Assessing the Effectiveness of Sovereign Wealth Fund Governance and Regulation through the Santiago Principles and the International Forum of Sovereign Wealth Funds.

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Declaration

I certify that the work contained in this thesis has not been previously submitted for a degree or diploma in any other higher education institution. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made.

List of Abbreviations

ADIA – Abu Dhabi Investment Authority (UAE's SWF).

AUM – Assets under Management.

BBA – British Bankers Association.

BIT – Bilateral Investment Treaty.

CCC – Clean Clothes Campaign.

CCP – Chinese Communist Party.

CIC – China Investment Corporation.

CFIUS – Committee on Foreign Investment in the United States.

CSR – Corporate Social Responsibility.

EU – European Union.

FATA – Foreign Acquisitions and Takeovers Act 1975.

FATR – Foreign Acquisitions and Takeovers Regulation.

FDI – Foreign Direct Investment.

FINSA – Foreign Investment and National Security Act 2007

FIRB – Foreign Investment Review Board.

FIRRMA – Foreign Investment Risk Review Modernization Act 2018.

FTA – Free Trade Agreement.

FSC – Forest Stewardship Council.

G7 – Group of 7 Nations.

G20 – Group of 20 Nations.

GAPP – Generally Accepted Principles and Practices.

GATT – General Agreement on Tariffs and Trade.

GIC – Government Investment Corporation.

GPFG – Government Pension Fund Global (Norway's SWF).

HKMA – Hong Kong Monetary Authority.

ICANN – Internet Corporation for Assigned Names and Numbers.

IFSWF – International Forum of Sovereign Wealth Funds.

IMF – International Monetary Fund.

IMFC – International Monetary and Financial Committee.

ISDA – International Swaps and Derivatives Association.

IWG – International Working Group.

KIA – Kuwait Investment Authority (Kuwait's SWF).

KIC – Korea Investment Corporation (South Korea's SWF).

LIA – Libya Investment Authority (Libya's SWF).

NGOs – Non-Governmental Organisations.

NSIA- Nigerian Sovereign Investment Authority (Nigeria's SWF).

OECD – Organisation for Economic Cooperation and Development.

PIF – Public Investment Fund (Saudi Arabia's SWF).

PRI – Principles for Responsible Investments.

QIA – Qatar Investment Authority (Qatar's SWF).

RIC – Reserve Investment Corporation.

ROSCs – Reports on the Observation of Standards and Codes.

SAMA – Saudi Arabian Monetary Authority

SAFE – State Administration for Foreign Exchange (China's second SWF).

SBAI – Standards Board for Alternative Investment.

SDF – Sovereign Development Fund.

SOE – State-Owned Enterprise.

SWF – Sovereign Wealth Fund.

TSR – Transnational Self-Regulation.

UNCED – United Nations Conference on Environment and Development.

UNCTAD – United Nations Conference on Trade and Development.

WTO – World Trade Organisation.

Abstract

The rise, in the last decade, of government-owned investment vehicles – Sovereign Wealth Funds (SWFs) has provoked concern in several economies where these entities invest. Common concerns associated with these funds include a potential for strategic or geopolitical investments, a lack of transparency, poor governance and operational independence, anti-competitive conduct and a potential to disrupt the proper functioning of international capital markets.

The intersection or some might say, collision of the activities of SWFs and the concerns of their hosts sparked an international campaign to codify a set of best practices for these entities. Far from the genuine international regulation intended by their hosts, the emergent construct was a self-regulatory framework reflected in the Santiago Principles and the International Forum of Sovereign Wealth Fund Funds (IFSWF).

Questions have long been raised about the ability of these twin structures to effectively regulate the activities of SWFs in the broader public interest. This thesis responds to this debate. Its central argument is that the Santiago Principles and the International Forum are unlikely to constitute an effective Self-Regulatory regime for SWFs. This conclusion is premised on the limited ambition of the principles, relative to the founding policy objectives, the absence of independent monitoring and enforcement, the underwhelming levels of compliance even with this deeply troubled standard and the limited governance, Transparency and accountability of the forum.

CHAPTER 1: INTRODUCTION

1.1 Research Background and Context

For some part of the last century, nation states played a direct and active role in private markets through the deployment of investment vehicles for the maximisation of national economic value.[1] This ideology came to what is now regarded as a hiatus with the collapse of the iron curtain and the conversion of former soviet economies built on statist models to the diametrically opposed ideology of neoliberal capitalism under which private firms and private capital became the predominant form of financing.[2]

The dawn of the new century has seen a number of forces collide – an increasing disposition of sovereign states to recycle their wealth abroad in instruments other than sovereign debt instruments, the rise of transnational normative regimes for global market and business behaviour and increasing structural economic imbalances that have created a widening chasm between surplus and deficit countries.[3]

Among the more visible indicators of this tectonic change is the rise of a genus of idiosyncratic investors (formally sovereign yet functionally -private) called Sovereign Wealth Funds (hereinafter SWFs).[4] At the last count, these funds manage well over US$ 7 trillion of assets across the globe, including strategic and trophy assets in far flung countries of the world.[5]

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[1] Larry Backer, 'Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Wealth Funds and Public Global Governance through Private Global Investments' (2009) 41(2) Georgetown Journal of International Law 425, 427.

[2] Xu Yi-Chong, *The Political Economy of Sovereign Wealth Funds* (1st edn, Palgrave Macmillan, 2010) 7.

[3] Backer (n1).

[4] ibid.

[5] Preqin, '2018 Sovereign Wealth Fund *Review'* (2018), 5 <http://docs.preqin.com/samples/The-2018-Preqin-Sovereign-Wealth-Fund-Review-Sample-Pages.pdf> 3rd September 2018.

This market footprint coupled with the fundamentally sovereign nature of SWFs has provoked controversy in several of their hosts. Amongst the concerns ascribed to these funds include the risk of political investments that threaten the security of target countries, the notorious opacity of their activities, weaknesses in governance and operational independence and the risks of anticompetitive conduct and economic subsidisation.[6]

The scale of these concerns has prompted countervailing responses across target economies in which SWFs invest. Notable examples include the Committee on Foreign Investment in the United States (CFIUS) process in the United States and the Foreign Investment Review Board (FIRB) process in Australia which subjects individual SWF investments to formalised National Security or National Interest tests.[7]

To address the protectionist tide unleashed by the activities of SWFs, a transnational self-regulatory arrangement was pressured into existence by the triumvirate of the US Treasury, the Group of 7 Nations and the International Monetary Fund (IMF) in the latter part of 2008.[8] Prosaically known as the Generally Accepted Principles and Practices (GAPP) or Santiago Principles, these standards purportedly subject SWFs to norms of good behaviour on Governance, Transparency, Accountability and Risk Management amongst others.[9] The unveiling of this normative substrate was also followed by the creation of a quasi-governance apparatus called the

[6] See more generally Regis Bismuth 'the "Santiago Principles" for Sovereign Wealth Funds: The Shortcomings and the Futility of Self-Regulation' (2017) 28(1) European Business Law Review 69, 74.

[7] Wouter P.F. Schmit Jongbloed, Lisa E. Sachs and Karl P. Sauvant 'Sovereign Investment: An Introduction' in Karl P. Sauvant, Wouter P.F. Schmit Jongbloed and Lisa E. Sachs (eds) Sovereign Investment: Concerns and Policy Reactions (Oxford University Press, 2012) 11.

[8] Joseph Norton , 'The "Santiago Principles" and the International Forum of Sovereign Wealth Funds: Evolving Components of the New Bretton Woods II Post-Global Financial Crisis Architecture and Another example of Ad Hoc Global Administrative Networking and Related "soft" Rulemaking ?' [2010] 29 Review of Banking & Financial Law 465, 471.

[9] ibid.

International Forum of SWFs (IFSWF) to continue the process began by the ad-hoc grouping of SWFs in the midwifery of the principles. [10]

Ten years after the promulgation of the Principles and nine years after the creation of the forum, much of the literature surrounding these twin structures remain largely unformalised, unsophisticated and laudatory.[11] Some studies have noted the role of the principles as a normative layer for SWFs[12] whilst others have emphasised the nature of the forum as an incipient actor in global economic governance.[13]

However, there remains considerable scepticism amongst observers of the process about the ability of this self-regulatory arrangement to achieve its motivating objective – stronger governance and greater transparency of SWFs (effectiveness). In line with this scepticism, some analysts have questioned whether the process is likely to deliver genuine or sham standards for

[10] ibid.

[11]Victoria Barbary 'Santiago Principles turn 10 years old' Top1000Funds (18 September 2018) <https://www.top1000funds.com/2018/09/santiago-principles-turn-10-years-old/> Accessed 20th December 2018.

[12] Donghyun Park and Gemma Esther Estrada, 'Developing Asia's Sovereign Wealth Funds: The Santiago Principles and the Case for Self-Regulation' (2011) 1 Asian Journal of International Law 383, Eliza Malathouni, 'the Informality of the International Forum of Sovereign Wealth Funds and the Santiago Principles: A Conscious Choice or a Necessity?' In A Berman, S Duquet, J Pauwelyn, R Wessel and J Wouters (eds) Informal International Lawmaking: Case studies (1st edn, TOAEP, 2010) 263. Maurizia De Bellis 'Global Standards for Sovereign Wealth Funds: The Quest for Transparency' (2011) 1 Asian Journal of International Law 349-382.

[13] Joseph Norton , 'The "Santiago Principles" and the International Forum of Sovereign Wealth Funds: Evolving Components of the New Bretton Woods II Post-Global Financial Crisis Architecture and Another example of Ad Hoc Global Administrative Networking and Related "soft" Rulemaking ?' [2010] 29 Review of Banking & Financial Law 465, 471. See also: Eliza Malathouni, 'the Informality of the International Forum of Sovereign Wealth Funds and the Santiago Principles: A Conscious Choice or a Necessity?' In A Berman, S Duquet, J Pauwelyn, R Wessel and J Wouters (eds) Informal International Lawmaking: Case studies (1st edn, TOAEP, 2010) 263. George Kratsas and Jon Truby, 'Regulating Sovereign Wealth Funds to avoid Investment Protectionism' (2015) 1(1) Journal of Financial Regulation 95.

SWFs.[14] Others have simply expressed the perennial suspicion of soft and voluntary standards in their analysis of the principles.[15]

More recent analyses have started to enquire about the adequacy of these instruments, including to scrutinise the constitution of the Santiago Principles[16] and the parameters under which the IFSWF operates.[17] One example is a 2017 paper by Professor Regis Bismuth titled 'The "Santiago Principles" for Sovereign Wealth Funds: The Shortcomings and the Futility of Self-Regulation' in which he blisteringly critiques the origin, content and implementation of the Principles and the role of the IFSWF.[18] Professor Bismuth concludes that the principles, in particular, 'fail to live up to the expectation of effectively regulating SWF activities.'[19] Apart from this paper, there remains little, joined up analysis or measurement of the likely efficacy or effectiveness of the principles and the forum in regulating SWFs in the broader public interest.

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[14] Daniel Drezner 'Bric by Bric: The Emergent Regime for Sovereign Wealth Funds' in Andrew Cooper and Alan Alexandroff (eds), Rising States, Rising Institutions: Challenges for Global Governance (Brookings Institution Press 2010) 232. Sham Standards are defined by Drezner as 'a notional set of global standards with weak or non-existent monitoring or enforcement schemes. Sham standards are useful to states of all stripes, because they permit governments to claim the de jure existence of regulatory coordination, even in the absence of Effective enforcement. These standards act to relieve or redirect any domestic or civil society pressure for significant global regulations. They also create path dependencies in governance institutions that cast a shadow over future governance efforts. See: Daniel Drezner, *All Politics is Global: Explaining International Regulatory Regimes* (Princeton University Press, 2007) 81.

[15] Fabio Bassan 'The Law of Sovereign Wealth Funds' (Edward Elgar, 2011) 50. See also: Harry McVea and Nicholas Charalambu 'Game theory and sovereign wealth funds' (2014) 22(1) Journal of Financial Regulation and Compliance 61-76.

[16] Anthony Wong, 'Sovereign Wealth Funds and the Problem of Asymmetric Information: The Santiago Principles and International Regulations' (2009) 34 Brooklyn Journal of International Law 1081. Jason Buhi 'Negocio de China: Building upon the Santiago Principles to Form an Effective International Approach to Sovereign Wealth Fund Regulation' (2009) 39 Hong Kong L.J. 197, 198. See also: Julien Chaisse, Debashis Chakraborty and Jaydeep Mukherjee, 'Emerging Sovereign Wealth Funds in the Making: Assessing the Economic Feasibility and Regulatory Strategies' (2011), 45 Journal of World Trade 837, 866.

[17] Locknie Hsu, 'Santiago GAPPs and Codes of Conduct' in F Bassan (eds) Research Handbook on Sovereign Wealth Funds and International Investment Law (1st edn, Edward Elgar, 2015) 113.

[18] Regis Bismuth 'the "Santiago Principles" for Sovereign Wealth Funds: The Shortcomings and the Futility of Self-Regulation' (2017) 28(1) European Business Law Review 69-88.

[19] ibid. at 75.

This thesis responds to this literary gap. First, it considers the conditions under which Self-Regulation is likely to operate effectively and this is then applied to the Santiago Principles and the International Forum to test for its likely efficacy or effectiveness. To this end, the thesis constructs an assessment tool which argues that Self-Regulation is likely to be effective in the presence of three distinct but interrelated metrics.

The first is the presence of comprehensive and ambitious targets (the stringency of the targets relative to the policy objective), which operates alongside objective monitoring and robust enforcement. The second metric is actual compliance or implementation of the standards promulgated by the self-regulatory organisation and the third and final indicator focuses not on the normative side of things but on the institutional conditions necessary for effective Self-regulation. Three of these are identified as key. The first is the Representativeness or inclusivity of the Self-Regulatory organisation. This is followed by transparency and accountability as the institutional factors necessary for successful and effective Self-Regulation in the broader public interest.

1.2 Formulation of the Research Question and Methodology

In light of the above considerations, it has become imperative to consider the following question: To what extent does the Santiago Principles and the International Forum of Sovereign Wealth Funds constitute effective Self-Regulation for SWFs? This issue is the core research question in this thesis. The aim of this inquiry is thus to establish the likely effectiveness of the principles and the forum in regulating SWFs and if possible, to draw policy lessons as well as give recommendations on how to improve the regulatory process which the principles and the forum represent.

Given that the focus of the thesis is on the effectiveness or efficacy of regulation or law, it necessitates first, a 'law in context' research methodology or approach.[20] This is often understood in contemporary legal parlance as Socio-legal studies or research-about-law.[21] As Siems reminds us, 'a socio-legal scholar may also want to examine the "social origins, social conditions of existence, and social consequences" of legal ideas.'[22]

Law in Context research also studies, for the most part, law as a social phenomenon.[23] This is echoed by the Socio-legal Studies Association which notes that: 'Socio-legal studies embraces disciplines and subjects concerned with law as a social institution, with the social effects of law, legal processes, institutions and services and with the influence of social, political and economic factors on the law and legal institutions.'[24]

Broadly speaking, Socio-Legal research tends to take the form of either: Law in action scholarship which investigates how legal norms actually function in reality and what actors shape their implementation and second, theoretical insights on the relationship between law and society, which are informed by sociology, history, philosophy, economics, anthropology, political science and psychology.[25] This dovetails with much of Schiff's argument that Socio-legal research focuses on the consideration of the postulates/interests in society to which law necessarily must refer/relate/take account (2) efficacy studies which consider the effectiveness of rules for what

[20] Paul Chynoweth 'Legal research' in Andrew Knight, Les Ruddock (eds) Advanced Research Methods in the Built Environment(Wiley-Blackwell, 2008) 30.

[21] ibid. at 31. Roscoe Pound, 'Law in Books and Law in Action' (1910) 44 American Law Review 12

[22] Mathias M. Siems and Daithí Mac Síthigh 'Mapping Legal Research' (2012) 71(3) Cambridge Law Journal 651, 655.

[23] ibid.

[24] Socio Legal Studies Association, 'SLSA Statement of Principles of Ethical Research Practice' (January 2009) 1.2.1.<https://www.slsa.ac.uk/images/slsadownloads/ethicalstatement/slsa%20ethics%20statement%20_final_%5B1%5D.pdf> Accessed 20th December 2018.

[25] Darren O Donovan 'Socio-Legal Methodology: Conceptual Underpinnings, Justifications and Practical Pitfalls' in Laura Cahillane, Jennifer Schweppe (eds) Legal Research Methods: Principles and Practicalities (Clarus Press, 2016) 5.

they are intended, or for what they are not intended and; (3) law in action research.[26] Given that the focus of this research on the efficacy of Regulation or law, it is therefore well founded within the realms of 'law in context' research.

In addition to the above, there is a fine tradition of research on the constitution or efficacy of self-regulation undertaken in the Law in Context tradition. These include the celebrated paper by Gunningham and Rees in which they emphasise that industry self-regulation can be an effective and efficient means of 'social control' and identify certain conditions in which Self-Regulation is likely to be effective[27] and the seminal paper by Professor Julia Black in which she identifies Self-Regulation as a mechanism of social ordering.[28] This thesis continues this understanding of Self-Regulation as a means of social ordering by considering its efficacy.

Alongside the 'law in context' root of this thesis, there are also certain doctrinal elements to the research, in particular, the textual analysis of the regulatory responses to SWFs in the United States and Australia – two of the prime destinations for SWF Investments in Chapter 3. These jurisdictions have been chosen for analysis due to their position as the largest destinations for SWF investments as highlighted in Chapter 3. More so, both operate on a Common Law jurisprudential footing.

Doctrinal analysis is also engaged to understand the provisions of Customary International Law, WTO Law and International Investment Law on National Security – a matter of profound concern for the recipients of SWF investments.

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[26] David Schiff 'Socio-Legal Theory: Social Structure and Law' (1976) 39(3) The Modern Law Review 287, 295.

[27] Neil Gunningham and Joseph Rees 'Industry Self-Regulation: An Institutional Perspective' (1997) 19(4) Law & Policy 363-414.

[28] Julia Black, 'Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a Post-Regulatory World' (2001) 54(1) Current Legal Problems 103-108.

Broadly speaking, doctrinal research embodies the study of law and legal concepts and is the most dominant form of legal research design.[29] It has been described as a process of analysis[30] and is primarily aimed at providing a systematic exposition of the regulations or law governing a particular legal area.[31] By seeking to understand the Customary International Law on National Security and national law as it applies to inward SWF investments in the United States and Australia, this thesis relies on a doctrinal approach.

The thesis also incorporates an element of documentary analysis which is a qualitative approach well founded in the social sciences.[32] Documentary analysis is a systematic procedure for reviewing and evaluating documents (both printed and electronic documents). Its focus is often to examine or interpret documents to draw meanings, gain understanding and develop empirical knowledge.[33] This study utilised the documentary analysis approach in examining and interpreting data about SWFs, their investment patterns, target countries and overall behaviour. This is undoubtedly important in demystifying these entities and setting the background for a consideration of the regulatory responses to them which includes, of course, the subject matter of this thesis. The documentary analysis approach is also applied in evaluating data on SWF compliance with the Santiago Principles in Chapter 5. Here, the focus was on drawing broader meanings from the IFSWF Members Self-Assessment Reports, Truman Scoreboard and the Santiago Compliance Index which can be applied to the central theme of this thesis.

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[29] Terry Hutchinson and Nigel Duncan, 'Defining and Describing What We Do: Doctrinal Legal Research' (2012) 17 Deakin Law Review 83, 85.

[30] Paul Chynoweth 'Legal research' in Andrew Knight, Les Ruddock (eds) *Advanced Research Methods in the Built Environment* (Wiley-Blackwell, 2008) 37.

[31] Terry Hutchinson and Nigel Duncan, 'Defining and Describing What We Do: Doctrinal Legal Research' (2012) 17 Deakin Law Review 83, 85.

[32] Glenn Bowen 'Document Analysis as a Qualitative Research Method' (2009) 9(2) Qualitative Research Journal 27.

[33] Ibid.

Also central to the Research Methodology is the Three-pillar/Metric understanding of self-regulatory effectiveness advanced in Chapter 2 namely: (a) the presence of comprehensive and ambitious targets or standards, relative to the policy objective (b) Compliance (c) The institutionalisation of Good Internal Governance mechanisms – Representativeness, Transparency and Accountability. This is central to the research methodology because it allows for a consideration of the effectiveness of the Santiago Principles and the IFSWF which is at the heart of this thesis.

Above all, the research method adopted is a critical analysis of available literature or a library-based method during which reputable sources such as peer reviewed Journal articles, Reputable texts, Authoritative organisational reports, newspaper articles, blogs, diplomatic cables and published interviews involving key SWF officials and negotiators were actively considered.

1.3 Thesis Structure and Outline

This thesis is divided into seven chapters. Following this Introduction, Chapter Two provides the intellectual foundation for the research through a comprehensive review of the vast literature on Self-regulation. In this crucial task, the chapter considers the often large and voluminous literature across social science disciplines on the nature and structural properties of Self-Regulation. Having set out the theoretical background on Self-Regulation, the chapter then delves further into the question of measuring effectiveness as it has been developed in the literature. Here, several analytical frames are observed. The often-anecdotal studies emphasise process-centric elements which are often profoundly difficult to establish from a methodological sense. Other studies emphasise rather parochial understandings of effectiveness. Yet, as Abbott and Snidal remind us, 'in examining a highly political activity like regulation, effectiveness must be

conceptualized broadly.'[34] This is echoed by Cafaggi who notes that 'analyses of effectiveness must concentrate on the right combination of norms and institutions through which effective self-policing can be engendered.'[35] With this in mind, the thesis conceptualised effectiveness taking into account normative and institutional factors. These include: (a) the presence of comprehensive and ambitious targets, relative to the policy objective and backed by independent monitoring and enforcement (b) Compliance (c) The institutionalisation of Good Internal Governance mechanisms – Representativeness, Transparency and Accountability.

With this theoretical foundation in place, Chapter 3 provides further necessary historical and conceptual background to facilitate the reader's navigation of the rather esoteric issues comprising the terrain of this dissertation: the rise of Sovereign Wealth Funds and the emergence and evolution of concerns associated with these funds. Since the Santiago Principles emerged out of the intersection, or some might say collision, of the origins and activities of SWFs, this background is arguably important reading for anyone seeking to understand the broader policy issues that the Principles purportedly set out to address.

Chapter 4 adds to this background understanding by first introducing the pre-history to the Santiago Principles themselves. It recounts the important actors who shaped the boundaries of this self-regulatory arrangement including the US Treasury, the Group of 7 Nations (G7), the European Commission (EU) and importantly, the International Monetary Fund (IMF) whose expertise was initially tapped by the G7 to lead the Standard-Setting process before an acrimonious revolt by SWFs and the owner states upon which the scales tilted towards organic self-regulation by SWFs themselves. The Chapter also considered detailed accounts of the negotiations by SWFs

[34] Kenneth W. Abbott and Duncan Snidal 'the Governance Triangle: Regulatory Standards Institutions and the Shadow of the State' in Walter Mattli and Ngaire Woods, *The Politics of Global Regulation* (Princeton University Press, 2009) 61.

[35] Fabrizio Caffaggi and Andrea Renda, 'Public and Private Regulation: Mapping the Labyrinth' (2012) CEPR Working Paper No. 370, 13 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2156875> Accessed 29th January 2018.

towards the Santiago Principles. Drawing from published material, detailed interviews of SWF negotiators and diplomatic cables, the Chapter provides a graphic account of the bargaining process and the different ideological and power considerations at play in the negotiations by SWFs. In addition to the above, Chapter 4 also begins the analysis of the likely effectiveness of the Santiago Principles by subjecting its normative content to the test of effectiveness set out in Chapter 2.

Given that the understanding of self-regulatory effectiveness in this thesis is not limited to normative considerations, Chapter 5 undertakes the task of analysing the effectiveness of the International Forum of SWFs according to the remaining tests of representativeness, Transparency and Accountability. Here, the chapter draws from the published constitutional document of the forum, reports on its operations and other sources to determine its likely institutional effectiveness. The Chapter further considers the levels of compliance and implementation of the principles which is the third indicator of self-regulatory effectiveness. To this end, it draws from available data published by the IFSWF and other reputable sources to gauge the levels of compliance with the principles. This allows the researcher to make a full and pragmatic judgement of the likely efficacy of the regime as a whole – a question which lies at the heart of this thesis.

Following this is the sixth chapter which articulates a number of endogenous and exogenous reforms that can be made to enhance the quality and efficacy of the Santiago-IFSWF process. The final chapter offers the findings and concluding remarks.

CHAPTER 2: THE THEORETICAL FOUNDATIONS FOR A STUDY OF TRANSNATIONAL SELF-REGULATION.

2.1 Introduction

A distinctive feature of the modern era of regulatory capitalism is the fragmentation of nation states and traditional governance institutions and the emergence, across diverse fields of socio-economic activity of- new forms of governance, involving rule-based cooperation amongst self-governing actors. The rise of these regimes has often been explained through self-regulation theory.

At the heart of self-regulation theory is the idea of rulemaking by private or quasi-public entities aimed at shaping and constraining the behaviour of like-minded actors. These regimes often arise nationally and transnationally, the latter being the focus of this thesis.

At the same time, the ability of self-governing regimes to produce effective and efficacious governance in the public interest is hotly debated with renewed focus since the Global Economic Crisis. The legacy of the crisis was multi-fold. For one, it forcefully demonstrated that private markets often pose extremely serious risks to the solidity of the entire global economic system, but it also raised questions about the ability of organised private interest groups to govern in the wider public interest.[36]

Examples abound both domestically and transnationally of self-regulatory weaknesses ranging from the inability of the British Bankers Association (BBA) to halt the wide-spread manipulation of the Inter-bank Lending rate Market to the weaknesses of self-regulatory arrangements in the Derivatives Markets and Hedge Fund Industry, leading to the

[36] Saule Omarova, 'Rethinking the Future of Self-Regulation' (2010) 35(3) Brook. J. Int'l L 663, 670.

institutionalisation of stronger public oversight after the Crisis.[37] In both instances, critics point the finger at the self-regulatory regimes within these sectors, often questioning their effectiveness and thrust.[38] Yet, debates about effectiveness are not new to financial markets, nor are they isolated to them. Scholars in other fields speak with equal, if not more vehemence about the effectiveness of self-regulatory regimes.[39] Indeed, there is an alphabet soup of analysis measuring the instances in which self-regulatory arrangements may be effective and when they might not.[40]

This Chapter sets out to examine this 'effectiveness' dilemma. It pursues its objective in 5 sections. The first examines the foundations of self-regulation including its definitions and variants. The second section considers the rise of self-regulation beyond the nation state. This is described as transnational self-regulation (hereinafter TSR). Also examined within this section are the forms and drivers of transnational self-regulation.

The third section analyses the promises and limits of self-regulation. Drawing from a diverse and multi-disciplinary pool of research, this section surveys the debated benefits and weaknesses of self-regulatory arrangements. This is then followed by the fourth section which considers the substantial literature on effectiveness. This section examines, in particular, the broad analytical lens through which effectiveness of self-regulation is viewed across the social sciences. Drawing from the multi-disciplinary insights, this section comes up with a definition of effectiveness as well as provides a set of measurable indicators through which the effectiveness of self-regulatory regimes can be analysed and explained. These indicators are applied in the following

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[37] Marian Ojo, 'LIBOR, EURIBOR and the regulation of capital markets: The impact of Eurocurrency markets on monetary setting policies' (2012), 4 <https://mpra.ub.uni-muenchen.de/42093/1/MPRA_paper_42093.pdf> Accessed 20th January 2018. See also Eric Helleiner, & Stefano Pagliari, 'The End of Self-Regulation? Hedge Funds and Derivatives in Global Financial Governance' in Eric Helleiner, Stefano Pagliari & Hubert Zimmerman (eds), *Global Finance in Crisis: The Politics of International Regulatory Change* (Taylor & Francis, 2009) 125.

[38] Ibid.

[39] Renee De Nevers 'The Effectiveness of Self-Regulation by the Private Military and Security Industry' (2010) 30(2) Journal of Public Policy 219-240.

[40] Much of these are analysed below.

chapters in assessing the effectiveness of the self-regulatory framework for Sovereign Wealth Funds through the International Forum of Sovereign Wealth Funds (IFSWF) and the Santiago Principles.

2.2 the Foundations of Self-regulation

Scholars across vast disciplines of the social sciences have long identified the shift from top-down, centralised systems of regulation to forms of governance that are decentred, voluntary and non-hierarchical.[41] A visible indicator of this is the proliferation of rule-making and mediating bodies with little formal, legal or institutional links to government and the diffusion of voluntary codes and standards across various spheres of regulatory activity within and beyond national boundaries.[42] Underlying this shift is the realisation that the fluidity and complexity of informational flows and the cross-border nature of business and societal interactions does pose gigantic challenges to hierarchical, state-driven models of regulatory governance.[43]

Amongst these new forms of governance are self-regulatory approaches. Self-regulation as a form of social organisation has a long and controversial history, which can be traced back to the efforts of religious fraternities, medieval merchants and trade guilds to shape the conduct of their members.[44] Today however, modern self-regulatory regimes exist across vast areas of social activity. Oft-cited examples include professional associations in law, accountancy and medicine which regulate the conduct of their members, product accreditation bodies which certify certain

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[41] David Levi-Faur, '*From "Big Government" to "Big Governance'* in David Levi-Faur (eds) *Oxford Handbook of Governance* (1st edn, Oxford University Press, 2012), Saule Omarova, 'Rethinking the Future of Self-Regulation' (2010) 35(3) Brook. J. Int'l L 663, 672.

[42] Julia Black, 'Constitutionalising Self-Regulation' (1996) 59(1) 59(1) Modern Law Review 24, 25.

[43] Saule Omarova, 'Rethinking the Future of Self-Regulation' (2010) 35(3) Brook. J. Int'l L 663, 672. See also, J Black, '*Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a Post-Regulatory World'* (2001) 54(1) Current Legal Problems 103, 106 & 107.

[44] Saule Omarova, 'Rethinking the Future of Self-Regulation' (2010) 35(3) Brook. J. Int'l L 663, 671

products as fit for purpose and formal self-policing institutions and networks in diverse industries and sectors of the global economy who shape and constrain the behaviour of their members and participants.

Given the wide variety of self-regulatory regimes, it is therefore unsurprising that the concept continues to defy simple definitions. It has in fact been identified as a multifaceted and much disputed concept.[45] Similarly, Julia Black describes it as a normatively loaded term.[46] This definitional challenge is made much worse in scholarly literature where 'self-regulation' is often analysed under such diverse historic and modern nomenclature such as gentlemen agreements, codes of conduct, ethical guidelines, voluntary agreements, standards, networks, private regulation and private government amongst others.[47] Even worse, analyses of modern self-regulation is often applied fungibly with new theoretical perspectives such as new governance, collaborative governance, networked governance, interactive governance, and soft law.[48]

As suggested above, the meaning of self-regulation continues to evade clear-cut conceptual or definitional cohesion. Yet, several attempts have been made to describe this phenomenon. At one end of the spectrum are scholars of a collectivist or institutionalist persuasion who see self-regulation as the collective exercise of an industry, sector or network to regulate itself through standards of conduct and norms of good behaviour.[49] According to this view, self-regulation occurs when actors within an industry or sector design and enforce rules and standards

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[45] Ibid.

[46] Julia Black, 'Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a Post-Regulatory World' (2001) 54(1) Current Legal Problems 103, 115

[47] Tony Porter and Kasten Ronit, 'Self-regulation as policy process: The multiple and criss-crossing stages of private rule-making' (2006) 39 Policy Sciences 41-72.

[48] Ibid.

[49] Neil Gunningham and Joseph Rees, 'Industry Self-Regulation: An Institutional Perspective' (1997) Law and Policy 363, 365, Cosmo Graham, 'Self-Regulation', in G Richardson and H Genn (eds) *Administrative Law and Government Action, The Courts and Alternate Mechanisms of Review* (Clarendon Press, Oxford 1994), Robert Baldwin, Martin Cave, and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (2nd edn, OUP, 2011) pg 137.

themselves.[50] Proponents of this approach adopt a rather broad and expansive interpretation of the word 'self'. The focus of analysis is not on a particular firm or organisation but rather on the efforts of an industry, network or group of firms to organise, shape, steer and order interactions amongst themselves often with the use of negotiated and mutually agreed principles or codes of conduct which operate on a voluntary basis.[51] This approach thus assumes a horizontal system of ordering through which the 'self' (participants in a particular industry or network) initiates behaviour-modifying efforts – as opposed to top-down government imposition of rules and standards – for the benefit of the regulated industry or community.[52]

At the polar opposite of the debate are scholars who take an entity-level view of 'self-regulation.[53] Proponents of this approach favour a rather individualistic interpretation of the word 'self'. Here, the focus is on intra-firm or entity-level arrangements and techniques unilaterally adopted by a given organisation to regulate itself, independent of others.[54] This understanding of self-regulation or self-governance is obviously divorced from collectivist approaches explained above because it sees the regulating firm as the centre of analysis as opposed to the collectivist approach which views self-regulation as the product of relatively institutionalised interactions

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[50] Virginia Haufler, *A Public Role for the Private Sector Industry Self-Regulation in a Global Economy* (1st edn, Carnegie Endowment for International Peace, 2001) 8. See also Neil Gunnigham and Joseph Rees, Industry Self-Regulation: An Institutional Perspective (1997) Law and Policy 363, 365.

[51] Neil Gunningham and Joseph Rees, 'Industry Self-Regulation: An Institutional Perspective' (1997) Law and Policy 363, 365.

[52] CFA Institute, 'Self-Regulation in Today's Securities Markets: Outdated System or Work in Progress?' (2007) Available [online] at <https://www.cfapubs.org/doi/pdf/10.2469/ccb.v2007.n7.4819> Accessed 20th January 2018.

[53] Saule Omarova, 'Rethinking the Future of Self-Regulation' (2010) 35(3) Brook. J. Int'l L 663, 672, J Black, Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a Post-Regulatory World (2001) 54(1) Current Legal Problems 103, 106

[54] Cory Coglianese and David Lazer, 'Management-Based Regulation: Prescribing Private Management to Achieve Public Goals' (2003) 37 Law and Society Review 691, Neil Gunningham and Duncan Sinclair, 'Smart *Regulation'* in P Drahos (eds), *Regulatory Theory: Foundations and Applications* (ANU Press, 2017) 140, See also, Julia Black, 'Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a Post-Regulatory World' (2001) 54(1) Current Legal Problems 103, 118.

amongst rational actors in an industry or network with one of the objectives being the modification of behaviour amongst participants.

Between these extremes are middling explanations of self-regulation which emanate from a private transactional or private law perspective. In this context, self-regulation is used to explain the interactions of individuals and firms in negotiating legally binding contracts.[55] Collins' provocative treatise provides an illustrative example of this approach. He argues that private contractual arrangements can be characterised as self-regulation because the contracting parties are the source of the rules, they monitor each other's compliance and seek external enforcement or sanctions from the courts in the event of infractions.[56] As Collins opines "the private law of contract uniquely among regulatory systems provides a species of 'self-enforced self-regulation' in that it is left to the parties themselves to decide whether or not compliance with the rules should be insisted on."[57]

This interpretation of self-regulation at first sight seeks to explain private contracting by emphasising the flexibility of contract law, and the autonomy of the parties to contract on whatever terms they deem fit. Yet, a keen observer might equally observe that it is not entirely divorced from collectivist understandings of self-regulation. Indeed, one may argue that Collins' understanding of self-regulation is merely a variant of self-regulation in the collectivist sense, differing only in the fact that the contractual rules are bilateral rather than multilateral as in other examples of collective self-regulation.

Although divided in their different interpretation and understandings of self-regulation, all three approaches appear to be united by a common view of self-regulation as mutually exclusive

[55] Hugh Collins, *Regulating Contracts* (Oxford University Press, 2000) 63

[56] Ibid. at 66-7.

[57] Ibid.

from traditional forms of governance in which the state has a monopoly.[58] However, for the purposes of this thesis, attention is placed on collectivist understandings of Self-regulation which adopt a broad interpretation of 'self' as opposed to its unitary or entity-level variant.

2.3 Transnational Self-Regulation, Patterns and Drivers.

Although much of the literature analyses domestic forms of self-regulation, it is imperative to note that these regimes are in fact proliferating across the transnational regulatory space. By 'transnational', this thesis merely identifies the cross-border flows of business and society interactions and the emergence of rule-making in spatial regimes not confined to nation states' jurisdictional boundaries.[59] Given that these interactions occur outside the precincts of traditional inter-state or intergovernmental processes, 'transnational' rather than 'international' seems a more convenient analytical label. [60]

Transnational self-regulatory arrangements are also coterminous with the varied regulatory phenomena that has emerged in response to global governance gaps and which have been analysed in modern academic literature as Transnational 'new governance'[61] 'regulatory standard-setting'[62] and even Global or Transnational Private Regulation.[63]

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[58] Julia Black, Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a Post-Regulatory World (2001) 54(1) Current Legal Problems 103.

[59] Peer Zumbansen, 'Neither `Public' nor `Private', `National' nor `International': Transnational Corporate Governance from a Legal Pluralist Perspective' (2011) 38(1) Journal of Law and Society 50, 59

[60] Paul Verbruggen, 'Gorillas in the closet? Public and private actors in the enforcement of transnational private regulation' (2013) 7 Regulation and Governance 512, 514.

[61] Kevin Abbott and Duncan Snidal, 'Strengthening International Regulation Through Transnational New Governance: Overcoming the Orchestration Deficit' (2009) 42 Vand. J. Transnat'l L 501, 509.

[62] Kevin Abbott and Duncan Snidal, 'The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State Regulatory' in Walter Mattli and Ngaire Woods (eds), *The Politics of Global Regulation* (Princeton University Press, 2009)

[63] Fabrizio Cafaggi, 'A Comparative Analysis of Transnational Private Regulation: Legitimacy, Quality, Effectiveness and Enforcement' (November 2014) EUI Department of Law Research Paper No. 2014/145, 8 <https://ssrn.com/abstract=2530516 or http://dx.doi.org/10.2139/ssrn.2530516> Accessed 30th January 2018.

In studying these regimes, it is useful to keep certain analytical distinctions in mind. First, it is important to understand the relationship of these regimes to state authority and second, their structural nature and regulatory goals.

As to the former, most global self-regulatory regimes do not have formal linkages to state actors.[64] This however does not mean that they develop or exist in total isolation from sovereign authority or even that domestic regulators and nation states are on the cusp of irrelevance in so far as transnational regulation is concerned. The opposite is in fact the case. There are indeed numerous examples of public actors, states or collections of states playing more nuanced roles as catalysts, coordinators, facilitators, supporters or orchestrators of transnational self-regulatory regimes.[65] In some instances also, state actors participate indirectly in regimes of a multi-stakeholder nature. Yet, the subtle role of the state in facilitating or orchestrating these regimes does not mean that Transnational Self-Regulatory regimes derive their authority from nation states.[66]

In addition to their relationship to Sovereign authority, TSR arrangements also arise in different forms and shapes and pursue varied regulatory goals. They are either created as industry networks composed of actors within a particular industry whose own practices or those of supplier firms are the targets of regulation; or as multi-stakeholder regimes that bring together different interest groups including civil society organisations, private firms and occasionally public or private regulators in a single organisational aegis.[67] Yet, as Caffaggi and Renda remind us, any attempt to reach a complete taxonomy of the existing forms of private or self-regulation is likely to remain

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[64] Kevin Abbott and Duncan Snidal, 'Strengthening International Regulation Through Transnational New Governance: Overcoming the Orchestration Deficit' (2009) 42 Vand. J. Transnat'l L 501, 505.

[65] Ibid. at 510.

[66] Steven Bernstein and Ben Cashore, 'Can non-state global governance be legitimate? An analytical framework' (2007) 1(4) Regulation and Governance 347, 348-349.

[67] Kevin Abbott and Duncan Snidal, 'Strengthening International Regulation Through Transnational New Governance: Overcoming the Orchestration Deficit' (2009) 42 Vand. J. Transnat'l L 501, 505.

incomplete.[68] This is because of the wide variety of extant schemes and partnerships that can be characterised as self-regulatory. That said, certain scholars such as Kevin Abbott and Duncan Snidal have attempted to construct an operational taxonomy of transnational standard–setting regimes drawing on the nature of participants and actors within them. Figure 1 below shows their 'governance triangle' in which they examine a broad constellation of standard setting organisations, including self-regulatory regimes.[69] Although imperfect and often abstract, the triangle provides a helpful depiction of the actual variety of institutions of a self-policing nature.

The vertex triangles (Zones 1-3) show regimes in which actors of a single group develop and implement regulatory standards largely on their own, with only modest participation, from actors of another genus. For instance, Zone 1 shows regulatory arrangements in which a state, or group of states through an inter-governmental organisation sets standards that apply directly to transnational business organisations often through soft laws and the like.[70] Most prominent in Zone 1 are standards promulgated by the OECD such as the Guidelines for Multinational Enterprises, an international 'soft' benchmark agreed by OECD member states to regulate the cross border activities of Multinational Enterprises often in the global south.[71] These regimes are obviously more intergovernmental than self-regulatory. Yet, their inclusion in the governance triangle reflects the rise of soft forms of legalisation in the regulation of transnational actors.

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[68] Fabrizio Caffaggi and Andrea Renda, 'Public and Private Regulation: Mapping the Labyrinth' (2012) CEPR Working Paper No. 370, 9 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2156875> Accessed 29th January 2018.

[69] 'Governance Triangle' culled from Kevin Abbott and Duncan Snidal, 'The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State Regulatory' in Walter Mattli and Ngaire Woods (eds), *The Politics of Global Regulation* (Princeton University Press, 2009).

[70] "Soft Law" entails legal arrangements that are weakened along one or more of the dimensions of obligation, precision, and delegation. For more of an explication See Kevin Abbott and Duncan Snidal, 'Hard and Soft Law in International Governance' (2000) 54(3) International Organisation 421, 423.

[71] Kevin Abbott and Duncan Snidal, 'The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State Regulatory' in Walter Mattli and Ngaire Woods (eds), *The Politics of Global Regulation* (Princeton University Press, 2009).

Zone 2 on the other hand depicts the cascade of pure inter-firm or industry driven self-regulatory schemes in which the regulator and regulated coincide in the same entities.[72] These schemes are the polar opposite of public regulatory systems in which regulator and regulated are separate from each other and are organised in adversarial and vertical relationships. Examples referenced in Abbot and Snidal's triangle include Responsible Care, the self-regulatory framework for the Global Chemical Industry amongst others.[73] The Santiago Principles and the International Forum of Sovereign Wealth Funds (the subject matter of this thesis) also has enough of an historical, organisational or membership story to fit within this model.[74] Other modern examples include the Standards Board for Alternative Investment (SBAI) formerly known as the Hedge Fund Standards Board which produces transnational regulatory standards for the Hedge Fund industry.[75] In industry-driven models, typical institutional challenges revolve around conflicts of interest and regulatory capture both of which are analysed further below.

Zone 3 arrangements capture codes and regulatory standards promulgated by NGOs and NGO Coalitions. A common denominator in these regimes is that they are established by civil society actors acting collectively as a group. The governance triangle below depicts schemes such as the Clean Clothes Campaign (CCC), established by Western NGOs to promote Corporate Social Responsibility in the global garments and clothing sector and the Workers' Rights

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[72] Fabrizio Cafaggi, New Foundations of Transnational Private Regulation (2010) EUI Working Paper RSCAS 2010/53, 9 <http://cadmus.eui.eu/bitstream/handle/1814/15284/RSCAS_2010_53.pdf?sequence=1&isAllowed=y> Accessed 20th January 2018.

[73] International Council for Chemical Associations, Responsible Care (2018) <https://www.icca-chem.org/responsible-care/> Accessed 20th May 2018.

[74] IFSWF, Santiago Principles (2008) <http://www.ifswf.org/santiago-principles-landing/santiago-principles> Accessed 20th May 2018.

[75] SBAI, About the SBAI (2018) <https://www.sbai.org/about-us/> Accessed 20th May 2018.
For a broader discussion on the origins of the HFSB, see Andreas Engert, 'Transnational hedge fund regulation' (2010) 11(3) European Business Organization Law Review 329.

Consortium, established by civil society organisations to promote ethical practices in supply chains and promote safer working conditions for affected stakeholders.

Besides the vertex triangles are Quadrilateral triangles (Zones 4-7) which show schemes of a multi-stakeholder nature. Some of these self-regulatory schemes bring together different interest groups, typically private firms and civil society organisations within a single organisational aegis. Occasionally also, public authorities and regulators may participate either directly or indirectly as observers.[76] These schemes generally arise due to concerns about the independence, neutrality and objectivity of Industry-based models and are typically created in areas of high public salience such as environmental regulation, internet governance and increasingly, in areas of technical standardisation.[77] Notable schemes depicted in the quadrilateral triangles in Zones 4-7 include the UN Global Compact, in which the UN Secretariat collaborates with Private Firms, with limited input from civil society organisations. Also mentioned in Zone 4 is the Equator Principles which brings together Private Financial Institutions active in the Project Finance sphere, multilateral agencies such as the International Finance Corporation and civil society organisations in the drafting and revision of the principles.[78] Another prominent organisation shown in the quadrilateral triangles (Zone 6) is the Forest Stewardship Council (FSC), a multi-stakeholder regime in the environmental governance and sustainability sphere. The FSC was originally created as a private association regulated by Mexican Law but has since morphed into a recognised source of transnational forestry standards.[79] As Figure 3 below shows, the FSC is built around a truly

[76] Fabrizio Cafaggi, 'New Foundations of Transnational Private Regulation' (2010) EUI Working Paper RSCAS 2010/53, 11 <http://cadmus.eui.eu/bitstream/handle/1814/15284/RSCAS_2010_53.pdf?sequence=1&isAllowed=y> Accessed 20th January 2018.

[77] Ibid. at 12.

[78] Will Martens, Bastiaan Van Der Linden and Manuel Worsdorfer, 'How to Assess the Democratic Qualities of a Multi-stakeholder Initiative from a Habermasian Perspective? Deliberative Democracy and the Equator Principles Framework' (2017), 1 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2953404> Accessed 20th March 2018.

[79] Forest Stewardship Council 'Who we are' (2018) <https://ca.fsc.org/en-ca/about-us> Accessed 20th January 2019.

representative and dominant members' assembly which brings together different interest groups such as environmental and social NGOs, timber traders, forestry and indigenous peoples' organisations, retailers, manufacturers and interested private individuals.[80] The Assembly provides the strategic leadership of the Council and also doubles as its ultimate decision-making body.[81]

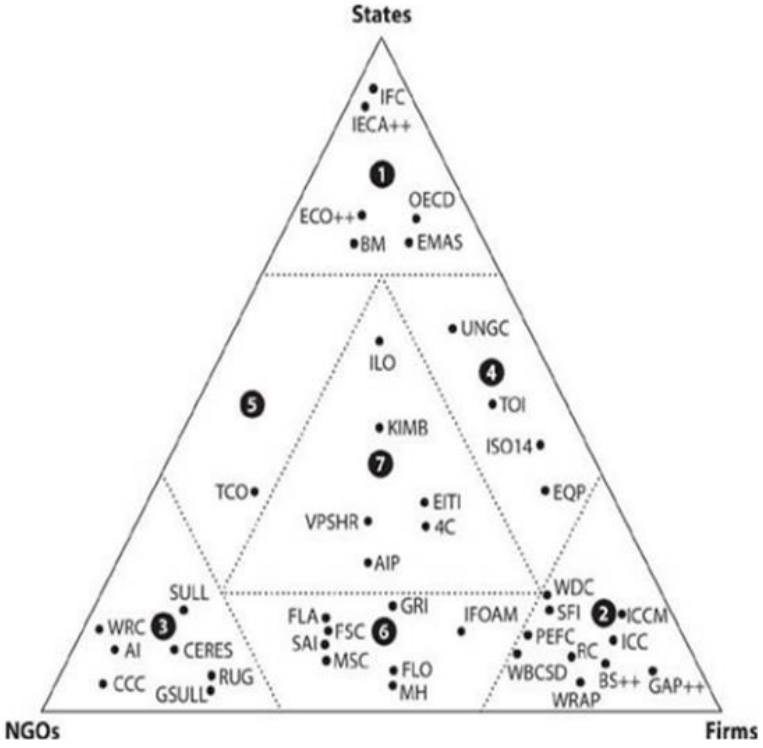

Figure 1: Kevin Abbott and Duncan Snidal's Governance Triangle which describes the different forms of transnational regulatory standard setting beyond the nation-state. sourced from Abbott and Snidal (2009)[82]

[80] Forest Stewardship Council, 'Governance' (2018) <https://www.fsc-uk.org/en-uk/about-fsc/who-is-fsc/governance> Accessed 20th February 2018.

[81] Ibid.

[82] sourced from Abbott and Snidal (2009) op cit.

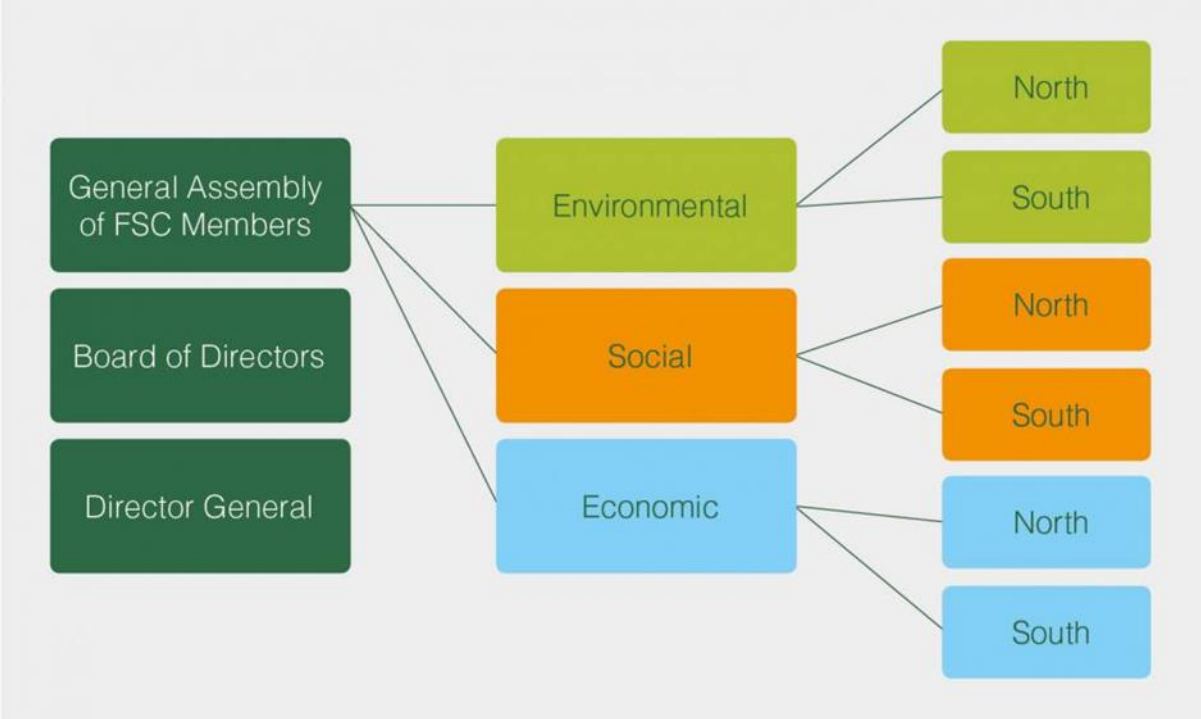

Figure 2: Forest Stewardship Council Organisational Structure showing its multistakeholder nature. Source FSC (2018)[83]

Beyond taxonomical considerations, it is also important to analyse why these schemes arise in the first place. Here, the literature identifies several motivations and factors, some strategic and others normative.

Certain accounts link the rise of transnational self-regulation to the weaknesses, inadequacies and shortcomings of the regulatory state as a global rule maker.[84] These weaknesses originally fostered the emergence of international policy coordination bodies such as the International Monetary Fund, the United Nations and the World Bank in the first half of the last century. Yet, International public regulation by states has often had an imperfect record. For

[83]Forest Stewardship Council, Governance (2018) <https://www.fsc-uk.org/en-uk/about-fsc/who-is-fsc/governance> Accessed 20th February 2018.

[84] Fabrizio Cafaggi, 'New Foundations of Transnational Private Regulation' (2010) EUI Working Paper RSCAS 2010/53, 5 <http://cadmus.eui.eu/bitstream/handle/1814/15284/RSCAS_2010_53.pdf?sequence=1&isAllowed=y> Accessed 20th January 2018.

instance, critics point to a difficult record of agreement or consensus on regulatory standards amongst negotiating states in intergovernmental fora.[85] Others point to the inconsistency of implementation and compliance even where regulatory standards exist.[86] Against this backdrop, certain scholars argue that transnational self-regulatory regimes arise, though not always, as a response to intergovernmental coordination deficits. For instance, Meidinger reminds us that attempts by the United Nations Conference on Environment and Development (UNCED) to create a binding forest convention often foundered, leading to the creation of self-policing regimes by Non-Governmental Organisations and other Non-state Actors including the Forest Stewardship Council (FSC).[87] Yet, a compelling rebuttal would be that self-regulatory regimes are themselves not immune from the imperfections of traditional inter-state regimes, in and around the compliance and implementation of norms.[88] As will be seen below, self-regulatory regimes also face free-rider problems involving actors and participants who freeload from the reputational benefits of being part of a regime without bearing the compliance costs. [89]

Related to the coordination deficit problem is the idea of a governance gap. These gaps arise given the fact that the mobility of goods and services across national frontiers does not always lend itself easily to direct regulation by national policy makers.[90] This is mostly the case in the context of Global public goods (Deforestation, reduction in carbon emissions etal) where inter-

[85] Ibid.

[86] ibid.

[87] Errol Meidinger, 'the Administrative Law of Global Private-Public Regulation: The Case of Forestry' (2006) 17 European Journal of International Law 47, 50.

[88] Anthony Ogus and Emmanuella Carbonara, 'Self-regulation' in F Parisi, O Wolff and Donnelly (eds) *Production of Legal Rules* (Edward Elgar, 2011) 232.

[89] Ibid.

[90] Fabrizio Caffaggi and Andrea Renda, 'Public and Private Regulation: Mapping the Labyrinth' (2012) CEPR Working Paper No. 370, 5 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2156875> Accessed 29th January 2018.

state policy cooperation is heavily needed but is often absent.[91] Critics argue that this lack of coordination and cooperation can often lead to a race to the bottom and disastrous outcomes.[92] Governance Gap theory thus assumes that the absence of cooperation amongst traditional policymakers can create enormous policy vacuums or gaps that transnational self-regulators often occupy. For instance, Meyerstein argues persuasively that the absence of international policy coordination in the projection of social and environmentally enhancing capital flows, prompted the creation of the Equator Principles, a Risk Management and Self-regulatory framework for Banks and Financial Institutions involved in the provision of project finance.[93]

Another driver of transnational self-regulation is the need to manage the realities of fast-moving markets. Here, scholars speak, in particular, of high-end, modern and fast-changing markets in technological and knowledge-intensive sectors in which the highly technicised information needed for effective ordering is often possessed by private actors.[94] Caffaggi and Renda opine that these markets often prove 'awkward' for public regulators, prompting a reliance on industry networks, at least for the elaboration of implementing standards and technical measures.[95] These technical standard-setting groups often arise in sectors characterised by functional complexity such as Internet Governance and Risk Regulation. Regimes of this mould include the Internet Corporation for Assigned Names and Numbers (ICANN), a multi-stakeholder regime that develops technical standards for the internet and the International Swaps

[91] Public Goods are goods characterised by non-rivalry and non-excludability. See Fabrizio Cafaggi, 'Transnational Private Regulation and the Production of Global Public Goods and Private bads' (2012) 23(3) European Journal of International Law 695, 696.

[92] Ariel Meyerstein, 'Global Private Regulation, Global Finance and the Future of Corporate Human Rights Accountability' (2012), 12 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2018999> Accessed 20th May 2018.

[93] Ibid.

[94] Fabrizio Caffaggi and Andrea Renda, 'Public and Private Regulation: Mapping the Labyrinth' (2012) CEPR Working Paper No. 370, 5 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2156875> Accessed 29th January 2018.

[95] Ibid.

and Derivatives Association (ISDA) which produces contractual and other technical standards for the regulation of Derivative Markets. [96]

An additional reason for the emergence of transnational self-regulatory regimes is the need to reduce transaction costs. Excessive costs arise if an actor, in conducting inter-organisational economic activity, is faced with inordinate burdens and risks.[97] We see these costs in industries in which participants engage in business operations and interactions that traverse national boundaries and which are subject to the risks of regulatory divergence.[98] TSR regimes therefore arise in these eco-systems to reduce transaction costs and thereby de-risk the cross-border interactions and activities of participating actors. In financial markets, for instance, self-regulatory regimes have often arisen to standardise contractual arrangements for participants in the OTC derivative markets. This is indeed the story of the emergence of the International Swaps and Derivatives Association (ISDA), the self-regulator for the Global Derivatives Industry.[99] As Biggins and Scott report, ISDA's formation was provoked, in part, by the proliferation of different contract types between participants in derivatives markets.[100] Since its inception however, ISDA has gone on to enact and revise a single Master Agreement which is a boilerplate contract containing standardised legal obligations regulating the relationship between parties in a derivatives contract. Provisions contained therein include, general day-to-day obligations owed by each party to the transaction, as well as provisions addressing events of default, termination and frustration events, immunity issues, choice of Law and so forth.

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[96] Ibid.

[97] John Biggins and Colin Scott, 'Public-Private Relations in a Transnational Private Regulatory Regime: ISDA, the State and OTC Derivatives Market Reform' (2012) 13 European Business Organization Law Review 309, 323.

[98] Fabrizio Cafaggi, 'A Comparative Analysis of Transnational Private Regulation: Legitimacy, Quality, Effectiveness and Enforcement' (November 2014) EUI Department of Law Research Paper No. 2014/145,28 <https://ssrn.com/abstract=2530516 or http://dx.doi.org/10.2139/ssrn.2530516> Accessed 30th January 2018.

[99] John Biggins and Colin Scott, 'Public-Private Relations in a Transnational Private Regulatory Regime: ISDA, the State and OTC Derivatives Market Reform' (2012) 13 European Business Organization Law Review 309, 323.

[100] Ibid.

Besides the need to reduce or eliminate transaction costs, Self-regulatory regimes also arise for signalling, reputational or legitimacy-based reasons. This is often a product of the activism of various stakeholder constituencies who may be adversely affected by certain business practices.[101] This pressure is most likely to be felt in areas of high public salience such as environmental protection, ethical trading, human rights, child labour amongst others.[102] Indeed, Haufler has profiled the rise of transnational activist networks, ranging from civil society organisations engaging in campaigns against socially irresponsible practices by transnational corporations to Shareholder activist groups proselytising the virtues of responsible investment.[103]

Vogel on the other hand talks of the spectre of political and societal pressures on businesses spearheaded by national and transnational activists who have embarrassed global firms by publicising the shortcomings of their business models on society and the environment.[104] The inordinate force behind these campaigns often spur the creation of self-policing regimes amongst business actors whose practices have provoked criticism. This is related to the idea of reputation as a global corporate asset.[105] Increasingly, corporations across several industries feel the need to protect their reputation from negative coverage and perceptions.[106] This is particularly so in consumer-facing sectors where a reputation for making a quality product or behaving in a socially responsible and reputable manner often equates to a stronger brand name.[107] it follows, therefore, that corporations perceived to produce non-quality products or linked to disreputable or unethical

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[101] Virginia Haufler, *A Public Role for the Private Sector Industry Self-Regulation in a Global Economy* (1st edn, Carnegie Endowment for International Peace, 2001) 23

[102] Ibid.

[103] Ibid. See Also David Vogel, 'The Private Regulation of Global Corporate Conduct: Achievements and Limitations' (2010) 49(1) Business and Society 68, 70.

[104] Ibid.

[105] Virginia Haufler, *A Public Role for the Private Sector Industry Self-Regulation in a Global Economy* (1st edn, Carnegie Endowment for International Peace, 2001) 26.

[106] Ibid.

[107] Ibid.

practices are likely to face bottom-line effects when and if consumers or stakeholders abandon them.[108] The rational and often calculated instinct to protect and safeguard the intangible asset of a corporation or industry's reputation sometimes spurs positive action in firms and across industries, including the institutionalisation of collective action or self-policing arrangements.[109]

Last but not least, Self-regulatory regimes can also arise to pre-empt or forestall far more stringent regulatory responses. This approach is often labelled self-regulation in the 'shadow of hierarchy' and can be observed again in areas where traditional policymakers or stakeholders have considered or called for more far stringent legislative actions. The primary objective of self-policing regimes in such a circumstance is simple: to avoid or pre-empt costly policy responses. Vogel reminds us that Responsible Care, the global self-regulatory program for the International chemical industry was adopted, in part, to forestall far stringent plant safety regulations by nation states following the cataclysmic tragedy at Bhopal, India in 1984.[110]

The same can be said for the International Chamber of Commerce's Business Charter for Sustainable Development which was initiated by transnational corporation who feared that the 1992 Rio 'Earth Summit' would lead to a rapid rise of stringent international environmental regulations.[111] Although certain schemes that have arisen in the shadow of hierarchy are considered robust and legitimate, there are deeper concerns about the underlying motives of these programs and their sponsors as well as their broader viability and credibility. Questions typically raised about these regimes revolve around whether they are primarily a defensive response and thus a sophisticated form of regulatory capture or whether they are pure rhetorical commitments without

[108] Ibid.

[109] David Vogel, 'The Private Regulation of Global Corporate Conduct: Achievements and Limitations' (2010) 49(1) Business and Society 68, 77.

[110] Ibid. at 76.

[111] Ibid.

any real drive or enthusiasm.[112] Having examined the rise, patterns and motivations of TSR regimes, it is important to consider their promises and limits.

2.4 Promises of Self-Regulation.

Like several forms of regulatory ordering, self-regulatory regimes are not without benefits and costs. For its staunchest advocates, Self-Regulation offers significant advantages over alternatives which manifest in flexible policy solutions, the use of Industry expertise and the promise of greater compliance. By contrast, strident critics argue that it is beset by flaws such as regulatory capture and conflicts of interest, weak enforcement and sanctioning and free riding. These benefits and costs are examined in greater detail below.

2.4.1 Regulatory Expertise

Perhaps the most publicised benefit of self-regulation both in its national and transnational manifestations is that it is capable of channelling the expertise of regulated firms across its processual phases.[113] A familiar claim in this context is that self-regulatory bodies and networks command higher levels of expertise and technicised knowledge than is commonly possible under state-driven forms of regulation and governance.[114] This argument is often hinged on the complexity of markets, the fragmentation of knowledge and the need to infuse relevant industry experience into the promulgation of regulatory instruments.[115] By way of example, Coglianese and Mendelson assert that self-regulation allows traditional regulators to address governance gaps

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[112] Ibid. at 78.

[113] Fabrizio Caffaggi and Andrea Renda, Public and Private Regulation: Mapping the Labyrinth (2012) CEPR Working Paper No. 370, 12 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2156875> Accessed 29th January 2018.

[114] Cory Coglianese and Evan Mendelson, 'Meta-Regulation and Self-Regulation' in Robert Baldwin, Martin Cave, and Martin Lodge (eds) *The Oxford Handbook of Regulation* (Oxford University Press, 2010) 9

[115] Julia Black, Critical Reflections on Regulation (2002) Centre for Analysis of Risk and Regulation, London School of Economics and Political Science, 3<http://www.lse.ac.uk/accounting/Assets/CARR/documents/D-P/Disspaper4.pdf> Accessed 20th January 2018.

when they lack the resources or information needed to craft sound discretion limiting rules.[116] Such a view assumes that traditional regulators do not always possess a monopoly of information or knowledge or even the answers to complex regulatory problems.[117] To compensate for this paucity of knowledge, market actors or industry participants are then co-opted to set behaviour-modifying standards amongst themselves. According to Baldwin, Cave and Lodge, this accumulated judgement and expertise allows self-regulating groups to craft rules that are practicable and acceptable to affected firms and organisations, leading to a level of 'buy in' and acceptance of the emergent norms.[118]

Although compelling, the expertise argument is not immune to challenges. For one, the potential for easier access to industry expertise does not guarantee that self-regulatory regimes will deploy such expertise effectively in policing its members.[119] Indeed, one danger with self-regulatory regimes is that 'expertise' may be used to craft easily evaded and loophole-ridden standards which make it easier for actors to game the process and undermine its efficacy.[120]

Also, it deserves to be mentioned that regulatory expertise is often not a monopoly of an industry or its participants.[121] As Baldwin, Cave and Lodge remind us, expertise can equally be sourced from outside the industry or network.[122] Indeed, many self-regulating regimes do not rely

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[116]Cory Coglianese and Evan Mendelson, 'Meta-Regulation and Self-Regulation' in Robert Baldwin, Martin Cave, and Martin Lodge (eds) The Oxford Handbook of Regulation (OUP, 2010) 9

[117] Julia Black, 'Critical Reflections on Regulation' (2002) Centre for Analysis of Risk and Regulation, London School of Economics and Political Science, 3<http://www.lse.ac.uk/accounting/Assets/CARR/documents/D-P/Disspaper4.pdf> Accessed 20th January 2018.

