The public policy focus on sovereign wealth funds (SWFs) during 2007–08 raised several important issues relevant for the functioning of the international monetary system. These issues encompassed the manner of funding and growth of SWFs, the purposes underlying SWF investments and their governance and transparency, discriminatory regulatory treatment, and protectionism against sovereign investments.

The IMF took the view that some of the public policy concerns relating to SWFs could be addressed by facilitating a structured dialogue between SWFs and recipient countries, and by developing a set of voluntary principles for SWFs. At the same time, the IMF became more aware of the need to integrate the operations of the SWFs more firmly within the macroeconomic policy frameworks of their home countries and within the structures for multilateral monitoring. Both objectives were consistent with the core mandate of the IMF to work toward ensuring that cross-border investment flows are conducted in a fair and open manner.

An IMF-facilitated International Working Group of Sovereign Wealth Funds (IWG) was formed in May 2008 to develop a set of principles that properly reflect the investment objectives and practices of SWFs. The IMF was tasked to provide a secretariat and to support the work of the IWG. Over the subsequent four months, the IWG went about its work, drawing upon SWF good practices and relevant international guidelines, standards, and codes. IMF staff provided background material and technical inputs and helped facilitate negotiation and consensus building among the IWG members.

In September 2008, a preliminary agreement was reached in Santiago, Chile, on a set of 24 Generally Accepted Principles and Practices, also known as the “Santiago Principles” (the principles). The IWG presented these principles to the IMF’s policy-guiding committee, the International Monetary and Financial Committee, on October 11, 2008.

This marked the first time that the SWFs, along with their owner countries, had set out a comprehensive framework for their legal, governance, and institu-
tional structures, and their investment policies. The output was a good example of multilateral collaboration, with the IMF acting as broker to facilitate development of consensus among the SWFs. Also, from the start, the IWG benefited from direct feedback and inputs from recipient countries and agencies such as the Organisation for Economic Co-operation and Development (OECD).

This chapter discusses the development of the Santiago Principles and the role of the IMF in that process. The first section defines SWFs and their role while the second section outlines key issues surrounding SWFs. The role of the IWG and the process that led to the development of the Santiago Principles are explained in the third section, which is followed by a discussion of the key features of the principles. The final section provides concluding thoughts on the progress thus far and some of the key challenges.

**SWFs: OBJECTIVES AND TAXONOMY**

SWFs are loosely defined as government-owned investment funds with investments in foreign financial assets. The IWG developed a more precise definition of SWFs\(^3\) that excludes, among other things, foreign currency reserve assets held by monetary authorities for traditional balance of payments or monetary policy purposes, traditional state-owned enterprises, government-employee pension funds, and assets managed for the benefit of individuals.

SWFs are a heterogeneous group funded from different sources and with a variety of purposes. Based on their dominant objectives, the IMF categorizes SWFs broadly into five types: (1) stabilization funds, the primary objective of which is to insulate the budget and the economy against commodity (usually oil) price swings; (2) savings funds for future generations, which aim to convert nonrenewable assets into more diversified portfolios of assets and mitigate the effects of Dutch disease;\(^4\) (3) reserve investment corporations, whose assets are often still counted as reserve assets, and are established to increase the return on reserves; (4) development funds, which typically help fund socioeconomic projects or promote industrial policies that might raise a country’s potential output growth; and (5) contingent pension reserve funds (from sources other than individual pension contributions) for contingent unspecified pension liabilities on the government’s balance sheet.

In practice, this system of categorization needs to be used flexibly because the objectives of the SWFs may be multiple, overlap, or change over time. For example, some countries’ stabilization funds have evolved into funds with savings objectives because accumulated reserves increasingly exceeded the amounts needed for short-

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\(^3\)SWFs “are special purpose investment funds or arrangements that are owned by the general government. Created by the general government for macro-economic purposes, the SWFs hold, manage or administer assets to achieve financial objectives, and employ a set of investment strategies that include investing in foreign financial assets” (IWG, 2008, p. 3).

