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IMF Working Group Clarifies Sovereign Wealth Fund Objectives, Structures, and Governance with Santiago Principles

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In October 2008, the International Working Group of Sovereign Wealth Funds (IWG), organized under the auspices of the International Monetary Fund (IMF), released the Santiago Principles, a set of best practices intended to guide the workings of their sovereign wealth funds (SWFs). The IWG is composed of representatives of 26 IMF-member countries with SWFs.[1] The IMF was instrumental in facilitating and coordinating the drafting process. Despite differences in the investment goals and capabilities of a number of SWFs, the Santiago Principles emphasize that they have a shared goal of promoting strong capital markets and facilitating cross-border investments.

Impetus for Santiago Principles

As capital has flowed from the United States and other industrialized countries to commodity-exporting countries, SWFs, and the need for them to provide capital infusions, have come under intense scrutiny from countries and companies receiving those funds. The growing wealth of SWFs and their importance in global capital markets have fueled concerns that these investors may seek, expressly or not, to undercut competition, take control of national assets, or promote a non-commercial agenda. The Santiago Principles were written to clarify the goals and investment intent of SWFs. They were drafted based on a review of practices already used by SWFs and practices in other areas of international cooperation that are applicable to SWFs. The Santiago Principles are a set of generally accepted principles and practices (GAPP) that cover three key areas:

1. legal framework, objectives, and coordination on macroeconomic principles;
2. institutional framework and governance structure; and
3. investment and risk management framework.

The focus on these areas is designed to reduce misinformation about SWF’s strategies abroad, and the controlling policies and regulations of their home states. The IWG expects the GAPP to guide the subsequent investment policies of each SWF, as well as any associated legal and institutional reform. It is the hope of the IWG that publication of these stated goals will underscore the SWFs’ desire to continue contributing to economic growth while reducing protectionist pressures, and provide some assurances to investee nations regarding the commercial bona fides of SWF investment.

Generally Accepted Principles and Practices

The Santiago Principles consist of 24 principles (many with subprinciples), with accompanying explanatory notes for each principle. While the Santiago Principles reflect guidelines that IWG member countries have implemented or aspire to implement, adherence is voluntary and expected only to the extent it is appropriate.[2] The Santiago Principles are explicitly subject to the laws, regulations, requirements, and obligations of each home country. The GAPP address many of the concerns articulated by investee countries, and the principles focus on promoting full disclosure, encouraging purely economic investment intent, or strengthening governance standards. Notable principles include GAPP 16, which states that 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; and GAPP 20, which urges SWFs not to seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities. Other GAPP provisions discuss disclosure of the sources of SWF funding, preparing financial statements on SWF performance in accordance with international accounting standards, disclosure of investment policies, and making investment decisions aimed at maximizing risk-adjusted financial returns.

Challenges Ahead

As the global financial crisis deepens, the importance of SWFs is undeniable. The Santiago Principles may represent a positive step towards increasing investee countries' comfort level with SWF funds and opening communication about SWF investment strategies. The IWG recognizes that both SWFs and international capital flows are constantly evolving, so a need exists for further research on GAPP implementation, ongoing evaluation of the GAPP provisions, and international dialogue about SWF issues. The IWG is exploring the establishment of a standing group of SWFs to address those needs. The Santiago Principles can be seen as an expression of the SWFs' determination to build a consensus on structures for their cross-border investments. The success of the Santiago Principles depends on a number of factors, including whether transparency from SWFs will be met with comparable transparency by investee countries, and whether the GAPP provisions engender a collaborative response that contributes to the maintenance of a healthy and stable investment environment. The IWG report suggests that in the coming months the companies and countries that SWFs engage with may well consider using these guidelines as a starting point for an examination of their own framework governing SWF investment.[3]

Footnotes

[1] The IWG was co-chaired by Hamad al Suwaidi, Under Secretary of Finance of Abu Dhabi and a Director of the Abu Dhabi Investment Authority; and Jaime Caruana, Director of the IMF Monetary and Capital Markets Department. The drafting group of the IWG was chaired by David Murray, Chairman of the Australian Future Fund Board of Guardians.

[2] The GAPP were created with the recognition that not all SWFs have achieved similar stages of development or share a similar investment mandate. For example, newer SWFs are not expected to implement all of the GAPP at once, because they may not yet have established long-term investment goals or strategies.

[3] There is evidence that such consideration is already underway. In March 2008, the United States signed a bilateral accord with officials from Abu Dhabi and Singapore. Their agreement also focuses on disclosure, SWF investment based on purely economic motives, and clear governance standards. Furthermore, the Organization for Economic Cooperation and Development (OECD) has started this discussion amongst its recipient countries. In June 2008, an OECD Ministerial Council Meeting adopted a *Declaration on Sovereign Wealth Funds* calling for recipient countries not to erect protectionist barriers, not to discriminate among investors in like circumstances, and to restrict the use of safeguards where national security concerns are involved.