[118] Robert Baldwin, Martin Cave, and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (2nd edn, OUP, 2011) 139.

[119] Ben Edwards, 'The Dark Side of Self-Regulation' (2016) 85 University of Cincinnati Law Review 573, 602.

[120] Ibid.

[121]Robert Baldwin, Martin Cave, and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (2nd edn, OUP, 2011) 139.

[122] Ibid.

solely on the expertise of participants in drafting rules or enforcing compliance.[123] Some look beyond the industry or network to epistemic communities, third-party certification bodies and non-governmental organisations in the promulgation and enforcement of standards.[124]

2.4.2 Flexibility

Self-regulation has also been promoted on the basis of its flexible credentials. Here, it is argued that rulemaking via command and control structures can often be ponderous, inflexible and less adaptable to the dynamism of markets and society at large.[125] Proponents of this view argue that the constraints of formal governance such as legislative scrutiny and other layers of accountability can often stymie the rulemaking process and leave command and control rules out of date and thus ineffective. Self-regulation is instead cast as a flexible policy solution which ensures that rules can be quickly and easily adjusted to changing circumstances.[126] Advocates of this worldview also aver that self-regulatory regimes and networks are immune from the procedural constraints of government referred to above and are thus light and quick on their feet.[127]

Whilst flexibility is identified as an advantage of self-regulation, it is not a silver bullet. For instance, quick and flexible self-regulatory responses may undermine broad industry or stakeholder representation and interests.[128] Flexibility may also imply vagueness of regulatory instruments or the exercise of discretion which favour certain interests above others.[129] More so, it is overly

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[123] Ibid.

[124] Ibid.

[125] Margot Priest, 'The Privatization of Regulation: Five models of Self-Regulation' (1998) 29 Ottawa Law Review 233, 270. R Ong, *Mobile Communication and the Protection of Children* (Leiden University 2010) 249.

[126] Robert Baldwin, Martin Cave, and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (2nd edn, OUP, 2011) 140.

[127] Margot Priest, 'The Privatization of Regulation: Five models of Self-Regulation' (1998) 29 Ottawa Law Review 233, 269.

[128] Ibid. at 270.

[129] Ibid. see also Rebecca Ong, *Mobile Communication and the Protection of Children* (Leiden University, 2010) 249.

simplistic to argue that self-regulatory regimes do not suffer from the procedural constraints associated with forms of command and control regulation. These regimes operate often on the basis of voluntarism and goodwill, meaning that the process of developing and agreeing rules can involve ponderous and protracted negotiations.

2.4.3 Better Compliance and Rulemaking

Yet another debated advantage of Self-regulation is the idea that close participation by industry actors in the promulgation of standards might induce a level of 'buy-in' and generate a high commitment to compliance.[130] Here, advocates for Self-regulation aver that participation in the complex interactions through which standards are created, interpreted and elaborated will enhance normative legitimacy and strengthen the claim to obedience.[131] By way of example, the renowned academic Professor John Coffee argues in his seminal treatise that "Self-regulation invites the participation of the regulated, thereby increasing the prospect of law compliance."[132]

At the heart of this approach is a suspicion of top-down rules and adversarial forms of enforcement (the hallmarks of command-and-control regulation).[133] It should be noted that in command and control regulatory systems, the state literally commands regulatory targets to meet specific standards either directly through legislation or indirectly through delegated authority.[134] This means that there is little or no room for firms to shirk their regulatory obligations without the possibility of sanction. The underlying rationale behind command and control regimes is

[130] Julia Black, 'Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a Post-Regulatory World' (2001) 54(1) Current Legal Problems 103,115.

[131] Ibid.

[132] John Coffee, Hillary Sale and Todd Henderson*, Securities Regulation: Cases and Materials* (13th edn, Foundation Press, 2015) 688.

[133] Darren Sinclair, 'Self-regulation versus Command and Control? Beyond false dichotomies' (1997) 19(4) Law and Policy 529, 534.

[134] Ibid.

therefore the theory of deterrence, under which compliance is seen as a by-product of the probability of regulatory targets being punished and the severity of the penalties.[135]

By contrast, Self-regulation rejects the above. The emphasis is instead on gaining the consent and commitment of regulated firms through voluntary processes which draw on what Gunningham and Selznick describe as the internal morality of the firm or industry being regulated.[136] The principal and rather optimistic rationale here is that it becomes harder for an actor within a self-regulatory regime to reject a norm after participating in its development and engaging seriously during deliberations.[137] That said, this patently optimistic view of self-regulation does not mean that all self-policing systems are endowed with identical claims to legitimacy and obedience in the eyes of its targets.[138] Indeed, it is not implausible that varying degrees of consent might ensue, including a recognition of the regime's legitimacy and its rightful claim to compliance, grudging acquiescence and even outright disobedience.[139]

2.5 Limits of Self-Regulation

Just as the supporters of self-regulation extoll its virtues, Strident critics also inveigh against its risks. These include the propensity of self-policing regimes to regulate in favour of narrow institutional and ideological interests, problems of enforcement and compliance and a serious lack of transparency.[140] These are examined in turn below.

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[135] Ibid.

[136] Neil Gunningham and Joseph Rees, 'Industry Self-Regulation: An Institutional Perspective' (1997) Law and Policy 363, 366, Philip Selznick, The Moral Commonwealth: Social Theory and the Promise of Community (Berkeley, Ca 1992) 345.

[137] Neil Gunningham and Joseph Rees, 'Industry Self-Regulation: An Institutional Perspective' (1997) Law and Policy 363, 367.

[138] Ibid.

[139] Neil Gunningham and Joseph Rees, 'Industry Self-Regulation: An Institutional Perspective' (1997) Law and Policy 363, 367.

[140] The risks of Self-Regulation are, by no means, limited to the above. It is also argued, for example, that Self-Regulation can induce anti-competitiveness and cartelisation especially in consumer-facing industries. This is said to

2.5.1 The Promotion of Industry Self-Interest and regulatory capture

As indicated above, one prominent criticism of self-regulatory arrangements is its propensity to promote industry interests above the wider public good. Indeed, one of the traditional rationales for regulating socio-economic activity is to enhance and protect the public interest.[141] Public interest theories of regulation ascribe to legislators and others responsible for enacting rules, a desire to promote and enhance the interests of the public at large rather than the interests of a particular group, sector or individual.[142] For theorists in this area, regulation is important because an uncontrolled marketplace or private sector will produce behaviour or results that are inimical to desirable public objectives.[143]

While a well-functioning self-regulatory regime may offer significant benefits, including the protection of the public interest, it is often argued that self-regulatory schemes are prone to

operate when industry actors utilise self-regulatory powers for the purposes of protecting members from external competition. This can take place through crafting or influencing rules that inordinately burden competitors mostly external to the regime. Likewise, it is argued that a self-regulatory group may through its rules, erect significant barriers to entry within that industry, creating a magic circle of participants and imposing burdensome costs on new entrants. Such an approach, if successful, is obviously inimical to the idea of free and competitive markets. It also limits the ability of stakeholders beyond the self-regulatory regime to access goods and services from the widest possible sources and options. Above all, it deifies the interests of actors within the regime above other social welfare-enhancing interests. For more information, See: Ben Edwards, 'the Dark Side of Self-Regulation' (2016) 85 University of Cincinnati Law Review 573, 605. See also: William Birdwhistle and Todd Henderson, 'Becoming a fifth branch' (2013) 99(1) Cornell Law Review 1, 10.

[141] Steven Croley, 'Theories of Regulation: Incorporating the Administrative Process' (1998) 98(1) Columbia Law Review 1, 66.

[142] Antony Ogus, *Regulation: Legal Form and Economic Theory* (1st edn, Hart publishing, 2004) 2. See also: Walter Mattli and Ngaire Woods 'In whose Benefit? Explaining Regulatory Change in Global Politics' in Walter Mattli and Ngaire Woods, *Politics of Global Regulation* (Princeton University Press, 2009) 20.

[143] Robert Baldwin, Martin Cave, and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (2nd edn, OUP, 2011) 15.

what is referred to as regulatory capture.[144] This term is often used in a variety of ways but it generally denotes a situation in which regulation is acquired by an industry and designed and operated primarily for its benefit.[145]

Regulatory Capture theory arose in orthodox economic literature in George Stigler's 1971 article titled *the Theory of Economic Regulation* in which he contended that regulations are influenced by a heavily politicised environment populated by self-interested actors. Stigler further contended that private interests who are the target of regulations will often have the strongest interest in manipulating rules for their own benefits.[146]

Although regulatory capture theory is ascribed to Stigler's seminal paper, prominent authors had years earlier sought to explain the risks of organised private groups. Adam Smith, the renowned free market economist, once inveighed against the propensity of private interest groups to prioritise their collective interests at the expense of the public interest. He famously remarked that, "people of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some connivance to raise prices."[147] Smith's work influenced another prominent economist Mancur Olson who in his 1965 treatise titled *the Logic of Collective Action* predicted that small, privileged groups such as industry cartels, professional associations and unions would organise to further their own interests, putting the interests of consumers, taxpayers and other stakeholders second-place.[148]

Like Stigler, Olson and Smith, critics of self-regulation assert that special problems of capture often arise in these ecosystems. The assumption here is that industry groups often craft

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[144] Robert Baldwin, Martin Cave, and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (2nd edn, OUP, 2011) 142.

[145] George Stigler, 'Theory of Economic Regulation' (1971) 2(1) the Bell Journal of Economics and Management Science 3.

[146] Ibid.

[147] Adam Smith, *The Wealth of Nations* (Book I, Chapter X, Part II, The Modern Library, New York, 1994).

[148] Mancur Olson, *The Logic of Collective Action* (1st edn, Harvard University Press 1965) 49.

regulations for their collective benefit and thus cannot be trusted to regulate their own activities in a manner conducive to the promotion of publicly desirable goals.[149] As one author highlights, the result of capture in self-regulatory settings is either the absence of regulations where rules have imposed costs on or eliminated privileges from capture groups, regulation that is inadequate to safeguard broad societal preferences, regulation that on paper meets these preferences but is not enforceable or enforced; or finally, regulation that eliminates present and future competition for capture groups.[150] This has prompted scathing criticisms of Self-Regulation. In the words of one author, 'self-regulation as akin to having a fox guard the hen house.'[151] For another, 'Self-regulation is frequently an attempt to deceive the public into believing in the responsibility of an irresponsible industry.'[152]

2.5.2 Free Rider Problems and Shirking

Besides concerns about regulatory capture and the pursuit of self-interest, critics are also sceptical about the viability of self-regulatory regimes to overcome problems of free riding and shirking. Free-riding occurs when those who benefit from particular resources and services do not in fact pay for them, leading to the under-provision of the said services.[153] In a self-regulatory context, free riding implies that some actors may sign up to a regulatory regime to gain the

[149] Margot Priest, 'The Privatization of Regulation: Five models of Self-Regulation' (1998) 29 Ottawa Law Review 233, 271.

[150] Walter Mattli and Ngaire Woods 'In whose Benefit? Explaining Regulatory Change in Global Politics' in Walter Mattli and Ngaire Woods, *Politics of Global Regulation* (Princeton University Press, 2009) 22.

[151] Madelyn Orr, 'Foxes Guarding the Henhouse: An Assessment of Current Self-Regulatory Approaches to Protecting Consumer Privacy Interests in Online Behavioural Advertising' (2009) <https://www.ftc.gov/sites/default/files/documents/public_comments/preliminary-ftc-staff-report-protecting-consumer-privacy-era-rapid-change-proposed-framework/00231-57343.pdf> Accessed 20th January 2018.

[152] John Braithwaite, 'Responsive Regulation for Australia' in P Grabosky and J Braithwaite (eds) Business Regulation and Australia's Future (Australian Institute of Criminology, Canberra 1993) 9.

[153] Michael Lenox, 'The Prospects for industry self-regulation of environmental externalities' (2004) Global Economic Governance Working Paper 2004/12, 9 <https://www.geg.ox.ac.uk/geg-wp-200412-prospects-industry-self-regulation-environmental-externalities> Accessed 30th February 2018.

legitimacy and learning benefits of membership with no intention of complying with the regime's standards.[154] These actors instead 'free-ride' or 'piggyback' on the efforts of other compliant members who are responsible for building and maintaining the regime's reputation.[155]

Freeriding and shirking of this sort is often exacerbated by the voluntarist nature of self-regulatory regimes. Unable to coerce members to participate, several of these regimes are often left with recalcitrant actors who simply elect not to participate in the program's activity whilst enjoying the fruits of the labour of other actors who assiduously pursue the objectives of the regime. This is more so where there are information asymmetries between actors within Self-regulatory Regimes and the regime sponsors.[156] In other words, where the self-regulatory regime is unable to monitor or observe the levels to which an individual participant is adhering to regime standards.[157] If left unaddressed, free-riding and shirking may threaten the integrity, legitimacy and credibility of regulatory regimes and in the worst instances, damage the regime.[158] This has prompted several authors to call for measures aimed at addressing these challenges.

One strand of the literature suggests that free-riding and shirking can be addressed through coercive, mimetic and normative pressures.[159] This strand of the literature is of an institutionalist or constructivist persuasion and largely draws from ideas in organisational sociology.[160] The premise of this argument is that the institutional structure that accompanies self-regulation can

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[154] Ibid at 12.

[155] Aseem Prakash and Matthew Potoski, 'Collective Action through Voluntary Environmental Regimes' [2007] 35(4) Policy Studies Journal 773, 779.

[156] Ibid.

[157] ibid.

[158] Ibid.

[159] Ibid.

[160] Paul DiMaggio and Walter Powell, 'The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organisational Fields' (1983) 48(2) American Sociological Review 147, 150.

control free-riding through processes that fall short of explicit sanctions.[161] Authors within this school of thought instead call for informal pressures and forces to address adverse behaviour. These pressures are considered below.

For one, coercive pressures refer to informal forces applied on actors within a regulatory construct aimed at behavioural modification and organisational change. In a self-regulatory context, this includes forms of peer pressure such as persuasion and socialisation. These pressures are aimed at encouraging target actors to adjust their practices in conformance with the regime's norms. Coercive pressures may also extend to more overt forms of peer pressure such as naming and shaming and escalating instances of non-compliance to external stakeholders.[162]

Besides informal coercive mechanisms, it is also argued that self-regulatory organisations can induce behavioural change through mimetic forces. These are more subtle. They include the diffusion of relevant information and the dissemination of best practices amongst participants in self-regulatory regimes. With mimetic pressures, the focus is on exploiting the social networks created through self-regulation to osmotically alter behavioural practices and induce compliance.[163] Proponents of this approach argue that with increased access to knowledge and information, laggards within self-regulatory regimes may be encouraged to model their practices according to the practices of leaders within the regime, thereby achieving behavioural change and eliminating free-riding.[164] There is some theoretical support for this view. Powell and DiMaggio find that organisations tend to model themselves after analogous organisations within their field that are

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[161] Andrew King and Michael Lenox, 'Industry Self-Regulation without Sanctions: The Chemical Industry's Responsible Care Program' (2000) 43(4) The Academy of Management Journal 698, 701.

[162] ibid.

[163] ibid.

[164] Paul DiMaggio and Walter Powell, 'The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organisational Fields' (1983) 48(2) American Sociological Review 147, 152. See also, Andrew King and Michael Lenox, 'Industry Self-Regulation without Sanctions: The Chemical Industry's Responsible Care Program' (2000) 43(4) The Academy of Management Journal 698, 701.

perceived to be more legitimate or successful.[165] Similarly, Tashman and Rivera argue that firms within inter-organisational networks may look to field-level "standards" or "best practices" used by other firms within their immediate environment that are widely perceived as legitimate.[166]

In addition to the coercive and mimetic forces described above, a number of authors have also identified normative forces as key to eliminating free-riding.[167] This suggests the creation of shared values, expectations, norms of appropriateness, logics, assumptions and conventions that penetrate the structures of participant firms, changing their preferences and altering entrenched practices.[168] It is often argued that normative forces provoke the standardisation of routines and practices across the regime, thereby providing a common means for social interaction and performance improvement.[169]

Although interesting, there is deep scepticism about the ability of the sociological pressures described above to eliminate free-riding. This is reflected in a separate strand of academic scholarship which suggests that the 'velvet glove' of sociological pressures on their own may be insufficient in eradicating problems of free-riding in self-regulatory regimes.[170] Authors within this line of thought typically call for more explicit institutional mechanisms aimed at dealing with these challenges.

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[165] ibid.

[166] Peter Tashman and Jorge Rivera, 'Are Members of Business for Social Responsibility More Socially Responsible?' (2010) 38(3) Policy Studies 487, 493.

[167] ibid.

[168] Magali Delmas, 'The diffusion of environmental management standards in Europe and in the United States: An institutional perspective' (2002) 35 Policy Sciences Journal 91, 97.

[169] Peter Tashman and Jorge Rivera, 'Are Members of Business for Social Responsibility More Socially Responsible?' (2010) 38(3) Policy Studies 487,493. See also Magali Delmas, 'The diffusion of environmental management standards in Europe and in the United States: An institutional perspective' (2002) 35 Policy Sciences Journal 91, 97.

[170] Michael Lenox and Jennifer Nash, 'Industry self- regulation and adverse selection: a comparison across four trade association programs' (2003) 12(6) Business Strategy and the Environment 343, 353.

Certain authors call for formal monitoring and sanctioning mechanisms to identify and deter free-riders. There is some intellectual support for this view.[171] For one, Potoski and Prakash find that regimes with the strongest 'swords,' i.e. institutional mechanisms to observe and enforce compliance are more likely to deter free riders.[172] They conceptualise strong 'swords' regimes as those with third-party monitoring, public disclosure of audit information, and sanctioning by program sponsors.[173] Potoski and Prakash argue that Strong Sword Programs are more likely to eradicate free-riding and also express deep scepticism in the ability of first party (self-assessment) monitoring mechanisms in addressing free-riding. [174]

King and Lenox also find that Self-regulatory clubs without credible monitoring and sanctioning mechanisms such as third party audits are more likely to facilitate "free riding" by participant firms.[175] This is echoed by Lenox and Nash whose statistical analysis of voluntary schemes without monitoring mechanisms and sanctions found that participant firms were more

[171] For a start, Gunningham and Rees argue that given the serious problems of free riding, a prerequisite for successful self-regulation will be effective monitoring and enforcement. Without it, free-rider problems may be insurmountable. For more explanation, See Neil Gunningham and Joseph Rees, 'Industry Self-Regulation: An Institutional Perspective' (1997) 19(4) Law and Policy 365, 396.

[172] Matthew Potoski and Aseem Prakash, 'Covenants with Weak Swords: ISO 14001 and Facilities' Environmental Performance' (2005) 24(4) Journal of Policy Analysis and Management 745, 748.

[173] Ibid.

[174] Ibid. Potoski and Prakash also admit that not all monitoring or auditing mechanisms are created equally, they come in at least four types: first-party (self-assessment), second-party (certification by a manager from a different unit of the same company, a different firm within the same industry, or certified by customers), third-party (certification by an external auditor but paid for by the company), and fourth-party (certification by an external auditor who is not paid for by the company). For them, first party certification or self-assessment is the least credible whilst fourth-party is the most credible. There are virtually no examples of fourth-party certification, so the best practice appears to be third party. See also: Aseem Prakash and Matthew Potoski 'Collective Action through Voluntary Environmental Programs: A Club Theory Perspective' (2007) 35(4) The Policy studies Journal 773-792.

[175] Andrew King and Michael Lenox, 'Industry self-regulation without sanctions: The Chemical Industry's Responsible Care Program' (2000) 43(4) Academy of Management Journal 698-716. See also Andrew King and Michael Lenox, 'Does it really pay to be green? An empirical study of firm environmental and financial performance' (2000) 5(1) Journal of Industrial Ecology 105–116.

likely to be in breach of regime objectives.[176] They go on to suggest that regimes that have demonstrated a serious commitment to discipline non-compliant members are less likely to suffer from adverse selection and free-riding.[177]

Lenox and Nash's sentiments are reinforced by Tashmann etal who, in a study of CSR self-policing regimes, find that regimes that provide members with common benefits such as blanket certification may be at risk of attracting free riders in the absence of third-party verification mechanisms and credible sanctions.[178] This is supported by McDermott, Noah, and Cashore who, in a study of Self-regulatory regimes in the sustainability area, also found that the most effective programs tended to have third-party oversight, performance standards, and credible sanctions for errant actors.[179]

More interesting is the work of Elinor Ostrom who argues forcefully that explicit and credible monitoring and sanctioning mechanisms are needed to address the potential for free-riding in self-regulatory systems.[180] According to Ostrom, collective action by a set of actors who wish to gain collective benefits, must also address common problems ranging from free-riding to broader commitment deficits.[181] To this end, she posits that any successful self-governance system is likely to require institutional mechanisms to secure and reinforce credible commitments, through

[176] Michael Lenox and Jennifer Nash, 'Industry self- regulation and adverse selection: a comparison across four trade association programs' (2003) 12(6) Business Strategy and the Environment, 343, 353.

[177] ibid.

[178] Peter Tashman and Jorge Rivera, 'Are Members of Business for Social Responsibility More Socially Responsible?' (2010) 38(3) Policy Sciences Journal 487, 490.

[179] Constance McDermott, Emily Noah, and Benjamin Cashore, 'Differences That Matter? A Framework for Comparing Environmental Certification Standards and Government Policies' (2008) 10 Journal of Environmental Policy and Planning 47–70.

[180] Elinor Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Action* (Cambridge University Press, 1990) 27.

[181] Ibid.

robust monitoring and credible enforcement.[182] For Ostrom, there can be no credible commitment; without credible monitoring.[183]

2.5.3 Inadequate Enforcement and Sanctioning

Allied to the point about free riding and shirking are concerns about the credibility of enforcement and sanctioning in self-regulatory systems. It would be recalled that the responsibility for drafting and enforcing rules are often reposed in the same entity in self-regulatory settings. This, more often than not, creates inherent conflicts in the regulatory cycle, including in the enforcement of standards.[184] Another criticism levelled against these regimes is the idea that they may have weak incentives to sanction errant members for fear of hurting the regime's reputation and damaging the image of honest or compliant members.[185] Regarding the latter, Vickers argues persuasively that public sanctioning in self-policing settings might constitute "a negative signal about the average quality of remaining members" and "a sign that the fraudulent member thought that vigilance was low enough for there to be a reasonable chance of getting away with it".[186] To an extent, this would constitute a bad signal about the levels of vigilance shown by the self-policing entity. He further submits that these reputational and strategic concerns often force self-regulators

[182] Ibid. at 36

[183] Ibid. at 45.

[184] Robert Baldwin, Martin Cave, and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (2nd edn, OUP, 2011) 142. See Also B Edwards, the Dark Side of Self-Regulation (2016) 85 University of Cincinnati Law Review 573, 609.

[185] Anthony Ogus and Emmanuella Carbonara, 'Self-regulation' in F Parisi, O Wolff and Donnelly (eds) *Production of Legal Rules* (Edward Elgar, 2011) 237.

[186] John Vickers, 'European Financial Regulation' in Alberto Giovannini and Colin Mayer (eds) *European Financial Integratio*n (Cambridge University Press, 1991) 134.

to adopt a lax approach to enforcement in order to protect the public image of the regime and to maintain external legitimacy amongst stakeholder constituencies. [187]

2.5.4 Lack of Transparency and Accountability

In addition to concerns about weak enforcement and free-riding, critics also argue that self-regulatory systems often exhibit a worrying lack of transparency and accountability.[188] Regarding the former, certain scholars argue that self-policing systems are prone to problems of opacity and visibility.[189] For instance, De Marzo and others have suggested that self-regulatory arrangements in financial markets have often resulted in lower transparency levels and disclosure of information.[190] Others argue that the rule development and enforcement processes of voluntary regimes are shrouded in secrecy and are thus detached from the public view.[191] In addition to the above, sceptics also inveigh against the propensity of self-regulatory regimes to operate without due regard, consultation or the involvement of actors that are potentially impacted or affected by regulatory outcomes and decisions.[192] This challenge is most prevalent in single-actor, industry-based schemes where regimes are often constructed around regulatory targets with the exclusion of affected stakeholders and groups.[193] This often raises deep questions about the ability of self-governing schemes to be held to account by external stakeholders and to govern in the broader public interest.

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[187] Ibid.

[188] Julia Black, 'Constructing and contesting legitimacy and accountability in polycentric regulatory regimes' (2008) 2 Regulation and Governance 137, 142.

[189] Ibid.

[190] Peter De-Marzo, Michael Fishman and Kathleen Hagerty, 'Self-Regulation and Government Oversight' (2005) 72 Review of Economic Studies 687–706.

[191] Kernaghan Webb, Andrew Morrison, 'Voluntary approaches, the environment and the law: A Canadian perspective' (Paper presented at the International Conference organised by the Fondazione ENI Enrico Mattei and CERNA, held in Venice, November 18 and 19, 1996), 8 <https://www.econstor.eu/bitstream/10419/154789/1/NDL1997-025.pdf> Accessed 20th May 2018.

[192] Ibid.

[193] Ibid.

Having addressed the promises and limits of self-regulatory systems, it is important to consider the conditions or factors that lend or contribute to their effectiveness.

2.6 Effectiveness of Transnational Self-regulatory regimes

As TSR regimes gain a more prominent governance role, it has become crucial to examine their effectiveness. The notion of effectiveness implies that these regimes, like other tools, can be evaluated to establish their utility in carrying out specific or particular governance tasks.[194] That being said, measuring the effectiveness of self-regulatory regimes is both methodologically and analytically challenging.[195] This is because of the wide variety of institutions and regimes that can be characterised as self-regulatory and also the availability and measurability of data.[196] The latter is even more so in financial regulatory settings where the paucity of data is matched only by the complexity of the governance problem. Moreover, as Rebecca Homkes reminds us, effectiveness is a highly subjective term which imports a diversity of concepts, ranging from the strength of a regime to its significance, consequence or influence.[197] This heightens the ambiguity of the term and renders any analysis of regime effectiveness highly problematic and complex. However, for the purposes of this thesis and its focus on the Self-regulatory framework for Sovereign Wealth Funds, it is important to undertake such an endeavour so as to understand the conditions for Self-Regulatory effectiveness before connecting the emergent characteristics to the Santiago Principles and the International Forum of Sovereign Wealth Funds.

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[194] Arild Underdall, 'Methodological Challenges in the Study of Regime Effectiveness' in A. Underdal and O. Young (eds) *Regime Consequences: Methodological Challenges and Research Strategies* (Kluwer, 2004) 27.

[195] Ariel Meyerstein, 'Global Private Regulation, Global Finance and the Future of Corporate Human Rights Accountability' (2012), 33 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2018999> Accessed 20th May 2018.

[196] Ibid. see also Martijn Scheltema, 'Assessing Effectiveness of International Private Regulation in the CSR Arena' (2014) 13(2) Richmond Journal of Global Law and Business 263, 285.

[197] Rebecca Homkes, 'Analysing the role of Public-private partnerships in global governance: Institutional dynamics, variation and effects' (PHD Thesis, London School of Economics and Political Science 2011) 69.

2.6.1 Mapping Effectiveness

The concept of effectiveness has received considerable research attention in the scholarship on self-regulation and transnational governance.[198] Scholars often agree that it is a highly elusive and multidimensional concept that is subject to a diversity of interpretations and formulations.[199] Broadly speaking, effectiveness denotes the degree to which a regime, process or institution meets or achieves the stated goals and objectives that prompted its establishment.[200] This is allied to Cafaggi and Renda's definition which sees effectiveness as the consistency between means and goals and the extent to which a regime or institution achieves its objectives. For Cafaggi and Renda, Effectiveness in self-regulatory contexts therefore spans the entire regulatory process from standard setting to enforcement and is fixated, in particular, on the proportionality between means and ends and the positive or negative impact of the regulatory measure over different constituencies including regulated actors and external stakeholders or beneficiaries.[201]

One of the challenges in understanding effectiveness is the question of effectiveness for whom. As Cafaggi reminds us, understandings of effectiveness may differ between the targets and beneficiaries of a regulatory process.[202] For instance, effectiveness for regulatory targets may concentrate on whether the regime addresses the narrow collective action problems that inspired

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198 Olga Malet, 'The Effectiveness of Transnational Non-State Governance: The Role of Domestic Regulations and Compliance Assessment in Practice' (September 2013) Max Planck Institute for the Study of Societies Discussion Paper 13/12, 4 <http://www.mpi-fg-koeln.mpg.de/pu/mpifg_dp/dp13-12.pdf> Accessed 20th January 2018.

199 Oran Young, 'Effectiveness of International Environmental Regimes: Existing Knowledge, Cutting-edge themes and research strategies' (2011) 108(50) PNAS 19853, 19854.

200 Fabrizio Cafaggi, 'A Comparative Analysis of Transnational Private Regulation: Legitimacy, Quality, Effectiveness and Enforcement' (November 2014). EUI Department of Law Research Paper No. 2014/145,5 <https://ssrn.com/abstract=2530516 or http://dx.doi.org/10.2139/ssrn.2530516> Accessed 30th January 2018.

201 Fabrizio Caffaggi and Andrea Renda, 'Public and Private Regulation: Mapping the Labyrinth' (2012) CEPR Working Paper No. 370, 13 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2156875> Accessed 29th January 2018.

202 Fabrizio Cafaggi, 'A Comparative Analysis of Transnational Private Regulation: Legitimacy, Quality, Effectiveness and Enforcement' (November 2014) EUI Department of Law Research Paper No. 2014/145,6 <https://ssrn.com/abstract=2530516 or http://dx.doi.org/10.2139/ssrn.2530516> Accessed 30th January 2018.

its formation in the first place. This is often one of the main drivers for joining a regulatory scheme voluntarily.[203] For instance, participants may want to improve corporate governance, clean out supply chains, eliminate corruption and reduce environmental pollution. Thus, an evaluation of effectiveness from such a perspective may have to be focused on whether the regulatory regime is one which adequately addresses these collective action problems.[204] For beneficiaries of the process however, effectiveness may concern the achievement of the regime's broader policy objectives, including the distributional consequences of the regime for various stakeholder constituencies.[205] Although there is considerable overlap between the two perspectives, it is important that in addressing the notion of effectiveness, both perspectives are considered and infused into any emergent indicators and metrics.

This brings one to the question of what variables or indicators, if any, are needed to measure the effectiveness of self-regulatory regimes or the conditions in which effective self-regulation is likely to arise. This challenge is exacerbated by the vast and often anecdotal studies on the effectiveness of self-regulatory regimes.

For instance, in the literature on self-regulation in its national manifestations, several hallmarks or conditions have been identified as key to regime efficacy or effectiveness.[206] By way of example, Balleisen and Eisner argue that the effectiveness of private regulation depends on five factors: the depth of reputational concern amongst target actors, the relevance of flexibility in regulatory detail, the existence of sufficient bureaucratic capacity and autonomy on the part of the self-regulator, the degree of transparency in the regulatory process and the seriousness of

[203] Ibid.

[204] Ibid.

[205] Ibid.

[206] Some of the literature particularly for Voluntary regimes in the Environmental sector in the United States considers a rather outcome-centric / before and after understanding of effectiveness and have been criticised as dismal. See: Ariel Meyerstein, 'On the Effectiveness of Global Private Regulation: The Implementation of the Equator Principles by Multinational Banks' (PHD Thesis, University of California, Berkeley) 29.

accountability.[207] This interesting elaboration of the conditions under which effective self-regulation is likely to arise is not far removed from a later analysis by Rebecca Ong in which she argues that effectiveness is often a by-product of robust commitments by regulated targets, strong accountability mechanisms, compliance, monitoring and enforcement, clarity of standards and industry-wide coverage among others.[208] Much of Ong's analysis dovetail with the work of the Organisation for Economic Cooperation and Development (OECD) in this area. For the OECD, effective self-regulation requires *inter alia*, the clarity and strength of objectives, Robust Monitoring and Enforcement, transparency and accountability from self-regulators and stakeholder participation.[209] The OECD also identifies what it describes as ecological factors which are important for effectiveness. These include a strong industry benefit and interest from self-regulation and the alignment of industry and public interests.[210] Whilst the studies highlighted above offer serious and compelling insights into the efficacy of self-regulation, they often fall short on measurability and comprehensiveness. Simply put, they are of limited analytical utility as measurable indicators and metrics for efficacy. For instance, how does one measure whether the progenitors of self-regulation have infused enough regulatory flexibility or whether there is a depth of reputational concern among target actors as Balleisen and Eisner suggest. Another dilemma would be how one can explain or measure the levels of industry commitment and concern amongst

[207] Edward Balleisen and Marc Eisner, 'The Promise and Pitfalls of Co-Regulation: How Governments Can Draw on Private Governance for Public Purpose' in David Moss and John Cisternino (eds) *New Perspectives on Regulation* (The Tobin Project, 1st edn, 2009) 131.

[208] Rebecca Ong, *Mobile Communication and the Protection of Children* (Leiden University, 2010) 253.

[209] OECD, 'Industry Self-Regulation: Role and Use in Supporting Consumer Interests' (2015), Committee on Consumer Policy Report, 8 <http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DSTI/CP(2014)4/FINAL&docLanguage=En> Accessed 20th May 2018.

[210] Ibid.

target actors as suggested by Ong and the OECD. These challenges caution against a complete reliance on the above conditions in evaluating the effectiveness of self-regulatory regimes.[211]

Besides the above, more formalised studies of effectiveness have arisen in the literature on transnational regulation and governance (which is better suited to the subject matter of this thesis). Like their national counterparts, these analyses of effective standard setting are often vast and employ numerous theoretical and explanatory lenses.

One example is the MSI Evaluation tool for Self-Regulatory Schemes of a Multi-Stakeholder nature which analyses effectiveness drawing from several indicators, including a scheme's approach to Human Rights, the presence of sufficient standards, inclusive and comprehensive internal governance, effective implementation mechanisms (robust monitoring and enforcement), ongoing evaluation and review, the involvement of affected stakeholders and Transparency.[212]

Without doubt, the MSI approach offers an interesting insight into the debate on the efficacy of self-regulation through its integration of normative and institutional elements in a single definition of effectiveness. Yet, the tool is not immune to weaknesses. For one, the evaluation tool seems more apt for analysing the efficacy of self-regulatory schemes with avowed social or environmental externalities such as those in the environmental or CSR sectors where risks of

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[211] Other explanations also speak to the need for external pressures from government, the shadow of hierarchy or the so-called 'Benign Big gun' for effective self-regulation. See generally: Adrienne Héritier and Dirk Lehmkuhl, 'Introduction: The Shadow of Hierarchy and New Modes of Governance' (2008) 28(1) Journal of Public Policy 1, 3. Adrienne Héritier and Sandra Eckert, New Modes of Governance in the Shadow of Hierarchy: Self-Regulation by Industry Actors in Europe (2007) EUI Working Papers 2007/20, 16 <http://cadmus.eui.eu/bitstream/handle/1814/6919/RSCAS_2007_20.pdf> Accessed 20th May 2018.
For this argument applied to Transnational Self-Regulation, See Andreas Engert, 'Transnational hedge fund regulation' (2010) 11(3) European Business Organization Law Review 329, 355.

[212] MSI Integrity, 'MSI Evaluation Tool for the Evaluation of Multi-Stakeholder Initiatives' (2017), xii <http://www.msi-integrity.org/wp-content/uploads/2017/11/MSI_Evaluation_Tool_2017.pdf> Accessed 20th June 2018.

human rights violations may be significant, yet it may prove less so for industry self-regulatory regimes in the financial sphere which operate often with tenuous links to issues such as human rights and Corporate Social Responsibility.

Another noteworthy contribution to the debate on the effectiveness of transnational self-regulatory regimes is that put forward by Martijn Scheltema. Scheltema argues that the effectiveness of Self-regulation might be assessed using a range of legal, economic, sociological and behavioural factors.[213] For him, Legal analyses of effectiveness must focus on the objectives of the regime and its enforcement. Here, Scheltema highlights clear, specific and measurable norms and robust monitoring and enforcement as key.[214] Economic effectiveness on the other hand relates to the actual impact of a regime in terms of economic benefits and growth. For Scheltema, Economic analyses of effectiveness should consider *inter alia* whether self-regulation is social-welfare enhancing and whether it induces consumer or environment detriment, economic disruption or trade obstruction.

Besides the above, Scheltema also identifies Sociological factors as important. These include the acceptance or legitimacy of self-regulatory instruments, the way in which instruments are communicated and implemented and questions surrounding the input of external stakeholders in the promulgation of Self-regulatory instruments. Last but not least, Scheltema considers psychological or Behavioural factors as important. These behavioural factors denote the effects, if any, of self-regulation on the behaviour of target actors.

Like the MSI evaluation tool, Scheltema's thesis offers a useful insight into the debate on the effectiveness of self-regulation. Yet, it is most challenging in a methodological sense. Although the focus on specificity of standards and the robustness of monitoring and enforcement is

[213] Martijn Scheltema, 'Assessing Effectiveness of International Private Regulation in the CSR Arena' (2014) 13(2) Richmond Journal of Global Law and Business 283.

[214] Ibid. at 291.

welcome and might constitute a measurable indicator of the effectiveness of self-regulatory regimes, the same cannot be said for his economic analysis of self-regulation which may prove profoundly difficult to assess or measure. For instance, it may be difficult for a researcher to decipher whether a particular scheme is social welfare enhancing or the effects, if any, a scheme might have on economic growth and development. Regarding the latter, there may be factors well beyond the regulatory scheme which contributes to a positive or negative economic impact within a particular industry or sector. Yet another challenge with Scheltema's approach is its insufficient focus on institutional design. It is argued that the fixation on norms and the acceptance and effect of norms neglects a crucial line of inquiry which includes what type(s) of institutions, institutional arrangements or processes are capable of producing or facilitating effective self-regulation. As Abbott and Snidal note, 'In examining a highly political activity like regulation, effectiveness must be conceptualized broadly. Concrete means-ends effectiveness is crucial, although even that is complex: effectiveness may turn not only on material factors, but also on subjective factors.'[215] It would appear therefore that a more optimal, measurable and inclusive approach to analysing effectiveness is necessary.[216]

Besides the approach offered by Scheltema, other authors have often analysed the effectiveness of transnational governance and self-regulatory regimes drawing from two distinct metrics/variables: Output and Outcomes.[217] Originally devised by David Easton in his seminal

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[215] Kenneth W. Abbott and Duncan Snidal 'the Governance Triangle: Regulatory Standards Institutions and the Shadow of the State' in Walter Mattli and Ngaire Woods, The Politics of Global Regulation (Princeton University Press, 2009) 61. Also, Fabrizio Caffaggi and Andrea Renda advocate an inclusive approach to understanding effectiveness which focuses on normative and institutional design. See: Fabrizio Caffaggi and Andrea Renda, 'Public and Private Regulation: Mapping the Labyrinth' (2012) CEPR Working Paper No. 370, 13 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2156875> Accessed 29th January 2018.

[216] Fabrizio Caffaggi and Andrea Renda, 'Public and Private Regulation: Mapping the Labyrinth' (2012) CEPR Working Paper No. 370, 13 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2156875> Accessed 29th January 2018.

[217] Ibid. at 14. This approach was also used in Olga Malet, 'The Effectiveness of Transnational Non-State Governance: The Role of Domestic Regulations and Compliance Assessment in Practice' (September 2013) Max Planck Institute

1965 treatise *a Systems Analysis of Political Life*, the duo have become a widely acknowledged analytical screen with which to examine the effectiveness of regimes and institutions, including self-regulatory regimes.[218]

More precisely, output refers to the direct result of the function carried out by a self-regulatory regime such as its standards, principles, commitments, policy instruments, rules of engagement and organisational procedures. [219] These instruments are important in self-regulatory settings, not least, for the purposes of inducing behavioural change and shaping the operation of the entire regulatory process. When studying the output effectiveness of self-regulatory regimes, these scholars often focus on certain elements including the stringency of standards and the monitoring and enforcement mechanisms adopted by Self-regulatory organisations.[220]

Stringency of standards is often conceptualised to mean strict and ambitious prescriptions that require target actors to enact changes beyond existing practice or regulation.[221] Scholars also

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for the Study of Societies Discussion Paper 13/12, 4 <http://www.mpi-fg-koeln.mpg.de/pu/mpifg_dp/dp13-12.pdf> Accessed 20th January 2018. See also Ralf Barkemeyer, Lutz Preuss and Lindsay Lee, 'On the Effectiveness of Private Transnational Governance- Evaluating Corporate Sustainability Reporting according to the Global Reporting Initiative' (2015) 50 Journal of World Business 312, 314. Also, Lothar Reith, Melanie Zimmer, Ralph Hamann, Jon Hanks, 'the UN Global Compact in Sub-Saharan Africa: Decentralisation and Effectiveness' (2007) 28 Journal of Corporate Citizenship 99-112.

[218] David Easton, *a Systems Analysis of Political Life* (Wiley New York, 1965). It is important to note that Easton originally referred to three metrics: Output, Outcomes and Impact. However, recent scholars have often isolated their analyses of Effectiveness to the Output and Outcome metrics given the difficulty in disentangling the impact of self-regulatory regimes from broader socio-economic or global trends, effects or phenomena. See also Doris Fuchs and Agni Kalfagianni, 'The Effectiveness of Private Environmental Governance' in P Dauvergne (eds), *Handbook of Global Environmental Politics* (2nd edn, Edward Elgar, Cheltenham, 2012) 300.

[219] Doris Fuchs, 'Business and Governance: Transnational Corporations and the Effectiveness of Private Governance' in Stefan A. Schirm (eds) *Globalisation: State of the Art and Perspectives* (Taylor and Francis, 2007) 129.

[220] Ibid. See also Agni Kalfgianni and Phillip Pattberg, 'Fishing in Muddy Waters: Exploring the Conditions for Effective Governance of Fisheries and Aquaculture' (2013) 38 Marine Policy 124, 126.

[221] Agni Kalfagianni and Phillip Pattberg, 'The Effectiveness of Transnational Rule-setting Organisations in Global Sustainability Politics: An Analytical Framework' (2011) Global Governance Working Paper No 43, 12 <http://www.glogov.org/images/doc/GGWP43.pdf> Accessed 20th January 2018.

associate Stringency with quantifiable, measurable and observable performance targets.[222] Related to this is the idea of robust monitoring and enforcement.[223] In the context of the former, Output-centric scholars often call for independent third-party auditing or monitoring. Enforcement on the other hand is conceptualised as formal and informal sanctions, delisting or expulsion from the regulatory regime.[224]

Whilst regulatory outputs are important, they are unlikely to be of much use if they do not produce causal effects. It is for this reason that some scholars also refer to the distinct metric of outcome effectiveness which denotes the behavioural changes that can be attributed to the implementation and compliance with regime outputs.[225] Many studies of outcomes have often focused on whether the actors within self-regulatory regimes are internalising regime outputs and whether desired changes in behavioural patterns are apparent.[226]

Although a compelling and interesting analytical tool, the Output-Outcome metrics suffer from acute weaknesses. For one, they pay inadequate attention to the organisational arrangements or governance processes and characteristics under which effective self-regulation can be

[222] Doris Fuchs and Agni Kalfagianni, 'The Effectiveness of Private Environmental Governance' in P Dauvergne (eds), *Handbook of Global Environmental Politics* (2nd edn, Edward Elgar, Cheltenham, 2012) 300.

[223] Agni Kalfgianni and Phillip Pattberg, 'Fishing in Muddy Waters: Exploring the Conditions for Effective Governance of Fisheries and Aquaculture' (2013) 38 Marine Policy 124, 126.

[224] Agni Kalfagianni and Phillip Pattberg, 'The Effectiveness of Transnational Rule-setting Organisations in Global Sustainability Politics: An Analytical Framework' (2011) Global Governance Working Paper No 43, 12 <http://www.glogov.org/images/doc/GGWP43.pdf> Accessed 20th January 2018. See Also Agni Kalfgianni and Phillip Pattberg, 'Fishing in Muddy Waters: Exploring the Conditions for Effective Governance of Fisheries and Aquaculture' (2013) 38 Marine Policy 124, 126.

[225] Doris Fuchs, 'Business and Governance: Transnational Corporations and the Effectiveness of Private Governance' in Stefan Schrim (eds) *Globalisation: The State of the Art and perspectives* (Routledge, 1st edn, 2007) 127.

[226] Fabrizio Caffaggi and Andrea Renda, 'Public and Private Regulation: Mapping the Labyrinth' (2012) CEPR Working Paper No. 370, 14 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2156875> Accessed 29th January 2018.

fostered.[227] As Cafaggi reminds us, analyses of effectiveness must concentrate on the right combination of norms and institutions through which effective self-policing can be engendered.[228]

In close parallel to the output-and outcome explanations are analyses of effectiveness situated in the rational-institutionalist, sociological or critical global governance tradition.[229] This perspective is utilised by scholars who aim to explain the outcomes or impacts of self-regulatory regimes and groups. Most prominent is the idea of first and second-order effects propounded by Kalfagiani and Pattberg.[230] They conceptualise effectiveness as a complex, two-dimensional concept involving first and second order effects.[231]

First order effects are those directly intended by the self-regulatory organisation, such as behavioural changes achieved in the course of implementing regime standards.[232] This unsurprisingly overlaps with the outcome-centric explanations of effectiveness elucidated above. According to Kalfgianni and Pattberg, first-order effects are restricted to the self-regulator's immediate audience, specifically, its target actors. [233]

By contrast however, second-order effects speak to the broader, regulatory and socio-economic effects that extend beyond the self-regulator's immediate audience including material and structural effects such as shifts in markets or power relations that go beyond mere compliance

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[227] Indeed, a focus on outcomes in Empirical studies of national forms of self-regulation has been criticised as dismal see: Ariel Meyerstein, 'On the Effectiveness of Global Private Regulation: The Implementation of the Equator Principles by Multinational Banks' (PHD Thesis, University of California, Berkeley) 29.

[228] Ibid. at 13.

[229] Agni Kalfagianni and Phillip Pattberg, 'The Effectiveness of Transnational Rule-setting Organisations in Global Sustainability Politics: An Analytical Framework' (2011) Global Governance Working Paper No 43, 7 <http://www.glogov.org/images/doc/GGWP43.pdf> Accessed 20th January 2018.

[230] Agni Kalfagianni and Phillip Pattberg, 'The Effectiveness of Transnational Rule-setting Organisations in Global Sustainability Politics: An Analytical Framework' (2011) Global Governance Working Paper No 43, 3 <http://www.glogov.org/images/doc/GGWP43.pdf> Accessed 20th January 2018.

[231] Ibid.

[232] Ibid.

[233] Ibid.

with regulatory standards and cognitive effects which includes the diffusion of knowledge by self-regulators and the recognisability of a particular regime by relevant stakeholders as a salient benchmark.[234] Kalfagianni also identify regulatory effects as part of the broader second-order effects. They conceptualise this as the influence of self-regulation on public regulatory instruments such as legislations and international treaties.[235]

To achieve first and Second-order Effects, Kalfagiani and Pattberg argue that self-regulatory organisations must operationalise sound Organisational structures and mechanisms, informational strategies and Transparency.

Amongst the organisational characteristics highlighted by Kalfagianni and Pattberg are participation and decision-making rules. The former seeks to co-opt relevant actors and external stakeholders into the regulatory process and the latter stipulates the processes through which regulatory decisions may be arrived at. For Kalfagianni and Pattberg, participation by target actors and external stakeholders in crafting self-regulatory rules and standards creates a level of buy-in which strengthens compliance and the legitimacy of the self-regulatory process.[236]

Besides the above, they also call for sound policy design which is elaborated through stringent and ambitious standards and robust monitoring and enforcement mechanisms. The latter, they argue, is essential in the context of heterogeneous groups of actors where free-riding or shirking may be prevalent.[237]

Kalfagiani and Pattberg further call for transparency of process, including the publication of timely, reliable and comprehensible information on the governance and performance characteristics of the self-regulatory organisation.[238] According to them, transparency on these

[234] Ibid.at 5.

[235] Ibid. at 6.

[236] Kalfgianni and Pattberg op cit at 10.

[237] Ibid. at 13.

[238] Ibid. at 15.

issues enhances public scrutiny and visibility in complex regulatory environments and strengthens the legitimacy of the regime amongst external stakeholders.[239]

Whilst Kalfagiani's conceptualisation of effectiveness is presumably context-specific and thus fixated on self-regulatory regimes in environmental governance and sustainability where second-order effects (material and structural) may be apparent, it nonetheless provides a compelling addition to the debate on the broader effectiveness of self-regulatory arrangements. For instance, one can detect a willingness to consider the design of norms and organisational characteristics in a single explanation of effectiveness. Further, there also seems to be an increased emphasis on the governance of the regime, including a focus on legitimacy through participation and decision-making rules as well as transparency and accountability through sound internal governance. Which is undoubtedly useful in reaching a future definition of effectiveness.

Another helpful contribution to the debate on the effectiveness of transnational self-regulation is that put forward by Professor Fabrizio Cafaggi. Cafaggi sees effectiveness as the consistency between means and goals and the extent to which self-regulation achieves its objectives.[240] For Cafaggi, effectiveness spans the entire regulatory process from the development of standards and norms to their monitoring and enforcement.[241] He also argues that analyses of effectiveness must be predicated on which combination of norms and institutions, lead to effective outcomes.[242] To this end, he offers an interesting evaluation method which weaves together normative and institutional characteristics into a single explanation of effectiveness. This tool is comprised of activity and governance indicators, compliance indicators and impact indicators.[243]

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[239] Ibid.

[240] Cafaggi and Renda (2012) op cit. at 13.

[241] Ibid.

[242] Ibid.

[243] Fabrizio Caffaggi and Andrea Renda, 'Public and Private Regulation: Mapping the Labyrinth' (2012) CEPR Working Paper No. 370, 26 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2156875> Accessed 29th January 2018.

Activity and governance indicators refer to the institutional features and the regulatory activities of the scheme. In other words, its organisational characteristics such as participation and decision-making rules and the nature or quality of its standards. Compliance indicators on the other hand refer to the means of reporting or signalling compliance with regulatory goals. Simply put, the monitoring, evaluation and enforcement mechanisms which the regime applies, and impact indicators appear to include the indicators used in evaluate the impact of a self-regulatory regime on target constituencies. In other words, whether there are changes in behavioural patterns associated with compliance to regulatory standards. [244]

Professor Caffaggi in a later paper appears to further conceptualise effectiveness. Here, he argues that:

> 'Typically, effectiveness depends on the comprehensiveness and quality of the rules, and the associated level of enforcement and compliance. Consequently, it also depends on the governance arrangements chosen by the regulatory scheme: good governance often leads to more legitimate, high-quality and ultimately effective rules.'[245]

This latter approach is most interesting. For one, it fuses together the design of norms and institutions into a single definition of effectiveness and appears to propound a comprehensive, helpful and measurable definition of regulatory effectiveness. Prof Cafaggi further elaborates on this definition in his paper. According to him, quality of rules should be measured in terms of the traditional criteria normally applied to conventional legislation such as its certainty, predictability, lack of ambiguity and efficacy.[246]

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[244] ibid.

[245] Fabrizio Cafaggi and Andrea Renda, 'Measuring the Effectiveness of Private Regulatory Organisations' (2014) Stribis Foundation Report, 62 <https://ssrn.com/abstract=2508684> Accessed 20th January 2018.

[246] Ibid. at 60.

On the need for credible monitoring and enforcement, Prof Cafaggi highlights the inherent conflict in having the same entity set a standard, monitor its compliance and enforce its violations. To this end, he suggests the use of independent monitors to introduce a 'fresh' and 'objective' look into the process of implementation and to provide insights on what works and what doesn't.[247]

On the effectiveness of governance arrangements, Cafaggi identifies several factors as key. For one, he recognises the need for functional separation or the existence of checks and balances within the organisation and in particular between the main standard-setting body and the key decision-making body within the self-regulatory regime. As highlighted above, there are inherent conflicts in fusing together regulatory responsibilities within a single body or part of a regime so the idea of a functional separation between parts of a self-regulatory regime holds significant promise.[248]

Another element of good governance identified in Prof Cafaggi's thesis is the need for representativeness and inclusion of relevant actors and stakeholders to contribute a degree of 'voice' and achieve balanced and effective decision-making.[249] This largely coheres with another understanding of effectiveness put forward by Abbott and Snidal and is hardly surprising.[250] Self-regulatory standards are, for the most part, 'soft' and voluntary and therefore depend on the inclusion of relevant actors to secure consent, promote balanced regulation and to strengthen the

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[247] This suggests the need for independent, 3rd party monitoring as begun by Potoski and other authors cited above. Ibid. at 65.

[248] Ibid.

[249] Ibid. at 66.

[250] Abbott and Snidal identify what they describe as a 'suite of competencies' necessary for effectiveness. These are: independence, representativeness, expertise, and operational capacity. They conclude that schemes lacking one or more of those competencies are likely to be ineffective. However, they note that the competencies identified are not necessarily sufficient given that a scheme that possesses all of them might still be paralyzed by infighting, adopt an ineffective monitoring system or otherwise fail. See: Kenneth W. Abbott and Duncan Snidal 'The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State' in Walter Mattli and Ngaire Woods, The Politics of Global Regulation (Princeton University Press, 2009) 62

regime's claim to compliance.[251] As the literature on legitimacy in non-state regulatory settings frequently identifies, the claims of non-state regulators to legitimacy and compliance often depends on the satisfaction of 'democratically-based claims' including the composition or deliberative procedures of the regime and its inclusion of relevant parties and actors.[252] This also coheres with Abbott and Snidal's suggestion that 'Effective regulatory institutions must balance the interests of stakeholders and instantiate prevailing norms.'[253]

In addition to the above, Prof Cafaggi also identifies transparency and accountability as key in the governance of self-regulatory organisations. The former is a provocative concept which conveys a sense of openness, trustworthiness and directness and has increasingly become part of the normative demands made of organisations of various shapes and sizes, both public and private. The force of transparency as a prevailing norm is such that Bianchi reminds us of its fundamentally distinctive nature in contemporary culture.[254] Yet, scholars have often struggled to condense it into an evaluative and analytical construct. In general, however, Transparency is widely regarded as the availability and accessibility of information to those directly affected by it.[255]

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[251] Ibid. at 60.

[252] In a nutshell, Legitimacy means social credibility and acceptability. Suchman describes it as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions." – See Mark Suchman, 'Managing Legitimacy: Strategic and Institutional Approaches' (1995) 20 Academy of Management Review 571, 574. See also Steven Bernstein, 'Legitimacy in intergovernmental and non-state global governance' (2011) 18(1) Review of International Political Economy 17-51. See also Julia Black, 'Legitimacy and the Competition for Regulatory Share' (2009) LSE Law, Society and Economy Working Papers 14/2009, 11 <http://eprints.lse.ac.uk/24559/1/WPS2009-14_Black.pdf> Accessed 20th March 2018.

[253] Kenneth W. Abbott and Duncan Snidal 'The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State' in Walter Mattli and Ngaire Woods, *The Politics of Global Regulation* (Princeton University Press, 2009) 62.

[254] Andrea Bianchi, 'On Power and Illusion: The Concept of Transparency in International Law' in A Bianchi (eds) *Transparency in International Law* (Cambridge University Press, 2013) 1

[255] United Nations Economic and Social Commission for Asia and the Pacific, 'What is Good Governance?' (2007) <https://www.unescap.org/sites/default/files/good-governance.pdf> Accessed 20th May 2018. Another interesting take is provided by Gupta and Mason who define transparency as 'disclosure of information intended to evaluate

Accountability on the other hand is no less provocative. As Mulgan notes, it is a word that 'crops up everywhere, performing all sorts of analytical and rhetorical tasks and carrying most of the burden of democratic governance.'[256] It is also associated with several other concepts such as transparency, trustworthiness, legitimacy, fairness, responsibility and integrity.[257] In an analytical sense, however, accountability denotes a relationship between an actor and a forum, in which the actor has an obligation to explain or justify its conduct, which in turn allows the forum to pose questions and pass judgement from which the actor may face consequences.[258] Accountability is thus a communicative relationship which entails responsiveness to demands external to an organisation.[259] Simply put, to be accountable is to agree to subject oneself to relationships of external scrutiny.[260]

Returning to Caffaggi's thesis, he argues that good regime governance demands transparency and accountability. For him, transparency requires the timely publication of relevant information about the self-regulatory regime, including its constituting documents and organisational rules, membership rules and other relevant organisational practices through which the regime is operated or governed.[261] Other elements of transparency include the publication of regulatory decisions, Ex Ante and Ex Post impact assessments, expert contributions, monitoring and enforcement reports and the financial and non-financial reports of the regulator amongst

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and/or steer behaviour.' See: Michael Mason and Aarti Gupta 'Transparency and international environmental politics' in M Betsill, K Hochstetler and D Stevis (eds.) A*dvances in International Environmental Politic*s. (Palgrave Macmillan, 2014) 351.

256 Richard Mulgan, 'Accountability: An Ever-Expanding Concept?' (2000) 78(3) Public Administration 555.

257 Mark Bovens, 'Analysing and Assessing Accountability: A Conceptual Framework' (2007) 13(4) European Law Journal 447, 449.

258 Ibid.

259 Julia Black, 'Constructing and contesting legitimacy and accountability in polycentric regulatory regimes' (2008) 2 Regulation and Governance 137, 150.

260 Ibid.

261 Fabrizio Cafaggi and Andrea Renda, 'Measuring the Effectiveness of Private Regulatory Organisations' (2014) Stribis Foundation Report, 67 <https://ssrn.com/abstract=2508684> Accessed 20th January 2018.

others.[262] Transparency of this sort serves a double function. It facilitates accountability to stakeholders who may be affected by the operations of the self-regulatory regime. Accountability in this sense refers to the ability of a regime to motivate external stakeholders and to subject itself to external scrutiny.[263] It follows therefore that an accountable regime is one which makes available important information to those directly affected by it and by so doing, explains its decisions and agenda to affected constituencies.[264]

This thesis agrees, for the most part, with Prof Cafaggi's approach.[265] Taking a cue from the preceding analysis and other approaches examined above, it conceptualises effectiveness as the ability of a self-regulatory organisation or regime to meet its founding or motivating objectives. For such an effect, this thesis proposes three distinct but often interrelated ways to assess the effectiveness of self-regulatory regimes. This includes (a) the presence of comprehensive and ambitious targets, relative to the policy objective and which exists alongside independent monitoring and robust enforcement (b) Compliance (c) The institutionalisation of Good Internal Governance mechanisms – Representativeness, Transparency and Accountability.

This study conceptualises comprehensive and ambitious targets as the promulgation of precise and stringent standards that require self-regulating actors to implement meaningful changes, relative to the policy objective (ambition).[266] Allied to the design of standards is the need

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[262] Ibid.

[263] Ibid.

[264] Ibid.

[265] It should also be noted that Prof Cafaggi's approach largely dovetails with a recent study by Prof Sethi Prakash in which he argues that effective Industry Self-Regulation is likely to be fostered in the presence of substantive and specific standards, Independent and inclusive regime-level governance, Independent external monitoring and Maximum regime-level transparency amongst others. For more information see Sethi Prakash Sethi, 'Self-Regulation through Voluntary Codes of Conduct' in S Prakash Sethi (eds*) Globalization and Self-Regulation: The Crucial Role That Corporate Codes of Conduct Play in Global Business* (Palgrave Macmillan, 2011) 12-14.

[266] As Scheltema notes: 'more precise commands generally result in better behavior.' See: Martijn Scheltema, 'Assessing Effectiveness of International Private Regulation in the CSR Arena' (2014) 13(2) Richmond Journal of Global Law and Business 263, 291.

for credible monitoring and enforcement mechanisms. The former is conceptualised as the use of independent mechanisms in monitoring or verifying the implementation of regime outputs.[267] This channels the scepticism of Potoski and Prakash in the ability of first-party approaches (self-assessment) to credibly verify compliance.[268] This thesis accepts this reasoning given the credibility gaps associated with first-party monitoring and the inherent conflicts involved in having an actor set the rules and monitor its own compliance simultaneously. Even so, the literature on Self-governance notes that free riding and shirking are likely to occur in settings where there are informational asymmetries between regime actors and regime sponsors. It follows therefore that to credibly verify whether participants are adhering to norms, effective clubs must institutionalise forms of objective monitoring including third-party monitoring.[269]

Simply setting rules or standards without providing adequate remedies in case of violations is obviously a very imperfect guarantee that regulatory objectives will be achieved.[270] This study therefore highlights the need for enforcement which denotes the presence of credible sanctioning mechanisms which can be applied to the violations of regime norms and standards. In a self-regulatory context, this would usually involve fines, suspension, naming and shaming or the ultimate expulsion of the errant member from the regime.[271] This study adopts this approach

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[267] Kenneth W. Abbott and Duncan Snidal 'The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State' in Walter Mattli and Ngaire Woods, *The Politics of Global Regulation* (Princeton University Press, 2009) 64.

[268] Aseem Prakash and Matthew Potoski, 'Collective Action through Voluntary Environmental Regimes' [2007] 35(4) Policy Studies Journal 773, 779.

[269] Indeed, Potoski and Prakash describe first party forms of monitoring as the 'least credible' and appear to favour more objective forms. See: Matthew Potoski and Aseem Prakash, 'Covenants with Weak Swords: ISO 14001 and Facilities' Environmental Performance' (2005) 24(4) Journal of Policy Analysis and Management 745, 748-750.

[270] Fabrizio Cafaggi and Andrea Renda, 'Measuring the Effectiveness of Private Regulatory Organisations' (2014) Stribis Foundation Report, 75 <https://ssrn.com/abstract=2508684> Accessed 20th January 2018.

[271] Neil Gunningham and Joseph Rees, Industry Self-Regulation: An Institutional Perspective (1997) Law and Policy 363, 396. See also, Fabrizio Cafaggi, A Comparative Analysis of Transnational Private Regulation: Legitimacy, Quality Effectiveness and Enforcement (2014) EUI Working Paper Law 2014/2015, 39 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2530516> Accessed 20th Feb 2018. See also: Kenneth W.

primarily for the purposes of safeguarding the robustness and credibility of the regime, eliminating free-riding, facilitating compliance and ultimately avoiding institutional failure.[272]

In addition to the above, this study also asks whether the self-regulatory regime is producing causal effects such as compliance with regime norms. Plausible Indicators of such changes can be found in organisational practices, performance patterns or improvements and other outcomes that are consistent with the substance of regime norms. The ideal and optimal level of compliance advocated in this study is full compliance with regime norms.

Regarding the governance of the regime, this study identifies the need for representativeness and inclusiveness – the latter for the purposes of securing actor consent, promoting balanced self-regulation in the broader public interest and enhancing process legitimacy. The study also identifies the need for transparency and accountability through the publication of relevant constituting documents and membership rules, impact assessments, financial and non-financial reports, regulatory decisions and the associated existence of broader communicative relationships with external stakeholders. It is argued that these characteristics form part of a necessary set of factors through which self-regulatory arrangements may achieve their true potential.

The following chapters apply the reasoning outlined above in testing the efficacy or effectiveness of the current self-regulatory apparatus for Sovereign Wealth Funds through the Santiago Principles and its institutional counterpart, the International Forum of Sovereign Wealth Funds.

Abbott and Duncan Snidal 'The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State' in Walter Mattli and Ngaire Woods, The Politics of Global Regulation (Princeton University Press, 2009) 64.

[272] Ibid. As Gunningham reminds us, a prerequisite for successful self-regulation will be effective monitoring and enforcement. Without it, free-rider problems may be insurmountable.

