CHAPTER EXPERT PERSPECTIVES ON REGULATION

Part 1: Protectionist actions taken by recipient countries: a key issue of concern for sovereign wealth funds

Interview with Dr Eliot Kalter, The Fletcher School, Tufts University

Dr Kalter established and is President of EM Strategies, Inc., which facilitates the relationship between emerging market countries and institutional investors. He also holds the position of Senior Fellow, Center for Emerging Market Enterprises at the Fletcher School, Tufts University, where he heads the Sovereign Wealth Fund Initiative (SWFI). Dr Kalter retired from the International Monetary Fund in 2007 as Assistant Director of the Capital Markets Department; prior to that he was Assistant Director of the Western Hemisphere Department. He has an MA and a PhD in International Finance from the University of Pennsylvania, and an MSc in International Monetary Economics from the London School of Economics . His publications are in the areas of international and local capital markets, public debt management, corporate restructuring, international competitiveness, and financial crises.

The SWFI was launched to provide Sovereign Wealth Fund (SWF) senior decision-makers with a value-neutral venue and world-class resources to identify their key international issues of concern and develop approaches for better management of their external relationships. The SWFI is driven solely by the needs of the SWFs themselves, complementing the broader goals of the International Forum of Sovereign Wealth Funds (described in Part 2 of this chapter below).

The initial activity of the SWFI has been to meet with SWFs and other financial entities in the Gulf, the Caribbean, North and South America and Singapore to initiate the process of identifying and analysing key international issues from the SWF point of view. A SWFI Group Meeting is planned for mid- 2010, with a likely focus on the SWF response to recipient countries' protectromist policies and pressures to adopt 'excessive transparency'.

Q: In your extensive work on SWFs and from your discussions with them, did you find that protectionist actions taken by recipient countries are a key issue of concern?

A: All participants in our discussions emphasised the importance of the possible impact of recipient countries' legal and regulatory regimes and practices on SWF external relationships. There was broad agreement that recipient country legal and regulatory regimes are important factors affecting investment decisions and external relationships. While all SWFs agreed that financial and macroeconomic variables were prime considerations, SWFs take into consideration recipient country legal, regulatory and political factors in their decision making.

In particular, participants stressed that recipient country discriminatory restrictions on SWFs are of concern and affect the general availability of capital. Financial participants were incredulous that SWFs as a group face discriminatory restrictions while hedge funds are not regulated.

This concern was reflected in the 'Baku Statement' issued by SWFs following the 8–9 October 2009 inaugural meeting of The International Forum of Sovereign Wealth Funds (IFSWF) where the IFSWF agrees to "...encourage recipient countries to continue making their investment regimes more transparent and non-discriminatory, avoid protectionism, and foster a constructive and mutually beneficial investment environment".

Q: What views did you find SWFs taking regarding the underlying reasons for recipient country concerns that precipitate regulatory actions? On a related note, how do you see the term SWF evolving? Is it being too broadly applied?

A: SWFs understand the reasons underlying recipient country concerns, including unclear motivations behind SWF investment with the possibility of eventual use of economic and political leverage, potential government use of 'inside information', and a general lack of transparency in a number of SWFs. The SWFs also acknowledged recipient country concern about the efficacy of Santiago Principles in achieving stated objectives due to the voluntary and non-binding nature of such principles and resulting unenforceability.

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However, participants noted that recipient country concerns are driven by the behaviour of state enterprises and other entities classified as SWFs that have both financial and political objectives. Several SWFs stated that there is a need for a clear distinction between funds that have a large degree of autonomy in investment decisions, investing purely for commercial purposes, and state enterprises and other entities that have less autonomy with investment potentially driven by political objectives.

Q: What messages did you hear in your discussions regarding recipient country concerns about direct investment from SWFs?

A: SWFs emphasised that the investment of most SWFs is for commercial purposes. Indeed, a majority of SWFs are not interested and do not have the expertise to take majority positions in their direct investments. Many said that they will only take minority positions, while others noted possible interest in 100% ownership when not confronted by recipient country barriers. A unanimous objective of SWFs is to stay out of the public eye.

