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Research Handbook on Sovereign Wealth Funds and International Investment Law

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noted, SWFs can be a powerful tool to promote global environmental protection under various perspectives, and this goal can be achieved with the development of best practices, by means of 'soft' normative instruments, and especially through an enhanced knowledge of the opportunities already existing for 'greening' investments, coupled with the involvement of SWFs and SOEs in these opportunities.

This should not be so difficult, given that SWFs and SOEs are State-owned entities, and international governmental organizations already operate to increase the attractiveness of 'green' investments: a connection between these two worlds seems therefore opportune, and indeed necessary for the sake of environmental protection.

This said, SWFs and SOEs can be used also to harm the environment, especially in host States, and above all when the concerned SWF and SOE belong to States whose environmental standards are lower and invest in target States equally having lower environmental standards: while a true State–State conflict cannot be excluded in certain cases mentioned earlier, possibly involving also third-party States, the golden rule to avoid sovereign investments increasing environmental depletion should be to draft new investment treaties, always bearing in mind the paramount importance of environmental standards. In this sense, specific provisions for this purpose should therefore be inserted, in line with the existing benchmark examples mentioned earlier.

In any case, environmental protection and sustainable development are mandatory principles in any inter-State relationship or transaction: irrespective of any express reference to them in any investment treaties, they should anyway guide the interpretation and enforcement of the latter, especially in those circumstances involving SWFs or SOEs as investors having a State nature and consequently bearing a special global responsibility to protect the environment.

13. SWFs and development*

Michele Vellano and Annamaria Viterbo

1. SWFS AS INSTRUMENTS TO PROMOTE A NEW TYPE OF SUSTAINABLE DEVELOPMENT

The purpose of this chapter is to assess whether and to what extent sovereign wealth funds (SWFs) can be considered tools of development and, in particular, tools of sustainable and long-lasting development in countries facing structural economic problems.

In literature the presumption often stands that the establishment of a sovereign fund by an emerging or developing economy helps wealth diversification for the benefit of future generations.[1] Clearly, SWFs are set up to contribute to a country's own macroeconomic growth by stabilizing prices and revenue and by cushioning the impact of economic turbulence.

However, SWFs can promote development not only in the country setting up the fund, but also in the countries where the investments will be made. In this sense, SWFs can be treated as development funds. This is the standpoint adopted in this chapter to analyse SWFs.[2]

* This chapter is the result of a joint reflection by the two authors. Specifically, Sections 1 and 2 were written by Michele Vellano and Sections 3, 4 and 5 by Annamaria Viterbo.

[1] According to the traditional classifications, SWFs can be distinguished based on whether they have (i) a stabilization mandate, to insulate the economy from volatility of commodity prices; (ii) an inter-generational mandate to transfer wealth accruing from non-renewable resources to future generations; (iii) the mandate to allocate resources to socio-economic projects (e.g., infrastructure); (iv) a pension reserve mandate. See, in particular, Fabio Bassan, *The Law of Sovereign Wealth Funds* (Edward Elgar 2011) 17.

[2] J. Santiso, 'Sovereign Development Funds: Key Financial Actors of the Shifting Wealth of Nations' (OECD Emerging Markets Network Working Paper, October 2008); U.S. Das, Y. Lu, C. Mulder, A. Sy, 'Setting Up a Sovereign Wealth Fund: Some Policy and Operational Considerations' (IMF Working Paper, WP/09/179, August 2009); P. Jacquet, 'Les fonds souverains, acteurs du développement?', in Jean-Paul Betbèze (ed.), *Fonds Souverains: à nouvelle crise,*

The role of SWFs in emerging economies and developing countries is part of a larger ongoing debate on the need to completely reconsider the traditional approach to development assistance.[3] There is no doubt that the traditional forms of assistance to local populations are still indispensable in mitigating the effects of emergencies linked to poverty, health and even the survival of individuals. These traditional methods, however, should be accompanied by broader interventions aimed at fighting structural economic problems through foreign investments, to allow for the full exploitation of local resources that have a competitive advantage in the world economy.

