

MORE LAYERS THAN AN ONION: LOOKING FOR A DEFINITION OF SOVEREIGN WEALTH FUNDS*

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ABSTRACT

We analyze definitions used by researchers about a single concept: Sovereign Wealth Funds (SWF). It is still a matter of recent controversy and debate. We place these definitions into one of eleven categories. The results show full agreement (what we have called 'the core') for just two characteristics: SWFs are owned by governments and they are investment funds. Beyond the core, there are three layers commanding general consensus: SWFs are (1) international investors; (2) without explicit pension liabilities; (3) determined by the source of funding. But the debate remains open. The dynamic nature of SWFs, morphing institutions in a continuous evolution led us to conclude that there is no definition capturing the essence of these new instruments of state intervention.

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1. Introduction

Sovereign Wealth Funds are nothing new. Hildebrand (2007) argues that the French *Caisse des Dépôts et Consignations* established in 1816 is the oldest SWF. However, the fact is that from the largest 30 active SWFs, only four were set up before 1970 while over half have been established in the 21st century. Even so, little is known about SWFs. Sovereign Wealth Funds made their debut on the international finance stage through two events in the U.S., one in 2005 and the other in 2007. First, two emerging-market state-owned enterprises (SOEs) failed to acquire 'strategic assets' in the United States. Dubai Ports World took over British P&O, which controlled several ports in the U.S. through a joint venture. Congress blocked the deal and DP World was unable to run the ports. Similarly, Chinese state-owned CNOOC abandoned its bid for Californian oil company Unocal. In both cases, the same arguments of 'national security' and 'strategic assets' were used to stop the deals. A second round of events put SWFs in the spotlight. SWFs tried to rescue several financial institutions around the globe (with global injections of more than \$40bn), mostly in the US (up to \$30bn), in the midst of the 2007-2009 financial crisis. The fact that the first two events involved SOEs and not SWFs gives one an idea of how loose the boundaries of SWF definition are when used by media, politicians, practitioners, and even scholars. It also highlights one of the key elements in this research: both SOEs and SWFs share an important feature. They are both controlled by governments; they are both 'sovereigns' and it is precisely this 'sovereignty' that raises suspicions among the investee countries.

Given the differences in definitions of SWFs and widely varying estimates of their assets under management, we were not surprised to find that seven sources of information on SWFs yielded seven estimates of SWF aggregate size. Estimates range from \$2.7tn¹ (GeoEconomica,

¹References to billion and trillion follow the Short Scale (*échelle courte*) convention whereby a billion is 10⁹ and a trillion is 10¹².

2012); \$2.9tn (Sovereign Investment Lab at University of Bocconi, 2011); \$3.2tn (Truman, 2011); \$4.6tn (Preqin, 2012); \$4.8tn (TheCityUK, 2012); \$4.9tn (ESADEgeo at ESADE Business School, 2012), up to the \$5.3tn guessed by Sovereign Wealth Fund Institute (2013). The average of these figures (whatever it actually means, given that different sources measure different things)- is \$4.05tn and we will use it for the size of the industry. For consistency, we will use the updated ESADEgeo online version — hereinafter cited as ESADEgeo (2013) — as the proxy for SWF assets under management.

The aggregate size of SWFs is almost double the whole hedge fund industry (estimated at \$2.13 trillion at June 2012) and four times the volume managed by private equity funds, with estimates varying from \$1 to \$2 trillion². This concentration of power is another source of fear for recipient countries. SWFs are not only sovereign (state-owned) funds but are really big ones. When compared to the hedge fund industry, we note that the ten largest hedge funds jointly managed \$233bn worth assets at the end of 2011 (Financial Times, 2012), while Kuwait Investment Authority — a SWF ranked in the 7th in the industry — manages \$290bn worth of assets on its own. There are over 10,000 hedge funds (Hedge Funds Review, 2012), and just some 70 SWFs. The average hedge fund controls \$213,000 while the average SWF³ manages \$57 bn.

This paper was originally conceived as an investigation to pin down what a SWF is. During our research, it quickly became apparent that SWFs are constantly evolving, making it hard — if not impossible — to come up with an all-embracing definition for a wide variety of SWFs. We initially sought to set clear criteria for determining whether a given institution qualified as a SWF or not. When this proved unrealistic, we changed the scope of our paper. We offer a ‘concentric definition’ of SWFs (hence the reference to onion layers in the paper’s title) to give

² Double counting is an issue. SWFs invest in private equity and hedge funds. It is not easy to net out SWFs’ assets included in those estimates, but an adjustment (%) should be provided.

³ Standard deviation in the SWF industry is high too. The biggest SWF manages more than \$700 billion while the smallest SWF is \$3 million.

a better idea of the nature of SWFs and leave others to argue the toss when it comes to specific cases. We will explore the various elements making up definitions of SWFs and try to identify which layers are at the 'onion's' heart and which ones lie further out (See Figure 1).

Figure 1. Sovereign Wealth Funds: More layers than an onion.



Note: concentric circles begin with "the core" characteristics of SWFs (investment funds and state ownership). This figure includes the 11 features cited by researchers when defining SWF. The closer to "the core" the more the feature has been used to define SWFs.

There are some studies focused on the challenges of defining SWFs. Balding (2008) provides a useful way of thinking and expresses many of the ideas that we present in this paper. The clarity of his argument is all the more remarkable when one considers the early stage of SWF research at the time his working paper was released. The distinction he draws between state-owned enterprises and SWFs is particularly useful. Rozanov (2011) recently reviewed his

original definition of SWFs (Rozanov, 2005) and some other early definitions shaping the notion of SWFs. He focuses on the definition set by the International Working Group on SWFs in 2008 and included, in The Santiago Principles. The rest of his paper explores the interesting corporate governance implications of transparency, non-commercial motives and reciprocity. Our contribution differs from these two previous definitional analyses in two respects. First, we conduct a complete literature review looking for SWF definitions appearing in published papers from different fields such as Finance, International Law, and Economics. Second, we distilled the definitions into eleven commonly-used elements to define SWFs.

Table 1. Main features included in the definition of Sovereign Wealth Fund.

Feature	Description	% Papers
Investment vehicle	Rather than an operating firm	100%
Ownership	Owned by a state entity	100%
International	Its portfolio includes foreign investments	68%
Liabilities	They do not have explicit pension liabilities	58%
Source of funds	Funded via commodity and non-commodity resources	53%
Risk	Invests above the risk-free asset rate*	42%
Long-term	Pursue long-term investment objectives	42%
Purpose	Belong to some of the 4/5 IMF categories of SWFs	37%
Financial objective	Driven by financial maximization purpose	32%
Sovereign authority	It excludes sub-national governments	16%
Independent structure	Managed separately from monetary authorities	16%

Source: Authors' analysis of SWF definitions. *Considering U.S. Treasuries as the risk-free asset benchmark.

The paper is structured as follows. This section 1 gives an introduction to the subject; Section 2 contains a literature review identifying eleven elements included in definitions of SWFs; Section 3 discusses of each of these eleven elements, illustrating points with specific SWFs and the implications in each case; Section 4 concludes.