2.7 Conclusion

This chapter set out to consider the effectiveness of self-regulation. It began with an analysis of the foundations of self-regulatory regimes, including their proliferation at the transnational level. Also analysed are the drivers of these regimes which range from the weaknesses of the regulatory state as a global rule maker to more strategic motivations such as the enhancement of industry reputation and legitimacy. This was followed by a consideration of the promises and limits of self-regulatory regimes. As to the former, it is identified that self-regulation allows for the utilisation of industry expertise and also leads to flexible policy solutions. By contrast, critics argue that these regimes are beset by problems of regulatory capture, free-rider challenges and often exhibit soft and lax enforcement.

Having established these foundational elements, the chapter proceeded to the central question of when Self-regulatory arrangements are likely to be effective. For a start, this section, considered the often-anecdotal studies of effectiveness, revealing diverse views on the conditions under which these regimes are likely to be effective. For the most part, these studies appear to focus on factors which may prove methodologically difficult.

To mitigate this methodological challenge, the section further examined more formalised studies of effectiveness. Under particular scrutiny are analyses which integrate normative and institutional characteristics in their conceptualisation of effectiveness.

Most helpful in this sphere is the approach of Prof Caffaggi who sees effectiveness as depending on the comprehensiveness and quality of the rules, the associated level of enforcement and compliance and the governance arrangements institutionalised by the self-regulatory regime. Drawing from these insights, the chapter conceptualises effectiveness as the ability of a self-regulatory regime to meet its motivating objectives. For such an effect, 3 distinct but often inter-related indicators are proposed. These are (a) The presence of comprehensive and Ambitious

Targets (relative to the policy objective), coupled with robust enforcement and independent monitoring, (b) Compliance with Regime norms and (c) The institutionalisation of Good Internal Governance mechanisms – Representativeness, Transparency and Accountability.

With this theoretical background as foundation, the next chapter begins the journey to studying the effectiveness of Santiago Principles and the IFSWF by first considering the nature of the actors in this self-governing network – Sovereign wealth funds.

CHAPTER 3: THE NATURE OF ACTORS IN THE SELF-REGULATORY REGIME

3.1 Introduction

Having established the theoretical foundations of this thesis, this Chapter goes on to introduce the participants in the Self-regulatory regime – Sovereign Wealth Funds (SWFs). This furthers the subject matter of the thesis, which investigates the effectiveness of the self-regulation of SWFs through the Santiago Principles and the International Forum of Sovereign Wealth Funds (IFSWF). Indeed, a study of the effectiveness of Self-regulation would be incomplete and manifestly absurd without a consideration of the actors within the self-regulatory regime and their characteristics.

To achieve this important aim, the Chapter proceeds along five main sections: Historical Perspectives and Definitions, Taxonomy of SWFs, Investment behaviour and Patterns, Concerns and National Regulatory Responses.

The starting point of analysis is the history of these funds. The focus of this section is the ancient but contested history of SWFs. Thereafter, the focus moves to the animated definitional contest surrounding SWFs, revealing the eclectic views of academics, policymakers, and multilateral institutions. To resolve the identity challenge surrounding SWFs, this thesis adopts the definition provided by the International Working Group of Sovereign Wealth Funds (IWG now IFSWF) and which is incorporated in the Santiago Principles – the subject matter of this thesis. This definition is both inclusive and pragmatic, and it incorporates the essential detail of sovereign ownership and control, difference from other state-backed vehicles, sources of funding, objectives and mandates which some other definitions have adopted.

Following this is an examination of the taxonomy of SWFs. Drawing from contemporary literature, a distinction is made between the different types of funds and their different policy mandates and objectives.

The third section examines the investment behaviour, asset allocation and distribution of SWF assets. Drawing from a variety of reputable interdisciplinary sources, this section considers the asset classes that SWFs invest in, their sectorial preferences and target destinations.

This is followed by an evaluation of the concerns ascribed to SWFs. Concerns typically associated with SWFs include the fears in recipient or host economies that SWFs may, through their investments, imperil national security and destabilise financial markets. Concerns also extend to the potential effects of SWFs on market competition and their likely use to extend subsidies to national champions in ways that may be distortive to the idea of a competitive economy. Other concerns focus on the often-poor internal governance and transparency of these entities.

The final section considers the national regulatory treatment of SWFs often enacted in response to the concerns highlighted above. It considers, in particular, the foreign investment regulations in the United States and Australia. These jurisdictions have been chosen based on their position as premier destinations for SWF investment and the relative ease of access to regulatory information.

3.2 Historical Perspectives and Definitions of SWFs

SWFs are unique and hybrid entities created by states but with significant operations in private markets. Although the term SWF is just over a decade old, their swift and prolific rise has provoked widespread attention.[273] At the start of 2018, there were over 78 funds in existence globally, with more than 21 established since 2010.[274] This surge in number is matched only by an explosive growth in the size of assets owned and managed by SWFs. As recent report by the consulting group Preqin suggests, SWFs hold over $7 trillion assets globally.[275] These include sizeable holdings in the biggest global corporate firms such as Barclays, HSBC, Glencore and Credit Suisse, leading to their characterisation as 'power brokers' and key players in international capital markets.[276]

The emergence of SWFs is, for the most part, related to the Commodity and Natural resource price boom of the 90s and the rise of emerging market exporters such as China, India and the Asian Tiger economies.[277] The compact of accelerating commodity prices and increasing cross-border exports created severe macroeconomic imbalances between the developing and developed world which has led to an explosion of surplus revenues across much of the former.[278]

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[273] First coined in 2005 by Commentator and Economist Andrew Rozanov. See Andrew Rozanov, 'Who Holds the Wealth of Nations?' (2005) 15 Central Banking Journal 52.

[274] Preqin, '2018 Sovereign Wealth Fund Review' (2018), 17 <http://docs.preqin.com/samples/The-2018-Preqin-Sovereign-Wealth-Fund-Review-Sample-Pages.pdf> 3rd September 2018.

[275] Ibid. at 5.

[276] Diana Farrell, Susan Lund, Eva Gerlemann and Peter Seeburger, 'The New Power Brokers: How Oil, Asia, Hedge Funds, and Private Equity are shaping global capital markets' (Mckinsey Global Institute, 2007), 13.

[277] ibid.

[278] Aaditya Mattoo and Arvind Subramanian, 'Currency Undervaluation and Sovereign Wealth Funds: A New Role for the World Trade Organization' (2008) World Bank Research Paper 4668, 11 <http://documents.worldbank.org/curated/en/817531468340866681/pdf/WPS4668.pdf> Accessed 20th May 2018. See also Bryan Balin, 'Sovereign Wealth Funds: A Critical Analysis' (2008) John Hopkins University School of

This is graphically represented in figure 3 below which shows a surge of surplus income accrued to several developing nations.

SWFs therefore offer an opportunity to raise the rate of return on these surplus assets which would otherwise be housed in the coffers of Central Banks. Accordingly, most SWFs have been established in countries that are rich in natural resources, with oil-related SWFs being the most common and largest cluster.[279] These include funds established by the Gulf countries, Russia and the ex-Soviet republics, Nigeria, Angola, Malaysia, Brunei, and Norway among others.[280]

A newer set of funds has emerged in response to the discoveries of major resource endowments—particularly natural and liquefied gas, but also coal, diamonds, copper, and other solid minerals.[281] A third and more modern set of SWFs includes those financed out of surplus foreign exchange reserves resulting from growing cross-border exports. Funds within this category include the funds established by Singapore, Korea, China, and other East-Asian economies.[282] Together, these constitute the modern ecosystem of SWFs.[283]

The idea of SWFs long predates their twenty-first century rise to prominence. Depending on which account, SWFs have been in existence either since the 1950s or since the 18th century.[284]

Advanced International Studies, 4 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1477725> Accessed 20th May 2018.

[279] Bernando Bortolotti, Veljko Fotak, William Megginson, 'The Rise of Sovereign Wealth Funds: Definition, Organisation and Governance' in Caselli, S. etal (eds) *Public-Private Partnerships for Infrastructure and Business Development: Principles, Practices, and Perspective*s (London, Palgrave McMillan, 2015) 298.

[280] Ibid.

[281] Ibid.

[282] Ibid.

[283] It is also important to note that some recent funds are at least partly financed by the disbursement of sovereign debt on international markets. See: Bryan Balin, 'Sovereign Wealth Funds: A Critical Analysis' (2008) John Hopkins University School of Advanced International Studies, 4 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1477725> Accessed 20th May 2018.

[284] Certain accounts suggest that SWFs have been existent since the 1950s with the creation of the Kuwait Investment Authority (KIA) in 1953. See Angela Cummine, *Citizens Wealth: Why and How Sovereign Wealth Funds should be Managed by the People for the People* (Yale University Press, 2016) 6. Other accounts suggest instead that the emergence of SWFs

Notwithstanding this seemingly ancient existence, an agreed definition of what constitutes a SWF remains elusive till this day. This partly reflects the ambiguity of these entities. To some, public but nongovernmental[285] to others, Private sovereign entities[286] and to a third category, formally sovereign and functionally private.[287] In a world characterised by an unflinching loyalty to a binary separation of public from private, this hybridity breeds confusion, misunderstanding and even misapprehension.[288]

Worse still, the variance between purported SWFs are so vast that one author posits that there is no such thing as a typical SWF.[289] This is because SWFs differ in institutional structure, governance characteristics, policy objectives, risk tolerance, investment profiles, asset classes and instruments, not to mention levels of transparency and accessibility.[290] In addition, these funds have arisen in a climate populated by similar public investment vehicles ranging from Central banks to Sovereign Pension Funds and State-Owned Enterprises who attract the same level of scrutiny

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can be traced to the 18th century with the establishment of the Caisse des Depots et Consignations (CDC) in 1816. See Xu Yi-Chong, *The Political Economy of Sovereign Wealth Fund*s (1st edn, Palgrave Macmillan 2010) 1. A third account provided by Paul Rose however suggests that the oldest SWFs were in fact created in the United States in 1835, 1854 and 1898 respectively. See Paul Rose, 'American Sovereign Wealth,' (2011) Ohio State University- Michael Moritz College of Law, Public Law Working Paper No 161, 3 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1960706&download=yes> Accessed 20 January 2016.

[285] Jurgen Braunstein, 'The Novelty of Sovereign Wealth Funds: The Emperor's New Clothes?' (2014) 5(2) Global Policy 169, 171.

[286] Fabio Bassan, *The Law of Sovereign Wealth Funds* (Edward Elgar, 2011) 24

[287] Larry Backer, 'Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Wealth Funds and Public Global Governance Through Private Global Investments' (2009) 41(2) G.J.I.L 425, 436.

[288] Ibid. Backer describes these funds as an assault on the traditional public-private divide.

[289] Andrew Rozanov, 'Definitional challenges of Dealing with Sovereign Wealth Funds' (2010) 1(2) Asian Journal of International Law 249, 251.

[290] Ibid.

and attention in their hosts – a reality which further complicates the task of defining or properly demarcating them. [291]

That said, a keen observer might wonder why a definition for SWFs is necessary in any case. An effective rebuttal would be that the identification of SWFs is vital firstly for characterisation purposes. In other words, it is always important to identify and understand the nature of the beast as well as to separate it from similar investment vehicles.[292] In addition, a definition is also necessary from a regulatory or governance point of view to properly apply domestic laws and transnational regulations to these funds as well as to assess the efficacy of existing rules and regulations (the subject matter of this thesis).[293]

Related to this is the fact that it is not uncommon for certain funds to eschew the SWF label for the purposes of avoiding scrutiny and greater oversight.[294] This is the case with the Saudi Arabian Monetary Authority (SAMA), China's State Administration of Foreign Exchange (SAFE) and Singapore's Temasek who have often disavowed public claims that they are SWFs even though they are classed in independent studies and rankings as SWFs.[295]

The above ambiguity surrounding SWFs has not stopped a definitional torrent of sorts. The origins of this can be traced to an article in the Central Banking Journal of May 2005 by

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[291] For a short expose of existing sovereign investment vehicles, see Figure 5 below.

[292] Chris Balding, 'A Portfolio Analysis of Sovereign Wealth Funds' (2008), 7 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1141531> Accessed 20th January 2018. See also Fabio Bassan, *The Law of Sovereign Wealth Funds* (Edward Elgar, 2011) 30-31

[293] Ibid. at 17.

[294] See: George Kratsas, 'Sovereign Wealth Funds: Their Operation and the Economic, Political and Legal Responses' (PHD Thesis, University College London 2013) 23-24.

[295] Ibid. See also: Sara Bazoobandi *The Political Economy of the Gulf Sovereign Wealth Funds: A Case Study of Iran, Kuwait, Saudi Arabia and the United Arab Emirates* (Routledge Studies in Middle Eastern Economies, 2012) 163. Temasek says on its webpage that it is 'neither a statutory board nor a government agency.' See: Temasek 'FAQ' (2018) <https://www.temasek.com.sg/en/faqs.html> Accessed 20th October 2018. For rankings, see: SWF Institute 'SWF Rankings' (2018) <https://www.swfinstitute.org/sovereign-wealth-fund-rankings/> Accessed 2nd December 2018.

Andrew Rozanov, an economist formerly of State Street Corporation.[296] Rozanov began by describing SWFs in the negative as "sovereign-owned asset pools, which are neither traditional public-pension funds nor reserve assets supporting national currencies."[297] To constitute a SWF, he continued, "A pool of funds would have to be managed separately under guidelines distinct from those applicable to central bank reserves."[298] As the pioneer definition of SWFs, Rozanov struck an interesting and provocative tone, revealing certain key components of these funds.

The first component is relatively uncomplicated. It is simply that SWFs are aligned to the concept of sovereignty – a difficult and often debated term reserved for nation states and their governments.[299] Indeed, most SWFs are established by central governments across the world to manage national wealth.[300] Yet, it is noteworthy that subnational units like Alaska and Alberta, although lacking in formal sovereignty, have established funds of their own which are widely considered as SWFs.[301]

The second and third pillars of Rozanov's definition invites us to acknowledge the assemblage of public entities of which SWFs are an increasingly important part. In particular, it invites us to disentangle these entities from Central Banks and Sovereign or public Pension Funds.[302] The former typically maintains a certain amount of foreign exchange to support and defend national currencies in the event of currency downturns.[303] Whilst the latter serves to invest resources contributed by public sector employers and employees for the benefit of current and future

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296 Andrew Rozanov, 'Who Holds the Wealth of Nations?,' (2005) 15 Central Banking Journal 52

297 Ibid.

298 Ibid.

299 Gordon Clark, Adam Dixon and Ashby Monk, *Sovereign Wealth Funds, Legitimacy, Governance and Global Power* (Princeton University Press, 2013) 35.

300 Ibid.

301Andrew Rozanov, 'Definitional challenges of Dealing with Sovereign Wealth Funds' (2010) 1(2) Asian Journal of International Law 249, 252. See also Fabio Bassan, *The Law of Sovereign Wealth Funds* (Edward Elgar, 2011) 32.

302 Ibid.

303 Ibid.

retirees.[304] For Rozanov, a SWF is distinct from both entities and exists to invest national wealth in private markets.[305]

This view brought SWFs into the mainstream and set off an animated definitional contest amongst Academics, private consultancies, Policymakers and Multilateral Institutions many of which are considered below. Yet, as will be seen, the views regarding SWFs are as eclectic as the institutions themselves, raising questions about the possibility of ever reaching a widely accepted definition.

The early definitional response to SWFs tended to pursue a dual approach, some systematic and the others less so. An example of the latter can be seen in the definition provided by Edwin Truman for whom SWFs are 'separate pools of government-owned or controlled assets that includes some international assets.'[306]

At first sight, this definition appears sufficiently precise and succinct. Indeed, its allusion to the public nature of SWFs and the geographical distribution of their assets captures the true character of these entities and their main investment strategy (foreign investment). Yet, Truman offers a deceptively simple characterisation of these entities. His definition would, for instance, capture any government-owned entity that holds or manages assets on behalf of owner states including crucially, Central Banks, Public Pension Funds and State-Owned Enterprises.[307] Since none of the entities mentioned above are widely considered as SWFs, a stricter definition is clearly necessary.

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[304] Ibid.

[305] Ibid.

[306]Edwin Truman, *Sovereign Wealth Funds: Threats or Salvation?(*1st edn, Peterson Institute of International Economics, 2010) 10

[307] Ashby Monk, 'is CAIPERS a Sovereign Wealth Fund?' (2008) Center for Retirement Research Paper Number 8-21, 4 <http://crr.bc.edu/wp-content/uploads/2008/12/IB_8-21-508.pdf> Accessed 20th January 2018.

Other authors have followed in Truman's tradition with broad definitions of these funds. This can be observed in the definition provided by Chris Balding, an academic and influential SWF commentator who sees SWFs as "pools of capital controlled by a government or government related entity that invests in assets seeking returns above the risk-free rate of return."[308] The breadth of the definition aside, Balding appears to focus on two interesting analytical variables.

First, he emphasises the need for government ownership and control of a SWF but remarkably also, he highlights the commercial or private nature of SWFs in seeking financial returns via private markets – an idea which meshes with Professor Backer's characterisation of SWFs as "formally sovereign but functionally private."[309] Yet, Balding's approach suffers from similar shortcomings as Truman's definition and is therefore limited for the same reasons highlighted above.

Another interesting contribution to the debate on the definition of SWFs is that offered by the United States Treasury. For the Treasury, a SWF is 'a government investment vehicle, funded by foreign exchange assets and which manages those assets separately from official reserves.'[310] Like Balding above, the Treasury's definition captures an essential component of SWFs – the fact that they are owned and controlled by government. It also differentiates SWFs from Central Bank Assets by emphasising their functional separation from official reserves. The definition also makes good progress from Truman's approach by highlighting a possible source of funding for SWFs (Foreign exchange assets).

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[308] Chris Balding, 'A Portfolio Analysis of Sovereign Wealth Funds' (June 8 2008), 10 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1141531> Accessed 20th January 2018.

[309] Larry Backer, 'Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Wealth Funds and Public Global Governance Through Private Global Investments' (2009) 41(2) G.J.I.L 425, 436.

[310] US Treasury, Press Room, Remarks by Acting Under Secretary for International Affairs Clay Lowery on Sovereign Wealth Funds and the International Financial System (21 June 2007) <https://www.treasury.gov/press-center/press-releases/Pages/hp471.aspx> Accessed 20th January 2018.

Yet, the Treasury's definition is, to some extent, problematic. Unlike Truman's approach, the Treasury definition does not consider the possible investment strategies adopted by these funds such as the distribution of their assets. Another source of difficulty is the absence of any consideration of the possible purposes or objectives of SWFs which as we shall see, is an explanatory variable adopted in other definitions.[311] A closer look at the Treasury's definition also reveals a problem of under-inclusion. One can observe, for instance, an allusion to a single source of SWF funding – foreign exchange assets. Whereas, SWFs are funded from a vast pool of sources including commodity export revenues, foreign exchange assets, proceeds of privatisation and increasing also, issued debt.[312] By emphasising one and excluding the other, it would appear that the Treasury's definition provides an incomplete analysis of the true scope of SWFs – a situation which clearly calls for a stricter definition.

More sophisticated and elaborate definitions have been offered by multilateral institutions such as the IMF and the International Working Group of Sovereign Wealth Funds (IWG).[313] The IMF takes a thought-provoking approach, defining SWFs as:

> "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

[311] See the IWG/Santiago Principles definition below.

[312] Javier Capape and Tomas Guerrero, 'More Layers than an Onion: Looking for a definition of Sovereign Wealth Funds' (2012) ESADE Business School Research Paper No. 21, 20 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2391165> Accessed 20th May 2018. See also, Chao Chao, 'the Theoretical Logic of Sovereign Wealth Funds' (2009), 2 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1420618> Accessed 20th January 2018.
The IWG and IMF definitions below also spell out the variegated sources of SWF funding.

[313] The IWG is the institutional predecessor to the IFSWF and was responsible for drafting the Santiago Principles with limited input from the IMF and other interested stakeholders such as the World Bank and recipient states of SWF investments.

surpluses, and/or receipts resulting from commodity exports. These funds employ a set of investment strategies which include investments in foreign financial assets.[314]

This definition, offered in early 2008, appears to have influenced the Santiago Principles definition of SWFs, crafted by its principal drafters, the International Working Group of SWFs (IWG).[315] According to the IWG, SWFs are:

> "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."[316]

The IWG further attempts to separate SWFs from other sovereign investment entities by excluding from its definition, vehicles such as Central Banks, State-Owned Enterprises (SOEs), and government-employee pension funds.[317] More interestingly, the IWG provides three key specifications that must be met for a fund to be legitimately classified as a SWF. This includes: Ownership, Investments and Purposes or Objectives.[318]

In the context of Ownership, the IWG makes the predictable claim SWFs are owned by the general government including sub-national governments. On top of being state-owned, the

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[314] International Monetary Fund, 'Sovereign Wealth Funds- a Work Agenda', IMF (Feb 29, 2008), 26 <http://www.imf.org/external/np/pp/eng/2008/022908.pdf> Accessed 29th January 2018.

[315] International Working Group on Sovereign Wealth Funds, 'Sovereign Wealth Funds: Generally Accepted Principles and Practices "Santiago Principles"' (2008), 27 <http://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf> Accessed 20th February 2016.

[316] ibid.

[317] ibid.

[318] ibid.

IWG/Santiago definition asserts that SWFs generally invest in foreign financial assets – an idea which effectively excludes SWFs with exclusively domestic investment horizons such as Singapore's Temasek, Malaysia's Khazanah Nasional Berhad or even the Russian Direct Investment Fund, to name just a few.[319] It is rather curious that the IWG's successor, the IFSWF has not barred such funds from its membership, suggesting that the initial exclusion of domestic-focused Funds in the Santiago definition is rather artificial than real.[320]

In the context of purposes, the IWG/Santiago approach highlights the fact that SWFs are generally established for macroeconomic or public policy purposes and are mandated to invest government funds to achieve financial objectives. According to the IWG, this allows SWFs to employ a wide range of investment strategies with a medium- to long-term timescale.

Far from ending the definitional contest surrounding SWFs, the Santiago/IWG definition has instead inspired several modern approaches. This can be observed in the definition offered by the Sovereign Investment Lab, a prominent SWF institute for whom a SWF is an investment fund that meets five criteria: (1) an investment fund rather than an operating company; (2) that is wholly owned by a sovereign government, but organised as an independent entity from the central bank or finance ministry to protect it from excessive political influence; (3) that makes international and/or domestic investments in a variety of risky assets; (4) that is charged with seeking a

[319] This exclusion has proved more artificial than real as the IFSWF (formerly IWG) has gone on to accept for membership, funds with largely domestic investment horizons such as Morocco's Ithmar Capital, Oman's Investment Fund, the Iran Development Fund, Palestine Investment Fund, the Russian Direct Investment Fund just to name a few. See also: IFSWF, 'Dealing with Disruption' (2017), 4 <http://www.ifswf.org/sites/default/files/IFSWF_ANNUAL_REVIEW_2018.pdf> Accessed 20th June 2018.

[320] International Working Group on Sovereign Wealth Funds, Sovereign Wealth Funds: Generally Accepted Principles and Practices "Santiago Principles" (2008), 27 <http://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf> Accessed 20th February 2016.

commercial return; and (5) which does not have a stream of explicit liabilities committed to individual citizens, such as pension funds.[321]

This definition, like the Santiago/IWG approach accentuates the sovereignty of SWFs. It also separates SWFs from the apparatus of its owner state by emphasising independent management from other state financial institutions such as the Central bank and Ministry of Finance.[322] Also interesting is its portrayal of the investments of SWFs. One can observe, for instance, a willingness to consider funds with exclusively domestic assets as SWFs – an idea which obviously conflicts with the initial definition provided by the IWG.

The Sovereign Investment Lab's definition is also remarkable for its depiction of the commercial intent of SWFs. This fits comfortably with the characterisation of SWFs elsewhere as formally sovereign but functionally private.[323] The definition also channels the differentiation agenda observed in other definitions by highlighting the absence of formal pension liabilities– a notion which separates SWFs from public pension funds who are otherwise liable to beneficiaries (current and future retirees of a pension scheme).

From the analysis above, one can discern a common assumption that SWFs are best understood as public investment vehicles, different from other sovereign investment entities and established with a mandate to pursue risk-adjusted returns in private markets for variegated reasons. Also apparent is the lack of an agreed and exclusive definition of SWFs. As can be seen above, several authors have emphasised different characteristics in defining and classifying SWFs.

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321 Bernado Bortolotti, Vejko Fotak, William Megginson, 'the Rise of Sovereign Wealth Funds: Definition, Organisation and Governance' (2013), 5 <https://www.unibocconi.eu/wps/wcm/connect/fbd0c50e-0402-4992-9a2f-0a46d3105261/SWF-PPP-Palgrave-1.pdf?MOD=AJPERES> Accessed 20th May 2018.

322 Some might argue that such a separation is rather optimistic than real

323 Larry Backer, 'Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Wealth Funds and Public Global Governance Through Private Global Investments' (2009) 41(2) G.J.I.L 425, 436.

This undoubtedly creates an analytical challenge for studies such as this one that seek to examine the efficacy of the extant rules governing SWFs.

As a remedy, this thesis adopts the official definition provided by the IWG and reflected in the Santiago Principles which has been discussed above. The IWG's definition seems sufficiently inclusive and pragmatic. It also incorporates the essential detail of sovereign ownership and control, difference from other state-backed vehicles, sources of funding, objectives and mandates which some other definitions analysed above have adopted.

At the same time, this study disagrees with the IWG's artificial exclusion of funds with domestic assets. This reasoning is hinged on its successor's acceptance of such funds within its ranks and more recent academic and practitioner commentary such as the Sovereign Investment Lab definition which includes these funds within the ecosystem of SWFs. Having examined the history and definitions of SWFs, it is important to study the different variations and models of these important entities.

Rank	Country	Forex Reserves ($B)
#1	China	$3,161.5
#2	Japan	$1,204.7
#3	Switzerland	$785.7
#4	Saudi Arabia	$486.6
#5	Hong Kong (China)	$437.5
#6	India	$397.2
#7	South Korea	$385.3
#8	Brazil	$358.3
#9	Russia	$356.5
#10	Singapore	$279.8

Figure 3: Largest holders of Foreign Exchange reserves in 2018 represented in Billions of US Dollars. Source: Business Insider (2018)[324]

[324] Jeff Desjardins, 'China has the largest forex reserves in the world — here's how other countries measure up', *Business Insider* (London, 29 May 2018) <http://uk.businessinsider.com/china-has-the-most-forex-reserves-heres-how-other-nations-measure-up-2018-5?r=US&IR=T> Accessed 20th June 2018.

Country	Sovereign Wealth Fund Name	Assets USD-Bil	Inception	Origin	*Linaburg-Maduell Transparency Index*
Norway	Government Pension Fund – Global	1074.60	1990	Oil	10
China	China Investment Corporation	941.4	2007	Non-Commodity	8
UAE – Abu Dhabi	Abu Dhabi Investment Authority	683	1976	Oil	6
Kuwait	Kuwait Investment Authority	592	1953	Oil	6
China – Hong Kong	Hong Kong Monetary Authority Investment Portfolio	522.6	1993	Non-Commodity	8
Saudi Arabia	SAMA Foreign Holdings	515.6	1952	Oil	4
China	SAFE Investment Company	441**	1997	Non-Commodity	4
Singapore	Government of Singapore Investment Corporation	390	1981	Non-Commodity	6
Singapore	Temasek Holdings	375**	1974	Non-Commodity	10
Saudi Arabia	Public Investment Fund	360	2008	Oil	5
Qatar	Qatar Investment Authority	320	2005	Oil & Gas	5
China	National Social Security Fund	295	2000	Non-Commodity	5
UAE – Dubai	Investment Corporation of Dubai	233.8	2006	Non-Commodity	5
UAE – Abu Dhabi	Mubadala Investment Company	226	2002	Oil	10
South Korea	Korea Investment Corporation	134.1	2005	Non-Commodity	9
Australia	Australian Future Fund	107.7	2006	Non-Commodity	10
Iran	National Development Fund of Iran	91	2011	Oil & Gas	5

Figure 4: Selected group of SWFs, Origin, Transparency Record according to the Linaburg-Maduell Index & Assets Under Management in USD Billions. Source: SWF Institute 2018[325]

[325] Sovereign Wealth Fund Institute, 'Largest SWFs by Assets under Management' (2018) <https://www.swfinstitute.org/sovereign-wealth-fund-rankings/> Accessed 20th August 2018.

SOVEREIGN INVESTOR TYPE	MAIN SOURCES OF CAPITAL	MAIN FUNCTIONS	TYPICAL INVESTMENT MODELS	EXAMPLES
Sovereign wealth funds	Resource revenues Excess foreign exchange reserves	Investing national wealth (surpluses and savings), typically through by an independent entity Promoting macroeconomic and fiscal stability	Savings funds: diversified portfolios with long-term horizons Stabilisation funds: highly liquid, fixed-income denominated portfolios	Norwegian Government Pension Fund Global, Abu Dhabi Investment Authority, China Investment Corporation, Kuwait Investment Authority
Central banks	Foreign exchange reserves	Held predominantly for exchange-rate management and intervention purposes	Highly liquid, fixed-income denominated portfolios Limited diversification into liquid equities, equity indexes and alternatives	National central banks Some equity exposure: Swiss National Bank, People's Bank of China, Hong Kong Monetary Authority, Saudi Arabian Monetary Agency
Public pension reserve funds	Earmarked fiscal provisions and/or surplus contributions	Dedicated asset pools without short-term liabilities, promoting long-term solvency of national pension and social security systems (anticipation of rising entitlements)	Diversified portfolios with long-term horizons and ability to hold illiquid assets	Swedish AP Funds, Australia Future Fund, National Pension Fund Korea, Government Pension Investment Fund of Japan, Canadian Public Pension Investment Board
Sovereign development funds, banks and agencies	Government transfers, debt- and equity-financing using own balance sheet	Investing in projects and sectors with high expected social and economic returns, particularly in context of financing gaps (commercial versus developmental orientation differs)	Large variation in assets and portfolios, with assets that may include debt, public and private equity, infrastructure and public-private partnerships	National and Regional Development Banks Mubadala (UAE), Temasek (Singapore), Samruk-Kazyna (Kazakhstan), Khazanah (Malaysia), Public Investment Fund (Saudi Arabia)

Figure 5: A typology of sovereign investors showing Investor type, main sources of Capital, Main Functions, Investment Model and Examples. Sourced from: Alsweilem etal (2018)[326]

[326] Khalid Alsweilem, Angela Cummine, Malan Rietveld and Katherine Tweedie, 'Sovereign investor models: Institutions and policies for managing sovereign wealth' (2015) Joint report by the Center for International Development Harvard Kennedy School and the Belfer Center for Science and International Affairs, Harvard Kennedy School, 13 <https://projects.iq.harvard.edu/files/sovereignwealth/files/investor_models_final.pdf> Accessed 20th January 2018.

3.3 The Taxonomy of Sovereign Wealth Funds

The preceding section, began the demystification of SWFs, focusing on the historical and definitional perspectives of these entities. This section continues this paradigm by studying the existing models of SWFs. Broadly speaking, contemporary literature identifies five main models of SWFs namely: Stabilisation Funds, Savings Funds, Reserve Investment Corporations, Development Funds and Contingent Pension Reserve Funds.[327] These different variations are examined in greater detail below.

3.3.1 Stabilisation Funds

The first type of SWF identified in the literature is the stabilisation fund which is also one of the oldest forms of SWFs.[328] The term 'Stabilisation' evokes the image of protection, security or stability.[329] This is precisely what Stabilisation funds are created to achieve. These funds, also known as commodity funds, are established by resource dependent states to insulate national budgets against adverse commodity price swings and other forms of market or economic volatility and instability.[330]

Such a policy approach is not novel. There are indeed instances of commodity-based economies seeking to hedge against fluctuating global oil prices by sequestering windfall revenues

[327] Udabair Das, Adnan Mazarei and Han Van der Hoorn, *The Economics of Sovereign Wealth Funds*, (1st edn, International Monetary Fund, 2010) 60. See also: IFSWF, About the IFSWF Membership (2018) <http://www.ifswf.org/about-ifswf-membership> Accessed 20th May 2018.

[328] Ibid.

[329] 'Stabilisation' (English Oxford Living Dictionaries Online, OUP, September 2018) <https://en.oxforddictionaries.com/definition/stabilization> Accessed 20th September 2018.

[330] Op cit Udabair Das.

into a separate institution to cushion national finances from future price swings.[331] Norway is a much-cited example, having established its fund in 1990 initially for stabilisation purposes.[332]

This important macroeconomic role means that stabilisation funds tend to adopt a short-term and conservative investment horizon, closely related to those of central bank reserve management vehicles.[333] This, in practice, means that they invest in short term, highly liquid or convertible assets like public treasuries and government bonds which can be liquidated expeditiously to provide financing to the Central Bank and other monetary or fiscal authorities at short notice.[334] Examples of stabilisation or commodity funds include Chile's Economic and Social Stabilization Fund, the Kazakhstan National Oil Fund and the Russian Stabilisation fund.[335]

3.3.2 Saving Funds

Next to stabilisation funds are saving funds also known as intergenerational or rainy-day funds. These entities manage the bulk of assets owned by SWFs globally.[336] They are created by owner states for the purposes of maximising profit and to transfer national wealth across generations.[337] Some saving funds are also established to transform finite natural resources into

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331 See: Gordon Clark, Adam Dixon and Ashby Monk, Sovereign Wealth Funds, Legitimacy, Governance and Global Power (Princeton University Press, 2013) 20.

332 Ibid.

333 Abdullah Al-Hassan, Michael Papaioannou, Martin Skancke and Cheng Chih Sung, 'Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management', (November 2013) International Monetary Fund, Working paper 13/231, 5 <https://www.imf.org/external/pubs/ft/wp/2013/wp13231.pdf> Accessed on 19 January 2016.

334 Ibid.

335 Evgenia Pismennaya and Olga Tanas, 'Why Putin Raiding Wealth Fund Won't Cure What Ails Russia', *Bloomberg* (London, 10 July 2014) <http://www.bloomberg.com/news/articles/2014-07-10/why-putin-raiding-wealth-fund-won-t-cure-what-ails-russia> Accessed 20th May 2016.

336 Massimiliano Castelli and Fabio Scacciavillani, 'Sovereign Wealth Funds and State Investments: A preliminary overview', in *Research Handbook on Sovereign Wealth Funds and International Investment Law* (1st edn, Edward Elgar 2015) 19

337 Abdullah Al-Hassan, Michael Papaioannou, Martin Skancke and Cheng Chih Sung, 'Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management', (November 2013) International Monetary Fund,

broader and more diversified financial wealth.[338] In view of their role in investing for savings and diversification purposes, these funds typically adopt a long-term investment horizon, a high-risk tolerance and unlike stabilisation funds, little liquidity constraints. This also means that their portfolios are more diversified and riskier.

Common holdings of savings funds include bonds (corporate and public), publicly and non-publicly listed equities, real estate, hedge funds, private equity funds, Infrastructure assets, commodities, natural resources and more recently, agri-business.[339] Contemporary examples include the Norway Government Pension Fund Global, the Abu Dhabi Investment Authority, the Kuwaiti Investment Authority, the Singaporean Government Investment Corporation and China Investment Corporation (CIC).

3.3.3 Reserve Investment Corporations

Besides a savings and capital accumulation objective, SWFs may also be created as Reserve Investment Corporations (RICs). RICs are commonly established by states to manage surplus foreign exchange reserves situated at the Central Bank.[340] This close nexus to Central Banks often blurs the distinction between RICs and Central Bank reserve management vehicles. However, the dividing line appears to be that Central Bank Reserve management vehicles typically invest in safe and easily convertible financial instruments like fixed income securities (sovereign bonds) that can be easily liquidated to provide refinancing to its principal (the Central Bank) in the event of a currency crisis whereas Reserve Investment funds invest 'excess' foreign exchange reserves in a much wider and more risky range of asset classes including corporate equities and debt to achieve

Working paper 13/231, 5 <https://www.imf.org/external/pubs/ft/wp/2013/wp13231.pdf> Accessed on 19 January 2016.

[338] ibid.

[339] Ibid.

[340] International Forum of Sovereign Wealth Funds, 'Santiago Principles: 15 Case studies' (November 2014), 11 <http://www.ifswf.org/sites/default/files/SantiagoP15CaseStudies1_0.pdf> Accessed 20th January 2018.

broader and more diversified national wealth.[341] In practice, these funds are created by states that have accrued excess foreign exchange reserves often through rising cross-border exports and trade. Notable examples of RICs include the Korea Investment Corporation (KIC), set up to manage excess foreign exchange generated from Korea's rising foreign exports,[342] the Hong Kong Monetary Authority (HKMA) and China's State Administration for Foreign Exchange (SAFE).[343]

3.3.4 Sovereign or Strategic Development Funds

Besides creating funds to manage excess foreign exchange reserves, states also establish innovative institutions to pursue domestic development and industrial priorities.[344] This includes the creation of publicly sponsored investment funds that combine financial performance objectives with local development objectives. These are Sovereign or Strategic Development Funds (SDFs).

By nature, SDFs allocate financial resources to priority socioeconomic projects within their home states, such as infrastructure. They also support strategic sectors in the domestic economy often by providing financing for local enterprises and firms.[345] This has often led to concerns of undue subsidisation and market distortion.[346] In practice, these funds adopt a number of

[341] Ibid.

[342] Ibid.

[343] Massimiliano Castelli and Fabio Scacciavillani, 'Sovereign Wealth Funds and State Investments: A preliminary overview', in Research Handbook on Sovereign Wealth Funds and International Investment Law (1st edn, Edward Elgar 2015) 18.

[344] Ibid. at 25.

[345] Peter Clark and Adam Dixon, 'Sovereign Development Funds: Designing High Performance, Strategic Investment Institutions' (2015), <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2667974&download=yes> Accessed 11th February 2016.

[346] Regis Bismuth, 'The "Santiago Principles" for Sovereign Wealth Funds: The Shortcomings and the Futility of Self-Regulation' (2017) 28(1) European Business Law Review 69, 73.

investment strategies, including attracting other private and public funds through joint ventures or investing their seed capital alone.[347]

The idea of creating funds to invest in the local economy is hardly new. The most illustrious example is Temasek, the Singaporean investment fund established in 1974 to administer and manage public equity investments in strategically important Singaporean firms.[348] In keeping with its mandate, Temasek has held majority stakes in hugely important Singaporean institutions since its inception including the Singapore airways.[349] The fund has also, through its investments, supported flourishing sectors in the Singaporean economy such as high-end manufacturing and pharmaceuticals.[350]

Buoyed by the Singaporean model, countries such as France and Russia have recently created prominent development funds to support strategic sectors and to protect national champions from hostile takeovers.[351] Other prominent development funds include the Malaysian Khazanah Fund, the Bahraini Mumtakalat Fund, the Oman Investment Fund, the Nigerian Infrastructure Fund and the UAE Mudabala fund.

3.3.5 Contingent Pension Reserve Funds

Last but not least are Contingent Pension Reserve Funds (PRFs). These investment funds are typically created to provide (from sources other than individual pension contributions) for

[347] Massimiliano Castelli and Fabio Scacciavillani, 'Sovereign Wealth Funds and State Investments: A preliminary overview', in Research Handbook on Sovereign Wealth Funds and International Investment Law (1st edn, Edward Elgar 2015) 18.

[348] Ibid.

[349] Ibid.

[350] Massimiliano Castelli and Fabio Scacciavillani, 'Sovereign Wealth Funds and State Investments: A preliminary overview', in Research Handbook on Sovereign Wealth Funds and International Investment Law (1st edn, Edward Elgar 2015) 25.

[351] Ibid. See also: Regis Bismuth, 'the "Santiago Principles" for Sovereign Wealth Funds: The Shortcomings and the Futility of Self-Regulation' (2017) 28(1) European Business Law Review 69, 73.

future, unspecified pension liabilities on the government's balance sheet.[352] They are not public pension funds. The crucial difference is that public pension funds are created to invest pension contributions from public sector employees whilst PRFs invest national wealth (surplus foreign exchange assets) to meet future unspecified pension liabilities.[353]

Like savings funds, the liabilities of Pension Reserve funds are unspecified meaning that they often invest in risky assets whilst also adopting a long-term investment horizon. Contemporary examples include the Irish National Pension Reserve Fund, Australia's future fund and New Zealand's Superannuation Fund – all established to meet the government's future liabilities for the payment of pensions in an ageing society.[354]

Having investigated the different models of SWFs and their objectives, it is imperative to study the Investment Patterns and Behaviours of these entities. This will pave the way for an appraisal of the concerns raised by SWFs and lay the groundwork for a study of the Santiago Principles and its Institutional counterpart, the IFSWF.

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[352] Massimiliano Castelli and Fabio Scacciavillani, 'Sovereign Wealth Funds and State Investments: A preliminary overview', in Research Handbook on Sovereign Wealth Funds and International Investment Law (1st edn, Edward Elgar 2015) 18.

[353] Ibid.

[354] Julie Kozack, Doug Laxton and Krishna Srinivasan, 'Sovereign Wealth Funds and Global Capital Flows: A Macroeconomic Perspective' in R Fry, W McKibben and J O'Brien (eds), *Sovereign Wealth: The Role of State Capital in the New Financial Orde*r (1st edn, Imperial College Press, 2011) 27

	Stabilization funds	Saving funds
Investment horizon	Short term	Long term
Asset composition	Limited to highly liquid assets	Broader asset classes
Currency composition	Negatively correlated with commodity prices	Matching net import of the country
Performance benchmarks	Minimizing expenditure volatility and maintaining adequate liquidity	Achieving real expected returns for long-term periods to maintain the long-term purchasing of the wealth
Risk tolerance	Low risk-return profile	Active investment management with higher risk-return profile
Asset and liability management	Ensuring the sustainability of future fiscal expenditure	Maximizing net value of the fund taken into account the correlation between asset prices and liabilities

Figure 6: Characteristics of Stabilization and Savings SWFs showing Asset Allocation, Investment Horizon, Currency Composition, Performance Benchmarks, Risk tolerance. Sourced from: International Monetary Fund (2013)[355]

[355] Abdullah Al-Hassan, Michael Papaioannou, Martin Skancke and Cheng Chih Sung, 'Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management', (November 2013) International Monetary Fund, Working paper 13/231, 6 <https://www.imf.org/external/pubs/ft/wp/2013/wp13231.pdf> Accessed on 19 January 2016.

Main Source	Country / Fund	Policy purpose			
		Stabilisation	Saving		Reserve Investment Corporations (excess foreign exchange reserves)
			Intergenera-tional equity	Future pension obligations	
Oil and natural gas	Azerbaijan: State Oil Fund	X	X		
	Canada: Alberta Heritage Savings Trust Fund		X		
	Iran: National Development Fund of Iran		X		
	Kuwait: Kuwait Investment Authority	X	X		
	Norway: Government Pension Fund Global		X	X	
	Qatar: Qatar Investment Authority		X		
	Timor-Leste: Petroleum Fund	X	X		
	Trinidad & Tobago: Heritage and Stabilisation Fund	X	X		
	United States (Alaska): Alaska Permanent Fund		X		
Other mineral resources	Botswana: Pula Fund		X		
	Chile: Economic and Social Stabilisation Fund and Pension Reserve Fund	X		X	
General government / foreign exchange reserves	Australia: Future Fund			X	
	Korea: Korea Investment Corporation				X

Figure 7: Taxonomy of selected IFSWF Members according to their mandates. Sourced from: IFSWF (2014)[356]

[356] International Forum of Sovereign Wealth Funds, 'Santiago Principles: 15 Case studies' (November 2014), 11 <http://www.ifswf.org/sites/default/files/SantiagoP15CaseStudies1_0.pdf> Accessed 20th January 2018.

3.4 Investment Behaviour and Investment Patterns.

The preceding analysis has shown that SWFs are hybrid entities without an exclusive definition. This section further considers the nature of these entities by examining their investment behaviour, sectorial preferences, and the geographical distribution of their assets.

3.4.1 Investment Behaviour and Asset Allocation

As the preceding analysis shows, SWFs are a growing component of international markets with over $7 trillion of assets under management.[357] Despite this considerable financial capacity, the assets held by SWFs pale into insignificance when compared to the assets of more mature institutional investors such as Pension Funds, Mutual Funds and Insurance companies.[358]

As Figure 8 below shows, the above-mentioned asset managers hold a combined total of $101 trillion assets – a figure which is over ten times the size of assets held by SWFs. Yet, SWF assets remain considerably larger than the assets held by Hedge Funds and Private Equity funds combined, making them key players in global financial markets.[359]

With such financial clout, the investment behaviour of SWFs is therefore a fruitful area for research. Indeed, one of the questions often asked about SWFs is how they invest their resources

[357] Massimiliano Castelli and Fabio Scacciavillani, 'Sovereign Wealth Funds and State Investments: A preliminary overview', in *Research Handbook on Sovereign Wealth Funds and International Investment Law* (1st edn, Edward Elgar 2015) 17.

[358]The CityUK, 'UK Fund Management Report' (April 2018), 14 <https://www.thecityuk.com/assets/2018/Reports-PDF/fe6b3af4b4/UK-fund-management.pdf> Accessed 20th October 2018.

[359] Ibid.

(Asset Allocation) and what sectors they invest in (Sectorial preferences).[360] Another issue often raised about SWFs is how their assets are distributed and the target countries for investments.

With respect to the asset allocation of SWFs, the general opinion in much of the economics and finance literature is that SWFs broadly invest in conventional financial assets such as Equities and fixed income instruments (Bonds) depending, of course, on the risk appetite of the individual fund.[361] Indeed, a study by the Consulting group, Preqin and projected in figure 9 below suggests that 82 and 78 percent of SWFs invest in Equities and Bonds respectively.[362]

As far as investments and sectorial preferences are concerned, SWFs invest in a wide range of sectors. Most prominent however is the financial sector where SWFs have injected capital into financial firms such as investment banks, insurance corporations and securities firms.[363] Indeed, one of the most reported investments of SWFs involved the acquisition of influential stakes in ailing western financial institutions such as Barclays, Credit Suisse, Morgan Stanley, and Citigroup amongst others at the height of the Global Economic Crisis – a move which earned them the collective moniker, white knights.[364]

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360 Elliot Hentov and Alexander Petrov, 'How Do Sovereign Wealth Funds Invest? Shift into Private Markets Continues' (January 2018) State Street Global Advisors, 5 <https://www.ssga.com/investment-topics/asset-allocation/2018/how-do-sovereign-wealth-funds-invest.pdf > Assessed 30th June 2018.

361 Bernado Bortolotti, Veljko Fotak, William Megginson and William Miracky, 'Sovereign Wealth Fund Investment Patterns and Performance' (2009), Fondazione Eni Enrico Mattei Paper 22 2009, 16 <https://www.feem.it/m/publications_pages/2010421511422-09.pdf> Accessed 20th January 2018.

362 Preqin, '2018 Sovereign Wealth Fund Review' (2018), 5 <http://docs.preqin.com/samples/The-2018-Preqin-Sovereign-Wealth-Fund-Review-Sample-Pages.pdf> 3rd September 2018.

363 Fondazione Eni Enrico Mattei Monitor, 'Weathering the Storm: Sovereign Wealth Funds in the Global Economic Crisis of 2008' (2009), 23 <http://www.bafficarefin.unibocconi.eu/wps/wcm/connect/78fa6ace-8977-4c44-8fd5-d0fd93b12d7a/2008+SWF+Annual+Report.pdf?MOD=AJPERES&CVID=lYg0s7j> Accessed 20th May 2018.

364 Steffen Kern, 'SWFs and Foreign Investment Policies – an Update' (2008) Deutsche Bank Research Paper, 15 <https://www.dbresearch.com/PROD/RPS_EN-PROD/SWFs_and_foreign_investment_policies_-_an_update/RPS_EN_DOC_VIEW.calias?rwnode=PROD0000000000435631&ProdCollection=PROD0000000000465344> Accessed 20th January 2018.

In addition to making investments in the financial sector, SWFs also show a bias for technology firms such as Apple, Microsoft and Alphabet, the parent company of Google Inc. For instance, Norway's SWF, the Government Pension Fund Global (GPFG) has made several high-profile investments in these companies totalling about $8.82 Billion.[365]

Besides conventional technology firms, disruptive technology start-ups are also of huge demand to SWFs. The Singapore SWFs, Temasek and GIC illustrate this trend. Both have led recent major investments into early-stage companies in the innovative technology space, exemplified by the recent acquisition of a majority stake in the Global Healthcare Exchange, a US-based provider of innovative healthcare technology by Temasek in a deal worth over $1.8 billion.[366] The same fund has also launched a $502 million investment in the US start-up, Magic Leap Inc., while its sister fund, the Government Investment Corporation (GIC) has invested over $220 million into the Chinese online-lending platform, Dianrong.[367]

Other funds with innovative technology exposures include the Saudi Arabian Public Investment Fund (PIF) which has directed significant funding into Silicon Valley companies, making it one of the largest single investors in U.S. Technology start-ups.[368] PIF's prominent investments include a recent acquisition of a 5 percent stake in the car-hailing app, Uber technologies Inc. in a deal worth over $3.5 billion and which allowed PIF to appoint its managing

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365 Will Martin, 'These are the Stocks the World's Biggest Sovereign Wealth Fund is putting its Faith in' *Business Insider* (31 August 2016) <http://uk.businessinsider.com/worlds-biggest-sovereign-investment-fund-top-stock-holdings-2016-8/#10-blackrock-1> Accessed 20th May 2018.

366 Laura Cooper, 'Temasek Buying Stake in Global Healthcare Exchange in $1.8 Billion Deal' *Wall Street Journal* (17 May 2017) <https://www.wsj.com/articles/temasek-to-buy-majority-stake-in-global-healthcare-exchange-1495043748 > Accessed 20th September 2018.

367 Ed Ballard, 'Sovereign-Wealth Funds Boost Tech Direct Investments' Private Equity News (16 July 2018) <https://www.penews.com/articles/sovereign-wealth-funds-boost-tech-direct-investments-20180716> Accessed 20th September 2018.

368 Eliot Brown and Greg Bensinger 'Saudi Money Flows Into Silicon Valley—and With It Qualms' *WSJ* (16 October 2018) <https://www.wsj.com/articles/saudi-backlash-threatens-u-s-startups-1539707574> Accessed 30th October 2018

director, Yasir Al Rumayyan to Uber's board.[369] Alongside its stake in Uber, the fund also holds a 5 percent stake in the electric car company, Tesla[370] and has also injected significant sums into Tesla's rival Lucid.[371]

Besides Technology, another sectorial preference for SWFs is the energy sector.[372] This is particularly the case for SWFs from net energy importers such as China.[373] China's fund, CIC exemplifies this approach through its investments into oil giants across the globe apparently to meet China's future energy security.[374] For instance, the fund holds a 30 percent stake in the French energy giant, GDF Suez[375] and a $1 billion stake in the British Energy giant BP.[376] CIC has also acquired energy assets in other parts of the globe, including an 11 percent stake in JSC

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369 Leslie Hook, 'Saudi wealth fund takes $3.5bn Uber stake' *Financial Times* (San Francisco, 1 June 2016) <https://www.ft.com/content/a7e31c58-282c-11e6-8b18-91555f2f4fde> Accessed 20th May 2018.

370 Tae Kim, 'Tesla shares rise on report Saudi Arabia sovereign wealth fund has $2 billion stake' CNBC (7 August 2018)<https://www.cnbc.com/2018/08/07/tesla-shares-jump-on-report-saudi-arabia-sovereign-wealth-fund-has-2-.html> Accessed 20th September 2018.

371 Matthew Martin and David Welch, 'Saudi Wealth Fund to Invest $1 Billion in Tesla's Rival Lucid' Bloomberg (17 September 2018) <https://www.bloomberg.com/news/articles/2018-09-17/saudi-wealth-fund-to-invest-1-billion-in-tesla-s-rival-lucid> Accessed 20th September 2018.

372 CityUK 'UK the Leading Western Centre For Sovereign Wealth Funds' (June 2015), 6 <https://www.thecityuk.com/assets/2015/Reports-PDF/9812c8ec8e/Sovereign-Wealth-Funds-2015.pdf> Accessed 20th June 2018.

373 Di Wang, 'Strangers are not all Danger: Sovereign Wealth Fund Investment in the Energy Industry' in Douglas Summing, Geoffrey Wood, Igor Filatotchev and Juliane Reinecke (eds) Oxford Handbook of Sovereign Wealth Funds (Oxford University Press, 2017). see also: Xiaolei Sun, Jianping Li, Yongfeng Wang, Woodrow W. Clark, 'China's Sovereign Wealth Fund Investments in Overseas Energy: The Energy Security Perspective' (2014) 65 Energy Policy 654, 657.

374 Ibid.

375 James Boxell, 'GDF unveils £2.3bn partnership with CIC' Financial Times (Paris, 10 August 2011) <https://www.ft.com/content/03c008e4-c327-11e0-9109-00144feabdc0> Accessed 20th January 2018.

376 Graeme Wearden, 'Chinese sovereign wealth fund buys £1bn stake in BP' Guardian (15 April 2008) <https://www.theguardian.com/business/2008/apr/15/bp.sovereignwealthfunds> Accessed 20th September 2018.

KazMunaiGas Exploration Production, one of Kazahkstan's largest oil companies[377] and a 45 percent stake in Russia's Nobel Oil group.[378]

The CIC is not the only Chinese fund with a preference for energy assets, its cousin, the State Administration for Foreign Exchange (SAFE) has also built up an impressive energy portfolio with stakes in companies like BP, Total, Eni and Madrileña Red de Gas, a Spanish energy company.[379]

In addition to conventional sectors such as financial services, technology and energy, SWF portfolios are also dominated by alternative asset classes such as real estate, infrastructure/ utilities, natural resources and agri-business. Much of this shift has been attributed to the need to further diversify holdings in line with their policy objectives and crucially also, to hedge against the volatility of traditional financial Markets.[380]

A noteworthy example is the recent acquisition of a 45 percent stake in New York's iconic Rockefeller centre by the China Investment Corporation (CIC).[381] CIC is not alone in acquiring notable real estate assets. The Qatar investment authority also features heavily in this sphere. The fund owns a 95 percent stake in the London Shard and influential stakes in major London hotels

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377 Jamil Anderlini and Isabel Gorst 'CIC buys stake in Kazakh oil and gas group' Financial Times (30 September 2009) <https://www.ft.com/content/be3bd146-ad88-11de-bb8a-00144feabdc0> Accessed 20th October 2018.

378 SWFI, 'China Investment Corporation Invests in Nobel Oil group – Another Commodity Investment' SWFI (15 October 2009) <https://www.swfinstitute.org/swf-news/china-investment-corporation-invests-in-nobel-oil-group-another-commodity-investment/> Accessed 20th October 2018.

379 Javier Capapé and Javier Santiso, 'Sovereign Wealth Funds 2017 Report' (2017), 34 <http://www.investinspain.org/invest/wcm/idc/groups/public/documents/documento/mde4/nzc5/~edisp/doc2018779750.pdf > Accessed 20th January 2018.

380 Sovereign Investment Lab, 'The Sky Did Not Fall: Sovereign Wealth Fund Annual Report 2015' (2015), 19 <http://www.bafficarefin.unibocconi.eu/wps/wcm/connect/9a18762e-52fc-4774-9a76-d387dcc46565/2015+SWF+Annual+Report.pdf?MOD=AJPERES&CVID=lYfWuO-> Accessed 20th May 2018.

381 Mark Maurer, 'Chinese sovereign fund, using Invesco as middleman, buys 1221 Sixth stake' *The Real Deal* (New York, 28 December 2016) < https://therealdeal.com/2016/12/28/chinese-sovereign-fund-using-invesco-as-middleman-buys-1221-sixth-stake/> Accessed 20th May 2018.

such as the Savoy, Claridges, Berkeley, Connaught and Intercontinental hotels.[382] More central however to QIA's property portfolio is Canary Wharf, London's business district which it acquired alongside the property investment group, Brookfield Property Partners in 2015.[383]

In addition to real estate, SWFs have also made notable investments in infrastructure. One example is the China Investment Corporation (CIC) which holds a 10 percent stake in London's Heathrow airport, one of the busiest international airports in the world and has appointed its director, Qing Zhang to Heathrow's board.[384] The CIC is joined by other SWFs – Qatar Investment Authority (QIA)[385] and Singapore's Government Investment Corporation (GIC) as the major institutional investors in the airport.

Heathrow's main rival, the London Gatwick Airport also has SWFs such as the Abu Dhabi Investment Authority (ADIA) as its shareholders.[386] This is also the case for the London City

[382] Jamie Robertson, 'Qatar: Buying Britain by the Pound' *BBC News* (London, 9 June 2017) <https://www.bbc.co.uk/news/business-40192970> Accessed 20th September 2018.

[383] Ibid.

[384] BBC News, 'China fund buys 10% stake in London's Heathrow airport' BBC News (London, November 1, 2012) <https://www.bbc.co.uk/news/business-20163907> Accessed 20th January 2018. For the appointment of Qing Zhang to Heathrow's Board, See: Jacob N. Koch-Weser and Owen D. Haacke 'China Investment Corporation: Recent Developments in Performance, Strategy, and Governance' (2013) US-China National Security Review Commission Paper, 30 <https://www.uscc.gov/sites/default/files/Research/China%20Investment%20Corporation_Staff%20Report_0.pdf> Accessed 20th January 2018.

[385] QIA and GIC hold 20 and 11.5 percent of the Airport respectively. See: London Heathrow, 'Company Information' (2018) <https://www.heathrow.com/company/company-news-and-information/company-information> Accessed 20th June 2018.

[386] Susan Fenton and Greg Roumeliotis, 'Abu Dhabi wealth fund buys into Gatwick Airport' *Reuter*s (London, 5 February 2010) <https://uk.reuters.com/article/uk-gatwick-abu-dhabi/abu-dhabi-wealth-fund-buys-into-gatwick-airport-idUKTRE6141WN20100205> Accessed 20th January 2018.

Airport and the UK Utilities Company, Thames Water which has the Kuwait Investment Authority (KIA) as a key Shareholder.[387]

SWFs have also acquired infrastructural assets beyond the UK. For instance, the Abu Dhabi Investment Authority (ADIA) holds an influential stake in the Port of Brisbane, one of Australia's largest seaports.[388] More remarkably, the fund, in a consortium including the Kuwait Investment Authority (KIA) has also acquired Trans Grid, Australia's power distribution network.[389] Alongside the ADIA and the KIA, The China Investment Corporation has also shown huge appetite for Australian infrastructure, acquiring recently a 50 year lease of Australia's Port of Melbourne[390] and the rail operating group, Asciano.[391]

Another sector where SWFs are showing rising interest is agriculture and agri-business. This is often the case for funds from heavily food-importing countries such as China, Singapore and Gulf States. SWF interest in this asset class is most exemplified by the acquisition of several farmlands and diary production businesses by Hassad Foods, a wholly-owned Subsidiary of the

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[387] Guy Faulconbridge, 'Exclusive - Kuwait sovereign fund's UK unit buys NSMP for $1.7 billion: source' R*euters* (London, 23 July 2018) <https://uk.reuters.com/article/uk-britain-northsea-kuwait-exclusive/exclusive-kuwait-sovereign-funds-uk-unit-buys-nsmp-for-17-billion-source-idUKKBN1KD0IM> Accessed 5 September 2018.

[388] Reuters, 'Abu Dhabi SWF buys stake in Australian port' R*euters* (11 November 2010) <https://www.reuters.com/article/uk-adia-port-australia/abu-dhabi-swf-buys-stake-in-australian-port-idUKLNE6AA03A20101111> Accessed 20th August 2018.

[389] Sarah Gerathy, 'NSW power asset privatisation: Consortium wins bid for TransGrid electricity 'poles and wires' lease' ABC News (25 November 2015) <https://www.abc.net.au/news/2015-11-25/transgrid-nsw-government-reveals-buyer-of-poles-and-wires-lease/6963420> Accessed 20th September 2018.

[390] Sarah Danckert, 'Future Fund, QIC and China's CIC Capital buy Port of Melbourne' (19 September 2016) <https://www.smh.com.au/business/the-economy/future-fund-qic-and-chinas-cic-capital-buy-port-of-melbourne-20160919-grjqzx.html> Accessed 20th January 2018.

[391] Chris Pash 'The $9 billion carve-up of Asciano is going ahead' Business Insider (21 July 2016) <https://www.businessinsider.com.au/the-9-billion-carve-up-of-asciano-is-going-ahead-2016-7> Accessed 20th September 2018.

Qatar Investment Authority, set up to make overseas investments as part of the Qatari Government's future food security policy.[392]

The QIA is joined in this investment pattern by China and Singapore whose state-owned corporations and SWFs have invested heavily in Agri-businesses across the world to meet the growing demand for agricultural produce in both countries.[393]

In addition to investments in real estate, infrastructure and agricultural assets, SWFs also invest in private equity funds and to a lesser extent in Hedge Funds.[394] A recent report suggests that 60 percent of SWFs invest in private Equity Funds whilst 35 percent commit capital to Hedge Fund managers.[395] An example of the former is the recent investment by the Saudi Arabian Public Investment Fund (PIF) and the UAE Fund Mudabala into the Softbank Vision fund – a buyout private equity fund focused on technology start-ups across the globe.[396]

3.4.2 Geographical Distribution of SWF Assets

Alongside the asset allocation and sectorial preferences of SWFs, another interesting subject for research is where these funds invest. This is particularly important for any study – such as this one – which seeks to understand the nature of SWFs and the regulatory responses to them. Yet, it is important to treat any answer to the question above with sufficient caution given the

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[392] Sarah Sippel, 'Arab-Australian Land Deals: Between Food Security, Commercial Business, and Public Discourse' (2013) Land Deal Politics Initiative Working Paper 27, 6 <http://www.plaas.org.za/sites/default/files/publications-pdf/LDPI27sippel.pdf> Accessed 20th May 2018

[393] Jamil Anderlini, 'China's sovereign wealth fund shifts focus to agriculture' Financial Times (Beijing, 17 June 2014) <https://www.ft.com/content/64362b08-f61a-11e3-a038-00144feabdc0> Accessed 20th March 2018. See also: Loch Adamson, 'Feeling Hungry SWFs Ramp up Food and Agriculture Purchases', Sovereign Wealth Center (5th March, 2015) <https://www.sovereignwealthcenter.com/Article/3433470/Feeling-Hungry-SWFs-Ramp-Up-Food-and-Agriculture-Purchases.html?ArticleId=3433470#.W8Cg8ntKiM8> Accessed 20th March 2018.

[394] Ibid.

[395] Ibid.

[396] Paul-Neol Guely, 'Co-opetition' The New Watchword among Technology Investors' *Forbes* (24 July 2018) <https://www.forbes.com/sites/paulnoelguely/2018/07/24/co-opetition-the-new-watchword-among-technology-investors/#4cad970b387a> Accessed 20th September 2018.

widely recognised opacity of several SWFs and the rebalancing of their assets, in particular, since the global financial crisis.[397]

That being said, the general academic and practitioner commentary suggests that SWFs invest both domestically and in foreign markets, more so in the latter.[398] As the preceding analysis makes clear, funds with pure domestic horizons are often strategic development funds which are established as part of local industrial policies to resuscitate national economies and to provide capital to national champions.[399] These funds constitute only a small part of the SWF ecosystem which is mostly composed of Saving Funds and Reserve Investment Corporations who typically invest outside their home states.[400]

The above sentiment is confirmed in Figure 10 below which shows that SWFs display a preference for foreign-based assets as opposed to domestic investments. Figure 11 provides even more granular details of the locational distribution of these assets, suggesting that SWFs typically deploy their resources more in OECD Markets than in non-OECD Markets.

More interesting though is Figure 12 which portrays the actual target economies for SWF investments. One can observe, for instance, a preference for assets based in the United States of

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397 Javier Santiso 'Esade Business School Sovereign wealth funds Annual Report' (2012), 12 <http://www.esade.edu/itemsweb/wi/Prensa/SWFsReport2012.pdf> Accessed 20 March 2018.

