

# Sovereign Wealth Funds & Risk Management Issues



**Risk Management Institute - NUS Conference  
30 June 2008 - Singapore**

Jan Randolph  
Head of Sovereign Risk  
Global Insight





# SWF – Presentation Outline

## Part 1:

- Origins, Global Finance Landscape
- Types, Motives: “Push and Pull” Drivers
- Size, Growth, Forecasts

## Part 2:

- “MACRO” SWF Risk Management Issues: –  
*perceived & real* : Debate: “Against”, “For”

## Part 3:

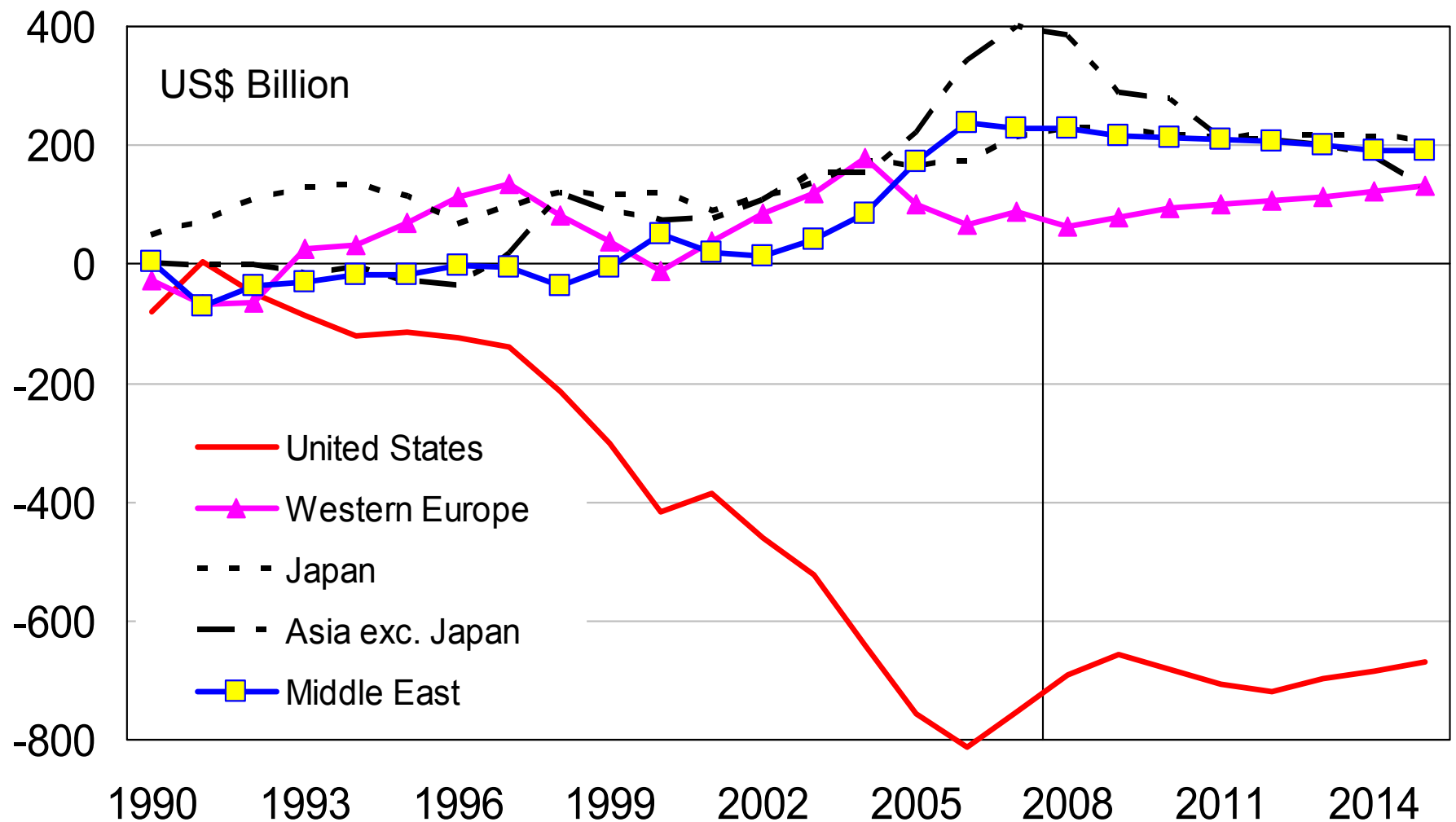
- “MICRO” SWF Risk Management Issues

## Part 4:

- Concluding Remarks

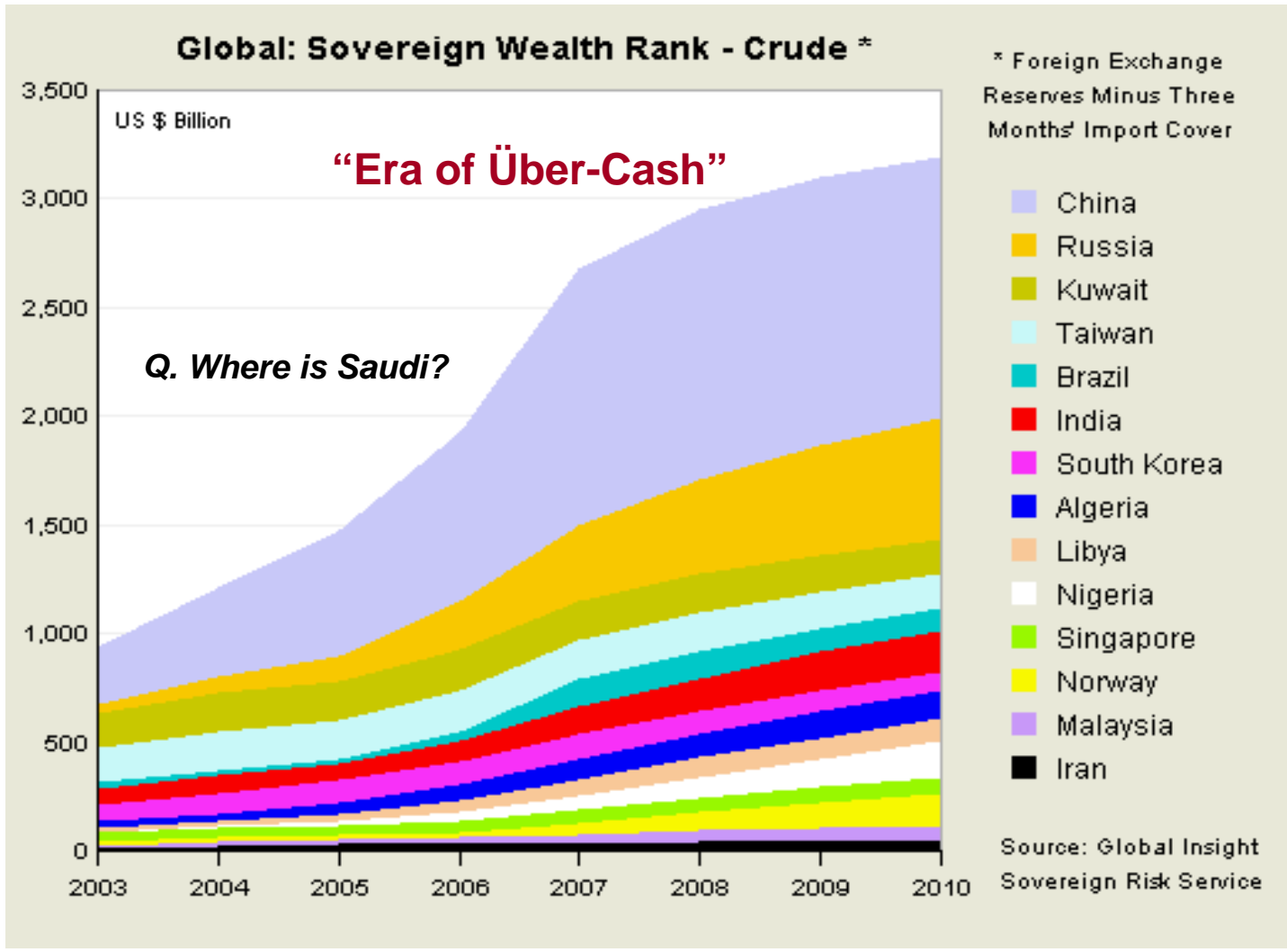


# SWF – Origins in Global Imbalances





# Emerging Markets – Financial Fundamentals





# Emerging Markets Financials – Origins of Wealth ?

Oil/gas and export surpluses are the main drivers

Sources & Drivers

## Commodities Export

High prices for oil and other commodities have pushed revenues in excess of current budget requirements

## External Surplus

For export economies of Asia, FX reserve accumulation has far exceed what is needed for stabilisation

## Pension Liabilities

Some countries have set up large, sovereign pension funds to cover the future liabilities of their pension schemes, drawn from **fiscal surpluses**

Current account balances  
= excess reserves

Investment Vehicles

## Sovereign Wealth Funds

Government (country-level) investment vehicles that invest state savings, often derived from commodity export or exchange rate intervention, and are separate from the official reserves of the Central Bank or other monetary authority

## Diversified Monetary Authorities (DMAs)

Central Banks/Monetary Authorities that have significantly diversified their investment portfolio without (or in addition to) a separate SWF vehicle