2. Literature review and summarizing definition

Rozanov (2005) first coined the term 'Sovereign Wealth Fund'. He did not give a formal definition but for the first time it put oil funds and non-commodity Asian funds into the same group. In 2007, the then Director of the IMF's Research Department, said "We don't know too much about these major state-owned players" (Johnson, 2007) and his main concern was that such uncertainties might lead to greater investment protectionism. Some months later, the U.S. Department of Treasury along with other Government agencies tried to "shape an appropriate international policy response to financial market and investment issues raised by sovereign wealth funds" (U.S Treasury, 2007). By then, the IMF had set up an International Working Group of SWFs (IWG) and supported a campaign for a clearer explanation of SWFs' investment strategies, the so-called 'Santiago Principles'. The OECD helped indirectly through its "Freedom of Investment" initiative which aims to "deepen consideration of how governments can maintain their long-standing commitment to open international investment policies — including for SWFs — while also protecting essential security interests." Other institutions such as the European Commission or the World Bank helped in the design of the IWG and The Santiago Principles, too. Yet, it was not clear what a SWF was and several attempts to capture its essence through a definition began.

The U.S. Department of Treasury provided its own definition in 2007. It emphasized the fact that SWFs manage their assets separately from the official reserves in the hands of central banks. That very same year, a researcher from Morgan Stanley — Stephen Jen — offered one of the first systematic definitions of a SWF. He posits that SWFs may include five key features, they: (1) are sovereign entities; (2) have high foreign exposure, (3) have no explicit liabilities, (4) have high risk tolerance; (5) have a long-term investment horizon (Jen, 2007). Subsequent definitions drew on these five characteristics.

Vagueness concerning the nature of SWFs prompted the IMF (2008), a research team led by Blundell-Wignall *et al.* (2008) from the OECD; two ECB researchers (Beck & Fidora, 2008), and the Monitor-Fondazione Eni Enrico Mattei (2009) to formulate a definition facilitating policy implementation and scholarly research. From these four sources, only⁴ the Monitor Group tried to set the boundaries of SWFs and provided a well structured definition. Monitor-FEEM (2009) defined a SWF in terms of the key features differentiating them from other government-owned investment vehicles. Specifically, a SWF must meet the following five criteria: (a) It is owned directly by a sovereign government; (b) It is managed independently of other state financial institutions; (c) It does not have major pension obligations; (d) It invests in a diverse set of financial asset classes in pursuit of commercial returns; (e) It has made a significant proportion of its publicly-reported investments internationally. It added to Jen's notion (2007) of "independent management" considered at the U.S Treasury (2008), and offered a more accurate explanation of 'excluding liabilities'. Moreover, it introduced a 'commercial returns' requirement, which can be considered one of the pillars of The Santiago Principles.

Before the release of The Santiago Principles, Truman (2008) channeled the debate to the issues of 'transparency' and governance. He provided the first set of indicators that may help host countries to identify differences among this investor class. He uses four categories in his blueprint: (1) Structure (i.e. includes objectives or fiscal treatment), (2) governance (i.e. separate roles from the government, ethical rules), (3) accountability and transparency (i.e. in its investment strategy, reporting and audit), (4) behavior (i.e. in using its portfolio and usage of derivatives). Late in the same year, and following the agenda proposed by the IMF, the International Working Group (IWG) of SWFs (established in May, 2008 after a meeting at the

⁴ Blundell-Wignall, Hu, and Yermo (2008) offer a definition, but it is mixed with examples and lacks the systematic approach observed in FEEM-Monitor (2009). Blundell-Wignall *et al.* (2008) definition section omits the fact that SWFs are controlled by governments, despite this key feature is considered in the rest of the paper.

IMF headquarters in Washington with representatives of the IMF, OECD, European Commission, World Bank, the recipient countries and the SWFs themselves) came up with a definition of SWFs. The document *Generally Accepted Principles and Practices (GAPP)* (also called The Santiago Principles) was released in October 2008 and provided the 'official' definition of a SWF. According to The Santiago Principles, SWFs are defined as "special purpose investment funds or arrangements, owned by the general government. Created by the general government for macro-economic 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. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports." Jointly with Monitor-FEEM (2009), The Santiago Principles definition has been adopted by a growing number of researchers (Bertoni & Lugo, 2011; Dyck & Morse, 2011; Castelli & Scacciavillani, 2012).

As noted before, one of the four guiding objectives of The Santiago Principles encourages SWFs to "invest on the basis of economic and financial risk and return-related considerations", the aim being to alleviate fears among recipient countries and to improve the governance of its members. However, there are no compulsory rules for the IWG members. Precisely, the fact that these are soft-rules has eased the inclusion of 27 SWFs from 24 countries. As stated by Victoria Barbary (currently leading one of the main research and data centers on SWFs in London) only 12 of the 35 Santiago Principles (and sub-principles) requires disclosure (Monk, 2010). That is why SWFs rank better under The Santiago Principles than under the stricter Truman scoreboard (Behrendt, 2010).

Balding (2008) and Monk (2008) enriched the discussion on definitions. Balding explained that SWFs are in essence pools of assets, controlled by the government or a government-linked entity, seeking returns above the risk-free rate of return. He provides a useful table with examples distinguishing SWFs and public pension funds (See our try in Table 2). Monk (2008)

emphasizes the absence of outside liabilities (all liabilities are intra-government, i.e. a public agency owes the Ministry of Finance) and identifies the beneficiary (the government or citizens as a whole but not an individual (i.e. a member of a royal family or a Prime Minister)). Surprisingly, these efforts have not been echoed in the literature and there has been a welter of new definitions since then.

We analyzed 30 studies — working and published papers, books and consultancy reports — on SWFs between 2007 and 2012. At least 19 of these provide a concise, systematic definition⁵ and are set out in Annex 1. Tracking these definitions, we identify 11 criteria used by researchers when defining a SWF. These criteria are set out in Table 1, in which we include the percentage of papers using each of them in their definitions.

There are two clear winners: SWFs are investment vehicles and SWFs are in the hands of governments. These two main characteristics are identified as the core of SWFs: all of them invest government-owned assets. Despite this general agreement among researchers on these two criteria, greater effort needs to be made in pinning down what each of these two concepts mean. We still need to clarify what is understood as an ‘investment vehicle’ and by ‘government’ (i.e. when compared to the notion of State or the issue of sub-national entities). Even the notion of ‘state/government ownership’ is challenged by SWFs which have recently issued debt. Should we still consider them as SWFs, even if their investments are to some extent, private? So far, we have briefly presented some of the debates on the core nature of SWFs. Given their importance we will treat these issues first. We identify the regularities and exceptions at the core-level and then we move to the outer layers, following our ‘onion’ metaphor. Only from a stable construct of the core can we then analyze the remaining criteria.

⁵ The rest usually defined it loosely and complete their views with examples, usually about the investment strategies, sources of funds or geographic location.

Table 2. Sovereign Wealth Funds: to be or not to be.