\(^4\)Dutch disease arises when foreign currency inflows cause an increase in the affected country’s real exchange rate. The effect of Dutch disease is to reduce external competitiveness, which weakens net exports, contributing to the loss of jobs in the relevant industries. The end result is that nonresource industries are hurt by the increase in wealth generated by the resource-based industries.
term fiscal stabilization or to sterilize foreign exchange inflows. The various objectives of SWFs imply different investment horizons and trade-offs between risk and return, which have led to different approaches in managing these funds. SWFs with stabilization objectives place more emphasis on liquidity and have shorter investment horizons than do SWFs with savings objectives, for which liquidity needs are lower. Several countries have revisited the objectives and redesigned the structures of their SWFs to broaden their policy roles and investment goal.⁵

ISSUES SURROUNDING SWFs

Commentaries and studies on SWFs have mainly focused on (1) the transparency of SWFs, including their size, approaches to risk management, investment strategies, and the possible influence of political objectives on SWF investments; (2) the integration of SWF activities into external and government accounts; (3) the impact of funds’ asset allocations on international capital movements and asset prices; (4) protectionist restrictions on SWFs; and (5) the transparency and predictability of capital-importing countries’ investment regimes.

The IMF’s interest in SWFs stems from two of its key functions: (1) macroeconomic and financial stability surveillance, and (2) ensuring the effective functioning of the international monetary system. Coverage by the IMF of SWF-type arrangements and their operations becomes important both for the domestic economies of countries with SWFs, as well as from the international perspective of financial stability and capital market spillovers. From the IMF’s standpoint, the following key issues have been raised with regard to SWFs:⁶

• First, the way in which SWFs fit within the domestic policy framework and in policy coordination is important. An SWF’s assets—and the returns they generate—have a significant impact on a country’s public finances, monetary condition, balance of payments, and balance sheet links.⁷ Well-designed SWFs can support fiscal and monetary policies and liquidity management. However, SWFs may also create macroeconomic policy challenges, so good coordination between the SWF and the fiscal and monetary authorities is necessary to ensure that overall policy objectives are met. The interrelations between SWFs and their home governments became even more complicated during the 2007–09 global financial crisis (IMF, 2009).

• Second, the operations of SWFs may affect global financial markets’ flows and prices. SWFs are generally long-term investors that are usually not leveraged, meaning

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⁵This has also occurred in the context of the recent global financial crisis, in which some SWFs have been tasked to play an active role in stabilizing domestic financial systems. The severity of the crisis prompted governments to turn to their SWFs to support troubled local firms, reduce government deficits, or fund economic stimulus programs. The role SWFs played in crisis management may prompt changes to the legislative framework of some SWFs.

⁶For a more detailed discussion, see IMF, 2008b.

⁷For a discussion of policy and operational considerations and factors that determine investment policies, see Das and others, 2009.
they can sit out longer during market downturns or invest against market trends. Thus, SWFs may tend to provide a stabilizing influence in financial markets. However, circumstances could also arise in which they could cause volatility in markets—for example, if they are operating in shallower markets or where rumored transactions affect relative valuations in particular sectors and lead to herd behavior, further adding to volatility (e.g., Corsetti and others, 2001). Looking ahead, it will be interesting to see if SWFs maintain diversified portfolios or whether they retrench toward U.S. dollar assets as global growth slows. Shifts in asset allocations are likely to contribute to changes in equity prices, interest rates, and exchange rates, raising the IMF’s interest in SWFs as it conducts multilateral surveillance, and more broadly, in its analysis of global financial stability and capital markets (IMF, 2007b, 2008a).

• Third, good corporate governance of SWFs is a critical issue for domestic stakeholders. Many aspects of good corporate governance are universally applicable. General principles regarding key ownership functions, the role of stakeholders, disclosure and transparency, the flow of information between management and the governing board, and the composition and responsibilities of the board are all relevant for SWFs. SWFs also need to ensure that adequate risk-management processes and human and system resources are present to correctly monitor and manage financial and operational risks, including those arising from the use of external fund managers.