Budget allocations

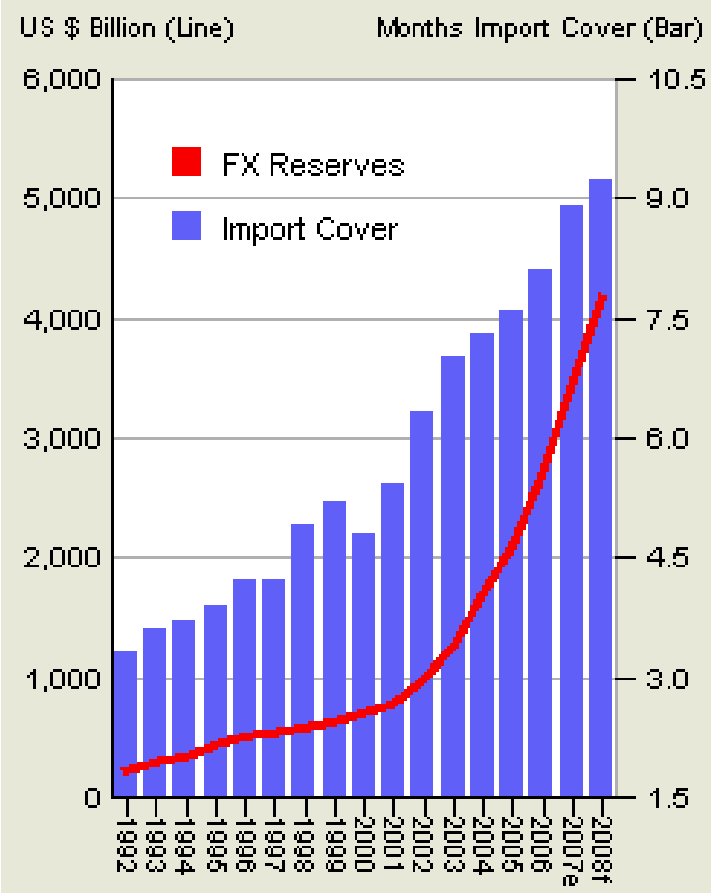
Sovereign Pension Funds



# SWF – Credit Indicators

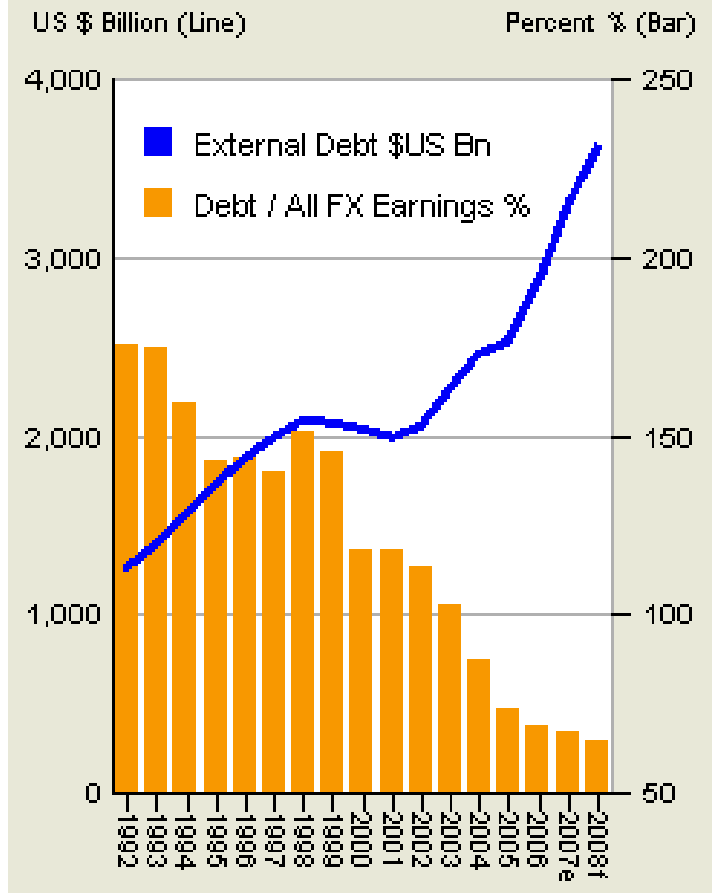
(1)

## Emerging Market Liquidity



(2)