SWFs are...	SWFs are not...	Conflicts
State-owned	Private investors	Some state-owned institutions manage public and private money simultaneously (i.e., Australia's QIC).
Investment funds	Operating companies	SWFs incorporated (Temasek, CIC), funds within central banks (SAMA, SAFE, HKMA).
International portfolio	Domestic funds	Chilean PRF is broadening the scope towards international securities; Bahraini Mumtalakat owns only one foreign company.
Have not explicit pension liabilities	Public pension funds	Australian FF or New Zealand Superannuation Fund serve as a buffer for future pension liabilities. But they do not face pension regular payments.
Determined by the source of funding*	N/A	
Above risk-free rate investors	Stabilization funds	Stabilization funds might evolve into SWFs as they improve in-house capabilities and invest into more complex asset classes.
Long-term investors	Money market instruments	CIC is still under the magnifying glass after lower short-term results.
Have a defined purpose		IMF categories overlap and change over time
Explicit financial objective	Development funds with social, regional, cultural goals	Many African SWFs would prefer a "dual model" where finance and development goals walk hand in hand.
Controlled /owned by a sovereign authority	Sub-national SWFs	Clashes with the U.S. sub-national SWFs and with the Emirates SWFs
Independent structures	Funds within the central bank and reserve-related functions of the Finance Ministry	SAFE, SAMA, and the HKMA-IP are all embedded in monetary authority or central banks structures; however, their investment strategies depart from the typical "conservative" central bank strategies

* This criterium would play a more important role if referred to the mechanisms and rules established to fuel SWFs. Definitions analyzed here do not clarify it.

We have examined publicly-available information (including published research but excluding private — and expensive — dataset collections) to check whether potential SWFs fit these 11 criteria. Normally, we focus on the vision and mission statements, portfolio composition (when available) and their governance structures. Our findings are explained in the following section.

3. Eleven categories for a SWF definition

a) The consensus starting point: SWFs are sovereign-owned investment vehicles

There are few points researchers agree upon when it comes to defining SWFs. One of them is that SWFs are public investors (Rose, 2008). This means at least two things: (a) SWFs are ‘public’ creatures; that is, the owner is a government or government-linked institution; (b) SWFs invest these public funds.

As we have said, even this apparently clear point raises some doubts. There are different ways to define the nature of what we are talking about. These two first concepts define what SWFs are. The remaining criteria will help us understand what they do, where they invest, the source of funding, their specific objectives, and their relationship with other government institutions. The two first concepts lead us to what we called ‘the core’ of the SWF definition. We found several names that seek to capture the essence. We have: “government investment vehicle” (US Treasury, 2007); “public investment agencies” (Beck & Fidora, 2008), “investment fund wholly owned by the government” (Monitor-FEEM, 2009); “finance vehicles owned by states” (Kern, 2007); “special purpose investment funds or arrangements, owned by the general government” (IWG, 2008); “Special purpose public investment funds, or arrangements... owned or controlled by the government” (IMF, 2008); “pools of assets owned and managed directly or indirectly by governments to achieve national objectives” (Blundell-Wignall, 2008); “pool of capital controlled by a government or government-related entity” (Balding, 2008); “special investment fund created/owned by a government” (Beck & Fidora, 2009); “government-owned investment vehicles’ (Kotter & Lel, 2011); “government-owned and controlled (directly or indirectly) investment funds” (Clark, Dixon and Monk, 2013), to name just a few.

Disagreement may arise from two sources. Regarding SWFs’ nature: we have found definitions that speak of ‘pools’ while others refer to ‘investment vehicles’, or ‘arrangements’. This point

reflects doubt about the legal nature of SWFs, which may vary depending on varying regulatory frameworks. Funds and pools may have different legal status. Funds may refer to a structured way of gathering pools of assets. Usually, neither funds nor pools are subjects of rights and obligations given that they have no legal personality. The investment/asset managers are the legal entities backing these pools/funds. Moreover, some SWFs claim they are an “investment management organization” (GIC), “investment company” (Temasek), “investment manager” (CIC), “a world class investor” (QIA). Hence, the legal constituents of SWFs will require further research as they have an impact on their organizational structures and may then affect how SWFs invest.

Another source of disagreement — the ‘public ownership’ aspect — may also need further refinement. Definitions state that SWFs are owned, controlled, or created by a government, however each term implies different issues. Some definitions (Monitor-FEEM, 2009) require that SWFs to be wholly-owned by the government, while others do not specify a given level of ownership — opening the door to public-private investment funds qualifying as SWFs. In general, we should say that it is important to note both features: ownership and control. Otherwise, the range of state-owned institutions that are controlled, at least in part, by private institutions that would qualify as SWFs would be huge. How much of this control is exercised by governments will be discussed in the following sections. This public feature will allow us to draw a clear dividing line between hedge or mutual funds and SWFs. However, as we have seen, there is scope for mixed-nature funds. Should we weed out SWFs that include some element of private funds in their capital?

As a corollary, one should mention the ‘pools’ of assets SWFs manage. These pools commonly arise from two sources: commodities and foreign exchange reserves⁶. The former, reflects the fact that natural resources ‘belong to the state’. Such pools may arise from revenues from

⁶ As explained before, these two big groups do not capture some other particular forms of funding: SOEs profits or debt issuance.

state companies exploiting these resources or from taxes and/or royalties paid by multinational enterprises (both local and foreign) engaged in this activity. Another group of SWFs receives its funds from foreign exchange reserves. Central banks 'separate' some of their foreign exchange reserves and allow these investment funds to manage them. How this 'separation' is achieved in practice remains unclear. Thus one also needs to clarify whether their accountancy differs from that used by the central bank. The IMF is working on these accountancy issues.

Another consequence of the previous explanation is that defining SWFs as investment funds may exclude from our classification those state-owned enterprises whose main objective is not investment. Monitor-FEEM (2009) notes that SWFs are more like an investment fund rather than an operating company. Yet how should we treat each of these two entities? Some potential SWFs, such as Samruk-Kazyna and Sonangol, act as holding companies and have an investment arm. Should we include them as SWFs? They are both state-owned organizations that invest in their own countries. With a clearer distinction between these two concepts — investment fund and operating company — we will be able to better identify the nature of SWFs. Kazakhstani Samruk-Kazyna controls \$78bn in assets, or nearly 55% of Kazakhstan's GDP in 2010. Its holdings include interests in mining, finance, energy, transportation, property and construction. The same argument holds for Sonangol. This public holding company from Angola has been able to operate as a SWF. It has domestic and foreign investments. It has stakes in the African Investment Bank, Millennium BPC (15%), Banco Caixa Geral Totta Angola (25%), and the Atlantic Private Bank. Last year, Angola established a 'pure' SWF managing \$5bn⁷, the Fundo Soberano de Angola (FSDEA).

⁷ The assets that make up its portfolio include: global private and public stocks; bonds; foreign currencies; financial derivatives; commodities; treasury bills; real estate and infrastructure funds.

We tend to include in the SWF category those investment funds arising from stakes in SOEs in the group. This is the case of the Singaporean Temasek (\$198bn) and the Malaysian Khazanah Nasional Bhd (\$28bn).

b) SWFs are not national funds

There is general agreement on the international character of SWFs. It is easy to find governments in many countries around the globe that own funds or agencies that promote co-investments in their territories. Should we consider each of these national (and often regional) funds, as SWFs? Widening the definition in this way may lead to serious confusion over SWFs' nature. For example, consider the JEREMIE fund in Andalusia (€235m) funded from the regional government and the European Regional Development Fund. JEREMIE invests through convertible loans but also through equity in Andalusian companies. These funds are managed by governments at both regional and national levels and do not have explicit pension liabilities. One way of excluding them from the SWF category is to rule them out because they do not invest in international assets.