398 Alan Gelb, Silvana Tordo, Håvard Halland, Noora Arfaa and Gregory Smith, 'Sovereign Wealth Funds and Long-Term Development Finance: Risks and Opportunities' (2014) The World Bank Poverty Reduction and Economic Management Network Policy Research Working Paper 6776, 2 <http://documents.worldbank.org/curated/en/788391468155724377/pdf/WPS6776.pdf> Accessed 20th September 2018. See also: Rolando Avendaño and Javier Santiso, 'Are Sovereign Wealth Funds' Investments Politically Biased? : A Comparison with Mutual Funds' (2009) OECD Development Centre Working Paper No. 283, 27-30 <https://www.oecd.org/dev/44301172.pdf> Accessed 20th September 2018. See also: Shai Bernstein, Josh Lerner, and Antoinette Schoar, 'The Investment Strategies of Sovereign Wealth Funds' (2013) 27(2) Journal of Economic Perspectives 219, 228.

399 Gelb Op cit at 2-5.

400 Amin Cheraghlou, 'Patterns and Trends in Sovereign Wealth Fund Investments: A Post-Crisis Descriptive Analysis' (2017) 21(4) Iran Economic Review 725, 738.

America, making it the single largest destination for SWF investments. The precise reason for SWF enthusiasm for US assets may not be unconnected with the US' position as the largest economy in the world, its relatively deep financial market and recent positive economic growth and productivity figures.[401]

Besides the US, there also appears to be a preference for strong emerging economies such as the Singapore and China, although, it has been suggested that this may be related more with domestic investments by state-owned funds such as the China Investment Corporation and Singapore's Temasek than by inward investments by foreign SWFs.[402]

Other favourable destinations for SWF investments include Australia which has recently allowed a considerable amount of foreign investment in infrastructure as part of a wider privatisation drive, attracting SWFs in the process.[403] Figure 12 also portrays Countries such as the United Kingdom, France and Netherlands as most appealing to SWFs within the European continent in the year 2016. This seems not at all surprising, given the relative size of these economies. Yet, a closer look at the individual positions of all three countries suggests that only France has made progress from its 2015 figures, in part, due to renewed SWF interest in Parisian

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[401] Sovereign Investment Lab, 'Hunting Unicorns: Sovereign Wealth Fund Annual Report 2016' (2016), 32 <http://www.bafficarefin.unibocconi.eu/wps/wcm/connect/e0b6bbe1-4df0-4d6c-b866-20eb5f38bac9/2016+SWF+Annual+Report.pdf?MOD=AJPERES&CVID=lYfVHE7> Accessed 20th October 2018.

[402] See also: Rolando Avendaño and Javier Santiso, 'Are Sovereign Wealth Funds' Investments Politically Biased?: A Comparison with Mutual Funds' (2009) OECD Development Centre Working Paper No. 283, 27 <https://www.oecd.org/dev/44301172.pdf> Accessed 20th September 2018.

[403] The SIL report reflected in Figure 12 suggests that Australia was the third largest single destination for SWF investments with over 3.9 US billion dollars of investments. This is broadly corroborated in a report by the Esade Business School which puts the figure attracted by Australia from SWFs in the year 2016 at over $3.6 Billion in Foreign Direct Investments, which represented 40 percent of the total infrastructure Investment conducted by SWFs that year. See: Esade Business School 'Sovereign Wealth Funds 2017 Report' (2017), 58 <http://www.investinspain.org/invest/wcm/idc/groups/public/documents/documento/mde4/nzc5/~edisp/doc2018779750.pdf > Accessed 20th January 2018.

Real Estate.[404] Indeed, the UK which was previously the most attractive European target in 2015 appears to have slumped from its heights for reasons not unconnected to recent political upheavals associated with the UK's impending exit from the European Union.[405] Notwithstanding the above, SWFs are clearly active investors in variegated sectors across different economies in the developed and developing world. However, these investments have provoked concerns which will be examined below.

	Assets under management, $trn	
Pension funds	36.4	Conventional investment management assets
Mutual funds	40.6	
Insurance funds	24.0	
SWFs	7.4	Non-conventional (alternative) investment management assets
Private equity	2.6	
ETFs	4.3	
Hedge funds	3.0	
Private Wealth	63.5	

Figure 8: The structure of the Global Fund Management Industry (Including Conventional and Non-Conventional Institutions) by Assets under Management at the end of 2018 (in USD trillions) Source: CityUK Fund Management Report 2018[406] Note that

[404] Sovereign Investment Lab, 'Hunting Unicorns: Sovereign Wealth Fund Annual Report 2016' (2016), 32 <http://www.bafficarefin.unibocconi.eu/wps/wcm/connect/e0b6bbe1-4df0-4d6c-b866-20eb5f38bac9/2016+SWF+Annual+Report.pdf?MOD=AJPERES&CVID=lYfVHE7> Accessed 20th October 2018.

[405] Ibid. at 31.

[406]The CityUK, 'UK Fund Management Report' (April 2018), 14 <https://www.thecityuk.com/assets/2018/Reports-PDF/fe6b3af4b4/UK-fund-management.pdf> Accessed 20th October 2018.

SWFs only constitute just over seven trillion dollars of assets under management with the majority managed by conventional asset managers such as Pension Funds.

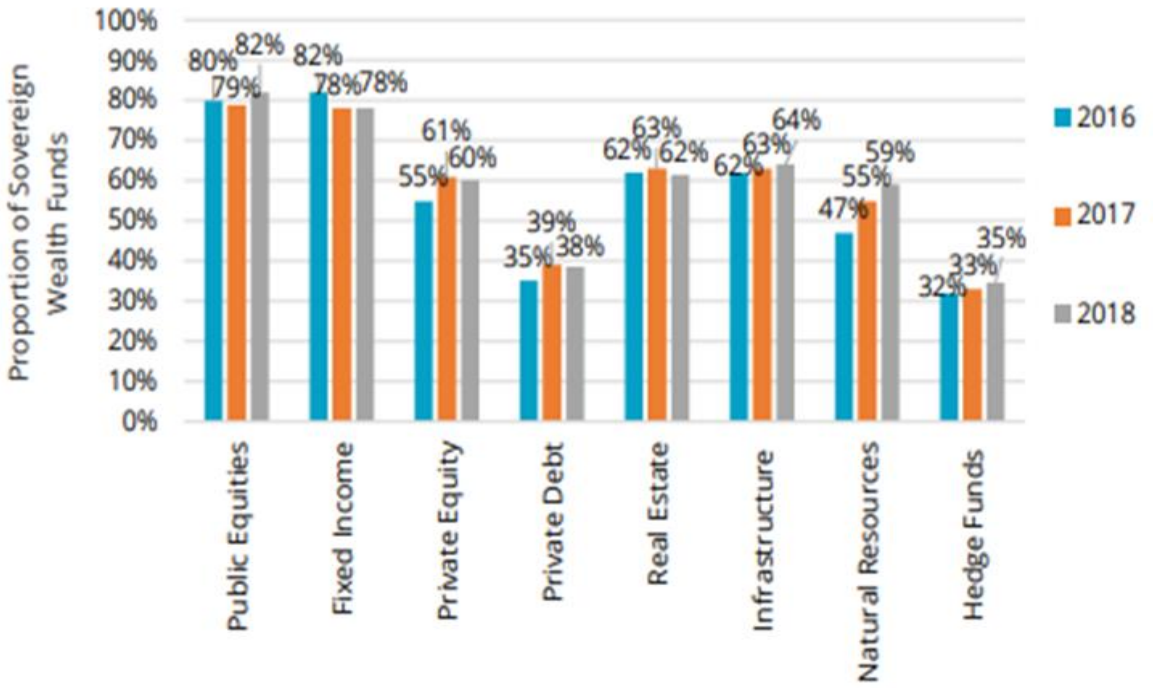

Figure 9: Net Percentage figure of Sovereign Wealth Funds Investing in Each Asset Class, 2016 – 2018. The figures show that 82 percent of SWFs invested in publicly listed equities in 2018 and 78 percent in fixed income or bonds. This is drawn from the Annual Sovereign Wealth Fund Review published by Preqin, a reputable financial data consultancy and is based on public data on SWF investment portfolios tracked by Preqin. Source: Preqin (2018). [407]

[407] See: Preqin, '2018 Sovereign Wealth Fund Review' (2018), 7 <http://docs.preqin.com/samples/The-2018-Preqin-Sovereign-Wealth-Fund-Review-Sample-Pages.pdf> 3rd September 2018.

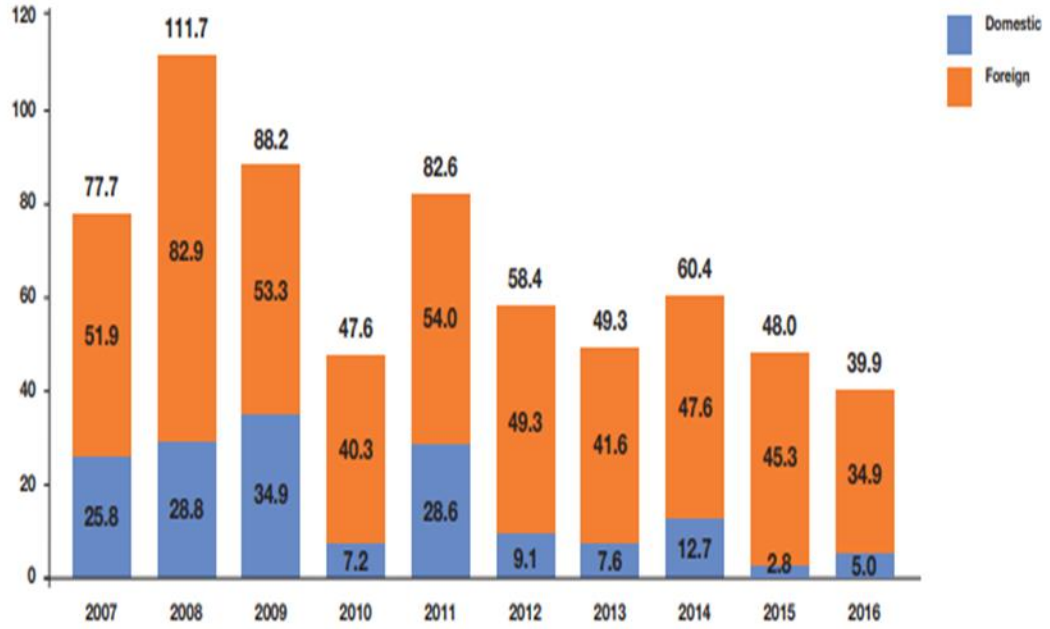

Figure 10: SWF investments in Domestic and Foreign Markets between the years 2007-2016 in US$bn. The blue part of the diagram portrays the investments allocated domestically and the amber part displays foreign investments by SWFs. For instance, SWFs allocated 34.9 Billion to foreign markets in 2016 and 5.0 Billion to domestic markets in the same year. This is drawn from available data for direct SWF equity & real estate deals, joint ventures and capital injections tracked by the Sovereign Investment Lab, a reputable Institute at Bocconi University and an educational partner of the International Forum of Sovereign Wealth Funds. Source: Sovereign Investment Lab, Bocconi University (2016)[408]

[408] Sovereign Investment Lab, 'Hunting Unicorns: Sovereign Wealth Fund Annual Report 2016' (2016), 31 <http://www.bafficarefin.unibocconi.eu/wps/wcm/connect/e0b6bbe1-4df0-4d6c-b866-20eb5f38bac9/2016+SWF+Annual+Report.pdf?MOD=AJPERES&CVID=lYfVHE7> Accessed 20th October 2018.

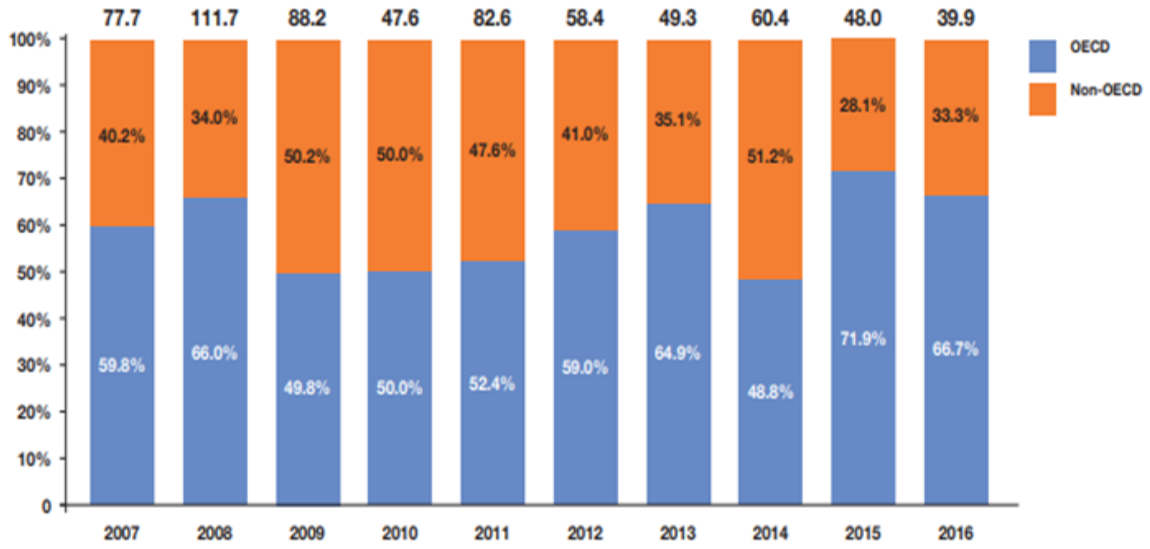

Figure 11: Sovereign Wealth Fund Investments in OECD and Non-OECD Markets in the years 2007 - 2016 in US$ Billion. The Blue part of the diagram indicates the percentage of SWF Investment allocated to OECD Markets in each year and the amber part illustrates the percentage of total investment allocated to Non-OECD Markets. For instance, SWFs allocated 66.7 percent of their investments to OECD countries in 2016, down from 71.9 in 2015. The diagram was drawn from the Sovereign Investment Lab SWF investment tracker which is based on publicly available data for direct SWF equity & real estate deals, joint ventures and capital injections. Source: Sovereign Investment Lab Report (2016)[409]

[409] Ibid.

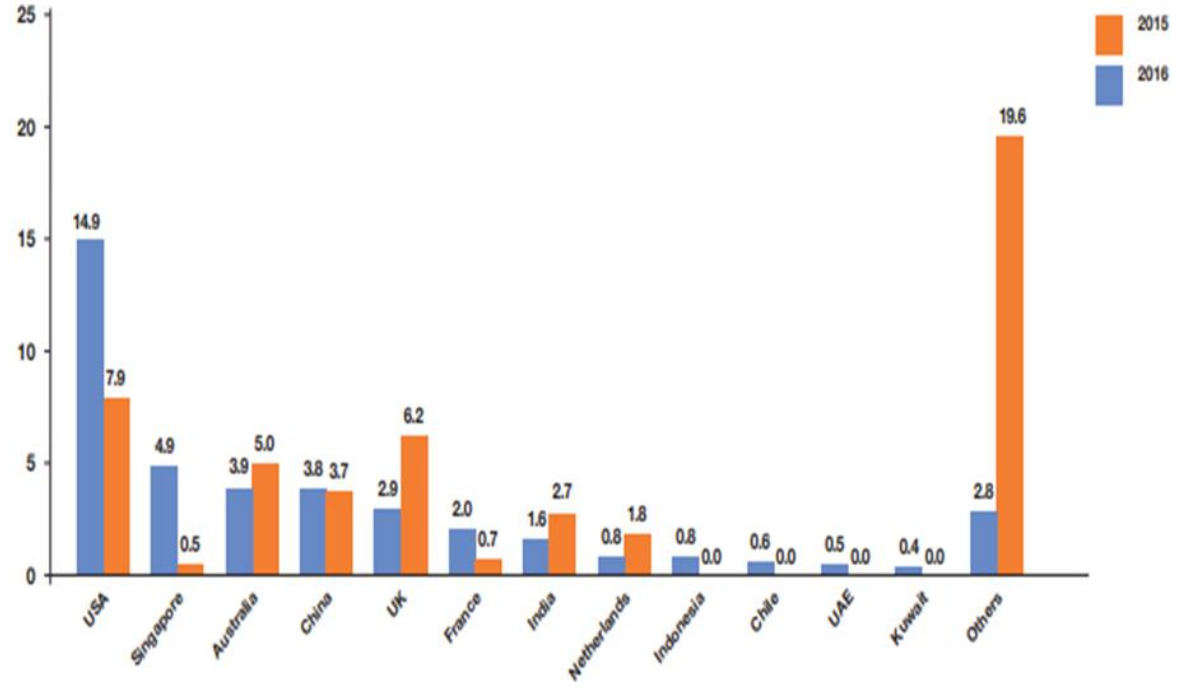

Figure 12: SWF Investments by target Country in 2015 and 2016 in US $bn. Note: The United States comes out in 2015 and 2016 as the single largest destination for SWF investment with 7.9 billion and 14.9 Billion of SWF investment respectively, followed by countries such as Singapore, Australia etal. 'Others' in the final part of the diagram does not signify the largest destination for investment. It instead represents a number of countries not mentioned in the diagram which the SIL report does not provide. This diagram has been drawn from the Sovereign Investment Lab investment tracker that is based on publicly available data for direct SWF equity & real estate deals, joint ventures and capital injections analysed by the SIL. Source: Sovereign Investment Lab Report (2016).[410]

[410] Ibid.

3.5 Sovereign Wealth Fund Investment and Associated Concerns

The frequency and magnitude of overseas Investments by SWFs graphically presented in the preceding section has often provoked controversy in a number of countries, especially the developed countries that receive the investments of these funds. This section investigates these concerns. Its broader relevance to the subject matter of the thesis is undeniable given that the subject matter of this thesis – the Santiago principles – was inspired by the collision of the rise of SWFs and the corresponding concerns associated with that rise. Therefore, a consideration of these concerns is necessary to facilitate the reader's understanding of the historical background to the principles.

Chief among the concerns ascribed to these funds is the belief that SWFs and other State-controlled FDI are symptomatic of a rising mercantilism in which financial statecraft can be strategically deployed to advance the political goals of owner states, thereby endangering the Security and economic interests of their hosts.[411] Critics of SWFs also inveigh against the likely impact of these funds on the stability of global markets given their growing size and the magnitude of their investments.[412] In addition, SWFs also raise concerns about the possible distortion of markets through anti-competitive conduct.[413] Cynics also point to the often poor Internal Governance, lack of independence and Transparency in several funds.[414] These concerns are considered in greater detail below.

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411 Ronald Gilson and Curtis Milhaupt, 'Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism' (2008) 60(5) Stanford Law Review 1345-1369.

412 Ibid.

413 Regis Bismuth 'The "Santiago Principles" for Sovereign Wealth Funds: The Shortcomings and the Futility of Self-Regulation' (2017) 28(1) European Business Law Review 69,74.

414 Georges Kratsas and Jon Truby 'Regulating Sovereign Wealth Funds to Avoid Investment Protectionism' (2015) 1 Journal of Financial Regulation, 95, 102.

3.5.1 Political Concerns and National Security risks

Foreign inward investments, including by SWFs are widely adjudged to contribute to economic growth and development.[415] Yet, the nature of foreign capital often means that potential risks to capital recipients cannot be discounted.[416] Conventional literature speaks of different categories of risks posed by FDI and for which national mechanisms to control FDI may be legitimate.

The first category is the idea that foreign acquisitions might make a host country vulnerable to a foreign-controlled supplier of goods or services crucial to the functioning of the host economy (including, but not exclusively, the functioning of that country's defence base).[417] The second threat is that foreign investments might allow for the transfer of valuable technology or other expertise to a foreign controlled entity that might be strategically deployed by the entity or its home state in a manner harmful to the host country's national political and economic interests.[418]

The third category is that foreign buyouts may allow for the insertion of some potential capability for infiltration, surveillance, or sabotage – via a human or non-human agent -- into the provision of goods or services crucial to the functioning of the host economy.[419]

Debates about these risks are in no way novel. As Esplugues reminds us, these concerns have lingered throughout history and about investors of different natures, classes and

[415] Carlos Esplugues, *Foreign Investment, Strategic Assets and National Security* (Intersentia, 2018) 23.

[416] Ibid.

[417] Theodore H. Moran, 'Foreign Acquisitions and National Security: What are Genuine Threats? What are Implausible Worries? A Framework for OECD Countries, and Beyond' (2010), 1 <https://www.usitc.gov/research_and_analysis/economics_seminars/2010/Moran_Summary_ITC_Presentation.pdf> Accessed 20th October 2018.

[418] Ibid.

[419] Ibid.

nationalities.[420] No country is immune from these concerns.[421] Even traditionally open economies such as the UK, US, Australia and Germany among others are increasingly adopting policy defences aimed at controlling inward foreign acquisitions. A widespread justification for these measures is the need to protect the 'national security' or the broader public, security or national interests of FDI recipient states.[422]

Notwithstanding the established presence of the measures described above, a definitional quandary exists in so far as the 'national security' paradigm is concerned. In ordinary parlance, the term evokes a sense of national safety. Indeed, the Oxford English Dictionary defines 'National security' as referring to 'The safety of a nation against threats such as terrorism, war, or espionage.'[423]

This definition possesses both a benefit and a detriment. For one, it is succinct and concise, but one could equally argue that it is unduly parochial and thus problematic. This is because the definition does not sufficiently treat the considerable and varied threats beyond war and terrorism which can, in principle, afflict a nation. As Barbieri reminds us, national security risks can also include the spread of diseases, civil strife and disobedience, severe economic crises and even hostile control of strategic industries or sectors.[424]

The definitional quandary highlighted above also threatens any attempt to completely define National security in the context of FDI regulation. A simplistic understanding would limit

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[420] Carlos Esplugues, *Foreign Investment, Strategic Assets and National Security* (Intersentia, 2018) 25.

[421] Ibid.

[422] Ibid.

[423]'National Security' English Oxford Living Dictionaries Online, (OUP, September 2018) <https://en.oxforddictionaries.com/definition/national_security> Accessed 20th May 2018.

[424] Michele Barbieri 'Sovereign Wealth Funds as Protected Investors under BITS and the Safeguard of the National Security of Host States' in Giorgio Sacerdoti (eds) *General Interests of Host States in International Investment Law* (Cambridge University Press, 2014) 133.

such considerations to foreign investments into a country's defence industrial sector.[425] Yet, as contemporary practice suggests, this is worryingly naïve. For countries across the world have adopted elastic constructions of National security which has allowed for the imposition of controls in respect of foreign investment into a large number of economic sectors or activities, and in respect of foreign investors of numerous nationalities, or types.[426] This is in keeping with a widely accepted principle that it is the absolute prerogative of a state to determine whether its security interests are under threat and what actions, if any, are necessary to guard against such threats.[427] In other words, national security threats and potential responses are self-judging in the context of national FDI Regulation.[428]

Although settled that a state is the ultimate arbiter of its essential security interests, there are nonetheless risks with such an approach. For one, self-determination of national security risks might fall prey to populist forces and sentiments. In such a situation, there is a danger that the 'National security' concept might become a 'black box in which a number of considerations unrelated to security can masquerade.'[429] At best, this may have the effect of deterring valuable foreign inward investment. Worse, it could spark retaliatory measures by other states, which might undermine the international trade and investment system.[430]

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[425] Chris Balding, *Sovereign Wealth Funds: The New Intersection of Money and Politics* (OUP, 2012) 15.

[426] Ibid.

[427] United Nations Conference on Trade and Development 'The Protection of National Security in IIAs: UNCTAD Series on International Investment Policies for Development' (2009), 22 <https://unctad.org/en/Docs/diaeia20085_en.pdf> Accessed 20th September 2016. See also: Carlos Esplugues, *Foreign Investment, Strategic assets and National Security* (Intersentia, 2018) 27.

[428]OECD, 'Guidelines for Recipient Country Investment Policies Relating to National Security' (2009), 3 <https://www.oecd.org/daf/inv/investment-policy/43384486.pdf> Accessed 20th May 2017.

[429] Rebecca Mendelsohn 'Australian investment decisions need demystifying' East Asian Forum (26 August 2016) <http://www.eastasiaforum.org/2016/08/29/australian-investment-decisions-need-demystifying/> Accessed 20th May 2018.

[430] Ibid.

In addition to National Foreign Investment Regulation, 'national security' and related concepts such as 'necessity' or 'essential security interests' are also concepts of paramount importance in the realms of international customary law, World Trade law and International Investment law where they often operate as defences to acts wrongful at law.

In the former, the essential security interests of a state are a ground through which a state could, in principle, evade culpability for an act otherwise prohibited.[431] This is confirmed in the Articles of the International Law Commission (ILC) on state responsibility – a set of authoritative texts drafted by eminent jurists that are widely construed as restatements of customary international law.[432]

More relevant to the instant discussion is Article 25 of the ILC Articles which allows a state to take necessary action (necessity) to safeguard an 'essential interest against a grave and imminent peril."[433] This provision applies, in principle, to preclude a wrongful act at international law although it is subject to very strict limits. These limits are codified in the accompanying commentary to the ILC Articles which declares that "necessity will only rarely be available to excuse non-performance of an obligation" and "is subject to strict limitations to safeguard against possible abuse."[434] The Jurisprudence of the International Court of Justice also supports this restrictive reading.

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[431] United Nations Conference on Trade and Development 'The Protection of National Security in IIAs: UNCTAD Series on International Investment Policies for Development' (2009), 34 <https://unctad.org/en/Docs/diaeia20085_en.pdf> Accessed 20th September 2016.

[432] For the history of the ILC see: Jurgen Kurtz 'Adjudging the Exceptional at International Law: Security, Public Order and Financial Crisis' (2010) 59(2) International & Comparative Law Quarterly 335.

[433] International Law Commission, *Draft articles on Responsibility of States for Internationally Wrongful Acts, with commentaries* (November 2001), Articles 20-25 <http://legal.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf> Accessed 20th January 2018.

[434] Ibid.

This can be seen in the decision of the Court in the *Nicaragua Judgement (Merits)*, where the Central American republic of Nicaragua instituted a claim against the United States of America, alleging the latter's violation of its sovereignty and territorial integrity through a series of hostile actions by the United States within its territory.[435]

As a matter of law, Nicaragua argued, *inter alia*, that the United States acted in violation of the United Nations Charter, and of a customary international law obligation to refrain from the threat or use of force against another sovereign state.[436] The United States in its response sought to rely on the essential security clause in the 1956 US-Nicaragua Treaty of Friendship, Commerce and Navigation which provided that the treaty shall not preclude measures 'necessary to protect the essential security interests of either party (emphasis added).'[437]

The US further contended that Nicaragua had destabilised the stability of its Central American neighbours including the US, through its overt support for armed militia operating within the precincts of adjacent states.[438]

In its decision, the ICJ was unpersuaded by the arguments of the United States. Although the court acknowledged that 'the concept of essential security interests certainly extends beyond the concept of an armed attack', it did not find the perceived threat posed by Nicaragua's alleged aggression in Central America to be of grave and imminent peril to the US for which a response may have been warranted– a decision which effectively consigns the invocation of the necessity defence in Customary International Law to the rarest of circumstances. [439]

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[435] Case Concerning Military and Paramilitary Activities In and Against Nicaragua (Nicaragua v. United States of America); Merits, International Court of Justice (ICJ), 27 June 1986.

[436] Ibid. at para 15.

[437] The Treaty of Friendship, Commerce and Navigation, 26 January 1956, United States-Nicaragua, 9 UST 449, TIAS No. 4024.

[438] Case Concerning Military and Paramilitary Activities In and Against Nicaragua (Nicaragua v. United States of America); Merits, International Court of Justice (ICJ), 27 June 1986. Para 221.

[439] Para 224.

Besides Customary International Law, National security also plays a role in the Jurisprudence of the World Trade Organisation (WTO) where Article XXI of the General Agreement on Tariffs and Trade (GATT) permits a member state of the WTO to take measures, 'which it considers necessary for the protection of its essential security interests' in 'situations of war or other emergency in international relations.'[440] Like its CIL variant, the precise scope of this provision is subject to some debate.[441] For some commentators, the Article XXI measure is of a self-judging character and is thus non-justiciable by a WTO tribunal.[442] Others take the opposing view, arguing that measures arising under the Article are non-self-judging and can be reviewed by a WTO tribunal.[443]

This controversy was recently adjudicated by the WTO Dispute Resolution Panel in the *Russia – Measures Concerning Traffic in Transit* dispute involving Russia and Ukraine which arose over Russia's decision to prohibit certain Ukrainian goods passing through its territory to Central Asian destinations such as Kazakhstan and the Kyrgyz Republic.[444] To justify these actions, Russia invoked the Article XXI defence arguing that its action was necessary to protect its national security and that its self-judging character meant that the measure was beyond the jurisdiction of the WTO tribunal.[445]

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[440] Article XXI of the General Agreement on Tariffs and Trade.

[441] Carlos Esplugues, *Foreign Investment, Strategic Assets and National Security* (Intersentia, 2018) 71. See also: Raj Bhala, 'National Security and International Trade Law: What the GATT Says, and what the United States Does Symposium on Linkage as Phenomenon: An Interdisciplinary Approach' (1998) 19 U. Pa. J. Int'l L. 263, 269. Roger Alford, 'The Self-Judging WTO Security Exception' (2011) Utah L. Rev. 697

[442] Roger Alford, 'The Self-Judging WTO Security Exception' (2011) Utah L. Rev. 697. Alford also describes the exception as an 'Unreviewable Trump Card' at 698.

[443] Michael J. Hahn 'Vital Interests and the Law of GATT: An Analysis of GATT's Security Exception' (1991) 12 Michigan Journal of International Law 558, 570.

[444] WTO, *Russia - Measures Concerning Traffic In Transit – Report of the Panel* (5 April 2019) WT/DS512/R

[445] Ibid. at para 7.23.

In its determination, the WTO Tribunal considered Russia's actions to be necessary and legitimate to protect its security interests, given its ongoing military conflict with Ukraine which in its view amounted to a 'situation of war or other emergency in international relations.'[446] Yet, the tribunal rejected the notion that measures arising under Article XXI were self-judging.[447] In the tribunal's view, measures of such character where entirely subject to review by a WTO tribunal, not least, to determine if they are necessary to protect national security.[448]

In addition to trade law, 'National Security' is also a putative exception to the standards contained in Bilateral or Multilateral Investment Treaties which serve to protect the investments of foreign investors in the territory of their hosts. By way of example, Article 18 of the United States Model Bilateral Investment Treaty allows parties to take measures 'it considers necessary for the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.'[449]

This approach is mirrored in the Hungary-Russia BIT which states explicitly: 'This Agreement shall not preclude the application of either Contracting Party of measures, necessary for the maintenance of defence, national security and public order, protection of the environment, morality and public health.'[450]

Like Trade law, there is some debate as to the precise scope of these standards. Some commentators take the view that such clauses are not self-judging, meaning that a state cannot

[446] Ibid. at para 7.149.

[447] Ibid. at para 7.103.

[448] Ibid.

[449] Article 18 2012 U.S. Model Bilateral Investment Treaty.

[450] Article 2(3) of the Agreement Between the Government of the Republic of Hungary and the Government of the Russian Federation for the Promotion and Reciprocal Protection of Investments 1995 (Hungary – Russia) (Signed March 6 1995, entered into force 29 May 1996).

unilaterally repudiate its BIT obligations by simply declaring that its essential security interests are affected.[451] Others tend to argue otherwise.[452]

The scope of these clauses has also provoked controversy in the jurisprudence of arbitral tribunals, most notably, in cases involving the Argentine economic crisis where Argentina invoked the national security defence in response to a number of actions brought by foreign investors regarding measures taken by the Argentine state at the height of the crisis. In the Argentine cases, arbitral tribunals have often construed the national security exceptions to be non-self-judging, but there is some dispute as to how restrictive the defence should be.[453]

For instance, some tribunals have been willing to equate national security exceptions in BITs with the strict necessity defence under customary international law, with the effect that states' ability to rely on such clauses to evade treaty obligations are perilously thin. Other tribunals, by contrast, have construed the clause in a more liberal fashion to allow a broader range of state action than customary international law.

The Tribunal in CMS v. Argentine Republic[454] exemplifies the first approach. In the CMS award, the tribunal rejected Argentina's argument that a severe national economic crisis was enough to warrant a derogation from its BIT obligations. Applying the Customary International Law on Necessity, the tribunal concluded that Argentina's socio-economic situation, although

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[451] The tribunals in CMS v. Argentine Republic at para 373 concluded that the essential security clause in the US Argentina-BIT was not self-judging. According to it, the legality of the measures can be challenged before any international court or tribunal. This was echoed in LG & E Energy Corp., LG & E Capital Corp., and LG & E International, Inc. v. Argentine Republic at para 212.

[452] Katia Yannaca-Small 'Essential Security Interests under International Investment Law' (2007) OECD International Investment Perspectives, 105 <https://www.oecd.org/daf/inv/investment-policy/40243411.pdf> Accessed 20 May 2018.

[453] The tribunals in CMS Gas Transmission, Enron, Sempra, LG& E and Continental Casualty all declared the clauses in the US-Argentina BIT to be non-self-judging and thus subject to review by the Tribunals. See Katia Yannaca-Small Op cit.

[454] CMS Gas Transmission Co. v. Argentine Republic, para 359.

severe, did not meet the requirement of 'grave and imminent peril' which the tribunals construed as applicable only to military or conflict situations.[455] This approach was subsequently endorsed in the Enron v Argentina award.[456]

By contrast however, the second interpretative approach adopted by arbitral tribunals attempts to construe the essential security provisions in BITs as applicable to a broader array of sovereign actions than customary international law. This approach is exemplified by the LG & E International Inc. v. Argentine Republic case where the investment tribunal rejected the notion that essential security or national security clauses are only applicable in moments of war or civil emergency.[457] The tribunal went on to accept Argentina's argument that its economic crisis was so severe, as to constitute a threat to national security – a decision which had the effect of excusing the Argentine state from liability for the alleged violation of its Treaty obligations to Foreign Investors whose investments were affected by Argentina's alleged interference.[458]

A variant of the LG & E approach can be seen in the decision of the investment tribunal in the case of Continental casualty v Argentina.[459] In Continental Casualty, the arbitral tribunal was again invited to consider Argentina's plea that its economic emergency amounted to an essential security interest which ultimately recused it from liability for putative breaches of the Argentina-US BIT. Like the LG & E tribunal, the Continental Casualty tribunal rejected the notion in the

[455] International Centre for the Settlement of Investment Disputes *CMS Gas Transmission Company v Argentina* (2005) Case No. ARB/01/8 at para 331.

[456] International Centre for the Settlement of Investment Disputes *Enron Corporation Ponderosa Assets LLP v Argentina* (2007) Case No. ARB/01/3 at para 313.

[457] International Centre for the Settlement of Investment Disputes *LG & E Energy Corp., LG & E Capital Corp., and LG & E International, Inc. v. Argentine Republic* (2006) ICSID Case Nº ARB/02/1 at para 238

[458] Ibid.

[459] International Centre for the Settlement of Investment Disputes *Continental Casualty Company v Argentina Republic* (2008) Case No. ARB/03/9.

CMS and Enron decisions that the standard of 'necessity' under the BIT was inseparable from the customary law meaning in Article 25 of the ILC Articles.

The tribunal took a rather different view, holding that the necessity provision in the BIT reflected the formulation of the essential security provision in Article XX of the GATT.[460] Applying WTO case law, the tribunal held that it was well established that 'necessary' under the GATT was not limited to that which is 'indispensable.'[461] To determine whether a measure that is not 'indispensable' may nevertheless be 'necessary', the tribunal held that it would 'weigh the relative importance of the interests furthered by the measure, the measure's contribution to realizing the ends pursued, and the impact of the measure on international commerce.'[462]

Assessing Argentina's situation against the above principles, the Tribunal concluded that the challenged measures were 'in part inevitable, or unavoidable'…and 'in any case material or decisive in order to react positively to the crisis, and to prevent the complete break-down of the financial system.'[463] The tribunal also considered Argentina's actions to be necessary in the ordinary meaning of the BIT to prevent 'the implosion of the economy and the growing threat to the fabric of Argentinean society.'[464] This had the effect of excluding Argentina's liability for the majority of the alleged breaches of the BIT.

Having considered the paradigm of 'National security' in its various manifestations both in national and international law, it is important to examine the possible reasons why this policy objective has become so prevalent in the recent discourse on the admission and regulation of FDI flows.

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[460] Ibid. at para 192.

[461] Ibid. at para 193.

[462] Ibid. at para 194.

[463] Ibid. at para 197.

[464] ibid.

One perspective is that the rise of 'national security' in the recent discourse on FDI regulation is reflective of a deeper concern about the rebalancing of capital flows between the global South and North, which has occurred against the background of a seismic shift in geopolitics and economics since the end of the last decade.[465]

The most visible indicator of this is the transformation of developed countries from net capital exporters into net capital importers.[466] Certain commentators argue that this has precipitated an attitudinal swing in which developed countries now share fears and concerns that were traditionally mooted by developing countries, and are increasingly willing to preserve their sovereign rights to control FDI and foreign investors.[467]

A second, plausible explanation for such a policy shift is the rising threat perception in many capital recipient economies since the Cold War and latterly, the harrowing events of September 2001.[468] As Larson and Marchick note, this has provoked a tide of regulatory policies aimed at locking out perceived barbarians at the gate – a term which is increasingly interpreted to include foreign investors.[469]

A third and perhaps more relevant explanation is the rise of different forms of Sovereign controlled FDI directed through state-controlled entities such as SWFs and SOEs.[470] Together,

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[465] OECD 'Current trends in investment policies related to national security and public order' (November 2018), 2<http://www.oecd.org/industry/inv/investment-policy/Current-trends-in-OECD-NatSec-policies.pdf> Accessed 7th December 2018.

[466] Carlos Esplugues, *Foreign Investment, Strategic Assets and National Security* (Intersentia, 2018) 75.

[467] Ibid.

[468] Alan Larson and David Marchick 'Foreign Investment and National Security: Getting the Balance Right' (2006), 19 <https://cfrd8-files.cfr.org/sites/default/files/pdf/2006/07/CFIUSreport.pdf> Accessed 20th May 2018. see also: Esplugues op cit page 85.

[469] Ibid.

[470] Larson and Marchick op cit.

these entities now carry out a sizeable proportion of Global FDI and international capital markets activity, including the direct acquisition of foreign companies of different shapes and sizes.[471]

State-controlled entities such as SWFs have provoked such concern for a number of reasons. First, they are wholly owned and controlled by foreign governments of different hues, including autocratic governments and governments perceived of harbouring sinister foreign policy objectives.[472] More so, they are deployed by owner states with avowed national policy or developmental objectives. This, as Felix Rohatyn notes, means that for many SWFs, political and commercial objectives are closely intertwined.[473]

With the above in mind, it is often questioned whether SWFs and other Sovereign investors can safely disentangle financial objectives from their political provenance. This concern is neatly summarised in a recent policy paper by the Organisation of Economic Cooperation and Development (OECD) where it is argued that:

> 'Investments controlled by foreign governments, such as those by SWFs, can raise concerns based on uncertainty regarding the objectives of the investor and whether they are commercially based or driven by political or foreign-policy considerations. They can raise concerns with respect to foreign government control of or access to defence-related technologies.'[474]

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[471] Carlos Esplugues, Foreign Investment, Strategic Assets and National Security (Intersentia, 2018) 178.

[472] Dan Drezner 'Sovereign Wealth Funds and The (In)Security Of Global Finance' (2009) 62(1) Journal of International Affairs 115, 117. See Also: Joseph Norton 'the Santiago Principles for Sovereign Wealth Funds: A Case Study on International Financial Standard-Setting Processes' (2010) 13(3) Journal of International Economic Law 645, 649.

[473] Andrew Ross Sorkin, 'What Money Can Buy: Influence' The New York Times (January 22, 2008) <https://www.nytimes.com/2008/01/22/business/22sorkin.html> Accessed 20th June 2008.

[474] Helmut Reisen 'How to Spend It Commodity and Non-Commodity Sovereign Wealth Funds' (2008) OECD Development Centre Policy Brief No.38, 6 <http://www.oecd.org/development/pgd/41412391.pdf> Accessed 20th August 2018.

The OECD's view is supported by Christopher Cox, a former Chairman of the US Securities and Exchange Commission who once wondered: 'whether government-controlled companies and investment funds will always direct their affairs in furtherance of investment returns, or rather will use business resources in the pursuit of other government interests.'[475]

In light of the above, concerns not dissimilar to the wider security risks associated with FDI have been ascribed to SWFs. [476] Notable concerns include the potential for SWFs to seek control of critical infrastructure or strategic industries such as the defence or dual-use technology sector and to weaponise this control against host states.[477] Another concern is that a foreign government could use its SWF to acquire valuable technology and proprietary knowledge about how companies operate abroad, and use this sensitive knowledge to bolster the competitiveness of rival state-managed firms.[478]

Another risk is the idea that SWFs may use their investments to influence investee companies to adopt strategies that benefit the owner state of the fund at the expense of the foreign state where its investments are located. In this regard, some authors speculate that a SWF might agree to invest in a foreign company subject to the condition that the company in question undertakes to transfer certain facilities or activities to its home country.[479]

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[475] Christopher Cox, Chairman US Securities and Exchange Commission (SEC) 'The Role of Government in Markets' (Keynote Address and Robert R. Glauber Lecture at the John F. Kennedy School of Government) <https://www.sec.gov/news/speech/2007/spch102407cc.htm> Accessed 20th October 2018.

[476] Wouter P.F. Schmit Jongbloed, Lisa E. Sachs and Karl P. Sauvant 'Sovereign Investment: An Introduction' in Karl P. Sauvant, Wouter P.F. Schmit Jongbloed and Lisa E. Sachs (eds) Sovereign Investment: Concerns and Policy Reactions (Oxford University Press, 2012) 11.

[477] Thomas Hemphill, 'Sovereign Wealth Funds: National Security Risks in a Global Free Trade Environment' (2009) 51(6) Thunderbird. Int. Bus. Rev, 551, 556

[478] ibid.

[479] Michele Barbieri 'Sovereign Wealth Funds as Protected Investors under BITS and the Safeguard of the National Security of Host States' in Giorgio Sacerdoti (eds) General Interests of Host States in International Investment Law (Cambridge University Press, 2014) 133.

In addition to the above, critics also inveigh against the potential use of SWFs by owner states to exact a degree of material influence over host governments or what Anderlini describes as cheque-book diplomacy.[480] A related concern is the so-called 'undue leverage' hypothesis.[481] This holds that foreign governments may use their financial statecraft, including SWFs, to gain leverage or strong-arm other states during transnational negotiations.[482] This is said to play out in two ways: deterrence and compellence.[483]

In a deterrence scenario, theorists argue that foreign states could deploy financial statecraft such as SWFs to deter other states from taking action perceived to be inimical to the interests of the donor state.[484] In a compellence scenario, by contrast, it is argued that a donor state could leverage its ownership of financial assets or SWFs to compel other states to take action in the donor state's interests.[485] One example cited in this regard is the threat of withdrawal of SWF assets.[486]

To date, the above mentioned political and security risks remain largely theoretical. Indeed, empirical assessments of SWF investments have often extolled the commercial and financial orientation of these entities, suggesting that they are likely to invest solely on economic and

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480 Jamil Anderlini 'Beijing's shadowy fund for buying assets' Financial Times (Beijing, 11 September 2008) <https://www.ft.com/content/cf2e1a1a-801e-11dd-99a9-000077b07658> Accessed 20th January 2018.

481 Brad Sester 'Sovereign Wealth and Sovereign Power: The Strategic Consequences of American Indebtedness' (2009) Council on Foreign Relations Special Report No 37, 23 <https://cfrd8-files.cfr.org/sites/default/files/pdf/2008/09/Debt_and_Power_CSR37.pdf> Accessed 20th May 2018. See also Justin O'Brien 'Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds' (2009) 42(4) International Lawyer 1231, 1241.

482 Ibid.

483 Daniel W. Drezner 'Bad Debts: Assessing China's Financial Influence in Great Power Politics' (2009) 34(2) International Security 7, 13.

484 Ibid.

485 Ibid.

486 Ibid. see also: Daniel W Drezner, 'Sovereign Wealth Funds and the Insecurity of Global Finance' (2009) 62 Journal of International Affairs 118, 121.

financial grounds like every rational investor and not in pursuit of political or geostrategic advantages for their owner states.[487] In one case, a group of authors compared them to private mutual Funds who pursue risk-adjusted returns in financial markets.[488] Another suggests that SWFs are similar to other institutional investors in their pursuit for prime targets.[489]

Notwithstanding the above, the behaviour of certain funds and their owner states serve to put the political and security risks highlighted above in context. One example is China whose second fund, SAFE Investments, was found to have invested in Costa Rican Government Bonds in return for Costa Rica's termination of diplomatic ties with Taiwan, a neighbouring area that China has for long considered part of its territory.[490] SAFE's investment in Costa Rica's public bonds was part of a wider agreement between the Chinese State and its Costa Rican counterpart which also included the transfer of significant financial aid, support for Costa Rica's application for a non-permanent seat on the UN Security Council and a Free Trade Agreement (FTA) between the two countries which was ratified in 2010.[491]

On the one hand, SAFE's behaviour reflects the Chinese state's inordinate control of this entity. Yet, the more disturbing question seems to be China's willingness to deploy its SWF in the

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[487] Rolando Avendaño & Javier Santiso, 'Are Sovereign Wealth Funds' Investments Politically Biased? : A Comparison with Mutual Funds' (2009) OECD Development Centre Working Paper No. 283, 27-30 <https://www.oecd.org/dev/44301172.pdf> Accessed 20th May 2019. See also: Jason Kotter and Ugur Lel 'Friends or foes? Target selection decisions of sovereign wealth funds and their consequences' (2011) 101(2) Journal of Financial Economics 360-381.

[488] ibid

[489] Jason Kotter and Ugur Lel 'Friends or foes? Target selection decisions of sovereign wealth funds and their consequences' (2011) 101(2) Journal of Financial Economics 360-381.

[490] James Anderlini. 'Beijing uses forex reserves to target Taiwan' Financial Times (Beijing, 12 September 2008) <https://www.ft.com/content/22fe798e-802c-11dd-99a9-000077b07658> Accessed 20th January 2018. See: R Bismuth, The "Santiago Principles" for Sovereign Wealth Funds: The Shortcomings and the Futility of Self-Regulation (2017) 28(1) European Business Law Review 69.

[491] See: Regis Bismuth, the "Santiago Principles" for Sovereign Wealth Funds: The Shortcomings and the Futility of Self-Regulation (2017) 28(1) European Business Law Review 69.

pursuit of a patently political and foreign policy objective – a move that has been criticised elsewhere as an exercise of 'cheque-book diplomacy'[492]

Another controversial example of the likely politicised nature of SWFs can be seen in the threat by the former Libyan leader, Muammar Gaddafi to withdraw Libyan SWF investment from African countries resistant to his idea of strengthening the African Union – a matter in which the former Libyan leader was personally invested.[493]

Although some might perceive the idea of strengthening the African Union as a sound and legitimate policy objective, the open and somewhat ominous desire of Libyan state executives to use SWF investments as an undue leverage is perhaps indicative of a residual risk that SWFs may be deployed in heavily politicised ways than is commonly acknowledged.

3.5.2 Financial Stability

In addition to national security and political risks, there are a number of analysts who focus instead on the macroeconomic risks arising from the investments of SWFs. These concerns typically revolve around the potential impact of SWF Behaviour, movements and investments on the stability of global financial markets.

One perspective is formulated by Blundell-Wignall and others who argue that investments by SWFs may affect asset prices in financial markets.[494] For instance, the authors find that changes

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[492] Andrew Batson 'China Used Reserves to Sway Costa Rica' WSJ (Sept. 13, 2008) <https://www.wsj.com/articles/SB122121919505927749> Accessed 20th May 2018.

[493] Daniel W Drezner, 'Sovereign Wealth Funds and the Insecurity of Global Finance' (2009) 62 Journal of International Affairs 118, 121.

[494] Adrian Blundell-Wignall, Yu Hu, Juan Yermo, 'Sovereign Wealth and Pension Fund Issues' (2008) OECD Working Paper on Insurance and Private Pensions No. 14, 15 <http://www.oecd.org/finance/private-pensions/40345767.pdf> Accessed 20th September 2018. See also: Tamara Gomes, 'The Impact of Sovereign Wealth Funds on International Financial Stability',(2008) Bank of Canada Discussion Paper 2008-14, 9 <http://www.bankofcanada.ca/wpcontent/uploads/2010/01/dp08-14.pdf> Accessed 20th February 2016.

in the strategic asset allocation of a large SWF, such as a shift from bonds to equities, could have a significant impact on the relative prices of these two asset classes.[495] This is broadly similar to an argument propagated by the IMF which states that a diversification by SWFs from low-risk, short-term instruments, such as U.S. Treasury bills into longer-term equity stakes may affect US interest rates and equity prices.[496] This is also supported by Mezzacapo who contends that the sheer size and scale of SWFs raise concerns as to the impact of their investment decisions on the prices of equity instruments.[497] Kimmitt also takes this view, arguing that SWFs represent large, concentrated, and often opaque positions in financial markets which means that a sudden shift in asset allocation is likely to induce asset price volatility.[498] Additional theoretical support for this view has been provided by Beck and Fidora who argue in a well-received paper that massive outflows of SWF capital from US and Euro Bond Markets to riskier equity markets can affect, amongst other things, the demand for bonds and overall bond yields.[499]

Alongside the probable impact of SWFs investments on asset prices, it is also argued that SWFs can create severe disturbances in financial markets through rapid divestments and liquidations of their holdings.[500] Critics point to recent stock market disturbances driven by the unwinding of equity positions by SWFs to strengthen their local economies as ample evidence of

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[495] Ibid.

[496] International Monetary Fund 'Sovereign Wealth Funds—A Work Agenda' (2008) Monetary and Capital Markets and Policy Development and Review Departments Paper, 13 <https://www.imf.org/external/np/pp/eng/2008/022908.pdf> Accessed 20th May 2018.

[497] Simone Mezzacapo, 'The So-Called 'Sovereign Wealth Funds': Regulatory Issues, Financial Stability and Prudential Supervision' (2009) European Economy, Economic Papers 378, 27 [Online] Available at <http://ec.europa.eu/economy_finance/publications/publication15064_en.pdf> Accessed 20th May 2016.

[498] Robert Kimmitt 'Public Footprints in Private Markets' *Foreign Policy* (20 February 2008) <https://www.foreignaffairs.com/articles/2008-01-01/public-footprints-private-markets > Accessed 20th May 2018.

[499] Roland Beck and Michael Fidora 'The Impact of Sovereign Wealth Funds on Global Financial Markets' (2008) European Central Bank Occasional Papers No 91, 14 <https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp91.pdf> Accessed 20th January 2018.

[500] Steffen Kern, 'SWFs and Foreign Investment Policies – an Update' (2008) Deutsche Bank Research Paper, 13.

this risk.[501] The views of Adnan Mazarei, the deputy director of the International Monetary Fund's Middle East and Central Asia Department perfectly encapsulates this concern. According to Mazarei, 'A withdrawal of assets by sovereign wealth funds against the background of liquidity concerns could lead to large price movements,' 'Nobody knows how much or when, but the concern is there.'[502] Although this argument is made in the context of SWFs, it must be emphasised however that such risks are inherent in the operation of financial markets.[503]

A related argument is that put forward by Sun and Hesse who argue that SWFs can induce crises in deeper markets like the currency or Foreign Exchange markets through rumours or actual announcements of changes in currency allocation or composition.[504] Under such circumstances, it is often argued that the affected currencies may suffer serious depreciations, with huge consequences for market stability.[505] A similar argument has been made elsewhere that shifts by SWFs away from US dollar holdings might precipitate a decline in capital inflows into the United States, causing an increase in real interest rate differentials and a dollar depreciation.[506]

Another perspective put forward by critics of SWF is the herding behaviour argument where it is posited that certain market movements by opaque and non-transparent SWFs may be

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501 Mantej Deol, 'Shares sell-off by sovereign wealth funds hurting markets', BBC News, (20th January 2016) <http://www.bbc.co.uk/news/business-35361661 Accessed 20th March 2016> Accessed 20th August 2016.

502 Simon Clark, Mia Lamar and Bradley Hope 'The Trouble With Sovereign-Wealth Funds' *Wall Street Journal* (22 December 2015) <https://www.wsj.com/articles/the-trouble-with-sovereign-wealth-funds-1450836278 > Accessed 20th January 2018.

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504 Tao Sun and Heiko Hesse 'Sovereign Wealth Funds and Financial Stability—An Event Study Analysis' (2009) IMF Policy Paper WP/09/239, 3 <https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Sovereign-Wealth-Funds-and-Financial-Stability-An-Event-Study-Analysis-23370> Accessed 20th May 2018.

505 Ibid.

506 International Monetary Fund 'Sovereign Wealth Funds—A Work Agenda' (2008) Monetary and Capital Markets and Policy Development and Review Departments Paper, 13 <https://www.imf.org/external/np/pp/eng/2008/022908.pdf> Accessed 20th May 2018.

misinterpreted by other market investors, resulting in herding behaviour.[507] Herding behaviour generally occurs when investors are forced to mimic the behaviour of a large market player whether rational or not.[508] In practice, this means that investors emulate the large player's behaviour by buying or selling on one side of the market or interpreting the player's withdrawal or purchase positions as a signal of the long-term health of the companies or markets involved.[509]

In extremis, herding behaviour can destabilise regional or segmental parts of the financial industry or even financial markets at a global scale.[510] Indeed, much of the existing literature on herding behaviour focuses on the role of large and opaque hedge funds in inducing market panics in emerging markets in the 1980s and 90s with severe costs to the affected economies.[511] This has prompted certain analysts to conclude that large and opaque SWFs may induce irrational behaviour of this sort through their movements in financial markets.[512]

One can observe a close example of this in the sale by the Singaporean SWF, Temasek Holdings of its shareholding in two big Chinese banks (Bank of China and China Construction

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[507] Tamara Gomes, 'The Impact of Sovereign Wealth Funds on International Financial Stability'(2008) Bank of Canada Discussion Paper 2008-14, 9 <http://www.bankofcanada.ca/wpcontent/uploads/2010/01/dp08-14.pdf> Accessed 20th February 2016

[508] Avinash Persaud 'Sending the Herd Off the Cliff Edge: The Disturbing Interaction Between Herding and Market-Sensitive Risk Management Practices' (2000) 2(1) Journal of Risk Finance 59, 61. See also: Steffen Kern, SWFs and Foreign Investment Policies – an Update (2008) Deutsche Bank Research Paper, 13.

[509]Ibid. see also: Tao Sun & Heiko Hesse, 'Sovereign Wealth Funds and Financial Stability- An Event Study Analysis', (October 2009) IMF Working Paper 09/239, 3 <https://www.imf.org/external/pubs/ft/wp/2009/wp09239.pdf> Accessed 20th February 2016.

[510] Steffen Kern 'Control Mechanisms for Sovereign Wealth Funds in Selected Countries' (2008) CESifo DICE Report, 43 <https://www.econstor.eu/bitstream/10419/166952/1/ifo-dice-report-v06-y2008-i4-p41-48.pdf > Accessed 20th May 2018.

[511] Tamara Gomes, 'The Impact of Sovereign Wealth Funds on International Financial Stability',(2008) Bank of Canada Discussion Paper 2008-14, 9 <http://www.bankofcanada.ca/wpcontent/uploads/2010/01/dp08-14.pdf> Accessed 20th February 2016.

[512] Steffen Kern, 'SWFs and Foreign Investment Policies – an Update' (2008) Deutsche Bank Research Paper, 13 <https://www.dbresearch.com/PROD/RPS_EN-PROD/SWFs_and_foreign_investment_policies_-

Bank) and in Asia's largest container-shipping group, Cosco. Temasek's abrupt disposal of these assets created rumours about the health of the Chinese banking sector and provoked a serious sell-off by other market players who misinterpreted the Fund's behaviour as indicative of the long term health of the concerned companies.[513] The seriousness of this episode prompted a rebuttal from Temasek that the 'sale was just part of an ongoing rebalancing of its portfolio' by which time, financial markets had already lost a significant amount of value.[514] The above situation shows, at best, a risk that market movements by opaque SWFs can create panics and potentially destabilise financial markets. However, it is important to state that these risks are not isolated to the activities of SWFs and is often prevalent in the operation of financial markets in general.[515]

3.5.3 Operational Independence

Alongside the macroeconomic risks posed by SWFs, critics of SWFs also inveigh against the governance attributes of SWFs, in particular their operational independence.[516]

Broadly speaking, SWFs face a different and perhaps more challenging range of governance issues than that faced by private firms.[517] Unlike private entities that are owned by a dispersed class of shareholders, SWFs are owned and controlled by governments of different

_an_update/RPS_EN_DOC_VIEW.calias?rwnode=PROD0000000000435631&ProdCollection=PROD0000000000465344> Accessed 20th January 2018.

513 Stefano Curto 'Sovereign Wealth Funds in the Next Decade' (2010) World Bank Poverty Reduction and Economic Management Network Paper 53915, 3 <http://documents.worldbank.org/curated/en/886451468341078325/pdf/539150BRI0EP80Box345633B01PUBLIC1.pdf> Accessed 20th May 2018. See also: Gwen Robinson 'Temasek signals further China doubts' Financial Times (30 November 2007) <https://ftalphaville.ft.com/2007/11/30/9284/temasek-signals-further-china-doubts/> Accessed 20th May 2018.

514 Ibid.

515 Persaud op cit.

516WPF SchmitJongbloed, L Sachs and K Sauvant, 'Sovereign Investment: An Introduction' in Sauvant, Sachs and Jongbloed (eds) *Sovereign Investment: Concerns and Policy Reactions*(1st edn, OUP 2012) pg 14

517 Choon Yin-Sam 'Understanding the Relationship between the Government and Sovereign Wealth Funds: The Case of Singapore' (2012) 14(2) New Zealand Journal of Asian Studies 86, 91

shapes and traditions.[518] They are therefore, agents accountable to a discernible principal – the owner state.

Although an ideal relationship between an SWF and its principal should see the SWF operate at arm's length from the state, it is often inescapable that the owner might assume a direct role in the governance of the fund, including setting its policy objectives and appointing the governing body or Board of Directors.[519] This can create fundamental difficulties in the operation of SWFs including the likelihood that SWFs may be hardwired into the body-politic of owner states and thus prone to political direction and non-independence.[520]

It is for this reason that commentators such as Choon Yin-Sam emphasise the importance of strong internal controls such as the appointment of independent directors and the existence of appropriate mechanisms which separate the narrow political interests of the state or state executives from the investment decision-making of SWFs.[521]

This sentiment is shared by Adam Dixon who reminds us that it is difficult for the state sponsor and the SWF to claim independence from political meddling, if, for instance, board selection is purely a political exercise where board members are selected on the basis of political relationships and not domain-specific expertise.[522] Notwithstanding the above, SWFs have often maintained dubious links to their owner states, sparking concerns in investment recipient countries

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[518] Ibid.

[519] Indeed the Santiago Principles recognise the ability of the owner state to set the objective of the fund and to appoint its governing body. See: Principle 7.

[520] Choon Yin-Sam 'Understanding the Relationship between the Government and Sovereign Wealth Funds: The Case of Singapore' (2012) 14(2) New Zealand Journal of Asian Studies 86, 91.

[521] Choon Yin-Sam 'Understanding the Relationship between the Government and Sovereign Wealth Funds: The Case of Singapore' (2012) 14(2) New Zealand Journal of Asian Studies 86, 91.

[522] Adam Dixon 'Enhancing the Transparency Dialogue in the "Santiago Principles" for Sovereign Wealth Funds' (2014) 37 Seattle University Law Review 581, 589.

over the independence of these institutions. These concerns are most apparent in funds from authoritarian states.

One example is Saudi Arabia's Public Investment Fund (PIF) which has been described as a 'one-man investment vehicle' for Saudi Crown Prince, Mohammed Bin Salman.[523] A recent Financial Times report reveals graphic details of practices and investments at the fund which appear to confirm a blurred boundary between the fund and Saudi royals.[524] By way of example, the Crown Prince has recently restructured the governance framework of the PIF, appointing himself as chairman and taking a sensitive executive committee seat which presumably gives him greater influence over the decision making of the fund.[525]

More alarming are indications that the PIF's investments may have been directed at the whims and caprices of the Saudi Crown Prince. This includes sizeable investments in domestic and international companies which are at the heart of the Crown Prince's 'Transformation Agenda' such as Uber, Tesla and Lucid – all technology giants apparently favoured by the Saudi Crown Prince.[526] Alongside the massive 'concentration of power' at the PIF, the FT Report also quotes a Saudi based analyst who acknowledges that the PIF has "become the most important vehicle for MBS (Mohammed Bin Salman) [in terms of his] political, personal, economic and social agenda in the country. It's a one-man investment vehicle." (Emphasis added).[527]

A similar circumstance exists at Temasek, one of Singapore's large SWFs where Ho Ching, the wife of Singapore's incumbent Prime Minister Lee Hsien Loong, currently serves as Chief Executive Officer, directing the affairs of the fund on a habitual basis. Worse, Ms Ching's

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[523] Andrew England and Simeon Kerr 'Saudi Arabia: how the Khashoggi killing threatens the prince's project' *Financial Times* (22 October 2018) <https://www.ft.com/content/227c99dc-d2b5-11e8-a9f2-7574db66bcd5> Accessed 30 October 2018.

[524] Ibid.

[525] Ibid.

[526] Ibid.

[527] Ibid.

appointment came on the heels of her husband's elevation to the exalted post of Prime Minister, suggesting that her selection was part of a wider strategy to transfer power to the next generation of Singapore's elite families.[528] Even so, the Chairman of the Fund, Suppiah Dhanabalan, is a prominent member of the People's Action Party (PAP), Singapore's only ruling political party and is widely considered a key member of Former Prime Minister Lee Kuan Yew inner circle.[529] For some commentators, this 'ensures the influence of the PAP on Temasek's day to day activities' (emphasis added) – a situation which does not bode well for the operational integrity of the fund.[530]

A broadly similar situation exists at Singapore's other fund, GIC where Prime Minister Lee Hsien Loong serves as chairman of the board, creating an absurd state of affairs where the Prime Minister and his wife are the top decision-makers at Singapore's largest funds.[531] Mr Loong is joined on GIC's board by other government functionaries, many of whom belong to the ruling Peoples Action Party, including two deputy Prime Ministers, Teo Chee Hean and Tharman Shanmugaratnam.[532]

For a bit of perspective, Mr Shanmugaratnam also serves as Coordinating Minister for Economic and Social Policies and as head of GIC's Investment Strategies committee, the committee responsible for directing the fund's vast foreign and domestic investments.[533] Worse,

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[528] Kyle Hatton & Katharina Pistor 'Maximizing Autonomy in the Shadow of Great Powers: The Political Economy of Sovereign Wealth Funds' (2011) Columbia Law and Economics Working Paper No 395, 23 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1787565> Accessed 20th May 2018.

[529] Ibid.

[530] Ibid. at 23.

[531] Mr Loong is the son of Singapore's first Prime Minister and leader of the PAP, Lee Kuan Yew. See: Victor Shih 'Tools of Survival: Sovereign Wealth Funds in Singapore and China.' (2009) 14(2) Geopolitics 328-344.

[532] GIC, 'Governance: Board of Directors' (2018) <https://www.gic.com.sg/about-gic/governance/board-of-directors/> Accessed 20th November 2018.

[533] Ibid.

he is also Chairman of the Monetary Authority of Singapore, Singapore's Central Bank, raising the prospect of severe conflicts of interest.

Besides the Saudi Arabian and Singaporean funds, there are also concerns about the operational independence of the Turkish, Qatari, Libyan and Chinese SWFs all of which are subscribers to the Santiago principles and members of the IFSWF.

In the former, Turkey's President, Recep Tayyip Erdogan has recently consolidated power, toppling the entire fund management and appointing himself and his son in-law as Chairman and Senior Director respectively.[534] This comes amid wider concerns about a power grab in Turkey – a move which has affected the Country's Central Bank and other sensitive agencies and parastatals of government.[535] This has provoked controversy about the operational independence of the fledgling SWF, established only two years ago to recapitalise domestic companies and revitalise the Turkish economy through direct investments.[536] According to a recent commentary, 'The shakeup of Turkey's SWF consolidates the president's influence over another key financial institution in Turkey.' (Emphasis Added)[537]

Issues of operational independence are not isolated to the above-mentioned funds, these concerns have also trailed the Libya Investment Authority (LIA) – another member of the IFSWF. A recent report revealed a set of practices at the fund, suggestive of an entrenched culture of political decision-making and non-independence.[538] For one, the report suggested that the LIA

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[534] Laura Pitel 'Erdogan takes control of Turkey's sovereign wealth fund' *Financial Times* (12 September 2018) <https://www.ft.com/content/8fe07c16-b693-11e8-bbc3-ccd7de085ffe> Accessed 20th October 2018.

