Policy Note: Sovereign Wealth Funds in East Asia

East Asia and Pacific Region

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EXECUTIVE SUMMARY

Sovereign Wealth Funds (SWFs) have been in existence around the world for many decades. However, the creation and growth of SWFs in East Asia and Pacific (EAP) is a relatively recent occurrence. The emergence of SWFs in Asia is a by-product of the strong economic development in the region and a desire by governments to enhance returns for the surplus foreign exchange reserves and fiscal and commodities-related revenues that have been accumulated. The EAP SWFs constitute of roughly 40 percent of total SWFs in the world.

The SWFs in the region are diverse and have various purposes, historical backgrounds, source of funds, investment strategies and governance structures. The largest, newest, and most prominent SWFs in the region are those created from surplus foreign exchange reserves. Despite a series of visible strategic investments, they typically pursue a balanced portfolio investment strategy. The other type of large SWFs are so-called “legacy funds,” which were originally established as national development funds, however operate more like private-equity funds today. As the size and number of SWFs are getting bigger and their influence becomes more significant in the international arena, the critical question of how to best utilize such funds will become more pressing. Undoubtedly, other regions and countries will watch EAP SWFs very closely with the keenest interest.

Most SWFs in EAP appear to have a straightforward legal status. However, such legal structures do not necessarily make them more effective in terms of their operational independence. Lack of transparency in the decision-making process as well as the ambiguous separation of responsibilities between the government authority and SWF management can obscure operational independence.

Despite the rapid increase in SWF money supply in EAP region, it is widely agreed that SWFs assets need to be better utilized to increase the developmental impact in the region. It remains to be seen if SWFs in Asia will ultimately become a better catalyst of long-term regional development. Success will largely depend on two critical questions: (i) Can the regional capital markets, with the help of an international institution such as the World Bank, develop scalable, long-term debt securities to fund physical investments while providing investors the ability to match their liabilities that are also long-term in nature?; and (ii) Will the corporate governance of SWFs meet international best practices improving the efficiency of fund management?

The prerequisite for EAP SWFs to play a much larger role in regional infrastructure investments is first to make such investment attractive enough for private global portfolios. SWFs will only then follow the frontier global assets. This is because SWFs
often have a lower risk tolerance than the average global portfolio, and therefore less appetite for untested asset classes. To attract private capital and better utilize SWFs, many obstacles need to be overcome by various stakeholders, including standardizing the asset classes in a transparent way through project management, appraisal, risk and performance measurement and reporting. Doing so will make it possible for private fund managers to allocate large sums of funds into regional development. The World Bank Group is well-positioned to help facilitate this process, given its reputable dealings with market players and expertise in development and project management.

Generating high yields on existing SWF assets are important and should continue to be the primary motivation of fund managers. This said, Asian capital markets can replicate some of the more sophisticated debt products offered in developed capital markets to fund long-term projects. Without proper financial tools, the paths between yield generation and regional infrastructure investment will not cross. Proper financial securities will allow Asian capital markets to compete for those funds that currently flow into other fixed income asset classes with long durations. The degree of success in obtaining proper financial instruments will largely determine if the growing assets base of SWFs will capitalize on this historic opportunity of serving its citizens through higher yield generation, while also strengthening the region’s physical infrastructure and integrated regional capital markets.
PART I: EMERGENCE OF SOVEREIGN WEALTH FUNDS IN ASIA

I.1 Introduction

1. Sovereign Wealth Funds (SWFs) have been in existence for many decades worldwide, however most SWFs in the East Asia and Pacific Region (EAP) are relatively new. The emergence of the SWFs in Asia is largely a by-product of the strong economic development at East Asian countries in the last two decades and the attendant accumulation of foreign exchange reserves. However, there are other types of SWFs in the region as well.

2. The Governments have taken a concerted strategy to enhance the returns on these excess reserves. Thus, SWFs no longer recycle capital without economic and political disruption, as many SWFs have opted for higher returns through diversified investment portfolios instead of largely taking conservative approaches by holding only government bonds (generally U.S. Treasury bonds).

3. The EAP region is an ideal region to take a look at the issues surrounding SWFs since Asia has the full range of funds – from long-established funds to brand new funds; from passive portfolio investors to more aggressive strategic investors; from resource-backed funds to foreign reserve-backed funds; and, based in the largest, most highly developed economies to the smallest, poorest economies in Asia. Therefore, the objective of this Report is to document the status of Sovereign Wealth Funds in the East Asia Region and to understand their governance structures. The report will also investigate how lack of standardized, long-term financial instruments devoted to emerging markets leads funds to leak out of the EAP region, an area with significant investment needs. It presents facts from publicly available sources on their size, institutional structure, and investment operations.

I.2 Definition of SWFs

4. There is no commonly agreed definition of sovereign wealth funds. For the purposes of this report, a sovereign wealth fund will be defined as a long-term investment fund owned by a sovereign nation, distinct from investments by national pension funds, state-owned-enterprises and development banks, and distinct from central bank management of liquid official foreign exchange reserves. Typically, sovereign wealth funds are funded from commodity (natural resource) revenues, currency intervention or fiscal savings.


3 The universe of information on SWFs is vast, but often incomplete since there are no consensus international standards of measurement and limited transparency of disclosure by SWFs. Given the scope and resources of this report, the research was as exhaustive as possible. The survey does not cover public pension funds or central banks. The survey covers all known SWFs in the EAP region.
5. Definitions of SWFs vary from the simple to the abstruse. The Federal Reserve Board has referred to an SWF simply as an investment fund that is owned by a national or state government. The US Department of the Treasury considers an SWF to be a government investment vehicle which is funded by foreign exchange assets, and which manages these assets separately from official reserves. Standard Chartered Bank uses a definition similar to what is used in this report. Morgan Stanley defines an SWF as having five characteristics: sovereign; high foreign currency exposure; no explicit liabilities; high risk tolerance; and long investment horizon. The International Monetary Fund (IMF) defines SWFs as special investment funds created or owned by governments to hold foreign assets for long-term purposes. As mentioned above, the IMF also introduces taxonomy of SWFs based on policy objectives: stabilization funds; savings funds; reserve investment corporations; development funds; and pension reserve funds.

6. Box 1 provides a framework for categorizing SWFs based on the underlying purpose of the funds. This framework is according to guidelines in an IMF paper entitled Sovereign Wealth Funds – A Work Agenda. The purposes of the SWFs are interlinked with the funding sources of SWFs. For instance, reserve investment funds are an obvious product of excess foreign currency reserve accumulation and savings, and stabilization funds are largely funded by revenues from oil and gas, minerals, and other commodities.