To achieve the desired result in a given country (i.e. a progressive and stable growth of economic and social indicators of development), funds should be directly invested in the private sector, for the benefit of small and medium-sized enterprises or even disbursed to individuals by means of microfinance projects. In fact, data show that resources provided by Western countries to poor countries through official programmes of development assistance – and thus through local public administrations – have rarely achieved the full intended result because of local ineffective public management.[4]

We contend that, as new actors in the financing for development context,[5] SWFs can have an extraordinarily interesting role in unleashing multidirectional virtuous dynamics for the benefit of people not only in the country where the SWF is set up, but also in the countries where the investments and acquisitions will be made. Some SWFs may even focus on regional areas, through investment strategies that extend beyond national boundaries.

However, for SWFs to have a positive impact on socio-economic development, it is essential that their investment decisions are adopted in accordance with objectives other than merely achieving the highest possible returns (as private investors would do) or pursuing the national interest (as governments would typically do). For a point of equilibrium between different goals to be achieved,[6] a number of factors acquire relevance.

In particular, for an SWF to be an effective instrument for the development of the home country, attention should be paid to its institutional independence from political influence, to the operational rules for the deposit and withdrawal of resources, and to the breadth of

nouvelles solutions (Presse Universitaire de France 2008); M. Shemirani, *Sovereign Wealth Fund and International Political Economy* (Ashgate 2011).

[3] On this subject, see among others, G. Venturini (ed.), *Le nuove forme di sostegno allo sviluppo nel diritto internazionale* (Giappichelli 2009); Daniel Aguirre, *The Human Right to Development in a Globalized World* (Ashgate 2008); Yong-Shik Lee, *Economic Development through World Trade: a Developing World Perspective* (Kluwer Law 2008); Roland Rich, 'Development Assistance and the Hollow Sovereignty of the Weak', in Trudy Jacobsen, Charles Sampford, Ramesh Thakur (eds.), *Re-envisioning Sovereignty: the End of Westphalia?* (Ashgate 2008) 231; I. Goldin, K. Reinert, *Globalization for Development: Trade, Finance, Aid, Migration and Policy* (Macmillan 2006); and the classic K. De Feyter, *World Development Law: Sharing Responsibility for Development* (OUP 2001).

[4] In this respect, see World Development Indicators (1960–2013), The World Bank, 18 Dec 2013, http://data.worldbank.org/data-catalog/world-development-indicators.

[5] Reference is made to the Monterrey Consensus on Financing for Development and to the Doha Declaration on Financing for Development, which, however, do not expressly consider the role played by SWFs for development. See the *Monterrey Consensus of the International Conference on Financing for Development*, adopted at the UN International Conference on Financing for Development, Monterrey, Mexico, 18–22 March 2002, available at www.un.org/esa/ffd/monterrey/MonterreyConsensus.pdf and the *Doha Declaration on Financing for Development*, adopted at the UN International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, Doha, Qatar, 29 November–2 December 2008, available at www.un.org/esa/ffd/doha/documents/Doha_Declaration_FFD.pdf.

[6] In this respect, some authors like Pierre Jacquet, cit., talk about a 'marché de l'aide', i.e. negotiations that can find a point of contact between the different needs of investors and beneficiaries of investments. See also Michael Klein and Tim Harford, *The Market for Aid* (International Finance Corporation 2005). It is clear that SWFs may turn their interest as investors to countries that do not yet attract private investments. Actually, SWFs may aim at long-term investment returns (also in terms of image and foreign affairs) that private investors cannot afford to wait for or that are even negligible to them. In this respect, the following example may be enlightening: a Chinese or Abu Dhabi SWF may be interested in purchasing large areas of equatorial forest in Africa, independently of whether such areas can be immediately exploited or not. The two SWF home countries do not have any forests and cannot create them from scratch for climatic reasons, but they need large quantities of wood in the building industry. The investment will provide an economic benefit to the local population (on the condition that it is not unduly intercepted and used by those who are in government) and a future benefit (which may even be very distant) to the next generations of the SWF home countries. On the specific characteristics and scope of the long-term investments made by SWFs, see Patrick Bolton, Frederic Samama, Joseph E. Stiglitz, *Sovereign Wealth Funds and Long-Term Investing* (Columbia University Press 2011).

its mandate. In fact, the design and governance structure of any organization have an impact on the organization's ability to meet its institutional objectives.