Participants were surprised by concerns about their investment motives because they are driven by the objective of good returns to assure wealth for future generations or to accumulate available capital if there is a short-term need for economic stabilisation. They noted that the non-political nature of SWFs is institutionalised in many countries, to the extent of making it difficult for local governments to get co-operation with SWF portfolio managers during times of global financial crisis. Many SWF managers, by their training, are more open to international bankers than to their home country politicians.

In contrast, there are wide differences of opinion among SWFs regarding the concern about the transparency of their investments. Many participants emphasised that in addition to the Santiago Principles calling for increased transparency, their own society demands transparency and the corresponding accountability needed for long-term returns for future generations. Indeed, many SWFs are increasing their transparency by publishing more information and working with credit rating agencies. However, other SWFs still have open issues, noting that external transparency is fine but the pressures that come with internal transparency are unwanted. Specific SWFs were pointed out as examples where transparency has resulted in pressures to invest for non-commercial (social) purposes or to aim for short-term success at the expense of their long-term objectives.

Q: To what extent do the OECD Guidance on SWFs and the Santiago Principles help to avoid potential protectionism? Or rather, have capital shortages stemming from the global financial crisis been a driving factor in easing protectionist forces?

- **A**: Although OECD recipient nations have begun working collaboratively to avoid protectionist pressures, SWFs see the results of their efforts as limited due to the following considerations:
- 0 The Declaration does not prohibit recipient nations from regulating SWFs, but rather seeks to establish a framework by insisting that such regulations be transparent and limited to national security interests;
- 0 The Declaration is non-binding, voluntary and unenforceable; and
- 0 Fear of political considerations in recipient countries that may affect the openness of markets and return on investments.

Similarly, while it was agreed at the IFSWF that SWFs "will continue to discuss the application of the Santiago Principles", results so far have been limited due, in part, to its voluntary nature.

However, the global financial crisis has indeed had an impact on the behaviour of both the SWFs and recipient countries:

- 0 As noted at the IFSWF, "the global financial crisis has made the domestic public and policymakers more vigilant about the use and investment of public money, and the Santiago Principles are serving as a useful guiding tool." However, the financial crisis has also created pressure on some SWFs to participate locally and regionally in ways that may be outside of their mandates, organisational skill sets and core competencies;
- 0 On the part of recipient countries, the shortage of capital inflows to finance (on the part of the US) still sizable external current account deficits may have eased protectionist actions on direct investment inflows.

- Q: That leads to my next question. What protectionist actions have recipient countries taken in recent years of particular concern to SWFs and have these actions been affected by the financial crisis?
- A: A wide range of countries have put in place mechanisms that allow stricter screening of direct foreign investment, with concerns regarding national interests often driven by economic factors. A number of SWFs expressed concern that they have been treated on a discriminatory basis under this provision. SWFs are concerned about the arbitrary nature of these actions, which lend themselves to politically-based protectionism and potential discrimination against SWFs, thereby hindering the stable and transparent legal and regulatory environment needed for long-term investments.

A recent World Bank publication gives a good overview and quantifies the impact of protectionist measures taken in recent years:

- 0 The US in 2007 passed the Foreign Investment and National Security Act (FINSA), which codified the role of the Committee on Foreign Investment in the United States (CFIUS) in reviewing the national security implications of direct foreign investment. FINSA has no restrictions specifically on SWFs. However, it gives broad discretionary powers through CFIUS to restrict investments based on national security interests;
- 0 The number of notifications to CFIUS and the number of investigations rose from, respectively, 55 and 1 in 2001 to 165 and 22 in 2008. However, data for the first six months of 2009 show a decline of notifications to 36 which likely reflects recognition of financing needs;
- 0 In Germany, a recent amendment to the Foreign Trade and Payments Act established a CFIUS-type review mechanism to protect 'public security' and 'public order';
- 0 In France, a decree was issued at the end of 2005 identifying 11 strategic sectors in which investment proposals fall under the purview of the review authorities. In 2008, this measure was strengthened to protect France's strategic industrial assets from foreign takeovers;
- 0 In Australia, a new policy was announced on 17 February 2008 for proposed investments by sovereign investors. It requires that reviews of applications by such investors consider six specific issues, including whether an investor's operations are independent from the relevant foreign government; the investor's observance of standards of business behaviour; the investment's impact on Australia's national security; and the contribution of an investment to the country's economy and community;
- 0 In Canada, which amended its investment law in March 2009 to include a national-security test for proposed investments;
- 0 In Japan, where foreign deals are subject to tough screening on many grounds, and a 2007 regulation strengthened government authority to review acquisition of 10% or more of listed companies with technologies that could be used in weapons systems;
- 0 In China, which strengthened its own broad review system in 2006; when the government announced 'Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors';
- 0 In Russia, which passed a 2008 law 'On Procedures for Foreign Investments in Companies of Strategic Importance for National Defense and Security' which requires government approval for certain transactions involving foreign investors if (i) the Russian company is engaged in an "activity of strategic importance to the country's defense and national security" and (ii) the foreign investor would control either the company or rights to "natural resource deposits having federal importance";
- 0 In India, which recently introduced a measure requiring prior approval for transfers to non-resident entities in sectors including air transport, banking, insurance and telecommunications.