• Fourth, recipients of SWF investments have raised concerns about SWFs’ objectives and investment practices. The key concern is whether SWFs follow commercial objectives or whether they might invest with political or strategic objectives in mind. A related concern is whether SWFs might be too active or passive in their approach to corporate governance in the companies in which they invest. A perception that SWFs could invest for noncommercial motives could fuel protectionism.

Various suggestions have been made about addressing these issues, including standards that could cover SWFs’ objectives and investment strategies, governance, accountability, and transparency.8 Observers have also suggested specific changes to SWFs’ investment behavior and the exercise of their voting rights to reduce perceptions of political influence.9 One proposal is that SWFs should invest at arm’s length solely through intermediary asset managers, as is the case for some endowment funds. However, others do not think that the use of mandates and outside managers would be sufficient to eliminate potential conflicts of inter-

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8For example, Truman (2007) argues that a standard should cover all international investment activities of governments. He suggests that a standard should cover their (1) objectives and investment strategy; (2) governance; (3) transparency; and (4) behavior (the scale and speed at which portfolio adjustments are made). Mervyn Davies has called for SWFs to adopt minimum standards on transparency and governance (Larsen, 2008).

9Sec, for example, Summers, 2007; Gilson and Milhaupt, 2008. Hildebrand (2007) suggested that SWFs be given independence from governments along the lines of independent central banks to reduce perceptions of political interference.
est because the SWF would still provide guidance to the asset manager. Other proposals include upper limits on the ownership or voting rights of SWFs in foreign private sector corporations, with the limits set below the typical threshold for a controlling minority in a firm. A less onerous suggestion is that SWFs should publish a voting list on a regular basis. Discussions have also considered a “negative list” of strategic and sensitive areas in which SWFs should not invest.

Some aspects of SWFs have been dealt with by other regulators, agencies, and country authorities directly. One example is market integrity issues, which are in the domain of domestic market regulators such as the Securities and Exchange Commission in the United States; market regulators’ activities are harmonized through the International Organization of Securities Commissions. National security issues are primarily in the domain of national safeguard procedures (e.g., the Committee on Foreign Investment in the United States). The OECD, which focuses its work on recipient countries, has formulated practices relating to the treatment of foreign investors with adequate safeguards for national security.

THE IWG AND THE DEVELOPMENT OF THE SANTIAGO PRINCIPLES

The IWG comprised 23 IMF member countries, with three additional countries, the OECD, and the World Bank acting as permanent observers. A subgroup of

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10 Some institutional investors disclose their voting policies. In the United States, mutual funds are required to disclose their proxy voting policies and records and these are published on the Securities and Exchange Commission Web site. A number of U.K. institutional investors have voluntarily published their voting records (e.g., co-operative insurance, Friends Provident, and the Universities Superannuation Scheme). The 2006 U.K. Companies Act (Sections 1277–1280) gives the government a reserve power to issue regulations, which would require institutional investors to report publicly on how they vote their shares. The institutions to which these provisions apply are unit trust schemes, open-ended investment companies, investment trusts, pension schemes, insurance businesses, and collective investment schemes.

11 See, for example, “Capital Movements—Legal Aspects of Fund Jurisdiction under the Articles,” SM/97/32, Supplement 3 (02/21/1997). Article VI, Section 3 generally preserves the members’ rights to impose capital controls to regulate international capital movements, including by limiting or prohibiting inward and outward capital transfers.

12 However, where such issues have an impact on the member’s domestic or external economic stability, or on international financial stability, they would fall under the IMF’s surveillance authority.

13 OECD Guidance on Sovereign Wealth Funds is available at http://www.oecd.org/document/19/0,3343,en_2649_34887_41807059_1_1_1_1,00.html. The final “tranche” of OECD guidance on recipient country policies toward SWFs was adopted by OECD members October 8, 2008, and presented to the International Monetary and Financial Committee meeting in Washington, DC, October 11, 2008. The guidance was developed by the OECD Investment Committee as part of its project on Freedom of Investment, National Security and “Strategic Industries.” The Investment Committee is treating the issue of recipient-country policies toward SWFs and other government-controlled investment entities as an integral part of the Freedom of Investment project.