7. The Peterson Institute for International Economics refers to SWFs as separate pools of international assets owned and managed by governments to achieve a variety of economic and financial objectives. The objectives include: accumulation and management of a tranche of reserve assets, the stabilization of the macroeconomic effects of sudden increases in export earnings, the management of pension assets, or the transfer of national wealth across generations. The Institute also defines SWFs broadly as stabilization funds, renewable resource funds, and government investment holding companies.

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8. For the purposes of this paper, we will consider three types of SWFs: legacy, reserve and endowment funds. The legacy fund is one in which the SWF was formed to manage the assets of the state, which were held as a legacy of past economic policies. In these cases, the SWF was established as the holding company for the Government’s shareholdings in state owned enterprises (SOEs) with a mandate to maximize shareholder value in those companies, and in some instances, fully or partially divest the state’s shareholdings. Endowment fund will refer to those funds owned by developed countries such as Australia’s Future Fund and New Zealand’s Super Annuation Fund. Finally, a reserve investment fund is owned by developing nations that manage funds separately from official reserves.

I.3 The Rise of SWFs Worldwide

9. The past five to ten years has seen a massive build-up of international liquidity globally. This has important implications for emerging markets, including in East Asia and the Pacific region, both in terms of the risks and opportunities it poses for macroeconomic management and growth of domestic economies. Since 2002, global foreign exchange reserves (including gold) have increased at an average rate of 20 percent each year. This compares to a rate of 6 percent per year, on average, that was observed during 1997-2001. Now, according to IMF, international foreign reserves amount to US$11 trillion, while SWFs hold around US$4.7 trillion in assets. This number certainly indicates dramatically fast growth of foreign reserve accumulation around the world, up from US$400 billion in 2005.11

10. Many developing countries have recently shifted a higher proportion of their foreign currency earnings from official foreign currency reserves to sovereign wealth funds. Sovereign wealth funds have an estimated US$1.6 trillion in assets under management in developing countries, dominated by China (US$567.9 billion held by SAFE Investment Company and US$482 billion held by the Chinese Investment Corporation) and Russia (US$175.5 billion held in the National Welfare Fund).12

11. Despite the shift in assets into SWFs by developing countries, the value of assets managed by SWFs worldwide is dominated by high-income countries. The range of estimates varies considerably (between US$3 trillion and US$3.5 trillion), implying that sovereign wealth funds in developing countries manage roughly 30 percent of all assets.

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Box 1: Purposes of SWFs in East Asia and Pacific

1) Stabilization Fund – meant to insulate the budget and protect against volatility in commodity prices.

2) Savings Fund – aims to convert nonrenewable assets into a more diversified portfolio of assets which will provide income/savings for future generations.

3) Reserve Investment Fund – geared towards enhancing the returns on reserve assets.

4) Development Fund – helps to fund projects or industrial policies that increase economic output.

5) Contingent Pension Reserve Fund – provides for contingent unspecified pension liabilities on government’s balance sheet.

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12 Sovereign Wealth Fund Rankings by Sovereign Wealth Fund Institute.
The wide range of estimates largely stems from uncertainty about the value of assets managed by some SWFs. For instance, the Abu Dhabi Investment Authority and Corporation is estimated to manage around US$627 billion at end-2012; Singapore’s Government Investment Corporation (GIC) manages around US$248 billion, while its Temasek Holdings manage roughly US$158 billion. The Kuwait Investment Authority allegedly managed around US$342 billion at end-2012.13

I.4 Overview of SWFs in Asia

12. Asian countries currently account for about 40 percent of total global SWF assets. The growth of SWFs in Asia is in fact a relatively new phenomenon which emerged as a consequence two primary economic factors. Firstly, as the large export-driven East Asian countries accumulated enormous foreign currency reserves, policy makers started evaluating the desirable level of reserves. Secondly, the US dollar, the main reserves currency, depreciated significantly in recent years and the returns of these reserves investments came under scrutiny. Thus a number of SWFs were established as a tool to address these two issues.

13. In contrast, large development funds in East Asia, such as Singapore’s Temasek and Malaysia’s Khazanah Nasional, were originally established in order to enhance the efficiency of managing the governments’ holdings in domestic corporations, which were accumulated in the process of government-led economic development. Subsequently, these funds started to invest internationally, and today these funds operate more like a commercial investment company. In addition there are also a few funds which were established by countries with commodity revenues, such as Brunei and Timor-Leste, which were established as savings or stabilization funds.14 Savings funds have relatively less need for short-term income streams. They do, however, need rather high long-term returns with prudent levels of risk so as to support productive investment in growth-enhancing and poverty-reducing spending on essential infrastructure, such as agriculture, education, health and basic service delivery. However, history has shown that in some instances, these funds have actually amplified rather than mitigated the adverse effects of oil and gas windfalls.15

14. Table 1 below presents a typology for four different types of SWFs based on their funding source: (i) fiscal surplus; (ii) commodity revenues – oil and gas, mining; (iii) legacy state ownership asset-holding companies; and (iv) foreign currency reserves. As the table shows, there are several large reserve investment funds and a few development funds. Reserve investment funds include the China Investment Corporation, Korea Investment Corporation, Government and Investment Corporation of Singapore (GIC), among others.

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13 Compiled from different sources.
14 Timor-Leste’s Petroleum Fund can be seen as a savings fund as well as a stabilization fund, considering the country’s still-fragile economic condition.
Table 1. Sovereign Wealth Funds in East Asia