This international focus is supported by over 70% of the definitions analyzed. They require SWFs to hold foreign investments. Again, the issue of 'degree' will need detailed examination. For example, Mumtalakat's analysis of their portfolio reveals that its only foreign investment is in Britain's McLaren Supercars (it owns 50%). Is this sole foreign investment enough to label Mumtalakat as a SWF? What percentage of a portfolio has to be invested internationally to make a national SWF into a 'pure' SWF? It is not only a matter of degree. We should also consider these issues from a dynamic perspective: Temasek was a pure domestic fund which turned into a renowned international (mostly regional) investor (Rozanov, 2011). Thus, it remains hard to differentiate between national SWFs with the potential for becoming international SWFs on the one hand, and public funds with a permanent local, regional, or national investment focus on the other. By ruling out 100% national SWFs, one would have to

exclude funds such as the Investment Corporation of Dubai (\$70bn), the French Strategic Investment Fund (\$26bn) and the Italian Strategic Fund (\$4bn). All of them invest mainly in national assets and serve a variety of goals: supporting national champions, company development and international expansion.

c) Stabilization purpose: Investing in 'risk-free' assets

Stabilization funds are the SWFs predecessors (Balding, 2012). In this broad category we include those funds set up to stabilize fiscal balances and those created to 'control' the exchange rate. However, both fiscal and currency stabilization funds were constrained by liquidity needs. They invest primarily in liquid assets such as debt securities or deposits that will allow them to intervene fast. However, as explained in 57% of the analyzed definitions, SWFs are characterized by their risky investments. We want to separate SWFs from pure stabilization-oriented funds. Some of them are managing large amounts of money but they focus exclusively on stabilizing their economies using strategies based on fixed-income assets (usually, U.S Treasury Bonds). Ruling out pure stabilization funds removes the likes of the Russian Reserve Fund (\$84.8bn), Algeria's Revenue Regulation Fund (\$60bn), the Chilean Economic and Social Stabilization Fund (\$15bn), Congo's Stabilization Fund and the Mexican Oil Revenues Stabilization Funds (both managing \$2bn apiece).

Even so, debate still rages on the boundaries that will allow a government fund to qualify as a SWF. Just how large should risky assets be within their portfolios to qualify? Is it sufficient that they invest in just one risky asset to qualify within this group? More interestingly, how can we capture the fact that SWFs change and evolve over time? Do they have to follow an active management strategy? Chilean PRF (\$5.9bn) has recently opted for a passive investment strategy in both global corporate bonds (20% through Barclays Capital Global Aggregate: Corporate Bond Index) and equity (15% via MSCI All Country World Index). Does this strategy

make it a SWF? Thus, the 'level or percentage' of risky assets within SWF portfolios remains a major issue in seeking an appropriate definition.

The notion of 'risk-free assets' has taken a big knock given 'the fiscal cliff' in the U.S. and the EU's recurrent sovereign debt crises. Even so, we still consider some investments to be risk-free (Gourinchas & Jeanne, 2012). A simple way to resolve the debate may be to require SWFs to invest over a certain percentage of their portfolios in corporate bonds, equities or alternative investments (real estate, funds of funds, infrastructure, commodities, etc.). The IFSWF does not require its members to do so. It comes as no surprise given that its members include the Chilean ESSF, Iran's Oil Stabilization Fund and the Russian Reserve Fund, all of them, solely investing in sovereign bonds. Although Clark *et al.* (2013) do not include this dimension in their definition, we can read in their work that "a new investment vehicle was (...) needed to facilitate the diversification of accumulated reserves into higher yielding assets (...). The idea was that by investing sovereign wealth in riskier assets, and generating higher returns, government sponsors could contain the costs of holding such reserves" (Clark *et al.*, 2013: 3-4).

d) Liabilities: An old consensus with new characteristics

The literature evidences a major effort to draw a distinction between SWFs and public pension funds. To be eligible as a SWF requires the absence of 'explicit current pension liabilities'. Unlike public pension funds, SWFs do not deal with a stream of current pension obligations. However, the absence of current pension liabilities does not exclude SWFs from meeting future pension contingencies (falling under what the IMF in 2008 termed 'contingent pension reserve funds'). This is the case of the Australian Future Fund and the New Zealand Superannuation Fund⁸. Of course, we should rule out public funds with explicit pension liabilities. Thus, we do not include the likes of the Japanese Government Pension Investment

⁸ This criterion is not applicable to the Government Pension Fund – Global. On its website, the Norwegian SWF notes that: "Despite its name, the fund has no formal pension liabilities. No political decision has been made as to when the fund may be used to cover future pension costs."

Fund (\$1.5tn), the Netherlands' Stichting Pensioenfonds ABP (\$352bn), and the North-American CalPERS (\$243bn). Their investment policies and asset allocation strategy are influenced by their periodically-occurring explicit liabilities.

Traditional definitions of SWFs emphasized the absence of any kind of liabilities. This is no longer the case. A new wave of leveraged investment strategies and the fact that one of the biggest SWFs (China Investment Corporation) was established through a bond issue call for new ways to understand these aspects. This leads us to another question raised by Ashby Monk, researcher at Stanford University, in one of his daily posts⁹: If a sovereign wealth fund is financed by something other than sovereign wealth, should we still think of it as a sovereign wealth fund?

The answer is not simple. So far, the literature suggests that SWFs, as public investors, are only financed from the current account surpluses of their sponsoring states. Other authors (Monk, 2008) delved deeper. Monk distinguishes between external and intra-governmental liabilities. He explains that SWF liabilities are "typically intra-governmental where one arm of the government owes another arm of the government money (i.e., the SWF might owe the ministry of finance, the central bank or even the social security reserve fund money). However, SWFs have no external creditor, which means the assets are not encumbered by the property rights of outside, non-governmental owners. In short, SWF liabilities (if they have any) should be part of the broader national balance sheet" (Monk, 2008).

Yet, in recent years, the increasing role played by private capital financing SWFs' transactions is challenging these views of SWFs. The intentions of the two Singaporean SWFs, Temasek and Government of Singapore Investment Corporation (GIC), to attract private capital from the IPO of the Seatown venture and GIC Real Estate, respectively, are evident. Given this new scheme, the question is: Does the presence of private funding change the nature of SWFs? This shift in

⁹ See <http://oxfordswfproject.com/author/ashbymonk/page/55/>

the financing of SWFs has two main effects: the emergence of non-governmental creditors and the pressure for short-term investment strategies (we will examine the latter in following discussion section). The presence of both non-governmental creditors and short-term strategies within SWFs is a revolution in the sector, as they affect the performance of the funds as we know them today (Monk, 2010). What reasons have led SWFs to seek private funding sources? According to Monk, there are five reasons: (1) The lack of SWF liquidity as a result of the financial crisis; (2) Good credit ratings of SWFs linked to the search for higher returns, (3) Greater harmony between the strategies of private investors and funds (increasingly short-term), (4) The need to justify the losses suffered during the crisis; (5) The SWFs as domestic demand for private investment.

One should clarify that in most cases debt is issued by those SWFs established as company-like structures. That debt typically supports operating companies rather than leverage returns; anyway, private creditors would affect SWFs strategies to some extent.