[535] Ibid.

[536] Onur Ant 'Erdogan Names Himself Turkey Wealth Fund Chairman in Shakeup' Bloomberg (12 September 2018) <https://www.bloomberg.com/news/articles/2018-09-12/erdogan-names-himself-chairman-of-turkey-wealth-fund-in-overhaul> Accessed 20th October 2018.

[537] Ibid.

[538] Roula Khalaf, Lina Saigol and Henny Sender 'The two faces of Libya's investment fund' Financial Times (6 March 2011) <https://www.ft.com/content/232adcca-481d-11e0-b323-00144feab49a> Accessed 30th October 2018.

operated according to the whims and caprices of the Gaddafi family who amongst other things undertook significant roles in directing its investments.[539] The report also revealed that senior managers of the LIA appeared to be taking investment instructions from Libyan state executives. This is confirmed in an interesting extract which reads as follows:

> 'The LIA had the good guys and the bad guys in it,"... "You had a group of very young, well-meaning investment professionals and various senior people who answered largely to the likes of Seif Gadhafi and made investment decisions based on what they were told." (Emphasis Added).[540]

The dangers of a weak governance framework can be seen in the litany of scandals currently besieging the LIA, including a protracted litigation with its investment adviser, Goldman Sachs regarding the latter's alleged provision of negligent advice to the LIA and several other scandals involving missing documentation, unaudited accounts[541] and the alleged misappropriation of the fund's resources for private gain.[542]

The nexus between owner and fund seems to be even more entrenched in the case of the China Investment Corporation (CIC) which maintains very strong connections with the apparatus of its owner state through the appointment of several current and former government and communist party officials on its board in ways akin to a revolving door between the CIC and the Chinese communist party leadership.[543] For instance, the Fund's incumbent president, Tu

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[539] Ibid.

[540] Ibid.

[541] Lina Saigol and Cynthia O'Murchu 'After Gaddafi: A spent force' *Financial Times* (8 September 2011) <https://www.ft.com/content/1b5e11b6-d4cb-11e0-a7ac-00144feab49a> Accessed 30th October 2018.

[542] Margaret Coker 'Libya's Sovereign Fund Seeks Investment Probe' *WSJ* (23 September 2011) <https://www.wsj.com/articles/SB10001424053111904563904576587041911379606> Accessed 20th May 2018.

[543] Iacob N. Koch-Weser and Owen D. Haacke 'China Investment Corporation: Recent Developments in Performance, Strategy, and Governance' (2013) U.S.-China Economic and Security Review Commission paper, 35<https://www.uscc.gov/sites/default/files/Research/China%20Investment%20Corporation_Staff%20Report_0.pdf> Accessed 20th May 2018.

Guangshao, a former vice mayor of the Chinese city of Shanghai has repeatedly been identified as a leading Chinese Communist Party figure.[544] This state of affairs has prompted one leading academic to conclude that "CIC positions taken by former or current governmental officials are pragmatically and essentially job-rotations that are part of their careers within the Communist party."[545]

A further sign of the fund's close ties with the Chinese state is embedded in its operational mandate which requires five leading government agencies to 'nominate one of their officials for director positions.'[546] One of such departments is the National Development and Reform Commission (NDRC), a Chinese super-ministry in charge of industrial planning and the approval of outbound foreign direct investment.[547] The NDRC has acquired a controversial reputation for sequencing and directing China's vast outbound foreign direct investments into foreign sectors where China suffers from a structural deficit.[548]

The department's presence on the CIC's board is even more startling given that it has little to do with monetary policy – a rationale supposedly behind the establishment of the CIC.[549] This has fuelled concerns of a pervasive state involvement in the fund's overseas investment drive.[550]

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[544]Shanghai Forum, 'People' (2018) <http://www.shanghaiforum.fudan.edu.cn/en/index.php?c=news&a=detail&aid=1179> Accessed 20th November 2018..

[545] Jing Li, 'Investment Contractual Terms and Level of Control of China's Sovereign Wealth Fund in its Portfolio Firms' in *Oxford Handbook of SWFs*. (OUP, 2017) 379.

[546] CIC 'Articles of Association' (2018) Available at <http://www.china-inv.cn> Accessed 20th October 2018.

[547] Iacob N. Koch-Weser and Owen D. Haacke 'China Investment Corporation: Recent Developments in Performance, Strategy, and Governance' (2013) U.S.-China Economic and Security Review Commission paper, 36<https://www.uscc.gov/sites/default/files/Research/China%20Investment%20Corporation_Staff%20Report_0.pdf> Accessed 20th May 2018.

[548] Ibid.

[549] CIC was established to invest China's vast Foreign Exchange reserves on behalf of the Central Banks

[550] Iacob N. Koch-Weser and Owen D. Haacke 'China Investment Corporation: Recent Developments in Performance, Strategy, and Governance' (2013) U.S.-China Economic and Security Review Commission paper,

Also represented on CIC's board are officials from four other powerful government departments such as the Ministry of Finance, the Ministry of Commerce (which also approves outbound FDI), the People's Bank of China and the State Administration of Foreign Exchange (SAFE).[551] Other members of the Board are mostly drawn from Chinese State-owned Financial Institutions and Banks such as the China Construction Bank, and the Export-Import Bank in which CIC maintains significant equity stakes, highlighting potentially serious conflicts of interests.[552]

More worrying still, China's Company Law requires all Chinese entities (CIC inclusive) to establish Communist party committees or cells. This arrangement is codified in Article 19 of the Company Law of the People's Republic of China which requires an organization of the Chinese Communist Party (CCP) to be set up in all enterprises, regardless of whether it is a state, private, domestic, or foreign-invested enterprise, to carry out activities of the CCP.[553] Although the existence of this committee is not openly acknowledged in CIC's publications, the sizeable public-sector and communist party representation in the fund's governing body provides little reassurance that its investment decision-making will be immune from political calculations.

3.5.4 Transparency

Transparency[554] is another prominent concern involving SWFs. SWFs are often accused of being opaque and failing to disclose important information about their practices, behaviour,

36<https://www.uscc.gov/sites/default/files/Research/China%20Investment%20Corporation_Staff%20Report_0.pdf> Accessed 20th May 2018.

551 Ibid.

552 Ibid. at 35.

553 PRC Company Law (adopted by the NPC on Dec. 29, 1993, amended Dec. 25, 1999, further amended Aug. 28, 2004 and Oct. 27, 2005 and Dec. 28, 2013) <http://www.fdi.gov.cn/1800000121_39_4814_0_7.html> Accessed 20th October 2018.

554 Transparency has been recognised across vast disciplines of the social sciences as a serious normative demand in areas of social, business and regulatory activity. See: Andrea Bianchi, 'On Power and Illusion: The Concept of

investments and returns.[555] This is a provocative issue in many host states where the investments of these funds are located. For instance, in a testimony to the US National Security Review Commission, the former Director of Enforcement at the US Securities and Exchange Commission, Linda Chatman Thomsen noted: 'when it comes to transparency, the track record to date of most sovereign wealth funds does not inspire confidence.'[556] Afshin Mehrpouya another prominent SWF scholar also notes the high level of variability amongst SWFs in their approach to transparency and information disclosure.[557] Notwithstanding this somewhat blemished record, it is naïve to assume that these demands are isolated to SWFs. Indeed, a large literature exists which notes the existence of transparency concerns, in multiple contexts, including in financial markets.[558]

Following the rise of SWFs and the corresponding concerns of transparency, a growing literature has emerged that seeks to understand what 'transparency' truly means in the context of these entities.

One perspective is offered by Zhang who sees the Transparency of SWFs as involving information disclosure to the markets, relevant administrative agencies of the recipient state, stakeholders or the public about the operation of SWFs. He further argues that such disclosure must include basic corporate information, management information, risk management and

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Transparency in International Law' in Andrea Bianchi (eds) Transparency in International Law (Cambridge University Press, 2013) 1.

[555] Georges Kratsas and Jon Truby 'Regulating Sovereign Wealth Funds to Avoid Investment Protectionism' (2015) 1 Journal of Financial Regulation, 95, 102.

[556] Linda Chatman Thomsen, Director, Division of Enforcement U. S. Securities & Exchange Commission 'Sovereign Wealth Funds and Public Disclosure' (Testimony Before the U.S.-China Economic and Security Review Commission, February 7, 2008) <https://www.uscc.gov/sites/default/files/08_02_07_chatman_thomsen_statement.pdf> Accessed 20th May 2018.

[557] Afshin Mehrpouya 'Sovereign Wealth Funds, The IMF and Transparency: Are they all talking the same thing?', 16 (2013) <www.hec.edu/heccontent/download/8396/185943/version/.../CR+963+Mehrpouya.pdf> Accessed 20th May 2018.

[558] For example, Kratsas and Truby note the concerns about the transparency of hedge funds. See: Georges Kratsas and Jon Truby 'Regulating Sovereign Wealth Funds to Avoid Investment Protectionism' (2015) 1 Journal of Financial Regulation, 95, 102.

investment information.[559] This collectivist understanding of transparency is closely paralleled to the approach offered by Toledano and Bauer for whom the transparency of SWFs revolves around the accessibility of information on managerial activities, assets and returns, funding and withdrawals and the relationship between the fund and its owner state.[560] Having explored the theoretical underpinnings of transparency for SWFs, it is pertinent to understand why SWFs should, in principle, be transparent about their operations and behaviour.

The first rationale is that a transparent SWF is likely to build trust, acceptance and legitimacy in owner states and hosts.[561] Under such circumstances, the investment decisions and motivations of the particular SWF are more likely to be understood by the domestic citizenry and external observers which can, in turn, insulate the Fund from political and regulatory risks such as a backlash from host state regulators and provide its domestic citizenry the tools to hold fund managers accountable.[562]

By contrast, a lack of transparency is likely to impede an understanding of SWF operations, making it difficult for any interested observer to allay suspicions of illicit behaviour or political capture.[563] It follows therefore that opacity on the part of SWFs is likely to translate into higher investment risks, including the risk of a regulatory backlash in target countries.[564] This is broadly

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[559] Jin Zhang 'Enhancing the Transparency of Sovereign Wealth Funds: From the Middle East to China' (2016) 10(1) Journal of Middle Eastern and Islamic Studies 90, 94.

[560] Perrine Toledano and Andrew Bauer 'Natural Resource Fund Transparency' (2014) Revenue Watch Institute Policy Brief 1-2, <https://resourcegovernance.org/sites/default/files/NRF_RWI_BP_Transp_EN_fa_rev1.pdf> Accessed 20th May 2018.

[561] Edwin Truman 'Sovereign Wealth Funds: The Need for Greater Transparency and Accountability' (2007) Peterson Institute for International Economics Report PB07-6, 7 <https://piie.com/sites/default/files/publications/pb/pb07-6.pdf> Accessed 20th May 2018.

[562] Wouter P.F. Schmit Jongbloed, Lisa E. Sachs and Karl P. Sauvant 'Sovereign Investment: An Introduction' in Wouter P.F. Schmit Jongbloed, Lisa E. Sachs and Karl P. Sauvant (eds) *Sovereign Investment: Concerns and Policy Reactions* (Oxford University Press, 2012) 12

[563] Ibid.

[564] Simone Mezzacapo, 'European Economy – The so-called "Sovereign Wealth Funds": Regulatory Issues, Financial Stability and Prudential Supervision' European Commission, Economic Papers 378 (April

consistent with Mezzacapo's statement that 'the veil of secrecy can be used as an excuse to aim or simply give room to the adoption of protectionist policies by investment recipient countries.'[565]

An additional rationale for SWF transparency is the need for market stability and discipline. As one can see from the preceding discussion on financial stability, a non-transparent SWF is likely to give rise to adverse disruptions in financial markets. One disruption is the risk of herding behaviour which occurs when financial market operators misinterpret the behaviour of a SWF or another large market player due to the paucity of information.[566] The antidote for market turbulence of this kind is therefore, the disclosure of timely and relevant information about a fund's operation which can help inform other market operators about its likely movements and behaviour.

Another rationale for SWF Transparency is that it may serve as an insulator against the inefficient and unaccountable use of SWFs.[567] This is allied to the argument put forward by Dixon and others who posit that 'Transparent and verifiable good governance practices will immunize SWF investment decisions from politics and establish trust.'[568] Indeed, one can see from the experience of large corporations in the industrialised world that the potential for error and abuse exists in organisations and cultures characterised by opacity, secrecy and clandestinity.[569] It follows therefore that a SWF which operates in opaque settings is likely to be susceptible to similar challenges.

2009), 39–40 <http://ec.europa.eu/economy_finance/publications/publication15064_en.pdf> accessed 20th May 2018.

[565] Ibid.

[566] Ibid.

[567] Ibid.

[568] Gordon Clark, Adam Dixon and Ashby Monk, *Sovereign Wealth Funds, Legitimacy, Governance and Global Power* (Princeton University Press, 2013) 17.

[569] George Kratsas, 'Sovereign Wealth Funds: Their Operation and the Economic, Political and Legal Responses' (PHD Thesis, University College London 2013) 47.

Notwithstanding the above, the record of SWFs on transparency remains fragmented and has become the focus of increasing concern amongst recipients of their investments. One example is the Qatari SWF QIA – a member of the IFSWF – which produces no annual report, does not disclose its assets under management, says nothing about its returns, and barely mentions any of its holdings.[570] Indeed, the QIA's webpage contains a section titled 'QIA Review' that has contained the words "Coming Soon" for so long that it has become an industry joke about the fund's notoriously opaque tradition.[571] The same fund was also revealed in a report by the whistle-blower site, WikiLeaks, to hoard information about its holdings and asset allocation including from the Qatari public and other regulators.[572] The WikiLeaks report quotes a senior Qatari official who acknowledged that "Only five or six people in Qatar knew the QIA's asset allocation" (Emphasis added).[573]

QIA's strategic opacity is closely matched by the Kuwait Investment Authority (KIA), another member of the IFSWF. Like the QIA, the Kuwaiti Fund does not disclose information about its holdings or even its total Assets under Management (AUM). Also undisclosed are information about the fund's asset allocation, performance and its use of external managers.[574]

Another opaque SWF within IFSWF ranks is the Abu Dhabi Investment Authority (ADIA) which still does not disclose the size of assets under management, its targets, asset

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570 Chris Wright 'Sovereign wealth funds: What is Santiago for?' *EuroMoney* (6 January 2016) <https://www.euromoney.com/article/b12kp1gbztgx10/sovereign-wealth-funds-what-is-santiago-for> Accessed 20th November 2018.

571 Chris Wright 'Scoring the Santiago Principles as they turn 10' *EuroMoney* (8 October 2018) <https://www.euromoney.com/article/b1b950f21d36bd/scoring-the-santiago-principles-as-they-turn-10> Accessed 20th November 2018.

572 Wikileaks 'Qatari Officials Discuss Currency, Sovereign Wealth Funds, Investment and Iran with Secretary Paulson' (2008) <https://wikileaks.org/plusd/cables/08DOHA422_a.html> Accessed 20th May 2018.

573 Ibid.

574 The Sovereign Wealth Fund Initiative, 'Fund Profile: Kuwait Investment Authority' (2011), 3 <http://fletcher.tufts.edu/~/media/Fletcher/Microsites/swfi/pdfs/2012/profiles/KIA%20Fund%20Profile_v2.pdf> Accessed 20 April 2018.

allocation, specific holdings or investment performance despite recent positive changes to its disclosure policy.[575]

The ADIA's opacity however pales into insignificance when compared with the approach of the Saudi Arabian Public Investment Fund (PIF).[576] With reportedly over $230 billion of Assets under Management, the PIF has become a serious player in international capital markets. Its reported holdings include influential stakes in international firms such as Uber, Tesla and Lucid.[577] Notwithstanding this sizeable market footprint, the PIF still does not name many of its investments nor does it publish an investment policy, asset allocation or annual report.[578]

The examples cited above should be contrasted with the Norwegian SWF, the Government Pension Fund Global (GPFG) – the largest SWF in the world and a former member of the International Forum of Sovereign Wealth Funds – which discloses down to the last krone the market value of its holdings.[579] The GPFG also publishes information on all its investments, portfolio techniques, positions on corporate responsibility and ethics, voting records and internal governance arrangements.[580]

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[575] Khalid Alsweilem, Angela Cummine, Malan Rietveld and Katherine Tweedie, 'Sovereign investor models: Institutions and policies for managing sovereign wealth' (2015) Joint report by the Center for International Development Harvard Kennedy School and the Belfer Center for Science and International Affairs, Harvard Kennedy School, 8 <https://projects.iq.harvard.edu/files/sovereignwealth/files/investor_models_final.pdf> Accessed 20th January 2018.

[576] Simon Clark 'Saudi Wealth Fund May Be World's Least Transparent' WSJ (1 November 2016) <https://www.wsj.com/articles/saudi-wealth-fund-may-be-worlds-least-transparent-1477997912> Accessed 20th May 2018.

[577] Ibid.

[578] Ibid.

[579] Chris Wright 'Scoring the Santiago Principles as they turn 10' Euro Money (8 October 2018) <https://www.euromoney.com/article/b1b950f21d36bd/scoring-the-santiago-principles-as-they-turn-10> Accessed 20th November 2018.

[580] Ibid.

In addition, the Fund discloses monthly reports detailing its returns and performance.[581] The fund appears to pursue such an approach due to entrenched democratic and normative standards which view information disclosure as the explicit representation of the constitutional relationship between citizens and the state.[582] This is reflected in a statement by the former Norwegian Finance Minister Kristen Halvorsen who once observed:

> 'We believe transparency is a key tool in building trust. Domestically, it helps build public support and trust in the management of Norway's petroleum wealth. Openness about the fund's management can contribute to stable financial markets and exert a disciplinary pressure on managers.'[583]

The varieties of practices amongst SWFs with regards to transparency which has been analysed above remain a matter of continued controversy. The same informational disparity inspired the Self-Regulatory norms at the heart of this thesis – the Santiago Principles. Yet, the levels of transparency amongst SWFs remains fragmented since the promulgation of these norms. As one commentator recently observed:

> 'In truth, transparency varies dramatically in the sovereign wealth world: there is just no comparison between Norges Bank and the Qatar Investment Authority (QIA) in terms of disclosure.'[584]

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[581] Ibid.

[582] Afshin Mehrpouya 'Sovereign Wealth Funds, The IMF and Transparency: Are they all talking the same thing?', 42 (2013) <www.hec.edu/heccontent/download/8396/185943/version/.../CR+963+Mehrpouya.pdf> Accessed 20th May 2018.

[583] Kristin Halvorsen 'Norway's sovereign fund sets an ethical example' Financial Times (14 February 2008) <https://www.ft.com/content/2657f7a6-db20-11dc-9fdd-0000779fd2ac> Accessed 20th May 2018.

[584] Ibid.

3.5.5 Competition-related Concerns and Economic Subsidisation

As state funded investment vehicles, SWFs are also prone to the charge that their activities stand in sharp contrast to the idea of a free market economy based on an arms-length relationship between private providers of capital and regulators or government.[585] Indeed, it is often remarked that SWFs compromise this binary distinction through their status as the investment arms of sovereign states. Based on the above, certain commentators posit that SWFs may pose significant risks to the free market ideals of market competition based and a level playing field amongst market operators.

Among the competition-related concerns is the idea that SWFs unlike private-sector competitors enjoy forms of concessionary or preferential financing and forms of state guarantees that hands them undue and often superlative advantages over private sector challengers in the competition for investment and market opportunities.[586] With such advantages, it is said that SWFs may be able to purchase the most appealing financial assets without folding up or relying on forms of leverage as their private sector competitors.[587]

Another argument put forward in this sphere is that SWFs may utilise their proximity to owner states and Central Banks to obtain asymmetric informational advantages, not readily available to private market operators and to exploit such advantage in their investments.[588] For example, Rose argues that a SWF may obtain inside information from agencies and regulators linked to its owner state about impending action against a portfolio company, allowing it to divest

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[585] Steffan Kern 'Sovereign wealth Funds – State Investments on the Rise' (2007) Deutsche Bank Research Paper, 13 <https://leblog-boursier.typepad.com/leblogboursier/files/fonds_dinvestissement_detat.pdf> Accessed 20th May 2018.

[586] Antonio Capobianco and Hans Christiansen 'Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options' (2011),6 <https://www.oecd-ilibrary.org/governance/competitive-neutrality-and-state-owned-enterprises_5kg9xfgjdhg6-en> Accessed 23 January 2019.

[587] Ibid.

[588] Paul Rose 'Sovereigns as Shareholders' (2008) 87 North Carolina Law Review 83, 97.

from the company in advance of the public disclosure of such information.[589] It is also argued that SWFs may obtain secret financial information from its country's intelligence or other regulatory agencies such as its Central Bank which enables it to take advantage of favourable market conditions.[590]

Allied to the above is the concern is that SWFs may be accorded preferential treatment by target countries such as tax breaks and sovereign immunity from lawsuits which are not ordinarily available to comparable private market operators.[591] Such exemptions are not necessarily based on better performance, superior efficiency, better technology or superior management skills but are merely government-created and can distort competition in the market against private sector organisations whose tax liabilities may be considerably larger than the SWF and who may not be immune from lawsuits occasioned by their commercial activity.[592]

Relatedly, some commentators argue that it may prove difficult to enforce the laws of a host state against a foreign SWF, especially if such enforcement involves the cooperation of the owner state of the fund.[593] In this regard, government ownership becomes a shield that insulates SWFs from adverse enforcement action from foreign authorities.[594] This is a competition related concern since other private competitors are not availed similar privileges.

In the addition to the above, critics also argue that SWFs may also confer anti-competitive advantages to portfolio companies and other State-Owned Enterprises vis a vis other private sector

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589 Ibid.

590 Ibid.

591 Ibid. See also: Jennifer Bird-Pollan 'The Unjustified Subsidy: Sovereign Wealth Fund and the Foreign Sovereign Tax Exemption' (2012) 17 Fordham Journal of Corporate and Financial Law 987.

592 Capobianco op cit at 5.

593 Ibid.

594 Christopher Cox, Chairman US Securities and Exchange Commission (SEC) 'The Role of Government in Markets' (Keynote Address and Robert R. Glauber Lecture at the John F. Kennedy School of Government) <https://www.sec.gov/news/speech/2007/spch102407cc.htm> Accessed 20th October 2018.

competitors through the means of hidden subsidies.[595] This hidden aid can take several forms, including the provision of loans or equity capital at advantageous conditions, co-investments, or even the outright subsidisation of acquisitions or investments by State-Owned entities or portfolio companies.[596] This creates a magic circle of firms that are able to carve out a dominant role in the domestic economy and in export markets.[597]

A cautionary example of the above can be seen in the European Commission's investigation of possible violations of EU State Aid rules by the French Strategic Development Fund, Fonds Stratégique d'Investissement through the fund's investments in national automobile champions.[598] Although the Commission's inquiry returned a negative finding, the existence of the investigation and the conditions of the fund's investments in the French Automobile Sector, puts a spotlight on the probable risk that SWFs may provide hidden subsidies to portfolio companies in ways that are potentially distortive to competitive markets.[599]

Having considered the main concerns associated with SWFs, it has become imperative to examine the national regulatory responses that have arisen partly in response to the increasing assertiveness of SWFs in overseas capital markets. This analysis lays the groundwork for a consideration of the Santiago Principles in the next chapter which emerged out the collision of rising international activity by SWFs, the corresponding concerns of hosts states to this rise and the national regulatory responses enacted by target countries in response to these concerns. Whilst jurisdictions such as Germany, France, Canada and Italy have all enacted regulatory measures in

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[595] Pierre-Ignace Bernard and Jean-Christophe Mieszala 'The Role of Sovereign Wealth Funds' (2009) 9 Revue d'Économie Financière 223.

[596] Ibid.

[597] Ian Bremmer 'State Capitalism Comes of Age: The End of the Free Market?' (2009) 88(3) Foreign Affairs 40, 43.

[598] European Commission Decision of 20 April 2011 on Suspected Aid to the Company Trèves C 4/10 (ex NN 64/09) Implemented by the French Republic, [2011] OJ C 133.

[599] Regis Bismuth, 'The Santiago Principles for Sovereign Wealth Funds: The Shortcomings and the Futility of self-regulation' (2017) 28(1) EBLR 69, 73.

response to the rise of SWFs, the responses in United States and Australia who coincidentally are the two major recipients of SWF capital as per Figure 12 merit particular attention and are analysed in the following section. [600]

3.6 Selected Cases of National Investment Regulations applying to SWFs

Since SWF investments first came to public attention in the latter part of the last decade, fears (analysed in the preceding section) have been raised in their hosts – mostly developed countries – that the government owners of SWFs would seek to use them as a political tool, purchasing strategically important assets to undermine the economies of their hosts.[601] This has led to a 'regulatory avalanche' of sorts, aimed at subjecting investments by SWFs to inward screening processes aimed at sourcing out potential security risks.[602]

The policies in question which were, for the most part, introduced or refined in the mid to late-2000s, in response to the increasing assertiveness of SWFs and other forms of State-Directed FDI, are a key part of the vicious circle of sorts that led to the promulgation of the Santiago Principles and the establishment of the IFSWF.[603] These regulations therefore merit examination if one is to understand the broader regulatory and policy environment that faced and still face SWFs and which crucially inspired the search for broader, multilateral rules now reflected in the Santiago Regime – the subject matter of this thesis.

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[600] David Marchick and Matthew Slaughter, 'Global FDI Policy: Correcting a Protectionist Drift' (2008) Council on Foreign Relations Report No 34, 1 <http://www.cfr.org/foreign-direct-investment/global-fdi-policy/p16503> Accessed 20th May 2016

[601] Ibid. See also: Victoria Barbary and Bernardo Bortolotti 'Sovereign Wealth Funds and Political Risk: New Challenges in the Regulation of Foreign Investment' in Zdenek Drabek and Petros Mavroidis (eds) *Regulation of Foreign Investment: Challenges to International Harmonization* (World Scientific Studies in International Economics, Volume 21, 2013) 318.

[602] Ibid.

[603] Ibid. at 2.

In the interests of clarity and specificity, this thesis investigates the regulatory responses in two jurisdictions – the United States and Australia which are among the popular destinations for SWF investments as reflected in figure 12. Both jurisdictions also merit attention owing to the relative ease of access to regulatory information which will be used in analysing the scope and reach of these policy measures.

3.6.1 United States

The United States operates what Mark Clodfelter and Francesca Guerrero have described as a targeted transactions approach to FDI regulation.[604] This is woven around an evolutionary patchwork of institutional and legislative provisions. At the core of the US regime is a relatively obscure body known as the CFIUS – a committee of government departments created by a 1975 Executive Order issued by President Gerald Ford to screen inward FDI into the US.[605]

The emergence of the CFIUS by way of the 1975 executive order laid the groundwork for a later 1988 Amendment to the Defense Production Act 1950 which empowered the President of the United to restrict foreign inward investments that are deemed to be of peril to the National Security of the United States, on the recommendation of the CFIUS.[606]

Since the last decade, the CFIUS Process has undergone significant reform partly in response to changing national security risks since the harrowing events of September 2001 and the increasing assertiveness of foreign government-controlled entities such as SWFs in the

[604] Mark Clodfelter& Francesca Guerrero, 'National Security and Foreign Government Ownership Restrictions on Foreign Investment: Predictability for Investors at the National Level', in WPF Schmit Jongbloed, L Sachs and K Sauvant,(eds) *Sovereign Investment: Concerns and Policy Reactions*(1st edn, OUP 2012) 178.

[605] The Committee has often been criticised for its vast powers and its secrecy hence the use of the word 'obscure'. See: Alan P. Larson & David M. Marchick, 'Foreign Investment and National Security' (2006), 16. For composition of the Committee See: James K. Jackson, 'The Committee on Foreign Investment in the United States (CFIUS)' (2018) Congressional Research Service Report 7-5700, 14 <https://fas.org/sgp/crs/natsec/RL33388.pdf> Accessed 20th August 2018.

[606] Ibid.

international marketplace.[607] This culminated in the enactment of the Foreign Investment and National Security Act 2007 (FINSA) and more recently, the Foreign Investment Risk Review Modernization Act 2018(FIRRMA). Both statutes have, to varying degrees, introduced tighter regulatory requirements which affect, in principle, the inward investments of SWFs.[608]

CFIUS jurisdiction over foreign inward investments is painfully wide and typically depends on whether a proposed investment by a SWF or any other foreign party is a 'covered transaction.' Under the Foreign Investment and National Security Act 2007 (FINSA), this has the unassuming definition of 'any transaction that is proposed . . . by or with any foreign person, which could result in 'control' of a U.S. business by a foreign person.'[609]

'Control' is also defined loosely under the FINSA and may be surmised as the power, direct or indirect, whether or not exercised, to determine, direct, or decide important issues affecting a concerned entity.[610]

The CFIUS itself tended to interpret the notion of 'control' very broadly such that minority voting interests in the range of ten percent of a company's total share capital may be considered controlling, especially when fused with other rights or relationships in the investee company.[611] This practice is now reflected in the recent Foreign Investment Risk Review Modernization Act

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[607] David Marchick and Matthew Slaughter, 'Global FDI Policy: Correcting a Protectionist Drift' (2008) Council on Foreign Relations Report No 34, 5 <http://www.cfr.org/foreign-direct-investment/global-fdi-policy/p16503> Accessed 20th May 2016. See Also: Jonathan Wakely and Andrew Indorf 'Managing National Security Risk in an Open Economy: Reforming the Committee in Foreign Investment in the United States' (2018) 9 Harvard National Security Journal 1, 36.

[608] Ibid. see also: James Jackson 'CFIUS Reform: Foreign Investment National Security Reviews' (August 2018) Congressional Research Service Report 7-5700, 1 <https://fas.org/sgp/crs/natsec/IF10952.pdf> Accessed 20th October 2018. See further: US Treasury, 'FIRRMA FAQs' (2018) <https://www.treasury.gov/resource-center/international/Documents/FIRRMA-FAQs.pdf> Accessed 20th November 2018.

[609] Paul Rose 'US Regulation of Investment by State-Controlled Entities' (2016) 31(1) ICSID Review 77, 80.

[610] Ibid.

[611] Jonathan Wakely and Lindsay Windsor 'Ralls on Demand: US Investment Policy and the Scope of CFIUS' Authority (2014) 48(2) *International Lawyer* 105

2018 (FIRRMA) which further expands the notion of control, meaning that the CFIUS could, in principle, scrutinise non-controlling, non-passive transactions in U.S firms involved in critical technology or other sensitive sectors that are deemed to be of significant risk to the National Security of the United States.[612] This presumably means that a SWF or any other foreign investor now looking to acquire below 10 percent of a US Company involved in the critical technology or sensitive sector may find its investment subject to a review by the CFIUS.

The CFIUS process normally begins with the voluntary filing, by a transacting party such as a foreign SWF of any proposed transaction which putatively falls within the notion of a covered transaction as defined above.[613] In the absence of a voluntary filing, the CFIUS can also instigate a review on its volition if it considers a proposed investment to be potentially injurious to the National Security of the United States.[614] More recently however, covered transactions (as defined above) by foreign SOEs and SWFs have become subject to a Mandatory declaration Process by virtue of the Foreign Investment Risk Review Modernisation Act 2018 (FIRRMA). Accordingly, SWFs and other foreign government-controlled entities engaging in covered investments are obliged to notify the CFIUS of their proposed investments. This appears to have been designed to provide the CFIUS with more oversight of transactions involving foreign government owned investors.[615]

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[612] Paul Rose 'FIRRMA and National Security' (2018) Ohio State University Moritz College of Law Public Law and Legal Theory Working Paper Series No. 452, 14 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3235564> Accessed 20th November 2018.

[613] See: Squire Patten Boggs, 'Understanding the Impacts of CFIUS Reform and Emerging Technologies' (2018) <https://www.squirepattonboggs.com/en/insights/publications/2018/08/understanding-the-impacts-of-cfius-reform-and-emerging-technologies> Accessed 20th October 2018.

[614] Jonathan Wakely and Andrew Indorf 'Managing National Security Risk in an Open Economy: Reforming the Committee in Foreign Investment in the United States (2018) 9 Harvard National Security Journal 1, 8.

[615] Paul Rose 'FIRRMA and National Security' (2018) Ohio State University Moritz College of Law Public Law and Legal Theory Working Paper Series No. 452, 15 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3235564> Accessed 20th November 2018.

When triggering the CFIUS review process, parties are obliged to furnish the Committee with relevant information regarding the foreign acquirer, the target Business and any other information with respect to the proposed transaction.[616] Upon receipt of this information, the Committee is obliged by law to conduct a thorough 30-day review during which it evaluates the National Security Risks associated with the proposed Transaction.[617] The FIRRMA further extends this review period by 15 days, bringing the initial review period to a total of 45 days.

If at the end of this review, the CFIUS determines that there are no unresolved threats to the National Security of the United States, it may authorise the parties to complete the transaction. If, however, the Committee determines that a proposed transaction is potentially injurious to the National Security of the United States, the FIRRMA authorises the CFIUS to conduct a further 45-day investigation.[618]

In practice, the CFIUS treats each proposed transaction on its merit and conducts a thorough 'national security' assessment. What constitutes 'National Security' is not defined either in the FINSA 2007 or the FIRRMA.[619] Yet, in practice, the Committee is obliged to consider a broad range of factors in conducting such an assessment. This includes the effect of the proposed transaction on domestic production for national defence needs, the effect of the transaction on the sale and control of military or other sensitive technologies, the effect of the transaction on

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[616] Ibid.

[617] This has now been increased in the FIRRMA to 45 days with the option of a fifteen day extension see: Paul Rose 'FIRRMA and National Security' (2018) Ohio State University Moritz College of Law Public Law and Legal Theory Working Paper Series No. 452, 14 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3235564> Accessed 20th November 2018.

[618] Ronald A Oleynik, Antonia I. Tzinova, Seth M.M. Stodder and Libby Bloxom 'FIRRMA Expands CFIUS Jurisdiction in 2 Major Ways' *Lexology* (16 August 2018) <https://www.lexology.com/library/detail.aspx?g=bb4dfd6a-0288-4f91-a174-aacb402914bb> Accessed 20th October 2018.

[619] Ibid.

critical infrastructure and energy assets and, whether the transaction involves a foreign government entity such as a SWF.[620]

The FIRRMA appears to toughen this list of considerations and now requires the CFIUS to consider, amongst other things, whether a covered transaction involves a country of special concern that has a demonstrated or declared strategic goal of acquiring a type of critical technology or critical infrastructure that would affect United States leadership in areas related to national security.[621] The above has been interpreted as a response to recent acquisitions by Chinese private companies, SOEs and SWFs of technology and critical infrastructure assets in the United States some.[622]

If in the course of conducting the National Security assessment, the CFIUS concludes that concerns surrounding a proposed or pending transaction persist, the Committee possesses a broad jurisdiction to take remedial action to protect the national security of the United States. It may, for instance, issue mitigation agreements which the transacting parties must implement.

These agreements have typically required foreign acquirers to sequester data, ensure that only US citizens handle certain products or services, notify the CFIUS of visits by foreign nationals to sensitive facilities and provide the committee with the right to review, and possibly veto, certain business decisions if they raise potential national security concerns.[623] Conversely, the committee, upon a finding of national security risks, may recommend to the President of the United States that the investment be prohibited or blocked.

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[620] Paul Rose 'US Regulation of Investment by State-Controlled Entities' (2016) 31(1) ICSID Review 77, 80

[621] Paul Rose 'FIRRMA and National Security' (2018) Ohio State University Moritz College of Law Public Law and Legal Theory Working Paper Series No. 452, 11 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3235564> Accessed 20th November 2018.

[622] Ibid. at 12.

[623] Ibid.

Although SWFs as a group have yet to attract major controversies through their activities in the US, other state-controlled entities have often courted controversy. Amongst the high-profile incidents was the proposed acquisition of Unocal, a prominent US energy producer by the government-controlled China National Oil Corporation (CNOOC) in 2005. The principal concern over the CNOOC transaction was that Unocal produced over 150,000 barrels of oil per day, of which 70,000 came from oil wells in the United States and 80,000 from wells in Asia.[624] CNOOC's bid also meant the potential transfer of Unocal's key energy production and distribution facilities in the United States and beyond.[625] Critics of the deal argued that the transfer of such a strategic asset to Chinese hands could undermine future US energy security and thus constituted a national security risk.[626] This fuelled significant Congressional uproar including a threat in Congress to respond forcefully to future Chinese led transactions which ultimately forced the Chinese SOE to abandon the transaction altogether.

3.6.2 Australia

Like the United States, Australia is another premier destination for SWF investment. As Figure 12 shows, Australia was the 3rd largest destination for SWF investment in 2016 attracting over $3.6 billion of SWF investments.[627] Yet, Australia also stands alongside the United States in the league of nations that have enacted regulatory measures in response to increasing inward investment by foreign SWFs.

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[624] Theodore Moran, 'Chinese Investment and CFIUS: Time for an updated and revised perspective' (2015) Peterson Institute of International Economics- Policy Brief No 15-17, 2 <https://www.piie.com/publications/pb/pb15-17.pdf> Accessed 12th February 2016.

[625] Ibid.

[626] Ibid.

[627] Esade Business School 'Sovereign Wealth Funds 2017 Report' (2017), 58 <http://www.investinspain.org/invest/wcm/idc/groups/public/documents/documento/mde4/nzc5/~edisp/doc2018779750.pdf > Accessed 20th January 2018.

Like the US, its regulatory regime is woven around a number of statutory provisions including notably the Foreign Acquisitions and Takeovers Act 1975 (FATA) and Foreign Acquisitions and Takeovers Regulations 2015 (FATR).[628]

These legislative instruments are also supplemented by the Australian Government's Foreign Investment Policy (AFIP), a document published by the Treasury on a yearly basis that sets forth the government's approach to administering the FDI framework and which provides guidance about the evaluation of inward FDI proposals.[629]

Amongst the regulations outlined above, the most prominent is the Foreign Acquisitions and Takeover Act (FATA), enacted in 1975 in response to rising Japanese investments in Australian Industry which sparked concerns that 'Australia was being sold off to the Japanese.'[630]

The FATA amongst other things empowers the Australian Treasurer to examine proposals by foreign persons (including corporations and trustees) to acquire: (i) a "substantial interest" or a controlling interest in an Australian corporation over a certain value; or (ii) an interest in Australian "urban land."[631] Assisting the treasurer in this crucial task is the Foreign Investment Review Board (FIRB), a non-statutory, advisory body similar to the CFIUS which undertakes the scrutiny of Individual investments into Australia to ascertain whether such influx corresponds to a controversial and largely undefined notion of 'national interest.'[632]

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[628] Carlos Esplugues, *Foreign Investment, Strategic Assets and National Security* (Intersentia, 2018) 358.

[629] The Treasurer 'Australia's Foreign Investment Policy: Our Approach' (January 2018) <https://cdn.tspace.gov.au/uploads/sites/82/2017/06/Australias-Foreign-Investment-Policy.pdf> Accessed 20th May 2018.

[630] Megan Bowman, George Gilligan, and Justin O'Brien 'Foreign Investment Law and Policy in Australia : A Critical Analysis' (2014) 8(1) Law and Financial Markets Review 65.

[631] Ibid.

[632] Ibid. see also: Rebecca Mendelsohn and Allan Fels 'Australia's foreign investment review board and the regulation of Chinese investment' (2014) 7(1) China Economic Journal 59, 61.

As highlighted above, the Treasurer's jurisdiction over an inward investment typically begins if the proposed transaction entails the acquisition of a 'substantial' or 'controlling interest' over an Australian Corporation.[633] What constitutes a 'substantial' or 'controlling interest' depends on whether the acquirer is a government controlled investor such as a SWF or a non-government controlled investor.[634]

In the case of the former, any investment of at least 10 percent or which grants a foreign government entity control of an Australian Corporation is potentially reviewable by the Treasurer.[635] By contrast, investments by private, non-governmental entities are only reviewable when they are above the 20 percent threshold.[636] This suggests a considerably tighter regulatory regime for investors of a Sovereign character much like the US approach investigated above – a move which reflects the broader shift in several recipient states in response to the potential risks posed by state-controlled investment vehicles such as SWFs.

In addition to the above, the treasurer, through the FIRB, is obliged to consider individual investment proposals including by SWFs against a broad notion of the Australian 'National Interest.' Although largely undefined, the notion of 'National Interest' has been clarified through additional guidance published by the FIRB and the Australian government.

A cursory glance at these documents suggests that the idea of National Interest is interpreted broadly to include: National Security, competition, the impact of a foreign investment proposal on Australian tax revenues, the impact of the investment on the general economy and

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633 Ibid.

634 Section 17 of the Foreign Acquisitions and Takeovers Regulation 2015.

635 The Treasurer 'Australia's Foreign Investment Policy: Our Approach' (January 2018), 5 <https://cdn.tspace.gov.au/uploads/sites/82/2017/06/Australias-Foreign-Investment-Policy.pdf> Accessed 20th May 2018.

636 Ibid. at 3.

the Character of the acquirer.[637] Each of the factors mentioned above are also subject to further bureaucratic checks aimed at ascertaining the potential impacts of a proposed investment.

For instance, in the case of National Security, the Australian Government considers the extent to which proposed investments may affect Australia's ability to protect its strategic and security interests. To this end, the Government relies on advice from the relevant national security agencies for assessments as to whether an investment raises national security issues.[638]

In addition to the National Interest test, the FIRB further subjects inward investments by foreign government-controlled entities such as SWFs to even tougher entry standards.[639] Under these standards, the FIRB considers whether a proposed investment by a foreign government investor is commercial in nature or if the investor may be pursuing broader political or strategic objectives that may be contrary to Australia's national interest.[640] The FIRB also considers whether the prospective investor's governance arrangements could facilitate actual or potential control by a foreign government including through the investor's funding arrangements.[641] To put things in perspective, an investment by a foreign SWF that is adjudged by the FIRB and the Treasurer to be dangerously close to its owner state may be truncated on the basis of these proposals.[642]

Although SWFs have largely escaped reprisals for their investments in Australia, other state-owned entities haven't always emerged unscathed. Amongst the high-profile controversies is

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637 The Treasurer 'Australia's Foreign Investment Policy: Our Approach' (January 2018) 8-9 <https://cdn.tspace.gov.au/uploads/sites/82/2017/06/Australias-Foreign-Investment-Policy.pdf> Accessed 20th May 2018.

638 Ibid. at 8.

639 Rebecca Mendelsohn and Allan Fels 'Australia's foreign investment review board and the regulation of Chinese investment' (2014) 7(1) China Economic Journal 59, 61.

640 The Treasurer 'Australia's Foreign Investment Policy: Our Approach' (January 2018) 10 <https://cdn.tspace.gov.au/uploads/sites/82/2017/06/Australias-Foreign-Investment-Policy.pdf> Accessed 20th May 2018.

641 Ibid.

642 Carlos Esplugues, *Foreign Investment, Strategic Assets and National Security* (Intersentia, 2018) 370-371.

the botched acquisition of the multinational miner, Rio Tinto by a Chinese SOE, Chinalco in 2009 which was annulled in the wake of a backlash to the investment in the Australian Press and Parliament.[643]

From the two jurisdictions studied above, it can be discerned that foreign investment decisions by state-controlled entities such as SWFs are matters of considerable concern for the host states where these investments are located. To this end, these states have, to varying degrees, enacted inward FDI regulations which can be construed as considerably onerous for investors of a sovereign character in comparison to private transnational investors.

Host states like Australia and the United States have often justified these measures by emphasising the nexus between these entities and their owner governments many of whom are perceived to harbour geopolitical interests which may be inimical to the interests of the host states where these investments are located.[644]

Although this thesis does not address the proportionality of these measures, it instead recognises the agelong principle that a sovereign state is the ultimate arbiter of its security interests.[645] Notwithstanding the above, a consideration of these regulations – which were either introduced or strengthened in the mid to late 2000s – when SWFs and other State-controlled entities came to prominence – was deemed necessary to facilitate the reader's navigation of the political and regulatory environment faced by SWFs, which inspired the search for broader multilateral rules to prevent a further protectionist slide in the countries that receive the

[643] Rebecca Mendelsohn and Allan Fels 'Australia's foreign investment review board and the regulation of Chinese investment' (2014) 7(1) China Economic Journal 59, 69.

[644] Paul Rose 'US Regulation of Investment by State-Controlled Entities' (2016) 31(1) ICSID Review 77, 81

[645] United Nations Conference on Trade and Development 'The Protection of National Security in IIAs: UNCTAD Series on International Investment Policies for Development' (2009), 22 <https://unctad.org/en/Docs/diaeia20085_en.pdf> Accessed 20th September 2016. See also: Carlos Esplugues, Foreign Investment, Strategic assets and National Security (Intersentia, 2018) 27.

investments of these funds. These rules now reflected in the Santiago principles are the mainstay of this thesis and are thoroughly investigated in the following chapter.

3.7 Conclusion

This chapter set out to evaluate the nature and characteristics of SWFs. It began with an analysis of the origin of these funds, revealing a disputed but ancient existence. Also established was the lack of consensus on a definition. To resolve the definitional quandary, the section adopted the Santiago Principles definition as the applicable definition throughout the thesis.

The second section examined the taxonomy of SWFs. Here, the heterogeneity of these entities is again observed, showing linkages between SWFs and national policy priorities of their owner states such as budget stabilisation, savings, wealth transfer, the smoothening of central bank revenues and the settlement of unspecified pension liabilities.

To further demystify SWFs, the following section investigated their investment behaviour, strategies and patterns. In particular, the section analysed hard data on the investments of SWFs, their asset classes and target countries.

This was followed by a thorough examination of the concerns of various constituencies towards SWFs. From the standpoint of investment recipient countries, the concerns over national security, financial stability, transparency, non-independence and economic subsidisation stand out.

The following section considered the policy responses to the above concerns raised by SWFs which helps us in understanding the wider policy terrain that inspired the rise of a multilateral self-regulatory regime for these funds. In the interests of specificity and clarity, the policies of the United States and Australia – two attractive destinations for SWF investments were considered. The examination of these FDI systems reveals a set of policy reactions that are potentially onerous to a wider pool of sovereign capital, including SWFs. This lays the groundwork for a study of the

self-regulatory framework for SWFs, reflected in the Santiago Principles which is undertaken in the next chapter.

CHAPTER 4: THE BIRTH OF THE SANTIAGO PRINCIPLES AND THE ACCIDENTAL RISE OF SELF-REGULATION.

4.1 Introduction

As the preceding chapter makes clear, SWFs rose to the apex of the policy-making agenda in the mid-2000s. Underlying this rise was severe anxiety in host countries like the United States about the potential effects of these funds on National Security. This sparked corresponding responses in several host countries of SWFs from which an attempt arose to subject these funds to broader multilateral rules. This Chapter examines the moves from the recipients of SWF investments to subject these entities to governance standards and the Birth of Self-Regulation by the funds themselves through the promulgation of the Santiago Principles.

It pursues this aim in 3 sections. The first section explores the pre-negotiation atmosphere which was dominated by severe anxiety in host countries about the motives of these funds. This section also traces the search for SWF standards from the national policy arena in the United States to the transnational space, examining in particular, the roles of the US treasury, the G7 and G20 and international financial institutions like the International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD) in setting the boundaries for SWF standards.

The second section investigates the actual negotiations for SWF standards and the rise of Self-Regulation by SWFs. Under scrutiny is the role of the IMF after it was instructed by the G7 to lead the Standard setting process. The section also examines the IMF's work, including the convening of an ad-hoc group of SWFs – the international working group of SWFs (hereinafter IWG) - from 26 countries to assist the drafting process. The work of this grouping of SWFs merits attention not only because it negotiated the final draft of the principles but also because the IWG later metamorphosed into what we now know as the IFSWF today.

In analysing the negotiations, the section reveals the several flashpoints which began with a vehement protest from SWFs against IMF leadership of the drafting process. The severity of the protests by SWFs prompted a shift from IMF dominancy to organic self-regulation amongst sovereign funds– a concept at the core of this thesis and which has informed the research question. This shift to a more voluntary or self-regulatory institutional arrangement led to an agreement of sorts on a set of principles and practices now known as the Generally Accepted Principles and Practices for SWFs (GAPP in short) or the Santiago Principles, which for the most part reflects the ideological preferences of its authors – SWFs.

Having explored the historical background of the Principles, the third section begins the test for effectiveness by examining its nature and substance. Under particular scrutiny are the most substantive recommendations of the document relating to Governance and Operational Independence, Transparency, Political Investments and Competition which also reflects the main concerns ascribed to SWFs. The inquiry here is on the comprehensiveness and ambition of these measures (both tests for normative effectiveness as advanced in Chapter 2). To aid the later objective, the selected principles are compared to similar benchmarks such as the OECD Principles of Corporate Governance, the OECD Guidelines for State-Owned Enterprises and the IMF's Guidelines for Good Reserve Management. These standards have been chosen given their status as recognised benchmarks for Institutional Investors of a similar nature to Sovereign Wealth Funds. The section also investigates the provisions on monitoring in the principles. This allows for a full and pragmatic inquiry into the GAPP's normative effectiveness.

4.2 Setting the Boundaries for SWF Standards

As noted above, regulatory concerns about state-capitalist vehicles – a group which includes SWFs – emerged in the late 2000s in the aftermath of the CNOOC and the Dubai Ports World controversies in the United States.[646] What began as a concern about the renaissance of internationally active State-Owned Enterprises, slowly morphed into a growing realization of the existence of a comparatively similar but probably more sophisticated genus of State-Owned investment vehicles – SWFs.[647]

These concerns rose to the forefront of the policy-making agenda on the announcement in late 2007, of the proposed formation of the Chinese and Russian SWFs, which were both viewed with deep suspicion on both sides of the Atlantic.[648] In addition to this, domestic policymakers also began to fully appreciate the fact that SWFs had been slowly acquiring significant assets across much of the developed world and were beginning to represent a progressively significant (although not systemic) component of international capital markets.[649]

In a rather paradoxical fashion, officials in the United States Government also began to generate heightened investment interest in these entities, partly for the self-interested purpose of securing badly needed financing for ailing US financial institutions during the tremors of the Global Economic Crisis.[650] Yet, this strange, positive sentiment towards SWFs in US executive

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[646] For a broader take, see: Benjamin J. Cohen 'Sovereign Wealth Funds and National Security: The Great Trade-off' (2009) 85(4) International Affairs 713, 721-722.

[647] Joseph J. Norton 'The 'Santiago Principles' For Sovereign Wealth Funds: A Case Study on International Financial Standard-setting Processes' (2010) 13(3) Journal of International Economic Law 645, 649

[648] Joseph J. Norton 'The 'Santiago Principles' For Sovereign Wealth Funds: A Case Study on International Financial Standard-setting Processes' (2010) 13(3) Journal of International Economic Law 645, 649.

[649] Joseph Norton , 'The "Santiago Principles" and the International Forum of Sovereign Wealth Funds: Evolving Components of the New Bretton Woods II Post-Global Financial Crisis Architecture and Another example of Ad Hoc Global Administrative Networking and Related "soft" Rulemaking ?' [2010] 29 Review of Banking & Financial Law 465

[650] Regis Bismuth, 'The Santiago Principles for Sovereign Wealth Funds: The Shortcomings and the Futility of Self-regulation' (2017) 28(1) EBLR 69, 72.

circles was enmeshed alongside familiar, corresponding concerns, particularly in the US Congress over the possible geopolitical, foreign investment and national security risks that a fund could bring – some of which has been explained above –. [651]

The intersection or some might say collision of the rise of these entities and host country concerns provoked a slew of legislative reforms across much of the developed world aimed at subjecting their investments to screening measures (investigated in the preceding chapter). The speed and scale of these measures also prompted a growing realisation in US executive circles, particularly in the US Treasury, about the risks of a wider protectionist backlash across the developed world in response to these funds.[652]

For Treasury officials, the cross-border operations of SWFs, the rising tremors of the financial crisis and the prevailing commitment to foreign investment meant that unilateral responses to these entities were potentially inadequate, if not counterproductive.[653] This was perfectly summarised in a June 2007 speech by the then Assistant Secretary-General of the US Treasury, Clay Lowery who argued that: 'The risk is that, over the medium term, the size, investment policies, and/or operating methods of these funds fuel financial protectionism.'[654]

Against this background, US Treasury officials began concerted efforts, via multilateral bodies like the G7, OECD and IMF, to build a consensus for a global standard or code that would infuse certain market governance traits on governance, transparency and accountability into

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[651] Ibid. at 75.

[652] US Treasury 'Remarks by Acting under Secretary for International Affairs Clay Lowery on Sovereign Wealth Funds and the International Financial System' (21 June 2007) <https://www.treasury.gov/press-center/press-releases/Pages/hp471.aspx> Accessed 30 May 2018.

[653] Robert Kimmitt, 'Public Footprints in Private Markets' *foreign Affairs* (January 2008) <https://www.foreignaffairs.com/articles/2008-01-01/public-footprints-private-markets> accessed 6th April 2017

[654] US Treasury 'Remarks by Acting under Secretary for International Affairs Clay Lowery on Sovereign Wealth Funds and the International Financial System' (21 June 2007) <https://www.treasury.gov/press-center/press-releases/Pages/hp471.aspx> Accessed 30 May 2018.

institutions of an inherently sovereign nature as a bulwark against a wider protectionist backlash. The pathway to what is now prosaically known as the Santiago Principles involved a whistle stop tour of sorts which started at the US Treasury.[655] This multi-track journey will be investigated in turn.

4.2.1 US Treasury

As noted above, the increasing number and projected size of SWFs had pushed these entities to the forefront of the international financial agenda, to the attention of research institutes and the academia, the private sector, and latterly to the attention of the U.S. Treasury.[656]

The initial impulse of the Treasury was one of circumspection given the deep pockets of SWFs, their attachment to states with dubious foreign policy agendas and their vast international focus.[657] Alongside this sense of caution was a dose of pragmatism that SWFs had the potential to augment the ailing capital buffers of systematically important financial institutions in the United States many of which were in the throes of a liquidity crisis precipitated by the collapse of prominent financial services firms among others.[658] Amid this shift in understanding, SWFs were fast growing as a polarising issue in the US Congress which had mooted ideas about strengthening US FDI regulations – an idea which eventually culminated in the Foreign Investment and National Security Act 2007 – a statute that subjected SWFs and other state capitalist vehicles to tighter regulatory scrutiny.

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[655] US Department of Treasury, *'Under Secretary for International Affairs David H McCormick Testimony Before the House Committee on Financial Services'* (3 May 2008) <https://www.treasury.gov/press-center/press-releases/Pages/hp861.aspx> accessed 6 April 2017

[656] Joseph Norton , 'The "Santiago Principles" and the International Forum of Sovereign Wealth Funds: Evolving Components of the New Bretton Woods II Post-Global Financial Crisis Architecture and Another example of Ad Hoc Global Administrative Networking and Related "soft" Rulemaking ?' [2010] 29 Review of Banking & Financial Law 465, 467.

[657] Ibid.

[658] Ibid.

The emergent asymmetry between the US Congress and a pro-investment US Treasury prompted the former to initiate an international policy campaign aimed at building the groundwork for a set of ambitious standards on the transparency and accountability for SWFs.[659] To this end, the treasury sought to escalate the issue of SWFs to the transnational policy fora in which it participated and often led, beginning with the Group of 7 countries (G7).

4.2.2 Multilateral policy track

At the G7, US Treasury Officials, in particular the then Treasury Secretary Hank Paulson tabled the issue of SWFs at the network gathering of G7 Finance Ministers and the International Monetary and Financial Committee (IMFC) in October 19th 2007.[660] At this meeting, the G7 finance ministers and the IMFC agreed that SWFs were increasingly important participants in the global financial system and that the global economy could benefit from openness to SWF investment flows.[661] This positive statement was however overshadowed by an admission by the G7 and the IMFC of the merit in identifying SWF best practices in such areas as institutional structure, risk management, transparency and accountability.[662]

To carry the agenda forward, the G7 and IMFC agreed two work programs.[663] The first involved the identification and agreement of a set of practices for SWFs to be led by the International Monetary Fund (IMF) and the second involved a set of voluntary principles for recipient countries of Sovereign fund investments to be led by the OECD. The latter is beyond the scope of this thesis and will not be considered further.

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[659] Ibid. See also: Regis Bismuth op cit.

[660] G7, 'Statement of G7 Finance Ministers and Central Bank Governors' (Washington, October 19, 2007) <http://www.g7.utoronto.ca/finance/fm071019.htm> Accessed 20th May 2018.

[661] Ibid.

[662] Ibid. See also: Ted Truman, *Sovereign Wealth Funds: Threat or Salvation?* (1st edn, Peterson Institute of International Economics 2010) 121.

[663] Ibid.

The choice of the IMF to lead the formulation of SWF best practices is interesting. As Anna Gelpern has argued, the fund was both a natural and unlikely candidate for such an arduous task.[664] First, its macroeconomic and financial stability know-how made it such an obvious choice to lead the standard-setting process. This was bolstered by years of setting best practices for Reserve Management funds – institutions which bear a certain semblance to SWFs.[665] Further, the IMF's near universal membership which included several recipient and SWF owner states meant that in theory at least, the IMF could convene a broad coalition to agree a set of best practices for SWFs. However, it should be noted that the Fund's surveillance and conditionality record especially with developing countries (many with SWFs) was mixed at best. This proved difficult in the actual negotiations which is investigated below.

Following the G7 rendezvous, Secretary Paulson hosted an outreach dinner with the finance ministers and executives of major SWFs from China, Kuwait, Norway, Russia, Saudi Arabia, Singapore, South Korea, and the United Arab Emirates.[666] At this event, Paulson confirmed that there should be openness to SWF investments, provided these funds were not used for the foreign policy objectives of their sponsoring states. The other participants equally expressed their common interest in maintaining an open investment environment and protecting financial stability.[667]

The first signs of fracture surrounding the G7's instruction to the IMF and OECD emerged a month later at the G20 Finance Ministers summit in South Africa in November 2007. The G20 communique praised the virtues of SWFs and then merely stated that they "noted the

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[664] Anna Gelpern, 'Sovereignty, Accountability, and the Wealth Fund Governance Conundrum' (2011) 1(2) Asian Journal of International Law 289, 312

[665] IMF, 'Revised Guidelines for Foreign Exchange Reserve Management', Monetary and Capital Markets Department (February 1, 2013).

[666] Robert Kimmitt, *'In Praise of Foreign Investment'*, The International Economy, Spring 2008 <http://www.international-economy.com/TIE_Sp08_Kimmitt.pdf> accessed 1st April 2017

[667] Ibid.

work of the IMF and the OECD", without express affirmation or endorsement.[668] This highlights the differing perspectives in global economic governance between the G7 and G20. The former appears to be a network of like-minded peers whilst the latter appears to be more representative of the global diversity of power, wealth and values and thus is more amenable to dissent.[669]

Subject to the G7 finance ministers' guidance and the IMFC's direction, the IMF began the initial round of preparatory work. First, it convened a 'roundtable of sovereign asset and reserve managers' from 28 countries on 15-16 November 2007 to exchange ideas about how best to address the policy and operational issues raised by SWFs.[670] At this meeting, the IMF dialogued with the attendee funds to learn from their experience and views on industry best practice.[671] Following this meeting, the then IMF Managing Director Dominique Strauss-Kahn, noted that 'a process is underway to define a role for the Fund on the issue of how SWFs can be managed in ways that are consistent with global financial stability.'[672] He also underlined that some form of agreement on best practices from the operations of SWFs could help maintain an open global financial system, and discourage recipient countries from imposing unilateral restrictions on capital flows. Strauss-Kahn further stressed the importance of 'a candid and continuing dialogue with recipient countries in order to get a better picture of the concerns and constraints they face.'[673]

Having convened this roundtable, the IMF launched a survey of the main SWFs to identify their investment objectives, risk management practices, governance structures and accountability

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668 G20, 'Finance Ministers meeting', Kleinmond, South Africa, (17-18 November 2007), <http://www.g20.utoronto.ca/2007/2007communique.pdf> Accessed 20th March 2017

669 John Kirton, *G20 Governance for a Globalized World* (1st edn, Routledge, 2013) 278

670 IMF, 'IMF Convenes First Annual Roundtable of Sovereign Asset and Reserve Managers' (November 16 2007) <http://www.imf.org/external/np/sec/pr/2007/pr07267.htm> Accessed 20th April 2017

671 Ibid.

672 Ibid.

673 Ibid.

arrangements.[674] The rationale for this exercise was to gain a deeper understanding of the operation of SWFs which it was hoped would inform the fund's standard setting process.

Following the commissioning of this survey, the IMF published a document perfectly titled 'Work Agenda' on the 29th February 2008, under which its staff would begin to work with member countries to facilitate the development of SWF best practices.[675] In this document, the Fund acknowledged the growing importance of SWFs and the perceived National Security risks associated with these funds.[676] It further alluded to the various proposals put forward by academics and policymakers to regulate these funds. The document, highlighted, in particular, proposals floated by Larry Summers, a notable economist, in which he called for SWFs to be allowed to invest only through intermediary asset managers.[677] Notwithstanding this, the IMF maintained that its intention was to "draw principles for the establishment and operation of SWFs and to identify best practices currently used by them."[678] The fund further clarified that the process it was leading was not to develop a prescriptive code—but to develop something along the lines of a code of best practice, in the mould of its standards on fiscal transparency and reserve management, to serve as a point of reference for members that operate or plan to establish SWFs, and that would inform the Fund's policy advice.[679]

On the technical aspects of the proposed IMF-led best practice, the focus was two-fold. First, to set out standards on the governance of SWFs that would provide for operational,

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[674] IMF Survey Online, *IMF Intensifies Work on Sovereign Wealth Funds*, March 4 2008, <https://www.imf.org/external/pubs/ft/survey/so/2008/POL03408A.htm> Accessed 13th April 2017

[675] IMF, 'Sovereign Wealth Fund: A Work Agenda' (2008) <https://www.imf.org/external/np/pp/eng/2008/022908.pdf> Accessed 13th April 2017

[676] IMF, 'Sovereign Wealth Fund: A Work Agenda' (2008), 15 <https://www.imf.org/external/np/pp/eng/2008/022908.pdf> Accessed 13th April 2017

[677] Ibid. at 16.

[678] Ibid. at 29.

[679] Ibid. see also: Anna Gelpern, 'Sovereignty, Accountability, and the Wealth Fund Governance Conundrum' (2011) 1(2) Asian Journal of International Law 289, 312.

functional and political independence between SWFs and their home states.[680] This was so designed to address fears in recipient countries about the potential deployment of SWFs for geopolitical and mercantilist purposes.[681] This was however followed by a pragmatic recognition that any governance standards agreed would need to accommodate the differing legal forms through which these funds are created.[682]

The IMF work program further called for transparency regarding fund objectives, organisational structure and investment portfolio (size, composition, returns, and risk indicators). On the transparency aspect, the work agenda emphasised the need for an optimal approach to disclosure. It noted, in particular, that 'Transparency was of interest to various groups, including the general public, markets, counterparties, recipient countries, and regulators.'[683] For the IMF, optimal transparency therefore involved sufficient disclosure with respect to the objectives of the fund, its organizational structure, institutional arrangements; and last but not least, its investment portfolio (size, composition, returns, risk indicators).[684] Of all three, the IMF predicted that transparency of investment portfolio was likely to generate considerable discussion – a statement which proved prescient.

The 'Work Agenda', further made clear the IMF's intention to conduct the standard-setting process in an inclusive manner. In particular, the IMF cited its intention to convene an international Working Group of SWFs to assist with the technical discussions.[685] Following these discussion, the IMF proposed that additional subgroups would be established to undertake further technical drafting work aimed at setting out the final best practices. Thereafter, the survey results

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[680] Ibid. at 24

[681] Ibid.

[682] Ibid.

[683] Ibid.

[684] Ibid.

[685] IMF 'Sovereign Wealth Fund: A Work Agenda' (2008), 29
<https://www.imf.org/external/np/pp/eng/2008/022908.pdf> Accessed 13th April 2017

would be processed and presented to the SWFs along with a brief structure of what could constitute the SWF principles and practices.[686] At this stage, it was clear that the IMF saw some role for itself in drafting the principles if not in influencing the drafting process.