<table>
<thead>
<tr>
<th>Country</th>
<th>Name of Fund</th>
<th>Assets (USD)</th>
<th>Year of Inception</th>
<th>Source of Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Future Fund</td>
<td>88.7 bn</td>
<td>2006</td>
<td>Fiscal Surpluses</td>
</tr>
<tr>
<td>Brunei</td>
<td>Brunei Investment Agency</td>
<td>30 bn</td>
<td>1983</td>
<td>Commodity – Oil and Gas</td>
</tr>
<tr>
<td>China</td>
<td>China Investment Corporation</td>
<td>482 bn</td>
<td>2007</td>
<td>Foreign Reserves / State-owned holdings</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>Hong Kong Monetary Authority Investment Portfolio</td>
<td>326.7 bn</td>
<td>1993</td>
<td>Foreign Reserves</td>
</tr>
<tr>
<td>Kiribati</td>
<td>Revenue Equalization Reserve Fund</td>
<td>0.64 bn</td>
<td>1956</td>
<td>Commodity revenues – Phosphates</td>
</tr>
<tr>
<td>Korea</td>
<td>Korea Investment Corporation</td>
<td>56.6 bn</td>
<td>2005</td>
<td>Foreign Reserves</td>
</tr>
<tr>
<td>Malaysia</td>
<td>Khazanah Nasional</td>
<td>39.1 bn</td>
<td>1993</td>
<td>Legacy State Ownership</td>
</tr>
<tr>
<td>Mongolia</td>
<td>Human Development Fund</td>
<td>1.3 bn</td>
<td>2009</td>
<td>Mineral windfall revenues</td>
</tr>
<tr>
<td>Mongolia</td>
<td>Fiscal Stability Fund</td>
<td>0.3 bn</td>
<td>2010</td>
<td>Mineral windfall revenues</td>
</tr>
<tr>
<td>Nauru*</td>
<td>Phosphate Royalties Trust Fund</td>
<td>70 m</td>
<td>1968</td>
<td>Commodity revenues – Phosphates</td>
</tr>
<tr>
<td>New Zealand</td>
<td>Superannuation Fund</td>
<td>18.5 bn</td>
<td>2003</td>
<td>Fiscal Surpluses</td>
</tr>
<tr>
<td>Singapore</td>
<td>Temasek Holdings</td>
<td>157.5 bn</td>
<td>1974</td>
<td>State-owned holdings</td>
</tr>
<tr>
<td>Singapore</td>
<td>Government of Singapore Investment Corporation</td>
<td>247.5 bn</td>
<td>1981</td>
<td>Foreign Reserves</td>
</tr>
<tr>
<td>Taiwan*</td>
<td>Taiwan Stabilization Fund</td>
<td>15 bn</td>
<td>2000</td>
<td>Foreign Reserves</td>
</tr>
<tr>
<td>Timor-Leste</td>
<td>Timor-Leste Petroleum Fund</td>
<td>13.2 bn</td>
<td>2005</td>
<td>Commodity revenues – Oil and Gas</td>
</tr>
<tr>
<td>Vietnam</td>
<td>State Capital Investment Corporation</td>
<td>0.5 bn</td>
<td>2005</td>
<td>State-owned holdings</td>
</tr>
</tbody>
</table>

Source: Compiled from the Sovereign Wealth Fund Institute and the SWFs’ annual reports.

*No recent information is publicly available.
PART II: INVESTMENT APPROACHES OF SWFS IN ASIA

16. Given the difference in policy purposes set by their hosting government and the arrangement of the source of Funding, investment objective and approaches, benchmarks and asset allocations vary among SWFs. If a Fund is set for fiscal stabilization purpose, it is highly likely that its portfolio be public-market allocated to maintain a high degree of liquidity when rainy days come. If a Fund is set for inter-generational wealth transfer, or for seeking long-term and higher risk-adjusted financial returns, whether normal or absolute, it usually has a longer term investment horizon and invests its portfolio either through public markets (bonds and securities in listed companies) or carry direct investment like Temasek. Institutional capacity and top-notch human capital are also a key factor to alter investment style.

II.1 Risk & Return Objectives

17. Setting a return benchmark is important, and in fact each asset or sub-class of asset has its own benchmark as well. Looking at the sources of funding, the SWFs in the EAP can be divided into those that are funded through the revenue from sales of commodities, such as the Timor-Leste Petroleum Fund, Brunei Investment Agency, and Kiribati Revenue Equalization Fund, or non-commodity funds which are more common to East Asia and Pacific. For these SWFs funded with commodity revenues, the nature of their liabilities depends on the economic and fiscal conditions of each country. The SWFs of wealthier countries with strong fiscal positions serve more as savings funds, allowing more allocation into equities, which may be invested aggressively to enhance long-term real returns. In contrast, the SWFs of the countries with fragile economies or unstable fiscal positions would serve more as stability funds, which require these countries to treat the funds as temporary resources. Consequently these temporary funds would need to maintain a high level of liquidity and nominal value.

18. The sources of non-commodity funds also deserve a closer look. The East Asian countries with SWFs are all large exporters that have accumulated large foreign exchange reserves. These countries generally conducted foreign exchange intervention operations, often in the form of sterilized interventions. They also typically have relatively small external debts. This means that their foreign currency reserves are funded largely by broad money and domestic debts, and their liabilities are mostly denominated in domestic currencies and may be better measured in real terms. These domestic liabilities are a part of the country’s fiscal and monetary policies. The part funded with debts must be repaid with the future fiscal surplus, and the rest is effectively financed by seigniorage.

16 In the case of the China Investment Corporation, the funds are sourced by the government’s domestic debt issuance, which made the source and cost of the funds very explicit. In 2007, when the CIC was established, the Ministry of Finance issued a number of tranches of special 10-15 year treasury bonds, totaling approximately US$200 billion, to buy the foreign currency from the US$1.4 trillion in foreign exchange reserves (at rates ranging between...
4.3% – 4.68%) and then injected the funds into the CIC.\textsuperscript{17} By doing so, the CIC has an implicit nominal hurdle rate, which is the sum of ca. 4.5% plus appreciation (or minus depreciation) of RMB.

19. The largest and most visible East Asian SWFs are, as described in table 1, reserve investment funds. The underlying logic of establishing these SWFs is that these EAP countries have excess foreign currency reserves which will not be needed for a foreseeable future, and such excess reserves can be invested more aggressively to enhance returns. Conceptually, by slicing the foreign currency reserves into tranches according to the likelihood of being needed for central bank operations, the excess reserves which are not likely to be liquidated for a foreseeable future are treated as if they were equities.\textsuperscript{18} Being freed from the need for maintaining liquidity and stable nominal market value, these SWFs invest excess reserves more aggressively into riskier assets with a longer investment horizon. However discussions on the desirable level of foreign currency reserves remained in the domain of rules of thumb such as the Guidotti-Greenspan rule, as there is no reliable analytical method to determine the appropriate reserve levels today.\textsuperscript{19} Based on these commonly-used rules of thumb, the East Asian countries with SWFs set their SWFs’ asset volumes at relatively conservative levels, compared to each country’s total volume of foreign exchange reserves.

20. The common features of SWFs in terms of investment objectives are to earn superior returns in a risk-controlled manner over a long investment horizon. However, they typically do not elaborate much further, providing little information in terms of investment styles, benchmarks, or asset allocations.

