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Good governance of sovereign wealth funds
The case of the Australia Future Fund
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INTRODUCTION

Sovereign Wealth Funds are not new. They exist since 1953 and the creation of the Kuwait Investment Board. They are special purpose investment funds owned by a Government. Their total asset size is estimated at $5.5 trillion in 2012 and they are present in all the continents and especially in the countries that have natural resources reserves.

But, it is the financial crisis that has put them in light. As the other institutional investors they faced sudden falls of their asset prices. This has created a reaction from their investors and has revealed that most of them lack of transparency. But, the crisis has also permitted to show that the sovereign wealth fund could be the funding source of the future. Indeed, the lack of confidence that has followed the 2008 crisis has driven funds and investors away from corporation. However, despite of the crisis and because of their vast pool of assets, the sovereign wealth funds have continued investing in some countries’ economy.

Furthermore, in parallel with the crisis in developed economies, developing economies have started generated surplus and accumulate foreign exchange reserves. Thus, to reinvest this money they have created their own sovereign wealth funds and it has created an “uphill flow”.  

Finally, sovereign wealth funds have engendered a new phenomenon which is the redistribution of funds from private to public hands.

Many concerns about SWFs are exaggerated in the media because of the lack of understanding of SWFs and other vehicles for foreign investments. But, given the increasing role of sovereign wealth fund in the global economy and the fact that they are sovereign and can potentially take the control

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1 “Uphill flow”: the developing economies which were traditionally the host countries, have starting to invest in developed countries. Page 1, ESWAR PRASAD, RAGHURAM RAJAN, ARVIND SUBRAMANIAN, The paradox of capital, Is foreign capital associated with economic growth, if not, why does it flow uphill?

2 April 2008, EDWIN M. TRUMAN, A blue Print for SWF best practices, Peterson Institutes for International Economics, Number P1308-3
of strategic sectors, a better control of their activity and governance happen to be indispensable today. In particular, the International institutions have set in place principles of good governance that could be applied to sovereign wealth funds. They are principles of Corporate Governance but applied to public entities. Indeed, the term corporate governance has been set in place for private entities that have other objectives and constraints than public investment vehicles such as sovereign wealth funds. The term “Corporate governance” has been defined by the Basel Committee as:

“a set of relationships between a company’s management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. The presence of an effective corporate governance system, within an individual company or group and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy.”

This definition has to be adapted to sovereign wealth funds. It is what the Santiago Principles have tried to do and thus, they are key principles for sovereign wealth funds.

In my dissertation, I will first explain what are sovereign wealth funds, then I will analyze the Santiago principles by classifying them in broad categories in order to have a better understanding of them and to finish I will study the case of the Australia Future Fund to see if the Santiago Principles can be effectively applied in a sovereign wealth fund.
CHAPTER 1: THE RATIONAL OF HAVING SOVEREIGN WEALTH FUNDS

1.1 Introduction

The role of sovereign wealth funds during the crisis has underlined the two sides of their action: they can have positive influence on the market because their size allows reducing the impact of crisis. However, their complexity is fearsome because they will add some new factors to take into account in the companies in which they invest. Indeed, they are different from the other investors because they are public entities, thus they are not submitted to the same rules of reporting and transparency which make them difficult to understand because of their opacity. ³

So, as one can see, sovereign wealth funds have a lot of different aspects that could be difficult to understand. This is why before explaining their governance, it is important to understand all their rationales.

1.2 What is a sovereign wealth fund?

a. A new term

Even if the first sovereign wealth fund has been created in 1953, the term “sovereign wealth fund” appeared in 2005 in ANDREW RAZANOV’s book Who hold the wealth of the nations? and no consensus has yet been reached on it exact meaning.⁴

“ Typically, sovereign wealth funds are a by-product of national budget surpluses, accumulated over the years due to favorable macroeconomic, trade and fiscal positions, coupled with long term budget planning and spending restraint. Usually these funds are set up with one or more of the following objectives: insulate the budget and economy from excess volatility in revenues, help

³ EDWIN M. TRUMAN, Four myths about sovereign wealth funds, 14 August 2008, Vox, www.voxeu.org

monetary authorities sterilize unwanted liquidity, build up savings for future generations, or use the money for economic and social development”

b. The numerous types of sovereign investment and the KIMMIT classification

There are several types of sovereign investments. KIMMIT analyzes the different types of sovereign investment instruments: 

- The official reserves or the central banks which are meant of extern funds which permit to finance the international imbalances from the balance of payments. They are very liquid and are often sovereign obligations of the OECD’s members.
- The pension funds which are investment vehicles to serve to cover the state duties regarding retirement funding. They are assets in local currency.
- State Enterprises which are companies where states own a significant level of control. It can invest in foreign assets.
- Domestic sovereign funds which are investments meant for the national development. They are expressed in local currency.
- Sovereign Wealth Funds which are investment vehicles composed of surplus of the external trade. They are governed separately from the official reserves. They have a high risk tolerance.

c. The difficulty to define the term of “Sovereign Wealth Funds

We can find various definitions of sovereign wealth funds, for example:

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The US deputy secretary of External Affairs, CLAY LOWERY in its speech of June 21, 2007, defines a sovereign wealth fund as: “a government investment vehicle which is funded by foreign exchange assets and which manage those assets separately from official reserves”.  

The IMF has published a work agenda regarding sovereign wealth funds. SWFS are funds with long term objectives and various types of funding. It has a different definition than the one of the American Treasury because it distinguishes 5 types of sovereign wealth funds: Stabilization funds, Saving funds, Reserve investment corporations, Development funds, Contingent pension reserve funds which permit to face unexpected contingent pension non-specified in the revenue of the government’s balance sheet.

STEPHEN JEN has proposed in 2007 a new approach of the sovereign wealth funds definition by comparing it to other types of state or private funds and by underlining their specificity. For him, sovereign wealth funds contain 5 essential “ingredients”: they have to be sovereign, to have high currency exposure, no explicit liabilities, high risk tolerance and have a long term investment horizon.

There are a lot of reasons for the difficulty of definition of the sovereign wealth funds. Firstly, each of the sovereign wealth funds has its own form, there is no generic model. Secondly, sovereign

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7 Page 5 to 10, International Monetary Fund, Sovereign Wealth Funds, A Work Agenda, February 29, 2008


9 Page 21, Jean-Michel ROCCHI and Michel RUIMY, Les Fonds Souverains, ISSN 1778-4492, Edition ECONOMICA, July 2011
wealth funds are not always sovereign because as the CalPers\textsuperscript{10}, they can be part of a federated state. Thirdly, sovereign wealth funds are considered to invest outside of their territories but some as exclusively domestic investment such as the Malaysian Khazanah Nasional. Lastly, the sovereign wealth funds could be distinguished from central bank because of the risky nature of their investments. But, some central banks have also risky investments such as the Banque National Suisse (SWITZERLAND).

1.3 Characteristics of sovereign wealth funds

a. The resources of sovereign wealth funds

The resources of sovereign wealth funds are made of commercial surpluses coming from export of natural resources or of manufactured products, or by budgetary surplus. Thus we have a distinction between Commodity and non-commodity funds.\textsuperscript{11}

The Commodity Funds are situated in the Middle-East, Norway and Russia. The first sovereign wealth fund was created to follow this aim in Kuwait in 1953. Following the two oil crashes of 1973 and 1981 the necessity to protect the natural resources rent economies became evident because of the high price volatility that was generated. There first source of financing is made of the export of natural resources, mainly oil but also gas, copper, diamonds and phosphate.\textsuperscript{12} The countries rich in natural resources have a rent-seeking economy based only on the revenue coming from natural resources.

\textsuperscript{10} The CalPers is the California Pension Fund. It is one of the biggest and it manages $180 billion.

\textsuperscript{11} Page 14, European Economy, The so-called “Sovereign Wealth Funds”: regulatory issues, financial stability and prudential supervision, Economic Paper 378, April 2009, \url{www.europa.eu}

\textsuperscript{12}SALEEM H. ALI, GARY FLOMENHOFT, Innovating Sovereign Wealth Funds, February 17, 2011, \url{http://www.policyinnovations.org/}
So, for them, sovereign wealth funds permit to diversify the revenues of those countries and to generate revenues for the future generations.

The other funding resources of the sovereign wealth funds are made of commercial surplus or the budgetary surplus of some economies which fund foreign exchange reserves. The economic crises that have faced numerous Asian countries in the years 1997 and 1998 have incentivized them to reinforce their budgetary and financial policy and to base their revenue on export. The increasing power of China and India has been followed by an increase in the demand and the consumption which has allowed the exporting countries to accumulate massive currency reserves. So, sovereign wealth funds have been to invest the money abroad in order to decrease the evaluation of the local currency and stimulate exports.

In other countries, the resources of sovereign wealth funds come from budgetary surpluses. They come from taxation surpluses, mandatory social and pension levy at very high rates, from the proceeds of sale of assets or from the revenues of the privatization of public enterprises.

b. Objectives of sovereign wealth funds

Sovereign wealth funds have various objectives:

- Stabilization of revenue: The stabilization funds have for aim to fight against price volatility of the natural resources and thus, to stabilize the revenues coming from their exportation

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because natural resources are subject to brutal fluctuations thus it can result in an imbalance of the budget of the countries exporting them.  

- Intergenerational savings: Saving funds are made to constitute savings for future generations by distributing the revenues from non-renewable natural resources between the different generations.  

- Financing of retirement pensions: Some sovereign wealth funds have for objectives to finance implicit pension retirement. The fund accumulates and invests the financial reserves as long as the demographic context stays favorable and uses them to contribute to pension financing when the need increases under the effect of ageing. But, contrary to pension funds, those sovereign wealth funds do not have explicit pension commitments and are not financed by employees’ or enterprises’ contributions. Their financial rules are meant to cover the estimation of the future needs. Unless exceptional circumstances and prior authorization from the highest State authorities, it is forbidden to take money from the funds.