Q: How are these regulatory issues impacting SWFs' investment strategies? Is regulation in developed economies, or the threat of such regulation, driving SWFs to shift investment to emerging markets? Similarly, will the threat of protectionism cause SWFs to use alternative assets as a means of investing in the developed countries without raising the possibility of discretionary protectionism? How have these issues been affected by the global financial crisis?

A: In the context of the global financial crisis and sharp decline in assets under management, there has been evidence of increased investing regionally and domestically by SWFs. Most SWFs emphasised that they are maintaining their investment mandate, with some fulfilling their role of short-term financing for budgetary purposes. All SWFs stressed the growing investment opportunities in SWFs' own regions, driven by the realisation that their knowledge and expertise in their own region positions them to take advantage of these opportunities. However, some participants expressed concern about pressures from within and abroad and that a reversal of recently gained financial openness could be taking place, noting that recipient country regulatory discrimination will hasten these pressures.

Data from the Thomson Reuters dataset support these observations. Using this information, the value of SWF investments in own-country relative to the total value of their investments averaged less than 10% for 2006 and 2007. However, this asset allocation shifted dramatically in 2008 and the first half of 2009, with domestic investments jumping to roughly 45% of total in the second half of 2008 and then declining to 17% in the first half of 2009. Information for the second half of 2009 indicates a moderation in this shift in asset allocation.

The global financial crisis has also reinforced the secular shift of financial and economic power away from the traditional centres of the US and Western Europe and towards emerging markets. A gradual shift of asset allocation to emerging market debt and equity is being reinforced, with the financial crisis eliminating investors' perception that developed markets in the West are less risky and more secure than emerging markets.

A number of SWFs began investing in private equity during 2008 and a few are expected to make maiden allocations to the asset class over the course of 2009. More broadly, JP Morgan has recently projected that the share of alternative investments globally held by SWFs will double in the next five years to 15%.

Some examples include:

- 0 China Investment Corporation (CIC)made its first investment in a private equity fund in April 2008, committing US\$3.2bn to a buyout fund managed by JC Flowers & Co;
- 0 Other SWFs have increased their allocations to private equity in order to take advantage of favourable pricing as a result of the recent turmoil in the financial markets. One such example is Australia's Future Fund, which increased its allocation to the asset class in order to take advantage of dislocation in the markets;
- 0 Another SWF that started investing in private equity during 2008 was Korea Investment Corporation (KIC), which adopted a more aggressive approach to its investments generally, and this included a debut allocation to private equity;
- 0 Temasek Holdings stated recently that its portfolio would increase its allocation to emerging market assets.

Q: In this volume of SWF Review, we are introducing the concept of a National Wealth Fund (i.e. a fund that is focused on investing domestically to develop the national economy) in contrast to a traditional SWF that invests aboard. As the financial crisis has become a real economy crisis, many SWFs are also acting as NWFs and moving their resources into the domestic economy. Should domestically focused and internationally focused funds be regulated differently?

A: As noted, SWFs see themselves primarily as professional investment management firms with specific missions and investment objectives to deliver investment returns from diversified, international portfolios. A key operating assumption and mandate has been that international markets are the place to be except when local markets require temporary financial support. The current global downturn is creating pressure on management to participate locally and regionally in ways that may be outside of their mandates, organisational skill sets and core competencies.

