

# MANAGING RESOURCE REVENUES: SOVEREIGN WEALTH FUNDS IN DEVELOPING COUNTRIES

EVARISTUS OSHIONEBO<sup>\*</sup>

---

## INTRODUCTION

Resource-rich developing countries often experience economic hardship primarily because of the mismanagement of their resource revenues. In response to this phenomenon, many developing countries have enacted laws that stipulate specific principles and guidelines for managing and investing resource revenues. In addition, revenue management bodies, usually referred to as Sovereign Wealth Funds (SWFs), have been established by developing countries in the hope of promoting prudent and responsible investment of resource revenues.

Generally speaking, about 50 countries have established their SWFs, the vast majority of which are located in the developing world.<sup>1</sup> In fact, a few

---

<sup>\*</sup>Ph.D. (Osgoode Hall Law School, York University), Associate Professor, Faculty of Law, University of Calgary, Canada. Initial funding for this project was provided by the Legal Research Institute, Faculty of Law, University of Manitoba. Additional funding was provided by the Faculty of Law, University of Calgary. I am grateful to Samir Hassan and Jennifer Cox for their excellent research assistance.

countries including Chile, China, Kuwait, Oman, Saudi Arabia, Singapore, United Arab Emirates, and Venezuela have two or more SWFs. Of the 50 countries that have established SWFs, at least 34 countries have their SWFs based specifically on natural resource revenues.

The usual practice on the part of governments establishing SWFs is to inject some initial capital into the SWFs. For example, upon its establishment in 2011, the Sovereign Fund of Angola was endowed by the government with an initial capital of US\$ 5 billion.<sup>2</sup> Similarly, the initial capital available to the Nigeria Sovereign Investment Authority (NSIA) is the local currency (naira) equivalent of US\$ 1 billion.<sup>3</sup> Initial capital may be derived from budgetary allocations, particularly where there is a budget surplus in a country. In other instances, initial capital is derived from excess revenues arising from high commodity prices or the proceeds of privatization of government assets.<sup>4</sup>

The exact value of the assets owned and managed by SWFs is unclear. However, conservative estimates of the assets owned and managed by SWFs range from US\$3 trillion to US\$5 trillion.<sup>5</sup> Given the vast financial resources available to SWFs, it is little surprising that in the last decade or so, SWFs have emerged as powerful players on the international investment arena. For example, in 2012 direct foreign investments made by SWFs were reported to be US\$54.6 billion, while the corresponding value of investments made by SWFs in 2011 was US\$66.3 billion.<sup>6</sup>

<sup>1</sup> These countries are Algeria, Angola, Australia, Azerbaijan, Bahrain, Botswana, Brunei, Brazil, Chile, China, Colombia, Equatorial Guinea, France, Finland, Indonesia, Gabon, Ghana, Guinea, Hong Kong, Iran, Iraq, Ireland, Italy, Kazakhstan, Kiribati, Kuwait, Libya, Malaysia, Mauritania, Mexico, Mongolia, New Zealand, Nigeria, Norway, Oman, Panama, Papua New Guinea, Peru, Russia, Saudi Arabia, Sierra Leone, Senegal, Singapore, South Korea, Timor-Leste, Trinidad and Tobago, Turkmenistan, United Arab Emirates, Venezuela, Vietnam, and Qatar. The US States of Alabama, Alaska, Louisiana, Montana, New Mexico, North Dakota, Texas, Wyoming and the Canadian Province of Alberta have their own SWFs.

<sup>2</sup> See Sovereign Fund of Angola, "Overview", online: <[www.fundosoberano.ao/about-fsdea](http://www.fundosoberano.ao/about-fsdea)>.

<sup>3</sup> *Nigeria Sovereign Investment Authority (Establishment, etc.) Act*, 2011, s 29(1) [NSIA].

<sup>4</sup> See International Working Group of Sovereign Wealth Funds, *Sovereign Wealth Funds: Generally Accepted Principles and Practices* (2008) at 27 [*Santiago Principles*] (stating that "SWFs are commonly established out of balance of payment surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.") See also Justin O'Brien, "Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds" (2008) 42:4 *Intl Lawyer* 1231 at 1235.

<sup>5</sup> Abdullah Al-Hassan et al, "Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management" (2003) IMF Working Paper WP/13/231 at 3, online: <[www.imf.org/external/pubs/ft/wp/2013/wp13231.pdf](http://www.imf.org/external/pubs/ft/wp/2013/wp13231.pdf)>.

<sup>6</sup> ESADE & KPMG, *Sovereign Wealth Funds 2013* at 12, online: <[itemsweb.esade.edu/wi/Prensa/ESADEgeo\\_SWF\\_Report\\_2013.pdf](http://itemsweb.esade.edu/wi/Prensa/ESADEgeo_SWF_Report_2013.pdf)>.

This article examines the legal and institutional frameworks for SWFs in developing countries within the context of the *Santiago Principles*.<sup>7</sup> The *Santiago Principles* denote “a framework of generally accepted principles and practices that properly reflect appropriate governance and accountability arrangements as well as the conduct of investment practices by SWFs on a prudent and sound basis.”<sup>8</sup> The article identifies common features of SWFs including the governance structure of SWFs, the rules governing investment of assets, and accountability and transparency of SWFs. In particular, the article analyzes the degree to which the legal regimes governing SWFs promote transparency and accountability in the management and investment of resource revenues in developing countries. Finally, the article addresses the concerns raised by Western politicians and academics regarding SWFs investment in Western countries. The article suggests that, contrary to the clamour for more regulation of SWFs investment in Western countries, a better strategy would be to encourage or incentivize SWFs to be more transparent in the course of pursuing their investment objectives.

## I. OBJECTIVES AND TYPES OF SOVEREIGN WEALTH FUNDS

The International Working Group of Sovereign Wealth Funds defines SWFs as:

...special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets.<sup>9</sup>

There is a myriad of reasons for establishing SWFs. Generally speaking, SWFs are established in developing countries primarily to promote efficient management and utilization of resource revenues. For example, Ghana’s SWF provides “a framework for the collection, allocation and management of petroleum revenue in a responsible, transparent, accountable and sustainable manner for the benefit of the citizens of Ghana.”<sup>10</sup> Similarly, the Sao Tome

---

<sup>7</sup> This article focuses primarily on natural resource-based SWFs, that is, SWFs established for the purpose of managing and investing revenues derived from natural resources.

<sup>8</sup> *Santiago Principles*, *supra* note 4 at 4.

<sup>9</sup> *Ibid* at 27.

<sup>10</sup> *Petroleum Revenue Management Act*, 2011 (Act 815), Preamble.

and Principe *Oil Law*, which establishes that country's SWF, expresses the purpose of the law as regulating "the payments, management, use and oversight of oil revenues resulting from oil operations in the entire national territory, including its terrestrial and marine areas".<sup>11</sup>

The need to promote efficient management and utilization of resource revenues in developing countries is often situated within the context of the so-called 'resource-curse' phenomenon. The 'resource curse' is said to occur where there is a negative correlation between a country's level of economic development and its natural resource endowment.<sup>12</sup> The expectation in many developing countries is that the prudent management of resource revenues by their SWFs would help these countries to ameliorate or avoid the 'resource curse'.

However, the objectives of SWFs go beyond prudent management of resource revenues. Some SWFs are established for the purpose of preserving and saving resource revenues for future generations, as well as to provide social infrastructure for citizens of their country. For example, Nigeria's NSIA is tasked with the objectives of building a savings base for the Nigerian people; enhancing the development of infrastructure and providing stabilization support for the Nigerian economy in times of economic stress.<sup>13</sup> Similarly, the Sovereign Fund of Angola has, amongst its objectives, the development, maintenance and management of large infrastructural projects.<sup>14</sup>

In some instances, SWFs are established with the objective of aiding the government to meet its contingent liabilities such as pension liabilities, while other SWFs are established for the more specific objective of investing a country's foreign reserves, thus offsetting or reducing "the negative carry costs of holding reserves" in bank accounts.<sup>15</sup>

That said, it should be observed that, although SWFs have a myriad of objectives as articulated above, these objectives are not mutually exclusive. Rather, they are complementary. Thus it is quite often the case that SWFs in

---

<sup>11</sup> *Sao Tome and Principe Oil Law*, 2004, art 2.

<sup>12</sup> See generally Michael L Ross, "The Political Economy of the Resource Curse" (1999) 51:2 *World Politics* 297; Terry Lynn Karl, *The Paradox of Plenty: Oil Booms and Petro-States* (Berkeley & Los Angeles, California: University of California Press, 1997); Richard M Auty, *Sustaining Development in Mineral Economies: The Resource Curse Thesis* (London: Routledge, 1993).

<sup>13</sup> NSIA, *supra* note 3, s 3.

<sup>14</sup> *Presidential Decree No. 89/13 of 19<sup>th</sup> June, 2013*, art 4, online: <[www.fundosoberano.ao/wp-content/themes/fsdea\\_theme/article/english/N\\_89\\_of\\_19\\_June\\_2013.pdf](http://www.fundosoberano.ao/wp-content/themes/fsdea_theme/article/english/N_89_of_19_June_2013.pdf)>.

<sup>15</sup> Al-Hassan et al, *supra* note 5 at 6.

resource-rich countries are charged with multiple objectives.<sup>16</sup> For example, as indicated in the Table below, SWFs in resource-rich countries often have the objectives of economic stabilization and saving of investment proceeds for future generations.

With regard to the types of SWFs, the International Monetary Fund has identified five different types of SWFs: Fiscal Stabilization Funds, Savings Funds, Development Funds, Pension-Reserve Funds and Reserve Investment Funds or Corporations.<sup>17</sup> These five types of SWFs are classified along the lines of their objectives. As indicated in the Table below, of the five types of SWFs, Fiscal Stabilization Funds and Savings Funds are the most common type of SWFs in resource-rich countries. However, SWFs in countries such as Botswana, Brunei and Libya are Savings Funds only.

While Fiscal Stabilization Funds are designed to insulate a country's economy from volatility and shocks, particularly those countries that place heavy reliance on resource revenues, Savings Funds are aimed primarily at saving and investing excess revenues for future generations.<sup>18</sup> Development Funds cater to infrastructural development, particularly large-scale economic and social infrastructure such as roads, housing, schools, and hospitals. Pension-Reserve Funds invest pension funds on behalf of governments, and the proceeds of such investments are then used by the governments to meet their pension liabilities. Finally, Reserve Investment Funds/Corporations are responsible for investing a country's foreign reserves.<sup>19</sup>

*Select Resource-based SWFs\**

Country	SWF Name	Type	Legal Form	Governance Structure / Operational Management
Angola	Sovereign Fund of Angola	Fiscal Stabilization Fund  Savings Fund  Development Fund	Separate Legal Personality	Board of Directors

<sup>16</sup> *Ibid.*

<sup>17</sup> *Ibid* at 5-6.

<sup>18</sup> *Ibid* at 5.

<sup>19</sup> *Ibid* at 6.

Azerbaijan	State Oil Fund	Fiscal Stabilization Fund Savings Fund Development Fund		Three-tier management:  (1) President of the Republic (2) Supervisory Board (3) Executive Director
Bahrain	Future Generations Reserve Fund	Fiscal Stabilization Fund Savings Fund		Ministry of Finance
Botswana	Pula Fund	Savings Fund		Central Bank (i.e., Bank of Botswana)
Brunei	Brunei Investment Agency	Savings Fund	Separate Legal Personality	Board of Directors
Chile**	Economic and Social Stability Fund	Fiscal Stabilization Fund		Central Bank
Ghana	Ghana Petroleum Funds	Fiscal Stabilization Fund Savings Fund		Central Bank (i.e., Bank of Ghana)
Iran	National Development Fund of Iran	Development Fund Savings Fund		(1) Board of Trustees (2) Managing Board
Kazakhstan	Kazakhstan National Fund	Fiscal Stabilization Fund Savings Fund		Central Bank (i.e., National Bank of Kazakhstan)
Kuwait**	Kuwait Investment Authority	Fiscal Stabilization Fund	Independent Public Authority	Board of Directors

		Savings Fund		
Libya	Libyan Investment Authority	Savings Fund		Board of Trustees
Mexico	Oil Stabilization Fund	Fiscal Stabilization Fund		Ministry of Finance
Nigeria	Nigeria Sovereign Investment Authority	Fiscal Stabilization Fund Savings Fund Development Fund	Separate Legal Personality	Board of Directors
Oman**	State General Reserve Fund	Savings Fund	Separate Legal Personality	Board of Directors
Qatar	Qatar Investment Authority	Reserve Investment Fund Savings Fund	Separate Legal Personality	Board of Directors
Sao Tome and Principe	National Oil Account	Fiscal Stabilization Fund Savings Fund		Central Bank
Saudi Arabia**	SAMA Foreign Holdings	Reserve Investment Fund		Central Bank
Timor-Leste	Petroleum Fund for Timor-Leste	Fiscal Stabilization Fund Savings Fund		Central Bank

Trinidad and Tobago	Heritage and Stabilization Fund	Fiscal Stabilization Fund Savings Fund		Central Bank
United Arab Emirates**	Abu Dhabi Investment Authority	Savings Fund	Separate Legal Personality	Board of Directors

\*Sources: Various sources including constitutive statutes; the *Santiago Principles* (at 31-49); Abdullah Al-Hassan, *et al* (at 31); and websites of the SWFs.

\*\*Countries with multiple SWFs.