21. Setting a return benchmark is critical step in determining the fund’s long-term performance and viability. While setting the hurdle rate, solely relying on the borrowed fund costs would present only half of the picture. The opportunity cost of not investing the funds into an SWF’s own economy’s real sectors also requires consideration. This means the hurdle rate will be a mix between the actual cost of fund’s borrowings and the aggregate growth rate of the country’s real sectors.

22. It appears that the East Asian SWFs can be broadly classified into two categories: diversified funds which aim to earn a real rate of return, are benchmarked to inflation indexes, and quasi “private equity funds,” which focus on strategic investments aimed at earning absolute returns in nominal terms. The GIC and KIC can be classified in the first category and Temasek and Khazanah in the latter.

\textsuperscript{17} In the case of the CIC, the complexities are compounded by the fact that the liabilities are in local currency, but over one-third of the investments are in foreign currency, thus requiring a higher level of currency risk management processes in place.

\textsuperscript{18} This approach is akin to tranching techniques for securitized products, such as Collateralized Debt Obligations (CDOs).

\textsuperscript{19} Commonly used rules of thumb include: 1) Guidotti-Greenspan rule (the ratio of foreign currency reserves and debt service payments for next 12 months); 2) import coverage (the ratio of foreign currency reserves and import bills for 6 months; and 3) the ratio of foreign currency reserves and the broad money (M2).
23. In the case of GIC, its investment objective is to achieve a real rate of return over and above the global inflation rate over a long-term horizon. Korea Investment Corporation appears to pursue a similar investment objective. Despite a few widely publicized strategic investments by SWFs, this type of SWF typically maintains diversified portfolios. As the GIC aims to earn a real rate of return over the global inflation rate, it would by default force the GIC to maintain a balanced portfolio, which consists of the sub-portfolios with investments in diverse asset classes. KIC would presumably follow a similar investment approach. Overall, their investments are well diversified in terms of asset classes as well as geography, to allow them to meet their investment objectives.

Box 2 below provides three examples of Asian SWF inception purpose.

<table>
<thead>
<tr>
<th>Box 2: Inception Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Most Sovereign Wealth Funds</strong> do not fully disclose their investment strategies, activities, and allocations. However, the three examples in this box provide some indications.</td>
</tr>
<tr>
<td><strong>Temasek Holdings</strong> is more or less the Government of Singapore’s investment holding company that now has assets of US$158 billion. It was originally setup to run the strategic investments of the government in order to avoid conflict of interest that may arise from the government pursuit of commercial returns versus its public interest role of policy and market regulations.</td>
</tr>
<tr>
<td><strong>New Zealand Superannuation Fund</strong> was created to assist future governments in meeting the cost of providing retirement income. Established in 2003 the Superannuation Fund has reached US$ 17.5 billion using a blend of passive and active investor practices and well-diversified portfolio management. Investments range from currency, asset classes and alternative investments. The Superannuation Fund also makes use of External Fund Managers.</td>
</tr>
<tr>
<td><strong>The China Investment Corporation</strong> was established in 2007 to diversify China’s foreign exchange holdings and seek maximum returns for its shareholder within acceptable risk tolerance. At inception, State shareholdings of local banks were transferred into the CIC.</td>
</tr>
</tbody>
</table>

Source: Compiled from each fund’s most recent annual report.

24. The investment approaches and strategic asset allocation of SWFs in EAP, however, has changed somewhat after the global financial crisis in 2008. Throughout the crisis, the SWFs with a sole focus on savings was hit the hardest, which declined by about 50 percent between 2008 and 2009 due to their riskier holdings. On the other hand, SWFs with a mandate of both stabilization and saving objectives passed through the crisis relatively unscathed due to their more conservative and liquid holdings supporting the stabilization mandate. Looking at the difference in asset allocation after the crisis, SWFs have increased their investments in alternative assets and diversified their

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portfolios. As an example, the Australian Future fund has introduced fixed-income and alternative assets investments, and increased equity shares; KIC also has introduced alternative assets investments and increased equities in their portfolio. This has potential long-term implications. As the allocation into alternative investments increase, the risks along with the return expectations increase for the Fund. As a result, less annual contribution, if any, is needed to be paid out to supplement the Fund to reach its target figure in the future. Alternatively, due to increased return expectations, policymakers can be tempted to carve out a larger portion of the assets for annual spending.

II.2 Time, Tax, Legal, Liquidity and Unique Restrictions

25. SWFs generally have a long time horizon and low liquidity requirements. The funds are generally tax-exempt except for the income earned outside of the fund’s home country. It is common practice that funds are incorporated in off-shore tax havens for investing abroad, minimizing tax liabilities.

26. One of SWFs limitations is caused by their political proximity to their respective states. To mitigate concerns, some SWFs have set limitations on the maximum shares held in a single company that forgo voting rights in investments. Doing so ensures host country regulators and politicians that the SWF investments are long-term, commercial shareholdings that are not politically charged. The most prominent example of this in the EAP region is the China Investment Corporation, which has stated that it has limited its investments to a minority stake (less than 10 percent) with non-voting rights. The New Zealand Superannuation Fund does set investment limits in their Investment Guidelines and the investment policy states explicitly that “the Fund will not own any business outright.” Although the limits are not specified, the fund is highly diversified and does not have any significant holdings that are more than a certain percentage of the total value of the fund. Currently, the fund’s portfolio is holding over 6,000 companies valued at around US$5.3 billion of the total fund as of June, 2011. However, many SWFs are not following this approach for various reasons and will not likely do so in the future. For example, the Australia Future Fund does not have any such limitations to share ownership and has an explicit policy of exercising voting rights with all of its investments, as its investment policy states that “the Board recognizes the strong link between good corporate governance and investment value and that the exercise of voting rights allows the Board to influence a company’s approach to corporate governance. The Board applies

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22 According to the CIC annual report 2011, CIC invested US$1.5 billion for 17.2% stake in Teck Resources in July 2009, US$1.6 billion for a 15% stake in AES in March 2010, US$3.15 billion for a 30% stake in GDF Suez Exploration and Production International SA, and US$850 million for a 10% stake in Atlantic LNG Company of Trinidad and Tobago in December 2011. In May 2007 the CIC made its first investment in a 9.4% non-voting share valued at US$3 billion in the US private equity firm the Blackstone Group, and in December 2007 the CIC invested US$5 billion for a 9.9% stake in Morgan Stanley. CIC’s investment in 2007 was a combination of mandatory convertible notes and mandatory convertible equity units, which were converted into common stock in August 2010 (from CIC 2009/2010 annual report).


