The Sovereign Wealth Fund Initiative
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A Conversation with Mr. Ewart Williams, Governor, Central Bank of Trinidad and Tobago

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Mr. Ewart Williams has been Governor of the Central Bank of Trinidad and Tobago since 2002. Prior to his appointment as Governor, he worked for thirty years at the International Monetary Fund (IMF), most recently as Deputy Director of the Western Hemisphere Department.

Sovereign Wealth Fund Initiative co-heads Eliot Kalter and Patrick Schena had the opportunity to speak with Mr. Williams on June 7 to discuss his tenure as central bank Governor and head of Trinidad and Tobago's Heritage and Stabilization Fund. An edited and slight abridged transcript of their conversation follows.

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Eliot Kalter (EK): *This month's Sovereign Wealth Fund Bulletin is about capacity development, getting at how to build a fund, and how to run and staff it effectively. I think yours is a great example to think about. One of the things we wanted to get a sense for is whether, as you think back: has the fund evolved in a way that is consistent with your earliest objective in putting the fund together. Did it evolve as you anticipated?*

Ewart Williams (EW): Our economy benefited tremendously from the two oil booms of the 1970s, but like many countries, we spent the windfall and more. When the collapse of oil prices came in the 1980s, we were unprepared, in part because the increased spending did not contribute sufficiently in increase in productive capacity. Our economy was forced to go through a period of robust adjustment. We needed an IMF program: We had a large external debt so we needed to get through the classic rescheduling. Also, we had a structural adjustment program with the World Bank. The adjustment program imposed a tremendous amount of hardship on the people and we learned our lesson. When oil prices started to recover, the government at the time started to put money aside in an interim revenue stabilization fund, and that went on for about 5 or 6 years. The new administration which assumed office in 2002 started working on a permanent stabilization or heritage fund - one backed by a legislative framework. It took 5 years to do the required preparatory work and in early 2007 the Heritage and Stabilization Fund was formally approved by Parliament.

It was, in a way, compromise legislation. We started to think about a fund along the lines of the Norwegian model. We were thinking about essentially a savings fund, putting money aside for future generations, recognizing that oil and gas were wasting assets. The idea was to build up a nest egg to be able to live on the returns from these funds when oil and gas supplies had dwindled. But it wasn't easy to convince the government of the day to simply save when we had so many immediate needs. The question was balancing immediate consumption with long term savings. Some people argued that if you wanted to provide for generations, the strategy should be to quickly develop our production capacity. While Government agreed with the need for savings, they insisted on a stabilization component to maintain exports when oil prices fell.

EK: *Was part of that compromise because some people said that you wanted the money to build up reserves as a central bank rather than save it or spend it?*

EW: At that time the issue was not building up reserves. The counter argument was, to build a fund for infrastructural investment to accelerate the development effort. It was not easy to convince the Government to put money aside to invest in foreign assets for the long term. The argument at the time was spending to meet our developmental needs rather than putting money aside.

EK: *So we have a compromise. We have a fund that is both for stabilization purposes and savings. But then you have to figure out the governance and management structure. Did you use Norway as your prototype for that?*

EW: We had to use a hybrid. Simply because the fund was a hybrid, it meant that in the development of the strategic asset allocation, we had to provide for the stabilization component. The Norwegian model does not have a stabilization component. It is just a savings fund and that allows for a more aggressive strategic asset allocation. But we started off with a constraint. Since we had to prepare for stabilization, 25% of fund was automatically allocated to short term investments, so it limits flexibility straight away. The hybrid nature of the fund certainly had a very important influence on the strategic asset allocation. The other aspects we took from the Norwegian example as regards the governance structure for instance, what we have is best practice. The Parliament approves the Fund. The Ministry of Finance has a major role in the selection of the HSF

Board. The HSF Board delegates its powers to the Central Bank, and the Central Bank, as the manager of the fund outsources the management to external managers. The governance structure mirrors the Norwegian model. The hybrid nature of the fund determines the savings and withdrawal rules. We also got all the transparency provisions from the Norwegian Fund.

EK: *Did you work closely with the Chilean Fund?*

EW: No, we were a member of RAMP - a World Bank program, the Reserve Asset Management Program run, by the Bank's Treasury Department. We were one of the early members. This program was initially for the management of the central bank reserves. However, because we were members, when we started to think about the Heritage and Stabilization Fund, we sought technical assistance from the World Bank. We worked closely with them in the legal drafting and in thinking through the strategic asset allocation.