## II. LEGAL AND INSTITUTIONAL FRAMEWORKS FOR SOVEREIGN WEALTH FUNDS IN DEVELOPING COUNTRIES

As noted previously, a principal rationale for the creation of SWFs is the promotion of prudent management of resource revenues which, in turn, could help a country to avoid the ‘resource curse’ phenomenon. The prudent management of resource revenues may not be accomplished unless there is a sound legal foundation or framework for SWFs. As observed by the International Working Group of Sovereign Wealth Funds:

A sound legal framework underpins a robust institutional and governance structure of the SWF and a clear delineation of the responsibilities between the SWF and other government entities. The framework facilitates the formulation and implementation of the appropriate objectives and investment policies, and is necessary for an SWF to operate effectively to achieve its stated purpose.<sup>20</sup>

---

<sup>20</sup> *Santiago Principles*, *supra* note 4 at 11. The International Working Group of Sovereign Wealth Funds (IWGSWF) was convened by several resource-rich countries in 2008. The primary objective of the IWGSWF was “to agree on a common set of voluntary principles for SWFs, drawing on the existing body of principles and practices”. See International Monetary Fund, Press Release, 09/97, “International Working Group of Sovereign Wealth Funds is Established to Facilitate Work on Voluntary Principles” (1 May 2008), online: <[www.imf.org/external/np/sec/pr/2008/pr0897.htm](http://www.imf.org/external/np/sec/pr/2008/pr0897.htm)>. In 2008 the IWGSWF adopted and published the *Santiago Principles* and in April 2009, the IWGSWF adopted the “Kuwait Declaration” through which it established the International Forum of Sovereign Wealth Funds. The purpose of International Forum of Sovereign Wealth Funds is “to meet, exchange views on issues of common interest, and facilitate an understanding of the *Santiago Principles* and SWF activities.” Membership of the International Forum of Sovereign Wealth Funds is open to SWFs who endorse the *Santiago Principles*. See “Kuwait Declaration: Establishment of the International Forum of Sovereign Wealth Funds”, online: <[www.iwg-swf.org/index.php?home=kuwaitdec.php](http://www.iwg-swf.org/index.php?home=kuwaitdec.php)>.



A sound legal framework for SWFs is important for another reason. The extent to which the ‘resource curse’ takes effect in any given country depends largely on the policy choices of its decision-makers.<sup>21</sup> These policy choices may be enabled or constrained by the legal regimes governing resource revenues. For example, the legal regimes could “mold the preferences and behaviors” of decision-makers, “thereby enhancing (or reducing) the probability of certain outcomes.”<sup>22</sup> Thus, where effective, the legal regimes in a given country could prevent or ameliorate the ‘resource curse’ by ensuring that fund managers make the rights choices in the management of resource revenues. In other words, the ultimate objective of SWFs to promote prudent management of revenues “can only be achieved if the SWFs are managed within a sound governance structure” as established by the legal framework governing the SWFs.<sup>23</sup> As noted by Abdullah Al-Hassan, *et al*:

A robust legal framework is required to promote sound institutional and governance arrangement for the effective management of SWFs. The SWF legal framework should among other things (i) provide clearly for the legal form and structure of SWF and its relationship with other state bodies (including the ministry of finance [and] central bank); (ii) be consistent with the broader legal framework governing government’s budgetary processes; (iii) ensure legal soundness of the SWF and its transactions; (iv) support its effective operation and the achievement of its stated policy objective(s), which should be economic and financial in nature; and (v) promote effective governance, accountability, and transparency.<sup>24</sup>

A number of developing countries have established certain legal regimes for the management and utilization of resource revenues. These legal regimes may be resource-specific legal regimes or generic legal regimes. Countries adopt the resource-specific approach by enacting laws stipulating specific principles and guidelines for the management of their resource-based SWFs.<sup>25</sup> The generic approach promotes prudent fiscal and budgetary practices in the management of government revenues, including natural resource revenues.

---

<sup>21</sup> Karl, *supra* note 12 at 5–12.

<sup>22</sup> *Ibid* at 11.

<sup>23</sup> Al-Hassan *et al*, *supra* note 5 at 3.

<sup>24</sup> *Ibid* at 9.

<sup>25</sup> See, for example, Ghana’s *Petroleum Revenue Management Act 2011*; Nigeria *Sovereign Investment Authority (Establishment, Etc.) Act, 2011*; Timor Leste’s *Petroleum Fund Law, Law No 9/2005*; Sao Tome and Principe’ *Oil Revenue Law (Law No 8/2004)*.

### a. Governance structure

The legal framework for SWFs not only provides “a clear mandate for the manager to invest the SWF’s assets and conduct all related transactions”,<sup>26</sup> but it also provides for the governance structure of SWFs. The *Santiago Principles* require that “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.”<sup>27</sup> In effect, the legal framework for SWFs impacts directly on the institutional governance of SWFs.

The governance structure of SWFs in developing countries can be divided into two distinct categories: (1) SWFs vested with a separate legal personality and (2) SWFs managed by Central Banks or designated government agency but lacking a separate legal personality.

#### 1. SWFs vested with separate legal personality

SWFs falling within this category are either created by statute and vested with separate legal personality or incorporated under the law as state-owned corporations with separate legal personality. A common feature of this variant of SWFs is that they have perpetual succession and the power to sue and be sued in their names. The Brunei Investment Agency and Nigeria’s NSIA are examples of SWFs in this category. The statute establishing the Brunei Investment Agency provides that it “shall be a body corporate and shall have perpetual succession and may sue and be sued in its own name.”<sup>28</sup> Likewise, the NSIA is a body corporate vested with perpetual succession<sup>29</sup> and the capacity to sue and be sued in its corporate name.<sup>30</sup> As well, the NSIA has power to acquire, hold and dispose of property for the purpose of discharging its statutory functions and objects.<sup>31</sup> Similarly, the Kuwait Investment Authority is an “independent public authority” vested with juridical status,<sup>32</sup>

---

<sup>26</sup> *Santiago Principles*, *supra* note 4 at 12.

<sup>27</sup> *Ibid* at 15, Principle 6.

<sup>28</sup> *Brunei Investment Agency (Chapter 137), Laws of Brunei, S 4/84, 1984 Ed. Cap 137*, s 3(1), online: <[www.commonlii.org/bn/legis/bia137307](http://www.commonlii.org/bn/legis/bia137307)>.

<sup>29</sup> *NSIA*, *supra* note 3, s 1(2)(a).

<sup>30</sup> *Ibid* s 1(2)(b).

<sup>31</sup> *Ibid* s 1(3).

<sup>32</sup> *Law No. 47 of 1982 (establishing the Kuwait Investment Authority)*, art 1, <[www.kia.gov.kw/en/Pages/KIALaw.aspx](http://www.kia.gov.kw/en/Pages/KIALaw.aspx)> [*Kuwait Investment Authority*].

while the Sovereign Fund of Angola is statutorily vested with the status of “a legal person, equipped with a legal personality, with administrative, financial and property autonomy.”<sup>33</sup>

It is often the case that statutes establishing this model of SWFs also create a governing or management board for the SWFs. For example, the Sovereign Fund of Angola,<sup>34</sup> the Brunei Investment Agency,<sup>35</sup> the Kuwait Investment Authority,<sup>36</sup> and the NSIA<sup>37</sup> are each managed by a Board of Directors.<sup>38</sup> Members of the board of directors of these SWFs are appointed by the government and, for the most part, members of the board are cabinet ministers and officials of governments, although in a few instances members of the board include representatives of the private sector. For example, the NSIA has a Board of Directors consisting of a non-executive chairman; a Managing Director; two Executive Directors; one non-Executive Director who is a distinguished legal practitioner with at least ten years post qualification experience; and four other non-executive directors.<sup>39</sup>

However, the boards of directors of some SWFs are assisted by advisory bodies created by statutes or executive instruments. The Sovereign Fund of Angola has an Advisory Board which acts as an auditing and consulting body and helps the Board of Directors in carrying out the program of investment of the Fund.<sup>40</sup> For its part, the NSIA has a Governing Council tasked primarily with the duty of providing advice and counsel to the Board of Directors.<sup>41</sup> That being said, advisory bodies do not have the power to

---

<sup>33</sup> *Presidential Decree No. 48/11*, art 1(2). See also *Presidential Decree No. 89/13* of 19 June 2013, art 2. The Sovereign Fund of Angola, formerly known as the Oil Fund, was created pursuant to the *General State Budget Law*, approved by *Law No. 26/10* of 28 December 2010. See *Presidential Decree No. 48/11*, art 1(1).

<sup>34</sup> *Presidential Decree No. 48/11*, art 13.

<sup>35</sup> *Brunei Investment Agency*, *supra* note 28, s 5(1).

<sup>36</sup> *Kuwait Investment Authority*, *supra* note 32, art 3.

<sup>37</sup> NSIA, *supra* note 3, s 16(1).

<sup>38</sup> *Presidential Decree No. 48/11*, art 13.

<sup>39</sup> NSIA, *supra* note 3, s 16(1).

<sup>40</sup> *Presidential Decree No. 89/13* (of 19 June 2013), art 9(1). See also *Presidential Decree No. 48/11*, arts 5, 9, 16(1).

<sup>41</sup> NSIA, *supra* note 3, s 7(2). The Governing Council of the Nigeria Sovereign Investment Authority consists of a diverse group of persons including the President of Nigeria who is Chairperson of the Council; governors of all of the states constituting Nigeria; the Attorney-General of Nigeria; the Minister of Finance; the Minister in charge of the National Planning Commission; the Governor of the Central Bank of Nigeria; the Chief Economic Advisor to the President of Nigeria; the Chairperson of the Revenue Mobilization, Allocation and Fiscal Commission; four individuals with cognate experience in finance, economics, investment or other related areas of expertise appointed as representatives of the private sector; two representatives of the civil society including non-governmental organizations and professional organizations focused on civil rights; two representatives of Nigerian youths; and four eminent academics. See NSIA, *supra* note 3, s 8(1).

interfere in the management of SWFs. For example, in discharging its statutory functions of advising and counselling the board, the Governing Council of the NSIA is obliged to “observe the independence of the Board and officers of” NSIA.<sup>42</sup>

The statutory creation of a governing board of directors for SWFs is significant because, quite often, the enabling statutes not only vest specific management powers on the board of directors but they also delineate the powers and obligations of the board of directors from other agencies of government. For example, the statute establishing the Kuwait Investment Authority (KIA) provides that the Board of Directors of the KIA “has all powers necessary for attaining [KIA’s] objectives, and in particular, the following:

- (a) Formulation of the general policy of the Authority and supervision of its implementation, preparation and follow-up of investment programs, and issue of decisions necessary thereto.
- (b) Adoption of financial and administrative regulations necessary for the authority and supervision of its implementation.
- (c) Undertaking of various transactions of assets investment whether directly or through other establishments.
- (d) Approval of the Authority’s draft budget and its annual accounts, before their submission to the competent authorities.<sup>43</sup>

The Board of Directors of the Brunei Investment Agency is “responsible for the policy and general administration of the affairs and business of the Agency,”<sup>44</sup> while the Board of Directors of the Sovereign Fund of Angola is statutorily vested with powers to, amongst other things, define the objectives, the strategy and the policies of management of the fund; formulate administrative policies and regulations for the internal management of its activities; design a policy of investment and the annual strategy for achieving investment targets; and formulate a Code of Conduct for its activities.<sup>45</sup> Similarly, the Board of Directors of the Nigeria’s NSIA is responsible for the general management and supervision of the affairs of the NSIA<sup>46</sup> as well as the making of policies, regulations, codes, internal guidelines and procedures in furtherance of the performance of its investment objectives.<sup>47</sup>

---

<sup>42</sup> *Ibid*, s 7(3).

<sup>43</sup> *Kuwait Investment Authority*, *supra* note 32, art 3.

<sup>44</sup> *Brunei Investment Agency*, *supra* note 28, s 5(1).

<sup>45</sup> *Presidential Decree No. 89/13* (of 19 June 2013), art 7.

<sup>46</sup> *NSIA*, *supra* note 3, s 15.

<sup>47</sup> *Ibid*, s 51.

The vesting of a separate legal personality on SWFs could promote operational independence on the part of managers of the SWFs. This is particularly so in those instances where the statute establishing an SWF expressly provides that the board of directors is independent of the government, owners of the SWF. For example, section 25 of the *Nigeria Sovereign Investment Authority (Establishment, Etc.) Act, 2011 (Act No. 15)* provides that the Board of Directors of the NSIA is independent in the exercise of its statutory responsibilities.<sup>48</sup> Thus, except to the limited extent that the Board reports to the government (more specifically, the National Economic Council) for advice and counsel, the government “may not, by resolution or otherwise, require the directors to take, or refrain from taking any specified action.”<sup>49</sup> In effect, the board of directors of the NSIA is statutorily insulated from political interference by government officials.

In some instances, members of the board of directors of SWFs owe both the duty of care and the fiduciary duty usually imposed on directors of companies in the private sector. For example, in discharging their duties, Directors of the NSIA are obliged to “act in utmost good faith, with care, skill and diligence.”<sup>50</sup> Directors of the NSIA also have a fiduciary duty which prevents them from acting “in any circumstance where their personal interests conflict with the interests of the” NSIA.<sup>51</sup>

However, the independence of the board of directors of SWFs may well be superficial because members of the board are appointed and dismissed by the government. The fear of being dismissed if a director disagrees with the government’s position regarding the affairs of an SWF has a chilling effect on the independence of the board of directors. Furthermore, even in instances where SWFs are statutorily declared to be independent of the government, the directors, officers and employees of the SWFs are often deemed to be public servants as defined by domestic law. For example, directors, officers and employees of the Brunei Investment Agency are “public servants within the meaning of the *Penal Code*” of Brunei.<sup>52</sup> Likewise, directors, officers and employees of Nigeria’s NSIA are public officers as defined under the *Public Officers Protection Act*.<sup>53</sup> The implication then is that such directors are subject

---

<sup>48</sup> *Ibid*, s 25(1).

<sup>49</sup> *Ibid*, s 25(2).

<sup>50</sup> *Ibid*, s 26(1).

<sup>51</sup> *Ibid*, s 26(2).

<sup>52</sup> *Brunei Investment Agency*, *supra* note 28, s 14(1).

<sup>53</sup> NSIA, *supra* note 3, s 53.

to the rules governing public officers including rules relating to termination of employment.