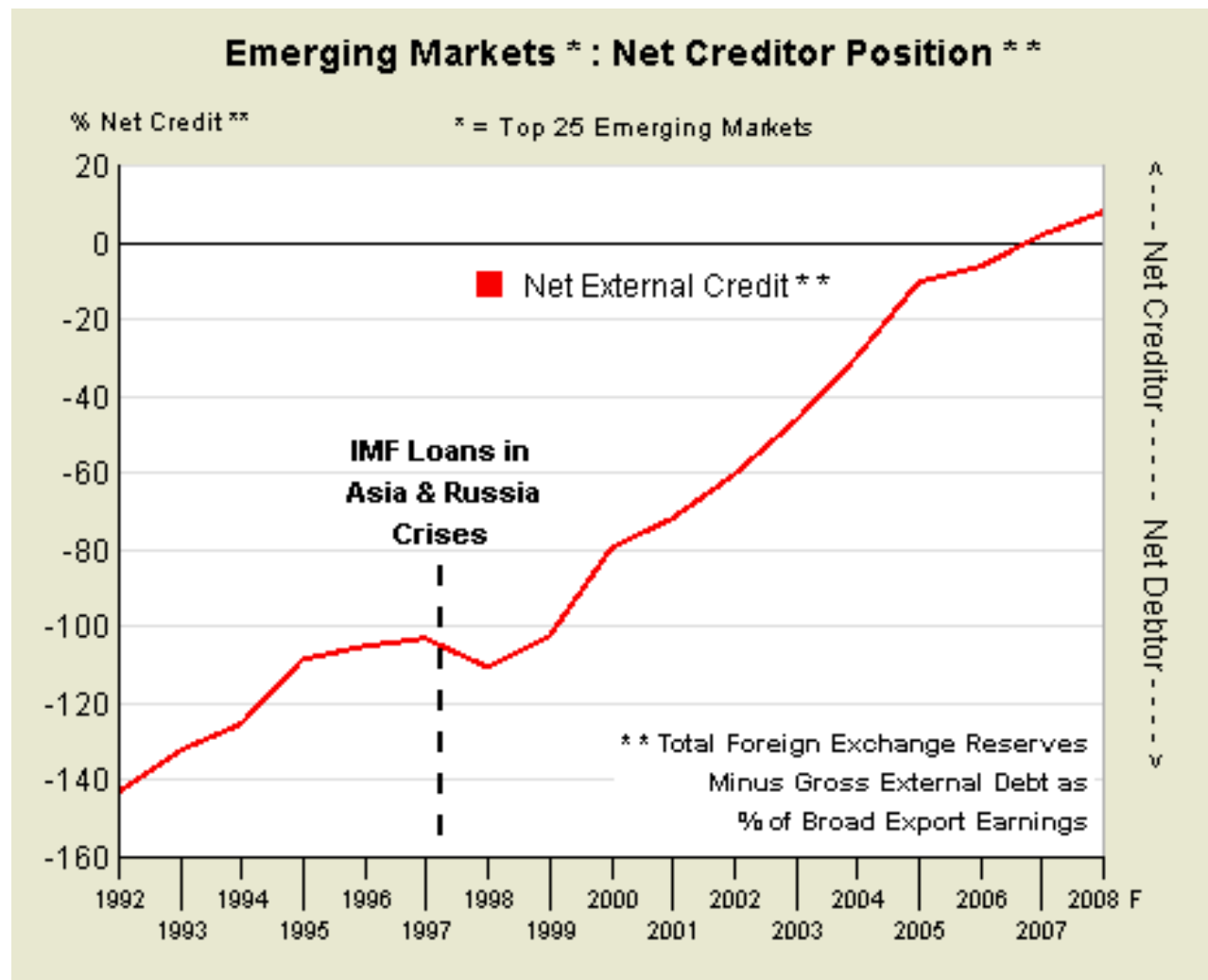
## Emerging Market Solvency





# Emerging Markets – Stronger Balance Sheets and...

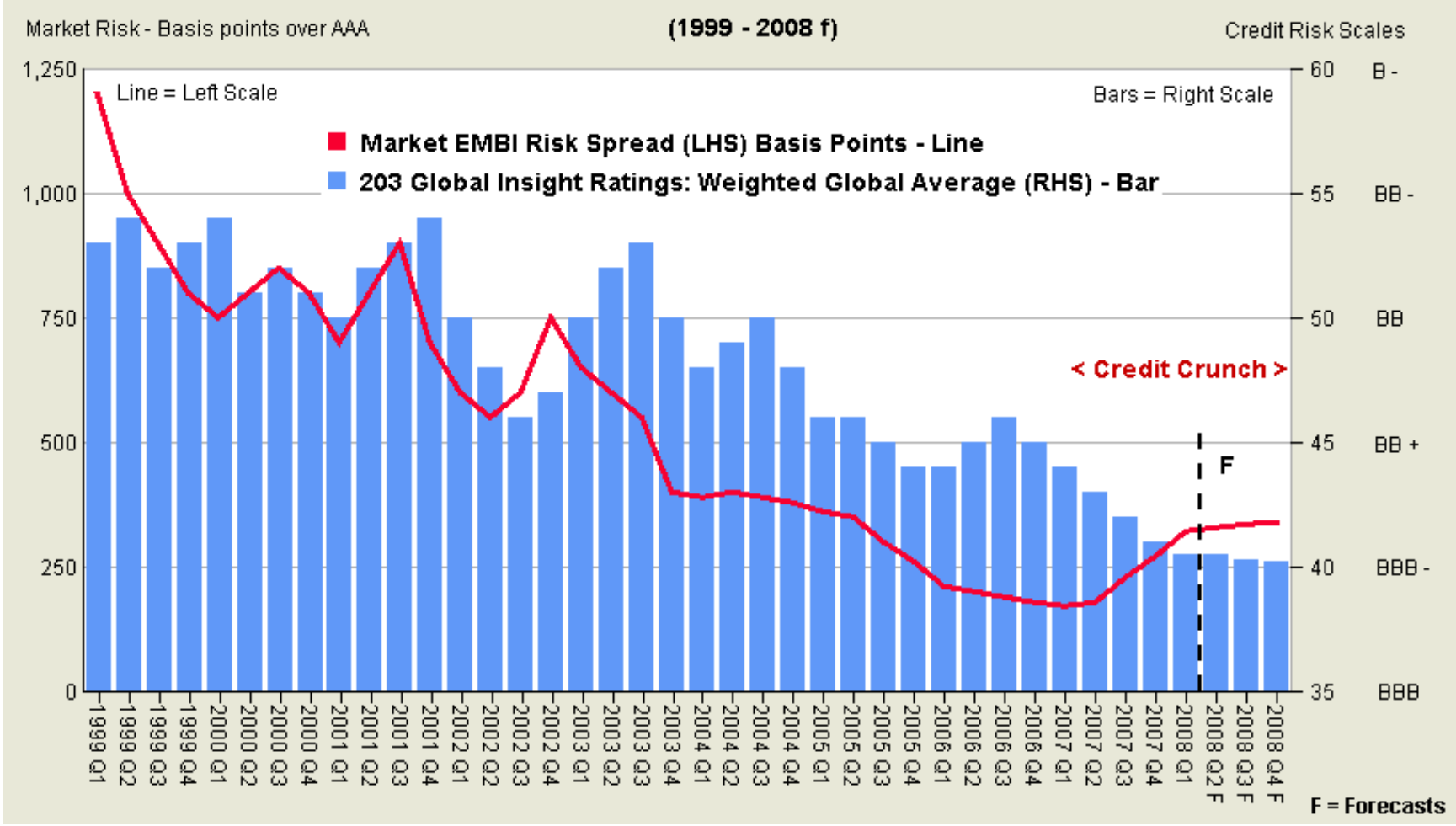
- Superior GDP growth, exports, pricing, lower debt
- Stronger balance sheets and credit ratings
- **BUT** some risks remain:
  - Overheating
  - Politics
- Growth in EM “Multinationals”
- Greater EM-sourced financing





# SWF – Credit Ratings and Market Risk

## 203 Sovereign Ratings & Sovereign