilitate a more efficient allocation of revenues from commodity surpluses across countries and enhance market liquidity, including at times of global financial stress."
- Strategic aims: A worry is that these funds see an opportunity to acquire strategic stakes in key industries around the globe. It is this that I call this State Capitalism aspect of SWFs that is of most concern. That is strategic investments in sensitive sectors whether telecoms, energy, media, maybe not necessarily in the financial sector, or whether it's to secure intellectual property rights in other fields. It

might make complete economic sense for countries, particularly as they need to move up the value curve, and it is clearly an issue that needs to be addressed.

According to the IMF, "It is unclear how active a role they have in these companies (in which they take stakes). However, the evidence suggests that SWFs are generally passive and long-term investors with no desire to impact company decisions by actively using their voting right.... That means that they vote by proxy and often ask external managers to vote on their behalf."

Also, it is important to stress that there are some generic issues. Many of the concerns are not, strictly speaking, just about SWFs but are often more about government controlled companies. For instance, Russia's SWF is relatively transparent, yet worries are very much focussed on Russian government influenced companies, such as Gazprom.

Is it possible to ensure that SWFs or government controlled companies like Gazprom will be good citizens? Can we seek some understandings that make a clear statement? For instance, in terms of a bid, is there a need to ensure that any offer documents include commitments on behalf of SWFs? One example might be the commitment that if an energy company was bought then there would be continuity of supply. But in addition to such a commitment, there is a need to consider how it can be enforced.

Other issues raised, include the role of SWFs on the decisions taken by the companies in which they invest. This has raised issues as to whether SWFs should be prevented from taking board seats; whether they should be limited to non-voting shares; or even whether where clear statements of commercial motive have not been forthcoming that guidelines could be set to include upper limits to investment stakes, setting these at a level significantly below the threshold of a controlling minority stake. Or, indeed, whether SWFs should be forced to invest via third parties. What happens if SWFs moved from minority to majority stakes, or if they take controlling stakes in monopolies? An interesting aspect of the recent debate has been the argument by some that rather than being passive investors, SWFs should be encouraged to be more active, particularly in terms of their recent investments in financial firms; the argument being that in such firms this would ensure management was kept on its toes!

The important issue is to address such concerns without unnecessary constraints on achieving an open and stable financial system, and one which encourages international flows. And it is important to ensure that recipient countries treat all investors, including SWFs, fairly. Indeed, various recent comments and speeches from US Treasury officials, including Mr Kimmitt, have focussed on the need to: a) avoid protectionism and counter product barriers; b) uphold fair and transparent investment frameworks; c) respect investor decisions; d) and treat investors equally. I agree with all these points.

In addition, the issue of reciprocity needs to be considered. The issue really should be about level playing fields and open access. In an ideal world it would be desirable to ensure that level playing fields exist between countries, but in practice this is hard to enforce, and it may be viewed as something that whilst desirable, could back-fire if seen as a necessary precondition before SWFs could invest in some economies or markets. The worry being that such an approach could provide an excuse for countries to pursue a protectionist stance. Furthermore, the West's approach to being open has not been based on ensuring level playing fields; rather it accepts that with countries at different stages of development, a level playing field is not a pre-requisite to allow foreign firms to operate in the West. In the

case of SWFs it would be hard to argue that a different approach should be adopted now, but other countries should be encouraged to cooperate fully in multilateral approaches to free-trade.

Quoting from this February's European Commission's report on SWFs, some underlying concern was evident, "Investment targets may reflect a desire to obtain technology and expertise to benefit national strategic interests, rather than being driven by normal commercial interests in expansion to new products and markets. By the same token, holdings could influence decisions by companies operating in area of strategic interest or governing distribution channels of interest to the sponsor countries. More generally, business and investment decisions could be influenced in the political interest of the SWFs owners."

