

## A positive force?

### Sovereign Wealth Funds

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*Moderator:* **Carolyn Ervin**, Director, Financial and Enterprise Affairs, OECD  
**Xiqing Gao**, President & Chief Investment Officer, China Investment Corporation  
**Jean-Daniel Gerber**, State Secretary for Economic Affairs, Switzerland  
**Kristin Halvorsen**, Minister of Finance, Norway  
**Giandomenico Magliano**, Director-General, Ministry of Foreign Affairs, Italy  
**Jean-Paul Villain**, Head, Strategy Unit, Abu Dhabi Investment Authority

Sovereign Wealth Funds (SWFs) have become a “hot topic”, but is there any reason for new rules and regulations?

**Carolyn Ervin** provided a quick overview of SWFs, some of which have been around since the 1950s. Today, there are about 40 SWFs controlling between USD 2.5 trillion and USD 3.5 trillion in assets, with the largest 7 funds managing \$2 trillion. But Ms Ervin warned that SWFs cannot be considered a homogenous group: some seek to maximize financial returns, others serve stabilization policies, others seek a fair distribution of returns over time; some are managed internally, others externally; some are active investors, others are passive. They certainly bring some benefits, argues Ms Ervin, by helping to recycle worldwide savings, or recapitalizing banks during the recent credit crisis. Nevertheless, two main problems have become associated with SWFs funds in recent years: first, they are big and becoming bigger; and second, many in the West still harbor suspicions that some have covert political strategies. “Are these concerns valid?” asks Ms Ervin. Not in the view of the OECD, which has established guidelines based on the principle of non-discrimination: SWFs are not a special case, and should be treated like any other investor.

**Xiqing Gao** is the head of one of the youngest, but most talked-about Sovereign Wealth Funds in the world, that of the China Investment Corporation. Mr. Gao presented a humorous but compelling defense of the fund’s strategy, and lamented that it was often unfairly portrayed as a “new world menace”. “We are not much different to other SWFs, except our lack of expertise...Our strategy is entirely passive...We want to be responsible, transparent, and play by the rules”, pleaded Mr. Gao, who explained that the fund consistently refuses to accept board appointments in the companies in which it invests, on the grounds that it is too inexperienced, and simply disinvests if it disagrees with the strategy of a firm. Nonetheless, Mr. Gao, as a former member of the regulatory authorities, understands the concerns the fund generates. This is why he is such a firm advocate of transparency – “we will be as transparent as is commercially viable... We will not provide specific details about what we are going to do, but we will disclose what we did last year, just as our Norwegian friends recommended us to do”. Mr. Gao wanted

to insist that the China Investment Corporation does its best to meet the sometimes conflicting requirements of the supervisory authorities and those of a mutating and demanding world, and believes that OECD principles are good and that SWFs are much easier to regulate than hedge funds. He pleaded for patience and understanding “our government has not been very transparent for the past 5,000 years or so... we are trying... we are learning... But we don’t have horns growing out of our heads.”

**Jean-Daniel Gerber** began his intervention by justifying Switzerland’s presence on a panel discussion about Sovereign Wealth Funds, pointing out that it is the 10<sup>th</sup> biggest exporter of capital in the world and has recently become one of the most important importers. Indeed, it was at the centre of two major SWFs’ strategies this year, associated with the capital requirements of banks hit by the subprime crisis. This generated a debate in Switzerland about whether it needed to change its legislation in response to SWF flows into the country, and the possible strategic nature of these investments. After thorough deliberations, the government reached a simple answer to the question: “No”. First, any legislative changes would require a definition of what a strategic firm is, which is not an easy task. Second, investment regulations already exist, and there is no justification to discriminate against SWFs. Mr. Gerber conceded that as many developed countries have tended to privatize, it might appear judicious to protect newly private firms from the ambition of SWFs. But in principle, regulations to protect such companies are already in place – such as the use of golden shares – and the principle of non-discrimination should continue to apply. Moreover, one should not forget that when a country embraces protectionism, it must always face negative trade-offs.

**Kristin Halvorsen** explained how the Norwegian government channels its oil and gas revenues into its SWF, the so-called the profits Government Pension Fund-Global (GPF), which now manages about \$400 billion in assets. “I believe transparency is the key issue in the debate on SWFs”. With the GPF absorbing the equivalent of 15% of Norway’s GDP, “transparency is essential to get public support. These are the savings of the Norwegian people.”. Ms Halvorsen detailed the strict guidelines under which the GPF operates, including an ethical code, and the purely financial nature of its investments: “We are financial investors, not strategic investors”. The fund has shareholdings in more than 7000 companies with an average stake of under 1% and a maximum permitted ceiling of 10%. Ms Halvorsen also sought to emphasize the means by which SWFs can demonstrate that they are not a threat, but believed there was absolutely no evidence of a hidden political agenda. The minister also stressed the importance of a well-working free trade economy: “We should not delude ourselves when it comes to protectionism”.

**Giandomenico Magliano** explained how the global economic context has changed with the opening up of markets and, as result, some actors have increased their clout. Is this a reason to create new rules? “No”, says Mr. Magliano. Indeed, Mr. Magliano concurred with previous speakers and said that SWFs need to be regarded as normal investors, and meet the established investment regulations in recipient countries. Financial regulations should aim to increase systematic stability as a whole, “which is a public

good”, and not be targeted specifically at SWFs. Mr. Magliano also highlighted the role that SWFs can potentially play in correcting balance of payments disequilibria and providing recipient countries with much needed funds, not least to finance the huge energy-related investments will be required in the next 20 years.

**Jean-Paul Villain** was not born in the United Arab Emirates, but is nonetheless head of strategy of the state-controlled fund that was founded in 1976 in order to reinvest the country’s massive oil revenues, which were considered too large to invest fully in the domestic market. Today, 80% of the fund’s assets are managed by external portfolio management companies, but the strategy is determined in-house. The government decided to establish the fund as an independent entity in order to recruit external experts and risk takers, who would not otherwise have become public workers. As regards transparency, not everything should be disclosed in the opinion of Mr. Villain, otherwise the strategy would vanish in the haze. But in 32 years of operation, the fund had always respected local legislation, and had successfully built relationships of trust with recipient states. Mr. Villain explained how the fund has progressively diversified into new asset classes, but always following strict internal regulations and decision making processes. “Summing up, SWFs want to comply with all rules and regulations, so what is the problem? A permanent dialogue needs to be established to build confidence between funds and recipients.”

During questions from the floor, the vice-president of the Indian Finance Institute asked if there were any bottlenecks impeding the flow of SWF flows. Jean-Paul Villain replied that there were not many, and added that we should not confuse the state and its wealth funds. Mr. Morgan, an Australian Professor, wanted a clarification on the links between SWFs and national companies. Xiqing Gao insisted that the funds were financial investors, and they had no interest in become involved in the investment strategies of domestic firms. Return on investment, not cronyism, was their main interest. A participant questioned whether the passive investment strategies preferred by the SWFs would result in a lack of proper monitoring of the management of the firms in which they had taken stakes. Kristin Halvorsen answered that it was not their role, and it would in any case be impossible to monitor the management of small stakes in 7,000 companies, and Xiqing Gao, as a newcomer in the world of investment funds, repeated that he prefers to stay away from any political involvement.

BMG/HEC-NJ, JR