Market Spread (EMBI)





# SWF Origins and Growth – “Push and Pull”

## “Push”

- “ÜBER CASH”
- Overheating: -
  - Inflation Latest
  - China 8.7%** (11 year High)
  - Saudi 8.7%** (27 year High)
  - Russia 12.0%** (rising..)
  - U.A.E. 10.0%** (20 year high)
- + Trade Surpluses are Expansionary
- Inflation = ↑ Opportunity cost funding ‘Sterilisation Bonds’ = Need Higher Returns

## “Pull”

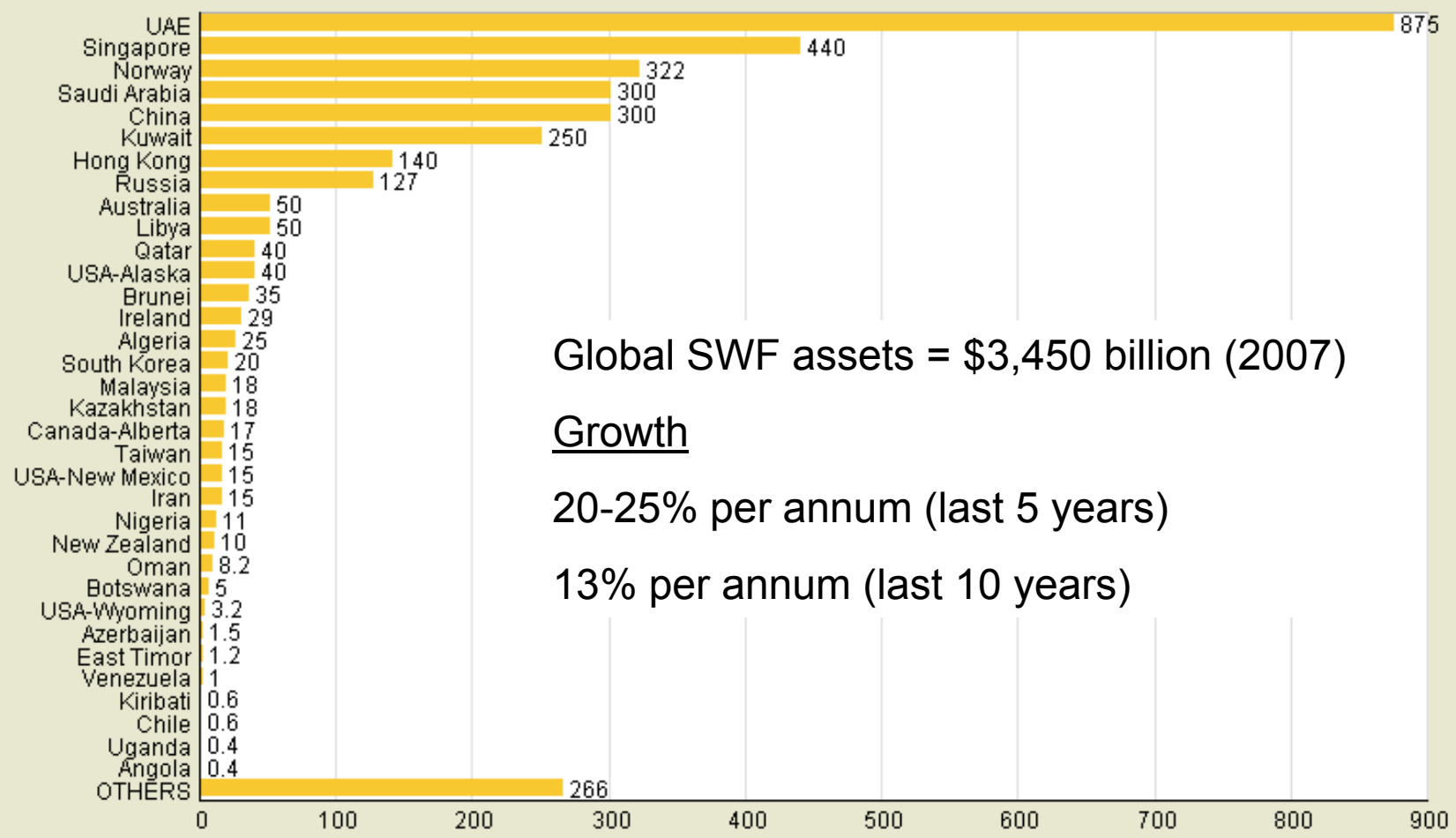
- Portfolio Shifts:
 

