

Open Editorial – The role that sovereign wealth funds can play in promoting free-flowing, open and stable capital markets.

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Finance Ministers and Central Bank Governors from around the world gathered in Washington last weekend to discuss economic issues and in particular, vulnerabilities to the global financial system. One key vulnerability is the growth of protectionist sentiment, which harms the free flow of capital and limits investment opportunities, and ultimately weakens economic growth and job creation. It is easy to lose sight of this risk at a time of upheaval in global markets. But the current financial crisis only underlines the importance of keeping markets open to capital and encouraging investors willing to take a long view.

Last weekend, officials from 23 countries with the world's major sovereign wealth funds (SWFs) took an important step toward addressing this issue. They unveiled a document, a voluntary set of Generally Accepted Principles and Practices for Sovereign Wealth Funds, now known as the "Santiago Principles," that represents a milestone in building trust in open markets. This is the outcome of just over five months of close cooperation and collaboration by the International Working Group of SWFs (IWG).

In March of this year, the Governments of Abu Dhabi and Singapore, and the US Treasury, representing two countries with a long track record of financially-oriented SWFs and one with long experience of receiving investments from SWFs, met in Washington and reached agreement on broad policy principles for SWFs and recipient countries. In so doing, we demonstrated that constructive collaboration between major SWF countries and recipient countries was not only possible but necessary, given our common interest in maintaining open investment regimes.

Our efforts supported the more ambitious goal of achieving broad international understanding of the SWFs' practices and mitigation of concerns of the countries in which they invest. Shortly after our policy principles were announced in March 2008, the International Monetary Fund (IMF) convened a diverse group of countries with SWFs, resulting in the creation of the IWG. Working effectively, the IWG drafted and agreed on the Santiago Principles in under six months. The IWG welcomed input from recipient countries as the group deliberated, demonstrating a collaborative spirit and a common interest in a credible set of voluntary standards.

Demonstrated accountability and enhanced transparency among both SWFs and recipient countries, as outlined in the Principles, will support global financial stability. The SWF's adoption of the Principles will reinforce confidence in their roles as constructive participants in global markets, making investment decisions subject only to economic and financial considerations. The Principles also serve as a benchmark for both existing and newly established SWFs to continue to hold themselves to high international investment standards.

The Principles call for public disclosure in key areas relevant to recipient countries' concerns, including a clear statement of a SWF's policy purpose and governance framework, its investment policy and risk management framework, and related financial information. The Principles confirm that investment decisions should continue to maximize risk-adjusted financial returns and be based solely on economic and financial grounds. In calling for a sound governance framework, the Principles promote operational independence of the SWFs from the governments that own them. However, matching the need for autonomy in investment decisions, the Principles will reinforce accountability of SWFs to their owners by reiterating the need for adequate reporting systems, annual audits, and professional and ethical standards.

Many SWFs demonstrate the Principles and we already see positive movement in this direction. The Government of Singapore Investment Corporation (GIC) released its first public report a month ago on how it manages the Government's portfolio, including key information on its governance framework, investment processes, asset mix, and long-term returns. Temasek already publishes detailed information annually. Also, Abu Dhabi Investment Authority has disclosed its broad asset allocation and is engaged in an on-going process to enhance disclosure in all these areas, including compliance verification.

The need to enhance transparency and maintain an open dialogue is in essence a two-way street. Recipient countries share responsibility for maintaining an open investment regime that is transparent, proportional and accountable. Alongside the IMF's and the IWG's efforts, the Organization for Economic Cooperation and Development (OECD) is advancing its work to promote open and predictable investment environments that do not discriminate among investors. Building on its April report and June Ministerial declaration, early next year, the OECD will issue its final report on the Freedom of Investment project, which will examine the nexus between national security and investment policies, including SWF policies of OECD countries.

The SWFs' long term orientation and ability to ride out market cycles brings important diversity to global financial markets and allows them to play a stabilizing role. We believe that the Principles are an important step forward in maintaining an open and stable global financial system. Success on this front is too critical to risk failure. As proponents of the March principles, we applaud the progress made by SWFs and recipient countries alike and urge all participants to deploy equivalent efforts on implementation.