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1 hot issues

What is a Sovereign Wealth Fund?

A Sovereign Wealth Fund (SWF) is a state-owned investment fund composed of financial assets such as stocks, bonds, real estate, or other financial instruments funded by foreign exchange assets. Basically, they are pools of money derived from a country's reserves that are used for investment purposes. Assets held in SWFs can include: balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports. While SWFs can be structured as a fund, pool, or corporation, they are similar to pension funds and large institutional investors. They take a long-term view to investing and tend to ride out business cycles. Some countries have created SWFs to diversify their revenue streams. For example, the United Arab Emirates (UAE) relies on oil exports for its wealth; therefore, it devotes a portion of its reserves to an SWF that invests in other types of assets that can act as a shield against oil-related risk.

The amount of money in these SWFs is substantial. Again, using the UAE as an example, as of May 2007, its fund was worth more than \$875 billion. The estimated value of all SWFs is pegged at \$2.5 trillion.

Santiago Principles

SWFs have a guiding document called the **Santiago Principles** and one of their four guiding objectives is to “invest on the basis of economic and financial risk and return related considerations” (just like institutional investors).

The International Monetary Fund (IMF) sponsored an International Working Group of SWFs in 2008. It resulted in the establishment of the Santiago Principles, which promotes a common approach to investing internationally, good governance and better disclosure. There was a working group of 26 IMF member countries. They created a document that listed 24 voluntary principles in three areas:

1. Legal framework, objective and coordination with macroeconomic policies
2. Institutional framework and governance structure
3. Investment and risk framework

It also includes a valuable profile of each working Group SWF member (ownership, investment policies, accounting, reporting and more).

The Santiago Principles were released as part of an attempt to address a number of concerns related to SWFs, including concerns that governments around the world would use these funds to advance their political agendas. Since their release, the Santiago Principles have had different effects on sovereign funds from different countries around the world.

In the United States, for example, the Santiago Principles have helped counter the belief held by some policymakers and transaction participants that SWFs are seeking political influence in addition to, or in place of, profits. Since the Santiago Principles are non-binding and subject to home country rules and regulations, SWFs still need to pay attention to political and third-party concerns when structuring investments in order to reduce the risk of attracting too much attention from the government.

In the United Kingdom, the Santiago Principles have generally been embraced. Although there has been a controversy about strategic assets being purchased by foreign owners, no acquisition of a public company has ever been blocked by the government because of public policy or national security.

Finally, the release of the Santiago Principles has resulted in sovereign funds based in the UAE and other Persian Gulf countries to shift their focus away from established markets such as the United States and Europe toward developing markets in the Gulf region and Asia.

SWFs are mandated to invest globally so they are sourcing opportunities to enhance returns:

Some funds also invest indirectly in domestic state-owned enterprises. In addition, they tend to prefer returns over liquidity. Thus they have a higher risk tolerance than traditional foreign exchange reserves.

Types of Sovereign Investment Vehicles:

- SWFs – example *Qatar Investment Authority* – in Alberta, Canada, *Heritage Saving Trust Fund*
- Public Pension Schemes – example *CalPERS*
- State-Owned Enterprises – example *Chinalco*
- Sovereign Wealth Enterprises (SWEs) – example *St Martins Property*

Effect on Investor Relations

A number of companies have SWFs that own their shares. Issuers might also want to consider targeting these investment classes.

Funds may have their origin in:

- **Commodities** – Created through commodity exports, either taxed or owned by the government.
- **Non-Commodities** – Usually created through transfers of assets from official foreign exchange reserves.

Some of the recent investments have been:

- Barclays Bank
- London Stock Exchange
- UBS
- Qatar Investment Authority (QIA)
- Mubadala Development C
- Government of Singapore Investment Authority

SWFs: Nature & Purpose

Each fund has its own unique reason for its creation; furthermore, all funds have their own objectives.

Some Fund Objectives:

- Protect & stabilize the budget and economy from excess volatility in revenues/exports
- Diversify from non-renewable commodity exports
- Earn greater returns than on foreign exchange reserves

SWFs generally indicate that they do not engage directly in macroeconomic policies, but with two exceptions:

- Transfers to the budget for exceptional and targeted needs
- The drawdown of funds for transfer to the central bank in case of exceptional balance of payments or monetary policy needs. In one case, a separate short-term fund was set aside for such purposes.

Investor Relations professionals can use a proprietary web based product called Thomson One (www.thomsonone.com) to obtain more information about equity investors from regulatory filings. To obtain more information on SWFs, there is a database called Prequin (www.prequin.com).

SWF – Can they be the next investor in your stock?

Some SWFs, such as the Alberta Heritage Savings Trust Fund, are close to home, but others are around the globe. Many SWFs manage their relationship with consultants and therefore create another target audience. Also, the level of disclosure of SWFs is not as robust as other investment groups so even gathering information may at times be challenging.

The Sovereign Wealth Fund Institute is an organization designed to study SWFs and their impact on Global Economics, Politics, Financial Markets, Trade, and Public Policy. They provide specialized services such as research and consulting to various corporations, funds, and governments and they strive to be the leading resource regarding these funds.

The Sovereign Wealth Fund Institute has helped shape the sovereign wealth market and has defined terms like the Linaburg-Maduell Transparency Index and Sovereign Wealth Enterprise.

Sovereign Wealth Fund Institute is located at 1380 Lead Hill Blvd, Suite 106, Roseville, U.S.A., 95661

Visit their site at <http://www.swfinstitute.org/> and sign up for a complimentary SWF newsletter.

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