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16 Page 15, European Economy, The so-called “Sovereign Wealth Funds”: regulatory issues, financial stability and prudential supervision, Economic Paper 378, April 2009, www.europa.eu. The saving and Intergenerational funds also permit to fight against the perverse effects of an over exploitation of natural resources. This phenomenon is called Dutch disease. The investment of the revenues of the natural resources in a sovereign wealth fund prevent them to be spent, which allows the rest of the economy not to suffer the foreign exchange and energy prices increases that will result from it.

- Optimization of the returns of the foreign exchange reserves: Some sovereign wealth funds have for aim to optimize the performance of the foreign exchange reserves such as reserves investment corporations. They are managed in a low risk way and on short term horizons to insure their security and liquidity. In principle, they have to cover at least 3 months of imports or the amount of exterior short term commitments of the country.\(^1^8\)

- Diversification of the economy: development funds have for aim to take strategic commitments. They can be holdings with state participations and act as the sword arm of the state.\(^1^9\) They can finance infrastructures, invest in strategic sectors for the development of their country or build industrial partnership projects.

### 1.4 Structure of sovereign wealth funds and corporate governance

#### a. Structure of sovereign wealth funds

The institutional frame of sovereign wealth funds is often unknown because of their lack of transparency. But thanks to the IMF inquiry of 2008 to which 21 SWFs have answered on a voluntary and anonymous basis, we can find some common management practices and structure.\(^2^0\)

#### b. Structure and management of the SWFS

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The sovereign wealth funds are generally set in place by a specific law or bill or by a financial law and in some case by the constitution. The government is represented in the boards of the sovereign wealth funds in 2/3 of the cases. In half of the cases the government parties are in majority. The assets of the sovereign wealth funds can be owned directly by the State or indirectly through a legal entity. Half of the sovereign wealth funds don’t have a legal personality distinct from the ones of their State or central bank. They are controlled by the treasury which defines the investment policy. The board may be composed exclusively of members of the government. The other half of the sovereign wealth funds are organized in legal entity distinct from the one of the government and of the central bank. Some are still managed under public law such as the South Korea fund. Others are managed by private law such as Temasek in Singapore. Their board is composed of personalities appointed by the government.  

The management of the sovereign wealth funds assets can be done internally or by an exterior company according to the size of the funds and the human and material means that it beneficiaries. Some have great internal capacities such as the Norwegian funds or the Singaporean one. Other such as the one of Australia and New Zealand, give the management of all or part of their assets to an exterior company, usually in developed countries.  

\[a.\] Sovereign wealth funds and corporate governance

- Financial reporting: It is mandatory for the fund to make their reporting according to precise accounting standards. The accounts of the funds have to pass an internal audit. The

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21 Page 5, IMF Working Paper, Sovereign Wealth Funds: Current institutional and operational practices, prepared by Cornelia HAMMER, Peter KUNZEL and Iva PETROVA, November 2008

22 Page 16, IMF Working Paper, Sovereign Wealth Funds: Current institutional and operational practices, prepared by Cornelia HAMMER, Peter KUNZEL and Iva PETROVA, November 2008

23 Page 12, IMF Working Paper, Sovereign Wealth Funds: Current institutional and operational practices, prepared by Cornelia HAMMER, Peter KUNZEL and Iva PETROVA, November 2008
external audits, when they exist, are often realized by independent companies with international reputation, sometimes by the Chancellor of the Exchequer or a government agency. The financial reporting varies to large extent according to the fund. The most transparent funds give their annual report to the parliament and deliver it to the public through their websites. 

- Responsibility and ethics of sovereign wealth funds: The sovereign wealth funds report about their management either to a financial supervision commission or to the Chancellor of the Exchequer or to a designed senior public servant (president or administrator of the central bank), or directly to the parliament. Most of the funds share common standards in term of morality and integrity. They have rules to prevent misuse of the funds by the administrators, conflict of interests, communication policy, warning and control systems of non-ethical or fraudulent behaviors. They are put in a legal code or a code of conduct adopted by the fund. The splitting of function between front, middle and back office also permits to reduce the operational risk as well as account reconciliation, intern and extern and the use of

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a repository for the physic detention of the fund-owned assets. Numerous people are feared about the moral and ethic dimension of the sovereign wealth funds. This is due to the fact that the majority of sovereign wealth funds are owned by countries where there are no political and economic liberties and where corruption is important. Several methods with those criteria have been developed.

- Public control of sovereign wealth funds: The sovereign wealth funds are hybrid entities because they are investment “funds” that manage their liquidities and portfolios. But they are also “sovereign” because these liquidities come from the State. The public control of sovereign wealth funds is a problem because their motivation might be only strategic. It is important to recall that for the moment sovereign wealth funds are mostly minority shareholders and do not participate to the governance of the companies. However, this doesn’t mean that they will have the same behavior in the future.

- Transparency of sovereign wealth funds: the communication rules are really different from one sovereign wealth fund to the other, from the greatest transparency to the absolute opacity. Two studies of 2008 allow us to classify the funds according to their transparency. The first one was realized by Edwin Truman from the Peterson Institute for International Economics. He has graded 38 sovereign wealth funds from 0 to 100 by asking them

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28 Page 13, IMF Working Paper, Sovereign Wealth Funds: Current institutional and operational practices, prepared by Cornelia HAMMER, Peter KUNZEL and Iva PETROVA, November 2008

29 Page 98, Edwin M. TRUMAN, Sovereign wealth funds, threat or salvation?, Peterson Institute For International Economics
questions. The second study was realized by Michael Madwell and Carl Lindburg, president and vice-president of the SWF Institute. They posed 10 questions to the sovereign wealth funds defined by reference of the transparency to the Norwegian fund. Despite some differences, the two studies allow us to see some tendencies: the funds of developed countries are by far more transparent. They are followed by Hong-Kong and Singapore funds. The least good grades have been given mostly to funds from the Middle-east, African funds, and numerous Asian funds. These funds represent more than the half of the sovereign wealth funds assets, give really few information about their activities. This opacity generates anxiety and makes us fear the pursuance of non-commercial objectives by those funds which in majority come from non-democratic countries.

1.5 Investment of sovereign wealth funds

a. Stable investors

With a long term investment horizon (sometimes 20 to 30 years), the sovereign wealth funds are stable on long term. They favor buy-and-hold strategies and have a moderate rate of portfolios rotation 3 times lower than the one of pension funds. They finance their investments with proper funds, have limited liquidity needs and are return exigent. Consequently, sovereign wealth funds

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30 Page 71, Edwin M. TRUMAN, Sovereign Wealth Funds, threat or salvation?, Peterson Institute For International Economics. See also, EDWIN TRUMAN, A Scoreboard for sovereign wealth funds, Peterson Institute for international economics, October 2007


32 Buy-and-hold strategies are passive investment strategy in which an investor acquire some assets and keep them during a long time, independently from market fluctuations.

33 The portfolios rotation rate measures the frequency to which a fund is buying or selling some assets.
have a greater capacity than others to take long term positions. They offer increased opportunities to companies, in particular developed countries’ ones, because they provide them with a quasi-permanent source of financing which insure the capital and stability and security. Finally, the participation of a sovereign wealth funds to a company’s capital offers to it an opportunity to enter the territory from where the sovereign wealth fund is originated with the possibility to develop there.

b. Passive investors

The sovereign wealth funds are most of the times passive investors. The exception is the development funds that sometimes acquire the control or the whole capital of unlisted companies. The others pursue a purely financial logic and seek long term returns. They take minority stakes that rarely go above 10% of the company’s capital and are most of the time inferior to 1%. They are non-activist or non-offensive investors in comparison with funds of capital investments or of alternative management. The sovereign wealth funds don’t take part in management and are not in the board of companies. Given the advantages brought by sovereign wealth funds, it’s often companies themselves that ask them to take participation in the company’s capital. They did that in particular during the subprime crisis.

c. Financing of big projects

With their financial power and their long term horizon, the sovereign wealth funds have strategic positions on the great projects of the future: energy, space, infrastructures. These investments respond to needs that are not directly satisfied by the market: they need huge financing, which overwhelms the capacities of private investors; they are deprived of immediate returns. However they are the more directed toward the future: they are structuring and long term projects regarding essential sectors.

d. Development of emerging economies
With their important amount of liquidities, their will of diversification and their long term horizons, the sovereign wealth funds could become major players of the financing and development of developing countries. The sovereign wealth funds have probably more to win in investing in Africa, Asia or South America because there are countries where the returns are less linked to the one of the OECD countries and the where the deficits in infrastructure are huge. The emerging markets are more volatile but on long term they generate more important profits. The sovereign wealth funds are already in those economies. For example, the sovereign wealth funds of the Persian Gulf are directed to Asia, Middle East, Africa and Latin America.

\textit{e. Strategic motivations}

Empirical data show that the sovereign wealth funds do not invest for political reasons. Governments are using sovereign wealth funds mostly to make investment profits. There are no precedents proving that sovereign wealth funds behaviors are generating general or national economic insecurity because of their investments. However the states can pursue, through the funds or other public entities strategic motivations in order to promote national interests mainly to ensure their energetic independence, acquire new technologies conquers new markets.

\textit{f. Protectionist reactions to sovereign wealth funds investments}

With the increase in power of sovereign wealth funds the OECD countries fear the strategic or political motivations of sovereign wealth funds. This engenders protectionist reactions.