A SWF that has an arms-length relationship with its government gains full control to operate under its investment mandate. The lack of an arms-length relationship can cause the investment mandate to be multifaceted and without a principal mandate. This may result in a lack of continuity in the investment programme, impeding the SWF's ability to build strong human capital needed for investment decisions. SWFs that lack an arms-length relationship with their respective governments tend to have a greater likelihood of investing in their domestic markets and in higher P/E industries domestically and abroad.

Thus, a critical factor in assessing the appropriateness of SWFs also acting as NWFs is whether this move is undertaken within a well-conceived mandate. This mandate would need to include specific investment objectives, an investment strategy with specific asset allocation guidelines, and risk management capabilities consistent with the types of investments that will be made.

Note: This chapter section © Dr Eliot Kalter

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Footnotes

1 The Santiago Principles are summarised in Appendix I of Volume One of the Sovereign Wealth Fund Review by John Howell & Company, published by Thomson Reuters, March 2009. 2 In Ted Truman's 'A Blueprint for Sovereign Wealth Fund Best Practices', Peterson Institute Policy Brief, April 2008, he notes that SWF operation at arm's length from the government would require, in the context of best practices, full compliance with regard to the role of government, role of managers, and whether the managers alone make investment decisions. He gives SWFs that serve as National Pension Funds an average score of 91 compared with an average score of 41 for non-pension SWFs. 3 Karl P. Sauvant, 'FDI Protectionism on the Rise', World Bank Policy Research Working Paper No. 5052, September 2009.

Part 2: SWFs in their own words at the Baku Summit

The coming of age for SWFs

By Natsuko Waki

The US\$3trn industry, whose often opaque operations have been subject to severe criticism by the West, is starting to open up gradually, invest in highly sophisticated instruments and act as a leading force to improve the global financial system and corporate governance.

There is no doubt that sovereign wealth funds (SWFs) are important players in the global financial markets. Already owners of a tenth of global stock market capitalisation, SWFs are expected to see their total assets more than double in the next 10 years.

However, what was previously a loose group of state-owned investment vehicles is now speaking with a collective voice under a newly formed umbrella organisation, the International Forum of Sovereign Wealth Funds (IFSWF), in a move that could have a major impact for the world's financial and investment community.

Their inaugural meeting in Baku, Azerbaijan, in October 2009 has marked an important point in their development. Twenty leading funds – ranging from heavyweights such as China, Kuwait and Norway to small and newer funds such as Timor-Leste and Botswana – urged host countries to make their investment regimes more transparent and less discriminatory and keep investment borders and flows as open as possible.

The forum has also vowed to further apply the Santiago Principles, a voluntary code of practice guidelines for SWFs adopted a year ago in response to the criticism by the West that they operate with political, rather than commercial, motives.

"We confirmed progress in application of the Santiago Principles. In this context we welcome multilateral efforts and commitment towards keeping recipient countries' borders open and keeping investment flows as open as possible," David Murray, chairman of the forum, and also the chairman of board of directors at Australia's Future Fund, told a news conference after the Baku meeting.

In a way they have turned the tables on the rest of the world. Having long been criticised by the West for the lack of transparency, they have improved their communication and disclosure levels — with some of them now publishing annual performance reports. And now it's their turn to demand the West work on improving transparency as well.

And the global credit crisis has given them opportunities to speak up. The world's industrialised nations were badly in need of long-term capital which only SWFs could provide after the crisis drained liquidity for previous leveraged buyers such as hedge funds and private equity.

"An open investment climate benefits everyone. We benefit from having an access. Recipient countries benefit from an access to funding from institutional investors who can provide long-term capital in a situation where there is focus on short-term financing," says Martin Skancke, director general of the Norwegian Ministry of Finance Asset Management Department, responsible for the country's wealth fund.

Indeed during the crisis, the perception of sovereign funds changed constantly, and both SWFs and the West – recipient countries – are learning to live with each other. Industrialised nations must accept SWFs as legitimate players of the global financial system if they are to benefit from long-term capital they can provide. SWFs, on the other hand, must play according to rules and regulations of the host countries and need to disclose what is necessary to gain entry into markets they target.

Challenges for the IFSWF

What are SWFs trying to become next? Still a young group, the IFSWF could help state-owned funds to play a more proactive role in the global economy as their assets and influence in the financial markets increase.