14 The IWG member countries were Australia, Azerbaijan, Bahrain, Botswana, Canada, Chile, China, Equatorial Guinea, the Islamic Republic of Iran, Ireland, the Republic of Korea, Kuwait, Libya, Mexico, New Zealand, Norway, Qatar, the Russian Federation, Singapore, Timor-Leste, Trinidad and Tobago, the United Arab Emirates, and the United States. Oman, Saudi Arabia, Vietnam, the OECD, and the World Bank were permanent observers. The IWG was co-chaired by Hamad Al Hurr
the IWG was formed to undertake the technical drafting work; that subgroup was supported by IMF staff. The IWG met three times and the drafting subcommittee also met on three occasions. Throughout its discussions, the IWG maintained an active dialogue with a number of recipient countries and the European Commission. In developing the principles for SWFs, the IWG considered the following objectives as its guiding tenets:

- to help maintain a stable global financial system and the free flow of capital and investment;
- to comply with all applicable regulatory and disclosure requirements in the countries in which SWFs invest;
- to ensure SWFs invest on the basis of economic and financial risk- and return-related considerations;
- to encourage SWFs to have in place transparent and sound governance structures that provide for adequate operational controls, risk management, and accountability.

The IWG also reviewed the practices followed by its members and drew upon the existing body of international standards and codes. These included relevant IMF guidelines and standards, the OECD guidelines on corporate governance (OECD, 2005b), and voluntary guidelines developed by large institutional investors in the private sector. Many of these guidelines focus on governance, transparency and accountability issues, and risk-management frameworks. A common objective of these standards and guidelines is to provide confidence to the public that institutions are properly run, with clear lines of responsibility and levels of transparency that facilitate accountability—which is especially important for SWFs because government ownership brings with it the need for high standards of accountability.

Al Suwaidi, Undersecretary of the Abu Dhabi Department of Finance and a Director of the Abu Dhabi Investment Authority, and Jaime Caruana, Director of the IMF’s Monetary and Capital Markets Department.

15 The IWG meetings were held in Washington, DC; Singapore; and Santiago. The drafting subcommittee met in Oslo, Singapore, and Santiago. A large part of the IWG work was conducted in a virtual mode, via the Internet and conference calls.

16 The IMF undertook a survey of SWFs and their operations (Hammer, Kunzel, and Petrova, 2008).


18 For example, the UK’s Hedge Fund Standards Board, the Guidelines for Disclosure and Transparency in Private Equity (Walker, 2007), and the Agreement Among the President’s Working Group and US Agency Principals on Principles and Guidelines Regarding Private Pools of Capital (PWG, 2007) were also considered.
THE KEY FEATURES OF THE SANTIAGO PRINCIPLES

The Santiago Principles cover three main areas: (1) legal framework, objectives, and coordination with macroeconomic policies; (2) institutional framework and governance structure; and (3) investment and risk-management framework. The principles are, of course, subject to home country laws, regulations, and requirements. Elements of transparency and disclosure are integrated in all sections of the Santiago Principles to ensure accountability. This structure is broadly similar to those of a number of other relevant guidelines, codes, and standards (e.g., OECD, 2005). References in the Santiago Principles to transparency and disclosure are embedded in its three sections rather than constituting a separate section.

The key features of the principles and practices are analyzed below. Box 5.1 illustrates how the principles seek to address the major issues surrounding SWFs.