There is a legal international frame of foreign investments. Since its creation the OECD has tried to promote the freedom of movements of capital between its members. The main principles promoted by the OECD are

- The cross border freedom of investment.
- The principle of non-discrimination: the host countries have to treat the investors in an equal way with national investors in the same circumstances.
The only exception that allows a country to pass a law that restricts the freedom of investment is the principle of national security which is often the case when SWF invests in strategic sectors. Thus, the OECD has initiated at the beginning of 2006 an intergovernmental dialogue on the theme “freedom of investment, national security and strategic sectors”. During the round table of March and October 2008 in Paris the participants agreed on 4 principles that should govern the adoption of measures meant to protect national security:

- Non discrimination
- Transparency and predictability
- Proportionality
- Responsibility

g. Asset allocation

- Shareholdings

There is a great disparity of the behaviors of sovereign wealth funds. The big capitalizations dominate in the portfolios compositions. The investment in shareholdings has some macroeconomic impact: as all the investors sovereign wealth funds are sensitive to economic cycles and market conditions. However, the OECD has realized a study comparing the investment strategy of the mutual funds and sovereign wealth funds. It has shown that: sovereign wealth funds are more prudent, SWFs prefer shareholdings with a higher PER (price earnings ratio), they prefer high return values, SWFs are less opportunistic than mutual funds, and SWFs have a lower beta in average. \(^{34}\) This comparison shows that globally SWFs are more prudent in their shareholding investments.

- Private equity

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\(^{34}\) The beta of a stake is its coefficient of volatility. It indicates the relation between the fluctuation title value and the fluctuation of the market prices.
Whereas globally, more than one sovereign wealth fund over two invest in private equity, the reality is more complex because great disparities exist according to the size of the vehicle. If the smallest have limited investments in the equity fund, the larger ones are fully committed in this class of assets. Indeed, their size allows them for a greater diversification as well as a greater flexibility in their investments.

- Impact of the developed strategy on the price of financial assets

With the relative stability of the assets, the apparition of new market players with new resources will have an impact on the asset prices. Indeed, it should normally increase asset prices according to the law of supply and demand. This situation can be reinforced by the high public debts which should push States to initiate austerity measures. Morgan Stanley tried to measure the impact of these measures\(^{35}\). It will result in an increase in price of safe bonds, a decrease of the return of the shareholdings, a decrease of market risk premium and a PER increase.

**1.6 Conclusion**

This chapter shows the great variety of structures and portfolios of the sovereign wealth funds which generate a variety of the approach of good governance. But, the financial crisis has had an important impact on the sovereign wealth funds and has revealed the necessity of adopting common standards of good governance. Thus, the Santiago principles have been set with the help of the IMF.

CHAPTER 2: PRINCIPLES OF GOOD GOVERNANCE FOR SOVEREIGN WEALTH FUND - THE SANTIAGO

PRINCIPLES

2.1 Introduction

The Santiago principles are the reaction of the international community to the growing size of SWFs. Even if, international institutions recognized the positive impact of sovereign wealth funds on development, growth and prosperity etc, they also take into account the fact that the growing influence of those funds implies that they will have more and more influence on the governance of the companies and will conduct to the emergence of more and more protectionist policies in the hosts countries.  

The respect of the Santiago principles will promote transparency and allow the general public to have more knowledge about them. Thus the international market will be less reluctant to accept them.

In 2008 the International Working Group on SWFs was created. The IWG and the IMF have agreed to collaborate in the creation of new set of principles to regulate the sovereign wealth funds. The IWG is composed of 26 IMF members. The Santiago principles were adopted at their third meeting. The IWG set those principles according to the work of the IMF in its paper “Sovereign wealth funds: a survey of current operational and institutional practices”.

2.2. The Santiago principles aim

a. Good practices

- Why do we need the principles of good practices of the Santiago principles?

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36 Page 3, Santiago principles

37 Sovereign wealth funds: a survey of current institutional and operational practices. www.iwg.swf.org/pub.htm
The Santiago principles are first meant to improve the practices of sovereign wealth funds in order to be sure that they will only have financial and economic purpose in the future.  

The good practices imposed by Santiago principles are meant to promote more transparency and a better governance of sovereign wealth funds in order to limit protectionist policies and to keep the global flows of investments. The application of good practices by the sovereign wealth funds will bring more confidence in the developed countries and they will be more open to the sovereign wealth funds. The adoption of international codes of conducts and good practices is a way for the countries that adopt them to accept to limit the reach of their sovereignty.

The OECD initiation of the process toward the adoption of good practices

It was the US, Abu Dhabi and Singapore that initiated the process of adoption of good practices. They established a common declaration to the OECD and IMF works. They took the formal commitment to take their investment on the basis of commercial motivations, to be more transparent in a frame that will not contain protectionist barriers, and will have a clear and stable legal frame with no discrimination and a reciprocity in the application of investment policies.

The work of the OECD on the good practices of the host countries regarding sovereign wealth funds investments are in the OECD project called “freedom of investment national security and “strategic” industries”40. This project has been set in place by 44 states and the European Commission. The OECD has made a declaration in June 2008 in which the member countries commit themselves to

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38 Page 4, Santiago principles

39 Page 2, Sven BEHRENDT, Sovereign wealth funds and the Santiago Principles, Where do they stand?, Carnegie Middle East Center, Number 22, May 2010

respect a set of principles comprising of: non discrimination, no protectionist barriers, proportionality, responsibility, proportionality and consistency. 41

b. The objectives of the Santiago principles

The Santiago principles are also called GAPP (Generally accepted principles and practices). They are applicable on a voluntary basis by all countries regardless of the level of economic development. The respect and the application of the Santiago principles are submitted to the law in force in the country. They are meant to reinforce the confidence of the host countries, reduce the protectionist pressure against the investment policies of sovereign wealth funds, contribute to the openness and stability of the global financial system and preserve the freedom of movement of capital and of investments. 42

One of the most important objectives of the GAPP is guaranty the independence of sovereign wealth funds from political power. To differentiate the investment from political pressures, the GAPP set in place a repartition of the rights and obligations between the State and the sovereign wealth funds management. To reduce the fears linked to the pursuance of strategic or politic interests by the sovereign wealth funds, the GAPP promote index portfolio management and economically driven investments. To limit the risk of political intervention, the GAPP promote the supervision of sovereign wealth funds by financial markets. 43

The other major objective of the GAPP is to improve the transparency level of sovereign wealth funds. Indeed, with transparency, the market players can anticipate the behaviors of sovereign

41 OECD, Meeting of the council at ministerial level, 4-5 June 2008, OECD Declaration on sovereign wealth funds and recipient countries.

42 Page 6, Santiago principles

43 Page 4, Sven BEHRENDT, Sovereign Wealth Funds and the Santiago Principles, where do they stand?, Carnegie Middle East Center, Number 22, May 2010
wealth funds. Thus, it creates confidence and thus stability of the markets. Indeed, as we have seen during the financial crisis, confidence is crucial for the financial global stability. It also benefits directly to the companies in which they invest because it contributes to the companies’ image improvement in which sovereign wealth funds invest. 44

The Santiago principles have also for objectives to

- Put the operation of sovereign wealth funds in the macroeconomic policy of their country
- Include the streams and positions in the fiscal, monetary and budgetary accounts.
- Improve the quality of governance of the sovereign wealth funds and to set in place appropriate mechanism of internal control, risk management and accountability.
- Guaranty the respect of the rules and regulations of the recipient countries, particularly regarding the mandatory disclosure of information and to promote the fair competition with private investors. 45

2.3 Detailed Analysis of the Santiago principles

The 24 principles are divided in 3 parts:

- Legal framework, objectives and coordination with macroeconomic policies
- Institutional framework and governance structure
- Investment and risk management framework

Those 3 parts have for aim to set in place a stable legal framework of the sovereign wealth funds as well as a good governance structure and a transparent and clear investment policy. 46

a. Legal framework, objectives and coordination with macroeconomic policies

44 OECD Message by the OECD secretary general to the international monetary and financial committee, 11 October 2008, Washington
45 Page 3, LES FONDS SOUVERAINS : DES INVESTISSEURS À LONG TERME EN MAL DE STRATÉGIES EFFICACES, MICHEL AGLIETTA, Revue n°hs09 Les fonds souverains 2009
46 Page 5 – Santiago principles
Legal framework

The first GAPP underlines the importance of the soundness of the legal structure of sovereign wealth funds. It should also be adapted to the funds objectives. 47

This principle includes the fact that the creation of the sovereign wealth fund is authorized by the law of origin country. Furthermore, the legal owners and the beneficiary of the products of the sovereign wealth fund should be identified. The managers of the funds should be empowered to invest the assets of the fund. 48

However, it is not important for the fund to have a legal personality different from the one of the State, since their legal framework and structure are sound. 49

Objectives and macroeconomic linkage

According to the GAPP 2, the purpose and objectives of the sovereign wealth fund should be clearly defined and disclose to the public. This will facilitate its management and governance and bring confidence in the investors because they will not fear strategic objectives from the fund.

Macroeconomic implications of sovereign wealth funds are important. For example they may increase the systemic risk because they are all interdependent and concentrated in some specific sectors such as finance and natural resources. 50 Thus, this influence added to the fact that they are sovereign and so, have limited liability they can be seen as dangerous for the macroeconomic

47 Page 7- Santiago principles

48 GAPP 1.1 Subprinciple. Page 12 Santiago principles

49 GAPP 1.2 Subprinciple. Page 12 Santiago principles

50 Page 4, Communication from the commission of the European parliament, the council, the European economic and social committee and the committee of the regions, a common approach to sovereign wealth funds, Brussels, 27.2.2008
security. According to the GAPP 3, the SWFs have to be coordinated with the fiscal and monetary policies of the State in order to limit and control their domestic macroeconomic effects.

b. Institutional framework and governance structure

- Host countries rules

According to the GAPP15, sovereign wealth fund operations and activities in a host country should be realized in conformity with the law in force in this country and in respect of mandatory disclosure requirements. In particular the sovereign wealth funds in their host countries have to respect and apply the regulations of financial markets which comprise the mandatory information disclosure, the rules against insider dealings and market manipulations. They have also to provide on request the financial and non financial information required by the rules and regulations. The sovereign wealth funds must allow the administrative authorities of the recipient country to conduct the inquiry and mandatory administrative control. They have also to respect the laws regarding concentration as well as tax regulations.