"We are here to support the sound global financial system and the highest quality of investment decisions for the long term, to promote confidence amongst recipient countries that a free flow of international capital is strongly positive," says Adrian Orr, chief executive officer of New Zealand's wealth fund.

"Going ahead I would like to see a group like us shift into a proactive force for a wider improvement in the global financial system, corporate behaviour, transparency and disclosure in areas in which we invest."

Many sovereign funds, scared of coming under the public spotlight, have often forgone board representation and voting rights, saying that they have no intention of becoming actively involved with the governance of companies they own.

However, there may be a danger in not participating, and the credit crisis might have highlighted the importance of SWFs' active corporate involvement as large shareholders. State Street, which manages US\$322bn for 67 central bank and government clients, says a sovereign fund could be liable for not fulfilling its fiduciary duty to the underlying fund beneficiaries if a large institutional shareholder removes itself completely from monitoring management and participating corporate governance.

Unlike activist hedge funds, lower leverage and higher cash reserves may be beneficial for SWFs – which may hold the stock over a much longer period – as the company considers investing in new business lines or future acquisitions.

"It is not unreasonable to expect that SWFs will gradually evolve to more closely resemble their large institutional peers in terms of active ownership and shareholder rights," writes John Nugée, head of official institutions at State Street.

One area which some SWFs are increasingly pursuing is socially responsible or ethical investing and related corporate behaviour.

Socially responsible investing (SRI) involves buying shares in companies that manage environmental, social and governance (ESG) risks. For example, firms which make clean technologies are favoured, while businesses which pollute environment, abuse human rights or produce nuclear arms are shunned.

Assets under management in the fast-growing SRI industry stand at US\$2.71tm, over a tenth of total assets held by US-based investors, according to the Social Investment Forum, and greater SWF involvement could accelerate expansion.

Critics say that SRI lacks convincing evidence of outperformance and that it narrows the investment universe by excluding or divesting firms. However, it does allow SWFs to combine a multitude of objectives: seek long-term returns via non-traditional assets, meet social goals, and gain wider acceptance even among critics who suspect they operate politically.

Norway is the leading force in SRI. Its sovereign fund strictly follows ethical investment guidelines, favouring firms which tackle climate change or water scarcity and pushes them to be greener. It names and shames companies the fund expels for not meeting its criteria. In September 2009 it ejected Israel's Elbit Systems for supplying surveillance equipment for the West Bank separation barrier. BAE Systems, Wal-Mart and Rio Tinto are among other expelled firms.

New Zealand's fund also believes that ESG risks are long-term factors that can be highly relevant to investment performance.

"It's a belief, and there's no empirical evidence. We do not do activities to the detriment of returns. We do not sit here and become more conscience of the world. We would hope companies that are concerned about meeting customers' desires tend to have a successful performance," Orr says.

In December the fund expelled from its portfolio six firms that are involved in cluster munitions, one of which is also involved in the simulated testing of nuclear explosive devices.

"It's our mandate to maximise returns without undue risk that appal the reputation of New Zealand," he adds.

Chile's SWF is also planning to follow the examples of Norway and New Zealand when it eventually starts investing actively in stocks.

"We have to align long-term returns with the objectives of a society at large... You have to change the trend. Maybe if everybody joins this type of initiative it would be a trendy way to invest," says Eric Parrado, international finance co-ordinator at the Ministry of Finance, which oversees the fund.

Gordon Clark and Ashby Monk, Oxford University researchers and SWF experts, say that Norway's fund – which only invests abroad – seeks to give global effect to national values and commitments with its ethical investment policies.

They argue the clear guidelines and the integrity of the selection process enhance transparency and accountability. Therefore, such a process might be more important than the resulting financial performance – or it might help explain to the wider public even if it resulted in a loss.

"It is apparent that the value attributed to ethical standards is... a moral value not a financial value... As such, these standards are not subject to a profit and loss statement," they wrote in a recently published paper.

"There is a premium on the transparency and accountability of the process whereby ethical issues are evaluated... In fact, it might be argued that the process is more important than any outcome in these circumstances."

While SWFs may have achieved considerably in opening their books, they still have a lot to do. Global credit ratings are one method some sovereign funds are using to open up, and at the same time to tap new source of financing.