24 New Zealand Superannuation Fund, “Full Final Equity List 30 June, 2011”

this view across both its Australian and international holdings.” The Korea Investment Corporation also follows this model and its investment policy states that “KIC shall exercise the voting rights attached to the investment assets and the rights relating to class actions or other litigations as mandated by clients.”

27. Given the relative paucity of information on the investment strategies and approaches of SWFs in Asia, it will be necessary for these SWFs to make a clearer statement on their investment style, as well as to provide more precise information on asset allocations, benchmarks and performance. While the SWFs may have valid arguments for keeping the details of their holdings or short-term investment performance confidential, their investment objectives and activities call for more information to determine if SWFs are contributing to the government’s overall economic policy implementation.

28. Some SWFs in the Asia-Pacific region are significantly exposed to their home markets, another unique limitation, due to geographical concentration in holdings. Some funds, including Singapore’s Temasek Holdings and Malaysia’s Khazanah Nasional, are established as a tool to pursue national economic development policies. In this sense, it is fully consistent that a large volume of funds are allocated to the home market. Furthermore, considering that they focus on strategic investments, it is crucial for them to have comparative advantage in analyzing the local market conditions and specific investee companies.

29. Another emerging element of SWF investing has been the adoption of codes of ethics and pursuing socially responsible investments (SRI). Some SWFs in the EAP region are following this SRI approach. For instance, the newest SWF in the EAP region, the China Investment Corporation, has stated that it will avoid politically controversial and polluting industries, for example arms manufacturing, tobacco, and gambling companies.

30. Additionally, SWFs use principles such as those of the Korean Investment Corporation and New Zealand Superannuation Fund, that both have explicit policies to invest in companies that uphold certain standards in governance, environment and social issues, as well as the avoidance of political impropriety. The New Zealand Fund’s policies are very detailed and uphold a variety of investment principles on human rights, labor standards, anti-corruption, and the environment, and as with other types of SRI, there is a negative list of investments that violate this criterion. Both of these funds also

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have specific ethical codes for the management and staff of the SWF, and the KIC’s Code of Ethics and Code of Conduct are very detailed and explicit on the issues. The basic idea behind these types of policies is to improve the international reputation of these SWFs and reassure their domestic constituencies that they are managing the public’s funds responsibly and in a way that is not harmful to the environment and other industries that are potentially hazardous to living creatures.

II.3 Missing Asset Class: Infrastructure

31. SWFs are major and obvious funding sources in EAP and could circulate more of their investment within emerging Asia. However, traditionally SWFs have invested in external assets, especially securities traded in major, developed markets. Over time, to respond to local pressure and in part reflecting low returns in developed countries after the financial crisis and the broad foreign banks’ pull-back from Asian assets to comply with Basel 3 requirements, SWFs investment holdings have broadened to include real property and long-term infrastructure investments.

32. Despite this recent shift, the modern global portfolio allocates a depressingly small sliver of assets to infrastructure in the emerging or frontier EAP markets. The size of EAP debt market is quite small compared to the potential of its economies. Furthermore, developed-world originated debt instruments are set to dominate the global portfolio’s fixed income asset class in the years to come. Currently the market capitalization of the emerging market corporate credit is a mere $250 billion, compared to U.S. housing market capitalization of $1.5 trillion. Worse yet, even the region’s own capital follows this trend. For example, China Investment Cooperation’s invests only 17.5 percent of its fixed income portfolio into emerging market debt while advanced economies’ debt take up nearly three times this figure.

33. There are many challenges. First, there is a scale and depth issue. Even the largest economies in the region have a limited debt market that can support bankable infrastructure projects. While in more developed countries such as Malaysia, infrastructure-related firms allocate 40 percent of their corporate bonds, the overall Asian market is too limited to attract sophisticated investors into project finance. For example, the Chinese corporate debt market had issued a mere US$336 billion bond issue in 2012, equating to roughly 35 percent of all issues for the year. In addition, the size of China’s asset-backed security (ABS) market is estimated to be about a miniscule US$15

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30 Mobilizing Sovereign Wealth Funds for Long-Term Development Finance: Opportunities and Risks by Alan Gelb, Silvana Tordo, Havard Halland with Noora Arfaa and Gregory Smith.
31 Investment depth refers to the market’s ability to sustain relatively large market orders without impacting security prices. This means the size of the market needs to offer plenty of capacity for the large fund pool while not distorting prices at the same time.
32 Asian Development Bank – September 2013
billion which is less than 1% of its all fixed-income market (US$4.2 trillion). While corporate bond growth has been significant compared to effectively no corporate debt market in the late-1990s, in its current form the region’s financial markets cannot effectively and efficiently absorb massive amounts of funds. Second, there is a liquidity challenge. Holders of development securities, often regional banks, generally buy and hold onto securities until maturity, due to the lack of securitization mechanisms that can offload assets from holder’s balance sheets. This leads to an inactive secondary market – a must-have for an efficient capital market. Third, financial assets do not employ standardized structures, turning project performance measurement and reporting into a guessing game. This makes the pricing of potential risks extremely challenging and labor-intensive. In order to be able to attract global wholesale funds to the local infrastructure projects, the project risks should be standardized so that they can effortlessly be quantified and plotted into financial models, similar way it is done with mortgages in the developed economies. We are in the view that these three elements are largely to blame for low number of “bankable” projects in today’s landscape, despite the tremendous needs for developing infrastructure around the globe.

*China Investment Corporation Fixed Income Allocation – Hardly a coincidence.*

![Diversified Fixed-Income Securities Graph]

34. The financial securities offered first and foremost needs to be able to attract any private portfolio structured with modern portfolio practices. Simply put; SWFs are not the leaders but followers in the capital markets. For instance, when the U.S. Federal Reserve announced scaling back of its asset purchases in July 2013, sovereign funds were to first players to abandon emerging markets due to increased risk perception of the asset class. This is why policies primarily and/or solely targeting regional SWFs as a regional

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36 Such private players include hedge funds, private equity funds, pensions, endowments and insurance funds.
infrastructure funding source are likely to be unsustainable in the long term. Instead, the focus should be on providing more incentives for private capital with long term liabilities to participate in the investment class. To properly adjust the risk and return profiles of these investments, governments or other development institutions such as the World Bank, newly forming Asian Bank and/or the BRICs Bank can do the following: 1) provide guarantees to reduce the cost of funds while making the credit issuances higher quality or creating subordinated debt tranches to carve out investment grade securities. 2) This will pave the way for increased secondary market liquidity, thereby increasing the market share of the asset class.