Similarly, the rules on portfolio allocation and the adoption of ethical guidelines are determining factors for an SWF to be considered a development tool also for host countries. As will be made apparent in the following paragraphs, ethical guidelines can have the effect of influencing the behaviour of companies willing to attract investments from an SWF. In fact, an SWF having adopted ethical guidelines will be prevented from investing in companies that pollute the environment, abuse human rights or produce nuclear weapons. Therefore, ethical guidelines may act as external drivers for socially responsible business decisions and create virtuous dynamics. Besides, it should be underlined that the SWFs' ethical guidelines cannot be assimilated to the International Monetary Fund (or World Bank) conditionality:[7] the ethical guidelines are intended to guide the SWF's investment strategy and they only have an indirect effect on the business decisions of the companies in which the SWF invests.

On the other hand, SWFs can indeed interfere with the sovereignty of recipient countries, pursuing politically strategic objectives instead of strictly economic ones or manipulating financial markets. This is a key aspect, not only in the case of economically underdeveloped countries, where influence can be more easily exerted, but also for traditionally more solid and independent countries facing an economic crisis that makes them particularly vulnerable.[8]

[7] See, among others, E. Denters and A. Viterbo, *International Monetary Fund* (Wolters Kluwer Law & Business 2013) 66.

[8] On this specific subject, see A. Gigante, A. Ligustro, 'Il diritto internazionale degli investimenti di fronte alla sfida dei fondi sovrani' (2010) *Diritto pubblico comparato ed europeo*, 1185. The authors point out that the most important SWFs, in terms of financial resources, belong to countries that are not considered fully democratic countries and make reference to events that took place in 2007, when the Chinese State Administration of Foreign Exchange (SAFE) purchased USD 300 million Costa Rica bonds, conditional upon the recognition by Costa Rica of the Chinese Popular Republic instead of Taiwan, with which Costa Rica had had diplomatic relationships for 50 years. See also Fabio Bassan, 'Host States and Sovereign Wealth Funds, between National Security and International Law' (2010) *European Business Law Review*, 165. For a different perspective, see Stephanie Griffith-Jones and José Antonio Ocampo, *Sovereign Wealth Funds: a Developing Country Perspective* (Columbia University 2008).

Today, the operation and conduct of the most important SWFs are still driven by criteria that are far from solidarity and philanthropy, and closer to profit achievement or, at least, foreign policy goals. Moreover, the absence of full transparency on the investments made by the SWFs makes it almost impossible to have sufficient information to determine, with reasonable accuracy, the exact composition of SWFs' portfolios and their impact on sustainable development.[9] However, it is still possible to make some observations on the situation as a whole, with the purpose of highlighting the most interesting and problematic issues from a legal standpoint.

2. INSTITUTIONAL INDEPENDENCE FROM THE GOVERNMENT AND OPERATIONAL RULES ON DEPOSITS AND WITHDRAWALS

An SWF can be established either following the 'manager model' or the 'investment company model': in the former case, the fund is set up within the central bank or the ministry of finance, while in the latter it is usually conceived as a separate legal entity.

Irrespective of the institutional framework chosen, board members and managers should be granted independence from political interference, an essential precondition for effective long-term performance. In fact, short-term government policies could hinder the achievement of the objectives the SWF is pursuing in the name of the country's wealth and for the benefit of future generations.[10] The importance of institutional independence is also acknowledged by the Santiago Principles.[11] Actually, the

[9] The most complex aspect is that of associating an investment made by an SWF in a developing country (in Africa, Asia or South America) with a specific intent to bring benefits to the local population. It is indisputable that the most important SWFs have a real and intrinsic interest in differentiating their investments all over the world, also for the purpose of mitigating risks and, therefore, in making investments in emerging countries as well, where they can seize great opportunities, especially in terms of medium- to long-term returns. However, this does not mean that the aforesaid investments are necessarily made for solidarity or philanthropic purposes.

[10] See A. Al-Hassan, M. Papaioannou, M. Skancke, C. Chih Sung, 'Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management' (IMF Working Paper WP/13/231, November 2013) 10.

[11] See Santiago Principles 'GAPP 6. The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence

practice shows that, with respect to SWFs set up in countries where the government does not operate in a properly democratic manner, the board members are chosen, either directly or indirectly, by those who are in government. Operational rules on funding and withdrawal of resources – either for direct spending or for allocation to the State budget – are also of significance. In times of economic recession, SWFs may become the target of discontent, with the public opinion calling for the fund to partly bear the cost of the crisis by balancing the budget or by repaying the State's external debt. Even in such cases, however, intergenerational equity requires that a clear distinction is drawn and preserved between the government's current spending needs and the long-term investments made by the SWF to convey wealth to future generations.