## 2. SWFs managed by central banks or other government agency but lacking a separate legal personality

The second model of SWFs, usually referred to as the “manager model”,<sup>54</sup> has three sub-models. First, as owners of the SWF, the government may, through the Ministry of Finance, delegate the power to manage the SWF to the Central Bank under an Operational Management Agreement. Second, the Ministry of Finance may establish a fund management entity within the ministry to manage the SWF or, third, the Ministry of Finance may appoint external and independent fund managers to manage the SWF.<sup>55</sup>

This model of SWFs may be established by a specific statute or established under the general administrative powers of the government. The latter is the case in Botswana where the Pula Fund was established under the government’s general powers pursuant to the *Bank of Botswana Act*.<sup>56</sup> However, even in the few instances where the ‘manager model’ of SWFs is established by statute, the SWF is usually not vested with the status of a separate legal person. Rather, the more common practice is to vest express powers on the country’s Minister of Finance or Central Bank to manage and invest the funds and assets of the SWF. SWFs in Ghana and Timor-Leste are good examples of the ‘manager model’ of SWFs. In Ghana the Minister of Finance is vested with the power to manage the SWF with a legal requirement that the Minister shall delegate the operational management of the SWF to the Central Bank of Ghana. As well, Timor-Leste’s *Petroleum Fund Law*, which establishes the “Petroleum Fund”,<sup>57</sup> expressly requires the Minister of Finance to “enter into an agreement with the Central Bank for the operational management of the Petroleum Fund and the Central Bank shall be responsible for the operational management of the Petroleum Fund.”<sup>58</sup>

Timor-Leste’s Minister of Finance has in fact executed an Operational Management Agreement (OPM) with the Central Bank. Under the OPM, the Central Bank is responsible for investing the capital of the fund, receiving and accounting for the investment income and other revenues

---

<sup>54</sup> See Al-Hassan et al, *supra* note 5 at 10.

<sup>55</sup> *Ibid.*

<sup>56</sup> See *Bank of Botswana Act*, Chapter 55:01.

<sup>57</sup> *Petroleum Fund Law*, [Timor-Leste], *supra* note 25, art 5.1.

<sup>58</sup> *Ibid.*, art 11.3.

of the fund; administering tax and royalty payments; maintaining books of account and all financial and asset records including a register of all payments made as Petroleum Fund receipts; appointing and dismissing financial intermediaries such as dealers and brokers; identifying and selecting portfolio managers to achieve the investment objectives of the fund; preparing quarterly reports to the Minister; advising the Minister on matters relating to the management of the fund; implementing systems, procedures and risk management practices in order to minimize the risk of operational loss to the fund; and providing the public with information regarding the fund.<sup>59</sup>

While the Central Bank is responsible for the operational management of this model of SWFs, the overall management of the SWFs is vested in the government. Quite often the government exercises its overall management power through a designated government official, usually the Minister responsible for finance.<sup>60</sup> Overall management power includes the power to make guidelines, rules and regulations for the operational management of the SWFs. In Timor-Leste, for example, the government, through the Minister of Finance, is responsible for establishing:

...the overall policies and guidelines for the investment of the capital of the Fund, including the determination of the overall investment objective, the asset allocation strategy, and the investment mandate comprising an overall financial mandate and subsidiary mandates with such benchmarks, financial targets, performance and risk measures as may be necessary to convey the Minister's intention to the Central Bank for the investment and anticipated return on the Fund.<sup>61</sup>

Similarly, section 25 of Ghana's *Petroleum Revenue Management Act 2011* provides that the Minister of Finance shall:

- (a) develop an investment policy for the investment of the Ghana Petroleum Funds,
- (b) be responsible for the overall management of the Ghana Petroleum Funds and shall oversee the transfers into and disbursement from the Ghana Petroleum Funds,
- (c) make decisions in relation to the investment strategy or management of the Ghana Petroleum Funds after seeking the

---

<sup>59</sup> *Petroleum Fund of Timor-Leste Operational Management Agreement*, Clause 3, online: <[www.mof.gov.tl/wp-content/uploads/2011/09/Management-Agreement-25-June-2009-English.pdf](http://www.mof.gov.tl/wp-content/uploads/2011/09/Management-Agreement-25-June-2009-English.pdf)>.

<sup>60</sup> For example, under Timor Leste's *Petroleum Fund Law*, Law No 9/2005, art 11.1, the government of Timor-Leste "is responsible for the overall management of the Petroleum Fund."

<sup>61</sup> *Petroleum Fund of Timor-Leste Operational Management Agreement*, *supra* note 59 at Clause 2(a).

advice of the Investment Advisory Committee and the Governor [of the Bank of Ghana], subject to the provisions of section 38, and  
(d) enter into an Operations Management Agreement with the Bank of Ghana for the operational management of the Ghana Petroleum Funds, in the form and substance similar to the format in the Second Schedule.<sup>62</sup>

Pursuant to these statutory powers, the Minister of Finance may establish investment mandates and benchmarks for the SWFs including the qualifying instruments in which the funds of the SWFs may be invested by the Central Bank. In some instances, the Minister may delegate to the Central Bank the power to determine the qualifying instruments in which the funds of the SWFs may be invested.

A variant of the ‘manager model’ of SWFs is found in Sao Tome and Principe, where the statute establishing that country’s SWF vests management powers directly on the Central Bank. In that country, the Central Bank manages the SWF by virtue of the managerial power conferred on the Central Bank under the *Oil Revenue Law (Law No. 8/2004)* to the effect that “[t]he Central bank, acting in the name of the State, shall establish and hold the Oil Accounts with a Custody Bank selected by the Government pursuant to this law.”<sup>63</sup> In essence, the powers of the Central Bank to manage Sao Tome and Principe’s SWF are not delegated to the Central Bank by the Minister of Finance.

As noted previously some SWFs in the ‘model manager’ are established by governments on the basis of general administrative powers. This could lead to unintended adverse consequences for the governance of the SWFs. For example, there is a tendency for secrecy in terms of the management of the SWFs where the managers are un-named officers of the Central Bank. Also, reporting and disclosure requirements are unclear since reporting on the activities of the SWFs, if any, is done within the context of the rules of the Central Bank. Moreover, the objectives of these SWFs could be flux or unclear, particularly where there is no specific legislative instrument setting out the objectives of the SWFs. For example, although as indicated in the Table above the objective of Botswana’s Pula Fund is the saving of resource revenues, that objective has over the years become unclear, leading

---

<sup>62</sup> *Petroleum Revenue Management Act*, *supra* note 10, s 25.

<sup>63</sup> *Oil Revenue Law*, *supra* note 25, art 3(1).



to a situation where the government has used the Pula Fund for revenue stabilization purposes.<sup>64</sup>

Finally, because this model of SWFs vests on the government (or the Minister of Finance) the overall power to manage the affairs of the SWFs, persons charged with the operational (or day-to-day) management of the SWFs cannot be truly said to be independent. The lack of independence could adversely impact operational management of the SWFs, a point which is elaborated in the next section of this article.

## b. Determinants of the model of governance

What determines the choice of governance structure for an SWF? For the most part countries establishing SWFs do not indicate their reasons for adopting a particular governance structure for their SWFs. However, it appears that the governance structure of SWFs depends largely on administrative, legal and economic factors. Administratively, governments may choose to confer a separate legal personality on SWFs in order to delineate the SWFs from other government agencies. As observed by the International Working Group of Sovereign Wealth Funds, SWFs that are established as separate legal entities tend to “have a governance structure that clearly differentiates an owner, a governing body, and management of the SWF.”<sup>65</sup>

Governments may also do so to “facilitate accountability and operational independence” for the SWFs, as enjoined by the *Santiago Principles*.<sup>66</sup> The vesting of a separate legal personality on SWFs also allows governments to separate ownership of the SWFs and control of the SWFs, thus insulating the SWFs from political interference on the part of the ruling elites. That being said, the author recognizes that the concept of separate legal personality does not, standing alone, guarantee operational independence for

---

<sup>64</sup> Natural Resource Governance Institute (NRGI) & Columbia Center on Sustainable Investment, “Natural Resource Funds: Botswana Pula Fund”, at 3, online: <[ccsi.columbia.edu/files/2014/04/nrf\\_Botswana\\_July2013\\_RWI\\_VCC.pdf](http://ccsi.columbia.edu/files/2014/04/nrf_Botswana_July2013_RWI_VCC.pdf)> [NRGI & Columbia Center on Sustainable Investment, “Botswana Pula Fund”]. Other African countries have similarly used their SWFs to fund debt repayment even though the objectives of the SWFs do not include debt servicing or repayment. See Thouraya Triki & Issa Faye, “Africa’s Quest for Development: Can Sovereign Wealth Funds Help?” (2011), African Development Bank Group Working Paper Series No 142, at 9, online: <[www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/WPS%20No%20142%20Africas%20Quest%20for%20Development%20%20Can%20Sovereign%20Wealth%20Funds%20help%20AS.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/WPS%20No%20142%20Africas%20Quest%20for%20Development%20%20Can%20Sovereign%20Wealth%20Funds%20help%20AS.pdf)>.

<sup>65</sup> *Santiago Principles*, *supra* note 4 at 15.

<sup>66</sup> *Ibid* at 15 (Principle 6).

SWFs in practice. However, the concept affords managers of SWFs the liberty to exercise their discretion in making decisions for the SWFs.

With regard to the ‘manager model’ of SWFs, governments might find the ‘manager model’ easier to manage and more cost-effective because the ‘manager model’ relies primarily on existing institutions such as the Central Bank to manage the SWFs. Because most Central Banks have a certain degree of expertise as well as the requisite personnel to manage and invest public funds, it makes economic sense for governments to tap into the Central Bank’s expertise. As observed by Al-Hassan, *et al*, “[s]etting up a fund as a separate legal entity has costs, while a unit in the central bank makes use of existing infrastructure and human resources [and thus,] it could be more cost-effective if a small size fund were to be managed within an existing institution.”<sup>67</sup>

In addition, SWFs adopting the ‘manager model’ as their governance structure are better able to claim certain legal privileges regarding their investments in foreign countries, such as tax exemptions.<sup>68</sup> As noted by some observers, “investments through central banks will normally be protected by sovereign immunity and may also enjoy tax privileges in recipient countries.”<sup>69</sup> In the legal sense, an SWF falling within the ‘manager model’ is an agency of the government given that it is not a separate legal person. Thus investments made by the SWF in foreign countries are deemed to be made by the government. And because sovereign governments enjoy tax exemptions with regard to their activities in foreign countries, the SWF, by extension, enjoys these tax exemptions.

However, SWFs managed by Central Banks or other government agencies have certain disadvantages including lack of operational independence. As noted previously, the ‘manager model’ of SWFs usually lacks a separate legal personality. In effect, SWFs falling under this model are, to all intents and purposes, part and parcel of the government. Thus, managers of the SWFs (be they the Central Bank or the Ministry of Finance) are susceptible to interference by government officials. For example, it was reported recently that Ghana’s Minister of Finance interfered with the management of the Ghana Stabilization Fund (one of the funds constituting

---

<sup>67</sup> Al-Hassan *et al*, *supra* note 5 at 11.

<sup>68</sup> On tax exemptions for sovereign governments and SWFs, see Matthew A Melone, “Should the United States Tax Sovereign Wealth Funds” (2008) 26:2 BU ILJ 143.

<sup>69</sup> Al-Hassan *et al*, *supra* note 5 at 9.

the Ghana Petroleum Funds) by unilaterally capping the capital available to the fund, apparently without parliamentary approval as required by law.<sup>70</sup>

Moreover, management of the ‘manager model’ of SWFs is sometimes shrouded with secrecy and lack of transparency. In some instances the Ministry of Finance or the Central Bank may not have clear rules for disclosure of information regarding the SWFs. Even where disclosures are made, such disclosures are randomly made within the context of the Central Bank rules. Moreover, some SWFs in the ‘manager model’ do not have explicit operational rules including rules governing deposits and withdrawal, as is the case with Botswana’s Pula Fund.<sup>71</sup>

### III. INVESTMENT POLICY AND STRATEGY

The *Santiago Principles* do not recommend any specific investment strategy for SWFs apparently because the drafters of the Principles recognize correctly that a one-size-fits-all strategy is inappropriate for SWFs given their diverse objectives. However, the *Santiago Principles* make general recommendations to the effect that:

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 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.<sup>72</sup>

#### a. Scope of investment policy

The investment policy of SWFs in developing countries depends largely on the objective(s) of the SWFs and their level of risk-tolerance. Generally speaking, large and financially stable SWFs tend to have a broad

---

<sup>70</sup> See Public Interest and Accountability Committee, Press Release, “Position of the Public Interest and Accountability Committee (PIAC) on Placement of Cap by the Minister of Finance on the Ghana Stabilisation Fund” (7 August 2014), online: <[www.piacghana.org/PressStatement11.pdf](http://www.piacghana.org/PressStatement11.pdf)> (stating that “[i]n the case of the Ghana Stabilisation Fund, Parliament was not informed about the amount that was expected to be in excess and therefore specific approval was required before the amount could be moved out of the Ghana Stabilisation Fund”).

<sup>71</sup> NRG1 & Columbia Center on Sustainable Investment, “Botswana Pula Fund”, *supra* note 64 at 2.