Regarding concentration, the acquisition of control of a company by an investor is submitted to the regime of the control of concentration if the operation is above a certain size.\textsuperscript{51} The notions of control and of size of the operation are defined by the national or international legislations. In European Law, the control is defined as the possibility for an investor to have a decisive impact on the company’s activity, its assets, the composition or the decision of its governing body. The size is defined by reference to the turnover realized by the investors and by the company in the EU and

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\textsuperscript{51} Page 5, \textit{Entre stratégie industrielle et politique de concurrence, quelle voie pour l'Europe?}, Amicus Curiae, Institut Montaigne, Briefing paper, February 2008
internationally. Some restrictions could be imposed if the fund already has some participation in companies of the same market, creating a concentration risk.

In exchange, the sovereign wealth funds expect the host countries to respect the principle of non-discrimination. They expect that the host countries will not impose them, rules, conditions or restrictions that will be more stringent for them than for other investors in similar circumstances.

Furthermore, according to the GAPP 20, the sovereign wealth funds should not seek to gain profit from privileged information or dominant market positions to compete unfairly with private entities. However, it is possible for the host countries to recognize to sovereign wealth funds some privileges such as a sovereign jurisdiction immunity or sovereign fiscal immunity. But, we have to underline that the rules of sovereign immunities, because they are different from one country to another, go again legal security and predictability. A tendency can be found, if the sovereign wealth fund is involve in commercial activities, as a private entity could be, by opposition to governmental or regulatory duties that are under public law.

- Sovereign wealth funds governance

According to the GAPP 6, the governance framework should be sound and clear as well as the division of the tasks between the State, the board of director and the managers of the sovereign wealth funds.

- The State role

The State can own the whole fund or only the assets managed by the fund.

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52. See EU Competition, rules applicable to merger control, http://ec.europa.eu/competition/mergers/legislation/merger_compilation.pdf

53. Pages 582 and 585, Régis BISMUTH, Les fonds souverains face au droit international. Panorama des problèmes juridiques posés par des investisseurs peu ordinaires. Annuaire français de droit international, LVI-2010-CNRS Editions, Paris
According to the GAPP 7, the shareholding state has to define the funds objectives, to choose members of the governing body and to control. The objective defined by the State should be set according to the laws and regulations in force. The funds objectives include the investment policy, its mission and the risks that it can take. The proceedings to nominate the members of the governing body have to be clear. It has to include the fact that the members designated should have good knowledge of financial market and expertise. This is a very important point to promote good governance. The principle 2 and 5 of the Basel principles published two years after the Santiago principles also underline the importance of having qualified staff and senior management able to control the company activities. 54

The State also has a power of control, which depend of the legal status of the fund. An appropriate system of transmission of information should be set in place in order that the State can have timely and reliable information on its fund.

Finally, according to the GAPP 10, the shareholding state can be obliged to render account parliament or to citizens of the objectives realization.

✓ Sovereign wealth funds governing body

According to GAPP 8, the governing body should have the necessary authority and competency and act in the best interest of the fund. It should be structured in such a way that it can independently and objectively achieve its objectives. A remuneration system meant to attract the qualified professional can be instituted.

The governing body is in charge of the elaboration of the fund strategy in order to realize the State objectives. According to the GAPP 10, the governing body, when the fund has a legal personality

54 Page 10 and 16, Basel Committee on Banking Supervision, Principles for Enhancing Corporate Governance, October 2010
different from the one of the state, controls the execution of the executive managers and reports to the State.

According to the GAPP 23, because the governing body is directly responsible for the performance of the fund, it has to be reliably quantified, and be communicated according to clearly defined rules.

✓ Sovereign wealth fund operational management

According to GAPP 9, the managers of the sovereign wealth funds have to set in place the strategy in an independent and responsible way.

According to the GAPP 10, the managers are in charge of the fund daily governance. They take the investment decisions as well as the one regarding human resources and finances. Thus, they are accountable for the fund management in front of the governing body when the fund have its own legal personality or in front of the shareholding state if it is not distinct from the State personality.

To improve the confidence of the recipient country in sovereign wealth funds, the operational managers should be independent from political influence. The state can define the general policy of the fund but not take particular decision. Operational management should really be independent to guaranty a good governance of the fund.

If the operational management of the fund is outsourced, it is really important that the GAPP 18.2 be respected. Indeed, it says that the policy applicable to the sovereign wealth fund should include the managers missions, the expected results, the acceptable risks levels, the occurrence of the reports and the remuneration of the managers.

According to the GAPP 14, the relationship between the operational management coming from an outsource company, should be based on commercial and financial basis with precise proceedings.

✓ The standards of conducts
According to the GAPP 13, the professional and deontological standards should be clear and established. They should be communicated to the members of the employees and managers of the funds. They have to be qualified and trained and submitted to a code of conduct. Indeed, codes of conduct are a key part of good governance. The codes of conduct should be elaborated by the employees, managers and directors together and sign by all the company members. They will promote good practices and deontology. It should also be compliance rules as well as methods to solve the conflict of interests.

According to GAPP 19.2, the asset management should be done according to generally accepted practices. They should be realized with due diligence, concern and competence. The fees and commissions obtained should be reasonable and be submitted to clear proceedings and be communicated to the shareholder or to the governing body.

c. Investment and risk management framework

- Investment regulation

According to the GAPP 2, the objectives of the sovereign funds, their strategy and their investment policy should be clear. According to GAPP3, their objectives have to be determined with the approval of the fiscal and monetary authorities and be part of the framework of the global macroeconomic policy. Indeed, sovereign wealth fund are often set in place for macroeconomic reasons. They can have an important impact on public finances on monetary conditions of the origin states. The objectives other than economic or financial should be specifically described and in a restrictive way.

According to the GAPP 18, the investment policy has to rest on adequate portfolio management principles. It has to precise how to realize the objectives according to the establish strategy. According to GAPP 18.1, it has to indicate the objectives according to a defined strategy that
indicates the risk allocation\[55\], the possibility for the fund to use leverage effect and derivate products and the risk tolerance of the investments.

According to GAPP 19, the investment decisions should be conform to the objectives, the strategy and to the investment policy of the fund. Indeed, they have for aim to optimize risk-adjusted financial returns of the fund. The investment decisions should also be based on economic and financial motivations. If they are not, according to GAPP 19.1 the other objectives should be clearly defined in the investment policy and disclose to the public.

According to GAPP 21, when a sovereign wealth fund is shareholder, it is supposed to use its powers in coherence with its investment policy and in a way to preserve the value of its participation.

- Financing

According to GAPP 4, the rules, proceedings and arrangement regarding the financing, the withdrawal and the expenditures of sovereign wealth funds should be clearly defined and in coherence with their objectives. They should reflect the mechanism of risk sharing between the government or the central bank and the sovereign wealth funds.

- Risk management

According to GAPP 22, the sovereign wealth funds should be equipped with a system that allows them to identify, evaluate and manage the risk of their activities. According to GAPP 22.1, this system insured that the risk don’t go above the level of risk tolerance defined in the investment policy, comprise reliable mechanisms of transmission of information and be regularly submitted to an independent audit.

\[55\] The strategic asset allocation is generally based on a benchmark. It could be a bond index for example. It determines the class of asset in which the fund can invest as well as the geographic and sector repartition of assets and the accepted level of concentration on individual participations. [http://www.investopedia.com/terms/b/benchmark.asp](http://www.investopedia.com/terms/b/benchmark.asp)
Sovereign wealth funds face a lot of different risks: 56

- Financial risks: it is comprised of liquidity risks, market risks, credit risks
- Operational risks
- Legal risks
- Reputational risks

The risks are evaluated and managed according to quantitative methods. Risk management has to involve the different phases of the investment process:

- Pre-trade: where the investment decisions are taken and all the important questions about the optimal asset allocation and the risk that goes with it are posed
- Trade: when the risk management policy are implemented. Large funds have difficulties to implement all the risk management policies.
- Post-trade: when we analyze the risk of the investment and we monitor the investment and its risks. The post-implementation analysis of the risk management policies really important to improve them in order to limit shortfalls in their applications. 57

2.4 The key principle of the GAPP: Transparency

The report of the “IFSWF on member’s application of the Santiago principles” 58 provides that the aim of the Santiago principles is not to increase transparency but to promote the general application of good practices to increase confidence in sovereign wealth funds. However, it recognized that transparency play an important role because the sovereign wealth funds that give a greater value to

56 Page 5, Proposed best practices in investment and risk management for sovereign wealth funds, International Forum of Sovereign Wealth Funds, Investment and risk management sub-committee

57 Page 11-12-14-18, Proposed best practices in investment and risk management for sovereign wealth funds, International forum of Sovereign wealth funds, investment and risk management sub-committee

58 IFSWF, IFSWF Member’s experience in the application of the Santiago principles, July 7, 2011, www.ifswf.org
transparency have good reputation. Thus, transparency is a key principle of Santiago Principles and can be found in various forms. I have decided to classify them in two parts: the general disclosure of information to the public and the periodic reporting of information.

a. General information to be disclosed to the public

The end of the sovereign funds and its investment policy should be disclosed to the public according to the GAPP 2 and 18.3.

The GAPP 17 provides that the economic and financial information necessary to testify the economic and financial direction of the fund should also be publicly disclosed. This duty is meant to check to the fund behavior is in adequacy with its strategy and it does not have political objectives. This information is composed by the funds’ objectives, the composition of its portfolio, the index of reference eventually used, of its cost-efficiency results, by its risk exposure and by its level of utilization of the leverage effect. Furthermore, according to GAPP 19.1, if elements other than economic or financial play a role in the investment decision, they have to be publically disclosed.