Patrick Schena (PS): *You mentioned outsourcing management, but then you also mentioned building a management team. Please speak specifically about building the team locally, and also to what extent in fact do you use outside managers.*

EW: That is one of the areas where we got the technical assistance from the World Bank under the RAMP program. Under the RAMP, the Central Bank is now managing about 60% of the central bank's reserves. We worked very closely with the World Bank in the selection of the new managers for the HSF. We started with this long list of a few hundred, and then we cut this list down. We interviewed a short list, we made lots of site visits. The World Bank could not participate in the interviews because they insisted that being an international institution they could not help us choose a company. It was a very transparent and detailed process. By that time we had decided on the strategic asset allocation, so that we knew we were looking for two kinds of managers: managers of fixed income instruments and international and U.S. equities. This elaborate process led us to the selection of eight mangers, two managers in each of the asset classes: two in short term fixed income, core fixed income, and core equities meaning U.S. equities and international equities. Central Bank staff has received training from the World Bank. We now invest about 60 per cent of our reserves and our staff closely monitors the operations of the external manager of the HSF. We hope that over time our staff will also be involved in the investment of part of the HSF.

EK: *So is this only for HSF or is it also for the reserves of the central bank?*

EW: Here I was talking about HSF. We had done a similar but not as detailed process with the official reserves. In the case of the central bank under the RAMP, the World Bank also was an external manager. That's one of the conditions of the RAMP. We received technical assistance, in part, by working with a shadow investment mandate with the World Bank. The whole purpose of RAMP was that over time, the central bank would take responsibility for more and more of the investment portfolio. Of course, you are aware that the central bank portfolio is rather conservatively managed, entirely in money select instruments and in fixed income securities. Now that our central bank reserves have grown beyond a certain threshold, we are now thinking about being a bit more aggressive.

EK: *Is there a difference between the management style of the central bank reserves and the one quarter of the HSF that's stabilization?*

EW: Great point. In fact, there isn't. And for that reason, now that we are reviewing the HSF, one issue on the table is whether there is a certain inefficiency in having the 25% stabilization and yet also having these sizable central bank reserves that are conservatively managed. The question on the table is: is there some way of introducing an asset - liability management approach where there is greater consistency in the assignment of all the country's foreign assets – the official reserves as well as the HSF.

EK: *Of the $10 Billion, how do you determine when some of that goes to the HSF. Is there some optimal level of reserves of the central bank versus those of HSF of which a quarter have the same strategy of the central bank?*

EW: We now manage both in separate compartments. We were managing the reserves according to one set of principles. It's a standard approach to central bank reserve management: a working tranche based on the variability of your trade and other transactions, a precautionary tranche representing a second line for trade financing: and the remaining 40 per cent in an investment tranche that is managed a bit more aggressively reaching as far as (investment grade agency bonds and so on). Then we have the strategic asset allocation for the HSF. With an integrated approach any need for stabilization could be accommodated by the reserves because we have "excess" reserves. The challenge is how these principles are implemented in practice.

EK: *You need to simulate a crisis shock and in the worst case scenario, how many reserves would you use up, and if you conclude you have more than the worst case scenario would require, then you proceed accordingly.*

EW: You know that deciding on the optimum level of official reserves is a very difficult proposition. Another challenge we face is that there are tight limits on central bank credit to Government, but if you want to use the central bank's reserves as a second buffer for budgetary shortfalls, it would translate into to central bank credit. The HSF is designed to finance revenue energy shortfalls directly, if needed. If actual reserves fall short of the budget projections, then the Government is allowed to withdraw from the HSF. The point is, if you wish to use the reserves as a source of funding for the Government, you will have to do it through central bank credit to the Government. That's what we have to work out.

PS: *Does the HSF have a professional staff? What functions have you retained?*

EW: The HSF as of now has no staff. The HSF is largely a Board, and the Board has delegated its powers to the Central Bank. In the review now being conducted, the need for a small research staff will be considered.

PS: *So for anything related to risk management decisions, for example – these are made by central bank staff for the HSF?*

EW: Yes: that is correct. But those decisions are ultimately reviewed by the Board.

EK: *What about political appointees at the central bank – how can they influence things? Which, according to the Act, must include a representative from the Central Bank and the Ministry of Finance.*

EW: The HSF is not a corporate body. The Minister of Finance appoints the members of the Board. The upcoming review will also reconsider the legal structure. Perhaps an example to consider is that of our national insurance board where the stakeholders - the business community, the government, and the trade unions - are all represented. One can envisage a situation where the HSF Board represents various sectors of society: the business sector, the Trade Union movement, perhaps the energy sector, the banking sector and so on. A structure like this will keep the Fund and secure national buy-in.