Legal Framework, Objectives, and Coordination with Macroeconomic Policies

The IWG recognized that clear and sound legal frameworks are important because they underpin governance structures, provide the construct for clear lines of responsibility, and help an SWF to operate effectively. Coordination with domestic macroeconomic policy matters, because the scale of assets, returns, and operations of SWFs can significantly influence public finances, monetary conditions, and the balance of payments. The principles cover a number of important elements in this area:

• The need for sound and clear legal frameworks that are publicly disclosed and that clarify the SWF’s relationships with other state bodies is set out in Principle 1. Principle 2 states that the policy purpose of the SWF should be clearly defined and publicly disclosed. Together, these elements contribute to good governance and transparency as reflected in a number of IMF and other standards and guidelines. Clarity about the policy purpose of the SWF, and importantly, its disclosure, guard against political interference in investment decisions and support public understanding of the SWF’s goals and its performance.19

• The need for close coordination between the SWF’s activities and macroeconomic policy formulation is provided for in Principle 3. The principles also highlight that the SWF’s activities with significant direct domestic macroeconomic implications should be closely coordinated with domestic fiscal and monetary authorities. This helps to ensure that the SWF supports, and does not work against, the macroeconomic policy framework.

### The Santiago Principles: Elements Addressing Issues Raised

<table>
<thead>
<tr>
<th>Main issues</th>
<th>Elements of the principles addressing the main issues</th>
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<tr>
<td><strong>Governance and Accountability</strong></td>
<td>Efficient management of the SWF is promoted by</td>
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<tr>
<td>Checks and balances are important to ensuring that an SWF is run efficiently and in accordance with the policy objectives of its owners.</td>
<td>- A clear policy objective for the SWF (Principle 2);</td>
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<td></td>
<td>- A sound legal framework underpinning a robust institutional and governance structure, which sets out a clear allocation and separation of responsibilities (Principles 1 and 6–9);</td>
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<td>- Adequate reporting systems—including audited annual reports and financial statements—allowing monitoring of performance and ensuring that the SWF's operations are consistent with its stated objectives (Principles 7, 10–12, and 23);</td>
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<td></td>
<td>- Professional and ethical standards, and clear rules and procedures for dealing with third parties to ensure the integrity of the SWF's operations (Principles 13–14);</td>
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<td></td>
<td>- Public disclosure of the SWF's policy objective, and legal and governance framework to enhance checks and balances and promote a clear understanding of the SWF (Principles 1–2 and 16).</td>
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<tr>
<td><strong>Macroeconomic Policy Challenges</strong></td>
<td>Consistency of the SWF's operations with the government's overall macroeconomic policies is furthered by</td>
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<td>SWFs' assets, returns, and operations are likely to have a significant impact on an owner country's macroeconomic framework.</td>
<td>- Appropriate coordination between the SWF’s operations and the macroeconomic authorities (Principle 3);</td>
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<td>- Clear rules on the SWF’s general approach to funding and withdrawal that are consistent with its policy objective (Principle 4);</td>
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<td>- Macroeconomic data sets incorporating SWF data to facilitate economic policy analysis (Principle 5).</td>
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<tr>
<td><strong>Management of the Nation’s Wealth</strong></td>
<td>The SWF’s performance is enhanced by</td>
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<td>Robust investment strategies and risk-management frameworks guard against the mismanagement of funds and poor portfolio performance.</td>
<td>- A clear investment policy showing commitment to a disciplined investment plan (Principle 18);</td>
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<td>- Care, skill, prudence, and diligence in the SWF’s investment practices (Principle 19);</td>
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<td>- Execution of ownership rights in a manner consistent with the SWF’s investment policy (Principle 21);</td>
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<td>- A robust framework to identify, assess, and manage the risks of the SWF’s operations (Principle 22);</td>
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<td>- Public disclosure of a description of the SWF’s investment policies, and of its general approach to the risk-management framework and to executing ownership rights (ex ante) to promote accountability (Principles 18 and 21–22).</td>
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</table>
• Clear rules on the SWF’s general approach to funding, withdrawal and spending rules, and their public disclosure are covered by Principle 4. This principle helps ensure consistency of the SWF’s activities with budgetary processes and objectives. A predictable framework is helpful for investment
managers, allowing them to think long term and invest over long horizons. Publication of these rules also strengthens accountability. The principles note that SWFs will publicly disclose policies or rules regarding their general approach to funding, withdrawal, and spending operations. Although useful, for overall fiscal transparency of a country, as suggested in the IMF codes on fiscal transparency, the government owners of SWFs should also provide clarity about the links between the SWF and the medium-term budget framework, and publish data relating to the SWF’s transactions with the government.  