<b>FX cash</b>	<b>X</b>
<b>Treasuries</b>	<b>X</b>
<b>Equity, Other Alt.</b>	<b>✓</b>
- Credit Crunch = Financial Stress = **Asset Bargains?**
- Diversification:
  - Assets and Risk-type**
  - Geography: Emerging Mkts**



# SWF – New Power Brokers

Sovereign Wealth Funds : US\$ billion - end 2006



Global SWF assets = \$3,450 billion (2007)

## Growth

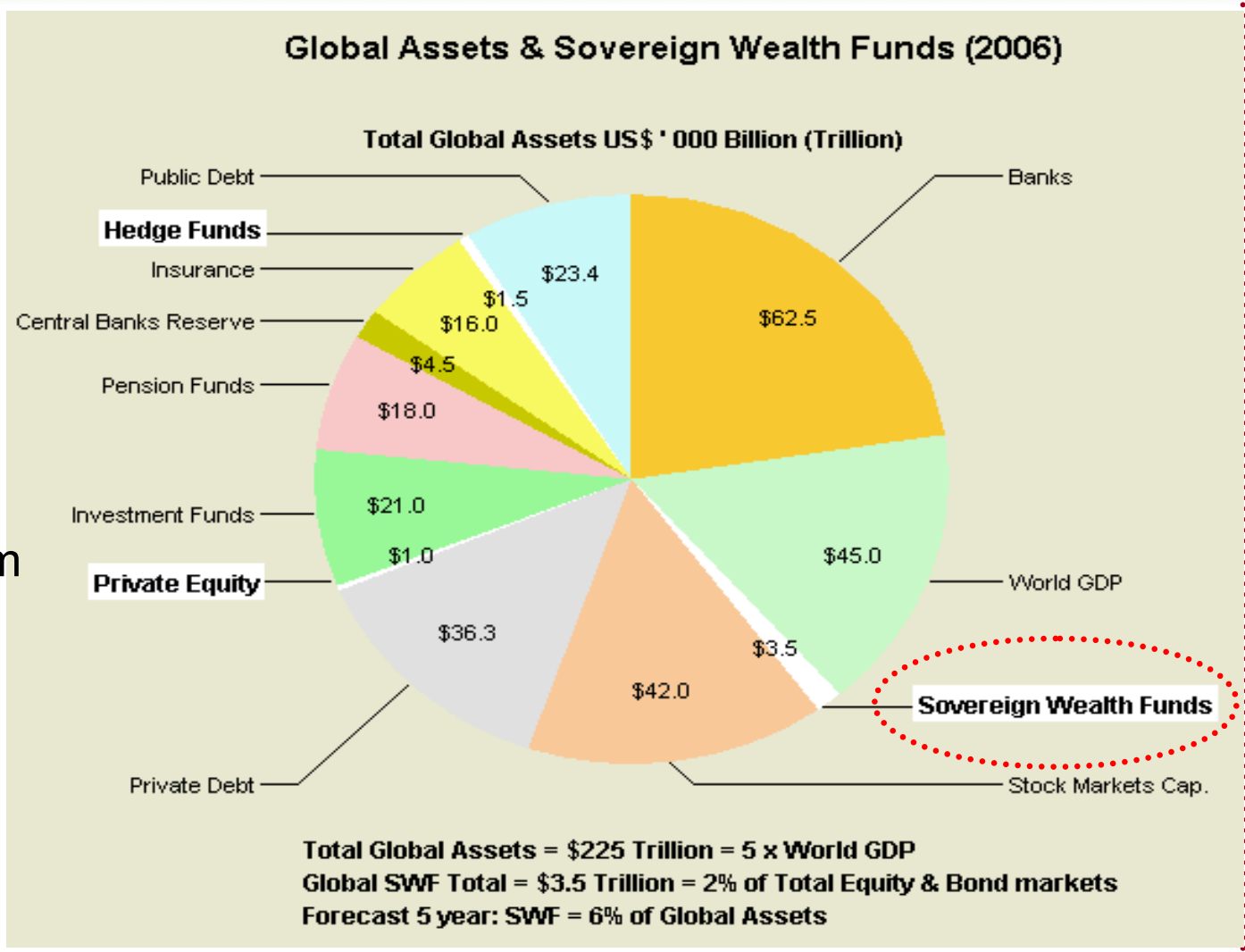
20-25% per annum (last 5 years)