II.4 Use of External Fund Managers

35. SWFs do not release much information on their investment activities, and they also do not disclose much information on the use of external fund managers. Of all the SWFs in East Asia and Pacific researched for this report, only some reported using external fund managers and what percentage of the portfolio designated to their supervision. These were: (1) New Zealand Superannuation Fund at 100 percent; (2) Brunei Investment Agency at 60 percent of assets; (3) China Investment Corporation at 64 percent; (4) Korea Investment Corporation at 29.3 percent; and (5) Hong Kong Monetary Investment Portfolio at 20 percent of assets. SWFs with balanced portfolios are likely to determine the asset allocation and mandate the external fund managers to manage the sub-portfolios in each asset class. However it is unknown if the East Asian SWFs today have the institutional capacity to determine the appropriate asset allocation for their funds or to evaluate the performance of the fund managers. Presumably, established ones like GIC would have strong institutional capacities, but others may need focused efforts to build in-house capacity to use the external managers effectively, provided the growing asset base will demand internal handling due to high cost structures of external managers.

II.5 Investment Performance of SWFs in Asia

36. Although SWFs could not veer away from the 2008/9 global financial crisis and had 20 to 30 percent reductions in the market value of their assets, SWFs in EAP survived fairly well from the crisis and are currently thriving. Some SWFs certainly followed the original objectives of their existence, as stabilization and savings fund, in financing government operations and supporting economic activities. Even though some East Asian SWFs disclose samples of past medium-term investment returns, such figures do not provide much information on their performance, as they do not provide any information on the risks they took to realize these returns. While established SWFs in the EAP region are reputed to have performed well, we can only speculate, given that there is no reliable information on their performance. 38

37 The New Zealand fund does not specify the percentage of assets managed by external managers, only that 41 asset management mandates have been given by the fund since 2003 and that the fund appoints external managers and that it is “not involved in individual investment decisions as to which shares or bonds are in a portfolio” (http://www.nzsuperfund.co.nz/index.asp?pageID=2145846741).
38 Despite the general secretive nature of SWFs, Australia Future Fund, New Zealand Superannuation Fund and Chinese Investment Corporation provide detailed information on their annual performance.
PART III: CORPORATE GOVERNANCE OF SWFs IN ASIA

37. Most SWFs in East Asia and the Pacific appear to have a straightforward legal status though a legislative act or ordinance. All East Asian SWFs except Timor-Leste are separate legal entities. However, such legal structures do not necessarily flow through to the effectiveness of their operational independence. Although operational independence is an assumed fact due to the legal foundations of the SWFs, in practice operational independence can be obscured by a lack of transparency in the decision-making processes and actual fund performance. In principle there is a clear separation of responsibility between the governmental authority (usually the Central Bank or Ministry of Finance), which provides oversight and supervision of the SWF, and the daily operations which are left to the management of the SWF. The SWF management is then held accountable for the performance of the fund. More often than not the separation of responsibilities is elaborated in the Articles of Agreement of the SWF (as is the case with the Pacific Island Countries) and the Articles may or may not be disclosed to the public. This setup appears to be most strictly applied in the case of savings funds, such as the Australian Future Fund and New Zealand Superannuation Fund.

38. However, in many SWFs across Asia, the separation of responsibilities is unclear between the governmental authority and SWF management in terms of operations and oversight. The Brunei Investment Agency (BIA) and Temasek Holdings of Singapore offer two different examples as to how the lines responsibilities are ambiguous. Temasek Holdings seems to have a clear delineation of responsibility with an experienced management team, a supervisory board of directors and oversight by the Ministry of Finance. However the president of Singapore has issued an executive clause in the Fifth Companies Act to safeguard the critical assets and reserves of Singapore. The Brunei Investment Agency has put in place a vague set of bylaws setting forth delegation of responsibility. However many bylaws are attached with caveats such as that in the Powers, Duties and Functions of Agency section: “…there shall be vested in the agency such other functions, duties and powers as His Majesty may, from time to time, by notification of Government Gazette, specify.” This statement appears to give the Sultan, the ruler of Brunei Darussalam, ultimate responsibility and discretion regarding activities of the Brunei Investment Agency.

III.1 Governance Structures

39. SWFs are a very heterogenous group comprising various types of funds and vary much among themselves in terms of the underlying purpose, funding source, governance structure and investment style. Indeed, different definition is given to SWFs. Nevertheless, The International Working Group (IWG), comprising senior official from 25 SWFs was constituted in May 2008, and met three times a year and agreed on a set of 24 principles and practices.

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Having secured the approval of the governments of International Working Group of Sovereign Wealth Funds (IWG) member counties, the Principles were presented to the IMFC on October 21, 2008 in Washington, D.C., and published immediately thereafter. In that document, SWF is defined as special funds or arrangements that are owned by the general government for the macroeconomic purpose. SWFs use a set of investment strategy to achieve financial objectives. As this definition was discussed thoroughly with IMF and agreed with 25 global SWFs in the course of 2008, and they were officially accepted when the Santiago Principles.

“Santiago Principles” targeted to establish a framework that defined suitable governance structures, accountability practices and criterion for commercial-based investment policies. To encourage further understanding of SWFs and build trust between governments, investors and regulators, the objectives behind the Santiago Principles are: 1) to maintain global financial stability and free flow of capital; 2) to abide by regulatory requirements in countries with investments; 3) to invest based on financial risk and return; and 4) to instill governance mechanisms that provide for risk management, operational procedures and transparency.

Box 3: Santiago Principles Feedback

A report published by the International Forum of Sovereign Wealth Funds (IFSWF) that analyzed the Santiago Principles implementation and perceived effectiveness found that most SWFs disclose information on investment objectives, risk tolerance, investment horizon, strategic asset allocation, investment constraints, use of leverage, and use of external managers. Furthermore, the overwhelming majority of members (19 out of 21) considered the Santiago Principles to have a helpful role in preserving the environment of enhancing the value of transparency and accountability. However, only half the members agreed that the Santiago Principals have a beneficial impact on SWFs’ reputations.

The responsibilities of the Board of Directors for SWFs in the EAP region are generally threefold: (1) a supervisory role through the use of committees, (2) decision-making regarding investment strategy and operations, and (3) liaising with a governmental authority, i.e. Central Bank or Ministry of Finance. The Board of Directors of these SWFs generally also has a committee structure with standard committee functions such as Executive, Investment, Remuneration and Audit. Investment committees oversee SWF performance, discuss overall risk profile, and evaluate new asset classes review portfolio strategies. The Korean Investment Corporation goes so far as to divide the steering committee into Investment sub-committees and Risk Management sub-committee. There are three divisions under the Chief Executive Officer, which are Investment Management, Corporate Management, and Risk Management.