<sup>72</sup> *Santiago Principles*, *supra* note 4 at 8.

investment policy in the sense that these SWFs have broad (and sometimes unrestrained) powers to invest their funds in any instrument they deem fit. For example, the Brunei Investment Agency can invest in any securities guaranteed by governments or financial institutions as approved by the Board of Directors.<sup>73</sup> As well, the Brunei Investment Agency has power to invest in “such other classes of investment assets as may be authorized by the board from time to time”.<sup>74</sup>

However, many developing countries with small-size SWFs adopt the ‘legal list’ approach in the course of investing their funds. A country adopts the ‘legal list’ approach where the SWF is empowered to invest only in “qualifying instruments” as determined under the law or an executive order. For example, Timor-Leste’s *Petroleum Fund Law* provides that “not less than ninety per cent (90%) of the amounts in the Petroleum Fund shall be invested only in qualifying instruments described in Article 15”.<sup>75</sup> In this regard, ‘qualifying instrument’ means:

- (a) a debt instrument denominated in the United States Dollars that bears interest or a fixed amount equivalent to interest, that is:
  - (i) rated Aa3 or higher by the Moody’s rating agency or rated AA- or higher by Standard & Poor’s rating agency; and
  - (ii) issued by or guaranteed by the World Bank or by a sovereign State, other than Timor-Leste, provided the issuer or guarantor is rated Aa3 or higher by the Moody’s rating agency or rated AA- or higher by Standard & Poor’s rating agency; or
- (b) a United States Dollars deposit with, or a debt instrument denominated in United States Dollars that bears interest or a fixed amount equivalent to interest issued by:
  - (i) the Bank for International Settlements;
  - (ii) the European Central Bank; or
  - (iii) the Central Bank of a sovereign State, other than Timor-Leste, with a long-term foreign currency rating of Aa3 or higher by the Moody’s rating agency or AA- or higher by the Standard & Poor’s rating agency;
  - (iv) a bank designated by Moody’s rating agency with a long-term foreign currency rating of Aa3 or higher or designated

---

<sup>73</sup> *Brunei Investment Agency*, *supra* note 28, s 18(e).

<sup>74</sup> *Ibid.*, s 18(f).

<sup>75</sup> *Petroleum Fund Law* [Timor-Leste], *supra* note 25, art 14.1.

by Standard & Poor's rating agency with a long-term foreign currency rating of AA- or higher.<sup>76</sup>

The 'legal list' approach is not peculiar to Timor-Leste. Ghana's *Petroleum Revenue Management Act 2011* requires funds belonging to the SWF to be invested only in "qualifying instruments prescribed by Executive Instrument."<sup>77</sup> However, unlike Ghana, Timor-Leste has a statutory exception to the provision that petroleum revenues are to be invested in qualifying instruments. In Timor-Leste, up to 10% of petroleum revenues may be invested in financial instruments other than the qualifying instruments specified in the *Petroleum Fund Law*.<sup>78</sup> However, investment in non-qualifying instruments can be made only if such instruments are issued abroad; the instruments are liquid and transparent and traded in a financial market of the highest regulatory standard.<sup>79</sup>

In effect, the 'legal-list' approach restricts the scope of the instruments in which SWFs can invest. This restriction is informed by a perceived need to prevent excessive risk-taking by SWFs. This is especially so in the case of SWFs lacking institutional capacity and expertise to invest in risky but high yielding instruments. In this sense, the 'legal list' approach could mold the investment preferences of fund managers so as to avoid excessive risk-taking.<sup>80</sup>

However, the 'legal list' approach could hinder the maximization of returns on investment. Nascent and new investment opportunities arise frequently on the global market. This statutory restriction on investment instruments could potentially prevent SWFs from taking advantage of new investment opportunities to the extent that these new investment opportunities are not designated as 'qualifying instruments'. This concern could be assuaged by constant and consistent review of the list of qualifying instruments to cater to emerging trends on the international investment market.

That being said, developing countries adopt different approaches with regard to the meaning and scope of 'qualifying instruments'. In countries such as Ghana, "qualifying instruments" are not static because the range of instruments designated as 'qualifying instruments' is subject to

---

<sup>76</sup> *Petroleum Fund Law*, Law No. 9 / 2005 [Timor-Leste], Article 15.

<sup>77</sup> *Petroleum Revenue Management Act*, *supra* note 10, s 27(1).

<sup>78</sup> *Petroleum Fund Law*, *supra* note 25, art 14.2.

<sup>79</sup> *Ibid.*

<sup>80</sup> See Karl, *supra* note 12 at 11.

periodic review.<sup>81</sup> In other countries such as Timor-Leste, the definition of “qualifying instruments” is strict, such that Timor-Leste’s SWF must divest its investment in “an instrument if it ceases to be a qualifying instrument because of a change in the rating of the instrument”.<sup>82</sup>

In some countries, the definition of ‘qualifying instrument’ focuses primarily on foreign or offshore instruments. Thus, in such countries the focus of SWFs investments is restricted largely to foreign instruments. In fact, in countries such as Sao Tome and Principe and Timor-Leste funds belonging to SWFs cannot be invested in domestic instruments.<sup>83</sup> More specifically, in Sao Tome and Principe, “[i]t is prohibited to invest the Oil Revenues deposited in the Oil Accounts in investments domiciled in Sao Tome and Principe, or in any investments controlled directly or indirectly, totally or partially, by any national Person, whether or not resident of Sao Tome and Principe”.<sup>84</sup>

The prohibition of investment in domestic instruments by certain SWFs is justifiable because “it allays concerns there might be bias in investment choices (for example, political elites investing in family businesses”.<sup>85</sup> Besides, domestic investment could be politicized to the benefit of the ruling elites and to the detriment of citizens. As Kyle Hatton & Katharina Pistor have observed:

...SWFs’ domestic investment decisions are sometimes heavily politicized. SWFs themselves admit that non-financial motivations influence domestic investment decisions. Less publicly, SWFs often take large minority stakes in domestic companies controlled by members of the existing elite and their allies; SWF-owned domestic financial institutions also provide extremely favorable lending facilities to the local merchant class on a “name-basis”. These actions prey on existing wealth and fail to maximize either country-level benefits or financial returns accruing to the SWF.<sup>86</sup>

---

<sup>81</sup> In Ghana, “qualifying instruments” are reviewable by the Minister of Finance every three years or sooner. See *Petroleum Revenue Management Act*, *supra* note 10, s 27(2).

<sup>82</sup> *Petroleum Fund Law*, [Timor-Leste], *supra* note 25, art 15.2.

<sup>83</sup> See *Oil Revenue Law* [Sao Tome and Principe], *supra* note 25, art 13(5); *Petroleum Fund Law* [Timor-Leste], *supra* note 25, arts 14–15.

<sup>84</sup> *Oil Revenue Law*, [Sao Tome and Principe], *supra* note 25, art 13(5).

<sup>85</sup> Jennifer Drysdale, “Five Principles for the Management of Natural Resource Revenue: The Case of Timor-Leste’s Petroleum Revenue” (2008) 26:1 J Energy & Natural Resource L 151 at 164.

<sup>86</sup> Kyle Hatton & Katharina Pistor, “Maximizing Autonomy in the Shadow of Great Powers: The Political Economy of Sovereign Wealth Funds” (2011) 50 Colum J Transnat’l L 1 at 12 [emphasis in original].

In fact, it has been reported that one of Kuwait's SWFs, the Kuwait Investment Authority, sometimes invests in domestic businesses in order to buy "out the political ambitions of the merchant class" who otherwise could be opposed to the ruling royal family.<sup>87</sup>

Moreover, it is quite possible for corrupt government officials in developing countries to influence the domestic investment choices of their SWFs by offering or paying bribes. To the contrary, investing in foreign instruments helps to mitigate corruption which would most certainly occur if SWFs were permitted to invest freely and without hindrance in domestic investment instruments.<sup>88</sup> Furthermore, foreign or offshore instruments in developed economies attract lower investment risks than domestic instruments in developing countries. However, the downside is that the prohibition of domestic investment could hinder economic development in these developing countries. This perhaps explains why some countries having multiple SWFs allow at least one of their SWFs to invest domestically while the other SWF invests in foreign instruments.

#### **b. Standard of care imposed on fund managers**

A standard of care may be imposed on fund managers by statute or executive order. Such standard of care may also be derived from the principles and rules established by the Board of Directors of SWFs. Usually, the prescribed standard is the 'prudent investor standard' which, though gives fund managers the liberty to invest the funds and assets of SWFs, imposes an obligation on fund managers to exercise the standard of care that a reasonably prudent investor would exercise in similar circumstances. The prudent investor standard requires fund managers not only "to invest the assets of a trust in order to generate income but also to do so prudently so as to conserve the value of the original assets."<sup>89</sup>

The prudent investor standard is adopted in developing countries such as Sao Tome and Principe where the *Oil Revenue Law* not only enjoins managers of petroleum revenues to observe the 'prudent investor standard'

---

<sup>87</sup> *Ibid* at 26.

<sup>88</sup> Drysdale, *supra* note 85 at 164.

<sup>89</sup> Stephen M Penner, "International Investment and the Prudent Investor Rule: The Trustee's Duty to Consider International Investment Vehicles" (1995) 16:2 *Mich J Int'l L* 601 at 610. On the 'prudent investor standard', see generally Stewart E Sterk, "Rethinking Trust Law Reform: How Prudent is Modern Prudent Investor Doctrine?" (2010) 95:5 *Cornell L Rev* 851; Philip J Renaud, "Alberta's 'Prudent Investor' Rule" (2003) 22:4 *ETP* 309.

but also defines the standard as follows:

Prudent Investor Rule - shall mean that in performing any investment transactions or services, the agent shall ensure high quality and efficiency standards, and shall discharge his or her duties protecting the legitimate interests of the State with diligence of a discerning and orderly manager, pursuant to the risk sharing principle and the safety of the investments, in accordance with the investment rules approved by the Management and Investment Committee pursuant to this Law.<sup>90</sup>

The justification for imposing the prudent investor standard on managers of SWFs is that such managers are trustees acting for and on behalf of citizens of the country who are the beneficiaries of the revenues entrusted to the care of the managers. The imposition of the prudent investor standard on managers of SWFs accords with commercial realities in both domestic and international arenas. It also accords with modern investment practice. For example, in the context of portfolio management it is generally accepted that investment managers bear a fiduciary duty to the beneficial owners of shares entrusted to their care.<sup>91</sup>

In other cases, statutes establishing SWFs may require fund managers to observe internationally recognized investment principles while investing the funds of the SWFs. For example, Ghana's *Petroleum Revenue Management Act 2011* enjoins the Bank of Ghana to manage petroleum revenues "prudently within the framework of the operational and management strategy provided by the Minister", while taking into account "established and internationally recognized principles of good governance".<sup>92</sup> Similarly, the *Petroleum Fund Law* of Timor-Leste provides that "[t]he Petroleum Fund shall be managed prudently in accordance with the principle of good governance for the benefit of current and future generations."<sup>93</sup>

---

<sup>90</sup> *Oil Revenue Law*, [Sao Tome and Principe], *supra* note 25, art 1(II).

<sup>91</sup> Jay Youngdahl, "The Time Has Come for a Sustainable Theory of Fiduciary Duty in Investment" (2011) 29 *Hofstra Lab & Empl LJ* 115. See also Benjamin J Richardson, *Socially Responsible Investment Law: Regulating the Unseen Polluters* (Oxford: Oxford University Press, 2008) at 221-34 (discussing the fiduciary duties of pension funds).

<sup>92</sup> *Petroleum Revenue Management Act*, *supra* note 10, s 26(2).

<sup>93</sup> *Petroleum Fund Law*, [Timor-Leste], *supra* note 25, art 11.4.



#### IV. ACCOUNTABILITY AND TRANSPARENCY OF SOVEREIGN WEALTH FUNDS

It is universally recognized that accountability and transparency are essential to the effective management of resource revenues.<sup>94</sup> In this context accountability means “the duty to give account for one’s actions to some other person or body,”<sup>95</sup> while transparency involves disclosure of information as well as public access to such information. In the recent past, a number of initiatives and mechanisms have been designed at international and domestic levels to promote transparency and accountability in resource revenue management. For example, the Extractive Industries Transparency Initiative<sup>96</sup> and the *Publish What you Pay Campaign*<sup>97</sup> require governments and companies to publish all payments and receipts derived from resource exploitation. Similarly, the International Monetary Fund’s *Guide on Resource Revenue Transparency* urges that “[r]eports on government receipts of company resource revenue payments should be made publicly available as part of the government budget and accounting process.”<sup>98</sup>

To ensure that SWFs are accountable and transparent, the *Santiago Principles* urge SWFs to publicly disclose their “policies, rules, procedures, or arrangements in relation to the SWF’s general approach to funding, withdrawal, and spending operations.”<sup>99</sup> In addition, SWFs are to disclose to the public the source(s) of their funding.<sup>100</sup> More specifically, the *Santiago Principles* exalt as follows:

GAPP 10. Principle: The accountability framework for the SWF’s operations should be clearly defined in the relevant legislation,

---

<sup>94</sup> See Joseph C Bell & Teresa M Faria, “Critical Issues for a Revenue Management Law”, in Macartan Humphreys, Jeffery D Sachs & Joseph E Stiglitz, eds, *Escaping the Resource Curse* (New York: Columbia University Press, 2007) 286 at 305; Abdullah Al Faruque, “Transparency in Extractive Revenues in Developing Countries and Economies In Transition: A Review of Emerging Best Practices” (2006) 24 *J Energy & Natural Resources* L 66; Philippe Le Billon, “Securing Transparency: Armed Conflicts and the Management of Natural Resource Revenues” (2006-2007) 62:1 *Intl J* 93; Alexandra Gillies and Antoine Heuty, “Does Transparency Work? The Challenges of Measurement and Effectiveness in Resource-Rich Countries” (2011) 6:2 *Yale J Intl Affairs* 25.

<sup>95</sup> Colin Scott, “Accountability in the Regulatory State” (2000) 27:1 *JL & Socy* 38 at 40.

<sup>96</sup> Extractive Industries Transparency Initiative, online: <eiti.org>.

<sup>97</sup> Publish What you Pay, online: <www.publishwhatyoupay.org/>.

<sup>98</sup> International Monetary Fund, *Guide on Resource Revenue Transparency* (Washington: IMF Publication Services, 2007) at 9, online: <www.imf.org/external/np/pp/2007/eng/101907g.pdf>.