Alongside SWFs, the IMF also outlined its intention to consult other multilateral agencies such as the OECD, G7 and the World Bank to generate their input and to incorporate these into the final set of practices. The consultations were also to include other multilateral development banks, the academic community, the business industry, international accounting and auditing bodies and investment recipient states, making the emergent standard a true international regulation for SWFs, promulgated by a cluster of relevant stakeholders and actors, including the funds themselves.[687] The above seems consistent with Bismuth's argument that the development of an international standard, irrespective of its legally binding dimension, is ideally based on the equitable participation of all stakeholders and is developed by bodies whose membership is open and not restricted to a limited number of actors.[688]

Suffice it to say that these plans did not go down well with SWFs and their owner states who perceived the idea of IMF imposed best practices as prescriptive and potentially discriminatory given the relatively scandal-free operations of SWFs at that point.[689] Underlying this discomfort was the notion that SWFs although market operators still retained a residue of sovereignty and were thus immune from control, taxation, regulation or direction.[690]

The extent of the fissures was revealed by a briefing authorised by Lou Jiwei, the then head of the China Investment Corporation in which he suggested that the IMF and SWFs were at

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[686] Ibid.

[687] Ibid.

[688] Regis Bismuth, 'The Santiago Principles for Sovereign Wealth Funds: The Shortcomings and the Futility of self-regulation' (2017) 28(1) EBLR 69,78.

[689] David Murray 'Negotiating a voluntary code' in Justin O'Brien eds, Sovereign Wealth: The Role of State Capital in the New Financial Order (1st edn, Imperial College Press, 2011) 149.

[690] Ibid.

the risk of a terminal disagreement over the meaning of transparency and political motivation.[691] Similarly, Aleskei Kudrin, the then Russian Finance Minister accused the IMF and the US Treasury of "trying to solve a problem that did not exist."[692] CIC's Gao Xiqing was even more unrelenting, describing the idea of an IMF led code as 'politically stupid.'[693] In a later interview, Mr Xinping was even more blunt, characterizing the process as 'political bullshit.'[694] The extent of the disagreement between SWFs and the IMF prompted a prediction from a senior IMF Official that the most likely outcome would be an agreement on vague generalities – "Something that is effectively toothless and devoid of anything other than motherhood and apple pie."[695]

As the dust raised by the IMF's agenda was settling, the European Commission unveiled its common approach on SWFs with principles on governance and transparency.[696] The EU had for long been a recipient of SWF investments in particular from the Middle East, China and Russia and this was beginning to generate tensions in countries like Germany and Italy.[697] This document

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691 Steven Weismann, 'Overseas Funds Resist Calls for a Code of Conduct', *New York Times* (New York, 8th February 2008) <http://www.nytimes.com/2008/02/09/business/09sovereign.html> Accessed 20th March 2017. See also Al-Sawaidi Comment below.

692 Ibid.

693 Carolyn Cui 'China Fund Vows Transparency' *WSJ* (4th April 2008) <https://www.wsj.com/articles/SB120728144338489001> Accessed 20th December 2016.

694 See: Daniel W. Drezner 'Bad Debts: Assessing China's Financial Influence in Great Power Politics.' (2009) 34(2) International Security 7, 26.

695 Steven Weismann 'Sovereign wealth funds resist IMF attempt to draft code of conduct' *New York Times* (New York, 9 February 2008) <https://www.nytimes.com/2008/02/09/business/worldbusiness/09iht-fund.4.9893264.html > Accessed 20th May 2018.

696Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions of 27 February 2008 – 'A common European approach to Sovereign Wealth Funds' [COM/2008/ 115 final].

697 Mark Thatcher, 'National policies towards sovereign wealth funds in Europe: A comparison of France, Germany and Italy' (2013) <http://www.lse.ac.uk/middleEastCentre/kuwait/documents/national-policies-towards-sovereign-wealth-funds-in-europe.pdf> Accessed 10th May 2017.

was released, for all intents and purposes, to add a European voice in the international negotiations led by the IMF and the OECD as well as to inform prospective policymaking in Europe.[698]

The EU's approach contained markedly tough standards. For instance on governance, the EU Commission insisted on clear allocation and separation of responsibilities in the internal governance structure of a fund, the development and issuance of an investment policy that defines the overall objectives of SWF investment, the existence of operational autonomy for the entity to achieve its defined goals; public disclosure of the general principles of internal governance that provide assurances of integrity and the development and issuance of risk management policies. [699]

On transparency, the EU position was even more assertive. It called for annual disclosures of actual investment positions and asset allocation, in particular for investments for which there is a majority ownership. The commission also called for disclosure on how SWFs exercise their ownership rights, disclosure of the use of leverage and currency composition, Disclosure of the size and source of a SWF's resources and the disclosure of the home country regulation and the oversight governing the Fund.[700]

Whilst, the EU was putting forward its agenda on SWF standards, US Treasury Secretary Hank Paulson was also pursuing a covert track. On 28th March 2008, Paulson convened a rendezvous with SWF executives from Abu Dhabi (ADIA), and Singapore (GIC) where five guiding principles were agreed.[701] These guiding principles provided *inter alia* that investment decisions by SWFs should be based solely on economic grounds. Secondly, that SWFs will disclose greater information, in areas such as purpose, investment objectives, institutional arrangements,

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[698] Daniel Drezner 'Bric by Bric: The Emergent Regime for Sovereign Wealth Funds' in Andrew Cooper and Alan Alexandroff (eds), *Rising States, Rising Institutions: Challenges for Global Governance* (Brookings Institution Press 2010) 229.

[699] Op cit EU Commission communication.

[700] Ibid.

[701] US Treasury, "Treasury Reaches Agreement on Principles for Sovereign Wealth Funds with Singapore and Abu Dhabi" press release HP-881, (March 20 2008) <https://www.treasury.gov/press-center/press-releases/Pages/hp881.aspx> Accessed 20th March 2017.

and financial information. Thirdly, that SWFs will put in place strong governance structures, internal controls, and operational and risk management systems, fourthly, that SWFs will allow fair competition with the private sector and finally respect host country rules.[702]

The SWFs present also laid down four broad principles for countries receiving SWF investments, including the US. These principles included a commitment from recipient countries not to erect protectionist barriers to portfolio or foreign direct investment, a commitment to ensure the predictability of investment frameworks, that inward investment rules should be publicly available, clearly articulated, predictable, and supported by strong and consistent rule of law, that recipient countries should not discriminate among investors and finally that recipient countries should respect investor decisions by being as unintrusive as possible, rather than seeking to direct SWF investment.[703] Some of these principles made it into the parallel work led by the OECD and is not explored further in this thesis.

Two explanations can be put forward for Paulson's actions. First, that the US Treasury may have been acting premptively to head off simmering dissent in the actual negotiations to be coordinated by the IMF or secondly that the Treasury was seeking to build consensus on broad principles which can be readily agreed to keep the door open to SWF investments in the United States bearing in mind that the tremors of the global economic crisis was well underway. There is some empirical support for this view. This can be seen in a recent interview by Paulson's assistant at the US Treasury, Clay Lowery in which he suggested that US Treasury decided to reach out to GIC and ADIA in 2007 to encourage their support for participating in the drafting principles as well as to build a coalition of SWFs willing to participate in such a process. Lowery is quoted as

[702] Ibid.

[703] Ibid.

saying: 'Let's work with them to come up with ideas about… principles and how to bring other countries [into the process].' [704]

On the other hand, the ability of the ADIA and GIC to extract strong commitments from the US Treasury on the global investment climate may be reflective of the changing power calculus signified by SWFs and occasioned by the shift of economic power from deficit countries such as the United States (which was at this stage in the throes of the global financial crisis) to surplus countries such as Singapore and Abu Dhabi with well stashed SWFs.[705] In other words, the tectonic plates of global politics and economics had shifted, and China, Abu Dhabi and Singapore were now the lenders and the US was now the borrower.[706]

Whilst these multi-track activities were going on, work was well underway at the IMF Secretariat on the composition of the Working Group and the related work of surveying SWF practices and structures. On April 12 2008, the IMFC Board met and endorsed the IMF Work Agenda to facilitate and coordinate work with SWFs on a set of Best Practices. Yet, the IMFC's position was not without rifts. Unsurprisingly, the work agenda was opposed by Russia and China (both countries with SWFs). However, the most scathing critique came from Middle-Eastern countries represented by Sultan Bin Nassar Al-Suwaidi, the governor of the UAE Central Bank who argued:

> "We reiterate our misgivings regarding the fund's involvement in setting best practices for sovereign wealth funds (SWFs). The Fund does not have the requisite expertise in the areas of governance and transparency to take the lead in producing a set of best practices for

[704] Clay Lowery interview in IFSWF, 'The Origin of the Santiago Principles: Experiences from the past; Guidance for the future' (2018) <http://www.ifswf.org/sites/default/files/IFSWF_Santiago_Principles_book.pdf> Accessed 20th November 2018.

[705] Anna Gelpern, 'Sovereignty, Accountability, and the Wealth Fund Governance Conundrum' (2011) 1(2) Asian Journal of International Law, 289, 300.

[706] Daniel Drezner, 'Bad Debts Assessing China's Financial Influence in Great Power Politics' (2009) 34(2) International Security 7, 8.

SWFs. We are also concerned about the treatment of SWFs, to the exclusion of other types of institutional investors with proven track record of excessive risk taking and destabilizing behaviour, would introduce a severe element of bias and lack even handedness in financial surveillance. Finally, the timing of this exercise and its political dimensions could inadvertently disrupt the flow of much-needed long-term capital from SWFs to institutions in the U.S. and elsewhere that face both liquidity and capital shortage issues."[707]

From the above, one can observe a scathing attack on the legitimacy of the IMF in leading the standard setting process. This may be reflective of the power dynamic referred to above which has emboldened surplus countries against deficit countries and global institutions in transnational governance negotiations.[708] This power dynamic is reflected not only in the shift of economic hegemony from west to east but also in the fact that many of the countries involved in the negotiations had built up their domestic economies during the resource boom and thus were no longer dependent on IMF Bailout and Conditionality programmes. This gave them the latitude and leverage to question the Fund's legitimacy.[709]

Despite opposition to the IMF Process for SWFs, members of the G7 continued to push the issue of best practices and standards. This implacable stance was supported by several bilateral meetings between US Treasury officials and SWFs where it was made clear that a successful IMF Process would keep barriers to investment relatively low in the United States & Europe.[710] At this

[707] IMFC, 'Statement by His Excellency Sultan N. Al-Suwaidi, Governor of the United Arab Emirates Central Bank' (April, 2008) <https://www.imf.org/External/spring/2008/imfc/statement/eng/uae.pdf > Accessed 20th May 2017

[708] Mehrpouya op cit at 52.

[709] Ibid.

[710] Daniel Drezner, 'Bric by Bric: The Emergent Regime for Sovereign Wealth Funds' in Andrew Cooper and Alan Alexandroff (eds), *Rising States, Rising Institutions: Challenges for Global Governance* (Brookings Institution Press 2010) 230

stage, SWFs increasingly understood the nexus between negotiating and accepting standards and access to OECD Markets.[711]

Given the sullen acceptance of the need for transnational standards, the SWF strategy switched from resistance to standards to resistance to the IMF's leadership of the standard setting process. The driving impetus for this came from a confluence of issues, the most important of which was the protectionist zeitgeist in several SWF target markets, which, it was feared, might lead to governments imposing further restrictions on SWFs' ability to invest overseas.[712]

Whilst this strategic shift was gathering speed, the IMF convened an international working group of SWFs (IWG) composed of funds from 23 countries including Australia, Azerbaijan, Bahrain, Botswana, Canada, Chile, China, Equatorial Guinea, Islamic Republic of Iran, Ireland, Korea, Kuwait, Libya, Mexico, New Zealand, Norway, Qatar, Russia, Singapore, Timor-Leste, Trinidad and Tobago, the United Arab Emirates, and the United States (with the US Treasury representing the Alaska Permanent Fund). Oman, Vietnam and Saudi Arabia also participated in the IWG but as observers.[713]

The IWG's composition merits attention. First, it puts a spotlight on the ability of the IMF to bring together a wide range of stakeholders in international governance processes. Secondly, the intermeshing of developed alongside developing countries suggests an attempt from the IMF to showcase the end product of the negotiations as truly global or transnational and thus to arrest future concerns of input legitimacy.

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[711] Ibid.

[712] IFSWF, 'The Origin of the Santiago Principles: Experiences from the past; Guidance for the future' (2018), 22 <http://www.ifswf.org/sites/default/files/IFSWF_Santiago_Principles_book.pdf> Accessed 20th November 2018.

[713] Ted Truman, *Sovereign Wealth Funds: Threat or Salvation?* (1st edn, Peterson Institute of International Economics 2010) 124

The IWG met for the first time on May 1 2008 to begin work on the principles. The working group was co-chaired by the Chairman of the Abu Dhabi Investment Hamad Hurr Al-Suwaidi and Jaime Caruana, then director of the IMF Monetary and Capital Markets department.[714] This again shows the IMF's best efforts to depict parity and by so doing, to douse rising tensions amongst SWFs about the manner of the standard-setting process. The negotiation process was also to be coordinated by a secretariat provided by the IMF. Besides the IMF Secretariat, The World Bank and the OECD were also invited to participate as observers as was originally envisaged in the work agenda examined above.[715] The following section provides further details of the actual negotiation process and the rise of Self-Regulation amongst SWFs.

[714] Ibid.

[715] Regis Bismuth, 'Sovereign Wealth Funds versus International Law – an Overview of the legal problems posed by unusual investors' in French Yearbook of International Law, volume 56, 2010. Pp 567, 604.

4.3 The Negotiation Process and the beginnings of Self-Regulation

As highlighted above, the IMF's original plan was to coordinate and facilitate the drafting of SWF standards with input from a wider variety of stakeholders including SWFs. The intent was therefore to produce some form of international regulation for SWFs in the mould of its best practices on fiscal transparency or its benchmarks on reserve management.[716]

In accordance with this plan, the IMF, in the first IWG meeting in Washington D.C, had an active, domineering and consequential role – setting the agenda and directing the process.[717] Another account described the IMF as 'somewhat heavy-handed.'[718]

This led to mounting dissent, particularly from large Middle Eastern SWFs and Asian funds such as the China Investment Corporation.[719] Afshin Mehrpouya reports that the Middle Eastern funds led by the Abu Dhabi Investment Authority, demanded that the drafting be led by SWFs themselves rather than the IMF.[720] Mehrpouya also finds that Middle Eastern funds considered the idea of IMF micro-management of the process as a case of "western powers imposing their norms" on Middle-Eastern nations, reinforcing the difficult critique of the IMF as a western dominated institution that espouses western liberal ideology.[721]

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716 Afshin Mehrpouya, 'Sovereign Wealth Funds, the IMF and Transparency' (2013), 36 <www.hec.edu/heccontent/download/8396/185943/.../2/.../CR+963+Mehrpouya.pdf> Accessed 11th March 2017

717 Mehrpouya op cit at 30.

718 Afshin Mehrpouya, 'Instituting a transnational accountability regime: The case of Sovereign Wealth Funds and GAPP' (2015) 44 Accounting, Organizations and Society 15, 26.

719 Afshin Mehrpouya, 'Sovereign Wealth Funds, the IMF and Transparency' (2013), 31<www.hec.edu/heccontent/download/8396/185943/.../2/.../CR+963+Mehrpouya.pdf> Accessed 11th March 2017

720 Ibid.

721 Ibid.

Mehrpouya notes that the dissenting funds were suspicious that IMF leadership would lead to a more prescriptive code, thus damaging the status of SWFs as sovereign institutions created and backed by the state.[722] This account is corroborated by the comments of the Kuwait Investment Authority's CEO Al Sa'ad around the time of the first IWG meeting. Al Sa'ad argued that:

> 'recipient countries are placing handcuffs on Sovereign Wealth Funds in the form of regulations, termed in the best tradition of George Orwell's Newspeak, by calling them code of conduct or principles of operations or best practices….. There should be limits placed on transparency. Complete transparency would raise more questions than answers.'[723]

Given the level of dissent and the prospect of damaging the negotiations, the IMF substituted itself from a coordinative role to a more marginal cum bureaucratic role in the second meeting in Singapore. This shift from an ostensibly hierarchical arrangement, placed the IMF in a bureaucratic or administrative capacity where it merely provided secretarial support with SWFs in full control of the process.[724] It is not clear whether this action was at the behest of the IMF's governing board, the G7 or the US Treasury but it highlights, in any case, the bargaining power of the SWFs involved.[725] The above seems consistent with the account of the IMF's former Managing

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[722] Ibid.

[723] Mr Bader Al-Saad, Managing Director of the Kuwait Investment Authority, 'Overview on the Kuwait Investment Authority and Issues related to Sovereign Wealth Funds', (Speech at the First Luxembourg Foreign Investment Conference, Luxembourg, 9th April 2008) <http://www.kia.gov.kw/en/Speetches/FINA_SPCH_LUXEMBORG_APR_9_092.pdf> Accessed 20th May 2017

[724] Mehrpouya op cit at 31. See Also: Regis Bismuth, 'The Santiago Principles for Sovereign Wealth Funds: The Shortcomings and the Futility of self-regulation' (2017) 28(1) EBLR 69, 77.

[725] Some accounts suggest that the IMF Surrendered to the influence of vocal Arab critics. See: Regis Bismuth "The Santiago Principles for Sovereign Wealth Funds: the Shortcomings and the futility of Self-regulation' (2017) EBLR 69, 77

Director John Lipsky in which he noted: 'If there were a sense that somehow 'best practices' were decided by someone else and dictated [to the funds], that could be extremely counterproductive…. This needs to be cooperative to be meaningful.'[726]

Although the IMF was defeated, it was not completely vanquished. Its survey of SWF practices, commissioned a year earlier, was quickly repackaged into a draft outline of SWF practices which was subsequently leveraged by SWFs at the second IWG meeting in Singapore to shape and inform the drafting process.[727] There are indications that the IWG also leveraged from the bilateral principles earlier agreed between the US Treasury and the Abu Dhabi and Singaporean Funds, with both documents, forming a normative substrate under which the negotiations was to proceed.[728] At this point, the IWG was further divided into three drafting sub-committees, populated by SWFs alone with the exclusion of the other invited observers, to reconcile putative differences between the funds and to carry forward the technical aspects of the negotiations.[729]

These subcommittees were led by representatives of the Norwegian SWF, the Australian Future fund and the Singaporean Fund, again reflecting a combination of western and eastern funds as opposed to the leadership of the International Monetary Fund which was considered unduly hierarchical.

At this stage, the negotiations became more dialogic and horizontal. There also seemed to have been a movement from the hierarchy or dominancy of the IMF to total SWF ownership of

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[726] Bob Davis 'U.S. Pushes Sovereign Funds To Open to Outside Scrutiny' WSJ (26 February 2008) <https://www.wsj.com/articles/SB120399388652192707> Accessed 20 May 2018.

[727] IFSWF, 'The Origin of the Santiago Principles: Experiences from the past; Guidance for the future' (2018), 21 <http://www.ifswf.org/sites/default/files/IFSWF_Santiago_Principles_book.pdf> Accessed 20th November 2018. The IMF's survey of SWF Practices was later published in October 2008 after the agreement of the Final draft of the GAPP. It can be accessed at <https://www.imf.org/external/pubs/ft/wp/2008/wp08254.pdf> Accessed 20th May 2017

[728] Ibid.

[729] Ibid.

the drafting process, reflecting the features of organic self-regulation.[730] As one of Mehrpouya's interviewees remarked of the IMF, "I think it (the tone) changed slightly, from being dominant in Washington to finding a role that was almost more humble…."[731] This is reinforced by KIA's representative at the negotiations who described the discussions after the Washington meeting as centred on the notion of 'self- regulation" or self-oversight.' [732]

As this organic self-regulatory arrangement was taking shape, the differing institutional and ideological preferences of the participant funds were thrown into sharp relief. There also appeared to be a common objective amongst the largest and most vocal funds in neutering the scope of any emergent standards. In other words, several participants did not want to change too much of the statusquo.[733] This seems consistent with Abbott and Snidal's warning that actors coalescing in 'the transnational regulatory space, operate not as neutrals seeking "good governance," but as partisans pursuing their special interests and values with differential power and capabilities.'[734]

The obsession among IWG funds in neutering the scope of the emergent standard can be observed in the serious conflicts amongst participant funds over the technical aspects of the negotiations. Contentious issues at stake included the logic underlying SWF investments (whether purely economic or not), funds' relationships with their respective owner governments, their investment portfolio, policies and returns, the type of shareholder rights/influence exercised

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[730]Afshin Mehrpouya, '*Sovereign Wealth Funds, the IMF and Transparency'* (2013), 33 <www.hec.edu/heccontent/download/8396/185943/.../2/.../CR+963+Mehrpouya.pdf> Accessed 11th March 2017.

[731] Ibid.

[732] IFSWF, 'The Origin of the Santiago Principles: Experiences from the past; Guidance for the future' (2018), 23 <http://www.ifswf.org/sites/default/files/IFSWF_Santiago_Principles_book.pdf> Accessed 20th November 2018.

[733] Regis Bismuth, 'The Santiago Principles for Sovereign Wealth Funds: the Shortcomings and the futility of Self-regulation' (2017) EBLR 69, 77

[734] Kenneth W. Abbott and Duncan Snidal 'The Governance Triangle: Regulatory Standards Institutions and the Shadow of the State' in Walter Mattli and Ngaire Woods, The Politics of Global Regulation (Princeton University Press, 2009) 51.

within investee corporations, and their size/capital flows, given the perceived implications of SWF activity on the stability of western markets.[735]

With regards to these issues, SWFs, especially large developing country funds dug in their heels over any ambitious or stringent standards covering these issues. The funds were more concerned either in preserving the statusquo or in pursuing their narrow competitive or institutional interests, reinforcing earlier critiques of voluntary regulation as prone to conflicts of interests and risks of regulatory capture.

One example was the proposal for the disclosure of absolute size as originally envisaged in the IMF's document. This clause provoked controversy amongst participating funds, in particular those from the Middle East, who feared a protectionist backlash if such disclosure revealed investments in strategic overseas sectors.[736] The funds were particularly concerned that revelations of holdings in critical or sensitive industries might feed the narrative that SWFs were mercantilist instruments seeking control of strategic sectors.[737] To protect their collective business and institutional interests from increased oversight by recipient country regulators and observers, the participant SWFs rejected this clause, defeating a central plank of the IWG agenda which was designed with the security concerns of recipient countries in mind. According to David Murray, who was the CEO of the Australian future fund and leader of one of the drafting sub-committees, "the view was that disclosure of absolute size was not a key issue in determining commercial intent."[738]

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[735] Afshin Mehrpouya, 'Instituting a transnational accountability regime: The case of Sovereign Wealth Funds and GAPP' (2015) 44 Accounting, Organizations and Society 15, 26.

[736] Travis Pantin, '*Sovereign funds set voluntary principles'* The National (September 2 2008) <http://www.thenational.ae/business/banking/sovereign-funds-set-voluntary-principles?pageCount=2 > Accessed 20th May 2017

[737] Ibid.

[738] David Murray, '*Negotiating a Voluntary Code'* in Justin O'Brien (eds*) Sovereign Wealth: The Role of State Capital in the New Financial Order* (1st edn, Imperial College Press, 2011) 151

Another point of tension for the IWG was the proposal to disclose investment portfolio, proxy voting stances and returns, including quarterly disclosures by SWFs.[739] This again generated considerable disquiet amongst participant funds, revealing two different rationales and explanations for SWF opposition.

For instance, Middle Eastern funds led by the ADIA, the Qatari and Kuwaiti funds were largely apprehensive about their local population's access to such information, if disclosed. The concerns of these funds seemed to revolve around the consequences of giving up their monopoly over fund-level information and the redistributive demands that might raise amongst the local populace. According to an interviewee in Mehrpouya's work, 'opinions varied greatly on the extent to which citizens of a country have a need to know.'[740]

The Kuwait Investment Authority was particularly vocal in its opposition to these clauses. The fund cited its willingness to provide detailed reports to agencies of its owner state but frowned at the possibility of disclosure to the public of information related to KIA's operation.[741]

The ADIA and QIA on their part had always expressed their opposition to public disclosure even in private conversations with the US Treasury so, in many respects, their opposition to these clauses were largely unsurprising.

For instance, the Managing Director of the ADIA, in a 2007 diplomatic cable with the US Treasury, observed that 'ADIA, as a matter of policy, did not disclose the size of its foreign

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[739]Afshin Mehrpouya, *Sovereign Wealth Funds, the IMF and Transparency* (2013) 33-35 <www.hec.edu/heccontent/download/8396/185943/.../2/.../CR+963+Mehrpouya.pdf> Accessed 11th March 2017

[740] Afshin Mehrpouya, 'Instituting a transnational accountability regime: The case of Sovereign Wealth Funds and GAPP' (2015) 44 Accounting, Organizations and Society 15, 28.

[741] Ibid. KIA traditionally discloses Information to its council of Ministers and Parliament – See also: Sovereign Wealth Fund Initiative, Fund Profile: Kuwait Investment Authority (KIA) (2011) <http://fletcher.tufts.edu/~/media/Fletcher/Microsites/swfi/pdfs/2012/profiles/KIA%20Fund%20Profile_v2.pdf> Accessed 20 March 2017.

investments publicly' and that 'confidentiality was a policy directed from above.'[742] This was broadly similar to the position of the QIA, revealed in another diplomatic cable, in which a senior official suggested that 'only five or six people in Qatar knew about the Fund's asset allocation' (Emphasis Added).[743]

Asian funds, on the other hand, led by the Singaporean funds, Temasek and GIC offered a different explanation for their reticence about these disclosure clauses. The funds were more concerned about the impact of such disclosure on their business models and operations, including their ability to compete in a fierce market place.[744] The funds were also clear that the disclosure of absolute returns should be over historical periods given the long-term horizon of their investments. Both Singaporean funds sought to justify this by arguing that the disclosure of quarterly performance (as the IMF initially proposed) would amplify local pressure to pursue short term returns.[745] This was in many respects, consistent with the earlier concerns of Singaporean funds about the disclosure of information, articulated months before the IWG process. One example is the statement of Lee Kuan Yew, Singapore's former premier and Chair of GIC in which he stated that: 'We will not disclose how much we invest in each particular sector because that's sensitive financial information, which will affect our future purchases, but we're prepared to say this is what we're doing in this sector and that sector.'[746]

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[742] Wikileaks 'Abu Dhabi Cautiously Positive on SWF Best Practices' (10 October 2007) <https://wikileaks.org/plusd/cables/07ABUDHABI1696_a.html> Accessed 20th May 2018.

[743] Wikileaks 'Qatari Officials discuss Currency, Sovereign Wealth Funds, Investment, and Iran With Secretary Paulson' (4 June 2008) <https://wikileaks.org/plusd/cables/08DOHA422_a.html> Accessed 20th June 2018.

[744] Afshin Mehrpouya, Sovereign Wealth Funds, the IMF and Transparency (2013) 34 <www.hec.edu/heccontent/download/8396/185943/.../2/.../CR+963+Mehrpouya.pdf> Accessed 11th March 2017

[745] Ibid.

[746] John Burton and Chris Giles 'IMF urges action on sovereign wealth' *Financial Times* (24 January 2008) <https://www.ft.com/content/2fe26904-cac3-11dc-a960-000077b07658> Accessed 20th January 2018.

Temasek and GIC's concerns were broadly echoed by China's SWF, CIC for whom the idea of disclosing its investment policy and financial returns was equally unpalatable. The fund emphasised its commercial orientation but stressed that disclosure of this sort was likely to distract it from 'maximizing long-run returns, subjecting it to greater political interference and media second-guessing.'[747]

By contrast, the Norwegian fund, traditionally seen as the most transparent in the world and which discloses all its holdings, emphasized that they were present in the negotiations to 'share their experiences' and to be a 'good global citizen.'[748] The Norwegians also affirmed that open access to information relating to the performance of the fund was a public right based on longstanding democratic commitments to the freedom of information and that they intended to continue disclosing information about the fund's activities.[749]

The above underscores the different ideological objectives and preferences amongst the participant funds and the intricacies of standard-setting in a room full of radically dissimilar actors. Whereas, the Western funds exemplified by Norway believe that the disclosure of information is a public good, Middle Eastern funds exemplified by Kuwait appear to perceive increased transparency as a sinister instrument that may empower the local populace – an interpretation consistent with Mehrpouya and Bianchi's conceptualisation of Transparency as power.[750] One can also observe another ideological understanding of transparency as a competitive or strategic resource to be protected, at all costs, from external access, advanced by the Singaporean and

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[747] Afshin Mehrpouya, 'Instituting a transnational accountability regime: The case of Sovereign Wealth Funds and GAPP' (2015) 44 Accounting, Organizations and Society 15, 28.

[748] Afshin Mehrpouya, Sovereign Wealth Funds, the IMF and Transparency (2013),35 <www.hec.edu/heccontent/download/8396/185943/.../2/.../CR+963+Mehrpouya.pdf> Accessed 11th March 2017.

[749] Ibid.

[750] Ibid. at 44. See also: Andrea Bianchi, 'On Power and Illusion: The Concept of Transparency in International Law' in A Bianchi (eds) Transparency in International Law (Cambridge University Press, 2013) 18.

Chinese funds.[751] As one author wisely put it, "Apart from having lots of cash, Norway, Singapore and Abu Dhabi have relatively little in common – and no tradition of working together. Getting agreement among the G-7 is hard; getting agreement among the SWFs is probably close to impossible."[752]

Further to the resistance raised by SWFs against increased openness, several technical details were dropped from the final draft of the principles and much of the requirements became weaker and broader.[753] In addition, several 'public disclosure' clauses were expunged from the principles, leaving a husk of standards that captured the plurilateral interests of the participant funds[754] – a situation which again confirms earlier suggestions that self-regulating groups may prioritise their collective interests at the expense of the wider social or public interest.

Alongside the technical debates on the extent of disclosure, IWG negotiators also sparred over the monitoring and verification of the Principles. Most contentious was the IMF's original proposal to verify adherence through its Article IV consultations with member countries or through periodic Reports on the Observation of Standards and Codes (ROSCs).[755] This option was flatly rejected by participating funds who saw it as an opportunity for increased IMF meddling.[756] Other funds saw the idea of formal verification as symptomatic of the IMF's obsession with regulating SWFs and thus inconsistent with the idea of principles based on voluntarism and goodwill.[757]

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[751] Ibid. at 43.

[752] Yves Smith, 'Sovereign Wealth Funds Say No on Transparency' (*Naked Capitalism*, February 11 2008) online at <http://www.nakedcapitalism.com/2008/02/sovereign-wealth-funds-say-no-on.html> Accessed 13th March 2017

[753] Op cit Mehrpouya at 36.

[754] Ibid.

[755] Ibid. at 37

[756] Ibid.

[757] Ibid.

Given the failure of this option, the proposals were calibrated to reflect a vague form of audits and reviews carried out by the funds collectively (peer review) or by an external organisation. This was again rejected by the participant funds.[758] The IWG members instead opted for self-oversight or monitoring of compliance with the principles, arrogating to themselves the role of player and umpire and effectively removing any form of independent or objective evaluation of compliance with the principles. This is reflected in Principle 24 which codifies a rather obscure system of self-assessment. This is addressed in greater detail below.[759]

In the end, the negotiations were completed over a quick fire round of three IWG meetings, held over five months – a remarkably expeditious timeframe given the intricacies highlighted above. This might align with earlier depictions of Self-regulation as capable of delivering swift and flexible policy solutions.[760] However, as highlighted in Chapter 2, flexible solutions may not be the silver bullet for policy problems. For instance, flexible regulatory responses may undermine broad industry or stakeholder representation and interests. They may also imply vagueness of regulatory instruments or the exercise of discretion which favour certain interests above others.[761] The Santiago Principles appear to confirm this hypothesis. At first, the document was negotiated by SWFs alone without the participation of relevant stakeholders such as recipient countries and multilateral institutions. Also, the final document is expressed by way of generically worded and vague provisions,[762] broadly focused on the institutional features of SWFs

[758] Ibid.

[759] Principle 24 in International Working Group, Sovereign Wealth Funds: Generally Accepted Principles and Practices (October 2008) <http://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf> Accessed 30th March 2017

[760] Robert Baldwin, Martin Cave, and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (2nd edn, OUP, 2011) 140.

[761] Ibid. See also: Rebecca Ong, *Mobile Communication and the Protection of Children* (Leiden University, 2010) 249

[762] The provisions often use verbs in the conditional tense and undefined adjectives such as 'clear' and 'sound'– as is typical of voluntary measures and but crucially also, it often codifies an unspecified form of activity disclosure – See Fabio Bassan, *The Law of Sovereign Wealth Funds* (Edward Elgar, 2011) 48

and their relationships with owner states and pays lip service to the founding objectives of the process articulated by recipient states and multilateral institutions.[763]

As Behrendt argues, general agreements on 'principles' imply a weaker form of regulatory accord.[764] This is because such instruments tend to describe and formulate a set of extant and fundamental assumptions – rather than introduce norms and standards of behaviour that commits signatories to achieving meaningful change.[765]

Presumably to compensate for the basic recommendations codified in the Santiago document, the IWG gently added comfort declarations, showing the 'aspiration' of participant funds to adhere to its contents. This is reflected in the preamble to the document which notes that IWG members 'support and either have implemented or aspire to implement' its provisions.[766] The participant SWFs also clarified the contours and reach of the document by declaring that its contents were subject to the idiosyncrasies of domestic law, further rendering its substance aspirational and hortatory.[767]

The outcome of this heavily fraught process have been criticised by observers and commentators. For one author, 'the Principles accomplish nothing but a reiteration of the least common denominators of the status quo.'[768] Another underscores the lip-service paid to target

[763] Anna Gelpern 'Sovereign Wealth and Governance in International Finance' (2009), 23 <http://www.astrid-online.it/static/upload/protected/1-2_/1-2_Gelpern.pdf> Accessed 20th May 2018. See also: Regis Bismuth '

[764] Sven Behrendt 'Beyond Santiago: status and prospects' (2009) 19(4) Central Banking Journal 75, 79.

[765] Sven Behrendt 'Beyond Santiago: status and prospects' (2009) 19(4) Central Banking Journal 75, 79.

[766] International Working Group, Sovereign Wealth Funds: Generally Accepted Principles and Practices (October 2008), 5 <http://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf> Accessed 30th March 2017.

[767] Ibid.

[768] Jason Buhi 'Negocio de China: Building upon the Santiago Principles to Form an Effective International Approach to Sovereign Wealth Fund Regulation' (2009) 39 Hong Kong L.J. 197, 198.

country concerns, arguing that, 'by dealing solely with the SWFs' side of the problem, the Santiago Principles are essentially putting a Band-Aid over a gaping wound.'[769]

The scathing criticisms above and the graphic detail of the negotiations portrayed in the preceding paragraphs, feed the suspicion that the principles exist mainly as a 'comfort blanket' to reassure target countries rather than a set of meaningful or far-reaching measures capable of lifting standards across the industry. A more cynical observation might be that the process was a carefully choreographed public relations exercise.[770] This seems rather consistent with the views of Mr Bastaki, a representative of the Kuwait Investment Authority at the negotiations who recently observed that: 'The Santiago Principles is more of a comfort document for recipient countries to be reassured that what we do will be done responsibly. However, it is voluntary'…. 'We have considerably greater oversight [in Kuwait] than is [implied] by the Santiago Principles.'[771]

Having completed the drafting of this rather questionable document, the focus of the IWG shifted to projecting the outcome as a regulatory milestone and by so doing, to temper the reception of the document by stakeholders such as investment recipient states and multilateral institutions. This is corroborated by the account of an interviewee in Mehrpouya's paper who is quoted as saying:

> 'They felt that the moment the principles were prepared and published… most of the work was done. That was a key milestone and hopefully the attention to this would subside over time – the political need would be off the table, if you like.' [772]

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[769] Anthony Wong, 'Sovereign Wealth Funds and the Problem of Asymmetric Information: The Santiago Principles and International Regulations' (2009) 34 (3) Brook. J. Int'l L 1081, 1106.

[770] Regis Bismuth 'The Santiago Principles for Sovereign Wealth Funds: The Shortcomings and the Futility of self-regulation' (2017) 28(1) EBLR 69, 75.

[771] IFSWF, 'The Origin of the Santiago Principles: Experiences from the past; Guidance for the future' (2018), 27 <http://www.ifswf.org/sites/default/files/IFSWF_Santiago_Principles_book.pdf> Accessed 20th November 2018

[772] Op cit Mehrpouya at 36.

The above clearly underscores the determination of IWG members to forge ahead with this heavily troubled document, with minimal opposition from recipient countries and multilateral institutions.

To facilitate the above, the IWG began to extoll the virtues of the document. One example is the joint statement of Hamad Al-Suwaidi of the Abu Dhabi Investment Authority and David Murray of the Australia Future Fund upon the publication of the principles. For Mr Al-Suwaidi, 'SWFs are open to being more transparent, but must not be put at a competitive disadvantage in the marketplace.'[773] Al-Suwaidi also highlighted what was topmost in the minds of SWFs throughout the negotiations. He noted that: 'through the implementation of the Santiago Principles, we seek to ensure that the international investment environment will remain open.' These sentiments were echoed by David Murray of Australia's Future Fund and Chair of one of the drafting sub-groups, who noted, '…we had to establish trust in recipient countries that the activities of SWFs were all based on an economic orientation.'[774]

As part of its charm offensive, the group unveiled plans to publish a survey of SWF practices to inform further discussion about SWFs and to explore the formation of a permanent group of SWFs.[775] Yet, they noticeably refrained from any suggestion of a robust coordination mechanism for the emergent group of SWFs. Instead, the IWG noted that the purpose of this group would be to 'monitor the principles' impact, facilitate dialogue amongst funds and recipient

[773] Al-Suwaidi cited in Simon Willson, Wealth Funds Group Publishes 24-Point Voluntary Principles (2008) <https://www.imf.org/en/News/Articles/2015/09/28/04/53/sonew101508b> Accessed 30th March 2017.

[774] David Murray cited in Simon Willson, *Wealth Funds Group Publishes 24-Point Voluntary Principles* (2008) <http://www.imf.org/external/pubs/ft/survey/so/2008/NEW101508B.htm> Accessed 30th March 2017

[775] Travis Pantin, 'Sovereign funds set voluntary principles' *The National* (2 September 2008) <http://www.thenational.ae/business/banking/sovereign-funds-set-voluntary-principles?pageCount=2> Accessed 20th May 2017

countries and make any necessary modifications to the principles and practices.'[776] The proposed group is now the IFSWF and will be explored in the following chapter.

Amid the IWG's charm offensive, several Middle-Eastern countries began a coordinated attack against further attempts to regulate SWFs at the IMF's governing board, the IMFC. This can be gleaned from the statement of Sultan Al-Suwaidi, the governor of the UAE Central bank at the October 2008 IMFC board meeting. Al-Suwaidi noted:

> "We welcome the recognition in the preamble to the Santiago Principles the voluntary nature of this exercise, and the emphasis that each of these Principles is subject to home country laws, regulations, and obligations. We have reservations regarding extending disclosure and transparency requirements to areas where the competitive position of SWFs relative to other types of investors would be compromised and a double standard created. In view of the voluntary and consensus-based character of the initiative, we are not convinced of proposals to monitor the implementation of the Principles. We have previously cautioned against 'voluntary' initiatives by the Fund from developing into 'mandatory' practices, which would detract from the ownership of these Principles by the SWFs. In addition, given the tight budgetary constraints that the Fund is operating under and the competing priorities in light of the ongoing financial turmoil, we would not be in favor of further Fund involvement beyond this stage."[777]

The above statement puts a spotlight on the increased assertiveness of certain SWF home states over further control of SWFs at the multilateral level. The coordinated attack by these states

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[776] Ibid. see also International Working Group, Sovereign Wealth Funds: Generally Accepted Principles and Practices (October 2008) <http://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf> Accessed 30th March 2017

[777] International Monetary and Financial Committee, 'Statement by His Excellency Sultan N. Al-Suwaidi Governor of the United Arab Emirates Central Bank United Arab Emirates' (October 11 2008) <https://www.imf.org/External/AM/2008/imfc/statement/eng/are.pdf > Accessed 20th May 2017.

also underscores the manifest political and economic leverage possessed by them in the Santiago negotiations which may be of broader significance in future transnational political and economic struggles.

It should also be noted that this broadside was delivered in the throes of the global financial crisis when western markets were in dire need of capital. Given the heightened risk of failure and the more pressing issue of the global financial crisis, the IMF's Board of Governors (IMFC) endorsed the final draft of the principles. Recipient states who were now in various stages of dependency and desperation, also suspended their reservations about the document, to satisfy respective national thirsts for liquidity.[778] This allowed SWFs to plough ahead with the principles as they stood with limited opposition. The next section will now consider the substance of this heavily political document to test for its efficacy in regulating SWFs.

[778] Jason Buhi 'Negocio De China: Building Upon the Santiago Principles to Form an Effective International Approach to Sovereign Wealth Fund Regulation' (2009) 39 Hong Kong Law Journal 197,198.

4.4 An Evaluation of the Normative Content of the Santiago Principles

As the preceding section indicates, the Santiago principles are elaborated as a set of voluntary principles and practices for SWFs. This means that they do not possess any legal or binding effect. Although sovereign entities are the primary subjects, the document cannot be characterised as traditional international law to the extent of treaties and other inter-governmental agreements.[779] Rather, they are voluntary principles and practices promulgated by a self-regulating group of SWFs in a unique transnational setting.[780]

For its authors, the underlying rationale behind the document 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 SWFs.'[781] Thus, in principle, the document formulates mostly a set of extant and fundamental assumptions about SWF institutional design and practices.

Substantively, the document is elaborated by way of 24 principles and practices, woven around three thematic areas: '(i) legal framework, objectives, and coordination with macroeconomic policies; (ii) institutional framework and governance structure; and (iii) investment and risk management framework.'[782] Each principle is accompanied by an 'Explanation and commentary' that endeavours to develop and interpret the substantive issues underlying each Principle.

To understand the true nature and scope of this document, it is imperative to conduct a thorough examination of its contents. Yet, much of the provisions reflected in the Santiago

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[779] Sven Behrendt 'Beyond Santiago: status and prospects' (2009) 19(4) Central Banking Journal 75, 79.

[780] Joseph J. Norton 'The 'Santiago Principles' For Sovereign Wealth Funds: A Case Study on International Financial Standard-setting Processes' (2010) 13(3) Journal of International Economic Law 645, 656.

[781] International Working Group, Sovereign Wealth Funds: Generally Accepted Principles and Practices (October 2008), 4 <http://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf> Accessed 30th March 2017

[782] Ibid. at p. 5

framework do not bear repeating since the document is largely iterative and focuses on the internal design of SWFs and their relationships with owner states.[783] Instead, emphasis is placed on the most substantive recommendations relating to Governance and Operational Independence, Transparency, Political Investments and Competition which also reflect the policy objectives that inspired the creation of the principles.

A consideration of these key elements allows one to test for comprehensiveness and ambition– all of which are metrics for self-regulatory effectiveness as detailed in Chapter 2. To deepen the inquiry into the ambition of the principles, this part further compares selected principles to comparable standards promulgated by and for sovereign investors such as the OECD Guidelines on the Corporate Governance of State-owned Enterprises and the IMF's Guidelines for Foreign Exchange Reserve Management Funds. It is hoped that a comprehensive picture emerges that provides a full story of the likely normative effectiveness of the Santiago Principles and helps inform the reader of the relevance of this document.

4.4.1 Governance and Operational Independence

Governance and operational independence are key concerns relating to SWFs. As has been noted in the preceding chapter, critics often inveigh against the poor governance practices at these entities, including their organisational structure, leadership and autonomy. Accordingly, a number of recommendations set out in the Santiago principles seek to address the governance of these institutions. These are reflected in several parts of the document but covered mainly in principles 7 and 9.

[783] Anna Gelpern 'Sovereign Wealth and Governance in International Finance' (2009), 23 <http://www.astrid-online.it/static/upload/protected/1-2_/1-2_Gelpern.pdf> Accessed 20th May 2018.

A cursory glance at these recommendations reveal that they are, for the most part, limited, unambitious and often seek to preserve or even entrench the ownership interests of SWF owner states. For example, Principle 7 requires the owner state of a fund to set its objectives, appoint its governing body and to exercise oversight over fund operations.[784] This underscores the inescapable fact that SWFs are, by definition, outgrowths of sovereign states, designed to invest national wealth in private markets often for public policy objectives.[785] Principle 7 therefore restates the residual responsibility of owner states to establish these entities and to shape their operations and institutional frameworks.

Yet, the principle can be criticised for its limited utility and ambition. For one, its authors make no attempt to codify standards on the rightful exercise of the power possessed by SWF owner states regarding the governance of these entities.

One can observe, for instance, that principle 7 preserves the right of SWF owner states to make appointments to the governing body of the fund and its operational management, yet there is the absence of any explicit provision mandating owner states to exercise this power judiciously including, for instance, a requirement to avoid board-level appointments that create inexorable conflicts of interests and ultimately undermine the operational autonomy of the fund. The codification of such a requirement would undoubtedly delegitimise the nepotistic appointments observed in certain SWFs, which is of paramount concern to recipients of SWF investments and other stakeholders.

This severely inadequate approach in the Santiago Principles should be contrasted with the OECD Guidelines for the corporate governance of State-owned Enterprises, a voluntary benchmark for State-Owned Enterprises promulgated by the OECD in conjunction with SOE

[784] Other principles further flesh out the owner's governance responsibilities including Principle 18 which states that 'The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner.' Principle 10 also provides for accountability to the owner.

[785] Regis Bismuth 'The Santiago Principles for Sovereign Wealth Funds: The Shortcomings and the Futility of self-regulation' (2017) 28(1) EBLR 69, 81.

owner states and other relevant actors in a more inclusive setting.[786] The guidelines require SOE owner states to set the objectives of SOEs and to appoint their governing bodies. However, they oblige SOE owner states to consider the establishment of well-structured and transparent board nomination processes, including where possible, the use of nomination committees and public appointment boards in appointing or electing SOE board members.[787]

The guidelines further regulate the board appointment process by requiring SOE owners to avoid appointing an excessive number of board members from the state administration.[788] The guidelines also proscribe the appointment of 'persons directly linked to the owner state executive' including heads of government and Cabinet ministers.[789] According to the OECD, the avoidance of such appointments is likely to safeguard the independence of the board, 'minimise conflicts of interests'… 'and prevent excessive government intervention in SOE management.'[790]

Given instances, highlighted above, of SWF owner states appointing cronies, government executives and Family Members to the governing body and management of SWFs, such an approach would arguably have served the utility of the Santiago Principles and improved the governance of SWFs.

Besides internal governance, the Santiago Principles also codify requirements on the operational independence of SWFs. This is reflected in a number of principles but mainly covered in principle 9. The principle requires the management of the fund to implement its strategies in an

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[786] The OECD Guidelines were promulgated by a large circle of partners and stakeholders, including the OECD, the World Bank, States with SOEs such as Argentina, Brazil, People's Republic of China, Costa Rica, Kazakhstan, Lithuania, Peru, the Philippines, South Africa and Ukraine. Inputs were received from the authorities in the following countries: Cabo Verde, Ecuador, Egypt, India, Indonesia, Iraq, Lao People's Democratic Republic, Malaysia, Mauritania, Morocco, Myanmar, Paraguay, Suriname, Thailand, Uruguay and Vietnam See: OECD, Guidelines on the Corporate Governance of State-Owned Enterprises (2015), 4 <https://www.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015_9789264244160-en> Accessed 20th May 2018.

[787] Ibid. at 34 and 39

[788] Ibid. at 35.

[789] Ibid. at 71

[790] Ibid. at 35.

'independent manner', in accordance with clearly defined responsibilities. To this end, Principle 9 suggests that the professional management of SWFs should have the authority to make individual investment decisions, as well as to make operational decisions relating to staffing and financial management.[791] This implies that the management of SWFs should be insulated from political direction and interference, which might go a long way in shielding the recipients of SWFs capital from investments of a potentially strategic or political nature.[792]

Notwithstanding this welcome tone, the commentary to Principle 9 which conveys the interpretation of its authors suggests something strikingly different. For a start, it suggests that the responsibilities of the Fund's management in investment decision-making should be subject to 'strategic direction from and accountability to the owner state or governing bodies.'[793] At its simplest, this implies that managers of SWFs should have the requisite authority to make investment decisions but should be open to direction from the owner state – a statement that hints at some form of qualified independence. This was presumably inserted by the IWG to preserve the ability of owner states to exercise their ownership duties without much restraint.

Yet, the practical and mortal risk with such a proviso is that it is unlikely to insulate fund managers from the whims and caprices of meddling owners – a situation that is likely to defeat the underlying objective of principle 9. Its inclusion in the Principles presumably underscores the reluctance of the IWG to prescribe, even on a voluntary basis, a set of ambitious standards on operational independence, including rules guaranteeing the organic or functional independence of SWFs, similar to that of independent financial regulators or central banks.[794]

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[791] Principle 9 – International Working Group, Sovereign Wealth Funds: Generally Accepted Principles and Practices (October 2008) <http://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf> Accessed 30th March 2017

[792] Ibid.

[793] Ibid.

[794] Regis Bismuth 'The Santiago Principles for Sovereign Wealth Funds: The Shortcomings and the Futility of self-regulation' (2017) 28(1) EBLR 69, 81.

This clearly inadequate approach should be contrasted with the OECD SOE guidelines which oblige owner states to allow SOEs 'full operational autonomy to achieve their defined objectives and to refrain from intervening in SOE management.'[795] According to the guidelines, this includes refraining from operational decision-making, including directing SOEs decisions.[796] The guidelines further attempt to disentangle ownership from control by recommending that the owner, through an ownership entity such as a government ministry or agency, should only provide direction to the SOE or its board in limited areas such as public policy objectives and should publicly disclose and specify the areas and types of decisions that it is competent to give instructions to the SOEs.[797]

This approach, although imperfect, is clearly robust in seeking to prevent owner states from unduly interfering in the operational management of an SOE. Even so, it is a world apart from the less than optimal standards on operational independence set out in the Santiago principles.

[795] OECD, Guidelines on the Corporate Governance of State-Owned Enterprises (2015), 34 <https://www.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015_9789264244160-en> Accessed 20th May 2018.

[796] Ibid.

[797] Ibid.

4.4.2 Transparency

Another key aspect of the principles is Transparency. As highlighted in the preceding Chapter, the variability in transparency amongst SWFs was one of the concerns that led to the promulgation of the principles in the first instance. Accordingly, the Santiago Principles broadly recommend the disclosure of information by SWFs.[798] Yet, much of these disclosure requirements are of tangential relevance to the broader activities of SWFs.[799] A deeper look at this document reveals however that the most substantive information about SWF activities are either exclusively reserved for the owner state or are not required to be publicly disclosed at all. In certain limited instances where key fund information is required to be publicly disclosed, this is carefully calibrated to defeat its relevance or meaningfulness – highlighting again the document's limited ambition and comprehensiveness.

One can observe the former in Principle 5 which provides that 'the relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner.' This is broadly similar to Principle 12 which recommends the disclosure of periodic internal and external audit reports to the owner.[800] For a bit of context, it is important to compare this principle to a similar benchmark

[798] Main aspects of the legal framework and structure of the fund are required to be disclosed (GAPP 1.2), a 'description' of the investment policy is also to be publicly disclosed (18.3), the general approach for the sources and withdrawal from the fund is also to be publicly disclosed (GAPP 4). Yet, most principles requiring general disclosure of information are often of tangential relevance to SWF investment activities or fail to give hints about how and when disclosures should be made – which again strikes at the clarity of the standards. See: Fabio Bassan 'The Law of Sovereign Wealth Funds' (Edward Elgar, 2011) 50.

[799] One example is the requirement for disclosure of the legal framework of the fund. This provision is arguably of little relevance to SWF regulation given that every mature or modern organisation is expected to disclose some element of their institutional or legal framework.

[800] Principle 12 op cit Santiago Principles

– the IMF's Guidelines for Foreign Exchange Reserve Management Funds which recommends public disclosure of audit reports.[801]

An additional instance where substantive fund level information is reserved for the owner state can be seen in Principle 23 which provides that 'the assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.'[802] This has the effect of denying overseas regulators, private counterparties and the domestic citizenry, access to information so basic as the fund's assets and investment performance.

Given the political history of the Santiago principles, this appears to be the product of intense IWG disagreements over the extent and nature of disclosure that has been graphically presented in the preceding section. Yet, a comparison with other governance benchmarks only serves to confirm the limited ambition and scope of this principle. One example is the OECD's guidelines for the Corporate Governance of SOEs which explicitly requires SOEs to publicly disclose material financial and non-financial information relating *inter alia* to 'enterprise financial and operating results.'[803]

Besides reserving key fund-level information to owner states, other elements of SWF operations are apparently not required to be disclosed at all in the Santiago principles. One example is Principle 11 which requires SWFs to 'prepare' in a timely fashion annual reports and accompanying financial statements on the SWF's operations and performance.[804] On paper, this

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[801] Guideline 20 – International Monetary Fund 'Revised Guidelines for Foreign Exchange Reserve Management' (2014)<https://www.imf.org/en/Publications/Manuals-Guides/Issues/2016/12/31/Revised-Guidelines-for-Foreign-Exchange-Reserve-Management-41062> Accessed 20th May 2018.

[802] Principle 23 op cit Santiago Principles.

[803] OECD, Guidelines on the Corporate Governance of State-Owned Enterprises (2015), 24 <https://www.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015_9789264244160-en> Accessed 20th May 2018.

[804] Principle 11 Santiago principles op cit.

principle serves to ensure the institutional integrity of the fund and to protect it from organisational risks such as misappropriation and corruption. A fund's annual report and accompanying financial statement is also a repository of information about the fund's underlying financial activities and modus operandi for a given financial year.

For a cursory observer, the wording of this principle might thus appear satisfactory and complete. Yet, a deeper consideration of its contents reveals a hidden and costly omission – a requirement for the public disclosure of annual reports and financial statements. The politics of the Santiago principles (examined above) suggests that the absence of such a requirement is a calculated attempt by the IWG to square the circles between rebel and conformist funds. However, this merely underscores the limited thrust of this document and the collective preference of its authors in excluding substantive information from the public domain.[805]

Another element of transparency covered in the principles concerns the redaction of certain public disclosure clauses to reduce their meaningfulness and relevance.[806]

One example is Principle 17 which recommends 'public disclosure of relevant financial information regarding a SWF to demonstrate its economic and financial orientation and to contribute to international financial stability.'[807] At first glance, this principle appears desirable and

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[805] As a consequence of the Principle 11's requirement for SWFs to merely 'prepare' an annual report, some IFSWF member funds publicly disclose these reports and several others do not. A Consideration of the Self-Assessment Reports published on the IFSWF webpage confirms this. For example, QIA notes in its answer to principle 11: 'The QIA issues to the Supreme Council for Economic Affairs (SCEAI) (its owner state) a consolidated annual report and consolidated financial statements in accordance with international and national accounting standards in a consistent manner.' (Emphasis Added) See: IFSWF 'Santiago Principles Self-Assessment: Qatar Investment Authority' (2017) <http://www.ifswf.org/assessment/qia> Accessed 20th May 2018.

[806] This is also the case in Principle 21 which states that SWFs 'should' publicly disclose *ex ante* their approach to voting on their shares. However, *ex post* disclosure (which is far more important and reflects the actual vote and orientation of the fund) is left to the discretion of an individual fund and is not, stricto sensu, to be publicly disclosed. To this end, the IWG merely notes that an SWF 'could' also make appropriate ex post disclosures – see Principle 21 Santiago Principles op cit.

[807] Principle 17 Santiago Principles op cit.

important. It underscores the nexus between transparency and financial stability which has been addressed in the preceding chapter and invites SWFs to disclose relevant financial information.

Yet, a careful consideration of its contents reveals serious limitations. For one, principle 17 interprets 'financial information' narrowly to include just 'the asset allocation of the fund,[808] benchmarks,[809] where relevant and rates of return.'[810] This suggests the explicit or at least implied exclusion of relevant financial data such as the fund's investment performance – which is reserved for the owner state in Principle 23, annual reports and financial statements and other information such as its currency composition, data on portfolio adjustment, use of credit ratings, size and actual holdings among others.[811]

In addition to this narrow conceptualisation of 'relevant financial information', principle 17 also imports a technical provision that further reduces the principle's significance and relevance. This concerns the disclosure of rates of return. Here, principle 17 refrains from prescribing the timely and periodic disclosure of rates of return, instead, it prescribes the disclosure of rates of return 'over appropriate historical periods consistent with investment horizons.'[812] This appears to

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[808] Asset Allocation is in simple terms, a statement of the instruments that a fund in likely to invest in such as bonds, shares/equities etc. See: FT.com/Lexicon, 'Definition of asset allocation' (2019) <http://lexicon.ft.com/Term?term=asset-allocation> Accessed 20th March 2019.

[809] Benchmarks are points of reference used to compare investment performance not actual data on performance. See: FT.com/Lexicon, 'Definition of benchmark' (2019) <http://lexicon.ft.com/Term?term=benchmark> Accessed 21st March 2019.

[810] Note that 'Rates of Return' are the profit of an investment, normally expressed as a percentage, not the fund's actual investment performance which as per Principle 23 is reserved for the owner state. For more Information, see: FT.com/Lexicon, 'Definition of Rate of Return' (2019) <http://lexicon.ft.com/Term?term=rate-of-return> Accessed 21st March 2019.

[811] Although Principle 17 notes that the 'narrow' financial information analysed above should be read in conjunction with Principles 2, 4, and 18.3, which speak to the fund's purpose, source of funding and investment philosophy/ policy, this is unlikely to bear out the fund's true, actual or ex post financial orientation (which is seemingly the ultimate purpose of principle 17) to the same extent as deeper financial information such as its asset performance, size, holdings etal – See: Ted Truman, Sovereign Wealth Funds: Threat or Salvation? (1st edn, Peterson Institute for International Economic, 2010) 135.

[812] Ibid.

be a compromise struck at IWG levels in response to Singapore's opposition over the disclosure of periodic returns but even so, the principle is problematic.

For instance, principle 17 is silent on what constitutes 'appropriate historical period', virtually leaving such a determination to individual SWFs. The history of the Santiago Principles and SWFs in general suggests that it is not implausible that these funds may simply apply this provision in ways that fail to improve public understanding of a SWF's performance or its rates of return. This risk is borne out in some of the self-assessment responses provided by SWFs to Principle 17.

One example is the Qatar Investment Authority (QIA) which in its self-assessment answer to principle 17 notes that 'QIA's Board will decide the time and the extent to which more information on the fund's financial orientation and position will be made publicly available.'[813] Similarly, the Kuwait Investment Authority merely notes in its self-assessment that 'KIA's investments are completely transparent to the State of Kuwait, which is responsible for protecting the interests of KIA's beneficiaries – the citizens of Kuwait.'[814] The above illustrates the diminished ambition and relevance of Principle 17 to SWF regulation.

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813 IFSWF 'Santiago Principles Self-Assessment: Qatar Investment Authority' (2017) <http://www.ifswf.org/assessment/qia> Accessed 20th May 2018.

814 IFSWF 'Santiago Principles Self-Assessment: Kuwait Investment Authority' (2017) <http://www.ifswf.org/assessment/kia> Accessed 20th May 2018.

4.4.3 Political Investments

Before addressing the principles that set out the position of the Santiago principles on political investments, it is worth recalling that the potential deployment of SWF for political and geostrategic reasons was perhaps the main catalyst for the promulgation of the Santiago Principles as foregrounded in the previous chapter.

Yet, the response of the document to the risk that SWFs may invest politically seems at best ambivalent, or at worst, futile. Indeed, the provisions that seemingly touch on the potential use of SWFs for political reasons are formulated in deliberately broad and elusive terms to obscure the contrarian intentions of its authors which can be observed in the accompanying commentary.[815]

This is reflected in Principle 19 which seemingly requires SWFs to invest purely on economic and financial grounds. To the ordinary eye, this might convey a sense of IWG disapproval about the deployment of SWFs for geopolitical reasons. Yet, the interpretation provided in the document suggests something markedly different.

This can be observed in sub-principle 19–1 which codifies an apparent proviso to the above and declares that 'if investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed.'

[815] This conclusion can also be observed in Principle 2 which requires the policy purpose of the SWF to be clearly defined and publicly disclosed. The importance of this principle is such that the IWG notes that: 'A clearly defined policy purpose facilitates formulation of appropriate investment strategies based on economic and financial objectives.' and …. 'ensures that the SWF undertakes investments without any intention or obligation to fulfil, directly or indirectly, any geopolitical agenda of the government.' Yet, with another breath the document suggests that 'the pursuit of any other types of objectives should be narrowly defined and mandated explicitly.' Which implies that the IWG were prepared to countenance situations where SWFs can indeed pursue secondary objectives that are beyond their stated policy purposes.

In this regard, the IWG refers only to investments with a social, environmental, ethical or religious dimension but not investments of a political or strategic nature, since it would naïve to expect SWFs to disclose such transactions.[816]

Yet, it is manifest that the IWG does not explicitly and totally proscribe SWFs from pursuing investments of a non-economic or financial nature, including those with a potentially political undertone since it is willing to countenance instances in which SWFs might deviate from such a foundational principle. This is short of a plain commitment that these entities would refrain from investing to meet political ends. [817]

[816] Regis Bismuth 'The Santiago Principles for Sovereign Wealth Funds: The Shortcomings and the Futility of self-regulation' (2017) 28(1) EBLR 69, 82.

[817] Julien Chaisse, Debashis Chakraborty and Jaydeep Mukherjee, 'Emerging Sovereign Wealth Funds in the Making: Assessing the Economic Feasibility and Regulatory Strategies' (2011), 45 Journal of World Trade 837, 866.

4.4.4 Competition

Alongside the above, the Santiago Principles also offer important recommendations on competition by SWFs with other market participants. This can be observed in Principle 20 which requires SWFs 'not to seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.' In principle, this establishes norms of competitive parity between SWFs and other private market counterparties – an idea that is most welcome. However, the provision contains severe limitations which contradict its underlying objective.

Quite noticeable is an accompanying footnote which implies that target countries may grant SWFs certain privileges based on their 'governmental status', such as sovereign immunity and sovereign tax treatment.[818] At first glance, this affirms that SWFs are indeed instrumentalities of government but remarkably also, it suggests that they can be accorded advantages not normally granted to private competitors – an idea that is directly contradictory with the text of Principle 20 and other provisions which emphasise the supposedly commercial or financial orientation of SWFs.[819]

By definition, immunity from lawsuits occasioned by the commercial activity of an SWF confers on it a direct competitive advantage that may not be enjoyed by an actor of a private

[818] Principle 20 – International Working Group, *Sovereign Wealth Funds: Generally Accepted Principles and Practices* (October 2008) < http://www.ifswf.org/sites/default/files/santiagoprinciples_0_0.pdf > Accessed 30th March 2017. Pg. 22.

[819] Principle 19 and 14 Santiago Principles

character.[820] So also, is the idea of preferential tax treatment based on the governmental status of the fund.[821] Indeed, one commentator has described tax exemptions for SWFs in the United States as an 'unjustified public subsidy', implying that the conferment of these benefits on SWFs is a direct competitive advantage vis a vis other market actors[822]

The inclusion of this proviso in the principles again highlights the reluctance of its authors to codify a full waiver of all competitive privileges accruing to SWFs and underscores the broader agenda of the IWG in limiting the thrust of the principles and safeguarding the interests of SWFs.

This should be compared with the OECD guidelines on the Corporate Governance of SOEs which provides an incisive disapproval of any privileges to SOEs vis a vis other actors of a private character in the context of their market activity. The guidelines provide quite simply that 'as a guiding principle, SOEs undertaking economic activities should not be exempt from the application of general laws, tax codes and regulations.'[823] This again underscores the suboptimal prescriptions of the Santiago principles on Competition between SWFs and other private market actors.

4.4.5 Monitoring

Alongside the limited prescriptions on Competition, the Santiago Principles also set out recommendations relating to the monitoring of adherence. These are contained in Principle 24 which reads as follows: 'A process of regular review of the implementation of the GAPP should

[820] Antonio Capobianco and Hans Christiansen 'Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options' (2011),5 <https://www.oecd-ilibrary.org/governance/competitive-neutrality-and-state-owned-enterprises_5kg9xfgjdhg6-en> Accessed 23 January 2019.