As noted by Schena and Chaturvedi (2011), Temasek and Khazanah issued debt recently. They have raised capital in an innovative fashion. However, these bond issues imply greater public scrutiny. Now, they are not only reporting to their sponsoring state but also to their creditors. Their 'new' private creditors will require more detailed disclosure. It is worth noting — as the authors did — that these SWF issuance documents are longer than the SWFs annual reports. Thus, 'private liabilities' seem to enhance their international accountability beyond their sponsoring government structures and would lead to more transparent funds (Gelpern, 2011 refer to this "private accountability").

e) Long-term strategy

SWFs are typically included in the broad group of long-term investors. However, several recent events are challenging this assumed role. For instance, Beijing's government put CIC under stricter scrutiny after its failed investment in Morgan Stanley. Public criticism from government

and media lead to more pressure for short-term performance. Managers at CIC had to demonstrate their investment prowess and they shifted (at least temporarily) from their ‘long-term stewardship,’ to the quest for better returns. To some degree, government shareholders have proven to be as impatient as their private sector counterparts (Monk, 2011).

There was an interest in identifying SWFs as being the longest-term investors in the world. The ‘absence’ of explicit liabilities, a peculiar source of financing and unusual governance structures (they report only to their sponsoring-government) all favor a long-term investment horizon. In fact, some initiatives have tried to link infrastructure funding needs (in emerging markets, and specifically Africa) to SWFs. However, long-term investments require major efforts in: (1) providing human resources; (2) measuring performance; (3) maintaining legitimacy. First, long-term investment strategies require outstanding staff to provide the right mix of experience and expert knowledge. These resources are scarce and thus costly. Second, departing from common performance benchmarks implies developing new data-intensive and time-demanding measurement systems — which in turn generate more costs. Third, long-term investments open the door to turning SWFs into non-commercial strategic investors and thus to a loss of legitimacy as institutional investors. SWFs face a trade-off: either follow a standard financial profile and fail to achieve long-term aims or transform into strategic investors and lose legitimacy as global investors (Clark *et al.*, 2013).

f) Source of funds and sub-national SWFs

Source of funds

Slightly over half of the definitions take into account the source of funds. They typically divide their sources of funding between commodity and non-commodity. Most of the early definitions (2007 and 2008) include a reference to their funding source. This information better described what SWFs are. However, as SWFs disclosed more and explained their funding sources in their annual reports, scholars tended to exclude SWFs’ funding sources

from the definition. Most commodity-SWFs are oil or gas-related but there are also funds based on copper or diamonds. Non-commodity SWFs are typically funded through foreign exchange reserves; others used debt or state-owned enterprises' revenues¹⁰. As noted earlier, both groups are increasingly accessing private funding. Moreover, recent events have opened the door to leverage-based SWFs. The CIC was initially capitalized in 2007 with \$200bn in foreign-exchange reserves purchased from the Central Bank of the People's Republic of China with the proceeds of a government bond issued by the Ministry of Finance. Technically, CIC does not satisfy any definition treating SWFs as liability-free funds. On the other hand, it falls within the Clark *et al.* (2013) definition, as its liabilities are simply intra-government liabilities.

Sub-national SWFs

Sub-national funds remain an interesting topic even though it has only been addressed by a few. The Balance of Payments and International Investment Position Manual (IMF, 2007), ECB economists (Beck & Fidora, 2008) and Monitor-FEEM (2009) refer in their definitions to central government as the SWF owner and thus exclude sub-national SWFs from the club. Only Monitor-FEEM (2009) gives reasons for doing so. It makes an exception of those in the United Arab Emirates. It considers that emirates such as Abu Dhabi, Dubai or Ras Al Khaimah enjoy decision-making powers comparable to a sovereign state. By contrast, it considered that sub-national SWFs from the U.S. lack that level of authority and therefore excluded all the US state funds based in Alaska (\$45.4bn), New Mexico (\$16.2bn), Wyoming (\$5.6bn), Alabama (\$2.2bn), and a newly-established one in North Dakota (\$0.3bn). The solution to this particular issue will also affect the sub-national SWF set up in Alberta (Canada). This strict requirement has two outcomes. On the one hand, it helps to simplify the separation of SWFs and any other sub-national funds investing locally. On the other hand, there is still scope to enlarge on what sovereign authority means (i.e., how this 'sovereignty' affects the way SWFs invest and the

¹⁰ The Agaciro Development Fund (also known as the Diaspora Fund) represents a new funding source category. It is funded via private donations made by Rwandans abroad. It is not without controversy.

nature of the differences between a national and a sub-national fund) — something that goes beyond the scope of our study but which opens the door to further research.

g) Purpose and financial objectives

Purpose

From the outset, there has been an interest in classifying SWFs according to different criteria. Here, we consider various categories based on a SWF's stated purpose and its financial objectives. The IMF has made an effort to identify which categories best fit the various policies pursued by SWFs. It initially identified five (IMF, 2008): (1) stabilization funds; (2) savings funds; (3) reserve investment corporations; (4) development funds; (5) contingent pension reserve funds. That list was pared down to four categories (Hammer, Kunzel & Petrova, 2011): (1) macro stabilization; (2) savings; (3) reserve investment; (4) pension reserve. The IMF warns that these objectives may change and overlap over time. Precisely because of this dynamism, other authors exclude their purposes from the definition. As one can see, the 'development' feature (announced by Santiso, 2008) of SWFs disappears in the second set of categories established by the IMF, even though funds such as Mumtalakat from Bahrain, State Capital Investment Corporation from Vietnam, or Emirati Mubadala were set up to diversify their respective national economies, usually developing non-oil or non-gas related sectors. Given the efforts made by the IMF to encourage SWFs to clearly disclose their mission and purpose and to restrict their investments to those driven by economic and financial objectives, it is not surprising that the IMF, over time has excluded the 'development' purpose as a SWF category. Development strategies usually imply something else. As shown by Dyck and Morse (2011), SWFs portfolios are better understood when we consider state-planning motives beyond mere financial considerations. Thus, Schena (2013) shows how SWFs secure energy projects at home through strategic private equity transactions abroad. One may consider the establishment of a new category labeled as "economic purposes" including all SWFs whose strategies are aligned with national long-term development plans, i.e. Qatar or Abu Dhabi.

Other authors (Clark *et al.*, 2013) have offered more innovative classifications. Drawing on institutional theory and sociology, they propose a stylized typology focusing on the long-term significance of SWFs. It includes five categories: (1) post-colonialist; (2) rentier; (3) productivist (4) territorialist; (5) moralist. Overall, these classifications are a useful tool for describing SWFs but given the dynamism that characterizes these funds, it might be better to avoid static definitions.

Financial objectives

Some definitions (32%) explicitly include SWFs' financial objectives. As just explained, these definitions (from the IMF or the IFSWF) tried to allay the fears of countries on the receiving end of SWF investment. Surprisingly, these definitions include financial objectives but some of them do not exclude other motives. The IFSWF through its sub-principle 19.1 states that "some SWFs may address social, environmental, or other factors in their investment policy. If so, these reasons and factors should be publicly disclosed." However, it is not clear what 'other factors' may drive SWF investments, hence the suspicion with which investment-receiving countries view other nations' SWFs.

h) SWFs separately managed from central bank and monetary authorities: The one trillion issue

Now we move to what we have called the 'one trillion issue.' That is, the decision to include or exclude from the SWF club, three funds forming part of central banks. IMF (2007), U.S. Department of the Treasury (2007) and Monitor-FEEM (2009), by definition, remove from the SWF club any candidate managing its assets within the organizational structure of either a central bank or ministry of finance. This implies the direct exclusion of the Chinese SAFE¹¹ (\$589.5bn), Hong Kong Monetary Authority - Exchange Fund¹² (\$358bn) and the Saudi Arabian

¹¹ Note that there are not official figures about SAFE (as SWF) and estimates vary from \$300bn (Sovereign Wealth Center) to \$590bn (Preqin).