According to GAPP 4.1 and 4.2, in order to improve the control of public finance, the source of financing and as well as the general approach of withdrawal and expenses of the sovereign wealth fund have to be disclosed to the public.

According to the GAPP 1.2, in order to promote a better knowledge of the institutional organization of the funds, the principal characteristics of the legal structure of the sovereign wealth fund have to be disclosed to the public as well as the relations between the funds and the other public structures such as the central banks.

The GAPP 21 provides that when the sovereign fund have a shareholding in a company, it has to disclose if it wants to use its voting rights and how. If it wants to be represented in the board of

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director, it has to disclose it. Furthermore, in this case its people have to act in the interest of company. The fund has also to publish its vote to allow observers to check if they have acted according to economic and financial interests.

According to the GAPP 22.2, the risk management of the sovereign fund has to be publically disclosed.

b. Periodic reporting of information by the Sovereign wealth funds

According to the GAPP 11, the sovereign wealth funds have to establish an annual report regarding their activities and results, in conformity with the recognized international regulations. This annual report has to include all the accounts details. In order to insure that the information provided by the funds on its investments are clear, reliable, sincere and comparable, sovereign wealth funds have to be prepared on the basis of principles of national accountability applied each years.

The GAPP 12 provides that the fund operations and accounts have to pass regular intern audit and annual extern audit. The internal audit has to be independent from the fund operational management. The annual external audit have to be realized according to the international accounting standards in order to be sure that they give a true and fair view of the financial situation of the fund. The external audit has to be independent and submitted to strict situations of qualifications and selected according to a transparent proceeding. This audit report has to be part of the financial report and to be submitted to the fund’s shareholders or governing body.

According to the GAPP 5, the sovereign fund has to timely transmit the necessary statistical information to the national agencies, in order to include them in macroeconomic data basis. Given the important financial power of the sovereign wealth funds, it is really important that their activities can be taken into account in the international economic statistic. This knowledge will permit to the politicians to take informed decisions.

c. The impact of transparency on the sovereign wealth funds
The IFSWF have made a report in 2011 to see the impact of the Santiago principles on the sovereign wealth funds and how the members apply those principles. It has a whole part on transparency which illustrates the fact that transparency is really the key principle of the GAPP. More precisely the chapter is about “The value of transparency and the Santiago principles”. The positive point is that all the members consider transparency as adding a value to the fund rather than having a negative impact. Thus, most of them value transparency.  

Thus, some funds like Norway saw it has “having a disciplinary effect on the management” of sovereign wealth funds. This is a good point because the aim of the Santiago principles are to promote good practices to bring some frame and discipline to the SWFs management in order to increase confidence in them. And, as we have seen during the financial crisis, market players’ discipline is crucial to the stability and soundness of the global financial system.

The biggest impact of transparency on sovereign wealth funds is on their reputation. It can be seen at an international and domestic level. Indeed, the general public as well as the experienced investors understands what the fund is meant for and how it acts exactly, thus the fear of it decreases. It gives them some legitimacy and thus have an impact on their commercial power.

Furthermore, transparency also has an impact on the general governance of the fund. Indeed, in order to have good governance all the funds members have to be implicated in its governance thus, they need to be informed. In a lot of financial companies’ stakeholders let the board of directors take the decisions without carrying much of what is going on since they make money. But, by promoting transparency, sovereign wealth funds also promote communication in particular with stakeholders.

Transparency has also an impact on the governance of sovereign wealth funds in improving operational and investment practices. Indeed, it has been a guide for sovereign wealth funds as well as for policy makers, in order to improve the practices of sovereign wealth funds.

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60 Page 38, IFSWF, ISFWF member’s experience in the application of the Santiago principles, www.ifswf.org, July 7, 2011
To conclude, some funds have conducted internal assessment to check how they comply to the Santiago principles. This is a good point because it shows the will of some sovereign wealth funds to fully implement Santiago principles even if they are non-binding. If all the advantages of having transparency, in particular the commercial ones, are confirmed in the future, they could serve as a model for the other funds. Indeed, companies in particular financial ones, are looking for profit maximization. Sovereign wealth funds are public entities however, they are still meant to increase the profit of their investment. SO, to succeed to combine principles of good practices and commercial advantages could really help expend the implementation of the Santiago Principles.

2.5 Santiago principles implementation

To analyze how sovereign wealth funds have implemented Santiago principles, I will base my conclusion on the Santiago principles compliance index set in place by Sven Behrendt. 61

a. Positive aspects of the Santiago principles implementation

Thanks to the consensus around the necessity of setting in place principles of good governance for the sovereign wealth funds, the IWG became a true instrument of international coordination. It has been renamed IFSWF, the International Forum of Sovereign Wealth Fund. 62 It has its own agenda policy as we can see in its “Kuwait declaration”. 63

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61 Sven Behrendt, Sovereign Wealth Funds and the Santiago principles, where do they stand?, Carnegie Papers, Number 22, May 2010


Furthermore, the fact that all this institution and the Santiago Principles have been established in cooperation with the FMI and all the countries that wanted participate to their elaboration is a good thing because it should permit a good implementation.  

Even if there are not concrete sanctions to the sovereign wealth funds if they do not respect the Santiago Principles, the most efficient way to insure the respect of the principle, is that it will influence their reputation and it is important to market players.

On the contrary, the countries that implement the Santiago principles will have a good reputation and will be none for the quality of their governance, thus, they will attract the investors.

In this way, the development and implementation of the Santiago Principles can contribute to stabilize the financial system by bringing more confidence and thus, less volatility. Thanks to this and the decrease of the mistrust from developed economies toward developing ones, the Santiago Principles will also be able to develop good relationships between countries of different economic levels which will contribute to the economic growth of the developing ones.

Some funds have complied really well with the requirements of the Santiago Principles. They represent 20% of the SWFs’ assets. They are, for example, the New Zealand, the Australian and the Norwegian funds. They are transparent about their investments, governance, funding etc. Furthermore, one of the important things regarding the implementation of sovereign wealth funds is that, as Sven BERHEDT demonstrated in its analyze, maturity of the Sovereign Wealth Funds, as well as the level of economic development of the origin countries, do not have impact on the level of

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64 Page 38, Joseph J. NORTON, The “Santiago Principles” and the International Forum of Sovereign Wealth Funds: evolving component of the new Bretton Wood II post-global financial crisis architecture and another example of ad hoc global administrative networking and related “soft” rulemaking?, 2008-2009, Santiago Principles and Sovereign Wealth Funds

65 Page 6, Sven BERHENDT, Sovereign Wealth Funds and the Santiago Principles, Where do they stand?, Carnegie Papers, Number 22, May 2010
implementation of the Santiago Principles. \textsuperscript{66} This is reassuring because that shows that all the types of countries can apply them. Indeed, the recurrent criticism made by developing countries to international institutions is that they are conceived by developed countries in their interests and are not adapted to the economic situations of developing countries. Furthermore, the fact that the Santiago principles can be applied to all sovereign wealth fund regarding their level of maturity show that the level of application of the Santiago principles doesn’t rest on the size or the level of experience of the fund managers.

\textit{b. Aspects to improve}

First, it is important to recall that Santiago Principles are the fruit of cooperation between countries with differences in terms of governance, tradition and economic level. Their sovereign wealth funds are even more heterogeneous, they have different legal status, rules of functions, objectives etc. Thus, all those differences mean that they necessarily have been some compromise made. In top of this, as a lot of international regulations, they are only recommendations, they are not binding and they do not provide any sanctions. They are instruments of auto regulation. The adoption and implementation of the principles by the sovereign wealth funds and their origin countries are left to their appreciation. \textsuperscript{67}Thus, the big question is to know if the sovereign wealth funds will effectively adopt and implement the Santiago principles.

\textsuperscript{66} Page 11 and 12, Sven BERHENDT, Sovereign Wealth Funds and the Santiago Principles, Where do they stand?, Carnegie Papers, Number 22, May 2010

\textsuperscript{67} GAAP 24
Regarding this, the principles specified that their application is submitted to the regulation in force in the countries in which they are applied. Thus, some rules of the SWFs’ origin countries can be obstacles for the effective application of the principles. 68

The second problem to the implementation of the Santiago principles is that even if numerous countries have already adopt the Santiago principles in their regulations, adoption doesn’t mean implementation. 69 Thus, indeed, thanks to the elaboration of a “Santiago Compliance Index” by S. BERHENDT, we can see that the group of SWFs representing more than 20% of the assets of SWFs under management and composed by the Russian, Kuwaiti and Qatari funds, provide really few information about they effectively apply the Santiago Principles. This is surprising because they are among the funds that have been accused of pursuing strategic rather than commercial objectives. 70

The level of compliance of the sovereign wealth funds is influenced by numerous factors in particular the presence of a high level of democracy in their origin country. So, for the moment, the Santiago principles don’t succeed to radically change the behaviors of the origin country because the

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68 Page 5, Sven BEHRENDT, Sovereign wealth funds and the Santiago Principles, Where do they stand?, Carnegie Paper, Number 22, May 2010. In the Kuwait declaration, it was written that the IWGSWF will set in place a peer review process to make sure that signatories comply with their commitment. However, nothing has been done yet.