[821] Ibid.

[822] Jennifer Bird-Pollan 'The Unjustified Subsidy: Sovereign Wealth Fund and the Foreign Sovereign Tax Exemption' (2012) 17 Fordham Journal of Corporate and Financial Law 987.

[823] OECD Guidelines op cit page 47.

be engaged in by or on behalf of the SWF.'[824] On the face of it, this codifies the idea of first-party reporting or self-assessment which as argued by Potoski is unlikely to constitute robust monitoring of adherence or even insulate the process from free riding.[825] The explanatory note to the principle confirms as much by stating that 'It is desirable for each SWF or its owner or governing body(ies) on behalf of the SWF to use the GAPP to review the SWF's existing arrangements and assess its ongoing implementation on a regular basis with the results reported to its owner or governing body(ies).' [826]

Notwithstanding the concerns over the credibility and ambition of such an approach, the principle further refrains from prescribing the public disclosure of self-assessment reports. This is again confirmed in the explanatory commentary which notes that: 'The owner or the governing body(ies) may choose to publicly disclose the assessment to the extent it believes such disclosure is consistent with applicable laws and/or regulations and may contribute to stability in international financial markets and enhance trust in recipient countries.' It thus appears that SWFs are not only the appointed judge and jury over the implementation process but they may also choose not to disclose the outcomes of the process.

The reservation of such disclosure to SWF owner states and governing bodies speaks volumes about the collective obsession of the IWG in limiting the scope of the standards and in prioritising the institutional and ideological preferences of SWFs and their owner states. Given that the supposed motivating objective of the principles was to ensure greater transparency and understanding of SWF operations, it is hard to see how opacity over a fund's own assessment of compliance achieves such an objective.

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[824] Santiago Principles 24 op cit.

[825] Matthew Potoski and Aseem Prakash, 'Covenants with Weak Swords: ISO 14001 and Facilities' Environmental Performance' (2005) 24(4) Journal of Policy Analysis and Management 745, 750.

[826] Santiago Principles 24 op cit.

To summarise, in addition to the fraught negotiations that produced the Santiago Principles, one can also observe via the preceding analysis of its substance that the document is severely limited. In addition to the high-level and often elusive nature of its provisions, there also appears to be a pattern of inconsistency between a number of recommendations and their underlying commentary – a situation which implies diminished clarity or a lack of precision.

Also, on the most substantive recommendations of the document on Governance and Operational Independence, Transparency, Political Investments and Competition which coincidentally were the policy objectives behind the Santiago framework, one can observe the reluctance of its authors to codify stringent standards requiring SWFs to internalise serious governance costs or waive important privileges (meaningful changes), – which again confirms the document's limited thrust and ambition. This becomes even more apparent when one juxtaposes certain key elements of the principles with other governance benchmarks applicable to sovereign investors such as the OECD guidelines for SOEs and the IMF's guidelines for Reserve Investment Funds.

The substantive deficiencies aside, the document also codifies a system of first-party monitoring of compliance (self-assessment) without a countervailing requirement for objective evaluation. Even so, the decision on the disclosure of these self-monitoring reports is left to the discretion of SWFs and their owners, meaning that in theory, a SWF may choose not to disclose its own assessment of compliance.

Given that the test for normative effectiveness as set out in Chapter 2 requires the existence of comprehensive and ambitious standards, relative to the policy objective and backed by robust, independent, third-party monitoring or evaluation, it would appear that the principles as they currently stand are unlikely to satisfy this test and are thus not likely to effectively regulate SWFs in the broader public interest.

4.5 Conclusion

This chapter set out to investigate the rise of transnational standards for SWFs and the associated rise of self-regulation amongst these funds. The first section began with an analysis of the issues which sparked the need for transnational standards – the perception in capital recipient states that SWFs are instruments for the foreign policy goals of their home states. The section also considered the multiple actors that shaped the path to SWF standards, focusing, in particular on the roles of the United States Treasury, the Group of 7 Nations (G7) and the IMF which was invited by the G7 to lead the original standard setting process. The first section also examined the logistics of the IMF's work, including the convening of an International Working Group of SWFs from over 26 countries of the world.

The second section moved beyond the pre-negotiation stage to the actual negotiations. Under scrutiny was the IMF's leadership of the drafting process which provoked concerns from SWFs, leading to the former's eventual withdrawal from a dominant role in the Standard-setting process. This led to the rise of organic self-regulation amongst SWFs themselves– a subject at the heart of this thesis.

The second section also delved into the technical aspects of the Negotiations, revealing the intricacies of reaching agreement on standards for SWFs. Also established was the collective agenda of the largest IWG funds in limiting the scope of any emergent standards which confirms the narrative that self-regulating groups are likely to pursue narrow individual or collective interests or what is often characterised in the governance literature as regulatory capture.

The product of this deeply political negotiation – the Santiago principles, largely portrays the fingerprints of its authors. It is characterised by minimum standards, expressed in generalised language and which broadly reflect the institutional interests of SWFs and their owner states.

The third section evaluated the substance of the Principles. Here, emphasis was placed on the most substantive recommendations relating to Governance and Operational Independence, Transparency, Political Investments and Competition which also reflect the main concerns ascribed to SWFs.

This section revealed a troubling pattern of inconsistency between certain principles and its underlying commentary – a situation which implies textual imprecision and diminished clarity. The section also revealed that the most important recommendations of the document on Operational Independence, Transparency, Political Investments and Competition, are marred by the lack of stringent or ambitious prescriptions requiring SWFs to internalise serious governance costs or waive important privileges, again showing the reluctance of its authors to codify ambitious and stringent standards. This lack of stringency and ambition becomes far more radical when some of the principles referenced here are juxtaposed with comparable benchmarks such as the OECD guidelines on the Corporate Governance of SOEs and the IMF's Benchmark for reserve investment funds.

Following this was a consideration of the form of monitoring enshrined in the principles. Here, the chapter established that the Santiago Principles appear to codify a system of first-party monitoring of compliance (self-assessment) without any countervailing requirement for objective or independent evaluation. Even so, the decision on the disclosure of these self-assessment reports is left to the discretion of SWFs themselves, meaning that in principle, a SWF may choose not to disclose the details of its own self-assessment. As highlighted in Chapter 2, self-assessment or first party monitoring is unlikely to facilitate effective self-regulation given the inherent credibility challenges associated with such a process.

This leads one to the disconcerting conclusion that the Santiago Principles as a whole are unlikely to meet the test of normative effectiveness given the diminished clarity and inconsistency of its provisions, the limited ambition of the standards contained therein and the absence of

independent monitoring and verification. The next Chapter continues the debate on effectiveness by considering the institutional aspects of effectiveness focusing, in particular, on the governance, transparency and accountability of the International Forum of Sovereign Wealth Funds (IFSWF). And the levels of compliance amongst SWFs since the promulgation of the questionable standards contained in the Santiago Principles.

CHAPTER 5: THE INTERNATIONAL FORUM OF SOVEREIGN WEALTH FUNDS AND THE IMPLEMENTATION OF THE SANTIAGO PRINCIPLES

5.1 Introduction

Having considered the structure of the Santiago Principles and their limited normative effectiveness, this Chapter sets out to examine the remaining aspects of self-regulatory effectiveness as defined in Chapter 2.

The first section introduces the International forum of SWFs through the lens of its publicly available constituting document: The Kuwait Declaration 2009. This section also examines the internal governance of the forum and its record on transparency and accountability. These are undoubtedly important in understanding the nature of this organisation and in establishing its broader relevance and efficacy.

The next section moves beyond institutional dynamics. It considers instead the levels of compliance amongst SWFs since the promulgation of the Santiago Principles in 2008. First, emphasis is placed on two IFSWF publications: the 2011 IFSWF Report on Members' Experience in the implementation of the Santiago Principles and its 2013 counterpart. Both reports set out the perception of the Forum's members on the level of compliance with the Santiago principles. This is significant because it helps one understand the dynamics of the forum's work and sets the tone for a deeper analysis of the likely levels of compliance with the principles.

The third section is allied to the second. It goes beyond the analysis of the IFSWF on compliance with the principles. Instead, it examines third-party, independent insights on the level of compliance amongst SWFs since the promulgation of the principles. Under particular consideration are the Truman Scoreboard and the Geoeconomica Santiago Compliance Index – both analyses are widely cited and reputable sources on the SWF compliance with the Santiago

principles.[827] Drawing from the insight provided in both indices, the section offers a strong narrative of the level of compliance with the principles but crucially also, the degree of progress or change in implementation. This helps in providing answers to the research question which considers the extent to which the Santiago Principles and the Forum can be considered as effective self-regulation for SWFs. The final section concludes the chapter.

[827] Anna Gelpern, 'Sovereignty, Accountability, and the Wealth Fund Governance Conundrum' (2011) 1(2) Asian Journal of International Law 289, 309.

5.2 The Nature of the International Forum of SWFs

As a postscript to the questionable set of principles analysed above, the IWG decided to formalise continuing interactions amongst SWFs by establishing an institutional counterpart to the Santiago principles.[828] This forum now known as the International Forum of Sovereign Wealth Funds was established in April 2009, just days after the April 2009 G-20 summit in London, by virtue of the Kuwait Declaration 2009.[829] Given that the pillars of self-regulatory effectiveness identified in Chapter 2 requires a consideration of institutional factors alongside normative considerations, it has become imperative to study the nature and structure of this organisation of SWFs, charged with driving the implementation of the Santiago Principles

The starting point of analysis about the nature of the forum is its constitutional document: The Kuwait Declaration of April 2009.[830] According to the Declaration, the International Forum is a voluntary group of SWFs.[831] The emphasis on the voluntarism of the forum channels the suspicion of SWFs to any perception of command and control regulation and fits completely within the self-regulation paradigm that is central to this thesis. The 'purpose of the forum is to meet, exchange views on issues of common interest, and to facilitate an understanding of the Santiago Principles and the activities of SWFs.'[832]

The declaration further underscores the soft and voluntary character of the Forum by averring that it is not a supranational authority and that its work does not carry any legal force.[833]

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828 Eliza Malathouni, 'the Informality of the International Forum of Sovereign Wealth Funds and the Santiago Principles: A Conscious Choice or a Necessity?' In A Berman, S Duquet, J Pauwelyn, R Wessel and J Wouters (eds) *Informal International Lawmaking: Case studies* (1st edn, TOAEP, 2010) 263.

829 Ibid.

830 IFSWF '*Kuwait Declaration'* (2009) http://www.ifswf.org/santiago-principles-landing/kuwait-declaration> Accessed 20th January 2018

831 Ibid.

832 International Forum of Sovereign Wealth Funds, *Kuwait Declaration* (2009) Available [online] at <http://www.ifswf.org/santiago-principles-landing/kuwait-declaration> Accessed 20th January 2018

833 Ibid.

The intention appears to be to create a soft institutional successor to the IWG presumably to carry on the latter's work as the author of the Santiago Principles.

More specifically, the Forum is to serve three objectives. First, it is to serve as a platform for exchanging ideas and views amongst SWFs and with other relevant parties.[834] This may be characterised as the dialogic or informational element of the Forum's work. According to the Kuwait Declaration, these interactions will focus on issues such as trends and developments pertaining to SWF activities, risk management, investment regimes, market and institutional conditions affecting investment operations and interactions with the economic and financial stability framework.[835] Given the challenges that SWFs raise on all these issues, it is not surprising that these matters should be a component of the forum's operations.

Secondly and more relevant to the instant discussion, the forum is to share views on the application of the Santiago Principles including operational and technical matters. This can be characterised as the governance element of the Forum's work. However, the emphasis on 'sharing views' underscores the hesitancy of the IWG in creating a robust construct with explicit monitoring and enforcement powers. It implies instead, a reliance on sociological pressures (normative and mimetic) rather than explicit sanctions in promoting the Santiago Principles.[836] This corresponds with institutional analyses of self-regulation which emphasise the role of normative and mimetic pressures such as the sharing of views, peer pressure and emulation in driving up standards in regulatory settings.[837] However, as Chapter 2 makes clear, the efficacy of

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[834] Ibid.

[835] Ibid.

[836] Joseph Rees, 'Development of Communitarian Regulation in the Chemical Industry' (1997) 19(4) Law and Policy 477, 512

[837] Neil Gunnigham and Joseph Rees, 'Industry Self-Regulation: An Institutional Perspective' (1997) 19(4) Law and Policy 363,381. See also Joseph Rees, '*Development of Communitarian Regulation in the Chemical Industry'* (1997) 19(4) Law and Policy 477, 512.

these forces in driving up standards and eliminating free-riding in voluntary systems are severely contested.[838]

Alongside this governance objective, the forum is also to encourage cooperation between investment recipient countries, relevant international organisations and capital markets functionaries to identify potential risks that may affect cross-border investments, and to foster a non-discriminatory, constructive and mutually beneficial investment environment.[839] This may be characterised as the defensive element of the Forum's work. Indeed, the focus on interactions with recipient states and multilateral institutions reminds one of the acrimonious atmosphere in which the Santiago principles were devised. Yet, cynics may argue that the intention of the forerunners of the IFSWF process in opening the door to these actors is precisely to keep them onside and perhaps to forestall tougher policy action in relation to SWFs – a situation which confers a veneer of respectability on the entire process.[840]

Besides the objectives and purpose of the forum, its mandate is also considered in the Kuwait Declaration. Here, the document notes that the Forum is to operate in an 'inclusive' manner and is to facilitate communication amongst SWFs, recipient country officials, representatives of Multilateral Institutions and the private sector. This is significant. Inclusivity and representativeness amongst relevant actors is a key element of effectiveness in voluntary regulatory systems as specified in Chapter 2.[841] It denotes the ability of relevant actors to participate in the operations of self-policing groups.[842] To this end, the IFSWF has continued its predecessor's

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[838] For one, Prakash and Potoski caution against a reliance on sociological pressures alone. See: Aseem Prakash and Matthew Potoski 'Collective Action through Voluntary Environmental Programs: A Club Theory Perspective' (2007) 35(4) The Policy Studies Journal 773, 780.

[839] International Forum of Sovereign Wealth Funds, Kuwait Declaration (2009) Available [online] at <http://www.ifswf.org/santiago-principles-landing/kuwait-declaration> Accessed 20th January 2018

[840] Anthony Ogus, *Regulation: Legal Form and Economic Theory* (1st edn, Hart publishing, 2004) 2

[841] Julia Black, 'Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a Post-Regulatory World' (2001) 54(1) Current Legal Problems 103,115

[842] Ibid.

tradition of offering associate or observer status to organisations such as the US Treasury, the European Commission, OECD, World Bank, IMF, the Commonwealth Secretariat and other self-regulatory groups such as the Hedge Funds Standards Board.[843] However, there is strong circumstantial evidence that the forum's limited operations are led, for the most part, by the funds themselves, with little to no input from the parties highlighted above. For instance, the most technical aspects of the forum's annual meetings are exclusively reserved for Member Funds and operated behind closed doors with the exclusion of other invited parties such as recipient state officials.[844] Moreover, there is little sign of the forum co-opting the above-mentioned actors or NGOs in the resource governance sector in its broader regulatory agenda.

The Kuwait Declaration also notes, as part of the forum's mandate that the organisation exists to serve the underlying objectives behind the Santiago Principles. The most optimistic reading of this is that the Santiago Principles are hard-wired into the operations of the IFSWF Forum. Indeed, one author has described the forum as a soft institutional counterpart of the Santiago principles, underscoring its putative role in the midwifery of the principles.[845]

Notwithstanding this purported nexus between the principles and the forum, one cannot help but notice the glaring omission of a serious commitment to further standard-setting, refining the principles or even the enforcement of deviance in the forum's mandate. The omission of such a crucial element underlines the lukewarm attitude of the forum's members to the idea of a robust

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[843] IFSWF 'Auckland Communique' (2016) <http://www.ifswf.org/general-news/auckland-communiqu%C3%A9> Accessed 20th May 2018. See also: IFSWF 'International Forum of Sovereign Wealth Funds (IFSWF) and Hedge Fund Standards Board (HFSB) establish Mutual Observer relationship' (2016) <http://www.ifswf.org/news/2016-04-04/international-forum-sovereign-wealth-funds-ifswf-and-hedge-fund-standards-board-hfsb> Accessed 20th May 2018.

[844] The International Forum of Sovereign Wealth Funds 'Meeting Presentation' (2017) 8-10 <http://www.ifswf.org/sites/default/files/files/IFSWF_Presentation_2017.pdf> Accessed 20th May 2018.

[845] Anna Gelpern, 'Hard, Soft, and Embedded: Implementing Principles on Promoting Responsible Sovereign Lending and Borrowing' in Carlos Esposito, Yuefen Li, Juan Pablo Bohoslavsky, *Sovereign Financing and International Law: The UNCTAD Principles on responsible Sovereign Lending and Borrowing* (1st edn, OUP 2013) 373.

coordination mechanism for SWFs. This sentiment is confirmed when read in conjunction with the IWG's accentuation of the 'voluntary' character of the IFSWF process and the acrimonious back story of the Santiago negotiations which resulted in vastly reduced standards with no monitoring mechanism.

On the one hand, this seems consistent with the narrative highlighted in Chapter 2 that Self-regulating groups are prone to adopting loose standards and procedures as part of a broader deregulatory and cost-limiting agenda. Yet, one cannot escape the sharp contrast between the loose mandate of the IFSWF and comparable voluntary organisations such as the Equator Principles Association – a self-regulatory organisation of financial institutions involved in Project Finance – which sets out in its operational Mandate, a responsibility for refining and reviewing the Equator Principles and Monitoring its impact.[846]

Besides the mandate of the IFSWF, its membership is also addressed in the Kuwait declaration. According to the Declaration, the initial members of the Forum are the twenty-six SWFs who participated in the IWG process and that have endorsed the Santiago Principles. The document also makes clear that Membership is open to other funds who meet the Santiago Principles definition of a SWF and that endorse the Principles on a voluntary basis. This has the effect of tying present and future membership of the forum to the endorsement of the questionable set of guidelines drafted and agreed by the IWG. It is also pertinent to note that the Forum's membership has grown since its inception in 2009 from a membership of about 26 funds to a membership of 33 SWFs at the time of writing in early 2018.[847] However, in reality, the

[846] Equator Principles Association, 'Governance Rules' (April 2017) Online at <http://equator-principles.com/wp-content/uploads/2018/01/governance-rules-april-2017-v2.pdf> Accessed 20th January 2018

[847] International Forum of Sovereign Wealth Funds, *Our Members* (2018) Online at <http://www.ifswf.org/our-members> Accessed 20th January 2018

forum's membership constitutes only a small part of the SWF Ecosystem with only US$ 3 trillion out of the over US$7 Trillion of Assets held by SWFs globally.[848]

This is hardly surprising given that the forum does not host some of the largest funds in the world. One example is Norway's Government Pension Fund Global – widely touted as the largest and most transparent fund in the world and which is not a current member of the Forum. It would be recalled that the Norwegian fund participated in the Santiago negotiations and was in fact a founding member of the IFSWF. However, the fund withdrew its membership in 2016, citing its frustration with the forum's inability to raise standards amongst SWFs.[849] This can be observed in the fund's explanation which notes that:

> 'It is important for the Norwegian government to encourage and ensure transparency about the management of sovereign wealth funds, including objectives, governance framework, investments and risk management. The IFSWF has not met our expectations as an organization with sufficiently strong progress in the implementation of these principles. Therefore, we decided to discontinue our membership in the organization in 2016.'[850]

The above statement clearly calls into question the efficacy of the forum in raising standards across the SWF industry and in driving implementation of the principles – an issue at the heart of the research question and which is addressed in greater detail below.

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[848] IFSWF 'Turkiye Wealth Fund approved for membership of the IFSWF' (2017) <http://www.ifswf.org/general-news/turkiye-wealth-fund-approved-membership-ifswf> Accessed 20th May 2018.

[849] Sarah Stone and Ted Truman, 'Uneven Progress on Sovereign Wealth Fund Transparency and Accountability' (October 2016) PIIE Policy Brief PB 16-18, 14. Online at <https://piie.com/system/files/documents/pb16-18.pdf> Accessed 29 January 2018

[850] Ted Truman 'Perspective: sovereign wealth funds: Building on a decade of progress' in IFSWF, 'The Origin of the Santiago Principles: Experiences from the past; Guidance for the future' (2018) <http://www.ifswf.org/sites/default/files/IFSWF_Santiago_Principles_book.pdf> Accessed 20th November 2018.

Besides the Norwegian fund, the Forum also does not count large funds from Algeria, Brunei, and Brazil amongst its membership. Also absent on the IFSWF's membership list is Saudi Arabia's Public investment fund (PIF) – which manages well over $230 billion and is regarded as one of the largest SWFs across the world.[851]

In a more insidious way, some States owning several SWFs are represented by only one fund at the forum. Such is the case for China, whose investment fund, the China Investment Corporation (CIC) is an active IFSWF member, whereas its other fund, SAFE Investments is not. As highlighted in Chapter 3, SAFE investments is largely responsible for directing China's vast foreign exchange reserves, sometimes in an aggressive and controversial manner. This is also the case for Russia,[852] Singapore[853] and the UAE[854] all represented at the forum by one fund with other controversial compatriots as non-members. This limited membership has prompted one author to question the forum's influence and significance in the world of SWF regulation and governance.[855]

In addition to membership, the Kuwait Declaration also sets out a number of requirements relating to forum meetings and representation. In the context of the former, forum members are to meet annually although special meetings may be convened by the forum's leadership.[856] The

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[851] Arash Massoudi, Anjli Ravil and Simeon Kerr 'Saudi Arabia taps BofA Banker for Sovereign wealth Fund Job' *Financial Times* (London, 1 November 2017) <https://www.ft.com/content/be8a8bd8-be78-11e7-9836-b25f8adaa111> Accessed 22 January 2018

[852] The Russian Direct Investment Fund (RDIF) is the only Russian representative at the Forum. Its compatriot the Russian National Reserve Fund withdrew its Membership. See:

[853] Singapore is represented only by GIC Investments whilst its other fund Temasek a founding Member of the Forum is not – having withdrawn its Membership.

[854] The UAE owns several funds including Mudabala Inc a controversial and strategic investor – see Chapter 3, yet only the Abu Dhabi Investment Authority (ADIA) is represented at the Forum.

[855] Regis Bismuth, 'The Santiago Principles for Sovereign Wealth Funds: The Shortcomings and the Futility of self-regulation' (2017) 28(1) EBLR 69, 85. For information on the forum's membership, See: International Forum of Sovereign Wealth Funds, Our Members (2018) Online at <http://www.ifswf.org/our-members> Accessed 20th January 2018

[856] International Forum of Sovereign Wealth Funds, 'Kuwait Declaration' (2009) Available [online] at <http://www.ifswf.org/santiago-principles-landing/kuwait-declaration> Accessed 20th January 2018

declaration also empowers the Chair or Deputy Chairs, in consultation with forum members, invite relevant recipient countries, and any other person, entity, or organization with an interest in the business of SWFs, as observers.[857] Past observers to IFSWF meetings include the US Treasury, the European Commission and multilateral organisations such as the International Monetary Fund and the World Bank.[858]

In terms of representation, the declaration states that 'each member is entitled to nominate up to three senior level officials of the SWF, its owner state or governing body as its representatives at Forum events and meetings.'[859] This is significant for two reasons. First, it highlights the proximity between several SWFs and the apparatus of their owner states and governments. Secondly, the incorporation of owner states into the architecture of the IFSWF further underscores the blurred divisions between public and private of which Sovereign wealth funds are perhaps the most visible indicators.

The declaration further addresses the organisational chart of the forum. This includes a requirement that the Forum is to be led by a chair, who is supported by two deputies and a secretariat. The precise functions and roles of these officers are not known nor are they addressed within the Kuwait declaration. Instead, the document goes on to prescribe a few requirements relating to the election of the Forum's leadership. This includes a requirement for board positions to be subject to bi-annual elections by forum members based on a consensus vote.[860] This raises additional questions.

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[857] Ibid.

[858] International Forum of Sovereign Wealth Funds, 'Auckland Communique' (November 2016) Available [Online] at <http://www.ifswf.org/general-news/auckland-communiqu%C3%A9> Accessed 30th April 2018.

[859] International Forum of Sovereign Wealth Funds, 'Kuwait Declaration' (2009) Available [online] at <http://www.ifswf.org/santiago-principles-landing/kuwait-declaration> Accessed 20th January 2018

[860] Ibid.

For one, it is unclear how candidates for IFSWF Board positions are to be nominated or chosen, including any geographical or diversity factors to be taken into considerations. This is significant given that the forum's predecessor, the IWG, had always strived to maintain a balance between Middle Eastern, Asian and Western Funds in leadership positions. The Declaration is also unnervingly silent about striking issues such as the conduct of Forum elections, the balloting process, suitability requirements for potential board level candidates and the rotation, if any, of board positions.

This stands in sharp contrast to other self-regulatory groups such as the Equator Principles Association whose Governance rules codifies detailed provisions on board elections, including the processes of nominations and rotations.[861] Another comparator is the Principles for Responsible Investment Association – a self-regulatory group of ethical investment funds – whose governance rules set out comprehensive procedural requirements for the conduct of leadership Elections, ranging from the processes for nominations to the electioneering process and the need for diversity at board levels.[862]

Last but not least, the Kuwait Declaration prescribes certain requirements regarding the internal governance of the Forum. Here, it requires the board in consultation with Forum members to establish working groups to carry on the forum's activities. These groups are to be staffed by SWFs themselves but not recipient state representatives or multilateral institutions.[863] According

[861] Equator Principles Association, 'Governance Rules' (April 2017), 24, Online at <http://equator-principles.com/wp-content/uploads/2018/01/governance-rules-april-2017-v2.pdf> Accessed 20th January 2018.

[862] PRI Association, 'Board Election Rules' (September 2016) Online at <https://www.unpri.org/Uploads/f/q/c/2016-09-22-PRI-Association-Board-Election-Rules-.pdf> Accessed 20th January 2018.

[863] International Forum of Sovereign Wealth Funds, 'Kuwait Declaration' (2009) Available [online] at <http://www.ifswf.org/santiago-principles-landing/kuwait-declaration> Accessed 20th January 2018

to the Declaration, these groups are to report and make recommendations to the Forum with regard to the mandates for which they are established.[864]

At the time of writing, the IFSWF operates three working groups or subcommittees. Sub-Committee 1 is responsible for examining the practical application of the Santiago Principles and to report back to the forum on the challenges faced by members in their implementation of the principles. The committee is also tasked with facilitating greater understanding of the principles – an undoubtedly important role.[865]

Sub-committee 2 on the other hand aims to reinforce the existing dialogue on a non-discriminatory investment environment between SWFs and their interlocutors such as recipient states, international organisations and regional institutions amongst others. The perception here seems to be that robust engagement with such stakeholders might keep the global investment environment open as well as douse further attempts to regulate SWFs in a stringent way. Finally, Sub-Committee 3 deals with investment and risk management practices amongst SWFs.[866]

To date, the operations of these committees are largely unknown and shrouded in secrecy. Indeed, the only publicly available information about these individual committees are the description of their respective roles in the Kuwait Declaration. Beyond this, there appears to be little public information on the forum's webpage about the meetings of these committees, their terms of reference or reports to the forum as provided by the Kuwait declaration. This stands in sharp contrast with the Global Investment Performance Standards, a self-regulatory group of

[864] Ibid.

[865] Ibid.

[866] International Forum of Sovereign Wealth Funds, 'Kuwait Declaration' (2009) Available [online] at <http://www.ifswf.org/santiago-principles-landing/kuwait-declaration> Accessed 20th January 2018

Investment Funds, established under the aegis of the CFA Institute, which publicly discloses the terms of reference of its subcommittees and details of meetings up till January 2015.[867]

There have been recent reports of the consolidation of these working groups into a single advisory committee but again, there is little public information about the rationale for this change or even information about the composition of the new advisory committee or its terms of reference.[868] Indeed, the forum's webpage contains a link christened 'advisory committee' which remains strikingly vacuous at the time of writing in late 2018. [869] This raises severe doubts about the seriousness of the IFSWF as a self-regulatory group of SWFs.

Other than the contents of the markedly limited Kuwait declaration, there appears to be no other publicly available procedural rules or requirements for the International Forum of Sovereign Wealth Funds and its members.[870] Although there have been press releases about a Constitution and Charter reportedly agreed by IFSWF Members at the 2013 Oslo meeting which presumably contains detailed procedural and governance rules, this has yet to be publicly disclosed or debunked.[871] This means that much of the decision-making processes in the forum as well as the function of its leadership and members, remain shrouded in secrecy nine years after its creation.

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867 See for more information: GIPs Standards 'Subcommittee Meeting Materials' (2018) <https://www.gipsstandards.org/governance/subcomm/Pages/meetings.aspx> Accessed 20th December 2018.

868 International Forum of Sovereign Wealth Funds, Advisory Committee (2018) Available [Online] at <http://www.ifswf.org/advisory-committee> Accessed 20th February 2018

869 IFSWF 'Advisory Committee' (2018) <http://www.ifswf.org/advisory-committee > Accessed 20th November 2018.

870 Locknie Hsu, 'Santiago GAPPs and Codes of Conduct' in F Bassan (eds) *Research Handbook on Sovereign Wealth Funds and International Investment Law* (1st edn, Edward Elgar, 2015) pg. 113.

871 IFSWF 'Oslo Statement of the International Forum of Sovereign Wealth Funds' (2013) <http://www.ifswf.org/press-release/oslo-statement-international-forum-sovereign-wealth-funds> Accessed 20th May 2018. See also Hsu op cit.

The opacity of forum extends beyond procedural matters to its conventional operations. For example, the minutes of the forum's board meetings and AGM[872] are not disclosed at all nor does it publish an annual report which explains its activities to interested observers and stakeholders. Given that Kuwait Declaration requires the forum's secretariat to maintain such records and minutes, it appears that the non-disclosure of these documents is more of a deliberate organisational approach rather than a problem created by the non-existence of these documents. This makes a mockery of the idea that the forum exists to raise the understanding of SWF operations.

Even worse, decisions of an important nature such as the withdrawal of forum Members are not reported or announced. Nor are the processes of Member on-boarding. This is remarkable given that the forum has lost 4 members since its inception namely: Norway's Government Pension Fund Global, Bahrain's Mumtakalat Fund, Singapore's Temasek and the Equatorial Guinea for Future Generations.[873] On each occasion, the Forum has not deemed it necessary to announce such withdrawals or to explain the rationale for the departure of its Members to external observers and stakeholders to whom it is presumably accountable.[874] Forum observers have therefore been left to read between the lines for the rationale of these decisions and in the case of the Norway fund, to obtain this information via independent press reports.

The ostensibly conscious opacity of the IFSWF stands in sharp contrast to the operations of other voluntary organisations. One example is the PRI Association – a self-regulatory

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[872] George Kratsas and Jon Truby, 'Regulating Sovereign Wealth Funds to avoid Investment Protectionism' (2015) 1(1) Journal of Financial Regulation 95, 132.

[873] Sarah Stone & Ted Truman, 'Uneven Progress on Sovereign Wealth Fund Transparency and Accountability' (October 2016) PIIE Policy Brief PB 16 -18, 15 <https://piie.com/system/files/documents/pb16-18.pdf> Accessed 20 April 2018.

[874] IFSWF Report 2011 discussed below referred to the possibility of reviewing the membership of inactive members but it is not clear what became of this suggestion. See Sarah Stone & Ted Truman, 'Uneven Progress on Sovereign Wealth Fund Transparency and Accountability' (October 2016) PIIE Policy Brief PB 16 -18, 15 <https://piie.com/system/files/documents/pb16-18.pdf> Accessed 20 April 2018.

organisation of ethical investment funds – which maintains a list of delisted or withdrawn members and discloses important details about its regulatory activities, including the minutes of its board, information on Board and Committee attendance records, regulatory decisions and an annual report which sets out its achievements for a given financial year and its priorities for the next.[875] A similar approach is undoubtedly important in enhancing the transparency and accountability of the IFSWF process.

In reviewing the IFSWF system, one can surmise that the Forum possesses a limited organisational and governance apparatus. This is reflected in the severely deficient Kuwait Declaration which constitutes the only publicly available document of constitutional status. More so, it appears to rely on informal sociological pressures ('sharing of views') in driving implementation with the Principles rather than more overt and explicit sanctions (enforcement). This thesis takes this position given the absence of any reference to forms of sanctioning on the forum's constitutional documents and in its wider operations. If the literature on self-regulation is any indication, this suggests that the forum might suffer from serious issues of free riding, shirking and adverse selection (Non-compliance).[876] This is explored in more detail below.

Besides the above, it also appears that the forum suffers from serious representational deficits given the overwhelming control by SWFs of its limited activities with the relegation of relevant stakeholders such as Recipient countries and multilateral institutions to a more second class and observer role. Worse, the forum's record on transparency leaves a spot of bother, in particular, its approach over the transparency of operational activities, such as the disclosure of meeting records, subcommittee operations, regulatory decisions and the absence of an annual

[875] Principles for Responsible Investment Association, 'PRI Governance' (2018) Online at <https://www.unpri.org/pri/pri-governance> Accessed 30th January 2018. See also, Principles for Responsible Investment Association, 'Annual Report' (2017) Available [Online] at <https://annualreport.unpri.org/docs/PRI_AR-2017.pdf > Accessed 20th February 2018.

[876] Neil Gunningham and Joseph Rees, Industry Self-Regulation: An Institutional Perspective (1997) 19(4) Law and Policy 365, 396.

report setting out its priorities. Not only does this strike at the seriousness of the forum, it also raises difficult questions about its efficacy. As highlighted in Chapter 2, Transparency and accountability are mutually inclusive and self-reinforcing. It follows therefore that the forum's difficult record on transparency is likely to translate into limited accountability to relevant stakeholders and observers.

5.3 Mapping the implementation of the Santiago Principles

Having established the limited internal governance, representativeness, transparency and accountability of the IFSWF forum, this section moves on to the remaining indicator for Self-Regulatory effectiveness: Compliance or Behavioural Change. To this end, it introduces hard data on the implementation of the Principles following its publication. The focus in this section is first on two reports or surveys published by the IFSWF which set out the experience of its members in their application of the Santiago Principles. The usual caveats apply since these documents reflect the self-reporting of Individual IFSWF Members themselves rather than an independent analysis of compliance carried out by the Forum with the help of independent assessors. Notwithstanding the inherent limitations with these reports, the data contained therein is important in providing a perspective on the internal dynamics of the IFSWF as well as highlighting the perception of SWFs themselves in the application of the Santiago Principles. This will be followed by a consideration of independent and more objective data on likely progress in the implementation of the principles which is reserved for the next section.

5.3.1 2011 Survey Report

The first of the 'IFSWF Members experiences' reports was published in 2011, two years after the Forum's establishment.[877] The 2011 report examined compliance with the Santiago principles along four major themes: Legal Framework, Objectives and Coordination with Macroeconomic Policies, Institutional Framework and Governance Structure, Investment and Risk Management Framework and the Value of Transparency. Its contents merit analysis.

For the most part, the report presents unsurprisingly laudatory and generic information about the performance of member funds – much of which is unnecessary to repeat here. Instead, focus is placed on key aspects of the report on Governance, Operational Independence and Transparency.

On Governance, the report makes the bold claim that most IFSWF Members operate 'sound' governance frameworks with a clear allocation and separation of responsibilities. Yet, the survey report itself cites the example of the Botswana Pula fund which indicated in its survey response that there is "less clear segregation of duties," given that the Central Bank Governor chairs both its investment committee and board. This alone appears to be an instance of non-compliance.

In the context of operational independence, the survey report also makes the predictable claim that "almost all members confirmed that they have operational independence."[878] Notwithstanding the heavily subjective and potentially biased nature of such responses, the report notes in the next paragraph, the example of the Alaska Permanent Fund Corporation (APFC) which suggested that "pressure is brought to bear on the board from elected officials on certain

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[877] International Forum of Sovereign Wealth Funds, 'Members' Experiences in the Application of the Santiago Principles: Report prepared by IFSWF Sub-Committee 1 and the Secretariat in Collaboration with members of the IFSWF' (July 2011) Available [Online] at <http://www.ifswf.org/sites/default/files/Publications/stp070711_0.pdf > Accessed 6th February 2016

[878] Ibid. at pg. 14.

issues."[879] The IFSWF report does not indicate the issues on which pressure was applied on the Alaska fund, it instead declares that "while APFC's board resisted this pressure, it created some issues for its operational management."[880]

The report also highlighted the example of the Russian National Welfare Fund (NWF) which in its survey response indicated that its management was implemented in an independent manner before the financial crisis – a situation the fund suggested had changed after its owner government placed a significant part of its assets (US$22 Billion) as deposits within a Russian bank to support a number of crisis measures.[881] This again portrays the risks of non-independence amongst SWFs and raises questions of non-compliance with the recommendations of the Principles on this important issue.

In addition to Operational Independence, the report also considered the issue of audits and annual reports. As argued in the preceding chapter, the Santiago Principles do not mandate the disclosure of these. Yet, the Forum finds that most members prepare audited financial statements and annual reports. However, the reporting of these documents appears to be more widespread with certain members reporting to agencies of their owner states or others through their webpages.[882] There however appears to be a case of a member who in response to the survey question indicated that they had no intention of 'preparing' an annual report.[883] This again looks like a case of non-compliance.

Another important consideration of the report was the Disclosure of members' Investment policies as provided by principle 18. It found that most members disclose information on investment objectives, risk tolerance, investment horizon, strategic asset allocation, investment

[879] Ibid. at 19

[880] Ibid.

[881] Ibid.

[882] Ibid. at 20

[883] Ibid. at 21.

constraints, use of leverage, and the use of external managers.[884] The report however conceded that the extent of disclosure varies.[885] For instance, it found that only eight members out of 21 respondents disclosed information on all the elements mentioned above.[886] It also found that one member did not disclose information on any of the above elements.[887] Rather interestingly, the identity of the member is not revealed nor does the forum set any targets on improving Members' compliance with the principle. Instead, the report attempts to explain away this blatant record of non-compliance by asserting that 'there is still some way to go before all members satisfy the aspirations underlying the principles.' The above underscores a potentially serious case of noncompliance in the IFSWF process and perhaps more startlingly, the blatant lack of control of the forum in eliminating such behaviour.

In the context of Risk Management and performance reporting (principles 18-24), the report concedes that 'where the principles concern transparency requirements, there appears to be scope for some improvements for individual Members.'[888] It however does not identify the member funds that have fallen short in individual areas nor does it set targets or timelines for improving members' compliance with the relevant principles.

The most interesting or rather controversial aspect of the 2011 report concerns Members' perception of the value of transparency. Here, the report makes what is perhaps its most startling contribution. It finds that IFSWF members consider that the purpose of the Santiago Principles was not to increase transparency per se, but rather to increase the understanding of SWFs activity.[889] Whether or not there is a semantical difference between increasing transparency and increasing understanding of SWFs, this response suggests, at best, a confusion about the true

[884] Ibid. at 28

[885] Ibid.

[886] Ibid. at 28

[887] Ibid.

[888] Ibid. at 37

[889] Ibid. at 8

purpose of the principles and at worst, a reticence amongst members of the IFSWF to be transparent about their operations.

More disturbing still, the report finds that members' approach to transparency is a combination of compliance and judgement. Compliance transparency according to the report is driven by domestic and international requirements, while voluntary or judgmental transparency is driven by a Member's assessment of what is necessary and desirable, relative to the formal and informal requirements of the Member's owner and the nature of the member's intended investment activities among others.[890] The latter suggests that members perceive their disclosure obligations to be dependent on what is absolutely necessary or desirable relative to their institutional interests, including the whims and caprices of their owners – an idea which hints at a lack of closure since the prickly IWG negotiations.

Having critiqued the substantive contents of the 2011 IFSWF survey report, it is worth considering its shortcomings and limitations. For one, much of the survey questions which informed the report appear not to have been disclosed. This makes it difficult for an observer to judge the substance of the questions asked and to understand the responses given.

Worse, the report appears to be based on asymmetric information provided by IFSWF member funds without independent verification or auditing of responses. Put simply, IFSWF members provided responses to a self-generated survey which has not been independently verified. This raises questions about the validity of the responses and the credibility of the wider process. As Wong reminds us, disclosures are only as meaningful as the credibility of the disclosing party.[891]

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[890] Ibid. at pg. 38

[891] Anthony Wong, 'Sovereign Wealth Funds and the Problem of Asymmetric Information: The Santiago Principles and International Regulations' (2009) 34 (3) Brook. J. Int'l L 1081, 1092

Wong further argues that 'a party's denials and disclosures might have little credibility when the party is already suspected or accused of misconduct.'[892]

It is precisely for these reasons that several voluntary regimes are increasingly adopting forms of independent verification and monitoring including third-party assurance.[893] By failing to create a method by which reporting by members can be verified, the IFSWF risks undermining the credibility of its processes.

Another criticism of the report centres on its failure to reveal sufficient information about the individual performance of member funds.[894] Indeed, much of the information analysed in the report is presented in an anonymised format. This presentational flaw thus makes it difficult for observers to analyse or compare the rates of compliance of individual members.[895] This is hardly in keeping with the stated purpose of the Santiago principles – which is to increase understanding of SWF activities amongst stakeholders.

A related concern is the fact that the contents of the report do not to entirely capture the collective views of IFSWF members at the time of its publication. Out of the 26 initial members of the Forum (in 2011), only 21 responded to the survey. In other words, 76 percent of members responded to an internal exercise of the forum.[896] Although noticeable that a majority of members

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[892] Ibid.

[893] For instance, the Global Investment Performance Standards for Institutional Investors devised by the CFA institute requires participants to obtain third party assurance. The standards can be accessed here at <https://www.cfainstitute.org/ethics/codes/gips-code> The PRI is also encouraging third party verification of signatory statements of compliance with its principles. See also. PRI Association, 'PRI Signatories and Assurance' (June 2016) Available [Online] at <https://www.unpri.org/Uploads/e/f/d/PRI-Assurance-Paper.pdf> Accessed 20th March 2018.

[894] Allie Bagnall and Ted Truman, 'IFSWF Report on Compliance with the Santiago Principles: Admirable but Flawed Transparency' (August 2011) PIIE Policy Brief PB11-14, 1. Available [Online] at < https://piie.com/sites/default/files/publications/pb/pb11-14.pdf > Accessed 20th January 2018

[895] Ibid.

[896] Ibid. at 10

contributed to the survey process, it is nonetheless significant that certain funds (in this case 14 percent) deemed it fit not to participate. This highlights the possible extent of free-riding in the forum and confirms Prakash and Potoski's warning that free-riding and shirking is likely to be predominant in voluntary organisations without monitoring, sanctioning and enforcement mechanisms.[897]

5.3.2 2013 Report

Having examined the first of the IFSWF members publication on compliance with the principles, it is important to consider the second of such reports. Like the 2011 document, the usual caveats apply since the 2013 report reflects the individual views of SWFs about their performance.

The 2013 report provides largely laudatory and generic information which is in many respects unsurprising and does not bear repeating here. Substantively, the report is even more abstruse than its predecessor. Whilst the former provided a few details of signatory responses, the 2013 report adopts an approach of blanket anonymity in describing the contributions of forum members. Locknie Hsu has described this is a retrograde step in the approach of the Forum towards transparency and disclosure.[898]

Structure wise, the 2013 report considers members' compliance under the same themes as its 2011 counterpart. The sheer breadth of this information – some of which is largely unnecessary– means that emphasis will be placed on a few aspects which are of critical importance.

[897] Potoski and Prakash op cit.

[898] Locknie Hsu, 'Santiago GAPPs and Codes of Conduct' in Fabio Bassan (eds) *Research Handbook on Sovereign Wealth Funds and International Investment Law* (1st edn, Edward Elgar, 2015) 113

On Governance, the 2013 report again found that most respondents have a clear allocation and separation of roles and responsibilities within their governance framework.[899] However, an anonymous member indicated that the optimal division of roles between its owner and operational manager would need to be reassessed to accommodate the fund's evolving asset allocation.[900] Never mind the identity of this member, the report does not address the question of when or whether the said member should take any remedial action.

In the context of operational independence, the report finds that nearly all respondents have clear responsibilities for its operational management in implementing its investment strategies. It even highlighted one member who reported an improvement from partial compliance in 2011 to full compliance in 2013. This is however followed by an unnamed member who indicated that it had not implemented the principle and "had no plan to do so."[901]

Yet another issue considered within the report is the issue of annual reports and audits. Regarding the former, the 2013 report finds a high compliance rate. In the context of the latter however, the report claims in a celebratory way that all respondents prepare audited financial statements that meet international accounting standards.[902] Although interesting that several funds are preparing annual reports and audits, the forum's hyperbolic characterisation of compliance in this area is largely unnecessary given that the Santiago principles do not expressly require the public

[899] Ibid. at pg.6

[900] Ibid. at pg.7

[901] IFSWF, 'Members' Experiences in the Application of the Santiago Principles: Prepared by IFSWF and presented at the Fifth Meeting of the International Forum of Sovereign Wealth Funds held in Oslo, Norway' (October 2013), 7 <http://www.ifswf.org/sites/default/files/Publications/2013ifswfreport.pdf > Accessed 30th March 2018

[902] Ibid. at pg. 8

disclosure of either annual reports or audits.[903] Some might in fact argue that audited financial statements and annual reports are of little use if they remain largely undisclosed publicly.[904]

Another interesting contribution of the 2013 report concerns the disclosure of relevant financial information to contribute to financial stability as required by Principle 17. The report finds here that 86 percent of members report full compliance with the principle, with 14 percent reporting partial compliance. The explanations for why several members have failed to implement this important principle range from unconvincing to farcical. In one example, an unnamed member blamed its non-compliance on the fact that the disclosure of such vital information was not required by its constituting legislation.[905] In another case, another member highlighted that its Board had not made such a decision.[906] Both examples highlight what appears to be a deplorable lack of seriousness and commitment on the part of certain members of the Forum. A situation which presumably calls for more aggressive action by the IFSWF in the context of monitoring and sanctions.

Having examined the contents of the 2013 report of the IFSWF forum, it is important to consider its shortcomings and limitations. Like its predecessor, the main limitation of the 2013 report is its reliance again on asymmetric, unverified responses provided by IFSWF members. The 2013 report acknowledges this limitation when it states that "the major, although inevitable, challenge to this report is that it rests on members' self-assessment of their own observance to the

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[903] Ted Truman, *Implementation of the Santiago Principles for Sovereign Wealth Funds: A Progress Report* (December 2013) PIIE Policy Brief PB13-31, 3 <https://piie.com/sites/default/files/publications/pb/pb13-31.pdf> Accessed 3rd march 2018.

[904] Anthony Wong, Sovereign Wealth Funds and the Problem of Asymmetric Information: The Santiago Principles and International Regulations (2009) 34 (3) Brook. J. Int'l L 1081, 1092

[905] International Forum of Sovereign Wealth Funds, Members' Experiences in the Application of the Santiago Principles: Prepared by IFSWF and presented at the Fifth Meeting of the International Forum of Sovereign Wealth Funds held in Oslo, Norway (October 2013), 9 <http://www.ifswf.org/sites/default/files/Publications/2013ifswfreport.pdf > Accessed 30th March 2018

[906] Ibid.

SP."[907] This undoubtedly raises difficult questions about the credibility of the responses and the process overall.

Further, it appears that the Forum has not learned the hard lessons from its initial 2011 report. Indeed, one could argue that it doubled down on the opacity which defined much of the 2011 report. For instance, it is most unsatisfactory that the forum did not attempt to address the presentational gaps highlighted in its initial report such as stating the rates of individual member compliance with the principles. Instead, the 2013 report arguably makes matters worse by omitting details of member statements and responses some of which were present in the 2011 report – a step which Locknie Hsu has described as negative.[908]

Like its predecessor, the 2013 survey report also shows that the forum has a problem with free-riding, and inactive members. Out of 25 members of the forum in 2013, only 21 responded to the survey which informed the report, with 4 members failing to provide responses.[909] This again raises questions of free-riding and shirking which as Prakash and Potoski argue, are often predominant in voluntary systems without formal monitoring and enforcement mechanisms.[910]

Further, the report highlights instances of underwhelming progress. For example, it finds that only 13 of the 21 respondents to the survey had fully implemented all 24 principles (compared to 10 members in 2011).[911] If this figure is to be believed, it suggests that in the 2 years since the

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[907] Ibid. at pg. 13

[908] Locknie Hsu, 'Santiago GAPPs and Codes of Conduct' in F Bassan (eds) *Research Handbook on Sovereign Wealth Funds and International Investment Law* (1st edn, Edward Elgar, 2015) 113

[909] International Forum of Sovereign Wealth Funds, Members' Experiences in the Application of the Santiago Principles: Prepared by IFSWF and presented at the Fifth Meeting of the International Forum of Sovereign Wealth Funds held in Oslo, Norway (October 2013), 19 <http://www.ifswf.org/sites/default/files/Publications/2013ifswfreport.pdf > Accessed 30th March 2018.

[910] Aseem Prakash and Matthew Potoski, 'Collective Action through Voluntary Environmental Regimes' [2007] 35(4) Policy Studies Journal 773, 779.

[911] International Forum of Sovereign Wealth Funds, Members' Experiences in the Application of the Santiago Principles: Prepared by IFSWF and presented at the Fifth Meeting of the International Forum of Sovereign Wealth

publication of the 2011 report, only 3 members had fully aligned their practices with the Santiago Principles. This underscores the underwhelming progress IFSWF members in implementing the principles and raises serious doubts about the forum's viability in the Santiago Principles implementation process.

Having considered IFSWF reports on compliance with the Santiago principles, it is equally important to examine independent efforts that analyse SWF compliance with the Santiago Principles. An analysis of these rankings is important in introducing an element of objectivity about the likely levels of compliance with the principles. More so, the rankings considered provide newer and more updated information about SWF compliance given the failure of the IFSWF to publish more analyses of its members' performance vis a vis the principles since 2013.

5.4 External/Independent Analyses of the Implementation of the Principles

Over the years, independent analyses of SWF adherence to norms of good governance have emerged. The most prominent include the Truman Scoreboard[912] and the Santiago Compliance Index produced by a Switzerland-based political risk consultancy GeoEconomica.[913] Both analyses provide useful, independent and objective information about the extent of SWF compliance with the principles which is undoubtedly important for this thesis which seeks to

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Funds held in Oslo, Norway (October 2013), 3 <http://www.ifswf.org/sites/default/files/Publications/2013ifswfreport.pdf > Accessed 30th March 2018

912 Sarah Stone & Ted Truman, 'Uneven Progress on Sovereign Wealth Fund Transparency and Accountability' (October 2016) PIIE Policy Brief PB 16 -18. Available [online] at <https://piie.com/system/files/documents/pb16-18.pdf> Accessed 20 April 2018.

913 GeoEconomica, 'Santiago Compliance Index 2014: Assessing the Governance Arrangements and Financial Disclosure Policies of Global Sovereign Wealth Funds' (October 2014) Available online at <https://www.nzsuperfund.co.nz/sites/default/files/documents-sys/SCI%202014%20October%202014_final.pdf> Accessed 20th March 2018.

examine the effectiveness of the Santiago Principles and the IFSWF. They will be considered in turn.

5.4.1 Truman Scoreboard

The Truman scoreboard was first commissioned in 2007 before the creation of the Santiago principles and the International Forum. Its author – an SWF expert and former Assistant Secretary at the US Treasury – Ted Truman, appears to have created the index at the height of the policy debates about SWFs led by the US Treasury.[914] Since the enactment of the Santiago Principles however, the scoreboard has been regularly revised with the latest edition published in October 2016.[915]

Structure-wise, the scoreboard considers the performance of SWFs and several Government owned Pension Funds according to 33 elements, all of which are constructed as simple, answerable questions (see figure 13 below).[916] These elements are further grouped into four categories that overlap with the themes of the Santiago Principles: (1) structure of the fund, including its objectives, fiscal treatment, and whether the fund is separate from its home country's international reserves; (2) governance of the fund, including the roles of the government and managers, and whether the fund follows guidelines for corporate responsibility and ethical investment behaviour; (3) accountability and transparency of the fund in its investment strategy,

[914] Sarah Stone & Ted Truman, 'Uneven Progress on Sovereign Wealth Fund Transparency and Accountability' (October 2016) PIIE Policy Brief PB 16 -18, pg. 1. Available [online] at <https://piie.com/system/files/documents/pb16-18.pdf> Accessed 20 April 2018.

[915] Ibid.

[916] Ibid.

investment activities, reporting and audits; and (4) behaviour of the fund in managing its portfolio and in the use of leverage and derivatives.[917]

Whilst elements of the scorecard are more than the 24 principles and 6 subprinciples in the Santiago Framework, there are nonetheless individual overlaps.[918] In many instances also, the scorecard goes further than the Santiago Principles. For instance, in question 22 (figure 13 below), the scoreboard requires SWFs to disclose information on currency composition – an element that is not reflected in the Santiago principles in its current form. It also goes further than the Santiago principles in requiring not only the preparation of annual reports but also the disclosure of annual reports and audits. This is indeed, a damning indictment of the questionable practices reflected in the Santiago framework.

Further, the scoreboard bases its scores on regularly available, public information about an individual fund.[919] Therefore, if a fund does not disclose information about a particular element of the scoreboard, it achieves a negative score.

The Truman scoreboard is not without its challenges. For one, its conclusions are based on the author's analysis of an individual fund's compliance, informed by publicly available information.[920] Notwithstanding this, the scoreboard still provides a veritable benchmark from which to analyse the levels of progress in the compliance of the Santiago Principles and the overall efficacy of the IFSWF Process. Its contents will be considered below.

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[917] Ted Truman, *Sovereign Wealth Funds: Threat or Salvation?* (1st edn, Peterson Institute for International Economic, 2010) p. 74.

[918] Sarah Stone & Ted Truman, 'Uneven Progress on Sovereign Wealth Fund Transparency and Accountability' (October 2016) PIIE Policy Brief PB 16 -18, pg. 16. Available [online] at <https://piie.com/system/files/documents/pb16-18.pdf> Accessed 20 April 2018.

[919] Ted Truman, *Sovereign Wealth Funds: Threat or Salvation?* (1st edn, Peterson Institute for International Economic, 2010) pg.71

[920] Ted Truman, 'A blueprint for SWF best practices' (April 2008) PIIE Policy Brief PB08-3, 6 <https://piie.com/sites/default/files/publications/pb/pb08-3.pdf> Accessed 20th March 2018

Figure 14 (below) captures data from the most recent 2015 scoreboard which was published in October 2016. As can be seen from the diagram, the scoreboard considers the performance of 60 globally recognised SWFs according to its 33 elements. The individual elements are then weighted and translated into a 100-point scale.

The SWFs represented on the scoreboard have been divided into three broad groups. The first cluster accommodates SWFs with a score of 80 points and above. The highest performer here appears to be the Norwegian Fund (An IFSWF non-member) which achieves a near perfect score of 98 points and is often regarded as the most transparent Sovereign Fund in the World.[921] Other notable mentions within this cluster include the New Zealand Superannuation fund and the State Oil Fund of Azerbaijan (both IFSWF members) who score 94 and 92 points respectively – the latter even more interesting given its emerging market origins.[922]

Just below the top tier funds are middling SWFs with a score between 44 and 78. The vast majority of funds on the scoreboard are represented here. This cluster shows funds whose performances on the scoreboard are not as poor as those in the bottom cluster but which nonetheless require significant improvement. Notable mentions within this group include IFSWF members such as the Korea Investment Corporation (KIC), the Nigerian Sovereign Investment Authority, Singapore's GIC and the China Investment Corporation amongst others.[923]

Following this is the bottom cluster which contains funds that appear to have performed poorly across many of the Scoreboard elements. This cluster again hosts prominent IFSWF members such as the Qatari Fund (QIA) and the Libyan Investment Authority who record scores of 40 and 23 points respectively.[924]

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[921] Ibid. at pg. 6

[922] Ibid. at 8

[923] Ibid.

[924] Ibid. at 9

Beyond the above, the latest scoreboard also finds an overall average of 62.5 percent across all 60 funds represented on the Scoreboard – a figure which highlights a relatively weak performance by individual funds with the elements of the scoreboard and suggests the need for improvements.[925] It is also worth noting that the 2015 average of 62.5 percent represents only an 8.5 percent positive swing from the average of 54 percent recorded in the previous 2012 scoreboard.[926]

In the context of overall performance, the document finds that several of the funds represented in the scoreboard achieve positive scores when it comes to the low hanging fruit of governance and operational structure. This would appear as no surprise given that a sound governance structure is a basic requirement for the smooth operation of any given business organisation. By contrast however, SWFs generally appear to be lagging behind on the more technical aspects of the scoreboard including transparency of investments, currency composition, portfolio adjustment, leverage and the use of credit ratings among others.[927] This suggests a reticence from SWFs as an industry to disclose deeper, more technical and valuable information.

The scoreboard also makes interesting reading for the IFSWF and its members in particular. For instance, it appears that 8 of the top 10 scoring funds on the overall scoreboard belong to the Forum, the only exceptions here appear to be Norway and the Permanent Wyoming Mineral Trust fund.

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[925] Ibid.

[926] Allie Bagnall & Ted Truman, 'Progress on Sovereign Wealth Fund Transparency and Accountability: An Updated SWF Scoreboard '(August 2013) PIIE Policy Brief PB13-99, 6. Available [Online] at < https://piie.com/publications/pb/pb13-19.pdf> Accessed 23rd March 2018.

[927] Sarah Stone & Ted Truman, 'Uneven Progress on Sovereign Wealth Fund Transparency and Accountability' (October 2016) PIIE Policy Brief PB 16 -18, 14 <https://piie.com/system/files/documents/pb16-18.pdf> Accessed 20 April 2018

Six of the next 10 funds are also members of the Forum.[928] This should however be of little solace for the forum given that the funds represented in this cluster all score below 80 points. Indeed, it would appear that IFSWF funds within this cluster should be achieving more than below 80 points given their membership of the forum – some for almost a decade.

More interesting however is the fact that three of the lowest-scoring funds in the bottom 10 are also IFSWF members. This include the Russia Direct Investment Fund, Qatar Investment Authority and the Libyan Fund.[929] These funds appear alongside poorly performing non-member funds such as the Equatorial Guinea Fund (a former member of the Forum). Interestingly also, these funds were founding members of the Santiago process which raises serious questions about their inability to make sufficient progress nearly a decade after the promulgation of the principles. This raises serious questions about the commitment of forum members and more broadly, the efficacy of the organisation itself in driving up standards amongst its non-compliant members.

More interestingly also, Truman finds that IFSWF members do not generally score higher than their non-member compatriots. For instance, the Russian Direct Investment Fund (an IFSWF member) scores 13 points lower than its compatriot – the Russian National Welfare and Reserve Fund (a non-member).[930] This pattern is also seen in the case of the Alaska Permanent Fund which is an IFSWF Member but scores lower than its US counterpart, the Wyoming Fund a non-member.[931]

For Singapore, Temasek Holdings (a former IFSWF member) also outscores its compatriot, GIC Ltd which currently belongs to the forum and serves on its board.[932] Lastly, the Abu Dhabi Investment Authority (ADIA) lags well behind its Emirati compatriot Mudabala which

[928] Ibid. at pg.16

[929] Ibid.

[930] Ibid.

[931] Ibid.

[932] Ibid.

also does not belong to the forum.[933] This is significant given that forum members already have the added advantage of the Santiago Principles and thus ought to be doing far better than non-member compatriots.

The progress of IFSWF member funds from the inception of the scoreboard in 2007 till its current edition in 2015 also merits attention. Figure 16 below helpfully summarises in the penultimate column, the improvement rates of several members of the forum between 2007 and 2015 scoreboards. It should however be noted that the figures contained in the diagram are in certain respects incomplete. For one, there are new entrants to the IFSWF who appear not to have been scored in the past (2007, 2009, 2012) given their recent establishment. These funds therefore do not have improvement rates in the second to last column of the diagram. Further, the data in figure 16 (below) includes the Norwegian SWF which at the time of writing has exited the forum.

Figure 16 shows that with the exception of the Nigerian fund (NSIA), the rate of improvement by IFSWF members who have been assessed on the Truman scoreboard between 2007 and 2015 averages 0 and 38 points. This is hardly dramatic improvement in compliance by any standard. Even so, Truman's characterisation of the NSIA's progress is deeply disturbing. He appears to have conflated the NSIA (which was established in 2011) with the older Nigerian Fund – the Excess Crude Account (ECA) (established in 2004) even though both institutions are different and are both existent at the time of writing.[934] This has allowed him to ascribe to the former, the ECA's scores in 2007 and 2009.[935]

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[933] Ibid.

[934] Ibikunle Adeakin 'The emerging role of sovereign wealth fund as an economic growth avenue for Nigeria: lessons from the Singapore experience' (2018) 56(3) Commonwealth & Comparative Politics 298, 299.

[935] Sarah Stone & Ted Truman, 'Uneven Progress on Sovereign Wealth Fund Transparency and Accountability' (October 2016) PIIE Policy Brief PB 16 -18, 20 <https://piie.com/system/files/documents/pb16-18.pdf> Accessed 20 April 2018

The disappointing pattern on progress is shared evenly by top and weak performers on the main scoreboard. For instance, the Alaska Permanent Fund appears to have made zero progress from its 2007 score of 88 points. So also has the Botswana Pula Fund who appears to have improved by only 6 points on the scoreboard from its 2007 score of 53 points. New Zealand the current leader of the forum, also appears to have made zero progress from its 2007 score of 94 points, meaning that it remains 6 points away from a perfect score of 100.

For bottom ranked funds, only the Qatari fund has made modest advancements from its low base of 14 points in 2007 to its current score of 40. Yet, a 26-point difference is hardly dramatic progress, given that the fund still ranks bottom in the overall scoreboard. This underscores what appears to be a picture of slow progress at best or stasis at worst. It also raises serious questions about whether the forum's sociological activities are really improving standards amongst members and helping them break free from entrenched practices.

This appendix presents the elements of the scoreboard described in the policy brief. For each of the 33 questions, if the answer is an unqualified yes, we score it as "1." If the answer is no, we score it as "0." However, partial scores of 0.25, 0.50, and 0.75 are recorded for many elements, indicated by (p) in the descriptions below.

The four categories in the scoreboard are listed below with subcategories where relevant. The words in bold are keyed to the results presented in table A.1 for each SWF on each element.

Structure

1. Is the SWF's objective clearly communicated? (p)

Fiscal Treatment

2. Is the **source of** the SWF's **funding** clearly specified? (p)
3. Is nature of the subsequent **use** of the principal and earnings of the fund clearly stated? (p)
4. Are these elements of fiscal treatment **integrated with** the **budget**? (p)
5. Are the **guidelines** for fiscal treatment generally **followed** without frequent adjustment? (p)

Other Structural Elements

6. Is the overall **investment strategy** clearly communicated? (p)
7. Is the procedure for **changing the structure** of the SWF clear? (p)
8. Is the SWF **separate from** the country's **international reserves**?

Governance

9. Is the **role of the government** in setting the investment strategy of the SWF clearly established? (p)
10. Is the **role of the managers** in executing the investment strategy clearly established? (p)
11. Are **decisions** on specific investments made **by the managers**? (p)
12. Does the SWF have in place and publicly available **guidelines for corporate responsibility** that it follows? (p)
13. Does the SWF have **ethical guidelines** that it follows? (p)

Transparency and Accountability

Investment Strategy Implementation

14. Do regular reports on investments by the SWF include information on the **categories** of investments? (p)
15. Does the strategy use **benchmarks**? (p)
16. Does the strategy limit investments based on **credit ratings**? (p)
17. Are the holders of investment **mandates** identified?

Investment Activities

18. Do regular reports on the investments by the SWF include the **size of** the **fund**? (p)
19. Do regular reports on the investments by the SWF include information on its **returns**? (p)
20. Do regular reports on the investments by the SWF include information on the geographic **location** of investments? (p)
21. Do regular reports on the investments by the SWF include information on the **specific** investments? (p)
22. Do regular reports on the investments by the SWF include information on the **currency composition** of investments? (p)

Reports

23. Does the SWF provide at least an **annual report** on its activities and results? (p)
24. Does the SWF provide **quarterly reports**? (p)

Audits

25. Is the SWF subjected to a **regular** annual **audit**? (p)
26. Is the audit **published** promptly? (p)
27. Is the audit **independent**? (p)

Behavior

28. Does the SWF indicate the nature and **speed of adjustment** in its portfolio? (p)
29. Does the SWF have limits on the **size of** its **stakes**? (p)
30. Does the SWF not take **controlling stakes**? (p)
31. Does the SWF have a policy on the use of **leverage**? (p)
32. Does the SWF have a policy on the use of **derivatives**? (p)
33. Are derivatives used primarily for **hedging**?