Typically SWFs are subject to a spending rule establishing a profit threshold beyond which resources may be allocated to contribute to the annual State budget. This is the case of the so-called 'revenue share model': unless pre-defined profit levels are exceeded, the fund's resources are protected from withdrawal requests.[12] In other cases, the transfer of resources from the fund to the State budget may be triggered by excessive levels in the country's annual deficit-to-GDP ratio.[13]

Another approach is that of the 'permanent income model', by which resources can be gradually withdrawn on the basis of pre-established social welfare criteria to the benefit of any generation, not just the future ones.

By reducing discretional policies, the adoption of strict rules on deposits and withdrawals can promote fiscal discipline and check government expenditure. However, some flexibility is also necessary to grant the government the power to deal with the increasing spending pressure and the unexpected shocks typical of an economic recession.

The full integration of an SWF with its country's fiscal policy and general budget framework is also required to comply with transparency and accountability principles: all spending decisions should be adopted within the budget allocation process to avoid the use of the fund's assets for one-off or extra-budgetary spending.

On at least two occasions, SWFs were at risk of being depleted to offset the effects of a serious financial crisis: in 2013 to cover huge

in the management of the SWF to pursue its objectives', available at www.iwg-swf.org/pubs/gapplist.htm, last visited 20 November 2013.

[12] For commodity SWFs, withdrawals can usually be made also when the government's revenues from oil, gas or diamonds exports are less than budgeted.

[13] See Das et al. (n 2) 11–12; IMF, *Papua New Guinea: Selected Issues Paper* (IMF Country Report n. 10/163, June 2010) 4–7.

budget deficits, the governments of both Russia and East Timor started to withdraw from their sovereign funds above the pre-set thresholds, in disregard of the operational rules, which were later amended to seek some sort of adjusted compliance.[14]

It should therefore be considered that, as already pointed out above, the main purpose of SWFs is to seek financial returns for the benefit of the reference shareholders and, accordingly, it would be currently incorrect to overestimate SWFs' intent to contribute to the development of developing countries: investments can be made in such countries, but mainly with a view to achieving returns, including long-term ones, for the benefit of the SWF that made the investments.

3. MANDATE AND PORTFOLIO ALLOCATION

SWFs are for the most part portfolio investors, with the bulk of their resources invested in relatively liquid financial assets and in mature market economies, to generate a high return at a moderate risk. Only few SWFs operate also in foreign direct investments.[15]

In fact, their mandate may restrict the range of investments to exclude, for example, the direct ownership of real assets and private equity or hedge funds. As a matter of fact, while these limitations strengthen independence from political influence, the fund's contribution to public and private projects in infrastructure, industry, agriculture, green economy and other sectors deemed strategic for the national development is negligible.

However, in recent years, mandates have been relaxed to allow SWFs to invest also in natural resources, real estate, new technologies, and infrastructure.[16] Data show a growing trend towards sector diversification

[14] Source: Sovereign Wealth Center, 'Petroleum Fund of Timor-Leste: History', 31 July 2013; Sovereign Wealth Center, 'Reserve Fund and National Wealth Fund: History', 25 October 2013, both available at www.sovereignwealthcenter.com/.

[15] SWF FDI flows doubled in 2012, from USD 10 billion to over USD 20 billion, bucking the global trend. Cumulative FDI by SWFs, at USD 127 billion, nonetheless remain somewhat small as a proportion of total SWF assets under management (UNCTAD, *World Investment Report 2013*, 10).

[16] See Javier Santiso (ed.), *Sovereign Wealth Funds Report 2012* (ESADEgeo – Center for Global Economy and Geopolitics 2012) 9–23; Javier Santiso (ed.), *Sovereign Wealth Funds Report 2013* (ESADEgeo – Center for Global Economy and Geopolitics 2013) 9–15 and 62 ff.

and away from finance. The fact that investments are being directed also to non-finance sectors reflects strategy changes in many SWFs.

Besides, while most Western SWFs, based on the model of the Norwegian Government Pension Fund Global (GPFG), are mandated to invest their capital entirely abroad and to seek the achievement of the highest possible returns, in the case of many developing countries, SWFs are also expected to contribute to the internal economic growth and development by investing part of their resources domestically.[17] In this case, an issue arises on the way to reconcile profit maximization with sustainable development and social returns.[18] For instance, while the entire portfolio of the Abu Dhabi Investment Authority is invested in foreign markets securities, around 50 per cent of the China Investment Corporation portfolio is invested in the domestic one.