70 Page 13, Sven BEHRENDT, Sovereign wealth funds and the Santiago Principles, Where do they stand?, Carnegie Paper, Number 22, May 2010. In the Kuwait declaration, it was written that the IWGSWF will set in place a peer review process to make sure that signatories comply with their commitment. However, nothing has been done yet.
sovereign funds belonging to the least democratic countries are still the ones that apply fewer principles of transparency and good governance. \textsuperscript{71}

Furthermore, the Santiago principles are meant to address some conducts that can have bad effects. However, they are only addressing behavioral problems and some problems linked to sovereign wealth funds activities are “non-conduct” problems. Indeed, a lot of sovereign wealth funds are meant to invest the money from exchange rate surplus. However, they may also be funded by money coming from exchange rate surplus artificially created by the origin countries. \textsuperscript{72}

Finally, the principle of reciprocity which is OECD key principle in term of freedom of investment is not present in the Santiago principles despite the fact that they have been created to avoid protectionist policies. \textsuperscript{73} Here, I think that there is incoherence, because in the Santiago principles, developed countries accept to sign a convention that will impose some principle on good governance on sovereign wealth funds in order to create confidence from other country. This confidence will permit sovereign wealth fund from developing countries to invest in developed ones with less restrictions. However, the developed countries will have less benefit because, even if they introduce principles of good governance in their SWFs, they are often undemocratic and for example, they may not apply principles of proportionality in their laws restricting foreign investment. For example, China


\textsuperscript{72} Page 7, Nicholas O’KEEFE and Andrew R. KELLY, The Santiago Principles, a step forward for Sovereign Wealth Funds, Latham & Watkins, Client Alert, Number 757, October 29, 2008

\textsuperscript{73} Page 11, Robert M. KIMMIT, Public Footprints in Private Markets, Heinonline 87 Foreign Aff. 128 2008
has more than 200 laws and texts that can affect foreign investments. The regulation is complex and opaque and in case of litigation the arbitration is often partial.  

2.6 Conclusion

Sovereign wealth fund are public entities that have impact on the global financial market. Thus, they have a particular status and their “sovereignty” prevents them of being submitted to the same rules of disclosure and management than the private companies. Thus, following the crisis and the polemic around SWFs regarding their influence on protectionist policies, it was important to find a way to improve the transparency and the governance of the funds. Thanks to an international cooperation the Santiago principles and the IFSWFs have been created. The Santiago principles, despite their few years of experience already had a positive impact on the funds that have applied it. The problem is that because they are only guidelines, they will never be fully implemented by the sovereign wealth funds. Thus, through the IFSWFs, it is important that sanctions and control for the implementation of those principles be set in place to be sure that they will have more and more positive impact in the future and will help strengthen the international financial system.

CHAPTER 3: THE CASE OF THE AUSTRALIA FUTURE FUND

3.1 Introduction

The Australian future fund is a young one; it was created in 2006 by the Future Fund Act 2006. I have chosen to study this fund because despite its young age it is a model in terms of transparency according to the IFSWF. There are very few studies on this fund thus; it could be interesting to see how the fund applies the Santiago principles. So, first I will explain what the future fund is, and then I will study the founded act of the Fund, the Future Fund Act 2006, to see if it provides a basis that follows the requirements of good governance of the Santiago principles. Then, I will see how the Future Fund has improved its governance by progressively integrating them to its functioning. So, the aim of this part is basically to see if the principles could be applied by Sovereign Wealth Funds by implementing them in their legislation and putting them effectively in practice.

3.2 Presentation of the Future Fund

a. Aim of the Fund

The Australia future fund has been created to help the government to meet its obligations regarding pensions. It has for objectives to strengthen Australia’s long term financial position by making provisions for unfunded Commonwealth pensions. Thus, the aim of the creation of this fund is to reduce the financial pressure on the government that will necessarily arise because of the ageing of the population. 75

The aim is to maximize the benefits of the fund with long term investment by making it consistent with the investment international best practices. 76


76 Page 12, Part 3, Section 18, Future Fund Act, 2006
b. **Structure of the Fund**

The Future Fund is composed of three different bodies:

- The Future Fund special account
- The Future Fund board of guardians
- The Future Fund management agency

The Future Fund Board of Guardians is composed of 7 members and comprises the Chair of the Fund. It is independent and it is responsible for the investment of the fund in front of the Australian Government. It is assisted by the Future Fund Agency which is basically the operational part of the Fund.  

The management of the assets is outsourced. The managers are chosen carefully and have to report regularly to the board which monitors their activities.

The Board of Guardians and the Agency are also in charge of the investment and management of three other Australian funds created in 2008, the building Australia Fund, the Education Investment fund and the Health and Hospital Fund.

The Future Fund Board of Guardians has to report annually to the Australian Parliament and has to pass an external audit every year.

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77 Page 32, *Santiago Principles*, International Working Group of Sovereign Wealth Fund

78 Page 2, Chapter 1, section 3, Nation Building Fund Act. The Building Australia Fund has for objective to make payment in relation to the development of transport, communication, broadband network, energy infrastructure and water infrastructure. The Education Investment Fund has for aim to make payment in to the creation or development of higher education infrastructure, research infrastructure and vocational education and training infrastructure. The Health and Hospital Fund has for objective to make payment in relation to the creation or development of health infrastructures.
c. Investments of the Future Fund

According to the mandate given by the minister for finance and administration, the return of the fund must be between 4.5 and 5.5 per cent per annum of the Consumer Price Index. It should do so by taking into account the change of the Australian markets and the reputation of the Australian government. It also has to respect principles of good governance. Furthermore, the risk taken by the Fund has to be “acceptable but not excessive”.

The Future Fund has a particularity. Indeed, it has a big investor which is Telstra. Telstra was a public telecommunication and broadband company. It has been progressively privatized. The 16.4% remained and belonging to the Australian has been invested into the Future Fund. Thus, even if the Future Fund has tried to progressively diversify its portfolio Telstra holdings are still an important part of its assets.  

3.3 Compliance of the Future Fund Act 2006 with the Santiago Principles

In this part, I will look closely to the founding act of the Future Fund, the Future Fund Act 2006. I will see if at least on paper, the Future Fund complies with the requirements of the Santiago Principles. This act has been amended several times and I will use the one updated in February 2012.

a. Governance of the Future Fund

According to the GAPP 6, the fund should have a sound and clear governance with a clear allocation of the roles and responsibilities.

The fund is composed of a Board of Guardians that is in charge of the investments of the fund and an Agency which represents the operational management of the funds. Furthermore, as we will see, the

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79 Future Fund Investment Mandate, 3 May 2006

80 Page 25, Annual Report, Future Fund, 2010-2011
role and responsibilities of them are clearly set and the management of the fund is done according to principles of good governance.

- Role of the shareholding state

According to the GAPP 7, the owner of the SWF would set in place the objective and the procedures to nominate the governing body as well as look closely to its operations.

According to the Future Fund Act 2006, the government has fixed for objectives to the future fund “to strengthen the Commonwealth long term financial position”, the term “Commonwealth” has to be understood “Commonwealth of Australia”.81 Furthermore, it is the government that chose the Chair and the 6 other members of the Governing body which is in the Future Fund, the Board of Guardians.82 The members are chosen for their experience and qualification and they are appointed for a maximum of 5 years but the minister of finance can decide of an earlier termination of their contract if they are involved in a conflict of interests or corrupted practices.

- Governing body

According to the GAPP 8, 10 and 23, the governing body should have a clear mandate and act in the best interests of the fund. It should be accountable and all the proceeding to achieve this goal should be clearly set in legislation. Furthermore the performance of the fund should be reported to the owner on a regular basis and with clearly defined standards.

In the future fund act it is specified that the Board of Guardians is responsible for the investments of the funds.83 The accountability framework of the SWF is defined in the Future Fund Act. The fund

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81 Part 1, section 3, Future Fund Act

82 Part 4, division 2, section 38, Future Fund Act

83 Part 4, Division 2, section 35-36, Future Fund Act 2006
has to report annually to the Minister of Finance which will transmit this report to the parliament. The performance of the fund is reported in the annual report by the Board according to the international standards of accountability. Furthermore, the assets held by the fund are held in the name of the Commonwealth of Australia, thus the board members have to act in the best interests of the fund for the Australian Government.

- Operational management

According to the GAPP 9, 10, 18.2 and 14, the operational management of the SWF should implement the policies of the fund independently with clear definitions of the responsibilities and of the accountability framework in a legislation or regulation. Furthermore, the investment policy should set in place how the internal and external managers are chosen and what their roles and responsibilities are. The SWF can deal with third parties but it has to be based on commercial grounds and with clear proceedings.

In the Future Fund Act the role of the operational staff is clearly defined. They have to assist the Board with their expertise by providing them with some information and resources. They are responsible for the administrative and operational part of the fund.

The Fund Agency is composed by a chair and the staff of the Agency. The Chair is designated by the Minister of Finance and is in charge of directing the Agency and managing the staffs. It is independent from the Chair of the Board. Indeed, it cannot be directed by the board “in relation to the Chair’s performance of functions or exercise of power in relation to the agency”.

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84 Section 80, Future Fund Act 2006
85 Part 4, division 2, section 74-75, Future Fund Act 2006
86 Part 5, division 2, section 74-75, Future Fund Act 2006
87 Part 4, division 2, section 79, Future Fund Act 2006
The staff is employed on the status of public servant and according to its expertise and experience. The Chair can also appoint experts from outside the fund to help the staff in its tasks. The staff can also be helped by others civil servants form other agencies of Australia’s government. The term and conditions of their contract is determined by the Chair of the Agency.

Regarding the employment of investment managers, the Board has the right to engage investment managers. But their role is strictly defined in the Future Fund Act. They have to report both to the Board and the Agency on a regular basis.

- **Good Conduct**

According to GAPP 13 and 19.2, the standards of good conduct should be clearly set and transmitted to all the staff of the sovereign wealth fund, managerial and governing. Furthermore, the assets of the funds should be managed according to generally accepted sound management principles.

According to the Future Fund Act 2006, the Board members have the obligation to apply the principles of care and due diligence when governing the Future Fund. When they conduct the operations of the fund, the Board Members have to apply the principle of good faith as well as when they report to the minister and to the parliament. This is a civil obligation but in case of recklessness or dishonesty it is considered as a criminal offence.