13% per annum (last 10 years)



# SWF: Asset Management – Market Context

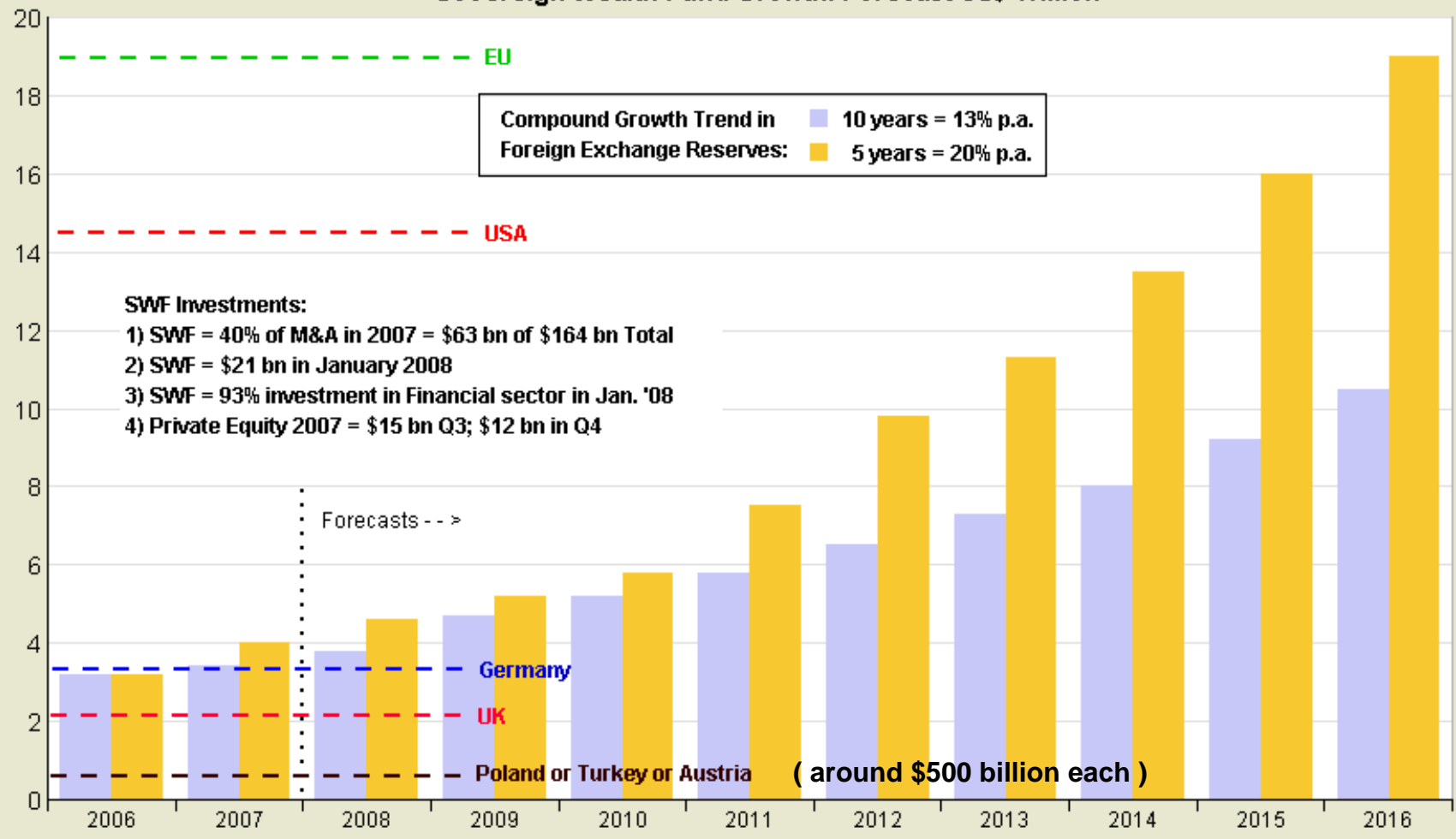
- SWF = Small **BUT**
- **Very Strong Growth = 24% per annum**
- **‘Debt Free’ = un-leveraged Agility = premium**
- **Shift in Sovereign Portfolio Allocations underway**





# SWF – Size and Growth

Sovereign Wealth Fund Growth: Forecast US\$ Trillion





# SWF Forecasts:

**Q. Do SWFs deserve the attention they get?**

**YES.**

**Future: -**

- Concentration of Balance of Payments Surpluses To MENA Oil Exporters and China; While Deficits more Diffuse; US deficit Narrows
- Recycling of Global Surpluses Will Increase Towards SWFs = Sovereign Wealth Portfolio Shift



# Sovereign Wealth Funds

## Part 2

# “MACRO” SWF Risks & The Controversies



## Sovereign Wealth Funds: *comments*

*“Europe must remain open to inward investments. Sovereign wealth funds are **not a big bad wolf at the door.**”*

**José Manuel Barroso, President of the European Commission**  
(27 February 2008)

*“There is, as far as I know, no instance of sovereign wealth funds acting in any manner **other than responsibly up until now.**”*

(and)

*“Some people are afraid of what might happen in the future.... We are open for business. **But...business...should follow some common principles on transparency and governance.**”*

**Charlie McCreevy, European Commissioner for Internal Market and Services**  
(27 February 2008)



## Sovereign Wealth Funds: comments

*“Recipient countries are placing **handcuffs** on sovereign wealth funds in the form of regulations termed – in the best traditions of George Orwell’s *Newspeak* – ‘**codes of conduct**’ or ‘principles of operation’ or ‘best practices’. These regulations will not solve or prevent any future financial crises... There should be a common level playing field for all... There is no evidence over the past many decades of any wrongdoing by any sovereign wealth fund... The consequences of imposing regulations on sovereign wealth funds will result in an adverse impact on global capital flows, which is not in our common interest. **Regulating sovereign wealth funds will not stimulate the global economy.**”*