<sup>99</sup> *Santiago Principles*, *supra* note 4 at Principle 4.

<sup>100</sup> *Ibid* at Principle 4.1.

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 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.<sup>101</sup>

Accountability and transparency are aided by several mechanisms including oversight and monitoring mechanisms as well as reporting and disclosure of information regarding the operations of SWFs.<sup>102</sup> Oversight mechanisms for SWFs in developing countries consist of both internal and external mechanisms. Internal oversight mechanisms are structures established within the SWFs designed to promote checks and balances in the management of SWFs. Internal mechanisms could take the form of an oversight committee constituted by members of the management board or an audit unit established within the SWFs. It could also take the form of an advisory body or audit body separate and distinct from the management board of the SWFs.

---

<sup>101</sup> *Santiago Principles*, *supra* note 4 at 8.

<sup>102</sup> See Bell & Faria, *supra* note 94 at 300–304 (discussing various mechanisms for overseeing and controlling the activities of SWFs).

In Angola, for example, both the Tax Board and the Cabinet of Internal Auditing perform oversight functions with regard to the activities of the Sovereign Fund of Angola. In that country, the Tax Board oversees the management of the Fund and ensures compliance with regulatory norms; certifies the value of the assets held by the Fund; examines the books of the fund and verifies that the investment criteria used by the Fund would lead to a correct assessment of the assets of the Fund; issues opinions on the documents of accountability of the Fund and informs competent authorities of any irregularities.<sup>103</sup> For its part, the Cabinet of Internal Auditing is charged with the duty of controlling the internal procedures of the Fund and enforcing the regulations and other Presidential Decrees regulating the activities of the Fund. In particular, the Cabinet of Internal Auditing monitors and checks the operations and activities of the Fund; ensures that investment of the Fund is undertaken in accordance with established rules and that the Fund is managed in a manner that guarantees the independence of the investment decisions made by the Fund.<sup>104</sup>

Similarly, oversight of Ghana's SWF is achieved by internal and external auditing and monitoring of its activities.<sup>105</sup> The Ghana Petroleum Funds are audited internally by the Bank of Ghana and externally by the Auditor-General of Ghana.<sup>106</sup> However, the Auditor-General of Ghana may appoint an external auditor to conduct such audit for a non-renewable three year period.<sup>107</sup> The Auditor-General's annual audit report is submitted to the Parliament of Ghana.<sup>108</sup>

External oversight mechanisms in Ghana include the Investment Advisory Committee (IAC) and the Public Interest Accountability Committee (PIAC). The IAC is responsible for "the general performance monitoring of the management of the Ghana Petroleum Funds".<sup>109</sup> For its part, the PIAC is charged with three key duties, viz:

- (a) to monitor and evaluate compliance with this Act by government and other relevant institutions in the management and use of the petroleum revenues and investments as provided in this Act;

---

<sup>103</sup> *Presidential Decree No. 89/13* (of 19 June 2013), art 10.

<sup>104</sup> *Ibid*, art 11.

<sup>105</sup> *Petroleum Revenue Management Act*, *supra* note 10, ss 42-47.

<sup>106</sup> *Ibid*, ss 44-45.

<sup>107</sup> *Ibid*, s 45(3).

<sup>108</sup> *Ibid*, s 46(2).

<sup>109</sup> *Ibid*, s 29.

- (b) to provide space and platform for the public to debate whether spending prospects and management and use of revenues conform to development priorities...; and
- (c) to provide independent assessment on the management and use of petroleum revenues to assist Parliament and the executive in the oversight and performance of related functions respectively.<sup>110</sup>

In some instances, external oversight of SWFs may be provided by parliamentary or legislative bodies. For example, the Parliaments of Ghana and Nigeria perform some oversight functions because the law obliges their SWFs to prepare and submit an annual report to the Parliament.<sup>111</sup>

With regard to transparency, many developing countries have laws requiring their SWFs to disclose their activities to the public. For example, in Sao Tome and Principe “all payments, management, use and investment of Oil Revenues or Oil Resources” are subject to the transparency principle including the public disclosure of (and access to) all documents relating to the management of the Oil Accounts.<sup>112</sup> Timor-Leste requires disclosure of certain information including the annual report and audited financial statements of the Petroleum Fund, while Nigeria’s SWF, the NSIA, is obliged to prepare and submit an annual report on its activities to a multitude of oversight bodies including the parliament (the National Assembly) and the Houses of Assembly of all states in Nigeria.<sup>113</sup> In addition, the NSIA’s annual report together with its financial reports and key policy documents are to be made accessible to the public. Likewise, the Bank of Ghana is obliged to submit to the parliament semi-annual reports on the performance and activities of Ghana’s SWF, as well as to publish the reports on its website and in two state-owned national daily newspapers.<sup>114</sup>

In keeping with statutory provisions requiring disclosure, SWFs in some developing countries publish a number of documents on their websites including annual reports which, among other things, contain financial statements. For example, the annual report published by Nigeria’s NSIA for the year 2013 indicates the income and profits earned by the NSIA, liabilities incurred by the NSIA; its cash flows from investment activities such as purchase of investment securities, property and equipment; and financial

---

<sup>110</sup> *Ibid.*, s 52.

<sup>111</sup> *Ibid.*, s 28(2); NSIA, *supra* note 3, s 37(1).

<sup>112</sup> *Oil Revenue Law* [Sao Tome and Principe], *supra* note 25, art 17.

<sup>113</sup> NSIA, *supra* note 3, s.37(1).

<sup>114</sup> *Petroleum Revenue Management Act*, *supra* note 10, s 28(2).

contribution by the government.<sup>115</sup> Interestingly, the NSIA's annual report shows that it invests predominantly in foreign instruments such as US treasury bills and US treasury bonds.<sup>116</sup> The report also shows that the NSIA's investments are made on its behalf by several independent or external investment managers including UBS, Goldman Sachs and Credit Suisse AG.<sup>117</sup> The appointment of independent managers by the NSIA bodes well for the transparency of the NSIA. This is so because, as observed by Yvonne Lee, the degree to which an SWF is accountable and transparent "generally corresponds with the degree of involvement of external managers and committees".<sup>118</sup>

Although some countries have enacted clear rules regarding accountability and transparency, in reality many SWFs in developing countries are neither accountable nor transparent.<sup>119</sup> More specifically, SWFs in non-democratic countries (particularly in the Middle East) are noticeably lacking with regard to accountability and transparency.<sup>120</sup> For example, the vast majority of SWFs at the lower end of the Linaburg-Maduell Transparency Index are based in non-democratic countries.<sup>121</sup> Very little information is disclosed by SWFs such as Brunei Investment Agency; SAMA Foreign Holdings (Saudi Arabia) and Qatar Investment Authority, to name but a few. This is hardly surprising given that the managers of SWFs in these non-democratic countries are often government officials or members of the ruling royal family.

---

<sup>115</sup> *Nigeria Sovereign Investment Authority, Annual Report & Accounts 2013* at 38-45, online: <[nsia.com.ng/wp-content/uploads/2014/06/NSIA-AR13-FULL-FINAL](http://nsia.com.ng/wp-content/uploads/2014/06/NSIA-AR13-FULL-FINAL)>.

<sup>116</sup> *Ibid* at 57.

<sup>117</sup> *Ibid* at 67.

<sup>118</sup> Yvonne C L Lee, "The Governance of Contemporary Sovereign Wealth Funds" (2010) 6:1 *Hastings Business LJ* 197 at 222.

<sup>119</sup> Ronald J Gilson & Curtis J Milhaupt, "Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism" (2008) 60:5 *Stan L Rev* 1345 at 1355, 1360 (asserting that "most SWFs, on the other hand, provide virtually no public disclosure" and that "[s]ome of the SWFs making the highest profile equity investments, such as those of Abu Dhabi, Qatar, and China, provide very little public information about their investment strategies and holdings"). See also Amy Keller, "Sovereign Wealth Funds: Trustworthy Investors or Vehicles of Strategic Ambition? An Assessment of the Benefits, Risks and Possible Regulation of Sovereign Wealth Funds" (2009) 7:1 *Georgetown JL & Public Policy* 333 at 360; Zhao Feng, "How Should Sovereign Wealth Funds be Regulated?" (2009) 3:2 *Brooklyn J Corporate Financial & Commercial L* 483 at 490.

<sup>120</sup> See generally, Allie E Bagnall & Edwin M Truman, *Progress on Sovereign Wealth Fund Transparency and Accountability: An Updated SWF Scoreboard* (Peterson Institute for International Economics, 2013) at 7-14, <[piie.com/publications/pb/pb13-19.pdf](http://piie.com/publications/pb/pb13-19.pdf)>.

<sup>121</sup> The Sovereign Wealth Fund Institute, *Linaburg-Maduell Transparency Index*, online: <[www.swfinstitute.org/statistics-research/linaburg-maduell-transparency/](http://www.swfinstitute.org/statistics-research/linaburg-maduell-transparency/)>.

The culture of secrecy surrounding the activities of some SWFs in certain developing countries may have been fostered by the legal environment in which these SWFs operate. For example, the statutes establishing both the Brunei Investment Authority and the Kuwait Investment Authority prohibit the disclosure of information regarding the operations of the SWFs except in a few instances such as where a court orders such disclosure.<sup>122</sup> In fact, under these statutes the unauthorized disclosure of information relating to the SWFs is a criminal offence punishable by imprisonment.<sup>123</sup>

In other instances, confidentiality clauses in resource extraction contracts signed by governments hinder the ability of SWFs to disclose information such as the exact amount of revenues paid into the coffers of the SWFs by resource extraction companies. This is particularly the case where an SWF is empowered to receive oil revenues directly from resource extraction companies. In Sao Tome and Principe, for example, “[a]ll monies owed to the State as Oil Revenue shall be deposited directly into the National Oil Account by the Persons liable to pay such monies.”<sup>124</sup> To forestall the deleterious impact of confidentiality clauses on the ability of the Central Bank of Sao Tome and Principe to disclose information relating its management of the SWF, the *Oil Revenue Law* declares any such confidential clauses to be null and void and contrary to public policy.<sup>125</sup>

Furthermore, although as mentioned previously some statutes establishing SWFs provide for disclosure of information, in some cases these statutes contain claw-back clauses which hinder the ability of SWFs to disclose information to the public. For example, in both Ghana and Timor-Leste the Minister of Finance is vested with statutory discretion to declare certain information or data as confidential where the Minister determines that the disclosure of the information or data could “prejudice significantly the

---

<sup>122</sup> See *Brunei Investment Agency (Chapter 137)*, *supra* note 28, s 12(1); *Kuwait Investment Authority*, *supra* note 32, art 8.

<sup>123</sup> *Kuwait Investment Authority*, *supra* note 32, art 9; *Brunei Investment Agency (Chapter 137)*, *supra* note 28, s 12(2).

<sup>124</sup> *Oil Revenue Law*, [Sao Tome and Principe], *supra* note 25, art 6(1).

<sup>125</sup> *Ibid*, art 20(1) states:

Confidentiality clauses or other mechanisms included in Oil Contracts or in any other transaction instrument concerning any Oil Revenue or Oil Resource that prevent or attempt to prevent access to documents and information pursuant to Article 17 of this Law shall be null and void, and contrary to public policy.

However, in Sao Tome and Principe, information relating to “proprietary industrial property rights” is exempt from the scope of mandatory disclosure. See *ibid*, art 20(2).

performance of the” SWFs.<sup>126</sup> As this author argues in a forthcoming piece, although in Ghana the Minister’s discretion is subject to parliamentary approval and while the Minister is obliged to “provide a clear explanation of the reason for treating the information or data as classified”, the Minister’s statutory discretion to declare certain information or data as confidential is counter-productive to the goal of financial transparency.<sup>127</sup> Conceivably, confidentiality clauses in oil contracts between the governments of Ghana and Timor-Leste and international oil companies could provide justification for the Minister to declare information as confidential.

That being said, some SWFs in developing countries have increased their level of transparency in the last few years apparently due to the concerns about SWFs investments in Western countries. For example, while the Abu Dhabi Investment Authority (ADIA) and the China Investment Corporation (CIC) have in the past been accused of lacking transparency,<sup>128</sup> both the ADIA and the CIC now publish statements about their investment holdings as well as the principles guiding their investment decisions. ADIA has published on its website an Annual Review of its activities since 2010.<sup>129</sup> ADIA’s Annual Review discloses its investment strategy, portfolio overview, investment activities, as well as its governance structure.<sup>130</sup> Mubadala Development Company, another SWF owned by the government of Abu Dhabi, also publishes an annual review of its activities, although it must be said that Mubadala’s annual reviews are less informative than comparable annual reviews or reports issued by other SWFs.<sup>131</sup> Likewise the CIC publishes on its website information relating to its investment strategy,

---

<sup>126</sup> *Petroleum Revenue Management Act* [Ghana], *supra* note 10, s 49(3); *Petroleum Fund Law* [Timor-Leste], *supra* note 25, art 32.2.

<sup>127</sup> See Evaristus Oshionebo, “Sovereign Wealth Funds in Developing Countries: A Case Study of the Ghana Petroleum Funds” (tentative title, forthcoming in 2015).

<sup>128</sup> See Gilson & Milhaupt, *supra* note 119 at 1360 (asserting that “[s]ome of the SWFs making the highest profile equity investments, such as those of Abu Dhabi, Qatar, and China, provide very little public information about their investment strategies and holdings”); Jason Bui, “Negocio De China: Building Upon the Santiago Principles to Form an Effective International Approach to Sovereign Wealth Fund Regulation” (2009) 39:1 Hong Kong LJ 197 at 208 (indicating that the Abu Dhabi Investment Authority “reveals little about its massive investments.”)

<sup>129</sup> See “ADIA Review”, online: <[www.adia.ae/En/News/media\\_review.aspx](http://www.adia.ae/En/News/media_review.aspx)>.