Furthermore, the Board members must not use the information to which they have access to cause harm to the board or to any other person. This is also a civil obligation that in case of infringement can be considered as a criminal offence. The board members can also rely on the information

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88 Part 4, division 2, section 76, Future Fund Act 2006

89 Part 5, division 4, section 82, Future Fund Act 2006


91 Part 4, division 7, section 56, Future Fund Act 2006

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provided by experts, other board members or the staff of the agency. They have to rely on it with good faith but in a reasonable way.  

Board members that are involved in a conflict of interests with the matter treated by the board must inform the other board’s members. They will follow some restrictions on voting and being present.

The board is in charge of establishing written investment policies. It establishes the benchmarks and standards for assessing the performance of the fund. It also set in place policies regarding the risk management of the fund. They do so by respecting the standards of the international best practices for institutional investments.

b. Transparency of the Future Fund

According to GAPP 2, 18.3, 17, 4.1, 4.2, 1.2, 21 and 22.2 it has to disclose the purpose of the SWF, the investment policy, the financial information, the investment decisions, the source of funding, the general approach to withdrawal, the legal basis and structure of the sovereign wealth fund, the potential exercise of the ownership rights and its risk management framework.

According to GAPP 11, 12 and 5 the Fund should publish annual reports about its operation and performance according to recognized national or international accounting standards, the fund should also pass an annual audit of its operations and financial statement. It has to be conducted in accordance with international auditing and accounting standards. Furthermore, the statistical data of the fund must be published by its owner in order to provide information for the macroeconomic data sets.

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92 Part 4, division 7, section 65, Future Fund Act 2006

93 Part 4, division 8, section 68, Future Fund Act 2006

According to the future Fund act the chair of the board must transmit an annual report to the responsible minister at the end of each year. The report has to include the details of the operations of the Board and the Agency, the performance of the fund, the details of withdrawals from the fund and the justification for them and the different benchmarks followed by the fund. The report has to be transmitted by the minister to the two houses of the parliament within 15 days. This report also contains the key features and the legal basis of the fund as well as the general risk management policy of the fund. The report is also disclosed to the public through the website of the fund.  

Furthermore, on top of the duty of making annual reports, the Future Fund also has other reporting obligations. The board has to keep the responsible minister informed of its activity and performance. 

To have a full control of the activities the fund, the responsible minister also has the possibility to ask the board for additional reports about specific subjects and the performance of the board. To report according to a demand of the minister is an obligation for the board. The minister can then choose to disclose the information he has obtained.

According to the Future Fund Act, the board is in charge of setting in place the investment strategy, the benchmarks and standards for assessing the performance of the Fund, the risk management of the fund. It has to do them by insuring that they comply with international recognized standards of best practices. Those policies should be published on the internet as soon as “practicable”. 

Furthermore, the Board cannot detain more than 20% of the shares of a foreign listed company. It has to disclose of its investment and shareholdings in the annual reports.

The Board meetings and vote has to be recorded and publically disclosed.

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95 Part 5, division 4, section 81, Future Fund Act 2006  
96 Part 4, division 6, section 5, Future Fund Act 2006  
97 Part 4, division 6, section 54, Future Fund Act 2006  
Regarding the audit of the fund, the Future Fund has to follow the Financial Management and Accountability Act 1997. This means that it should set in place a single fraud control for the Board and the Agency, a single audit committee, a single set of annual financial statements, audit in a single set the financial statements of the Agency and the Board.  

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c. **Investment Policy**

According to the GAPP 18, 3, 19, 18.2, 19, 19.1 and 21 the investment policy should be clear and consistent with the risk tolerance and investment strategy decided by the owner of the fund. Furthermore, SWFs have important macroeconomic implications. Thus, their activities should be closely coordinated with the fiscal and monetary authorities of the country. The investment decision of the SWFs should aim to maximize the risk-adjusted financial returns with its investment policy. It should be based on economic and financial grounds, but if some investment decisions are subject to reasons other than economic consideration, it should be disclosed to the public. Furthermore the SWF should disclose if it takes participation as a shareholder in its equity investment and disclose the vote if it is participating to it.

According to the Future Fund Act 2006, the direction regarding the investment of the fund has to be given by the responsible minister. They have to be consistent with the principles of best practices and with the objectives of maximizing the profit of the fund.  

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The board can invest in its name the money of the fund in any financial assets. They will be considered as investments of the fund.  

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However, there are limitations to the investments of the board. For example, the investments in

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\[\text{100}\] Part 4, division 4, section 50-51, Future Fund Act 2006

\[\text{101}\] Part 5, division 4, section 80, Future Fund Act 2006


derivatives are supervised and have to follow specific conditions. Those limitations are meant to limit the macroeconomic implications of the fund. 104

The investment mandate of the Fund is decided by the responsible ministers. The Board must comply with it and respect it. If it does not succeed to comply with it has to be justified to the responsible ministers. In the case of the Future Fund, the responsible ministers are the Minister of Finance and Administration and the Treasurer. They have defined the investment strategy of the Future Fund, in the “Future Fund Mandate Direction 2006”. In this paper, they recall the purpose of the fund; they set the benchmark return, the limits for holding in a listed company, and establish that the board has to consider the impacts of its investment strategy. It has to act to minimize the effect that the investments of the Fund can have in the Australian market and in the volatility of the investments and be careful to not diminish the reputation of the Australian Government’s in Australia and on the financial markets. Furthermore, the Board has to follow principles of institutional best practices for investments and follow principles of corporate governance in relation to its voting policy.

One of the roles is to set up written policies regarding the investment strategy of the fund, its risk management and to make sure that the fund activities follow the international codes of conducts regarding good governance and institutional investment. 105 The risk that the fund can take is defined by the responsible ministers in the investment mandate: it has to be “an acceptable but not excessive level of risk”. 106

To follow the requirements in terms of disclosure of investment policy the Future Fund has also published a “Statement of investment policies” in February 2012. In this document it describes its business model, and in particular the way it chooses its investment managers. The Board can only invest with the participation of an external investment manager. The selection of those managers is

106 Future Fund Investment Mandate Directions 2006, section 5.
strict and follows several criteria such its objectives and strategy and if they are suitable for investments of the Future Fund. When appointing an external manager, the Board has to determine several points such as the proportions of the different types of assets allocated to the manager and the risk it can take.  

- Risk management

According to the GAPP 22 and 22.1, the SWF should set a framework that identifies, manages and assesses the risk of its activities. This framework should include reliable information and timely reporting systems to help monitor the risk. It had to be done with the respect of acceptable parameters and levels of risks and by following codes of conducts in the frame of a business continuity planning and with the help of an independent audit function.

The Board is responsible for setting policies in order to ensure that risk is properly managed. The Agency works in parallel of the Board to ensure that the investments are made on long term views which permit to assess the risks of some specific assets progressively. Furthermore, when investing, the Board has to make an inquiry about the financial asset in order to have a good understanding of it and of its potential risks. In order to minimize the risk the portfolio has to be diversified. The Board can acquire assets in 6 different types of financial instruments: listed equities, private equity, debt, tangible assets, alternative assets and Cash. Because of the changing financial environment the Future Fund has adopted a strategy of “Dynamic management of portfolio” which permits to constantly adapt the policies to the types of investments and their variations.

The Investment mandate given by the minister in 2006 stipulates that the risk taken by the Board should be “acceptable but not excessive”.

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107 Page 6, section 2.3, Future Fund, Statement of Investment Policies, February 2012
109 Page 9, section 3.3, Future Fund, Statement of Investment policies, February 2012
Finally, the Board has management policies for 6 different types of risks:110

- For market risks the Board has set in place policies that allow them to adopt appropriate risk profiles according to each type of financial instrument thanks to enquiries. They also avoid concentration of assets of the same types and regularly assess the risk taken by the fund.

- Manager risks: because the fund outsources some of its investments, the Board faces manager risk because they may go under or above the objectives of the funds. Thus, the Board has taken policies to limit this manager risk: it selections the managers for their experience and knowledge of the financial instruments. It monitors the portfolios of the external managers to be sure of their quality and activities.

- Credit risks: the credit risk is taken into account by the board by checking if the credit rating of the counterparties stays within reasonable limits. The Board takes various measure to be sure that investment managers don’t contract with risky counterparties. A range of Guidelines are set to make sure that the risk taken does not exceed a certain limit.

- The liquidity risk: the principle of sovereign wealth fund is that they are long-term investors. It is also the case for the Australia Future Fund. Thus, they can bear a certain level of liquidity risk. Indeed, over the time the liquidity of an asset can evolve. However, the Board also manages this type of risk: they set monitoring systems to assess the liquidity of the portfolio and how it can evolve during a period of stress for financial markets. They also set in place monitoring for the cash flows that will go into the portfolios in order to know when there will be some needs of liquidity for the assets. Furthermore, this prevision is made by taking a margin in order to be sure that there will always be enough liquidity for the assets.

- Operational risks: An operational risk is the risk of loss because of failure of the internal structure of the fund. Operational risk is managed by various methods. Among them, there is

110 Page 16, Section 5.2, Future Fund, Statement of Investment Policies, February 2012
the necessity for the counterparties and asset managers to have insurances, the establishment of due diligence proceedings and the establishment of method of compliance with a duty for the managers to report periodically.

d. Conclusion

As we can see at the end of the Future Fund Act 2006, it has been amended several times in order to comply with all the requirements of the GAPP. So, as we have tried to demonstrate, the Future Fund follows all the principles of the Santiago. We can say that at least on the paper, Australia Future Fund follows principles of good governance. However, it is important to check if it is also the case in its daily functioning.

3.4 Influence of the GAPP on the Fund

In this part, I will analyze how the Future Fund has adapted its investments, structure and functioning to the requirements of the Santiago Principles. So, I will compare the annual reports of 2006-2007, before the Santiago Principles and the annual report of 2010-2011, after the Santiago Principles. This way we will see if the Future Fund applies principles of good governance in practice and not only in theory.


