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THE “SANTIAGO PRINCIPLES” OF THE INTERNATIONAL WORKING GROUP OF SOVEREIGN WEALTH FUNDS: BLUEPRINT FOR A 12-POINT ACTION PLAN¹

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In October 2008, the International Working Group of Sovereign Wealth Funds (IWG) published the “Generally Accepted Principles and Practices”, also known as the “Santiago Principles”.

The purpose of the Santiago Principles is to identify a framework of generally accepted principles and practices that properly reflect appropriate governance and accountability arrangements, as well as the conduct of investment practices by Sovereign Wealth Funds (SWF) on a prudent and sound basis.

The Santiago Principles introduce 24 practices and principles in three key areas to be implemented by SWFs: (i) legal framework, objectives, and coordination with macroeconomic policies; (ii) institutional framework and governance structure; (iii) investment and risk management framework.

The process that the IWG has engaged in is based on an innovative approach to global governance, and contributes to a growing body of international soft norms that provides order in the world of global finance. Based on broad participation from Asian, Middle Eastern, European, and American SWFs, the Principles are highly inclusive. This is remarkable since these kinds of arrangements are usually supported by a constituency that is predominantly recruited from developed countries, which is increasingly detrimental to their effectiveness given the current dispersion of economic clout.

The global discourse of the past two years about the impact of SWFs on the national security and economic competitiveness interests of recipient economies has very much been based on hypotheses and assumptions. These, to a considerable extent, have driven policy processes in recipient countries, substantially increasing the political and regulatory risk premiums for SWFs. Moving forward with the implementation of the Santiago Principles through of a dynamic process would actively address these risks.

To have an impact on the behavior of its signatories, and the overall perception that the global audience has of SWFs at large, the IWG now needs to demonstrate that it can sustain the process it has begun, and move SWFs towards higher levels of governance, transparency, and accountability. Otherwise, the Santiago Principles’ legitimacy could erode over time and by association, and eventually could become detrimental for individual, and presumably more advanced, SWFs.

¹ I am grateful to Andrew Rozanov for his very valuable comments and suggestions.

The current situation in global financial markets appears to have made moving forward with the Santiago Principles less urgent. Given market volatilities, SWFs have been less active in the past months. The public debate about their impact on the national interest of recipient economies has calmed down. However, the IWG should take a medium to long term perspective, and advance its agenda to be prepared when the global economy picks up and SWFs seek global opportunities again.

The following blueprint for a 12-point action plan is intended to make a contribution to the international discussion on how to move the work of the IWG forward. It is based on publicly available information. It does not claim to be comprehensive and does not represent the official position of any institution.

This blueprint supports the argument that the IWG and its members need to proactively move beyond the publication and adoption of the Santiago Principles. The IWG needs to sustain the process it has started, maintain or create incentives for individual members to move from adoption to implementation, and reach out to a global audience.

1 ENSURE TRANSPARENCY OF THE IWG

One key point of criticism held against SWFs has been their lack of transparency. Acknowledging that the concept of transparency is a key element of efficient markets, the Santiago Principles state that increased transparency will help build a stable and open investment environment.

Yet, it appears that the IWG itself risks turning into an ambiguous institution. There is inadequate public information about the IWG's governance structure, process management, or long term strategy.

The IWG risks gradually losing its legitimacy if it is not clear about how it wants to advance its work.

2 ESTABLISH IMPLEMENTATION TIMELINES

The IWG recognizes that for the implementation of the body of the Santiago Principles, individual SWFs require transitional periods. It suggests that SWFs should implement the Principles according to individual time frames.

However, it appears that an overly decentralized approach to the application of implementation timelines risks failing to inject the necessary discipline for individual SWFs to move forward.

The IWG should seek to reach an understanding on the timelines that are required to implement the Santiago Principles.

3 ADDRESS THE TENSION BETWEEN VOLUNTARY IMPLEMENTATION AND COLLECTIVE ACTION

The Santiago Principles leave it to each individual SWF, its owner, or governing body(ies), to assess their implementation, and disclose their assessment to the public. It is unclear, however, why SWFs have found it useful to engage in collective action during the drafting process of the Santiago Principles, while leaving the implementation process to its individual members.

The implementation of the Santiago Principles should not be based on an "à la carte" approach. SWFs that are more advanced in implementation might

see little value in being associated with a process that is not supported by the commitment of the entire group of SWFs.

To ensure commitment across the entire group of SWFs, the IWG could consider developing mechanisms, such as a peer review mechanism, that would support a certain degree of collective action in the implementation process of the Santiago Principles.

4 ADDRESS MOTIVATIONS OTHER THAN FINANCIAL OR ECONOMIC CONSIDERATIONS DRIVING INVESTMENT BEHAVIOR

One key aspect in the public debate about SWFs is the concerns about the motivations other than financial or economic considerations driving their investment behavior.

The Santiago Principles suggest that if investment decisions are subject to considerations other than economic or financial, these should be clearly set out in the investment policy and be publicly disclosed. The Principles suggest that SWFs may exclude certain investments for different reasons, such as legally binding international sanctions and social, ethical, or religious reasons. They might also wish to consider social, environmental, and other factors in their investment policy.