<sup>130</sup> See Abu Dhabi Investment Authority, *ADIA 2013 Review*, online: <[www.adia.ae/En/pr/Annual\\_Review\\_Website\\_2013.pdf](http://www.adia.ae/En/pr/Annual_Review_Website_2013.pdf)>.

<sup>131</sup> See Mubadala, “Financial Information and Reports”, online: <[www.mubadala.com/en/investors/financial-information-and-reports](http://www.mubadala.com/en/investors/financial-information-and-reports)>.

investment decision-making and its investment activities.<sup>132</sup> The CIC has also published an annual report since 2008.<sup>133</sup>

Regrettably, other prominent SWFs in the developing world do not appear to fully imbibe the virtue of transparency.<sup>134</sup> For example, while the Kuwait Investment Authority (KIA) declares that its “investments are completely transparent to the State of Kuwait” and its citizens,<sup>135</sup> there is very little information on the KIA’s website regarding its activities. The KIA reports to multiple bodies including the Council of Ministers and the National Assembly, but reports submitted by the KIA to these bodies are not posted on its website.<sup>136</sup> The KIA’s secrecy is hardly surprising given that, as noted earlier, the KIA is prohibited by law from disclosing data or information regarding its assets and investments without the written permission of the Chairman of its Board of Directors.<sup>137</sup>

## V. REGULATORY OBSTACLES TO SWFs INVESTMENTS IN WESTERN COUNTRIES

SWFs have become major players on the international investment scene. As mentioned previously, in 2012 direct foreign investment made by SWFs were valued at US\$54.6 billion, while the corresponding value of investment made by SWFs in 2011 was US\$66.3 billion.<sup>138</sup> Western countries are the primary recipients of SWFs investments. This is so for a number of reasons. Western countries have steady economies with clear investment rules and there are few restrictions on capital or profit repatriation. The steadiness of Western economies means there are low investment risks in these countries, thus ensuring better returns on investment.

Because many of these SWFs are owned by governments of developing countries and because many of these governments are non-democratic, serious concerns have been raised in Western countries regarding foreign investments by SWFs. The recent rise of the China Investment

---

<sup>132</sup> See *China Investment Corporation*, “Press Releases”, online: <[www.china-inv.cn/](http://www.china-inv.cn/)>.

<sup>133</sup> The CIC’s annual reports are available at <[www.china-inv.cn/wps/portal/](http://www.china-inv.cn/wps/portal/)>.

<sup>134</sup> See Natural Resource Governance Institute, “Index: Natural Resource Funds” (asserting that “eight of the 23 funds reviewed publish no information whatsoever on their assets..., transactions and investments”), online: <[www.resourcegovernance.org/rgi/nrf/](http://www.resourcegovernance.org/rgi/nrf/)>.

<sup>135</sup> *Kuwait Investment Authority*, “Overview on the Kuwait Investment Authority”, online: <[www.kia.gov.kw/En/About\\_KIA/Overview\\_of\\_KIA/Pages/OverviewofKIA.aspx](http://www.kia.gov.kw/En/About_KIA/Overview_of_KIA/Pages/OverviewofKIA.aspx)>.

<sup>136</sup> See *Kuwait Investment Authority*, online: <[www.kia.gov.kw/en/Pages/default.aspx](http://www.kia.gov.kw/en/Pages/default.aspx)>.

<sup>137</sup> *Kuwait Investment Authority*, *supra* note 32, art 8.

<sup>138</sup> ESADE & KPMG, *supra* note 6 at 12.



Corporation, China's SWF, has heightened the concerns of Western politicians and academics alike. These concerns revolve primarily around national security interest; the potential for SWFs to acquire controlling stake in Western companies which would allow the SWFs to exert political influence on these companies on behalf of their home governments, and the activism of SWFs with regard to equities held in Western companies.<sup>139</sup> SWFs investments in Western countries are equally alleged to be capable of destabilizing the investment market in situations where SWFs suddenly withdraw or divest (for economic or non-economic reasons) their large investments from any particular Western country.<sup>140</sup>

#### a. National security concerns

With regard to national security, the fear in Western countries is that, SWFs' acquisition of companies, critical infrastructure and other assets of national significance could have a detrimental impact on national security.<sup>141</sup> Hence, many Western countries have enacted laws that restrict or prevent non-citizens from purchasing or acquiring controlling stake in certain sectors of the economy such as critical infrastructure and cultural business. In Canada, for example, the *Investment Canada Act* empowers the Canadian government to review foreign investments that are potentially injurious to national security.<sup>142</sup> Upon any such review, the government may, where necessary, take any measures in respect of the investment that it "considers advisable to protect national security, including:

- (a) directing the non-Canadian not to implement the investment;
- (b) authorizing the investment on condition that the non-Canadian

---

<sup>139</sup> See O'Brien, *supra* note 4 at 1237-1248.

<sup>140</sup> See James K Jackson, "Foreign Ownership of U.S. Financial Assets: Implications of a Withdrawal" (14 January 2008) US Congressional Research Service RL34319, online: <[www.fas.org/sgp/crs/natsec/RL34319.pdf](http://www.fas.org/sgp/crs/natsec/RL34319.pdf)>.

<sup>141</sup> See Jackson, *ibid*. See also Joel Slawotsky, "Sovereign Wealth Funds as Emerging Financial Superpowers: How U.S. Regulators Should Respond" (2009) 40:4 *Geo J Intl L* 1239 at 1249 (asserting that "[d]ue to their affiliation with foreign governments, SWFs are motivated not just by profit, but also by non-financial reasons. Some of these motivations could place the funds at odds with U.S. national security interests.")

<sup>142</sup> *Investment Canada Act*, RSC 1985, c 28, s 25. Also on grounds of national security, the Canadian government has power to review foreign investments to acquire direct control of a Canadian company doing business in the cultural sector if the company's assets are worth at least CAD\$5 million or if the government considers that a particular investment in the cultural business ought to be reviewed in the public interest.

- (i) give any written undertakings to Her Majesty in right of Canada relating to the investment that the Governor in Council considers necessary in the circumstances, or
- (ii) implement the investment on the terms and conditions contained in the order; or
- (c) requiring the non-Canadian to divest themselves of control of the Canadian business or of their investment in the entity.<sup>143</sup>

Similar laws exist in other Western countries. In the United States, for example, the *Defense Production Act of 1950* empowers the President of the United States to veto or block any proposed or pending acquisition of a US company by foreign investors if the President considers that the acquisition is a threat to national security.<sup>144</sup> This provision, which was introduced into the *Defense Production Act* in 1988 through the “Exon-Florio” amendment,<sup>145</sup> empowers the Committee on Foreign Investments in the United States (CFIUS) to review any such foreign acquisition and make recommendations to the President regarding whether or not the President should veto the foreign acquisition. In 1990, for example, the CFIUS’s review of the acquisition of MAMCO Manufacturing, a U.S. company engaged in the manufacturing of airplane components and parts, by the China National Aero-Technology Import & Export Corporation led President George H.W. Bush to veto the acquisition.<sup>146</sup>

In addition, the *Foreign Investment and National Security Act of 2007* (FINSAs), which amended section 721 of the *Defense Production Act of 1950*, authorizes the CFIUS to review and/or investigate certain transactions in order to determine the impact of the transactions on the national security of the United States. Under the FINSAs, reviewable transactions include “covered transaction”, defined as “any merger, acquisition, or takeover that is proposed or pending after August 23, 1988, by or with any foreign person which could result in foreign control of any person engaged in interstate commerce in the United States.”<sup>147</sup> Also reviewable under the FINSAs are transactions involving ‘critical infrastructure’ and ‘critical technologies’. ‘Critical infrastructure’ is defined as “systems and assets, whether physical or

---

<sup>143</sup> *Ibid.*, s 25.4(1).

<sup>144</sup> *Defense Production Act*, 50 USC App § 2170.

<sup>145</sup> The “Exon-Florio” amendment is contained in the *Omnibus Trade and Competitiveness Act of 1988*, Pub L No 100-418 § 5021, 102 Stat 1107 at 1425.

<sup>146</sup> Jared T Brown & Daniel H Else, “The Defense Production Act of 1950: History, Authorities, and Reauthorization” (2014) Congressional Research Service Report No 7-5700 at 21, online: <[www.fas.org/sgp/crs/natsec/R43118.pdf](http://www.fas.org/sgp/crs/natsec/R43118.pdf)>.

<sup>147</sup> *Foreign Investment and National Security Act of 2007*, Pub L No 110-49, § 2, 121 Stat 246.

virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security”) while ‘critical technologies’ means “critical technology, critical components, or critical technology items essential to national defense”.<sup>148</sup>

#### **b. Acquisition of controlling stake in western companies**

A further concern is that the acquisition of controlling stake in Western companies by SWFs would ultimately lead to a situation where foreign governments would impose their political and policy objectives on Western companies.<sup>149</sup> The fear is that foreign governments that own SWFs would prevail on their SWFs to project the governments’ political interests in the course of exercising their share voting rights. This fear is encapsulated in a question posed by Ronald Gilson and Curtis Milhaupt: “Could anyone genuinely believe that the investment managers of China Investment Corporation or Singapore’s Temasek would hang up the phone if a senior government (or in Chana’s case, Party) official called to offer advice on the fund’s handling of a particular investment to advance the country’s, rather than the portfolio company’s, interests?”<sup>150</sup> Another author captures the fear of foreign control of Western companies in the following words:

In the coming years, SWFs likely will become more active, and their ownership of flagship international corporations could allow them to influence corporate boards in dramatic ways, radically transforming corporate governance. The fundamental difference between SWFs and other investors is the potential for investment decisions to be based on non-financial factors, due to their status as government-owned entities. Due to the wide-ranging interests of their state backers, SWFs, unlike any other group of activist

---

<sup>148</sup> *Ibid* at 247.

<sup>149</sup> This fear was expressed by Senator Evan Bayh before the US Senate Committee on Banking, Housing and Urban Affairs in 2007 as follows:

...unlike private investors and their representatives - pension funds and mutual funds, for example - government-owned entities may have [other] interests...that occasionally will take precedence over profit maximization. Just as the United States has interests in addition to financial ones, so do other countries. Just as we value some things more than money, so do they. Why should we assume that other nations are driven purely by financial interests when we are not? Or are we?

See US, *Sovereign Wealth Fund Acquisition and Other Foreign Government Investments in the US: Assessing the Economic and National Security Implications*, Hearing before the Senate Committee on Banking, Housing and Urban Affairs, 110th Cong (Washington, DC: United States Government Printing Office, 2007), <[www.gpo.gov/fdsys/pkg/CHRG-110shrg50364/html/CHRG-110shrg50364.htm](http://www.gpo.gov/fdsys/pkg/CHRG-110shrg50364/html/CHRG-110shrg50364.htm)>.

<sup>150</sup> Gilson & Milhaupt, *supra* note 119 at 1362.

investors, could impinge upon the sovereign interests of American economic and international policy.<sup>151</sup>

Relatedly, there is a concern that once SWFs take a controlling stake in Western companies, the SWFs would use their position to access sensitive intellectual property information or price-sensitive information which could then be used by the SWFs (or their governments) for insider-trading purposes.<sup>152</sup> However, this concern is at best hypothetical as there is no evidence thus far that SWFs are engaged in insider-trading on the basis of share acquisition in Western companies.<sup>153</sup>

Western countries have devised certain mechanisms to ensure that foreign investors do not acquire control of Western companies for sinister or non-economic purposes. For example, in addition to the government's power to review foreign investments on grounds of national security, the *Investment Canada Act* also allows the government to review, and if necessary prevent, the acquisition of a controlling stake in Canadian companies by foreign investors. More specifically section 14 of the Act empowers the Canadian government to review any investment by foreign investors to acquire control of a Canadian business where the assets of the Canadian business exceed the prescribed threshold.<sup>154</sup> Under current rules, the threshold for review differs depending primarily on the status and nature of the foreign investor. Where the foreign investor is a 'private sector WTO investor' (that is, foreign investors that are not state-owned enterprises), the threshold for review is "\$600 million in enterprise value for investments to directly acquire control of a Canadian business".<sup>155</sup> For this category of investors, the review threshold will increase to \$800 million and \$1 billion beginning April 24, 2017 and April 24, 2019, respectively.<sup>156</sup> However, the threshold for review is \$369 million in asset value where the foreign investor is a state-owned enterprise.<sup>157</sup>

---

<sup>151</sup> Slawotsky, *supra* note 141 at 1240–41.

<sup>152</sup> See Slawotsky, *ibid.* at 1254 (asserting that "[g]overnments may use their SWFs to guarantee access to cutting edge science and technology" and that "[t]he SWF would use its influence with the relevant corporate boards to develop and/or transfer resources and technology to the home nation.")

<sup>153</sup> O'Brien, *supra* note 4 at 1240.

<sup>154</sup> *Investment Canada Act*, *supra* note 142, s 14.

<sup>155</sup> Industry Canada, "Investment Canada Act: Threshold for Review", online: <[www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h\\_1k00050.html](http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_1k00050.html)>.

<sup>156</sup> *Ibid.*

<sup>157</sup> *Ibid.* It should be noted that the threshold for review is not static but is adjusted annually based on growth in nominal gross domestic Product. See Industry Canada, "Investment Canada Act: Threshold for Review", *ibid.* For the definition of "state-owned enterprise" see *Investment Canada Act*, *supra* note 142, s 3.