Figure 13: Truman Scoreboard elements showing the elements that Funds must meet to achieve a score on the Scoreboard. Sourced from Truman (2008) [936]

[936] Ted Truman, 'A blueprint for SWF best practices' (April 2008) PIIE Policy Brief PB08-3, 17 <https://piie.com/sites/default/files/publications/pb/pb08-3.pdf> Accessed 20th March 2018

Country	Fund name	Score
	Nonpension SWFs	
Norway	Government Pension Fund—Global	98
New Zealand	New Zealand Superannuation Fund	94
United States	Permanent Wyoming Mineral Trust Fund	93
Azerbaijan	State Oil Fund of the Republic of Azerbaijan	92
Canada	Alberta Heritage Savings Trust Fund	91
Chile	Economic and Social Stabilization Fund	91
Chile	Pension Reserve Fund	88
Timor-Leste	Petroleum Fund of Timor-Leste	88
United States	Alaska Permanent Fund Corporation	88
Australia	Future Fund	87
United States	New Mexico State Investment Council	84
Ireland	Ireland Strategic Investment Fund	82
United States	Alabama Trust Fund	82
Trinidad and Tobago	Heritage and Stabilization Fund	81
Korea	Korea Investment Corporation	78
Palestine	Palestine Investment Fund*	77
Nigeria	Nigeria Sovereign Investment Authority	76
Singapore	Temasek Holdings	76
United States	Texas Permanent School Fund*	73
China	China Investment Corporation	70
United States	(Texas) Permanent University Fund*	70
France	Caisse des Dépôts et Consignations*	68
Hong Kong	Exchange Fund	68
Kuwait	Kuwait Investment Authority	68
Mexico	Budgetary Income Stabilization Fund	68
United Arab Emirates	Mubadala Development Company	68
Angola	Fundo Soberano de Angola	67
Italy	Fondo Strategico Italiano*	67
France	BPIFrance Investissement*	65
United States	North Dakota Legacy Fund*	64
Malaysia	Khazanah Nasional Berhad	61
Singapore	GIC Private Ltd.	61
Brazil	Sovereign Fund of Brazil	60
Botswana	Pula Fund	59
United Arab Emirates	Dubai Holding	59
United Arab Emirates	Abu Dhabi Investment Authority	58
Rwanda	Agaciro Development Fund*	57
United Arab Emirates	Investment Corporation of Dubai	55
United Arab Emirates	International Petroleum Investment Company	55
Bahrain	Bahrain Mumtalakat Holding Company	52
Oman	State General Reserve Fund	52
Russia	National Welfare and Reserve Fund	49
Iran	National Development Fund of Iran	48
Kazakhstan	National Investment Corporation*	48
Mexico	Fondo Mexicano del Petroléo para la Estabilización y el Desarrollo*	48

(table continues)

Country	Fund name	Score
	Nonpension SWFs	
Peru	Fiscal Stabilization Fund*	48
Kazakhstan	Samruk-Kazyna JSC*	47
Morocco	Moroccan Fund for Tourism Development*	47
Ghana	Ghana Petroleum Funds	45
Venezuela	Macroeconomic Stabilization Fund	42
Qatar	Qatar Investment Authority	40
Vietnam	State Capital Investment Corporation	39
Russia	Russian Direct Investment Fund*	36
Kiribati	Revenue Equalization Reserve Fund	35
United Arab Emirates	Abu Dhabi Investment Council*	33
Brunei	Brunei Investment Agency	30
Algeria	Revenue Regulation Fund	26
Libya	Libyan Investment Authority	23
United Arab Emirates	Istithmar World	23
Equatorial Guinea	Fund for Future Generations	11
Subtotal (60 SWFs)		**62**
	Government pension funds	
United States	California Public Employees' Retirement System	95
Canada	Canada Pension Plan Investment Board	94
France	Fonds de réserve pour les retraites	94
Netherlands	Stichting Pensioenfonds ABP	92
Canada	Caisse de dépôt et placement du Quebec	91
Canada	Ontario Teachers' Pension Plan	86
Thailand	Government Pension Fund	86
Japan	Government Pension Investment Fund	83
China	National Council for Social Security Fund	59
Subtotal (9 GPFs)		**87**
All funds (69)		**64**

Figure 14: Truman 2015 Scoreboard showing the performance of SWFs and Government Pension Funds. A Fund's score on the Scoreboard is determined by the Author's assessment of the fund's performance according to the indicators in Figure 13, based on publicly available information. Sourced from Sarah Stone and Truman (2016)[937]

[937] Sarah Stone & Ted Truman, 'Uneven Progress on Sovereign Wealth Fund Transparency and Accountability' (October 2016) PIIE Policy Brief PB 16 -18, 8-9<https://piie.com/system/files/documents/pb16-18.pdf> Accessed 20 April 2018.

	Element	Nonpension SWFs	Government pension funds	All funds
	Structure			
1	Objective stated	98	100	99
2	Legal framework	85	100	87
3	Changing the atructure	83	100	86
4	Investment strategy	75	100	79
5	Source of funding	88	100	89
6	Use of fund earnings	69	100	73
7	Integrated with policies	64	50	62
8	Separate from international reserves	64	50	62
Subtotal		**78**	**88**	**80**
	Governance			
9	Role of government	88	100	89
10	Role of governing body	88	100	90
11	Role of managers	65	100	70
12	Decisions made by managers	54	89	59
13	Internal ethical standards	53	78	57
14	Guidelines for corporate responsibility	36	89	43
15	Ethical investment guidelines	22	83	30
Subtotal		**58**	**91**	**62**
	Transparency and accountability			
16	Categories	78	100	80
17	Benchmarks	45	89	51
18	Credit ratings	48	89	54
19	Mandates	28	78	35
20	Size	85	100	87
21	Returns	63	100	67
22	Locations	41	75	46
23	Specific investments	48	83	53
24	Currency composition	43	78	47
25	Annual reports	82	100	84
26	Quarterly reports	46	56	47
27	Regular audits	89	100	90
28	Published audits	58	89	62
29	Independent audits	82	100	84
Subtotal		**60**	**88**	**63**
	Behavior			
30	Risk management	67	100	71
31	Policy on leverage	35	44	37
32	Policy on derivatives	58	100	63
33	Portfolio adjustment	11	44	15
Subtotal		**43**	**72**	**46**
Total	**All categories**	**62**	**87**	**65**

Figure 15: Truman 2015 SWF scoreboard individual elements reflecting the Author's Calculations

Country	Fund	2007	2009	2012	2015	Percentage points	Relative to difference between 2007 score and 100
Libya	Libyan Investment Authority	—	—	5	23	—	—
Russia	Russian Direct Investment Fund	—	—	—	36	—	—
Qatar	Qatar Investment Authority	14	15	15	40	26	30
Morocco	Moroccan Fund for Tourism Development	—	—	—	47	—	—
Kazakhstan	Samruk-Kazyna	—	—	—	47	—	—
Iran	National Development Fund of Iran	26	26	26	48	22	30
Kazakhstan	National Investment Corporation	—	—	—	48	—	—
Oman	State General Reserve Fund	18	18	21	52	34	41
Rwanda[a]	Agaciro Development Fund	—	—	—	57	—	—
United Arab Emirates	Abu Dhabi Investment Authority	20	58	58	58	38	48
Botswana	Pula Fund	53	55	55	59	6	13
Malaysia	Khazanah Nasional Berhad	45	55	55	61	16	29
Singapore	GIC Private Ltd.	45	60	61	61	16	29
Angola	Fundo Soberano de Angola	—	—	15	67	—	—
Italy	Fondo Strategico Italiano	—	—	—	67	—	—
Mexico	Budgetary Income Stabilization Fund	42	42	42	68	26	45
Kuwait	Kuwait Investment Authority	58	64	65	68	10	24
China	China Investment Corporation	35	58	61	70	35	100
Nigeria	Nigeria Sovereign Investment Authority	12	12	18	76	64	73
Palestine	Palestine Investment Fund	—	—	—	77	—	—
Korea	Korea Investment Corporation	60	69	69	78	18	45
Trinidad and Tobago	Heritage and Stabilization Fund	61	75	75	81	20	51
Ireland	Ireland Strategic Investment Fund	77	79	82	82	5	22
Australia	Future Fund	77	86	86	87	10	43
Chile[b]	Pension Reserve Fund	—	80	82	88	—	—
Timor-Leste	Petroleum Fund of Timor-Leste	80	85	85	88	8	40
United States	Alaska Permanent Fund Corporation	88	88	88	88	0	0
Canada	Alberta Heritage Savings Trust Fund	82	86	86	91	9	50
Chile[b]	Economic and Social Stabilization Fund	74	86	86	91	17	65
Azerbaijan	State Oil Fund of the Republic of Azerbaijan	80	83	85	92	12	60
New Zealand	New Zealand Superannuation Fund	94	94	94	94	0	0
Norway[c]	Government Pension Fund–Global	97	97	97	98	1	33
Average 32 funds					68		
Average 25 funds				60	72		
Average 23 funds			64	65	75		
Average 22 funds		56	63	64	74	18	41

Figure 16: Rate of Progress on the Scoreboard in percentage points from 2007-2015. Note: the rate of Progress is shown on the Penultimate Column of the Diagram. Sourced from Sarah Stone and Truman (2016).[938]

[938] Sarah Stone & Ted Truman, 'Uneven Progress on Sovereign Wealth Fund Transparency and Accountability' (October 2016) PIIE Policy Brief PB 16 -18, 20<https://piie.com/system/files/documents/pb16-18.pdf> Accessed 20 April 2018.

5.4.2 Santiago Compliance Index

Another set of independent analyses worth considering is the Santiago Compliance Index. The index is regularly developed by Sven Behrendt of the Geneva-based political risk consultancy Geoeconomica.[939] Unlike the Truman Scoreboard, the index analyses compliance according to the Santiago principles themselves not according to a set of bespoke elements. The Index uses publicly available material to assess each signatory's compliance to each of the 24 principles. It also applies a set of performance indicators in assessing individual SWF performance (see figure 17 below). The index therefore offers a more precise and objective analysis of SWF performance vis a vis the principles than the Truman Scoreboard given its direct focus on the 24 principles and 6 sub-principles reflected in the Santiago Framework.

The first edition of the Index was published in 2010 (2 years after the creation of the principles). Yet, the more recent edition of the SCI published in October 2014 is far more important in establishing the recent levels of compliance with the principles.[940]

Figure 18 below helpfully summarises the compliance rates of funds represented in the latest Index. As can be seen below, the results are fairly striking. On one hand, they show the eight SWFs that more or less fully comply with the principles.[941] Funds within this cluster include the New Zealand Superannuation fund, Norway's Fund (now a non-member of the IFSWF), the Australian Future Fund and the Timor Leste Fund amongst others. These funds have apparently

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939 GeoEconomica, 'Santiago Compliance Index 2014: Assessing the Governance Arrangements and Financial Disclosure Policies of Global Sovereign Wealth Funds' (October 2014) Available online at <https://www.nzsuperfund.co.nz/sites/default/files/documents-sys/SCI%202014%20October%202014_final.pdf> Accessed 20th March 2018.

940 Sven Behrendt, 'Sovereign Wealth Funds and the Santiago Principles: Where Do They Stand?' (2010) Carnegie Papers, 6 <https://carnegieendowment.org/files/santiago_principles.pdf> Accessed 20th March 2018.

941 GeoEconomica, 'Santiago Compliance Index 2014: Assessing the Governance Arrangements and Financial Disclosure Policies of Global Sovereign Wealth Funds' (October 2014) pg.2 Available online at <https://www.nzsuperfund.co.nz/sites/default/files/documents-sys/SCI%202014%20October%202014_final.pdf> Accessed 20th March 2018

achieved these grades given that their governance, transparency, accountability arrangements and disclosure practices correspond with the disclosure requirements and substance of the Santiago Principles.[942] It also appears that these funds prepare and disclose convincing self-assessments with the Principles as required by GAPP 24. The only shortcoming which the authors identify within this cluster is the 'often imprecise self-assessment of the implementation of the principles' – a conclusion which suggests the need for improvements in the monitoring of the principles.[943]

Beneath this cluster are funds that are broadly compliant although not fully compliant with the principles. "Broadly compliant" denotes that the governance, transparency, accountability arrangements and disclosure practices of funds represented within this cluster correspond in a broad sense with the disclosure obligations and substance of the principles but remain below par.[944] Common challenges however encountered by the authors of the index in assessing funds within this cluster include minor shortcomings in disclosure and/or minor deviations from the Principles substance.[945] The authors also cite other shortcomings, such as inconclusive descriptions of a fund's approach to risk management, insufficient information about a fund's approach to executing shareholder rights (Principle 21) or insufficient information on measures which prevent SWFs from benefiting from privileged information as required by Principle 20. The authors also point to instances where the owner of the fund retains specific competencies that undermines the operational management of the fund.[946] These undoubtedly call for substantial improvements.

[942] Ibid. at pg.3

[943] Ibid.

[944] Ibid.

[945] Ibid.

[946] Ibid.

Funds represented within this cluster are nine in number and include SWFs such as the State Oil Fund of Azerbaijan, Botswana's Pula Fund and the Nigerian Sovereign Investment Authority amongst others.[947]

Below this cadre are the partially compliant funds which are eight in number and have been assessed in this manner given that their governance structures, transparency and accountability arrangements and disclosure practices correspond only partially with the substance of the principles and the disclosure obligations contained therein. The author's assessment of funds within this cluster typically identifies gaps which 'substantially compromise adherence with the principles.'[948] A conclusion which reads like a euphemistic way of characterising serious cases of noncompliance.

According to the authors of the index, partially compliant funds disclose just about enough information to allow the construction of a narrative about their policy objectives, the broader lines of their governance arrangements and some meaningful financial information.[949] Yet, funds within this cluster typically do not disclose far reaching financial information, such as audited income statements and balance sheet positions nor do they disclose conclusive information about their funding and withdrawal arrangements, rates of return, or performance benchmarks. The authors also find that partially compliant funds only provide limited access to their legal foundation and constitutive documents as well as limited access to management documents that might specify their return objectives, investment policies and the competencies of the operational asset manager.[950] Finally, the authors of the index find that the self-assessment reports of partially compliant funds are often fragmented, if they are disclosed at all – a conclusion which again

[947] Ibid.

[948] Ibid.

[949] Ibid.

[950] Ibid.

underscores serious deviations from the spirit and letter of the principles.[951] Funds represented in this cluster include some of the largest IFSWF member funds such as the China Investment Corporation, Abu Dhabi Investment Authority, GIC (Singapore and an IFSWF Board Member) and the Kuwait Investment Authority amongst others.[952]

The final cluster represented in the SCI contains funds that are not compliant with the Santiago Principles at all. The authors of the Santiago Compliance index argue that the funds represented within this cluster are deficient across vast areas of the principles. The sole representative in this cluster is the Qatar Investment Authority (QIA). Here, the authors of the index argue that QIA's governance and financial disclosure policies simply 'do not comply with the Santiago Principles."[953] This is hardly surprising. QIA's difficult record is transparency is well known and was revealed in a recent report by the journalistic transparency group WikiLeaks which cited leaked cables between the then Qatari Finance Minister Youssef Hussein Kamal and the former US Treasury Secretary Henry Paulson.[954] According to the cable, the Qatari minister suggested that the Santiago Principles were 'not for everyone."[955] The Minister also 'singled out the transparency requirements as a particular concern for QIA". A particularly difficult requirement was the disclosure of asset allocation which he suggested was against Qatari regulations.[956] Perhaps the most striking aspect of the said conversation was Kamal's admission that "only five or six people in Qatar know this asset allocation information."[957]

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[951] Ibid.

[952] Ibid.

[953] Ibid.

[954] WikiLeaks, 'Qatari Officials Discuss Currency, Sovereign Wealth Funds, Investment and Iran with Secretary Paulson' (June 2008) Available [Online] at <https://wikileaks.org/plusd/cables/08DOHA422_a.html> Accessed 20th April 2018.

[955] Ibid.

[956] Ibid.

[957] Ibid.

Besides closed-door conversations, Qatar has also been open about its reluctance to comply with the Santiago Principles. For instance, in its latest 2017 self-assessment report, the fund openly admitted that:

> "QIA's Board will decide the time and the extent to which more information on the fund's financial orientation and position will be made publicly available. There is no legal requirement for QIA to make public disclosure of such information. However, from time to time, senior executive management may make public comment on certain aspects of the operations of QIA or its principal operating subsidiaries.[958]"

The above is hardly a commitment to adhere to the principles to which QIA presumably signed up to. It also raises the question of why the fund remains a member of the IFSWF in the face of its brazen reluctance to adhere to key aspects of the principles and its rather poor performance on independent analyses such the Truman Scoreboard and the Santiago Compliance Index.

More startlingly, the SCI's author, Sven Behrendt, has opined in a recent update that the Index will 'remain largely unchanged today if updated based on more rigorous evaluations.'[959] This suggests that in the period after the publication of the 2014 Index, IFSWF members are still failing to make significant progress from the largely disconcerting performance in the 2014 index. This perspective is also consistent with the views recently articulated by the Forum's Chair, Adrian Orr

[958] International Forum of Sovereign Wealth Funds, 'Santiago Self-Assessment: Qatar Investment Authority' (2017). Available [Online] at<http://www.ifswf.org/assessment/qia> Assessed 30th April 2018.

[959] GeoEconomica, 'The Santiago Principles: what's next?' (March 2016). Available [Online] at <http://www.ifswf.org/sites/default/files/Publications/Moving%20the%20Santiago%20Principles%20foward.pdf > Accessed 20th March 2018.

at the 2015 annual meeting in Milan in which he warned members not to 'bankrupt the principles' or 'fall short in making them meaningful.' [960]

In the light of the foregoing, it appears that the implementation of the Santiago Principles remains far from ideal. It also appears that the levels of progress in complying with the principles are either static at worst or underwhelming at best, leaving substantial room for improvement. From an organisational perspective, the IFSWF Forum appears to be beset by severe limitations, including a lack of clear procedural rules, limited inclusivity, a difficult record on transparency and accountability and a lamentable absence of institutional controls on members Behaviour, including robust enforcement. It would therefore be charitable to describe the process as effective according to the tests set out in Chapter 2.

[960] International Forum of Sovereign Wealth Funds, 'Opening Address – From form to substance by Adrian Orr' (IFSWF Annual General Meeting, Auckland, 30 September 2015) Available [Online] at <http://www.ifswf.org/sites/default/files/blog/files/IFSWF_Annual_Meeting_Speech_Adrian_Orr_Milan_September_2015_0.pdf> Accessed 14 April 2018

GAPP	Standard	Indicator
GAPP 1	Legal framework	Legal basis and/or founding charter are disclosed.
GAPP 2	Policy purpose	The policy purpose of the fund is disclosed. Inconsistent policy purposes may receive a non-compliant rating as a consequence.
GAPP 3	Coordination with domestic fiscal and monetary authorities	Disclosure of processes that ensure coordination with domestic fiscal and monetary authorities. Alternatively, an explanation of why the fund's activities do not have significant direct domestic macroeconomic implications is required.
GAPP 4	Source of funding/ withdrawal and spending	Policies, rules, procedures or arrangements for the fund's funding, withdrawal and spending operations on behalf of the government should be clearly set out and consistent with the fund's policy purpose. Industry best practice also includes the annual reporting of the amount of inflows and withdrawals, if applicable.
GAPP 5	Statistical data reported to the owner	Description of procedures that ensure statistical data pertaining to the fund are reported on a timely basis to the owner.
GAPP 6	Governance framework	Holistic description of the fund's governance framework and identification of entities within that framework. Compliance with Principle 6 needs to be assessed in the context of Principles 7 to 9.
GAPP 7	Role of the owner	Disclosure of regulations that ensure the fund's owner sets the objectives, appoints the members of its governing body(ies) in accordance with clearly defined procedures, and exercises oversight over the SWF's operations.
GAPP 8	Role of the governing body(ies)	Disclosure of regulations that ensure the fund's governing body(ies) has(have) a clear mandate and adequate authority and competency to carry out its functions, including setting the fund's strategy and accountability arrangements.
GAPP 9	Operational management	Disclosure of regulations that provide the mandate for operational management, including reference to responsibilities and accountability arrangements.

GAPP 10	Accountability	Disclosure of accountability arrangements linking the fund to its political constituency and institutions.
GAPP 11	Annual report and accounting	Publication of annual reports and commitment to an international or national accounting standard.
GAPP 12	Auditing	Disclosure of audited financial statements.
GAPP 13	Professional and ethical standards	Disclosure of professional and ethical standards.
GAPP 14	Third parties	Disclosure of rules and procedures for dealing with third parties.
GAPP 15	Regulatory and disclosure requirements in host countries	Description of arrangements that ensure regulatory and disclosure requirements in host countries are complied with.
GAPP 16	Operational management independence	Disclosure of processes and policies that ensure operational management is independent from the owner of the fund.
GAPP 17	Disclosure of relevant financial information	Disclosure of asset allocation, benchmarks where relevant, rates of return over appropriate historical periods.
GAPP 18	Investment policy	Description of a conclusive investment policy.
GAPP 19	Disclosure of non-financial and economic considerations	Disclosure and discussion of factors beyond economic and financial considerations that drive investment decisions.
GAPP 20	Privileged information or inappropriate government influence	Disclosure of rules and regulations that prevent the fund from benefitting from privileged information or inappropriate government influence.
GAPP 21	Ownership rights	Adequate description of the approach to executing shareholder rights.
GAPP 22	Risk management framework	Description of the risk management framework.
GAPP 23	Investment performance and benchmarks	Disclosure of investment performance and performance benchmarks.
GAPP 24	Implementation of Santiago Principles	Description of the process to regularly review compliance with the Santiago Principles by or on behalf of the SWF. Disclosure of a Santiago compliance self-

Figure 17: Santiago Compliance Index Indicators under which a fund's performance is assessed. Sourced from GeoEconomica (2013).[961]

[961] Culled from GeoEconomica 'The Santiago Compliance Index 2013: Rating governance standards of

Fund	Rating
Fully compliant	
Petroleum Fund of Timor-Leste	A
PRF / ESSF (Chile)	A
Future Fund (Australia)	A-
New Zealand Superannuation Fund	A-
Government Pension Fund Global (Norway)	A-
Heritage & Stabilisation Fund (Trinidad & Tobago)	A-
Alaska Permanent Fund	A-
Heritage Fund (Alberta/Canada)	A-
Broadly compliant	
State Oil Fund of Azerbaijan	B+
Pula Fund (Botswana)	B+
Nigeria Sovereign Investment Authority	B+
JSC National Investment Corp. (Kazakhstan)	B
Korea Investment Corporation	B
Temasek Holdings (Singapore)	B
Reserve / National Wealth Funds (Russia)	B-
Fundo Soberano de Angola	B-
Partially compliant	
China Investment Corporation	C+
Abu Dhabi Investment Authority	C+
GIC Private Limited (Singapore)	C+
Khazanah Nasional Berhad (Malaysia)	C+
National Development Fund (Iran)	C+
Russian Direct Investment Fund	C
Kuwait Investment Authority	C
Libya Investment Authority	C
Non-compliant	
Qatar Investment Authority	D

Figure 18: Santiago Compliance Index 2014 showing the individual scores of IFSWF Member Funds. Sourced from GeoEconomica (2014).[962]

sovereign wealth funds' (2013).

[962] GeoEconomica 'Santiago Compliance Index 2014' op cit.

5.5 Conclusion

This chapter set out to investigate the nature of the International Forum of Sovereign Wealth Funds and the implementation of the Santiago Principles. The chapter began with a thorough examination of the institutional character of the Forum. Here, the emphasis was on its publicly available constituting document: the Kuwait Declaration which establishes the basic requirements for the operation of the forum. As per the contents of the declaration, it is clear that the IFSWF is to operate as a voluntary group of sovereign wealth funds without any formal legal authority. The chapter argued that the voluntarism of the IFSWF process fits perfectly with modern analyses of self-regulation which view these regimes as part of a patchwork of regulatory systems which deviate from conventional command and control understandings of law and regulatory ordering.

The chapter further analysed the contents of the declaration, revealing amongst other things, the limited clarity of this document over several aspects of the forum's operations. For instance, the declaration sets out the mandate of the forum which is to operate in an inclusive manner and to support the underlying objectives of the Santiago principles, however, it does not avowedly clarify the Forum's role with regards to future refinements of the principles or even its standard-setting credentials. Further, the declaration sets out several operational requirements for the forum such as its membership, its executive board, representation and working groups. Yet, its contents on the above elements appear to be severely limited. For instance, the declaration does not set out detailed procedural rules for board nominations and elections. A situation which stands in sharp contrast to other self-regulatory groups such as the PRI association.

Besides this rather limited organisational form, the forum also appears to be limited in its representativeness and inclusivity. Although recipient states and multilateral institutions are invited to its events as observers, there is little evidence of the co-optation of these actors into its broader

agenda. In addition, it also appears that the forum is distinguished by its opacity. For instance, the decision-making processes in the forum remain shrouded in secrecy, it also does not disclose the minutes of board and Annual general meetings or its membership rules nor does it explain regulatory decisions such as the departure or withdrawal of members. The chapter further contends that this raises severe questions about the seriousness and effectiveness of the IFSWF as a self-regulatory network of SWFs.

The chapter also examined the level of compliance with the implementation of the Santiago Principles. This is one of the metrics for assessing the effectiveness of self-regulatory regimes as set out in Chapter two. To this end, the chapter considered two prominent reports of the Forum on its Member's perception of the level of implementation with the Principles. The usual caveats apply since both reports are merely recitals of SWFs views of their own behaviour. Yet, the reports reveal striking information about the forum's membership, ranging from the incomplete levels of compliance, to the challenges of free-riding and shirking, occasioned by funds who appear not to be participating in the forum's activities. This raises the question of whether the forum's preferred approach of sociological pressures (sharing of views) are fit for purpose.

Both reports are also limited in several respects. For instance, they appear to have been drafted based on asymmetric information provided by individual members that have not been independently verified. This undermines the credibility of the reporting.

Further, the reports do not address the individual performance levels of members of the forum and are largely anonymised, meaning that it is difficult to see which funds belong to the fully compliant category and those who are partially compliant. Related to the above is the concerning fact that the forum does not set any timelines or targets for errant members to address their behavioural deficits, leading to the disconcerting conclusion of a blatant lack of institutional control over the implementation of the principles.

Still on the issue of compliance, the chapter also considered independent efforts aimed at establishing compliance levels with the principles. These efforts were considered to introduce an element of objectivity into the consideration of the likely levels of compliance. More so, they provide updated information on Santiago implementation given the failure of the IFSWF to publish more reports on members' implementation of the principles since 2013. The first of these efforts was the Truman Scoreboard, created in 2007 and which considers SWF transparency, accountability and behaviour based on 33 elements, some of which overlap with the Santiago principles.

The results of the latest Truman score board published in 2016 are striking in several respects. For one, they reveal a relatively low average score of 62.5 percent across all the 60 SWFs reflected on the scoreboard (IFSWF members and non-members). The scoreboard also finds that several funds are broadly complying with the low hanging fruits of governance and institutional structure but are struggling on the more technical aspects such as portfolio adjustments – a situation which suggests a reticence by SWFs to move beyond basic forms of disclosure.

The report also makes uncomfortable reading for the IFSWF. Whilst 8 of its member funds achieve a score of 80 or above, several of its members appear below this golden cut-off, including some funds such as the Qatar Investment Authority which appears at the bottom cluster of the Scoreboard – a situation which is both discomfiting and concerning given that forum members should be doing far more than non-members given their adoption of the Santiago principles over a decade ago.

Further, the scoreboard finds that several forum members do not score above non-member compatriots on the scoreboard, a situation that further highlights the reduced significance of the IFSWF process.

Even more interesting are the figures of progress between 2007 and 2015 recorded on the scoreboard. Here, IFSWF members (with the exception of the Nigerian Sovereign Investment

Authority) appear to have improved by a range of 0 to 38 points – a range that is largely undramatic or impressive. Worse, this underwhelming level of progress is shared across the board by the top performing funds and the underperformers. For instance, the Alaska permanent fund has flat-lined on its score of 88 points since the maiden scoreboard in 2007 and shows no sign of improving on this score in 2015/2016. Similarly, the Botswana Pula fund has only improved by 6 points in the same period from a low base of 53 points in 2007. Qatar's 26 point progress from its baseline score of 14 in 2007 is largely redundant given its entrenched position in the bottom cluster of the overall scoreboard. This scoreboard therefore paints a picture of stasis in compliance with the principles.

Also considered was the Santiago Compliance Index. An examination of the elements of this index reveals striking levels of underperformance in the latest edition. Whilst a few IFSWF member funds are more or less fully compliant, the vast majority are either broadly compliant, partially compliant or not compliant at all, with the report highlighting serial deviations and gaps which substantially compromise adherence with the Principles. Even so, there appears to be little sign of change since the publication of the 2014 Scoreboard. Sven Behrendt the author of the index in a 2016 update asserted that the index will "remain largely unchanged today if updated based on more rigorous evaluations."[963]

Taken together, this suggests huge gaps in the efficacy or effectiveness of the Santiago-IFSWF process which presumably require swift and far-reaching improvements.

[963] GeoEconomica, 'The Santiago Principles: what's next?' (March 2016). Available [Online] at <http://www.ifswf.org/sites/default/files/Publications/Moving%20the%20Santiago%20Principles%20foward.pdf > Accessed 20th March 2018.

CHAPTER 6: PROPOSALS FOR REFORM.

6.1 Introduction

This thesis has told a story of the rise and efficacy of the transnational self-regulation of SWFs through the Santiago Principles and the IFSWF. It began with an analysis of the conditions under which Self-Regulation is likely to be effective in Chapter 2. In this regard, the thesis established that the efficacy of self-regulation is likely to be determined by three distinct but interrelated metrics or factors namely: (a) the presence of comprehensive and ambitious targets (relative to the policy objective), (b) Compliance with Regime norms and (c) The institutionalisation of Good Internal Governance mechanisms – Representativeness, Transparency and Accountability.

With the above theoretical foundation in mind, the thesis began the journey towards an understanding of the efficacy of the Principles and the IFSWF. The first port of call was a study of the nature of SWFs in Chapter 3. This chapter established *inter alia* the rise, taxonomy, and behaviour of SWFs, situating them in the league of financial powerbrokers. The Chapter also considered the corresponding concerns associated with SWF investments which have provoked a backlash in a number of their target countries. The chapter also established that these responses inspired the search for broader multilateral rules, a variant of which, are reflected in the current version of the Santiago Principles.

Having established the main drivers for the Santiago Principles, the following chapter set out to examine its efficacy. This began with an analysis of the considerable acrimony that characterised the negotiations for the principles. What followed such acrimonious proceedings was a regulatory instrument which upon close examination is considerably limited and unambitious in the aspects of transparency, operational independence, political investment and competition which

also are the main policy concerns associated with SWFs. This, according to the thesis, fails to satisfy the tests of comprehensiveness and ambition – key determinants of self-regulatory effectiveness as set out in Chapter 2. Even so, the principles are devoid of independent monitoring and are instead subject to an obscure self-assessment mechanism which according to prominent studies is unlikely to constitute veritable monitoring.

In the face of the limited normative effectiveness identified above, the thesis further considered the efficacy of the institution (IFSWF) which emerged from the rubbles of the IWG negotiations in Chapter 5. Under scrutiny was the forum's representativeness, transparency and accountability – all elements of self-regulatory effectiveness. On all counts, the study found a record defined by limited inclusivity and representativeness and a deeply opaque tradition which broadly undermines any claim to efficacy.

On the crucial point of compliance with regime norms – another determinant of self-regulatory effectiveness, a picture emerges from analyses of both IFSWF records and independent studies of compliance of dismal levels of implementation and progress. This suggests huge gaps in the efficacy or effectiveness of the Santiago-IFSWF process as a whole which presumably requires far-reaching improvements

Building on the above deficiencies highlighted with the Santiago and IFSWF framework, this Chapter considers a number of practical reforms and improvements that may be introduced to enhance the efficacy of the Santiago-IFSWF Regime.

The reforms, designed along the lines of the determinants for self-regulatory effectiveness, are advanced in two key models. The first is characterised as endogenous reforms which denotes the reforms that can be made to the internal anatomy of the Santiago-IFSWF process by the forum itself and its members in recognition of the practical limits of the current approach to SWF Governance embodied in the present version of the principles.

The second model of reform can be characterised as exogenous reforms which speak to the external changes that can be made by external stakeholders such as recipient states which might affect the efficacy of the Santiago-IFSWF process and thus contribute to the creation of a truly effective and functionally integrated regulatory regime for SWFs. The exogenous reforms have been advocated given the reality that external stakeholders like Recipient states and multilateral institutions are inexorably affected by the outcome of the Santiago-IFSWF process and therefore ought to be given a proverbial seat across the table. This is indeed aligned with the inclusivity paradigm that was championed in Chapter 2 and -the preceding chapter as a determinant for effective self-regulation.

This chapter therefore considers the above proposals for reform in two sections. The first examines the probable endogenous reforms that can be made to the Santiago process, drawing, in many respects, from lessons in other self-regulatory groups and the second considers a number of plausible exogenous reforms that may be made by states or coalitions of states to their domestic trade and investment policies which might harden the gravitational pull towards the Santiago principles and other norms of good governance for SWFs. These reforms constitute the major contribution of this thesis and to broader knowledge and are considered in greater detail below.

6.2 Endogenous Reforms to the Santiago-IFSWF Process

Given the widespread deficiencies of the Self-regulatory process observed above, a few endogenous proposals are in order to improve the effectiveness of the Santiago-IFSWF process and ultimately avoid institutional failure.

Plausible endogenous reforms might include the codification of far more concrete, measurable and stringent standards which require SWFs to make meaningful changes and internalise serious governance costs. This was a surprisingly prominent theme at the 10th year anniversary of the Santiago principles held in September 2018 where the need for such changes

was exhaustively discussed with regrettably little action.[964] These reforms are necessary for a number of reasons.

For one, SWFs have become even more sophisticated investors both domestically and internationally since 2008, acquiring important assets. They are also a larger component of international capital markets with over 7 trillion of assets under management. It therefore makes practical sense to recognise the considerable weaknesses with the current principles and to toughen its impact.

More so, reforms to the process are necessary, given resurgent concerns over the investments of SWFs in the largest target countries. This concern can be seen in the recent enactment of the Foreign Investment Risk Review Modernisation Act 2018 (FIRRMA) in the United States which was specifically aimed at toughening access for Sovereign investors to US Financial Markets and recent moves towards the creation of a foreign investment screening process in Britain and in the European Union.[965]

SWFs themselves appear to appreciate these risks. This can be observed in a recent speech by the Director of the State Oil Fund of Azerbaijan, Shahmar Movsumov who noted: 'Today,

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[964] Amanda White 'Santiago Principles need update: panel' (20 September 2018) <https://www.top1000funds.com/2018/09/santiago-principles-need-update-panel/> Accessed 20th December 2018.

[965] James Jackson 'CFIUS Reform: Foreign Investment National Security Reviews' (August 2018) Congressional Research Service Report 7-5700, 1 <https://fas.org/sgp/crs/natsec/IF10952.pdf> Accessed 20th October 2018. See further: US Treasury, FIRRMA FAQs (2018) <https://www.treasury.gov/resource-center/international/Documents/FIRRMA-FAQs.pdf> Accessed 20th November 2018. See also, Department for Business, Energy and Industrial Strategy 'National Security and Infrastructure Investment Review' (2017), <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/652505/2017_10_16_NSII_Green_Paper_final.pdf> Accessed 20th May 2018. Philippe Le Corre 'EU moves to protect interests against predatory China' FT (28 November 2018) < https://www.ft.com/content/88c67050-ee58-11e8-8180-9cf212677a57> Accessed 20th December 2018.

there are new threats, protectionism is rising again…This might mean renewing the Santiago Principles, or maybe there are other ways we can impact that.'[966]

In light of the above, certain substantive, endogenous reforms are in order. For one, the IFSWF Forum should codify tougher requirements on the appointment of independent directors at SWFs and the creation of stronger firewalls between owner states and SWFs to guarantee the proper governance and operational independence of SWFs. To this end, it could borrow from or cross-reference the OECD guidelines for SOEs and the G20/OECD Principles for Corporate Governance. One example could be to introduce an amendment to Principle 7 which is formulated as follows:

Principle 7

The owner should set the objectives of the SWF and appoint the members of its governing body (ies) in accordance with clearly defined, transparent, accountable and well-structured procedures. To this end, it should consider the use of public appointment boards and nomination committees in the appointment or election of the governing body of the SWF as referenced in the OECD Guidelines for the Corporate Governance of SOEs. The Owner state should also consider the use of independent directors who are appointed or elected based on domain-specific expertise. The owner state should also refrain from appointing an excessive number of board members from the state administration and the appointment of persons directly linked to the owner state executive, including heads of government and Cabinet ministers.

The above reform recognises the deep anxiety occasioned by a perceived lack of independence amongst SWFs and tries to address such anxiety by prioritising stronger corporate governance and operational integrity through the appointment of independent directors.

[966] Amanda White 'IFSWF marks rise of protectionism' Top 1000 Funds (20 September 2018) <https://www.top1000funds.com/2018/09/ifswf-marks-rise-of-protectionism/> Accessed 20th December 2018.

Alongside the above, the forum should also consider reforms to Principle 9 by requiring SWFs to operate with greater autonomy from the apparatus of their owner states. A useful recommendation in this sphere might be to require owner states to allow SWFs comparable levels of independence as that afforded to Central Banks and independent regulators. This should be formulated as follows:

Principle 9

The state should act as an informed owner, ensuring that the governance of the SWF is carried out in a transparent and accountable manner. However, it should allow the operational management of the SWF the functional, operational and statutory independence to implement the SWF's strategies as defined in the fund's objectives and mandate in an independent manner and in accordance with clearly defined responsibilities. The owner state should also let SWF governing bodies exercise their responsibilities and refrain from directing SWF investment decisions. In return, the governing body of the SWF should develop clear lines of accountability to the owner, the public and markets by publishing periodic reports on the decisions and performance of the governing body and the fund in general.

Together with the reformed Principle 7, the above should help in easing concerns on the governance and operational independence of SWFs which was highlighted earlier in the thesis.

Besides governance and operational independence, a further area of reform is transparency. In this regard, the Forum should consider an amendment to Principle 17, requiring SWFs to disclose far more material information about their size, assets, use of leverage, use of credit ratings, portfolio adjustment and financial performance amongst others and this should be accompanied by exact and measurable public disclosure requirements. A plausible reform in this area might be formulated as follows:

Principle 17:

Relevant financial information regarding the SWF, including but not limited to its asset allocation, rates of return, benchmark, currency composition, absolute size, holdings, investment performance, valuation, use of leverage and/or credit rating should be publicly disclosed on a quarterly and/or annual basis to demonstrate its economic and financial orientation and to contribute to stability in international financial markets and enhance trust in recipient countries.

In addition to the above, the IFSWF forum should also proscribe once and for all, the potentially politicised use of SWFs by incorporating an addendum to principle 19 which requires SWFs to invest solely on financial grounds and to refrain from investments aimed at advancing the geopolitical interests of their owners. A plausible reform here should read as follows:

Principle 19:

While Members consider the free movement of capital to be of mutual benefit to capital exporting and importing countries, they also recognise the concerns of capital importing countries that forms of sovereign directed investments may represent critical risk factors in the international allocation of capital. Upon these considerations, members agree that the foreign investments of SWFs will proceed on an economic and financial basis and will, on no account, include the political or geopolitical considerations of owner states. To this end, members agree to abide by the enhanced transparency clauses in this document and to respect regulatory mechanisms as may be established by host states including submission to investment screening procedures and the establishment of transparent lines of communication with target country regulators to explain the rationale and purposes of inward investments into sectors that may be considered strategic.

The Forum should also consider reforms to Principle 20 on competitive parity between SWFs and private entities. A useful suggestion here might be the incorporation of elements of the OECD Guidelines on the Corporate Governance of State-Owned Enterprises into the Santiago Principles. The reformed Principle 20 should therefore read:

Principle 20:

The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities. In furtherance of this objective, SWFs should establish and publish information about the separation between their investment committees and other public authorities including Central Banks. And as a guiding principle, SWFs should not be exempt from the application of general laws, tax codes and regulations in host countries nor should they be accorded Sovereign Immunity and preferential treatment from taxation liabilities.

In contrast to the current Principle 20, the above reform makes a meaningful and measurable response to the risk that SWFs may seek privileged information from public authorities in competing with private enterprise but crucially also, it creates a level playing field between SWFs and other private sector entities by disallowing forms of preferential treatment based on the governmental status of the fund.

In addition to substantive clause by clause reforms, another key endogenous reform is the idea of meaningful changes to the monitoring of Implementation. As noted in Chapter 2, objective and independent monitoring is crucial determinant of self-regulatory effectiveness. A particularly useful contribution here may be the amendment of principle 24 to codify compulsory independent verification of compliance. This may operate by way of an external assurance engagement or the use of a performance auditor appointed by the Forum itself.[967]

There is some precedent for this. The New Zealand Superannuation Fund has often sought an external assurance of its self-assessment, meaning that the contents of its Santiago Compliance

[967] For the meaning of an Assurance engagement see: ICAEW 'The five elements of an assurance engagement' (2018) <https://www.icaew.com/technical/audit-and-assurance/assurance/process/scoping/assurance-decision/the-five-elements> Accessed 20th May 2018.

reports are often independently verified.[968] Also, the UK Stewardship code – a code which obliges the largest asset managers to engage proactively with their investee companies – requires signatories to seek out forms of external assurance or verification of their compliance with the code.[969] The forum should therefore consider rolling out this practice more widely or better still, reserve the right to appoint a specialised forum-wide performance auditor that is able to verify members compliance, including by making on-site visits to respective member funds. These ideas should also be codified in Principle 24 of the reformed Principles which should read as follows.

Principle 24:

Members of the International Forum and Subscribers to the Santiago Principles shall report annually on compliance with the Santiago Principles. In furtherance of this objective, Members are obliged to seek Independent, External Verification of Compliance and publish these reports in line with their reporting and compliance obligations. The forum also reserves the right to appoint an independent auditor to periodically verify the compliance and implementation of the principles among its Members.

Cynics may raise questions about the practicability of the above reforms to the monitoring of compliance given well-known IWG concerns over this issue. However, it is worth noting that newer members of the forum appear to be nudging the organisation in this direction. This can be seen in a recent report by the Irish Strategic Investment Fund (ISIF) in which it noted that:

> 'While appreciating the voluntary and inclusive nature of the Santiago Principles as a self-assessment exercise, as a new sovereign development fund, it would be very useful to ISIF to gain a better understanding of how we compare with peer funds. External assessment

[968] IFSWF 'Implementing the Santiago Principles: 12 Case Studies – From Demonstrating Commitment to Creating Value (November 2016), 51 <http://www.ifswf.org/sites/default/files/IFSWF_CaseStudies_Nov2016_0.pdf> Accessed 20th September 2018.

[969] Principle 7 UK Stewardship Code (2012).

of our implementation of the Principles to identify both areas of best practice and also potential scope for improvements would be useful.'[970]

Besides changes to monitoring and verification, The IFSWF should also consider a shift away from sociological pressures towards more explicit sanctions or threats of enforcement. This would infuse greater thrust and efficacy into the process as noted in Chapter 2. A useful suggestion here might be the publication of a blacklist of free-rider or non-compliant funds or what is often understood in regulatory parlance as naming and shaming. The forum may also consider a 'red card' system where inactive members are delisted or asked to withdraw from the IFSWF label in the face of persistent and unremitting records of non-compliance or inactivity.

In this regard, the Forum may want to learn from the PRI – a self-regulatory organisation of ethical investment funds – whose signatory accountability rules set out certain enforcement actions that may be taken against errant members of the PRI.[971] In learning from the PRI example, the IFSWF may want to codify stronger enforcement action through a full statement of member accountability allowing the forum to take disciplinary action or by way of an addition to the principles – a Santiago Principle 25 – setting out a number of appropriate action against non-compliant members. In the event of the latter, the new Principle may be formulated as follows:

Principle 25

Members reiterate their commitment to the Santiago Principles and membership of the IFSWF but in persistent cases of Non-compliance and inactivity, the board and advisory committee of the International Forum of Sovereign Wealth Funds (IFSWF) reserves the right to take appropriate action. This includes,

[970] Ibid. at 29.

[971] PRI 'Signatory Accountability Rules' (2018) <https://www.unpri.org/Uploads/p/j/v/2018-Signatory-Accountability-Rules.pdf> Accessed 29th March 2019.

in no particular order, the payment of fines, inclusion in the register of non-compliant members and in extreme circumstances, a withdrawal of Membership.

In addition to the above, some internal organisational reforms are also necessary to improve the efficacy of the IFSWF process. One recommendation here is a dramatic improvement in the transparency of the Forum, including real time disclosure of its full constitutional documents, membership rules, meetings records, financial and non-financial reports, subcommittee deliberations and work products. This should be followed by the timely publication of an annual report setting out the forum's achievements in a given financial year and its priorities for the next and detailed explanations of all regulatory decisions, including the criteria and metrics for the on-boarding of new members and disciplinary procedures for existing members. This is likely to satisfy the transparency and accountability factors which were identified in the second chapter as determinants for self-regulatory effectiveness.

On top of this, the Forum should also encourage the formal participation of a broader selection of stakeholders in its regulatory processes including Recipient States and Multilateral Institutions whose participation are already guaranteed in the current Kuwait Declaration but should be strengthened further including through more formal inclusion in relevant IFSWF subcommittees and working groups.

This should be followed by the addition to the stakeholder list of relevant civil society organisations such as the Natural Resource Governance Institute (NRGI)[972] and other stakeholder groups like the Extractive Industries Transparency Initiative (EITI) which formulates standards that touch on the role of SWFs as the investors of extracted wealth.[973]

[972] NRGI 'What We Do' (2019) <https://resourcegovernance.org/about-us/what-we-do> Accessed 20th May 2019.

[973] EITI 'Who we are' (2019) <https://eiti.org/who-we-are> Accessed 20th May 2019.

Epistemic communities such as the Sovereign Investment Lab which has been recently appointed as an educational partner of the Forum should also be given a proverbial seat across the table.[974] Together, this is likely to enhance oversight and expertise and allow for more legitimate and balanced regulation that caters for the wider interests of affected stakeholders rather than the narrow plurilateral interest of SWFs alone.

Alongside the above, the forum should further consider integrating itself into the global financial governance architecture by seeking associate or affiliate status with governance networks such as the Financial Stability Board, International Organisation of Securities Commissions (IOSCO)[975] and the International Capital Markets Association (ICMA). This might allow for the emergence of some form of meta-governance or the creation of a truly 'networked' setting through which SWFs can learn from and participate in the standard-setting processes ongoing in these organisations.

6.3 Exogenous Reforms to the IFSWF-Santiago Process

Upon the introduction of these endogenous reforms, some exogenous changes might also be necessary to enhance the thrust and effect of the Santiago-IFSWF process. By Exogenous, this thesis means reforms that cannot be undertaken by the forum or its members but by the target countries of SWF investments alongside other stakeholders. The idea of exogenous reforms recognises that Santiago-IFSWF process does not operate in a vacuum and in fact, operates in a continuum characterised by powerful actors and interests including the home states of SWFs, their host states and other multilateral institutions with avowed regulatory responsibilities over the global investment and financial order.

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[974] IFSWF 'Our partners' (2019) <https://www.ifswf.org/our-partners> Accessed 20 May 2019.

[975] The Hedge Fund Standards Board now Standards Board for Alternative Investment (SBAI) is an affiliate member of the IOSCO see: <https://www.iosco.org/about/?subsection=membership&orgID=416> Accessed 20th December 2018.

One suggestion here is the incorporation of the reformed Santiago Principles into Bilateral and Plurilateral Investment Treaties between the home states of SWFs and their target countries. This would thus allow recipient and home states of SWFs to crystallise a set of standards that subject SWFs to stronger behavioural obligations whilst also facilitating and protecting their investments.

The Comprehensive and Progressive Trans-Pacific Partnership (CPTPP), the Multilateral Trade Agreement between eleven Countries in the Pacific Rim provides a limited precedent of the potential use of trade agreements in this regard. The agreement codifies certain disciplines against the non-commercial use of state-owned enterprises but exempts from its reach, SWFs and Independent Pension Funds that are 'commercially oriented.'[976] Such an approach could be applied to SWFs and the Santiago Principles. In the sense that SWFs that are deemed compliant with the reformed principles may be exempted from treaty-based disciplines or offered increased access to overseas markets.

This should then be followed by the incorporation of aspects of the principles into domestic foreign investment regulation of host states and/or the provision of a safe harbour from the application of certain pre-admission processes to funds deemed to be fully compliant with the principles, of course subject to external verification.

One example may be the codification of a safe harbour from the more onerous aspects of inward investment screening in the CFIUS and FIRB legislations of the United States and Australia respectively which were thoroughly analysed in the third Chapter. For instance, the FIRRMA 2018 could be amended to exempt SWFs deemed to be compliant with the principles from its mandatory filing requirement which requires foreign government investors such as SWFs

[976] Comprehensive and Progressive Agreement for Trans-Pacific Partnership Agreement Between Australia, Canada, Japan, Mexico, New Zealand, Singapore, Brunei Darussalam, Chile, Malaysia, Vietnam and Peru (CPTPP). Article 17.2.

to make a mandatory filing to the CFIUS before making a covered investment in the United States. Equally, the FIRB legislation could be amended to ease the mandatory filing requirement for SWFs compliant with the Santiago Principles as well as to increase the screening threshold for compliant SWFs.

Linking compliance with the principles to the commercial interests of SWFs in such a way serves two functions. For one, it is likely to ease the regulatory burden for SWFs seeking investment opportunities in their target states but crucially also, it is likely to incentivise SWFs to prioritise compliance with the principles and other sound intra-organisational reforms.

A further exogenous reform that may be considered is the idea of a multilateral liberalisation of investment barriers for SWFs. This should be led by multilateral institutions like the IMF and OECD and target countries together. One useful contribution may be the revival of the OECD Freedom of Investment Initiative which in 2009 codified a set of voluntary practices for recipients of SWF investments.[977]

Although this project seems to have stalled somewhat, a revival may be appropriate in recognition of the endogenous reforms outlined above. The revived OECD/IMF Freedom of Investment initiative should allow for a further development of harmonised principles, best practices and guidance for recipient countries in their attraction and treatment of SWF investments from SWFs. The focus should be on ensuring that SWF investments are treated on a proportionate basis as other investments and to make sure that recipient countries collectively and multilaterally lower barriers especially for funds that are compliant with the reformed Santiago principles.

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[977] OECD, 'Guidelines for Recipient Country Investment Policies Relating to National Security' (2009) <https://www.oecd.org/daf/inv/investment-policy/43384486.pdf> Accessed 20th May 2017. See also: OECD 'Declaration on Sovereign Wealth Funds and Recipient Country Policies' (2008) <https://www.oecd.org/daf/inv/investment-policy/oecddeclarationonsovereignwealthfundsandrecipientcountrypolicies.htm> Accessed 30th March 2019.

The above seems consistent with a previous suggestion by Peter Costello, the Chairman of the Australian Future Fund – a member of the IFSWF – in which he called for 'countries that receive inward investment to recognize and acknowledge SWFs that comply with the Santiago Principles as suitable and beneficial investors.'[978]

A policy of multilateral liberalisation along the lines of that mooted by Costello and articulated above is likely to constitute a veritable exogenous reform as well as help in hardening the gravitational pull towards the principles for SWFs and more broadly, creating a viable, integrated and effective regulatory regime that links compliance with the principles to the broader commercial interests of SWFs.

[978] Peter Costello, Chair Australia Future Fund 'Building a Long-Term Sustainable SWF under the Santiago Principles' (Speech at the 7th Annual Meeting of the International Forum of Sovereign Wealth Funds in Milan, Italy 30th September 2015) <http://www.ifswf.org/sites/default/files/blog/files/2015_September_IFSWF-Chairman%27s_address_%28A443525%29_0.pdf> Accessed 20th October 2018.

CHAPTER 7: CONCLUDING REMARKS

The primary theoretical question that has directed this research is whether and to what extent the Santiago Principles and the International Forum of Sovereign Wealth Funds (IFSWF) constitute effective self-regulation for SWFs. The principal mechanism by which this is hypothesised is through the lens of Self-Regulation theory which explains the rise of informal forms of legalisation between public and/or private actors both nationally and in the transnational policy space. Proponents of Self-Regulation argue that it is capable of producing flexible policy solutions in comparison to the often-ponderous bureaucratic processes of conventional command and Control Regulation and that the co-optation of regulatory targets into the rule-making process might make for better rulemaking and compliance.

Critics on the other hand, question the ability of self-regulation to produce effective ordering and governance in the wider public interest. Arguments put forward in this regard include the risks of regulatory capture which occurs when self-regulating groups design rules and procedures in their narrow institutional and political interests, free-rider problems or lack of compliance, inadequate enforcement and poor accountability and transparency.

The second and most prominent concern of this study flows from the first: understanding the conditions or circumstances under which self-regulation and self-regulators are likely to produce effective governance in the public interest and trying to measure the different ways a voluntary regime's effectiveness can be measured. As Abbott and Snidal note, 'in examining a highly political activity like regulation, effectiveness must be conceptualized broadly.'[979]

To this end, the thesis consulted the vast stream of research on the effectiveness of self-regulation from various disciplines of the Social Sciences. In analysing this literature, one can

[979] Kenneth W. Abbott and Duncan Snidal 'the Governance Triangle: Regulatory Standards Institutions and the Shadow of the State' in Walter Mattli and Ngaire Woods, The Politics of Global Regulation (Princeton University Press, 2009) 61.

observe the notoriously diverse conceptual lenses and frames through which the effectiveness of Self-Regulation is understood.

Some studies emphasise process-centric elements such as reputational concern amongst target actors, the relevance of flexibility in regulatory detail, the existence of sufficient bureaucratic capacity and autonomy on the part of the self-regulator, the degree of transparency in the regulatory process and the seriousness of accountability.

Others argue that effectiveness is a by-product of robust commitments by regulated targets, strong accountability mechanisms, compliance, monitoring and enforcement, clarity of standards and industry-wide coverage among others. Although interesting, these approaches pose profound methodological challenges. For instance, how does one measure the commitment of regulatory targets to the regime or the extent of reputational concern amongst target actors? This clearly calls for targeted and measurable indicators through which self-regulatory effectiveness can be analysed and understood.

Besides the often-anecdotal analyses of effectiveness, more sophisticated analyses have been advanced. These mostly concentrate on the likely output and outcomes of voluntary regulatory systems. Although measurable, a pursuit of these approaches is likely to produce a parochial and thus dismal understanding of the effectiveness of self-regulation since output and outcome centric analyses involve, for the most part, a consideration of norms and a lesser focus on the likely institutional characteristics under which Self-Regulation is likely to be effective.

In line with Abbott's advice, this study instead prioritised an inclusive and measurable understanding of effectiveness which focuses on the right combination of norms and institutions through which effective self-policing can be engendered. One can observe trappings of this in the hypothesis put forward by Professor Fabrizio Caffaggi who observes that effectiveness of self-regulation depends 'on the comprehensiveness and quality of the rules, the associated level of enforcement and compliance and the governance arrangements institutionalised by the self-

regulatory regime.'[980] This clearly marries normative factors such as the quality and comprehensiveness of regulatory outputs, with institutional considerations such as the governance of the regime.

Taking cues from the Caffagi approach and other methods identified in the vast literature on self-regulation, this thesis conceptualised the effectiveness or efficacy of Self-regulation as the ability of a voluntary regime to meet its motivating objectives. For such an effect, the thesis proposed three distinct but interrelated metrics or factors namely: (a) the presence of comprehensive and ambitious targets (relative to the policy objective), (b) Compliance with Regime norms and (c) The institutionalisation of Good Internal Governance mechanisms – Representativeness, Transparency and Accountability.

Comprehensive and Ambition of Standards was conceptualised as the existence of precise, unambiguous and substantive standards which require regulating actors to implement meaningful changes (imposes costs on regulates and eliminates certain privileges from them), relative to the policy objective. Also allied to the design of standards is the idea of robust monitoring and enforcement. The latter is understood as the existence of explicit sanctions such as the expulsion, delisting or naming and shaming of deviant regime members rather than a reliance on informal or sociological pressures. This channels the scepticism of Potoski and others about the ability of informal pressures alone to drive up standards or eliminate free riding in voluntary settings. Robust monitoring on the other hand suggests a reliance on third-party auditing or verification rather than the heavily biased and conflicted practice of self-assessment or first-party reporting.

In close parallel to the design of standards is the idea of compliance with regime norms. Indeed, one might argue that regulatory instruments are of little use if they are not complied with.

[980] Fabrizio Cafaggi and Andrea Renda, 'Measuring the Effectiveness of Private Regulatory Organisations' (2014) Stribis Foundation Report, 67 <https://ssrn.com/abstract=2508684> Accessed 20th January 2018.

For this reason, the study emphasises the importance of implementation of the regime norms and behavioural changes that are broadly in tune with the substance of regime standards.

Last but not least is the idea of Good Internal Governance Mechanisms. The study identified three of these as key. The first is the idea of representativeness and the inclusion of relevant actors in the governance of the regime. As indicated in Chapter 2, representativeness and inclusion of relevant actors and stakeholders allows for consent, which in turn enhances process legitimacy, and allows for balanced self-regulation that protects the wider public interest.

The study also identified the need for transparency and accountability, the former through real time disclosure and publication of relevant constituting documents and membership rules, impact assessments, financial and non-financial reports and regulatory decisions of the self-regulatory organisation. It was argued that such real time disclosures allow for corresponding scrutiny of the self-regulatory organisation by concerned and affected stakeholder constituencies (accountability).

In applying the above to the Santiago Principles and the International Forum of Sovereign Wealth Funds, this study established that the principles arose in a highly political atmosphere characterised by frosty exchanges amongst negotiating funds, in ways reminiscent of traditional critiques of Self-regulation as likely to induce cascades of capture and self-interest.

Indeed, the product of these fraught negotiations was a heavily compromised document which largely reflected the institutional and ideological preferences of participant funds, especially those from wealthy developing countries, with a great deal of lip-service paid to the interests of constituencies with a high stake in the negotiations, including target countries of SWF investments. The cumulative effect was therefore a set of minimum standards, pinned to the lowest common denominator and devoid of objective monitoring or enforcement whatsoever.

The limitations of this document become even starker when one considers its substance. Here, one can observe, without play on words, a chasm between certain aspects of the principles and their underlying commentary. This fails the test for clarity and precision (comprehensiveness) as suggested in Chapter 2. Worse, key elements of the principles relating to Governance and operational independence, Transparency, Political Investments and Competition have been drafted in ways which do not require SWFs to expend serious costs, waive certain privileges, or implement meaningful behavioural changes, relative to the policy objective – a situation which suggests a strategic reticence on the part of the IWG to codify stringent standards and thus fails the test of ambition.

The limited ambition of the document becomes far more radical when selected principles are juxtaposed with comparable governance benchmarks such as the OECD Guidelines for the Corporate Governance of State-Owned Enterprises and the IMF's Guidelines for Reserve Management Funds which contain far more stringent prescriptions for other state-owned entities in certain respects.

Moving beyond the textual ambiguity and lack of ambition observed in the principles, the study further considered the efficacy of its institutional counterpart– the IFSWF. Under particular scrutiny was the representativeness of the forum and its record on transparency and accountability.

Regarding the former, circumstantial evidence suggests that forum's activities are led, for the most part, by SWFs themselves with the exclusion of other relevant parties such as recipient countries and multilateral institutions. Although these parties are generally invited as observers to the Forum's meetings, the most technical aspects of these meetings are often held behind closed doors with the exclusion of invited observers. Still, there seems to be little public record of the co-optation of recipient states and multilateral institutions in the broader regulatory agenda of the forum.

The words 'closed door' is largely indicative of the Forum's approach to Transparency and Accountability. On the former, the study established that the IFSWF Forum publishes little information about its internal governance and procedural requirements. This is even worse when one considers disclosure around the forum's regulatory activities such as minutes of its annual meetings, the operations of subcommittees, annual reports and the withdrawal of members. This makes a mockery of the forum's stated purpose which is to raise an understanding of SWF activities and operations.

In the context of the third and final metric for Self-regulatory effectiveness: Compliance, the study observed some indicia of compliance, especially amongst the traditionally well governed funds from developed countries. However, available data still paints an overall picture of widespread free-riding and low levels of compliance amongst the majority of IFSWF funds. When read in conjunction with data on the scale of progress made amongst IFSWF funds more or less since the promulgation of the principles, one can also observe a picture of underwhelming progress at best or stasis at worst.

At a general level, this suggests a record of failure on the part of the IFSWF in raising the levels of compliance amongst SWFs – a sentiment that is shared by Norway's SWF which noted in its departure statement that: 'the Forum has not met our expectations as an organization with sufficiently strong progress in the implementation of principles.'[981]

Given such profound weakness and inefficacy, this study further considered plausible reforms that may be introduced to strengthen the impact and effectiveness of the Santiago Process. These reforms were categorised as endogenous and exogenous.

[981] Chris Wright 'Scoring the Santiago Principles as they turn 10' Euro Money (8th October 2018) <https://www.euromoney.com/article/b1b950f21d36bd/scoring-the-santiago-principles-as-they-turn-10?copyrightInfo=true> Accessed 20th December 2018.

Exogenous reforms advanced include the codification of strict and measurable changes to the main recommendations of the document on Governance and Operational independence, transparency, political investments and competition. Reforms advanced also include meaningful changes to monitoring and enforcement such as the introduction of independent monitoring through third party assurance and the appointment of an independent auditor by the forum.

The study also called for stronger enforcement including the introduction of explicit sanctions such as pecuniary fines, publication of a list of non-compliant funds and withdrawal of membership. This is likely to move the Santiago-IFSWF regime from a 'velvet glove' process to a more effective governance platform for SWFs.

Alongside the above, the study also advocated additional changes to enhance the transparency and accountability of the process. Reforms suggested here include real time disclosure of the IFSWF's constitutional documents, membership rules, meetings records, financial and non-financial reports, subcommittee deliberations and work products which remain undisclosed at the time of writing.

It was also advocated that the forum should consider publishing an annual report setting out its achievements in a given financial year and its priorities for the next and the disclosure of detailed explanations of all regulatory decisions, including the criteria and metrics for the on-boarding of new members, disciplinary measures against existing members and all governance projects underway at the forum.

On top of this, the study advocated the inclusion of a broader network of stakeholders including Multilateral institutions, target countries, good governance institutions and epistemic communities, into the formal regulatory activities of the forum to address its representativeness deficit. This was followed by a suggestion that the forum should integrate itself into transnational governance networks such as the Financial Stability Board, International Organisation of Securities

Commissions (IOSCO) and the International Capital Markets Association (ICMA) through which forms of networked or meta-governance might unfold.

In addition to the abovementioned endogenous reforms, the study also considered a number of exogenous reforms to the process, in recognition of the fact that the Santiago-IFSWF process do not operate in a vacuum. Ideas proposed here include the incorporation of elements of the reformed principles into Bilateral and Plurilateral Investment treaties between SWF home and host states to provide additional safeguards for compliant SWFs and the codification of safe harbours from the more onerous requirements of domestic investment screening processes for Santiago-compliant SWFs.

The study also advocated the renaissance of multilateral initiatives such as the OECD Freedom of Investment project to further distil harmonised practices for target countries that receive SWF investments and by so doing, to collectively lower the barriers facing SWFs in the international marketplace, in recognition of the considerable effort made to reform the Santiago-IFSWF process.

These recommendations clearly project a number of structural reforms, which in the author's view, can be made within the discussion of a future regulatory framework for Sovereign wealth funds (SWFs) if a semblance of effective governance and regulation for SWFs is to be achieved. Altogether, it is the author's intent and hope that this research contributes to the debate in global epistemic and regulatory circles about the creation of a truly viable, integrated and efficacious regime for these increasingly important set of investors.

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