The use of SWF resources for domestic needs brings the risk of political interference in the fund's investment policy, to include quasi-fiscal elements like subsidies to preferred sectors or masked off-budget government operations.[19] Spending taking place outside the national budget process and away from parliamentary control could lead to issues of transparency, mismanagement of funds and waste.

It should be observed that, in the aftermath of the global financial crisis, Western SWFs have increasingly invested domestically, in particular in financial services. This suggests that they have also been active in pursuing the domestic policy objective to recapitalize and support domestic banks.[20] Other SWFs, like the China Investment Corporation, have

[17] Joshua Aizenman and Reuven Glick, 'Sovereign Wealth Funds: Stylized Facts about their Determinants and Governance' (2009) *International Finance* 12(3), 351–386. Edwin Truman, *Sovereign Wealth Funds: Threat or Salvation?* (2010 Peterson Institute for International Economics) and G.L. Clark, A.D. Dixon, A.H.B. Monk, *Sovereign Wealth Funds: Legitimacy, Governance and Global Power* (2013 Princeton University Press). See also World Bank Group for the G20 Investment and Infrastructure Working Group, 'Sovereign Wealth Funds and Long-Term Development Finance: Risks and Opportunities', February 2014.

[18] See Ashby Monk, 'Fascinating Roundtable in Cape Town', 5 March 2012, available at www.institutionalinvestor.com/blogarticle/2989922/Blog/Fascinating-Roundtable-in-Cape-Town.html?ArticleID=2989922&LS=EMS621374, last visited 2 January 2014.

[19] See Das et al. (n 2) 18.

[20] Andrew Rozanov, 'Long-Term Implications of the Global Financial Crisis for Sovereign Wealth Funds', in Udaibir S. Das, Adnan Mazarei, Han van der Hoorn (eds.), *Economics of Sovereign Wealth Funds: Issues for Policymakers* (IMF 2010) 252 ff.; Peter Kunzel, Yinqiu Lu, Iva Petrova, Jukka Pihlman,

started to invest also regionally, where spillover benefits from their investments might be more easily captured.

With regard to geographical distribution, assets are increasingly being allocated to developing countries (primarily in South-East Asia and – to a smaller extent – in Latin America and Africa) to seek higher financial returns and portfolio diversification.[21] In doing so, the funds may even pursue strategic outcomes, for example in order to create the conditions to improve their country's access to scarce natural resources or commodities. In this respect Chinese SWFs appear to be the most dynamic and active, especially in Africa.

Also increasing is the degree of cooperation among funds, which in some instances have teamed up to invest not only in private equity, but also in FDI.

From the standpoint of the host developing countries, SWFs' investments are a major opportunity, as the long-term and stable perspective of wealth funds and their status act as a catalyst for other investors. Notably, however, alongside policies to attract foreign investments, many African countries – such as, among others, Angola (2012), Zimbabwe (2012), Nigeria (2011), South Sudan (2008) and Libya (2006) – have established their own SWFs and others are following.[22]

The cases of Angola and Nigeria, the two largest crude oil producers in Africa, are worth mentioning. The Fundo Soberano de Angola (FSDEA) pursues three objectives: the preservation of capital, long-term return maximization and national infrastructure development (in particular in

Investment Objectives of Sovereign Wealth Funds: A Shifting Paradigm (IMF Working Paper WP/11/19, January 2011).

[21] 'The majority of SWF FDI is in developed economies, which received more than 70 per cent of inflows in 2012. Of this figure, Europe accounts for nearly two thirds, but the United States experienced a noticeable jump (39 per cent) in inward SWF FDI. Although cumulative SWF FDI to developing and transition countries increased from 2011 to 2012, the share of these countries in global SWF FDI actually fell, from 25 per cent to 23 per cent' (UNCTAD, *World Investment Report 2013*, 10). This may derive from the fact that in the aftermath of the global financial crisis, many SWFs invested in banking and financial institutions in Europe and the United States.