In effect, investment by an SWF to acquire control of a Canadian company whose asset value is at least \$369 million is subject to review by the government of Canada. Acquisition of control of a company may occur directly or indirectly. Under the *Investment Canada Act*, a foreign investor is deemed to acquire control of a Canadian business only by:

- (a) the acquisition of voting shares of a corporation incorporated in Canada carrying on the Canadian business;
- (b) the acquisition of voting interests of an entity that
  - (i) is carrying on the Canadian business, or
  - (ii) controls, directly or indirectly, another entity carrying on the Canadian business,
 where there is no acquisition of control of any corporation;
- (c) the acquisition of all or substantially all of the assets used in carrying on the Canadian business; or
- (d) the acquisition of voting interests of an entity that controls, directly or indirectly, an entity in Canada carrying on the Canadian business, where
  - (i) there is no acquisition of control, directly or indirectly, of a corporation incorporated elsewhere than in Canada that controls, directly or indirectly, an entity in Canada carrying on the Canadian business, or
  - (ii) there is an acquisition of control described in subparagraph (i).<sup>158</sup>

In the United States, the acquisition of a controlling stake in a U.S. company by foreign investors such as SWFs triggers CFIUS investigation. Under the FINSA, where a ‘covered transaction’ or a reviewable transaction qualifies as a “foreign government-controlled transaction”, the CFIUS must conduct an investigation of the transaction.<sup>159</sup> ‘Foreign government-controlled transaction’ means “any covered transaction that could result in the control of any person engaged in interstate commerce in the United States by a foreign government or an entity controlled by or acting on behalf of a foreign government.”<sup>160</sup>

In fact, the FINSA was enacted by the U.S. Congress in 2007 in direct response to the acquisition of U.S.-based companies by foreign governments or entities owned by foreign governments. The immediate impetus for the FINSA was the attempt by DP World, a company owned and

---

<sup>158</sup> *Investment Canada Act*, *supra* note 142, s 28(1)

<sup>159</sup> *Foreign Investment and National Security Act*, *supra* note 144, s 2.

<sup>160</sup> *Ibid.*

controlled by Dubai, to acquire Peninsular and Oriental Steam Navigation Company, a U.S. company that manages several ports in the United States.<sup>161</sup> Although the CFIUS reviewed the transaction under extant law and determined that the transaction did not pose a threat to national security, the intensity of the public outcry that arose from this transaction forced the U.S. Congress to enact the FINSA which, in the words of the Congress, was designed to “ensure national security while promoting foreign investment” and to “reform the process by which [foreign] investments are examined for any effect they may have on national security”.<sup>162</sup>

### c. An assessment of SWFs regulation in recipient western countries

To the extent that the *Investment Canada Act* and similar statutes in Western countries empower governments to review foreign investments in certain circumstances, they may be considered as barriers to entry on the part foreign investors. However, the investment review process is not necessarily hostile to foreign investments.<sup>163</sup> Rather, the review process is designed to screen out undesirable and potentially harmful investments, thus striking a delicate balance between national security and the promotion of foreign investments.<sup>164</sup> Under the statutes, governments have several options in the course of a review or investigation of a foreign investment. For example, the government may approve the transaction as proposed by the foreign investor or it may approve the transaction subject to certain terms and conditions to be satisfied by the foreign investor.<sup>165</sup> For the most part, the terms and conditions imposed on foreign investors are meant to mitigate any potential adverse impacts of the transaction on the host country. For example, terms may be imposed to protect and safeguard employment of citizens of the country by the foreign investor.

---

<sup>161</sup> Paul Rose, “The Foreign Investment and National Security Act of 2007: An Assessment of Its Impact on Sovereign Wealth Funds and State-Owned Enterprises” (2014) Center for Interdisciplinary Law and Policy Studies Working Paper No 231 at 10, online: <papers.ssrn.com/sol3/papers.cfm?abstract\_id=2387562>.

<sup>162</sup> *Foreign Investment and Security Act*, *supra* note 147, Preamble.

<sup>163</sup> In Canada, for example, only two foreign investment transactions have been rejected under the *Investment Canada Act* since its inception in 1985. See Mathieu Frigon, “The Foreign Investment Review process in Canada” (2011, Revised 2014), Parliamentary Information and Research Service Publication No 2011-42-E] at 4-5, online: <www.parl.gc.ca/Content/LOP/ResearchPublications/2011-42-e.pdf>.

<sup>164</sup> See Rose, *supra* note 161 at 3.

<sup>165</sup> See J Anthony VanDuzer, “Mixed Signals: What Recent Developments Tell Us About Canadian Foreign Investment Policy” (2010) 10 *Asper Rev Intl Bus & Trade L* 247 at 260.

In Canada, upon a review of a particular investment, the government of Canada may approve the investment if it considers that the investment is of “net benefit” to Canada. In determining whether an investment is of “net benefit” to Canada, the government considers a number of factors including:

- (a) the effect of the investment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada and on exports from Canada;
- (b) the degree and significance of participation by Canadians in the Canadian business or new Canadian business and in any industry or industries in Canada of which the Canadian business or new Canadian business forms or would form a part;
- (c) the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;
- ...
- (e) the compatibility of the investment with national industrial, economic and cultural policies, taking into consideration industrial, economic and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment; and
- (f) the contribution of the investment to Canada’s ability to compete in world markets.<sup>166</sup>

In the view of some scholars, the laws and regulation thus far enacted by Western countries do not sufficiently address or assuage the concerns about national security and control of Western companies by SWFs.<sup>167</sup> Hence, some scholars urge the introduction of stringent regulation of SWFs investment in Western countries. For example, some have suggested that the voting rights of SWFs in Western companies should be suspended while the shares are held by the SWFs and that the voting rights should be restored once the SWFs sell their shares to independent third parties.<sup>168</sup> Gilson and Milhaupt argue that:

If an SWF shareholder’s influence depends on its ability to vote its shares, then the obvious means to prevent strategic behavior – behavior that benefits the SWF or its sovereign owner in ways that do not proportionately benefit other shareholders – is to

<sup>166</sup> *Investment Canada Act*, *supra* note 142, s 20.

<sup>167</sup> See, for example, Slawotsky, *supra* note 141 at 1261–1265 (arguing that the U.S. needs to update its regulatory practices regarding SWFs). See also Gilson & Milhaupt, *supra* note 119; Buhi, *supra* note 125.

<sup>168</sup> Gilson & Milhaupt, *supra* note 119 at 1362–1365.

restrict an SWF's right to vote. Shares of U.S. companies acquired by an SWF would lose their voting rights (or automatically be voted in the same proportion as the votes of non-SWF shareholders).<sup>169</sup>

Gilson and Milhaupt's position is problematic for several reasons. First, they seem to assume that SWFs are active investors hence they suggest the suspension of SWFs' right to vote their equities in Western companies. However, the reality is that most SWFs are passive investors.<sup>170</sup> The ADIA declares, for example, that it "does not actively seek to manage or take an operational role in the public companies in which it invests."<sup>171</sup> And to the extent that some SWFs vote at annual meetings of shareholders, they exercise their voting rights in pursuit of their wealth-maximization objectives. For example, the Kuwait Investment Authority "exercises its voting rights, if at all, in the manner that it believes will protect the financial interests of KIA",<sup>172</sup> while the ADIA "exercises its voting rights in certain circumstances to protect its interests or to oppose motions that may be detrimental to shareholders as a body."<sup>173</sup>

Second, the curtailment or suspension of SWFs' voting rights could have unintended consequences for corporate governance including the exacerbation of the "problem of the separation of ownership and control within individual corporations".<sup>174</sup> Moreover, divesting SWFs of their voting rights would exacerbate a core cause of the recent global financial crisis, which is "the failure of institutional investors to take their ownership responsibilities seriously enough."<sup>175</sup>

Third, and perhaps more fundamentally, the suspension of voting rights simply on the basis that the shares are held by SWFs would not only be

---

<sup>169</sup> *Ibid* at 1364.

<sup>170</sup> See Hatton & Pistor, *supra* note 86 at 8 (asserting that "[o]ne of the trademarks of SWF behavior over the past thirty years has been passive foreign direct investment. Certainly, SWFs have sought influence on the boards of some of their investment targets, but in the large majority of cases, SWF wealth is employed passively.") See also Eric Langland, "Misplaced Fears Put to Rest: Financial Crisis Reveals the True Motives of Sovereign Wealth Funds" (2009) 18:1 Tul J Intl & Comp Law 263 at 270 (stating that "most SWF investments are passive—that is, they do not seek out controlling shares.")

<sup>171</sup> ADIA *Guiding Principles*, online: <[www.adia.ae/En/About/Guiding\\_Principles.aspx](http://www.adia.ae/En/About/Guiding_Principles.aspx)>.

<sup>172</sup> Kuwait Investment Authority, "Voting Rights", online: <[www.kia.gov.kw/en/ABOUTKIA/OrganizationStructure/Pages/Institutaional-Arrangments.aspx](http://www.kia.gov.kw/en/ABOUTKIA/OrganizationStructure/Pages/Institutaional-Arrangments.aspx)>.

<sup>173</sup> Abu Dhabi Investment Authority, *ADIA 2013 Review*, at 46, online: <[www.adia.ae/En/pr/Annual\\_Review\\_Website\\_2013.pdf](http://www.adia.ae/En/pr/Annual_Review_Website_2013.pdf)>.

<sup>174</sup> O'Brien, *supra* note 4 at 1252. See also Jennifer Cooke, "Finding the Right Balance for Sovereign Wealth Fund Regulation: Open Investment vs. National Security" (2009) 2 Colum Bus L Rev 728.

<sup>175</sup> O'Brien, *supra* note 4 at 1239-40.



discriminatory, but would also be contrary to the common law principle that the right to vote attaches to the shares but not the shareholder. Moreover, if the voting rights of SWFs were suspended, it would mean that private shareholders owning the same class of voting shares as the SWFs would be able to exercise their voting rights while the SWFs, members of the same class of shareholders, would lose their right to vote. This would be contrary to corporate statutes which, though allow companies to have more than one class of shares, provide expressly that shares of the same class must be accorded equal rights.<sup>176</sup> This is particularly the case where a company has one class of shares. For example, the *Canada Business Corporations Act* (CBCA) provides that:

Where a corporation has only one class of shares, the rights of the holders thereof are equal in all respects and include the rights (a) to vote at any meeting of shareholders of the corporation; (b) to receive any dividend declared by the corporation; and (c) to receive the remaining property of the corporation on dissolution.<sup>177</sup>

In *Re Bowater Canadian Ltd. v. R.L. Crain Inc.*,<sup>178</sup> for example, the Articles of Incorporation of a company provided that the special common shares held by a particular shareholder (Craisec) shall carry ten votes per share when held by Craisec and that these same special common shares shall carry only one vote per share in the event that the shares are sold or transferred by Craisec to a third party. The Ontario Court of Appeal held that such a provision in the Articles is void because it is contrary to the CBCA principle that shares of the same class are equal irrespective of the holders of the shares.

Finally, the suggestion that the voting rights of SWFs should be suspended does not take into account certain realities in corporate governance. Large institutional shareholders can exert influence on corporate managers even if they do not own voting shares or even if they are passive investors. As O'Brien notes, "[n]o entrenched management team is likely to

---

<sup>176</sup> See e.g., *Canada Business Corporations Act*, RSC 1985, c C-44, s 24.

<sup>177</sup> *Ibid*, s 24(3). For example, in *Jacobsen v United Canso Oil & Gas Ltd.* [1980] 23 AR 512, 113 DLR (3d) 427 at para 38, a company that had one class of shares passed a By-Law disentitling shareholders from voting more than 1000 shares. The Alberta Court of Queen's Bench held that this By-Law is contrary to section 24 of the CBCA because, under that section, "each shareholder has the right to vote at any meetings of shareholders on the basis of the number of shares held where the corporation only has one class of shares."

<sup>178</sup> *Re Bowater Canadian Ltd. v R.L. Crain Inc* (1987), 62 OR (2d) 752, 46 DLR (4th) 161.

ignore the voice or (perceived) interests of significant shareholders.”<sup>179</sup> Thus, the mere suspension of the voting rights of SWFs would not mean that SWFs would be devoid of influence regarding the governance of the Western companies in which they own shares. SWFs owning large amount of shares in a company would still be able to influence corporate management by publicly disclosing their positions regarding the issues on the agenda at the annual shareholders’ meeting.

It has also been suggested that the best way to ensure that SWFs’ investments are not used as political weapons is to adopt a three-prong regulatory regime: (1) the imposition of much stricter transparency standards on SWFs; (2) the restriction of SWFs investment to non-voting equities only; and (3) the barring of any single SWF from owning more than 10 percent equity in any private foreign company.<sup>180</sup> While the imposition of stricter transparency standards on SWFs is justifiable on grounds advanced below, the latter recommendations are difficult to justify as they run counter to free market principles. Besides, the restriction of share-ownership to 10 percent would not necessarily prevent control of Western companies by SWFs. Imagine, for example, that five or six SWFs each acquire 10 percent equity in a Western company. These SWFs would effectively attain control of such a company should they decide to pool their voting power in order to achieve what they perceive to be a common objective. This would remain so even if the shares held by the SWFs are non-voting. As O’Brien notes, few boards (if any) would ignore the voice or opinion of significant shareholders.<sup>181</sup>

The fear that SWFs would impose their policy objectives on Western companies through the acquisition of controlling shares may be a legitimate fear,<sup>182</sup> but it also appears exaggerated because, “only a small number of SWFs pursue investment strategies involving control acquisitions of foreign companies.”<sup>183</sup> As noted previously, most SWFs are passive investors and they are not necessarily interested in acquiring or exercising a controlling stake in Western companies.<sup>184</sup> Thus, the fact of the matter is that the fears and concerns raised about SWFs investment in Western countries, including the

---

<sup>179</sup> O’Brien, *supra* note 4 at 1250.

<sup>180</sup> Buhí, *supra* note 128 at 216.

<sup>181</sup> O’Brien, *supra* note 4 at 1250.

<sup>182</sup> See Keller, *supra* note 119 at 346 (observing that “[t]he idea of a foreign government owning a stake in an American company produces anxiety in many, particularly when that government is a country like China, Iran, or Venezuela.”)

<sup>183</sup> Gilson & Milhaupt, *supra* note 119 at 1350.