41. The responsibilities of the Board of Directors for SWFs in the EAP region are generally threefold: (1) a supervisory role through the use of committees, (2) decision-making regarding investment strategy and operations, and (3) liaising with a governmental authority, i.e. Central Bank or Ministry of Finance. The Board of Directors of these SWFs generally also has a committee structure with standard committee functions such as Executive, Investment, Remuneration and Audit. Investment committees oversee SWF performance, discuss overall risk profile, and evaluate new asset classes review portfolio strategies. The Korean Investment Corporation goes so far as to divide the steering committee into Investment sub-committees and Risk Management sub-committee. There are three divisions under the Chief Executive Officer, which are Investment Management, Corporate Management, and Risk Management.

Division. Executive committees – which in most cases include the Chief Executive Officer – make general recommendations to the Board and provide the overall strategy and performance of the SWF. To oversee human resources and compensation issues, remuneration committees are often established. The other responsibilities are integrated into the review and oversight process of the Board of Directors. The broad investment objectives are then given downstream to the Board of Management with oversight by the Board of Directors.

42. Members of the Board of Directors are usually a mixture of experienced private sector executives and influential public sector figures. Positions are selected either by official appointment, elected through internal voting, or based on de facto membership as an executive director. According to the IFSWF survey, all SWFs in East Asia confirmed that there was a clear requirement for a minimum standard of competency for governing body members. In case of the Korean Investment Corporation, its board comprises the CEO, Central Bank governor, Minister of Finance, and 6 civil service professionals, who are nominated by the Civil Member Candidate Nomination Committee and appointed by the President of Korea. For the China Investment Corporation, there are eleven Board members consisting of ten appointees, with the eleventh elected internally by employees. The members range in background from Lou Jiwei, a former Minister of Finance for China and one of its most able fund managers, to Gao Xiqing, a current Vice Chairman and President, to Li Keping, the current Executive Director.

43. The management structure of SWFs in the EAP region is largely based on the functions of designated business units and nature of the SWF investments. For example, in the Australia Future Fund, there are three business units that consist of: (1) investment program; (2) organizational design; and (3) control environment. Conversely, the China Investment Corporation is divided into two bodies with different investment objectives: (1) Central Huijin Investment Company is responsible for CIC investments in domestic financial institutions; and (2) CIC International to oversee external investments. The extent and variation of the management structure depends on the institutional capacity and objectives of the SWF.

44. In East Asia and Pacific SWFs, it is typical that each business unit appoints an executive director – such as Chief Investment Officer or Chief Financial Officer – who reports up the hierarchy. An example of this is spelled out in the Articles of Agreement of the Timor-Leste Petroleum Corporation. Conversely, in the case of Brunei, the Managing Director is also the Permanent Secretary of the Ministry of Finance, blurring the separation of responsibilities. While these seems simple enough, much of the decision-making and information channels are more obscured.

45. On this same note, critics have openly questioned the management capabilities of SWFs, particularly in emerging economies. In some cases this may be true as the SWFs

45 IFSWF Members’ Experiences in the Application of the Santiago Principle, July 7, 2011
may not have the same ability to compensate management and staff at levels seen in competing private sector institutions. Thus some SWFs, especially the newer funds such as the China Investment Corporation, have expressed legitimate concerns over their own ability to pursue active investment strategies due to human resource constraints. However many SWFs in Asia do possess very qualified management and staff. An example is Azman bin Hj. Mokhtar, the Chief Executive Officer (Managing Director) of Khazanah Nasional in Malaysia. Prior to this position, he was head of research at both Salomon Smith Barney and UBS in Malaysia.  

III.2 Conflict of Interest and Fiduciary Responsibilities

46. Given the nature of SWFs, it is essential that they engender public trust, safeguard against potential mismanagement of assets, and are accountable for their performance. Policies dealing with conflicts of interest and fiduciary responsibility are meant to preserve these qualities. SWFs in East Asia and the Pacific offer not only a unique snapshot of approaches meant to solve conflict of interest and fiduciary issues, but also provide some striking examples of why such policies are necessary. In its simplest form, conflicts of interest are solved with a code of conduct policy that outlines decision-making mechanisms and channels the exchange of information. This is done by the Australia Future Fund, New Zealand Superannuation Fund, and Hong Kong Monetary Authority Investment Portfolio.

47. The internal checks and balances provided by the corporate governance structures also strengthen such conflict of interest policies. Fiduciary responsibility is preserved with a combination of adhering to the SWF’s purpose, appropriate fiscal treatment and effective withdrawal rules. The risk of problems appears to be greatest with commodity funds where there is no real liability for the funds, but these are far less prevalent in the East Asia and Pacific region than in other regions. Box 5 on Brunei provides a striking example where the combination of weak internal controls, a lack of transparency and public accountability, and limitations in the corporate governance of the SWF led to fiduciary mismanagement and the loss of SWF funds.

48. Fiduciary responsibility also seems to improve when the returns of the SWF are integrated into the fiscal framework. Of the SWFs in East and Pacific region, ten disclosed the fiscal treatment, but not in great detail in most cases. Of these ten SWF, five integrated the receipts of the SWF into a broader fiscal framework which means not carving out funds annually into the budget until it is balanced – i.e. Australia, New Zealand, Timor-Leste and Taiwan. With the exception of Taiwan, the remaining SWFs that were integrated into a fiscal framework were also three of the six highest-ranking SWFs on the Transparency and Accountability Scorecard of SWFs released by the Peterson Institute for International Economics.  

49/50 More specifically, the Australia Future

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50 The Transparency and Accountability Scorecard is ranked on the following criteria: 1) Structure; 2) Governance; 3) Transparency and Accountability; and 4) Behavior.
Fund has passed a Freedom of Information Act that requires the SWF to release financial transactions, savings and returns of the SWF to the public. In Norway, which is seen by many observers to be a “best practice” example of a SWF, the returns from its SWF, the Government Pension Fund Global, are not transferred into the budget until it is balanced, which is then measured to see the actual amount of assets accumulated by the State. This could offer a model for SWFs in East Asia and Pacific. To help encourage sound fiduciary responsibility in the Timor-Leste Petroleum Fund the returns are earmarked to fund the non-oil revenue portion of the budget.

