

The Rise of Sovereign Wealth Funds

The rapid growth of Sovereign Wealth Fund's (SWFs) has placed them at the forefront of the world's media as well the world's capital markets. In particular, the collapse of the American mortgage market has highlighted the growing role of capital investment by foreign governments. Since the start of the sub-prime crisis in 2007, SWFs are estimated to have invested over \$60bn in return for large minority stakes predominantly in the financial sector.

Subprime capital infusions from SWFs

Institution	\$bn	Stake (%)
Citigroup	22.0	12.7
Merrill Lynch	12.2	23.0
UBS	11.5	12.0
Morgan Stanley	5.0	9.9
Barclays	5.0	5.2
Canadian Imperial Bank	2.7	11.1
Bear Stearns	1.0	6.0
Chrysler Tower	0.8	n/a
Kaupthing	0.3	5
Total	60.5	

Source: Bloomberg, SWF Institute – October 2008

Although there is no agreed upon definition, SWFs can be defined as, "large pools of capital controlled and owned by governments and invested in foreign assets for long-term purposes." A broader definition of SWFs would include funds held by other sovereign investment vehicles such as state owned enterprises and possibly some public pension funds.

SWFs are not a new phenomenon, yet the recent sustained period of high oil prices has meant that countries that have significant exports have amassed huge current account surpluses. Unsurprisingly therefore around 45% of SWFs come from oil rich countries in the Middle East, although SWFs are also present in countries such as, Norway, Singapore, China and Russia.

Top 5 Sovereign Wealth Funds by \$bn assets under management:

Sovereign Wealth Fund	\$bn assets under management	Country
Abu Dhabi Investment Council	875	UAE
Government Pension Fund of Norway	380	Norway
Government of Singapore Investment Corp.	330	Singapore
Saudi Arabia – various holdings	300	Saudi Arabia
Kuwait Investment Authority	250	Kuwait

Source: SWF Institute, IFSL estimates – April 2008

Recent Developments

In the recent weeks however, SWFs in the Gulf have been switching their focus away from Western stock markets to shore up ailing economies in the Middle East and protect themselves from losses in the City and on Wall Street. Local stock markets have collapsed and some SWFs are shifting their assets into local shares in an attempt to inject confidence in their local markets. SWFs in Kuwait, Qatar, Dubai and Abu Dhabi have been changing their investment strategies and several Gulf-based banks are being propped up with state investment.

The Kuwait Investment Authority (KIA) has shifted \$4 billion (£2.6 billion) from Western markets into its own bourse and the Qatar Investment Authority has begun a bailout of local banks. Dubai International Capital (DIC) is concentrating on emerging markets and the Abu Dhabi Investment Authority, is reported to be retreating to local markets.

Investments in banks such as Citigroup and Merrill Lynch have cost the funds dearly. The KIA, which has assets estimated at \$250 billion, said two months ago that it had lost \$270 million on a \$3 billion investment in Citigroup, which was made at the beginning of this year. Citigroup's share price has fallen by two thirds since that announcement and now the bank is being supported by the US Government.

The ruling families of Qatar and Abu Dhabi agreed last month to inject £6 billion into Barclays, giving the Gulf-based investors a 30 per cent stake. However, this sort of bailout may

become more difficult as funds are diverted to the Middle East.

Issues for IRO's

Despite emerging as a significant class of global investor, SWFs have in turn attracted a great deal of controversy. Criticism centres on the fact that there is limited disclosure and transparency amongst SWFs. For example, the Abu Dhabi Investment Authority does not disclose the amount of assets it controls, nor how it is run. This in turn makes it extremely difficult for management, companies and IROs to gauge the underlying motives and investment rationale of such funds. Furthermore the European Central Bank estimates that the seven least transparent SWFs account for almost half of all SWFs' holdings.

International governments have also expressed reservations that SWFs may invest to secure control of strategically important businesses or sectors for political rather than commercial reasons and could potentially use these investments to advance their own national interests. DP World, the Dubai controlled group experienced these problems when it tried to take control of some US ports as part of its acquisition of P&O the UK group.