One issue not fully covered in much of the debate – and a question is whether it needs to be – is that of intellectual property. If a SWF acquired a minority stake, such intellectual property may not be lost, but it could with a majority stake. But even then, how could safeguarding intellectual property be enforced, particularly where the people in any company may be a key part of that skills advantage? But rather than prevent majority stakes being bought, a better option may be to seek advances on transparency and motives behind these SWFs.

One issue that goes to the heart of the debate on globalisation, is that in the West there is an assumption that western economies will become the knowledge based economies, but SWFs and the shift in the balance of power, is likely to seriously challenge this thinking. Economies across the Middle East and Asia, for instance, will be keen too to become knowledge based economies themselves.

#### **4. Implications**

SWFs represent and reflect a major shift in the global balance of power.

SWFs also point to a dramatic rise in the role of government ownership and management of international assets, particularly commodities.

In the future, I would also expect the influence of SWFs on markets to grow, with SWFs investing more in four areas: in the nascent bond and equity markets across emerging economies; putting more funds into alternative investments, such as hedge funds and private equity; playing greater role in terms of State Capitalism, making strategic investments in sensitive areas; and investing in countries not benefiting from globalisation, such as across Africa, and this investment linked in to resource nationalism.

Thus, this issue needs to be addressed on a national and international basis.

Last October, at the International Monetary Fund (IMF) meetings in Washington, the US Treasury hosted an 'outreach dinner' with the IMF, OECD, World Bank and eight SWFs from Norway, Russia, Kuwait, UAE, Saudi Arabia, Singapore, South Korea and China. The day after that dinner the International Monetary Financial Committee (IMFC) then asked the IMF to look further into this subject. Since then there has been intense focus on this topic, at a global, regional and national level, with the OECD focussing on this issue from the perspective of recipient countries and the IMF looking at best practice for SWFs.

In its Statement at the October 2007 IMF, the G7 said that they see, "Merit in identifying best practices for SWFs in such areas as institutional structure, risk management, transparency and accountability." Furthermore, some of the issues raised regarding SWFs apply to government controlled companies across countries such as Russia and China.

The IMF is working on a framework for a voluntary code of conduct for SWFs, whilst the OECD is focusing on how recipient countries of the money from SWFs should respond.

All countries, including the UK and US need to have complete confidence in the robustness of their present legal, competition and regulatory set-up to cope with any issues arising from SWFs. They need to be both able to safeguard national interests, ensure their countries remain open to investment and to provide input into the current multilateral approaches being adopted by both the IMF and the OECD.

The US Treasury has argued that a voluntary code should address four areas: (a) the need for SWFs to invest commercially, not politically; (b) For SWFs to convey world class institutional integrity, particularly with respect to increase transparency; (c) to compete fairly with the private sector; and (d) to respect host country rules.

The US has a strong position, and is implementing the Foreign Investment and National Security Act (FISIA) through the Committee on Foreign Investment in the US (CFIUS), to ensure robust reviews of investment transactions, based on the consideration of genuine national security concerns and it requires heightened scrutiny of foreign government-controlled investments. In the UK, and indeed across Europe, there may be a need to view particular transactions on a case by case basis, particularly if they involve a change of ownership from private into public hands.

The UK's present approach also warrants international attention, as the UK is often seen as one of the economies most open to international business. The UK's approach is largely based on the view that ownership is not the issue. Whilst this may hold up with private companies (domestic or foreign) it needs to be established that this approach is also sufficient with respect to government ownership. Under the present UK regime, it is felt that competition and regulation are covered. Competition is covered by independent competition authorities, who provide sensible restraint without political interference. Likewise with regulation. In addition, the Enterprise Act covers exceptions, protecting sensitive areas, such as national security and the media.