*Bader al-Sa’ad, Head of Kuwait Investment Authority, Luxembourg 9 April 2008*



# SWF = “Problematic”

- Return of state players (end of Reagan-Thatcher era) = *inefficiencies*
- Political motives and sovereign shareholders – SWF reputational risks
- “Not transparent”
- *Brave New Future?: “Rio Tinto Shanghai”, “Gazprom-Shell”, “Citi-pore”, Abu-Lynch”, “Temasek-Chartered”, “UB-Sberbank”*
- Technology transfer (Knowledge-based)
- Gulf “royal prize fighting”
- “History = money buys influence...”
- Market de-stabilisers & exploit currency pegs: unfair/even advantages
- An “ottoman omen”? = Visible Mark in Shift in power ‘West’ to ‘East’



# SWF = “Beneficial”

- Credit crunch: “beggars and choosers” (\$64bn Vs \$600+ bn?)
- Market stabilisers – over the cycle (Norway post dot-com)
- Placid long-term investors + very deep pockets = great shareholders
- SWF asset diversification = market allocation efficiency ↑
- SWF recycle global finance
- SWF promote reduction in global imbalances ↓
- SWF = ‘....still investment’
- SWF = Chinese and Russian stakes in capitalism
- SWF = increase pension returns



# SWF – MICRO Risk Management Issues

## Part 3

### “MICRO” SWF Risk Management Issues



# SWF – MICRO Risk Management Issues

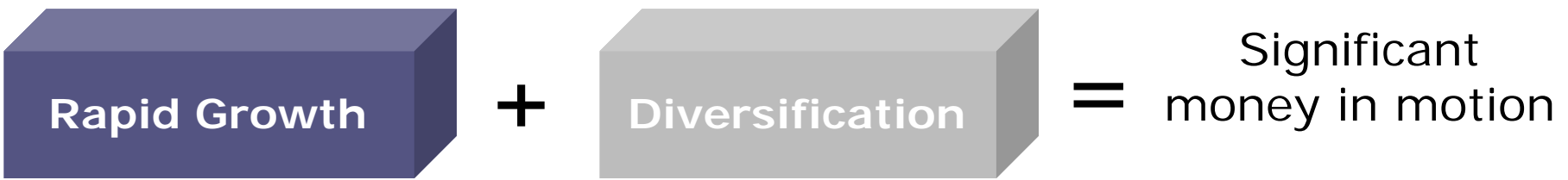
Rapid growth of excess reserves and wealth is prompting more aggressive investment

Traditional official reserves **ISSUES:** (1) “ÜBER Cash” (2) EM Growth (3) Credit Crunch (4) Falling Dollar



Often managed both in-house and with external managers with the advice of consultants

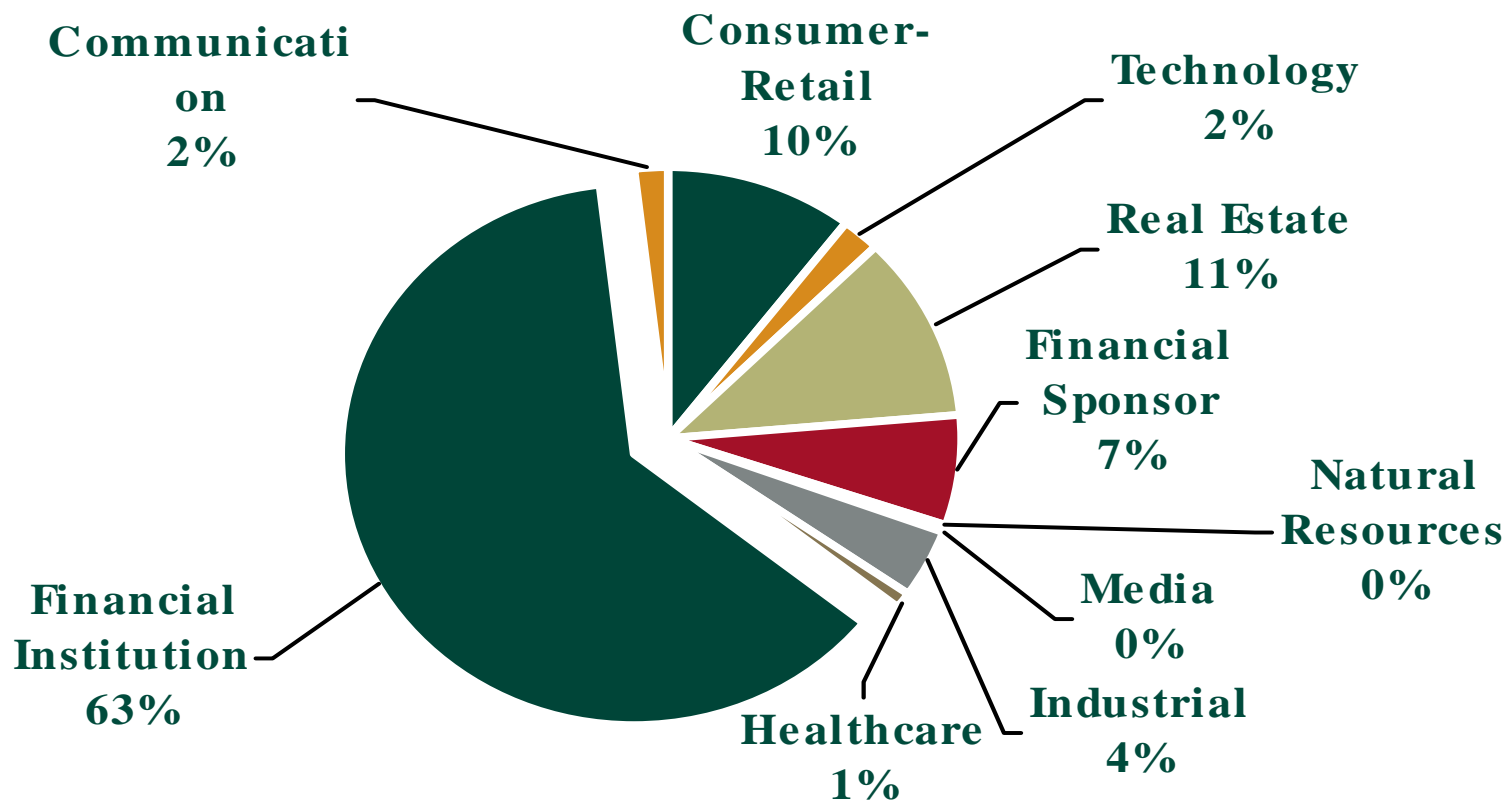
**Alternatives:** generally outsourced to external managers (increasing interest in GP stakes)