The IWG should further explore the nature of investment activities that are based on considerations other than economic and financial, and more actively engage with both, the representative bodies of recipient countries and the public, regarding this issue to address concerns.

5 PLAY A LEADERSHIP ROLE BY CONTRIBUTING TO GLOBAL PROJECTS

Given the current state of global financial markets, and the economic climate around the world, there might be an opportunity for SWFs to play a leadership role in contributing to the financing of global projects that provide benefits for the global society at large. This engagement might also open new investment perspectives for individual SWFs.

An investment fund for a common global future could make such a contribution. This investment fund, financed by the members of the IWG, would be established on the assumption that the fate and economic well being of their own societies are necessarily linked to the fate of the global society at large.

Investments that benefit the global common good, such as economic development and environmental sustainability, could become a major reference points in the discourse about the constructive role that SWFs can play now and in the future, and build the political capital that they need to keep financial markets open.

6 CONTRIBUTE TO THE DISCUSSION OF A REVISED GLOBAL FINANCIAL ARCHITECTURE

The G20 has begun a process to address the deeper challenges of the global financial crisis. It has produced a catalogue of action items that should make the global financial markets, and the world economy, more robust.

Some countries that own large SWFs and could play a stabilizing role in global financial markets are not included in the G20 deliberations, e.g., Norway, the UAE, Kuwait, or Singapore. Discussions of a new financial architecture risk missing an important dimension if they do not take into account the perspectives and interests of the world's major capital exporters.

In order for these players to be given a platform, the IWG might want to mediate the development of policy propositions, which could contribute substantially to the G20 process as it moves forward. This might also render the G20 process more efficient.

7 REACH OUT TO THE REPRESENTATIVE BODIES OF RECIPIENT ECONOMIES

The Santiago Principles state that to ensure their success, a constructive and collaborative response from recipient countries will be essential. They rightly presume that they will only be valuable if recipient economies acknowledge their legitimacy.

It would advance the objectives of the IWG and its members to develop a reach-out strategy, and establish inclusive platforms that would enable them to engage recipient economies and their representative bodies in a sustained dialogue.

8 REACH OUT TO THE BROADER PUBLIC

SWFs have been exposed to public scrutiny in recipient countries based on concerns about national security or economic competitiveness. Many political leaders have tried to curb these concerns, and identify avenues to keep these economies open for investment. Nevertheless, they are subject to the political will of their constituents, which in turn risks to be driven by populist sentiment.

It would thus make sense for the IWG and its members to build political capital within the public of recipient economies in order to facilitate a more rational process of political decision making.

9 BROADEN MEMBERSHIP OF THE IWG AND PARTICIPATION IN THE SANTIAGO PRINCIPLES

In order to be effective, the Santiago Principles need to be based on an inclusive approach to membership.

It would therefore be useful to broaden membership of the IWG and include special purpose investment funds or arrangements that are owned by the general government; invest in a variety of assets, including foreign financial assets; and operate for macroeconomic purposes and financial objectives.

10 ESTABLISH AN INTERNATIONAL ADVISORY GROUP OF EXPERTS

The Santiago Principles suggest that the IWG explore the idea of establishing a Standing Group of SWFs to keep them under review, facilitate their dissemination, proper understanding, and implementation. The Standing Group should also provide SWFs with a continuing forum for exchanging ideas and views among themselves, and with recipient countries.

In the spirit of creating unique knowledge and advice that the community of SWFs can act on, an International Advisory Group of Experts could be established, convene on a regular basis and engage with the Standing Group.

Such an advisory body could be the source of unique knowledge and insight for the SWF community regarding governance and structure, investment strategies, risk management, public relations, and other pertinent issues.

The members to this Group of Experts would be current and/or former policymakers, academics and investment professionals, including former SWF executives and officials. Membership would be based on a rigorous selection process.

11 FACILITATE RESEARCH AND KNOWLEDGE DISSEMINATION

An ever growing community of experts, based in financial services institutions, consulting firms, think tanks, and academic institutions, have developed a substantial body of research about SWFs. This body of research is largely based on assumptions, and a “connecting the dots”-approach, assembling disparate fragments of information. However, these efforts have resulted in an ever more accurate picture of the SWF landscape.

Beyond the work of the Advisory Group of Experts, the IWG could stimulate an informed debate, driven by further academic research, on the role of SWFs in national and global economic affairs. This would also help to reduce some of the mystique that has driven much of the research agenda on SWFs in recent years.

Independent research could also support the IWG in moving forward with the implementation of the Santiago Principles. It would allow an educated and politically mature public audience to perform a watchdog function, and foster the transfer of knowledge and best practices amongst its members.

12 ESTABLISH A SECRETARIAT

In order for the IWG to be operationally effective, it appears to be useful to establish a fully functioning and professional secretariat to provide process management, monitoring, and outreach services, to the IWG and its different bodies.

At a later stage, this secretariat could also serve as a representative body on issues that SWFs collectively wish to move into the global public policy arena.

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