<sup>184</sup> See Hatton & Pistor, *supra* note 86 at 8; Langland, *supra* note 170 at 270.

fear of influence peddling by SWFs, are “not based on facts”.<sup>185</sup> In reality, most SWFs are organized on the basis of wealth maximization.<sup>186</sup> For example, the ADIA states that its investment “decisions are based solely on its economic objectives of delivering sustained long-term financial returns.”<sup>187</sup> The Qatar Investment Authority says its investment objectives are financially driven, although it also considers environmental factors in making its investment decisions.<sup>188</sup> For its part, the CIC states that they invest their funds “on a commercial basis” and that they “are a financial investor and do not seek control of the companies in our portfolio.”<sup>189</sup> In fact, it has been reported that the CIC “rarely purchases more than a 10 per cent stake in target companies”,<sup>190</sup> thus living true to their investment strategy of not seeking control of the companies in which they invest.

Moreover, the policy objectives of SWFs are financially driven and they are often meant to complement the investment objectives of SWFs. As Backer points out, the projection of policy preferences by SWFs is not done for sinister purposes.<sup>191</sup> Rather, the aim is to protect the SWFs investments “abroad like other private investors”.<sup>192</sup> Thus, for the most part, SWFs behave rationally in the pursuit of their investment objectives, a fact so glaringly demonstrated by SWFs during the recent global financial crisis. Eric Langland captures this sentiment when he surmises that:

The critical lesson from the ongoing financial crisis is that SWFs act like any rational, financially motivated investor. When share prices went down, they increased holdings [in Western firms], expecting the market to recover. When it became uncertain whether these financial firms would ever recover, SWFs diverted

---

<sup>185</sup> Keller, *supra* note 119 at 346. See also Richard A Epstein & Amanda M Rose, “The Regulation of Sovereign Wealth Funds: The Virtues of Going Slow” (2009) 76:1 U Chicago L Rev 111 at 116 (asserting that “[t]o date there is little evidence that any SWF has actively sought to lever its investment positions for either political or collateral business purposes” and that critics of SWFs are “[u]nable to identify any example where an SWF has in fact acted in this manner”); Melone, *supra* note 68 at 169-70.

<sup>186</sup> See generally, Langland, *supra* note 170.

<sup>187</sup> ADIA *Guiding Principles*, *supra* note 171.

<sup>188</sup> See Qatar Investment Authority, “Investments: Investment Approach”, online: <[www.qia.qa/Investments/Pages/Investment-Approach.aspx](http://www.qia.qa/Investments/Pages/Investment-Approach.aspx)>.

<sup>189</sup> China Investment Corporation, *Annual Report 2013*, at 26, online: <[www.china-inv.cn](http://www.china-inv.cn)>.

<sup>190</sup> Buhi, *supra* note 128 at 198.

<sup>191</sup> Larry Cata Backer, “Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance Through Private Global Investment” (2010) 41:2 Geo J Intl L 425 at 497.

<sup>192</sup> *Ibid* at 497.

new investments into other sectors of the global economy or into traditional, conservative financial instruments.<sup>193</sup>

While some have called for the imposition of stringent regulation on SWFs investments, stringent regulation is unnecessary<sup>194</sup> because, several years after these fears were first expressed; none of the fears has materialized or been borne out by the facts. Rather, the fears and concerns about SWFs investments in Western countries remain exactly what they are: unsubstantiated fears.<sup>195</sup> Besides, as Epstein and Rose have noted, the concerns raised “by SWF critics often involve activities that would be caught by existing laws, either as they relate to national security or to various forms of business regulation under the securities and antitrust laws.”<sup>196</sup>

It would be hypocritical for Western countries to impose stringent regulations on SWFs investments simply because of the fears expressed above.<sup>197</sup> It is not uncommon for Western institutional investors, including state-owned pension funds in the U.S., to engage in shareholder activism or to champion changes in the governance of foreign companies in which they have an interest. It has been reported, for example, that the California Public Employees’ Retirement System (CalPERS) conscientiously voted its shares in Japanese companies with the aim of changing Japanese corporate governance.<sup>198</sup>

## VI. THE WAY FORWARD

As mentioned previously, SWFs behave like private investors in that their primary objective is maximizing returns on investment. Thus the hysterical response to SWFs investments by many Western politicians and academics appears misguided.<sup>199</sup> While it is fair for Western countries to seek

---

<sup>193</sup> Langland, *supra* note 170 at 276.

<sup>194</sup> See Backer, *supra* note 191 at 431 (asserting that “special or disabling regulation [of SWFs] is unnecessary, and these funds can contribute to the integrity of global private financial markets.”)

<sup>195</sup> See Langland, *supra* note 170 at 272 (asserting that “calls for heightened scrutiny [of SWFs] are grounded largely on unfounded fears” and that “[c]ritics have yet to provide a concrete example of foreign investment funds pursuing nonfinancial ends.”) See also See also Melone, *supra* note 68 at 169-70.

<sup>196</sup> Epstein & Rose, *supra* note 185 at 113. See also See also Melone, *supra* note 68 at 170 (asserting that “effective mechanisms have been put in place for some time that address national security concerns.”)

<sup>197</sup> Buhi, *supra* note 128 at 210.

<sup>198</sup> Sanford M Jacoby, “Convergence by Design: The Case of CalPERS in Japan” (2007) 55:1 Am J Comp L 239.

<sup>199</sup> Langland, *supra* note 170 at 270. These fears reached their peak during the global financial crisis of 2007/2008 which resulted in many distressed U.S. banks turning to certain SWFs for financial bail-out. See Yvonne C L Lee, “The Governance of Contemporary Sovereign Wealth Funds” (2010) 6:2 Hastings

legitimate ways to regulate the activities of SWFs, such regulatory regimes ought not to constitute unnecessary barriers to entry. Rather, the focus of regulation should be to encourage SWFs to better behave like rational private investors. As Larry Cata Backer suggests, provided SWFs act like private investors, SWFs ought not to be treated differently than private investment funds merely because SWFs are owned by governments or States.<sup>200</sup> In Backer's words, "sovereign wealth funds that adopt the behaviors of private investment fund can be treated no worse than private funds in host states."<sup>201</sup> This being the case, the question becomes, how do we best ensure that SWFs continue to behave like rational private investors? In the view of this author, a principled but responsive approach ought to be adopted in regulating the investment activities of SWFs. Such 'principled but responsive' approach encompasses complementary soft-law and hard-law regimes which could encourage SWFs to better behave like private investors. As with the case of private funds, issues revolving around investment principles should be regulated primarily through soft-law, while the accountability and transparency of SWFs are better handled through hard law.

Thus, behaving like private investors would involve adherence by SWFs to the investment principles enunciated in the *Santiago Principles*, a soft law instrument. In particular, SWFs should strive to abide by the *Santiago Principles* regarding their investment and risk management framework. For example, the investment policy of SWFs should be clear and consistent with their "defined objectives, risk tolerance, and investment strategy".<sup>202</sup> Also, investment decisions should be based primarily on economic and financial grounds and where such investment decisions are subject to considerations other than economic and financial considerations, the SWFs should set out these extraneous considerations in their investment policy and disclose same

---

Business LJ 197 at 200 (asserting that SWFs' "recent acquisitions of Western financial institutions such as Barclays, Citigroup, UBS and Merrill Lynch, during the U.S. sub-prime crisis have attracted significant flak and fascination from certain politicians and governments in recipient countries notably, those from U.S., France and Italy." See also Gilson and Milhaupt, *supra* note 119 at 1348-49 (reporting that, as of 2008, SWFs "made multi-billion dollar investments in the U.S. investment banks such as Citigroup, Morgan Stanley and Merrill Lynch, whose capital was depleted by the meltdown in the subprime mortgage market" and that "[c]ollectively, sovereign wealth funds have invested approximately \$60 billion in Western banks since May 2007.")

<sup>200</sup> Backer, *supra* note 191 at 430-31.

<sup>201</sup> *Ibid* at 431.

<sup>202</sup> *Santiago Principles*, *supra* note 4 at 8, Principle 18.

to the public.<sup>203</sup> SWFs should compete fairly with private investment funds without taking undue advantage of their affiliation with governments.<sup>204</sup>

Perhaps more fundamentally, SWFs should observe the same level of transparency in corporate governance as is observed by private investment funds. Transparency in this context would include disclosure of voting records regarding equities held by SWFs, disclosure of investment policies, and disclosure of audit reports.<sup>205</sup> As the *Santiago Principles* exalt:

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 ownerships rights.<sup>206</sup>

Transparency in the management of SWFs could allay many of the fears about SWFs investments in Western economies, thereby tempering the hostility of Western politicians and academics towards SWFs.<sup>207</sup> Transparency could also enable regulators to better monitor SWFs activities.<sup>208</sup>

However, the accountability and transparency of SWFs ought not to be left entirely to the dictates of soft law instruments such as the *Santiago Principles*. Statutory provisions in developed and developing countries alike ought to demand such accountability and transparency on the part of SWFs. Some developed countries have enacted laws requiring disclosure of investment information by investors, be they domestic or foreign investors. For example, in the United States, Rule 13d-1 made pursuant to the *Securities Exchange Act of 1934* requires investors acquiring more than five percent of any equity security of a class of shares of a publicly-listed company to make certain disclosures regarding their share ownership. In fact, where the investor acquires directly or indirectly the beneficial ownership of more than five percent of any equity of a class of the company's shares, the investor must file with the Securities and Exchange Commission a statement containing the names of the reporting person(s); number of shares beneficially owned by the reporting person(s) and the nature of such ownership (whether sole voting

---

<sup>203</sup> *Ibid*, Principle 19.

<sup>204</sup> *Ibid*, Principle 20.

<sup>205</sup> See Feng, *supra* note 119 at 509; Amy Keller, *supra* note 119 at 366-71.

<sup>206</sup> *Santiago Principles*, *supra* note 4 at 9, Principle 21.

<sup>207</sup> Feng, *supra* note 119 at 510.

<sup>208</sup> *Ibid* at 510.

power; shared voting power; sole dispositive power or shared dispositive power); and the type of reporting person.<sup>209</sup> In addition, the United States requires any person(s) acquiring control of a bank to give 60 days' written notice prior to the acquisition unless the acquisition is exempt under the rules.<sup>210</sup> For this purpose, acquisition of control occurs if "the acquiring person (or persons acting in concert) will own, control, or hold with power to vote 25 percent or more of any class of voting securities of the [bank]."<sup>211</sup>

Developing countries may also do well to enact laws requiring their SWFs to make certain disclosures including their voting records as well as the factors on which their votes are based. To be sure, a number of developing countries such as Ghana, Nigeria, Timor-Leste and Sao Tome and Principe have laws mandating disclosure of SWF activities, but there are many developing countries lacking disclosure laws. As noted previously, SWFs in non-democratic and autocratic countries tend to be secretive regarding their operational management. For the most part, information regarding SWFs in non-democratic countries is rarely disclosed, if at all.<sup>212</sup>

Perhaps the adoption of the corporate entity principle, whether by way of a statute vesting a separate legal personality on SWFs or through the incorporation of a corporate entity, could encourage SWFs to behave like private investment funds. SWFs could also appoint independent third parties as fund managers which "could help to assure that the SWF's sovereign owner has an economic, rather than a political or strategic, interest in investing in" Western countries.<sup>213</sup> Happily, as noted earlier, some SWFs are already engaging the services of independent fund managers.

## CONCLUSION

SWFs play an important role in world investment because, as noted at the beginning of this Article, SWFs infuse much needed capital into the global investment market. Moreover, as demonstrated by events during the recent global financial crisis, SWFs could partner with governments in stabilizing the international financial market. Many of the Western financial

---

<sup>209</sup> 17 CFR §240.13d-1 read with 17 CFR §240.13d-102 – Schedules 13D & 13G .

<sup>210</sup> 12 CFR §225.41(a).

<sup>211</sup> 12 CFR §225.41(c)(1).

<sup>212</sup> See Keller, *supra* note 119 at 360.

<sup>213</sup> *Ibid* at 363 [emphasis in original].

institutions and banks which were distressed during the financial crisis are in business today partly due to the infusion of SWFs capital into the Banks.<sup>214</sup> In essence, SWFs are beneficial to both the governments that own them and the governments of the recipient (Western) countries of SWFs investments. Thus, as suggested in this article, a principled but responsive approach ought to be adopted in regulating the investment activities of SWFs. A principled approach ought to recognize that SWFs are already excelling in certain areas and that consequently SWFs should be encouraged through soft-law instruments to strive to improve on these aspects. As mentioned in this article, evidence thus far reveals that, for the most part, SWFs behave like rational private investors and that SWFs are primarily motivated by wealth-maximization and returns on investment. Hence, SWFs neither seek to acquire control nor have they acquired control of Western companies.

However, there are areas where SWFs have yet to fully demonstrate that they ought to be left alone. These include issues such as accountability and transparency. Hence, as suggested in this article, a hard-law regulatory regime that complements the soft law principles of the *Santiago Principles* should be adopted by developed and developing countries alike. This is what I mean by responsive approach to the regulation of SWFs. Statutory provisions ought to require SWFs to make public disclosures regarding their investment activities including their financial statements, the specific instruments and equities in which the funds of SWFs are invested, as well as the identities of financial intermediaries and fund managers engaged by SWFs.

While as noted in this article a number of developing countries have passed laws requiring the disclosure of certain information by their SWFs, regrettably, many developing countries have yet to enact such disclosure laws. Ultimately, this author hopes that full disclosure of SWFs activities would not only assuage critics of SWFs investment in Western countries but, more importantly, would also enhance the efficiency and effectiveness of SWFs across the developing world.

---

<sup>214</sup> See O'Brien, *supra* note 4 at 1238 (indicating the level of investment made by SWFs in Western financial institutions); Gilson & Milhaupt, *supra* note 119 at 1348-49 (indicating that, between 2007 and 2008, SWFs collectively invested approximately US\$60 billion in Western banks).