Getting a credit rating has several implications. It allows SWFs – those that run private equity-type vehicles as opposed to portfolio investment – to become more transparent, given the level of disclosure they must offer to receive a rating from international agencies. Ratings also allow SWFs to access long-term debt from capital markets, which is essential in funding private equity-type projects that usually run for three to five years. It can also highlight business independence from their owners by raising debt themselves.

"We like debt. When you take debt, not only do we like the financial returns that come with leverage, it also imposes a financial discipline. When you raise third party capital, it's almost like third party validation of the project you are doing," says Matthew Hurn, executive director of group treasury at Abu Dhabi-owned fund Mubadala.

So far, Mubadala, Singapore's Temasek, the UAE emirate of Ras al-Khaimah's investment arm RAKIA and Malaysia's Khazanah Nasional have ratings.

State-owned Abu Dhabi Invest AD wants to talk to major ratings agencies Moody's, Standard & Poor's and Fitch about getting a credit rating prior to its plan to float at least a quarter of the firm in three to five years.

Bahrain's sovereign fund Mumtalakat is also in the process of choosing a rating agency before the end of 2009.

Credit ratings are not without risks. Sovereign private equity arms are most likely to get the same or similar level of ratings as their owners – governments. And higher ratings open the gate for access to cheap financing, potentially luring them to take up more leverage – a practice many sovereign funds are not used to, given that they were originally set up to invest central bank surpluses.

Thorough implementation of the Santiago Principles is also a key task for the industry as a whole. Given its voluntary nature, the group cannot enforce every fund to strictly follow the code. The level of transparency depends a lot on funds – with those from developed economies more prone to disclosure and regular reporting. As the IFSWF develops into a more mature group with proper agenda setting and self-policing powers, SWFs might be able to address the problem of uneven implementation.

On the other hand, however, growing pressure on sovereign funds to open up may force them to cut their investment horizons short and discourage them from taking a so-called 'liquidity' premium – investing in illiquid but higher-return instruments.

"We are happy to report but it does create some significant difficulties. It forces the community to take very short-term views in returns in the fund and causes management of the fund to be concerned about media and community responses," says Murray, whose Future Fund publishes quarterly results.

Jin Liqun, chairman of the board of supervisors at China's wealth fund, says excessive transparency does more harm than good. China Investment Corp published its first annual report in August 2009.

"SWFs are not publicly traded companies. We do not have obligations to publish quarterly information to the public. Indeed, this kind of quarterly disclosure has done more harm than good. It has encourages managers to do reckless things," he says.

"If you simply disclose without clarification, explanation or technical knowledge, it damages completely. This kind of practice encourages the management to seek short-term, high profit, to the detriment of long-term returns."

In some cases, an excessive push for transparency, coupled with recent poor performance, has opened SWFs up to an uncomfortable monitoring process which did not previously exist – especially from their domestic audiences.

Under greater scrutiny than ever before, SWFs have sharply reduced their headline activities. Their sponsoring governments dipped in SWF assets to support the struggling domestic economies, depleting them of capital to continue their often lavish investment activity. Going forward, sovereign funds may opt for safe debt securities or instruments that will give visible and accountable returns, rather than equity stake building or other riskier equity-related projects that may or may not yield some returns in a loosely defined, somewhat 'long', investment horizon.

However, safety-first strategies for sovereign funds defeat the purpose. Long-term investment with sensible risk taking is their *raison d'être*. Sponsoring governments therefore must spell out the mandate of their SWFs with a clearer investment horizon – thereby allowing them to ride out short-term portfolio fluctuations and protecting them from domestic criticism.

Finding the right balance of transparency in China

The following is an interview by Reuters correspondent Natsuko Waki with Jin Liqun, chairman of the board of supervisors at China Investment Corp and also a deputy chair of the International Forum of Sovereign Wealth Funds, on the sidelines of the inaugural meeting of the IFSWF in Baku on 9 October 2009.

Reuters: SWFs are under pressure to open up and some have started to report on a quarterly basis. What is the stance of CIC on transparency?