49. Though withdrawal rules are different than integrating a SWF into a fiscal budget, it still encourages fiduciary responsibility and deters frivolous use of resources. Given the limits of available information – or perhaps narrowly used practice – the Pacific Island countries are the best example of the use of withdrawal rules. These basically regulate when and how SWFs can be used, mostly in coordination with fiscal policy. In countries like Kiribati, Timor-Leste and Papua New Guinea withdrawal rules are anchored in the principle of sustainable income over the long-term. For Timor-Leste, sustainability and withdrawal rules are measured against a non-oil budget deficit; whereas in Kiribati withdrawal is linked to the drawdown period of the SWF. This provides an expectation as to how and why assets should be used. If flexibility is needed in the event of stabilization or other crises, permission is granted through processes between the Board of Directors and Ministry of Finance.

III.3 Transparency and Reporting

50. As was mentioned in an earlier section, East Asia and Pacific region SWFs are targets of the same criticisms surrounding any other SWFs – they lack transparency. The key concept to keep in mind is that the SWFs are acting as a public trust for the funds of the governments and by extension the people and thus, should be accountable (by law) for their actions. This accountability ideally should also take a public, transparent form in periodic reports regarding their activities and the submission to annual, independent audits of their activities. Such disclosure could also include the SWF’s overall investment strategy, financial condition, and performance against specified objective benchmarks. In terms of international financial markets, SWFs could reinforce stability – given their increasing size and influence – and prevent potential contagion effects with minimum and timely reporting size of funds, broad strategy of management and investment objectives. In East Asia and Pacific SWFs, accountability seems to be better in SWFs that have more explicit purposes and future liabilities. For instance, the Taiwan Stabilization fund needs to be accountable in a time of currency crisis. To be prepared it invests its assets in liquid investment vehicles.

51. Regarding commercial desirability, it is understandable and expected that a government entity in the form of SWF does not want to compromise its capacity, maneuverability and competitive advantage when making strategic investments. In the East Asia and Pacific context, Temasek and Government of Singapore Investment Corporation seem to demonstrate this practice. The Singapore Companies Act stipulates that a private company with no more than 20 shareholders and no corporate shareholder is exempted from filing its audited financials with the public registry.\(^{54}\) Despite this, Temasek has been voluntarily more forthcoming with its investment practices of late and ranks respectably on the SWF Accountability and Transparency Scorecard.\(^{55}\) The China Investment Corporation also exhibits this behavior, which is shown in public statements by CIC officials, “…adopt a prudential accounting system…adhere to commercial lines on the condition that company interest will not be jeopardized.”\(^{56}\) Yet another example is the Taiwan National Stabilization Fund, which makes an annual report available to the public that includes the account balances and details of the fund operations. All the same, it still vigorously guards the confidentiality of its practices and commercial interests by imposing fines or imprisonment for leaking information by managers or other persons associated with the SWF.\(^{57}\)

52. Although SWFs are entrusted with public funds, reporting and auditing of SWFs is largely not in line with the requirements for other public companies and financial institutions. SWFs are generally not covered by conventional regulatory requirements for reporting and auditing, such as those used for pension and investment funds, and are rightfully criticized for lack of transparency. Auditing of this kind is difficult to enforce because SWFs operate at an international level and are owned and supervised by sovereign states, which complicates the issue of enforceability. In spite of this, efforts are being made by SWF both internationally and in East Asia and Pacific as a result of the acknowledgement that public funds are becoming more important systemically to financial markets.

53. Annex 2 provides a snapshot of the available auditing information for SWFs in the East Asia and Pacific region. In almost all cases, except for the Brunei Investment Agency, there is some sort of audit activity. Employing an audit committee seems to be the preferred method of auditing rather than developing a full internal department. Another positive sign is the presence of external auditors in some of the SWFs’ auditing and reporting process and the issuance of annual reports.

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ANNEX 1. SANTIAGO PRINCIPALS

- **GAPP 1. Principle**
The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).
  - **GAPP 1.1 Subprinciple** The legal framework for the SWF should ensure the legal soundness of the SWF and its transactions.
  - **GAPP 1.2 Subprinciple** The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and the other state bodies, should be publicly disclosed.

- **GAPP 2. Principle**
The policy purpose of the SWF should be clearly defined and publicly disclosed.

- **GAPP 3. Principle**
Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

- **GAPP 4. Principle**
There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal, and spending operations.
  - **GAPP 4.1 Subprinciple** The source of SWF funding should be publicly disclosed.
  - **GAPP 4.2 Subprinciple** The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.

- **GAPP 5. Principle**
The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

- **GAPP 6. Principle**
The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.

- **GAPP 7. Principle**
The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.

- **GAPP 8. Principle**
The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.

- **GAPP 9. Principle**
The operational management of the SWF should implement the SWF’s strategies in an independent manner and in accordance with clearly defined responsibilities.

- **GAPP 10. Principle**
The accountability framework for the SWF’s operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.

- **GAPP 11. Principle**
An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

- **GAPP 12. Principle**
The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.

- **GAPP 13. Principle**
Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management, and staff.

- **GAPP 14. Principle**
Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.

- **GAPP 15. Principle**
SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.
• **GAPP 16. Principle**
The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.

• **GAPP 17. Principle**
Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

• **GAPP 18. Principle**
The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.
  - **GAPP 18.1 Subprinciple** The investment policy should guide the SWF's financial risk exposures and the possible use of leverage.
  - **GAPP 18.2 Subprinciple** The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.
  - **GAPP 18.3 Subprinciple** A description of the investment policy of the SWF should be publicly disclosed.

• **GAPP 19. Principle**
The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.
  - **GAPP 19.1 Subprinciple** If investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.
  - **GAPP 19.2 Subprinciple** The management of an SWF's assets should be consistent with what is generally accepted as sound asset management principles.

• **GAPP 20. Principle**
The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

• **GAPP 21. Principle**
SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

• **GAPP 22. Principle**
The SWF should have a framework that identifies, assesses, and manages the risks of its operations.
  - **GAPP 22.1 Subprinciple** The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning, and an independent audit function.
  - **GAPP 22.2 Subprinciple** The general approach to the SWF’s risk management framework should be publicly disclosed.

• **GAPP 23. Principle**
The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

• **GAPP 24. Principle**
A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.
## ANNEX 2. AUDITING OF SWFS IN EAST ASIA AND PACIFIC

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<th>Internal Audit</th>
<th>External Audit</th>
<th>Audit / Annual Report</th>
<th>Accounting Standard</th>
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</table>

\(^{58}\) According to IMF Working Paper: *Sovereign Wealth Funds in the Pacific Island Countries: Macroeconomic Fiscal Linkages*, there are strict rules for auditing and financial reports in the Pacific Island Countries, but information is usually unreliable and inaccurate.