The Regulation of SWFs

How to regulate SWFs, if at all, is a question being asked by a number of international organisations. The IMF is currently developing a voluntary code of conduct, under which SWFs would become more transparent and accountable. Lawmakers in the USA and Europe are also devising similar proposals. The OECD, which groups 30 of the world's richest economies, has said that SWFs should not be unduly restricted provided they meet certain criteria namely:

- They are motivated by the pursuit of profit
- They are professionally led and managed
- They regularly divulge results and information in keeping with other financial institutions

Interestingly, the Norwegian SWF sets the standards by which other sovereign wealth funds

are judged, providing benchmarks for transparent and accountable management. For example, they:

- Make no strategic investments
- Invest in individual companies and sectors
- Average ownership of a company is below 1% as this does not distort the market
- Investment decisions are either made by individuals at the fund with specific investment mandates or are contracted out to external asset managers
- Transparency is paramount. The Norwegian ministry receives advice on the investment guidelines from the Central Bank. Consultants are also employed to help with this work in order to judge performance and to better manage costs

However representatives of many SWFs argue that it is their money and therefore they should not be subjected to unnecessary regulation especially when other areas of finance, such as hedge funds, remain unregulated.

How to deal with SWFs

At present, most SWFs appear to represent long term investors who seem unwilling to interfere with management and strategy. Despite investments totalling \$40bn in Citigroup, Merrill Lynch, Morgan Stanley and UBS, no SWF is represented on the board.

This does not mean however that SWFs will never take an activist stance. China Development Bank has been accused of building a strategic stake in Rio Tinto. Dubai International Capital has significant holdings in Travelodge, Sony and Daimler Chrysler and earlier this year, failed in a high profile bid to buy Liverpool Football Club. Furthermore, Istithmar a private equity group based in Dubai has created joint venture partnerships with four international equity players from Germany, the UK, the US and Singapore.

From an investor relations perspective, SWFs should in theory be treated the same way as institutional investors – with the same level of

information and access to management. The only way to bring any influence to bear on a SWFs activity is to form a direct relationship with the individuals concerned. And these relationships once formed need to be closely watched as the funds presence on the register can undermine other long term institutional interest.

Having determined which SWFs and at what level they are invested, the next step is to understand the investment rationale and the strategy's that the investment stock is being held for. An independently conducted audit should be undertaken as it will enable Management to be prepared for all eventualities and take pre-emptive action should it be required.

Should the situation arise where pre-emptive action is required then close relationships will need to be maintained with the corporate brokers and their trading desks. This is a network that should be used to the maximum at times of share price volatility.

In many cases these funds will go public with their own concerns only if communication breaks down or if their issues are not being addressed at a fast enough pace. Often negotiations are friendly and constructive, as both parties have the best interests of the company in mind. Sometimes unfortunately they are not and any adverse publicity that makes the firm look unresponsive cannot be good for the company's image.

Whatever your view on SWFs there is no doubt that in terms of individual company stocks, the rise and importance of this investor group brings with it a sense of unease for Management teams and the investor relations officers are often caught in the cross-fire.

Despite this, IROs should accept and embrace the rise of SWFs and take this opportunity to work with them to find common ground rules and a code of practice.

Movers and Shakers

PSigma Asset Management has hired **David Hallam** as an analyst to its UK equities team. Most recently, Mr Hallam worked at Fiske.

Aladdin Capital has hired **Neal Neilinger** as vice-chairman and chief investment officer.

Thomas Connolly has left the Abu Dhabi Investment Authority to become head of asset management for the Middle East region for **BNY Mellon Asset Management**, based in Dubai.

Mark Pignatelli has closed the long-short chapter and returned to long-only fund management as he takes on the job of managing the **Smith & Williamson European Growth Trust**. Mr Pignatelli had run Remus Capital since 2004 after leaving Schroders Investment Management, where he was chief investment officer.

Jupiter Asset Management is doubling its private client team. Four fund managers, **Oliver Burns, William Day, David Blake and William Luttrell-Hunt**, will join from Bestinvest later this month. The team will also see the addition of **Robert Walker, Paula Forecast, Phil Gent and Oliver Pearson-Lund** between November 2008 and January 2009.

Newton Investment Management has hired two senior investment research analysts. **Amanda Young** was previously a socially responsible investment analyst with CCLA Investment Management, while **Laura Aarnio** joins from PIRC London, where she had a similar role.

Miles Cresswell-Turner has joined **Duke Street Capital** as partner, specialising in financial services. Mr Cresswell-Turner joins from Palamon Capital Partners.

State Street Global Advisors has made two appointments to its UK and European active equity team. **Toby Warburton**, from Barclays Global Investors, joins as senior portfolio manager and **Fabio Agostini**, formerly of Axa Rosenberg, joins as portfolio manager. As well as managing UK and European portfolios, Mr Warburton will also do research with SSgA's Advanced Research Centre and Mr Agostini will do quantitative research to support active equity strategies