¹² At December 31, 2012, the Exchange Fund managed HK\$2.78bn. See <http://goo.gl/T3PzK>

SAMA¹³ Foreign Holdings (\$661.7bn), from the SWF club. Between them, these three funds manage \$1.7 trillion — over 25% of SWF AUM.

These three SWFs operate within the bounds of their parent institutions. They do not qualify as independent organizations but they can be seen as different entities because their investment strategies differ from conventional central bank risk-hedging (Bodie & Brière, 2011), which typically focuses on short-term fixed-income assets. SAMA and HKMA-EF, give a breakdown of their portfolios on their web sites. SAMA has assets of \$661.7bn of which \$444.7bn¹⁴ are invested in risky assets.¹⁵ HKMA-EF, which primarily invests in bond and equity markets in OECD and emerging countries, owns assets worth \$358bn, of which \$27.2bn¹⁶ are invested in risky assets in its Long-Term Growth Portfolio (LTGP). The organizational structure of both SAMA and HKMA¹⁷ does not reveal the entity as a SWF but their investment strategies qualify them as non-central banks entities and make them pretty similar to any other SWF.

Meanwhile, by some accounts SAFE's investment portfolio (as distinct from its reserves portfolio) is some of the world's largest SWF. SAFE reports directly to the People's Republic of China Central Bank, while its 'younger cousin' (China Investment Corporation) reports to the State Council. The Chinese government is probably interested in keeping SAFE foreign investment portfolios alive to enhance competitiveness between its two sovereign investment units (CIC manages over \$480bn). SAFE is some of the most opaque SWF in the World. However, SAFE invests through its Hong-Kong subsidiary (SAFE Investment) internationally.

¹³ In late October 2011 SAMA had about 70% of their portfolio in foreign assets. See <http://goo.gl/IgR9a>

¹⁴ Quarterly Statistical Bulletin (Fourth Quarter 2012) published by SAMA on 30/01/2013.

¹⁵ Monitor-FEEM (2009) argued that SAMA investments abroad are "low-risk." The fact is that behind the foreign securities label used by SAMA we found debt (usually bonds), equity or even derivatives, thus qualifying as risk or high-risk securities.

¹⁶ Long-Term Growth Portfolio positions at the end of 2012 were as follow: Emerging market bonds and equities (\$5.3bn); RMB assets, including bonds and equities (\$6bn); Private equity (\$6bn); Real Estate (\$1.7bn); Outstanding investment commitments at the end of 2012 (\$8.2bn).

¹⁷ HKMA-EF has its own governance structures, different from its parent HKMA, despite it is not public available information.

The Economist (2011) states that it had, at least, \$22bn invested in the FTSE 100. It is not easy to find other central bank or monetary authority elsewhere (and even SWFs¹⁸) investing over \$20bn in foreign equities.

In line with the Monitor-FEEM criterion for excluding SAMA, HKMA-EF and SAFE, we would not consider the Pula Fund (\$6.9bn) from Botswana or the Investment Unit from Indonesia (\$0.3bn) to be SWFs. Their management is part of their respective central banks or finance ministries. IWG (2008) is vague on the issue. The Santiago definition states that “foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes” should not be considered. Those applying The Santiago Principles would probably agree that investment pools like the ones maintained by SAFE or by the HKMA-EF do not follow the ‘traditional’ approach taken by foreign currency reserve managers. However neither SAFE nor SAMA nor HKMA belong to the IFSWF. Who knows whether they will join in the future?

It seems that huge central banks or monetary authorities are actually separating a portion of their large pools of assets (normally foreign-exchange reserves) into ‘internal’ special units taking higher risks. These ‘internal special units’ are not invested in safe and liquid instruments ready to attend budgetary or currency management needs. They are seeking higher returns by investing in a broader set of assets that include corporate bonds, equities, and derivatives. We acknowledge that there is still a need for better descriptions of the institutional framework in which SWFs operate. We should advance our knowledge of how central banks, SWFs, foreign-exchange pools and governments interact in each case.

To sum up, there is still a need to refine our views on the most appropriate institutional structure for SWFs. Das *et al.* (2009) addressed these issues clearly. For them, SWFs can be established as either separate entities or within central banks or ministries of finance. Where

¹⁸ First, only 38% of the SWFs manage more than \$20bn. And secondly, central banks reserve managers typically invest in liquid and government fixed income assets.

SWFs are established as separate units, this should facilitate independence. The second alternative may cut costs and thus be more appropriate for small SWFs. In either case, corporate governance structures are the key to success. Clear rules and processes on reporting, auditing, and operating should be established. Proper governance is a necessary condition for success, and should be carefully strengthened regardless of the institutional structure.

4. Conclusion

We have analyzed over thirty definitions of a single concept: Sovereign Wealth Funds. We continued early efforts to clarify the definition of SWF. Our results show that scholars and practitioners agree on just two features: SWFs are state-owned and they are investment units. A third feature (argued by 68% of our sample) — which better characterizes SWFs — is that their foreign investments make up a sizeable chunk of their total holdings. Scholars have yet to agree on the minimum required percentage. The source of funding (53%) remains one of the main characteristics. However, we forecast it will become of less interest as funding sources become more heterogeneous. Two other features share the same support (42%): SWF invest in securities yielding high-return assets (above the risk-free rate) and pursue long-term strategies. Other characteristics include policy purposes, financial objectives, sub-national considerations and separation from the central bank or ministry of finance.

We began this project to come up with a working definition of SWFs with a view to fostering research in the field. After reviewing the definitions, we realized a different strategy was called for. SWFs are living entities. Today's wholly domestic funds can swiftly mutate into tomorrow's international investors. Some funds are starting to acquire leverage for investments so should we treat them as if they were fundamentally different? They can enter into riskier activities, they can change their policy purposes or even their funding source but they will always be

Sovereign Investors. Three other characteristics should probably be added if we want to differentiate these particular actors from other well-known state-owned investment agencies. First, the fact that SWFs hold foreign assets allows us to exclude purely domestic funds and many sub-national funds. Second, the absence of current pension liabilities distinguishes these sovereign funds from public pension funds. Third, SWFs act in risky investment scenarios. This will help us to distinguish between SWFs and mere stabilization funds whose concerns are limited to liquidity and currency volatility.

The core of our onion is clear: SWFs are state-owned investment funds. From there one can create one's own definition, adding as many layers as needed. The first three layers — portfolios with risky securities, non-pension and limited liabilities, foreign holdings — help to distinguish SWFs from stabilization funds, public pension funds and pure domestic funds (respectively). The outer layers can be more easily discussed separately and used if and where needed.

In the end, a SWF definition remains obscure, complex and to some extent elusive. The dynamic nature of SWFs, morphing institutions in a continuous evolution led us to conclude that there is no definition capturing the essence of these new instruments of state intervention. One may ask why should we focus on the definition and categorization, rather it seems we should learn how these new concentric concepts move from layer to another in the real world and how these moves affect global finance, international investment and national development.

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Annex. SWFs' definitions.