One issue, sometimes raised by SWFs, is their desire for more clarity on what sectors they may, or may not, be able to buy into. That is more clarity on sectors that could give rise to problems. Many countries seek to protect their defence areas. The challenge is to impose safeguards on other sectors without been seen to be protectionist. But other countries do outline areas. For instance, France has a Code Monétaire et Financier. The law requires that investment in certain sectors require a specific authorisation by the French Minister of Finance: (i) sectors related to public security or national defence; and (ii) sectors in R&D or trading of arms. The regulations are more specific and define eleven sectors, related to areas such as defence, transmission technology and casinos.

Finally, if there was to be a Code of Conduct then, ideally, it should be voluntary, and it needs to cover:

- a) The motivation for the Code needs to be made clear;
- b) There is the need for clarity of objectives and investment strategies;

- c) The need for best practice on corporate governance and on accountability;
- d) There is a need for greater transparency regarding transactions;

The issue of enforceability needs to be considered.

- a) The motivation for the Code needs to be made clear

The Code of Conduct should outline a set of factors SWFs should satisfy. The Code should ensure a balanced and rationale approach is adopted, recognising that in many instances the risks associated with SWFs are more perceived than real. The Code needs to allow the recipient countries to have confidence that the aims of SWFs are commercially driven and do not pose any risks. The Code also accepts that it is in the interests of countries that favour an open investment climate, and the countries owning SWFs, to engage in international dialogue to promote and sustain investment flows. The Code needs to address concerns about the transparency of objectives of the institutional structure and about their portfolios. In addition to conforming to this Code, SWFs should be encouraged to develop their own code of best practice. The aim is to encourage a discussion aimed at achieving best practice guidelines for both sides. Whilst there are no specific international rules on SWFs, various agreements on investment will apply to investments made by SWFs. And, like other investors, SWFs already have to comply with applicable regulatory and disclosure requirements in the countries in which they invest. These best practice guidelines should apply in addition to such existing investment rules:

- b) There is the need for clarity of objectives and investment strategies

- The aim is not to differentiate against SWFs compared with other groups and not to compromise the need for SWFs to safeguard sensitive information regarding future commercial investments.
- SWFs should have a clear mandate set around commercial objectives. The investment practices of the funds should be made public.
- Even where SWFs direct investments via third-parties, the overall guidelines should be made clear.
- Set out risk management objectives and policies.

- c) The need for best practice on corporate governance and on accountability

- The desire should be to convey world class institutional integrity.
- These funds should be seen as independent bodies, free of government control, and statutory independent from government in the way they pursue their objectives.
- There is a need for clarity of the institutional structure and lines of responsibility within SWFs.
- Good governance guidelines for SWFs could be outlined. There has to be a fiduciary responsibility to shareholders. How should one define such a responsibility needs to be made clear.
- A pre-commitment by SWFs to uphold established guidelines should be called for.
- State corporate responsibility and ethical guidelines.

- d) There is a need for greater transparency regarding transactions

- Minimum standards of transparency should be outlined.

- SWFs should be asked to specify a minimum set of information, including size, returns achieved and portfolio composition.
- The best practice of the most open and transparent SWFs should be adopted, with annual statements clarifying investment performance and goals and guidelines around their objectives.
- These annual accounts should be subject to independent and public audits.
- SWFs should make clear any concentrated positions.
- Reporting requirements need to be made clear.
- Some countries may also be worried about leverage and SWFs to make clear any leveraged positions, although that is not, in my view, a concern for many of these SWFs.

Finally, the issue of enforceability needs to be considered. Given the challenge of enforceability when it comes to sovereign nations, it is important that the guidelines outlined are developed in dialogue with the countries from which SWFs emanate. Countries should reserve the right to veto investments by funds not pursuing best practice but need to do this in a way in which is still seen as open to business.

In conclusion, I have focussed on the context, issues raised and implications. There is a need for common ground rules, best practice, and the need to promote an investment framework that is fair and commercially driven. Any constraints on SWFs should be based on an objective appraisal of facts within a stable framework of roles and processes. Yet, as long as investments by SWFs are made for commercial reasons and not for political purposes then these funds should be accepted.

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