- The provision of data to national statistics agencies for inclusion in macroeconomic data sets is important so that policymakers and other users have access to complete data that include SWFs’ operations (Principle 5). Such access will ensure that the information about a country’s economic performance is accurate. To date it has not always been clear whether information on SWFs has been accurately reflected in macroeconomic data sets. The principles unambiguously state that statistical agencies should be provided with the relevant data. The IMF intends to encourage, and work with, statistics agencies to ensure that these data are included in the macroeconomic data sets.

**Institutional Framework and Governance Structure**

Clear and sound governance structures, the division of roles and responsibilities, and high-quality accounting and auditing standards support good corporate governance by providing the checks and balances that enable and promote operational independence in the management of an SWF’s operations. The provision of regular financial information presents a reliable picture of an SWF’s performance, strengthens accountability, and could help to reduce uncertainty in financial markets and enhance trust in recipient countries. The principles in this area include key elements essential for good corporate governance; they establish the framework for information provision to the owner and regulators of SWFs but provide for public disclosure of only a limited set of financial information.

- The allocation and separation of responsibilities is set out in Principles 6–9 and 16. A number of these principles are derived from the *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, which promote operational independence. The principles set out clear distinctions and division of responsibilities among the owner of the SWF, the governing bodies, and management. The principles are also sufficiently flexible to take into account the different institutional structures of SWFs; for example, some

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20 For example, the IMF’s *Code of Good Practices on Fiscal Transparency* (IMF, 2007a) identifies the need for receipts from all major revenue sources to be separately identified in the annual budget presentation. The IMF’s *Guide on Resource Revenue Transparency* (IMF, 2007c) elaborates on these requirements in relation to resource funds.

21 The extent to which SWFs are classified as international reserves is also set out in the commentary accompanying Principle 4.1.
SWFs are established as separate legal entities and others are established as pools of assets without a separate legal personality. These differences are reflected in the commentary accompanying the principles.

- Accounting and auditing in line with recognized international or national accounting standards is covered, and an annual report is required, although there is no requirement that it be published. The principles recognize the need for rigorous internal auditing procedures and standards and an independent external audit (Principle 12), and an annual report and accompanying financial statements (Principle 11). However, the principles do not promote the publication of an annual report even though publication is universally accepted as an important part of transparency and accountability.22

- The principles provide for disclosure of an SWF’s financial information to its owners (Principle 23) and to regulators in recipient countries (Principle 15), but greater public disclosure would also be desirable. According to the principles, SWFs should publicly disclose relevant financial information, including asset allocation, benchmarks, and where relevant, rates of return over appropriate historical periods (Principle 17). But other areas of financial information about an SWF, such as audited financial statements, information on the size of assets under management, the use of derivatives, and leverage, are not covered in the principles, and will only be publicly provided at the discretion of the SWF or in confidence to regulators upon request. It is also recognized that some newly established SWFs may require time to be able to disclose the relevant information indicated in Principle 17. The IWG discussed what additional public disclosure of financial information should be required by the principles. Although views varied widely, the group eventually decided that public disclosure need not go beyond provision of relevant financial information sufficient to demonstrate an SWF’s economic and financial orientation.

**Investment and Risk-Management Framework**

Sound, well-defined investment policies and risk-management frameworks are imperative to ensure that an SWF’s decisions are consistent with its purpose and investment objectives, and to ensure that risks are well managed. In particular, transparency with respect to an SWF’s voting behavior would provide assurance to other stakeholders, including those in recipient countries, that its actions are consistent with its stated objectives.

