



SOVEREIGN WEALTH FUNDS REPORT

*INTERNATIONAL WORKING GROUP
PUBLISHES GENERALLY ACCEPTED
PRINCIPLES AND POLICIES*

The International Working Group of Sovereign Wealth Funds (“IWG”) recently published the Generally Accepted Principles and Practices (the “GAPP”), a voluntary set of 24 principles that the IWG members support and have either implemented or aspire to implement in light of the member’s specific intergovernmental agreements and applicable legal and regulatory requirements. The aim of the GAPP, also known as the “Santiago Principles”, is threefold: to improve the understanding of the objectives, structures, and governance arrangements of Sovereign Wealth Funds (“SWFs”); to enhance the understanding of SWFs as economically and financially oriented entities; and to help maintain an open and stable investment climate, both in home and recipient countries.

The IWG is comprised of 26 members of the International Monetary Fund – the majority of which maintain their own SWFs, as well as representatives from the Organization for Economic Cooperation and Development (the “OECD”) and the World Bank. In light of the recent SWF activity, the IWG believes that the GAPP, in addition to the upcoming release of investment policy guidance for recipient countries by the OECD, will help achieve the goal of maintaining a stable and open investment environment. The three main themes underlying the GAPP are (i) public disclosure, (ii) sound governance and (iii) investment and risk management.

Public Disclosure

Statements by a number of representatives to the IWG stressed the building of trust as a crucial aspect of the GAPP, especially in light of the current financial market turmoil.

The lack of transparency generally associated with SWF operations has led to heightened concerns among recipient countries, who fear that SWF investments might threaten their national security, and have geopolitical rather than financial motivations. These concerns have led to an increase in discussions on protectionist measures which, if implemented, may negatively affect the investment activities of SWFs and consequently global capital markets in general.

In order to address recipient country concerns over the motivations for SWF investment, the GAPP calls for increased public disclosure by SWFs. The IWG believes that compliance with the recommended public disclosures regarding SWF funding, withdrawal and spending, investment policies, governance, objectives, financial information and accountability will enhance the view of SWFs as economically driven investment vehicles both in home and recipient countries. By providing greater transparency regarding their investment intentions, SWFs hope to reduce protectionist measures and better contribute to the achievement of a stable and open investment environment.

Governance

In addition to public disclosure requirements, the GAPP highlights the need for SWFs to be properly established and managed. The GAPP recommends that SWF operations be based on a sound governance framework, with constitutive documents that clearly distinguish the responsibilities of the SWF’s owner or governing body from those of its operational management.

The IWG emphasizes that an appropriate governance framework enables an autonomous decision-making process, allowing the operational management to pursue the SWF’s financial and economic objectives without political interference. Such a framework should clearly define the role of government in determining the SWF’s broad objectives, and the role of managers in executing these objectives, as well as ensuring an effective division of oversight, decision-making authority and operational responsibilities.

The GAPP points out that a sound governance framework should facilitate accountability arrangements for the owner, the governing body and the operational management that are commensurate



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with their respective responsibilities. In that respect, access to accurate, timely and relevant information is essential. Hence, the GAPP recommends that an annual report and accompanying financial statements on the SWF's operations, performance and liabilities be prepared in accordance with international financial reporting standards, in addition to annual external audits.

Investment and Risk Management

The GAPP calls for SWFs to establish clear investment policies, consistent with the objectives and investment strategies set out by the owner or governing body. The investment policy should be based on sound portfolio management principles, define the risk exposure of the SWF (including the use of derivatives and leverage), determine the extent to which internal and/or external managers are used, and establish a clear, publicly disclosed approach to voting securities in listed entities.

SWFs are encouraged to establish a strong risk management culture, in order to identify, assess and manage risk, and therefore remain within the tolerance levels commensurate with their investment horizon and risk-bearing capacity, as determined by the SWF's investment policies. The IWG's advice is founded on the belief that adopting high standards of risk management will contribute to international financial stability and help maintain a transparent and open investment environment.

The Way Forward

As noted by Hamad al Suwaidi, Undersecretary to the Abu Dhabi Department of Finance and Co-Chair of the IWG, the GAPP is far from a finished product and will require further study and work in several aspects. For that reason, the IWG is considering the creation of a Standing Group for SWFs and has set up a Formation Committee that is expected to present its proposal by year-end.

Although still a work in progress, the GAPP can be expected to play an important role in shaping emerging SWF best practices. Time will tell, however, whether voluntary adherence to the GAPP will succeed in quelling recipient country concerns regarding SWF investments. Going forward, compliance with the GAPP by SWFs and a constructive and collaborative response from recipient countries will be essential to ensure the

success of the GAPP and set a level playing field for all investors (private or public) in the capital markets.

The full text of the GAPP and the related explanatory material is available at:

<http://www.iwg-swf.org/index.htm>

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About the International Funds Group

Curtis' International Funds Group has been counseling investment managers and investors on a global scale for close to half a century. We specialize in developing tailored structures for the international investment community, in particular in the area of private equity and hedge funds. Our clients include financial institutions, domestic and international fund managers, their sponsors and principals, including Funds of Funds, pension plans, governmental and quasi-governmental institutions, Sovereign Wealth Funds, high net worth individuals, their family offices and other institutional asset managers and investors.