- Letter of transmittal from the Chair to the Minister of Finance

In the letter transmitted by the Chair of the Board to the ministry of finance, as in the report of 2006-2007\(^\text{111}\), it is said that it will be transmitted within 15 days to the parliament. However, in the 2010-2011 reports the Chair certified that the Fund has set in place proceedings and measures to make

sure that the report will be exempt of any fraud. Indeed, the fund has now set in place fraud risk assessment and fraud control plans.  

- Report of the Chair

Since 2006, the chairman is still David Murray. In this report, he says that in 2006 the fund’s value of assets is $52 billion. In 2010 it is of $75.4 billion. Thus we can say that despite the fact that between 2006 and 2011 there has been the setting in place of the Santiago principles, the fund has continued to grow by respecting the objective of 4.5 to 5.5% return per annum set in place in place by the Minister of Finance in the investment mandate in 2006. So, the Fund is likely to meet its objectives on the long term and with an acceptable level of risk. Furthermore, in the 2010 report it has also complied with the Santiago Principles by developing a Board of Education and a Market Management Program for the staff of the Agency and the Board. Regarding the recruitment of the staff, the criteria of experience and education did not have change from 2006 to 2010. Indeed, the Fund has always sought to have skilled individuals.

- Report from the General Manager

What has changed between 2006 and 2010 is the role of the Agency. Indeed, 2006 was just the beginning of the fund thus, its role was mainly to set in place the good infrastructures and to consolidate the finance and audit management capabilities of its team. It also nominated a global bank, the Northern trust. But, even before the Santiago principles, it knew that a Sovereign Wealth Fund, as a manager of public assets has to be prudent when investing in private markets.

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114 Page 6, Annual Report of the Australia Future Fund 2010-2011

In 2010, the General Manager has changed, it was Paul COSTELLO and it now Mark BURGESS. It is important the Heads of the governing body and the operational management change regularly because new individuals will bring new skills. It will avoid the immobility of the funds in particular regarding innovation in the application of good practices. In its report, Paul BURGES, says that now the Fund has a sophisticated and well constructed portfolio. It wants to continue to attract talented professionals and to improve the quality of the infrastructures. More importantly he also wants to improve the risk management arrangement in order to take into account the instability of the financial markets nowadays. It its report he also disclosed the fact that the operational management has set in place a list of values that have to be respected by the Fund: integrity, excellence, innovation, team work, partnership.

b. The influence of the Santiago Principles on the investment reports of the Future Fund

- The 2006-2007 Annual Report

In the 2006 report the mandate of the fund is recalled. It has to have a return of 4.5 to 5.5% per annum in a long term rolling period of 10 years. At the time, the portfolio of the Fund was essentially made of cash, Australian Equities, International Equities and Telstra assets. The Fund was trying to develop both on the public and private market in order to diversify its portfolio. The Fund justifies the fact that the Australian Equities are a small component of the portfolio. The advantage is that they are exempt of taxation but the inconvenient is that they are concentrated in a very small market and thus they carry an important risk.

The philosophy of the Fund was to fully understand the risk carried by the assets of its portfolio. This shows that even before the Santiago principles the Fund has understood that being a public manager


\[117\] The value of partnership provides that the Fund will treat equitably the external providers in order to build commercially rigorous relationships.
with public money in hand implies limiting the risk taken by the Fund, in particular regarding the credit risk.\textsuperscript{118}

- The 2010-2011 Annual Report

In the investment report of 2010-2011, the mandate of the fund is also recalled but this time the Board recalls how important it is that the Fund reaches its objectives by taking into account International Best Practices for Institutional Investments. It also explains in details the meaning it has given to the mandate of “acceptable but not excessive level of risks”. It has for objective to review and balance the structure of the portfolio in the long term in order to minimize the risks of losses in this period of high market volatility.

The portfolio is now designed to be as flexible as possible in order to permit the fund to capture opportunities. It order to do so it has set in place two major categories of asset allocations, long term and short term. The broad investment categories of the Fund have changed. It is now composed of listed equity, private equity, debt, tangible assets, alternative assets and cash. It has also reorganized the governance framework of the portfolio in order to generate more return and to monitor risk more closely.\textsuperscript{119}

- Conclusion

From 2006 to 2011, one can see that the investment strategy of the funds has changed. It is now more robust and it tries to comply with the requirement of the Santiago Principles to carefully monitor risk and to consolidate the portfolio to make it more able to resist to the volatility of the financial market.

\textsuperscript{118} Page 20, Australia Future Fund Annual Report 2006-2007

\textsuperscript{119} Page 12, Annual Report of the Australia Future Fund 2010-2011
c. Influence of the Santiago Principles on the Governance of the Future Fund

- The 2006 Annual Report

In the 2006 report there is no part regarding the governance of the fund. There is a part named “Administrative reports” and is composed of 5 elements.

- Outcomes and resourcing
- Human resources
- Purchasing
- External scrutiny
- Freedom of information

It discloses the fact that it complies with all the requirements of the article 81 of the Future Fund Act 2006 and even more because it also disclosed portfolios and policy updates on its website. Thus, it shows that since the beginning it has really tried to comply with international best practices and good governance principles.

It also discloses its management costs and gives their definition: they include all the internal operating costs of the fund including remuneration. The Fund also tries to include in its functioning sustainable development and environmental performance. Furthermore, there are “Commonwealth fraud control guidelines” which is fraud risks assessment and fraud control plan set in place by the Board and approved by the audit committee.

Regarding human resources, the Fund disclosed that it has set in place a performance and management system and a training and development strategy established in order to keep a high performing staff. Furthermore, it has set in place a set of principles to selection its Consultants. It has
to take into account: and effective competition, ethics and fair dealing and accountability and reporting. ¹²⁰

- The 2010-2011 Annual Report

The part on governance in the 2010 annual report is particularly important in size. That shows a good will from the Fund to apply principles of good governance. In the beginning of the part the Board gives its definition of Corporate Governance: “how an entity is structured, operated and controlled to optimally achieve its objective”. Furthermore, it believes that “a positive relationship exists between good governance and the creation of investment value”. Indeed, since its creation the investment value of the fund has increased. It has more assets and they are of better quality.

The Board and the Agency have independent roles but they are both asset managers of the fund. Their aim is to make a maximum of profit in the respect of the international best practice for institutional investment and corporate governance. Furthermore, another key role in the good governance of the fund is the one of the Minister of Finance because it has an oversight role.

However, as provided by the Santiago Principles, there are arrangements that permit the Fund and its Board to be independent:

- The expenses of the funds are taken from the funds profit and do not depend on the parliament
- Very few limitations are imposed on asset allocation by the government. However, the board has to know the risk level and the content of each of its assets.
- Board members have to be chosen outside of the government and have to have sufficient qualification and expertise.

The board does not play a role of advisor for the government regarding macroeconomic policies and does only have for role to respect the objectives of the funds.

The accountability of the fund rests on the annual report and the audited financial statements. Furthermore, the disclosure of the attendance and votes of the different board members shows that the board is reliable and fully committed to its task. The report also says that the Board focuses on the good management of risks in particular by investing through well-tested frameworks and in compliance with the laws and the principles of good governance. Thus, the Fund does not invest in scheme that contravene to the OECD’s principles of transparency. It encourages the application of principles of good governance in the companies in which it invests by exercising its ownership rights.

The audit committee has approved the fraud risk assessment and fraud control plan prepared by the agency and the fraud control framework is part of the agency internal control framework.  

\[d\] The influence of the Santiago Principles on the Financial Statements of the Future Fund

In the 2006 report, in order to have a good independent auditor’s report, the Agency and the Board have the responsibility to provide reliable information to the auditors.  

The annual report seems good to the Chair and the Operational managers.

In the 2010 report, the financial statements are now “consolidated”. Indeed, there are more details regarding the investments of the funds. And, now, the Future Fund complies with more accounting standards which should guarantee it a greater liability. But, the only thing that has really changed is the addition of a new part regarding the implementation of the Santiago Principles by the Australian Future Fund. It details how it implements each of the principles with the internet address in reference.

\[121\] Page 30, Australia Future Fund Annual Report 2010-2011

\[122\] Page 34, Australia Future Fund Annual Report 2006-2007


e. Conclusion

From 2006 to 2011, one can see that the Funds has given more and more importance to the application of the principles of good governance set in place in the Santiago principles. However, it is also important to underline that since its creation good governance practices have been important to it.

3.5 Conclusion

The comparison of the two reports gives us information about the evolution of the place of the principles of good governance and the Santiago principles in the Future Fund daily routine. We see that the Board and the Agency try to comply efficiently with those principles and to transmit them to the companies in which they exercised their ownership powers. Thus, to my mind the Australian Future Fund can be seen as a model in term of good governance. However, in order to make those principles really efficient they have to be applied by a greater number of companies.
CONCLUSION

To conclude, one can say that sovereign wealth funds are complex investments vehicles. They are a heterogeneous group. They are dependent of States for their structures and governance frameworks. The IMF with the other international institutions has succeeded to establish tendency in the functioning and governance of those funds. From there, they have established principles of good governance that are supposed to be applicable to all the Sovereign Wealth Funds. In this dissertation, I only analyze the case of the Australia Future Fund and as we can see it has successfully implemented all the Santiago Principles.

However, we must not forget that this fund belong to a developed democratic country that is used to comply in its public and private sector with International Codes of Best Practice. It may not be the case for developing countries or non-democratic ones. Thus, a lot of countries that are signatories such as the Abu Dhabi Investment Authority are not complying with the Santiago Principles. Thus, to render them more efficient it is indispensable that the Sovereign Wealth Fund Institute set in place effective sanctions mechanism in order to improve the implementation of the Santiago Principles.

With a broader and effective implementation of those principles the sovereign wealth funds will be able to expend their power in a safe way. They can really be some assets for the future of the international finance because they will be able to provide a safe and broad pool of assets for investors. Thus, they will help balance the financial system in times of crisis.
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