22The *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (OECD, 2005b) emphasize that in the interest of the general public, state-owned enterprises should be as transparent as publicly traded companies. The *OECD Principles of Corporate Governance* (OECD, 2004) include disclosure of the financial and operating results of the company. In addition, the *Guide on Resource Revenue Transparency* (IMF, 2007c) states that operations of resource funds should be clearly identified, described, and reported in the budget process and final accounts documents.
• The principles in this area aim to achieve greater clarity about SWFs’ investment policies and risk-management frameworks, as well as about their policies on exercising ownership rights. The principles provide for the presence of a sound investment policy, and the publication of a description of this policy (Principle 18). This principle also sets out that the SWF’s investment policy should be clear and consistent with its defined objectives and risk tolerance, as set by the owner or the governing body or bodies, and be based on sound portfolio management principles. By defining its investment policy, an SWF commits to accountability for a disciplined and appropriate investment plan. The investment policy should also guide the SWF’s financial risk exposures and its possible use of leverage.

• Principle 19 firmly establishes that SWFs should operate on economic and financial grounds. According to the principles, an SWF’s investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy. This key commitment aims to allay concerns in recipient countries.

• The principles also address the critical issue of public disclosure of SWF voting policies. The principles call on SWFs to publicly disclose, beforehand, their approaches to voting, including the key factors guiding their exercise of ownership rights, but any after-the-fact disclosure of actual voting behavior is left to the discretion of the SWF. Although the disclosure of voting records could help to verify whether SWF voting behavior is consistent with stated intentions, a number of IWG members felt that a commitment to publicly disclose voting records would be more than they understood to be required for other institutional investors (e.g., hedge funds and private equity funds). IWG members, however, agreed that the disclosure of voting policies should be sufficiently transparent to demonstrate that the policies are based on economic and financial criteria.

• SWFs are encouraged to review their existing arrangements, and assess the implementation of the principles on an ongoing basis (Principle 24). Options for this review include self-assessment and third-party verification. Follow-up work on this issue is needed.

CONCLUDING OBSERVATIONS AND THE ROAD AHEAD

The Santiago Principles set out a broad and comprehensive framework, and reflect a strong unanimity of views among the SWFs and their governments. The principles provide a clearer understanding of the institutional framework, governance, and investment operations of SWFs. They also provide greater clarity about the provision of information to the owners of the funds and to regulators in recipient countries. It is impressive that such a diverse group of SWFs was able to reach a consensus on many issues in such a short time frame.
However, as recognized by the IWG, certain areas could benefit from further study and work, such as those relating to reliable information about SWFs’ operations. From macroeconomic and financial-stability perspectives, SWFs should continue to strive toward clearer explanations of their activities and performance, and policymakers in their home countries should strengthen clarity about the role of SWFs in their domestic policy framework. Since the publication of the Santiago Principles, some SWFs have begun to clarify and explain their structures and governance arrangements. However, the 2007–09 global financial crisis has emphasized the need for greater institutional clarity, stronger risk-management practices, and proper oversight across all types of firms involved in financial intermediation functions.

The work with the IWG marked a departure from the IMF’s usual mode of operation. The IMF was not the protagonist in the negotiations. Instead, it provided a secretariat for the work, technical expertise, and background analysis, and helped to facilitate the negotiations of the IWG. The process worked well, and the SWFs recognized the benefits of this multilateral format to meet and address issues of common interest. The experience gained by the IMF in these negotiations also suggests that the involvement of IMF staff can be helpful in bringing together different types of institutions (or officials from different regions and countries), discussing issues of common importance, facilitating negotiations, and helping push forward work programs that can be of widespread relevance to the international community. The IMF’s work with SWFs could be a model for future work, possibly with regard to financial system surveillance, and on issues where international common ground needs to be reached.23

The recent global financial crisis has drawn attention to new and important challenges for SWFs in managing their wealth and the markets in which they operate. The Santiago Principles demonstrate a firm commitment on the part of the IWG member governments and the SWFs to keep the principles under review, facilitate their dissemination, and provide a forum for an exchange of ideas with recipient countries. Future work could also examine ways in which aggregated information on SWF operations could be periodically collected, made available, and explained. Continued efforts are thus needed to adjust the Santiago Principles as the postcrisis financial landscape evolves and SWFs adjust to domestic, external, and capital market developments.