ROZANOV (2005)

A different type of public-sector player has started to register on the radar screen- we shall refer to them as sovereign wealth managers (...) Sovereign wealth funds are a by-product of national budget surpluses, accumulated over the years due to favorable macroeconomic, trade and fiscal positions, coupled with long-term budget planning and spending restraint. (...) These are neither traditional public-pension funds nor reserve assets supporting national currencies.

U.S. DEPARTMENT OF THE TREASURY (2007)

A government investment vehicle which is funded by foreign exchange assets, and which manages those assets separately from the official reserves of the monetary authorities (the Central Bank and reserve-related functions of the Finance Ministry)

IMF-GLOBAL FINANCIAL STABILITY REPORT (2007)

“SWFs can generally be defined as special investment funds created or owned by governments to hold foreign assets for long-term purposes”

IMF-BALANCE OF PAYMENTS MANUAL (2007)

Some governments create special purpose government funds, usually called sovereign wealth funds (SWFs). Created and owned 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. The funds are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.

STEPHEN JEN (2007)

To me, a SWF needs to have five ingredients: 1. Sovereign; 2. High foreign currency exposure; 3. No explicit liabilities; 4. High risk tolerance; 5. Long investment horizon.

There are close cousins of SWFs. Official reserves are related to SWFs, as are sovereign pension funds (SPFs). These three categories of public funds have different characteristics, but are not necessarily mutually exclusive. Rather than providing a more precise definition of SWFs, I believe that it would be more accurate to describe what these funds are in a diagram. Official foreign reserves are, by definition, 100% in foreign currencies. They have no liabilities explicitly attached to them, though, indirectly, they are financed by domestic government bonds used to finance the foreign exchange interventions in the first place. In my definition, SWFs don't need to be 100% in foreign currencies, but should be mostly in foreign currency terms. For example, Singapore's Temasek Holdings, Malaysia's Khazanah Nasional

BHD and Canada's Fond des generations (Quebec) are not 100% held in foreign currency assets, but we still consider them SWFs, as they have high exposure to foreign currencies.

STEFFEN KERN (2007)

Sovereign wealth funds – or state investment funds – are financial vehicles owned by states which hold, manage or administer public funds and invest them in a wider range of assets of various kinds. Their funds are mainly derived from excess liquidity in the public sector stemming from government fiscal surpluses or from official reserves at central banks. SWFs can be categorised into two types of funds according to their primary purpose. On the one hand, so-called stabilisation funds aim to even out the budgetary and fiscal policies of a country by separating them from short-term budgetary or reserve developments which may be caused by price changes in the underlying markets, i.e. in oil or minerals, but also in foreign exchange conditions. On the other hand, savings or intergenerational funds create a store of wealth for future generations by using the assets they are allocated to spread the returns on a country's natural resources across generations in an equitable manner.

Even though similar in their purpose and investment behaviour to other forms of funds – such as pension funds, investment funds and trusts, hedge or private-equity funds – SWFs essentially differ from the former as they are not privately owned, raising important questions in terms of financial market policy and corporate governance. State-owned funds represent just way of holding financial and corporate assets from a state's perspective. Alternatively, states can invest directly in financial assets, especially stocks, and act as passive or active minority or majority stakeholders. Similarly, state entities can hold assets on behalf of the state. These entities primarily include central banks, holding official reserves. Further, states can be indirect owners of financial assets via existing state-owned companies which in turn take stakes in private companies. Finally, states can take informal influence on private corporations, e.g. by influencing corporate decisions or management selection of private companies. These are important channels of state influence on the private sector that in many cases today are more significant inroads than SWFs.

SOVEREIGN WEALTH FUND INSTITUTE (2008)

A Sovereign Wealth Fund (SWF) is a state-owned investment fund or entity that is commonly established from balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, governmental transfer payments, fiscal surpluses, and/or receipts resulting from resource exports. The definition of sovereign wealth fund exclude, among other things, foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, state-owned enterprises (SOEs) in the traditional sense, government-employee pension funds (funded by employee/employer contributions), or assets managed for the benefit of individuals.

BECK AND FIDORA (2008)

Sovereign wealth funds (SWFs), broadly defined as public investment agencies which manage part of the (foreign) assets of national states, have recently attracted considerable public attention. Three elements can be identified that are common to such funds: First, SWFs are state-owned. Second, SWFs have no or only very limited explicit liabilities and, third, SWFs are managed separately from official foreign exchange reserves.

SANTIAGO PRINCIPLES - INTERNATIONAL WORKING GROUP (2008)

SWFs are defined 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. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.

This definition excludes, *inter alia*, foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, operations of state-owned enterprises in the traditional sense, government-employee pension funds, or assets managed for the benefit of individuals.

Three key elements:

1. **Ownership:** SWFs are owned by the general government, which includes both central government and subnational governments.
2. **Investments:** The investment strategies include investments in foreign financial assets, so it excludes those funds that solely invest in domestic assets.
3. **Purposes and Objectives:** Established by the general government for macroeconomic purposes, SWFs are created to invest government funds to achieve financial objectives, and (may) have liabilities that are only broadly defined, thus allowing SWFs to employ a wide range of investment strategies with a medium- to long-term timescale. SWFs are created to serve a different objective than, for example, reserve portfolios held only for traditional balance of payments purposes. While SWFs may include reserve assets, the intention is not to regard all reserve assets as SWFs.

Furthermore, the reference in the definition that SWFs are “commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports” reflects both the traditional background to the creation of SWFs—the revenues received from mineral wealth—and the more recent approach of transferring “excess reserves.”

AIZENMAN AND GLICK (2008)

Sovereign wealth funds (SWFs) are saving funds controlled by sovereign governments that hold and manage foreign assets.

SWFs are fundamentally different from monetary authorities holding official foreign reserves, where liquidity and security issues necessitate a short investment horizon and low risk tolerance. Central banks generally invest their foreign exchange reserves conservatively in safe and marketable instruments that are readily available to monetary authorities to meet balance of payments needs. In contrast, SWFs typically seek to diversify foreign exchange assets and earn a higher return by investing in a broader range of asset classes, including longer-term government bonds, agency and asset-backed securities, corporate bonds, equities, commodities, real estate, derivatives, and foreign direct investment.

SWFs typically make little use of leverage, in contrast to hedge funds and private equity funds which generally engage in highly leveraged transactions. SWFs also differ from large institutional private investors such as mutual and insurance funds, in that although they hold assets, they generally have no specific liabilities to be paid to shareholders or policyholders. SWFs similarly differ from sovereign pension funds (SPFs) in that the latter, while government-owned, have explicit liabilities, such as worker pensions.

CARUANA AND ALLEN (2008)

SWFs are special purpose public investment funds, or arrangements. These funds are owned or controlled by the government and hold, manage, or administer assets primarily for medium- to long-term macroeconomic and financial objectives. *The funds are commonly established out of official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports. These funds employ a set of investment strategies which include investments in foreign financial assets.

*SWFs are a heterogeneous group and may serve various purposes. Five types of SWFs can be distinguished based on their main objective:

(i) stabilization funds, where the primary objective is to insulate the budget and the economy against commodity (usually oil) price swings;

(ii) savings funds for future generations, which aim to convert nonrenewable assets into a more diversified portfolio of assets and mitigate the effects of Dutch disease;

(iii) reserve investment corporations, whose assets are often still counted as reserve assets, and are established to increase the return on reserves;

(iv) development funds, which typically help fund socio-economic projects or promote industrial policies that might raise a country's potential output growth; and

(v) contingent pension reserve funds, which provide (from sources other than individual pension contributions) for contingent unspecified pension liabilities on the government's balance sheet.

