

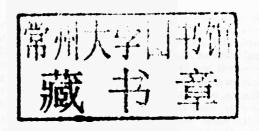
Marina Danilina

# World Largest Sovereign Wealth Funds

Main trends and development



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#### Introduction

A **sovereign wealth fund** (**SWF**) is a state-owned investment fund composed of financial assets such as stocks, bonds, property, precious metals or other financial instruments. Sovereign wealth funds invest globally.

Some of them have grabbed attention making bad investments in several Wall Street financial firms including Citigroup, Morgan Stanley, and Merrill Lynch. These firms needed a cash infusion due to losses resulting from mismanagement and the subprime mortgage crisis. Most SWFs are funded by foreign exchange assets.<sup>[1]</sup>

Some sovereign wealth funds may be held by a central bank, which accumulates the funds in the course of its management of a nation's banking system; this type of fund is usually of major economic and fiscal importance.

Other sovereign wealth funds are simply the state savings which are invested by various entities for the purposes of investment return, and which may not have a significant role in fiscal management.

The accumulated funds may have their origin in, or may represent foreign currency deposits, gold, SDRs and International Monetary Fund reserve positions held by central banks and monetary authorities, along with other national assets such as pension investments, oil funds, or other industrial and financial holdings.

These are assets of the sovereign nations which are typically held in domestic and different reserve currencies such as the dollar, euro and yen.

Such investment management entities may be set up as official investment companies, state pension funds, or sovereign oil funds, among others. The current work examines the caracteristics of the world biggest SWFs in different countries.

#### Chapter 1. Sovereign wealth funds: general trends

A sovereign wealth fund (SWF) is a state-owned investment fund composed of financial assets such as stocks, bonds, property, precious metals or other financial instruments. Sovereign wealth funds invest globally. Some of them have grabbed attention making bad investments in several Wall Street financial firms including Citigroup, Morgan Stanley, and Merrill Lynch. These firms needed a cash infusion due to losses resulting from mismanagement and the subprime mortgage crisis. Most SWFs are funded by foreign exchange assets.

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There have been attempts to distinguish funds held by sovereign entities from foreign exchange reserves held by central banks. Sovereign wealth funds can be characterized as *maximizing long term return*, with foreign exchange reserves serving short term *currency stabilization* and liquidity management. Many central banks in recent years possess reserves massively in excess of needs for liquidity or foreign exchange management. Moreover it is widely believed most have diversified hugely into assets other than short term, highly liquid monetary ones, though almost no data is publicly available to back up this assertion. Some central banks have even begun buying equities, or derivatives of differing ilk (even if fairly safe ones, like Overnight Interest rate swaps). Sovereign wealth funds are generally not keen to publish information about themselves.

The term *sovereign wealth fund* was first used in 2005 by Andrew Rozanov in an article entitled, 'Who holds the wealth of nations?' in Central Banking journal. The previous edition of the journal described the shift from traditional reserve management to sovereign wealth management; subsequently the term gained widespread use as the spending power of global officialdom has rocketed upwards.

Sovereign wealth funds have been around for decades but since 2000, the number of sovereign wealth funds has increased dramatically. The first SWF was the Kuwait Investment Authority, a commodity SWF created in 1953 from oil revenues before Kuwait even gained independence from the United Kingdom. According to many estimates, Kuwait's fund is now worth approximately \$250 billion.

Another of the first registered SWFs is the Revenue Equalization Reserve Fund of Kiribati. Created in 1956 when the British administration of the Gilbert

Islands in Micronesia put a levy on the export of phosphates used in fertilizer, the fund has since then grown to \$520m.

SWFs are typically created when governments have budgetary surpluses and have little or no international debt. This excess liquidity is not always possible or desirable to hold as money or to channel into immediate consumption. This is especially the case when a nation depends on raw material exports like oil, copper or diamonds. In such countries the main reason for creating a SWF is because of the properties of resource revenue: high volatility of resource prices, unpredictability of extraction and exhaustibility of resources.

There are two types of funds: saving funds and stabilization funds. Stabilization SWFs are created to reduce the volatility of government revenues, to counter the boom-bust cycles' adverse effect on government spending and the national economy. Savings SWFs build up savings for future generations. One such fund is the Government Pension Fund of Norway.

It is believed that SWFs in resource rich countries can help avoid resource curse, but the literature on this question is controversial. Governments may be able to spend the money immediately, but risk causing the economy to overheat, e.g. in Hugo Chávez's Venezuela or Shah-era Iran. In such circumstances, saving the money to spend during a period of low inflation is often desirable.

Other reasons for creating SWFs may be economical, or strategic, such as war chests for uncertain times. For example, the Kuwait Investment Authority during the Gulf war managed excess reserves above the level needed for currency reserves (although many central banks do that now). The Government of Singapore Investment Corporation and Temasek Holdings are partially the expression of a desire to bolster Singapore's standing as an international financial centre. The Korea Investment Corporation has since been similarly managed.

There are several reasons why the growth of sovereign wealth funds is attracting close attention.

- As this asset pool continues to expand in size and importance, so does its potential impact on various asset markets.
- Some countries worry that foreign investment by SWFs raises national security concerns because the purpose of the investment might be to secure control of strategically-important industries for political rather than financial gain. These concerns have led the EU to reconsider whether to allow its members to use "golden shares" to block certain foreign acquisitions. This strategy has largely been excluded as a viable option by the EU, for fear it would give rise to a resurgence in international protectionism. In the U.S., these concerns are addressed by the Exon–Florio Amendment to the Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, § 5021, 102 Stat. 1107, 1426 (codified as amended at 50 U.S.C. app. § 2170 (2000)), as administered by the Committee on Foreign Investment in the United States (CFIUS).
- Their inadequate transparency is a concern for investors and regulators.
   For example, size and source of funds, investment goals, internal checks and balances, disclosure of relationships and holdings in private equity funds. Many of these concerns have been addressed by the IMF and its Santiago Principles, which set out common standards regarding transparency, independence and governance.
- SWFs are not nearly as homogeneous as central banks or public pension funds. However they do have a number of interesting and unique characteristics in common. These make them a distinct and potentially valuable tool for achieving certain public policy and macroeconomic goals.