Since late 2009, the financial media have again been filled with news of high-profile acquisitions and divestitures by many SWFs. As the crisis phase unwinds, global merger and acquisitions activity is increasing, as is participation in that activity by SWFs, whereas many SWFs had a more domestic focus during the crisis. The severity of the crisis prompted governments to turn to their SWFs to

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23 The IMF is, in fact, playing a similar role in the context of the Group of 20 (G-20) Mutual Assessment Process. The IMF has been asked by the G-20 to help it with its new process of mutual assessment aimed at achieving strong, sustainable, and balanced growth. The IMF’s job will be to assist the G-20 countries achieve this goal by providing analysis of how their policy frameworks and economic projections fit together. The IMF’s role will be that of a “trusted advisor,” with the G-20 countries firmly in the driver’s seat.
bail out troubled local firms, reduce government deficits, or fund economic stimulus programs. The crisis and SWFs’ role in their domestic economies have prompted many of them to review their investment frameworks, including their strategic asset allocations.

A number of SWFs have started to make use of the Santiago Principles as a framework to strengthen and review their internal processes, governance, and accountability. The successor to the IWG, the International Forum of Sovereign Wealth Funds (IFSWF), established in April 2009, is actively engaged in sharing experiences about the emergence of good implementation practices.\(^{24}\) However, little feedback has been received thus far on the implementation of the Santiago Principles from countries that are recipients of SWF investments. Priorities in recipient countries have shifted to coping with the aftermath of the crisis, and a question remains about how or whether these countries will make formal use of the principles and follow up with SWFs on their implementation. While private sector analysts have provided much positive commentary on the principles, little feedback has been forthcoming from those in the private sector who are directly affected by the investment operations of SWFs. It is too early to judge whether capital markets will reward good implementation of the Santiago Principles.

The role of SWFs as providers of significant cross-border long-term capital is here to stay. Given the international profile SWFs assumed in the late 2000s, their investment objectives and operations, and how they are adhering to the spirit of the Santiago Principles will continue to make news. The IMF succeeded in partnering with the SWFs and their governments to provide a balance in the international debate on the role of SWFs. The ball is now in the court of the SWFs. The establishment of the IFSWF is a commendable step, and an important contribution to the architecture of the international financial system. The IFSWF has already begun to play an important role in clarifying the objectives and functions of SWFs, as well as in improving their transparency. The SWFs themselves have also become more active in participating in this debate, either through the IFSWF or individually through public statements. Their main message seems to be unified: “Borders need to remain open for foreign investments, including those of SWFs.” It is encouraging that collaboration and partnership with recipient countries and other parties, which has been a key feature of the IWG’s work so far, will continue and that the IFSWF will operate in an inclusive manner.

The IFSWF is placing a high premium on active and continuing engagement with the private sector to improve the private sector’s understanding and interpretation of SWF activities. It would be helpful for representatives of

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\(^{24}\)The IFSWF is a voluntary standing group of SWFs that was established by the IWG in Kuwait City in April 2009 (IWG, 2009). Its purpose is to meet, exchange views on issues of common interest, and facilitate an understanding of the Santiago Principles and SWF activities. The forum is not a formal supranational authority and its work does not carry any legal force. The forum has a professional secretariat to facilitate its activities and those of its subgroups, and to enable efficient cooperation and communication among its members and with other relevant parties.
recipient countries and the private sector to work together with the IFSWF, to
discuss issues of common concern (while maintaining strategic and commercial
confidentiality), and to provide feedback. This dialogue could promote an
investment regime that operates on a more collaborative basis. In a world in
which capital, especially long-term investment capital, is scarce and wealth has
eroded, responsible and mutually reinforcing arrangements for cross-border
investments are important.

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