Jin Liqun: SWFs are not publicly traded companies. We do not have obligations to publish quarterly information to the public. Indeed, this kind of quarterly disclosure has done more harm than good. It encourages managers to do reckless things. I'm not saying they should not disclose the information, but if you simply disclose without clarification, explanation or technical knowledge, it damages completely. This kind of practice encourages the management to seek short-term, high profit, to the detriment of long-term returns. We don't want to do that. We give you an annual report with all the results, true factual things so our people and the world will know what we've been doing."

Reuters: Have you experienced any negative consequences from transparency?

Jin: I knew back in October or November [2008], the worst of times, it was a good time to invest. But could we do it? I don't think so, because the whole country would be accusing us: "Are you crazy?" Everyone thinks cash is king. So we couldn't do it, if we tell the world every month and every quarter. That's not the way to do it. We started to (go into markets) only this year. That's the pressure we were under.

Reuters: Some SWFs are interested in socially responsible investing, but there's no convincing data that these products outperform significantly. What's China's view?

Jin: We are not going to do this as a subsidy. We do this only when we see there is a profit to be made. We would exercise our social responsibility by making profits and give the money to our people. Our contribution to this community, the state, and the people is to give them handsome returns.

Norway's perspective on the systemic role of SWFs

The following is an interview by Reuters correspondent Natsuko Waki with Martin Skancke, director general of Norway's Ministry of Finance Asset Management Department, responsible for the country's sovereign wealth fund, on the sidelines of the inaugural meeting of the International Forum of Sovereign Wealth Funds in Baku on 9 October 2009.

Reuters: What is the important message from this meeting?

Martin Skancke: The useful starting point is to acknowledge that an open investment climate is to the benefit of everyone. We benefit from having ... access [to attractive investment opportunities]. Recipient countries benefit from ... access to funding from institutional investors who can provide long-term capital in a situation where there is a focus on short-term financing.

Reuters: How do you enforce through implementation of transparency?

Skancke: This is a very diverse group in terms of history of the fund, the size of the fund, investment style of the fund. Then you have an enormously complex technical area as well. For these very diverse countries to come up with a set of very comprehensible principles is unprecedented for all the international work I've been involved with for over 20 years. That proves there's strong commitment to come to a document that properly reflects the way we do our business. For newer funds it's a blueprint as to what sort of standards they should aspire to as they develop their funds. It's a useful tool for the fund to communicate domestically and internationally, as guidance for the fund which is building up capacity.

Reuters: Norway is a leader in socially responsible investing. Why do it, when there's no convincing evidence of outperformance?

Skancke: You have to look at the whole responsible investing as a package. It's not just about asset allocation; it's certainly not about short-term returns. It reflects [our] long-term horizon: there are certain concerns that are relevant to us that may not be as relevant to those with a four to five-year horizon. Pollution – where there is a company which is polluting a river, we may not own a share of that company. But we may also own a share of other companies down the same river. So for a universal investor with a very broadly diversified portfolio, what seems external to the portfolio may be internal. We're best served by promoting good standards of corporate behaviour. This is something very consistent with pursuing long-term investment objectives. It's not so much about deviating from a benchmark; it's about changing the performance of the benchmark by exerting pressure on companies to be socially responsible because you believe that there are certain aspects of shareholder behaviour that affect long-term returns of the portfolio. There's a strong case to be made you need well-functioning businesses to have a well-functioning market. There's clear commercial justification for what we are doing. I don't think there's contradiction.

Reuters: Going forward, will SWFs become more actively involved with the companies as a large shareholder?

Skancke: We have a common interest in well-functioning markets. One aspect of well-functioning markets is that the board of the company has a responsibility to promote the economic interest of the shareholders. So we have to make sure there's a good mechanism to discipline the board. That's an important aspect of corporate governance.

New Zealand's perspective on its future and that of the Santiago Principles

The following is an interview by Reuters correspondent Natsuko Waki with Adrian Orr, chief executive officer of the Superannuation Fund, on the sidelines of the inaugural meeting of the International Forum of Sovereign Wealth Funds in Baku on 9 October 2009.

Reuters: What kind of opportunities do you see in the market at the moment?

Adrian Orr: For a long-term investor with a liquid portfolio, opportunities are high. I'm pleased to see some of the equity risk premium come back to positive and liquidity risk premium is starting show properly...

Infrastructure, property... we continue to look at a full universe of alternative assets. We are spoilt for choice.

We're a growth-oriented fund.