These objectives may be multiple, overlapping, or changing over time. For example, in some countries (e.g., Botswana, Russia) stabilization funds have evolved into funds with a savings objective, as accumulated reserves increasingly exceeded the amounts needed for short-term fiscal stabilization. The various objectives of SWFs imply different investment horizons and risk/return trade-offs which have led to different approaches in managing these funds. SWFs with a stabilization objective would put more emphasis on liquidity and have a shorter-term investment horizon than SWFs with a saving objective, where liquidity needs are low.

BLUNDELL-WIGNALL (2008)

A SWF is a fund set up to diversify and improve the return on foreign exchange reserves or commodity (typically oil) revenue, and sometimes to shield the domestic economy from (cycle inducing) fluctuations in commodity prices. As such most invest in foreign assets. This group (in order of size) includes the Abu Dhabi Investment Authority (ADIA), the Norway Government

Pension fund – Global, the Government of Singapore Investment Corporation (GIC), the Kuwait Investment Authority (KIA), the Saudi Arabian Monetary Authority (SAMA), the China Investment Corporation (CIC), the Stabilisation Fund of the Russian Federation, Temasek Holdings (Singapore), The Reserve Fund of Libya, the Revenue Regulation Fund of Algeria, the Qatar Investment Authority (QIA), and many more. Where national resource funds are earmarked for particular regions, such as Canada’s Alberta Heritage Savings Trust Fund, and the USA Alaska Permanent Fund, they are included as a SWF. Some of the above funds are set up to meet industrial objectives, such as regional development, as in Temasek.

Sovereign Wealth Funds (SWFs) are pools of assets owned and managed directly or indirectly by governments to achieve national objectives. They may be funded by: (i) foreign exchange reserves; (ii) the sale of scarce resources such as oil; or (iii) from general tax and other revenue. There are a number of potential objectives of SWFs, which are not always easy to attribute to a particular fund; and some funds may have more than one of the distinguishable objectives. Some of these are: (i) to diversify assets; (ii) to get a better return on reserves; (iii) to provide for pensions in the future; (iv) to provide for future generations when natural resources run out; (v) price stabilisation schemes; (vi) to promote industrialisation; and (vii) to promote strategic and political objectives.

BALDING (2008)

A sovereign wealth fund is a pool of capital controlled by a government or government related entity that invests in assets seeking returns above the risk free rate of return.

MONITOR-Fondazione Eni Enrico Mattei (2009):

A sovereign wealth fund is an investment fund that meets five criteria: 1. It is owned directly by a sovereign government; 2. It is managed independently of other state financial institutions; 3. It does not have predominant explicit pension obligations; 4. It invests in a diverse set of financial asset classes in pursuit of commercial returns; 5. It has made a significant proportion of its publicly-reported investments internationally.

We made an exception to the first criteria for funds based in Abu Dhabi, Dubai and Ras Al Khaimah because we believe that the emirates within the UAE federation possess decision rights comparable to those of a sovereign authority. We do not believe that sub-national governments in North America possess these decision rights. Norway’s Government Pension Fund — Global, however, is not an exception to the fourth criteria despite its name. The Fund is a continuation of the former Petroleum Fund, which was established in 1990. “In spite of the name change, the Fund is more similar to an endowment than to a pension fund”, stated Norges Bank Governor Svein Gjedrem in June 2008. The Fund is a long-term savings instrument to help “cope with future financial commitments linked to an aging population,” and has no current explicit pension liability streams.

We have included two UAE funds — the Mubadala Development Company and the RAK Investment Authority — that appear to contravene the fifth criteria because they are stated to primarily invest in the development and diversification of their home economies. However, both funds have been active abroad. Before 2008, only a third of Mubadala’s publicly-reported equity and real estate investments and joint ventures were at home, 44 percent were in the OECD, and the remaining quarter were in non-domestic emerging markets. The RAK Investment Authority (RAKIA), despite its principal domestic focus, has extensive interests in Georgia and India, reflecting a strategy to fortify its portfolio of global investments. In the

current economic climate, however, this has taken a back seat to developing its home economy. Nevertheless, its international investments and willingness to invest abroad warrant RAKIA being considered as a SWF.

Our criteria enabled us to filter out several funds that are commonly included on lists of sovereign wealth funds. Dubai International Capital is a notable exclusion because it ultimately is based on the personal wealth of the ruler of Dubai, Sheikh Mohammed bin Rashid Al Maktoum. As such, it acts more like a private equity fund. Clearly it is intimately interconnected with Dubai's economy and state investment vehicles but its managers emphatically deny that it is a SWF. We have also excluded funds used solely for currency stabilization, economic development or charitable purposes that have non-commercial objectives. By nature, these tended to violate either criteria four or five in our definition.

EUROPEAN CENTRAL BANK-FINANCIAL STABILITY REVIEW (2009)

[SWF is a] special investment fund created/owned by a government to hold assets for long-term purposes; it is typically funded from reserves or other foreign-currency sources, including commodity export revenues, and predominantly has significant ownership of foreign currency claims on non-residents.

KOTTER AND LEL (2011)

We define SWFs as government-owned investment vehicles with no explicit liabilities to their owners other than internal to the government, significant exposure to high-risk foreign assets, and a long-term investment horizon

BALDING (2012)

A SWF is a pool of capital derived from net wealth accumulation controlled by a government or government-related entity that invests in assets seeking returns above the risk-free rate of return.

CLARK, DIXON AND MONK (2012)

SWFs are government-owned and controlled (directly or indirectly) investment funds that have no outside beneficiaries or liabilities (beyond the government or the citizenry in abstract) and invest their assets, either in the short or long term, according to the interests and objectives of the sovereign sponsor.

1. Ownership: Governments, both central and sub-national, own and, to varying degrees, control SWFs. Control can be exerted either directly or indirectly through the appointment of the SWF board.

2. Liabilities: One point of agreement illustrated by the IWG's (2008, 15) survey of SWFs is that these SWFs "have no direct liabilities". This is perhaps a surprising point of agreement, as certain SWFs do have liabilities, such as sterilization debt or some deferred contractual liability to transfer money out of the SWF and into the general budget or a social security system (Rozanov 2008). However, the point is that SWFs have no outside (non-governmental) liabilities. For those funds that do have a liability, it is typically intra-governmental, i.e. one arm of the government owes another arm of the

government money. For example, the SWF might owe funds to the Ministry of Finance, the central bank or even the social security reserve fund. However, SWFs have no external creditor, which means the assets are not encumbered by the property rights of outside, non-governmental owners. In short, SWF liabilities (if they have any) are part of the broader national balance sheet.

3. Beneficiary: Despite certain explicit goals (e.g., filling a future PAYG pension gap), SWFs are managed according to the interests and objectives of the government or sovereign. As the accounting distinction underpinning Point 2 above suggests, the ultimate beneficiary of a SWF is not a specific individual. Rather, the beneficiary is either the government itself, the country's citizenry in the abstract, the taxpayer generally or is simply left unidentified. This objective function drives the strategic choices made by funds' asset managers, as the notion of fiduciary duty, which disciplines the investment practices of western financial institutions like pension funds, does not apply.