# SWF – MICRO Risk Management Issues

## Sector Distribution – Deal US\$ Value

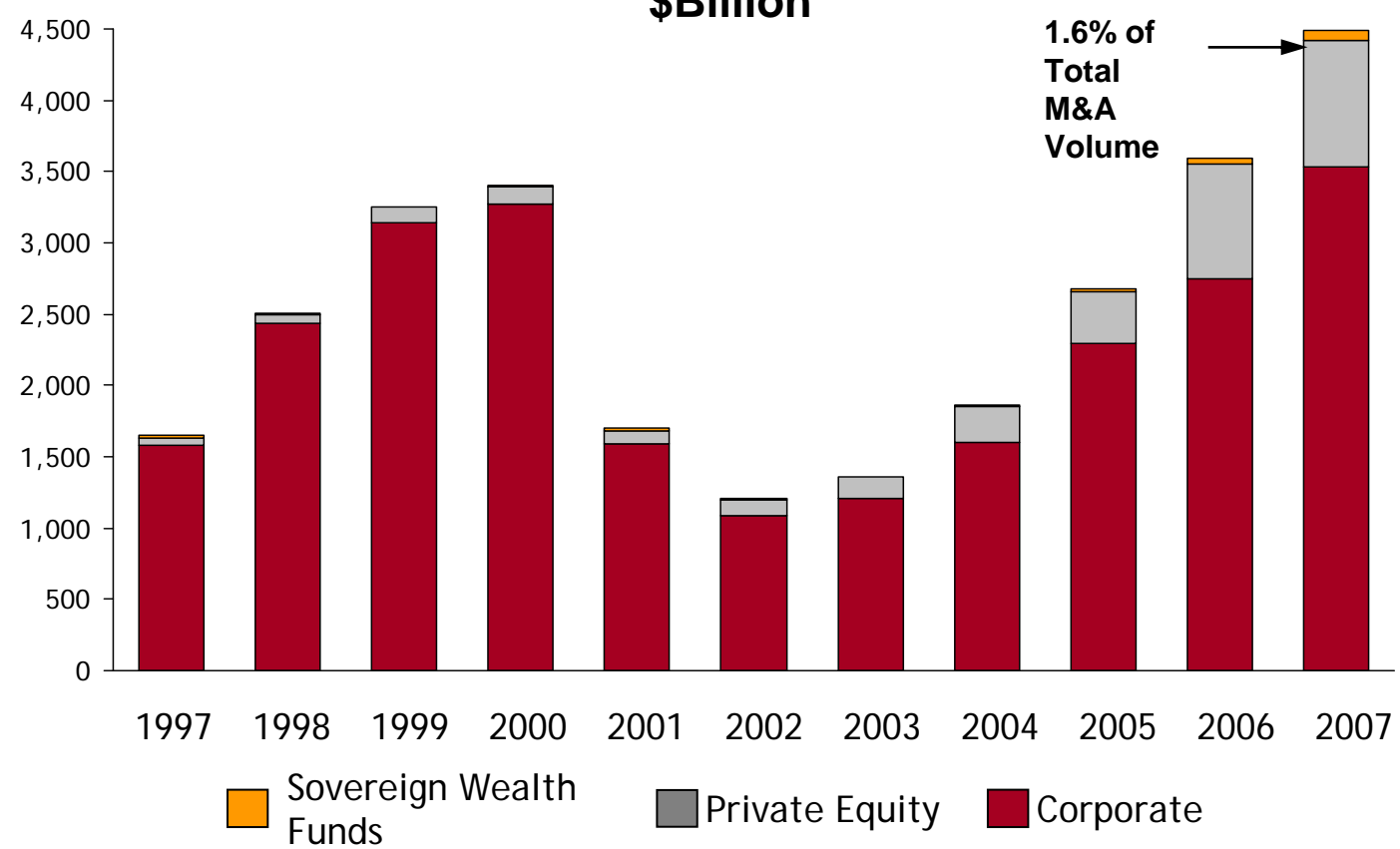


Source: Dealogic

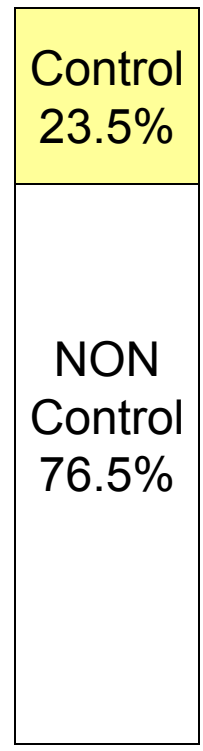


# SWF: M&A activity

**Breakdown of Global M&A Activity US  
\$Billion**



**SWF Assets Control**





# SWF – Concluding Remarks

- SWF rise: linked to global imbalances & SW portfolio shift
- SWF perform essential function: *recycling global finance*
- Danger of “financial protectionism” = West Backlash = SWF as scapegoats for globalisation downsides / losers
- “New lenders of last resort”
- A (mutual) ‘code of conduct’ should dispel most concerns
- “New financial power brokers” – still small, but growing
- Danger of “G7 hypocrisies” (except) “reciprocity principle”
- No real evidence of de-stabilisation and political motives
- SWF = “stakes in capitalism”
- Alternatives?

**FREE “Sovereign Wealth Fund Tracker” at:  
[www.globalinsight.com](http://www.globalinsight.com)**



**Thank You!**

Jan Randolph  
Head of Sovereign Risk - Country Intelligence Group  
Global Insight



**GLOBALINSIGHT**