Reuters: What is the importance of this meeting, a year after you adopted the Santiago Principles?

Orr: (The mood is) positive around the information-sharing opportunities, in terms of learning from each other's experiences. I find it extremely useful, and we are a long-term investor, and you have to be able to weather ups and down with all of your stakeholders. We are all long-term investors; we have to explain to our shareholders. There's strong support across all of the members towards practices and principles. The initial starting point of the Santiago Principles was a defensive mode – that we were concerned about international regulatory barriers which might prove unnecessary or ineffective... We are here to support the sound global financial system and the highest quality of investment decisions for the long term, to promote confidence amongst recipient countries that a free flow of international capital is strongly positive and also to show that we are investing with economic needs in mind. We are trying to speak as a collective group.

Reuters: Would the voluntary nature of the Santiago Principles mean the group cannot enforce every fund to strictly follow them?

Orr: There's already an enough legal binding force within laws of any countries. Another set of global international laws even if you could establish such laws is unnecessary... Going ahead I would like to see a group like us shift into a proactive force for a wider improvement in the global financial system, corporate behaviour, transparency and disclosure in areas in which we invest.

Reuters: The Superannuation Fund is focused on socially responsible investing (SRI). Why do it at all? Critics say SRI lacks strong evidence of outperformance and that it narrows one's investment universe by excluding or divesting firms.

Orr: It is a strong belief of the fund that if you have sound social principles you end up with a better financial outcome. We want companies to be sustainable... It's a belief, and there's no empirical evidence. We do not do activities to the detriment of returns. We do not sit here and become the moral conscience of the world. We would hope companies that are concerned about meeting customers' desires tend to have a successful performance... There's no trade-off. Exclusion or divestment is an unfortunate position... (but) it's our mandate to maximise returns without undue risk that appal the reputation of New Zealand.

Chile's evolving investment strategy – risk with responsibility

The following is an interview by Reuters correspondent Natsuko Waki with Eric Parrado, international finance co-ordinator at Chile's Ministry of Finance, which looks after the country's sovereign wealth fund, on the sidelines of the inaugural meeting of the International Forum of Sovereign Wealth Funds in Baku on 9 October 2009.

Reuters: What kind of investment strategies do you have at the moment?

Eric Parrado: The financial committee made recommendations to go into equities and corporate bonds in 2007 – 15% equities, 20% in corporate bonds. This is the first step towards more risk. Lehman Brothers happened, and we decided to postpone the implementation of the new investment policy. And it was a very good idea. But now the financial committee is taking into consideration financial volatility is coming down and there is some certainty about developments in the global economy and has recommended to go and implement the investment policy. We would have to take the decision soon. Our first stage is to invest in an index with a passive strategy.

Reuters: Some SWFs are transparent, others are not. What about Chile's SWF and what kind of progress are SWFs making globally to enhance transparency?

Parrado: We're transparent from scratch. You had a lot of volatility in 2008. At the end of the day our citizens and politicians need to understand that these are long-term investments. We can have some volatility between months. You have to be very clear on the communication process, teaching the population and stakeholders. You are going to suffer some volatility. One of the key things for SWF management is to have clear objectives and rules of spending. If you look around, they have enhanced their websites – two-thirds of SWFs have annual reports. There is a learning process too. There are some new SWFs and we are learning from each other. We have an agreement like the Santiago Principles to show we are committed to transparency. We want to have the same regulation as any other investors.

Reuters: What's your view on socially responsible investing (SRI)?

Parrado: We are looking at the experiences of Norway and New Zealand, and we are looking this initiative of PRI (UN Principles for Responsible Investing). As soon as we get into equity and corporate, we have to look at SRI. We have to align long-term returns with the objectives of society at large. You have to change the trend. Maybe if everybody joins this type of initiative it would be a trendy way to invest.

Natsuko Waki – Since joining Reuters as a graduate trainee in 2000, Natsuko Waki has reported on issues surrounding global financial markets, monetary policy and central banking from Tokyo, Singapore, London, Paris, Madrid, Davos, Moscow, Dubai and Istanbul. She won the Reuters best scoop of the year in 2007 for a story on China's foreign exchange reserves policy and was also given State Street's best journalist of the year award in the same year. Currently based in London, she covers global investment issues on the Investment Strategy Desk.