EK: *You have said you would like to see the HSF work in an asset liability management framework, but I haven't heard you tell me what the actual mandate is of the 75% that is the heritage part of the HSF. Is it a mandate that would be able to meet pension needs if demographics change? Or is it for when oil starts to run out?*

EW: The HSF allows us to convert oil in the ground into a pool of financial assets, the returns from which will accrue to the budget when oil resources have dwindled. The Norwegian fund has been converted into a pension fund. Our Fund aims to build a nest egg, so that when oil and gas resources are dwindling, the returns from the nest egg will contribute to the budget and take the place of the oil and gas revenues. Our HSF concept does not earmark HSF revenues to meet pension obligations or any specific type of expenditure.

EK: *Have you projected oil revenues over the next 30 years and tried to match those to revenue goals?*

EW: Yes, we did. Originally, we used a model where we said that oil and gas would be around for 30 years (along with certain price assumptions). Then we said that if you contributed a certain amount over the next 30 years and invested at a real rate of return of 3.5%, the Fund would accumulate about US$30 – 40 billion. But things have changed. For example a recent report suggests a small pool of oil and gas reserves, excluding new discoveries, of course. In these circumstances, one of the questions we need to address immediately is whether we should be changing our rules to increase our rate of savings. Another question is whether we should continue to have a hybrid on strategic asset allocation to target a higher rate of return.

PS: *To the extent that you were to modify your strategic asset allocation, does it make sense to harvest liquidity premia? Maybe you're looking at different kinds of investment structures with much longer time horizons? Also, how would you propose to reconcile what becomes a very short term reporting horizon, with year over year scrutiny on returns, against this notion of harvesting higher returns from less liquid investments.*

EW: Responding to your last question, we face a major challenge of getting the politicians and the public to recognize that it's a long term fund that will be subject to short term volatility. There is a tendency for the public to focus on short term returns and to expect changes in the investment strategy based on these short-term results. There is need for more education and greater buy-in to the long term savings strategy.

PS: *As we close perhaps you would discuss your perspective on the Santiago principles, including the rate of adoption and some of the related challenges. Also, as you reflect on your experiences in designing and building a sovereign investment vehicle, would you please share any specific lessons you have learned that would benefit new funds and those considering a launch?*

EW: First I'll talk about the Santiago Principles. I was in the first meeting. I think that the steps that the IMF took to bring the wealth funds together were absolutely important and necessary. If you remember, there was a great deal of hostility and suspicion about sovereign wealth funds. Some of it might have been justified due to the opaque nature in which the funds were operating, and given the geopolitics just after 9/11. I think the IMF did a good job in trying to bring some order to sovereign wealth funds when there was fear that they could destabilize the global financial system. The formation of a Sovereign Wealth Fund Group was successful in allaying the fears of the advanced countries. But from the start, we were aiming at a standardized blueprint – a template of transparency and good governance - not recognizing that both are grounded in your political situation. So what is transparency and good governance in Australia, New Zealand, the U.S. and Trinidad and Tobago does not necessarily apply to the Chinese wealth fund, the Russian wealth fund, or the Abu Dhabi Fund. So while there is a template, adherence is going to vary considerably. I think, however, a good forum has been set up for discussion about issues and challenges faced by SWFs. It is going to provide some comfort to advanced countries that SWFs are not operating to destabilize the international financial system. But I'm not sure that the kind of adherence to these parameters of reporting and transparency can be depended upon. The ones that would have been transparent, like Norway and like the pension funds in the U.S. and so on would otherwise continue to adhere to these high standard of good governance.

EK: *Many of the new SWFs that have come into existence in the last 10 years from smaller countries or countries that are less democratic have not engaged the International Forum of Sovereign Wealth Funds. What do you get from it as a country? Do you get technical advice that is useful?*

EW: It's an institution that will serve a purpose, but we have to be realistic in our expectations as to what we'll get from it. The meetings constitute a forum for discussing experiences, and that is always useful. People tell you about the kind of challenges they are getting with their investment managers and so on. It provides an opportunity for trading information on best practices among investment managers. These kinds of things are very useful. We are now trying to get, for instance, comparative information on SWFs based on extractive industries. Are other countries saving much more from their windfall? But that kind of information is hard to obtain, as is information on rates of return for some Funds. I recognize the shortcomings of international comparisons, because you have different strategic asset allocations and so on, but even if you allow for all these caveats, you would like to be able to see how you are doing in comparison to your peers. It is difficult to get reliable information. Similarly, it would be useful to have more access to information and analysis related to capacity building, governance and asset allocation issues.