[22] See Thouraya Triki and Issa Faye, *Africa's Quest for Development: Can Sovereign Wealth Funds Help?* (African Development Bank Working Paper Series No. 142, 2011); Edouard Turkisch, *Sovereign Wealth Funds As Investors in Africa: Opportunities and Barriers* (OECD Development Center Working Paper No. 303, September 2011). An updated list is available at www.swfinstitute.org and www.baffi.unibocconi.it/wps/wcm/connect/. Recently, Botswana, Gabon and Ghana have also set up their own SWFs.

the water and energy sectors).[23] The FSDEA is mandated to gradually diversify its 5 billion USD portfolio across a number of asset classes and industries (including agriculture, mining, infrastructure and real estate) with a focus on promoting the country's socio-economic growth.[24] Half of its initial endowment will be invested in cash, fixed income and stocks of G7 countries and 32.5 per cent in the BRICS; furthermore, the FSDEA Social Charter provides for the investment of at least 7.5 per cent to support development and socially responsible projects in the areas of education, income generation, energy, healthcare and access to clean water. It has been pointed out that the FSDEA will not only contribute to the stabilization of the national economy supporting the diversification of the national economy, increasing the capacity of attracting FDIs and improving Angola's credit rating, but it will also support poverty reduction, the improvement of the Human Development Index, national infrastructures and transparency as well as the fight against corruption.[25]

Similarly, the Nigeria Sovereign Investment Authority (NSIA) was established in 2011 for the purposes of providing stabilization support in times of economic stress, investing in a diversified portfolio to grant future generations a solid savings base and investing in infrastructure.[26] Accordingly, the NSIA is structured in three distinct windows: the Stabilization Fund, the Future Generations Fund and the Nigerian Infrastructure Fund.

A final point can be made: some SWFs have so many financial resources that they can purchase – at least theoretically – the most important industrial and agricultural assets of developing countries as well as companies operating in strategic sectors (e.g. mineral resources,

[23] See Art. 3, par. 3 of the Decreto Presidencial n. 108/13, 'Regulamento de Gestão do Fundo Soberano e Angola', 28 June 2013, published in *Diário da República*, 28 de Junho de 2013, I Serie, N. 122, p. 1650, available at www.fundosoberano.ao, last visited 10 January 2014.

[24] See Art. 6 of the Decreto Presidencial n. 107/13, 'Política de Investimentos do Fundo Soberano de Angola', 28 June 2013, published in *Diário da República*, 28 de Junho de 2013, I Serie, N. 122, p. 1650, available at www.fundosoberano.ao, last visited 10 January 2014.

[25] See Celeste Cecilia Moles Lo Turco, *The Upcoming African Sovereign Wealth Funds: The Fundo Soberano de Angola – FSDEA* (Sovereign Wealth Funds Law Centre Bi-Annual Legal Report 2013, 3 April 2013), 56 ff.

[26] See Art. 3 of the Nigeria Sovereign Investment Authority (Establishment etc.) Act 2011, published in Federal Republic of Nigeria Official Gazette, 3rd June 2011, N. 64, Vol. 98, p. A223, available at www.nsia.com.ng, last visited 10 January 2014.

energy, transportation and information technology).[27] This is a sensitive issue, in particular as far as access to natural resources is concerned. Moreover, the risk of neo-colonialism in the form of State capitalism, conducted through profit-oriented entities which may in fact pursue the national interest, cannot be underestimated.

4. ETHICAL GUIDELINES

Ethical guidelines are a key issue to understand what kind of impact SWFs may have on the economic and social development of the countries where their investments are made.[28] The mandates of both the Norwegian GPFG[29] and the New Zealand Superannuation Fund (NZSF) contain specific provisions to ensure that their investments are ethical, transparent and sustainable.[30] Consequently, investment decision-making processes have also to take into account minimum standards in terms of human rights, labour rights, and environmental, social and governance concerns.[31] The Ethical Guidelines of the Norwegian fund are particularly interesting. They identify three ways in which ethical considerations

[27] The assets managed by the first three SWFs, i.e. Norway, Abu Dhabi and Saudi Arabia, are in an amount of USD 818 billion, USD 773 billion, and USD 675 billion, respectively (see www.swfinstitute.org). Such amounts, taken alone, are larger than the GNP of most African economies.

[28] Socially responsible investing by SWFs, in the absence of an explicit mandate to do so, is the focus of Chapter 14 by Benjamin J. Richardson and Angela Lee.

[29] According to a 2013 ranking available at www.swfinstitute.org, the Norwegian GPFG is the largest SWF by assets under management. The Norwegian GPFG manages approximately USD 838 billion, which is equal to 60 per cent of the yearly GNP of Italy.

[30] See the Management mandate for the GPFG, adopted by the Ministry of Finance on 8 November 2010 and more recently amended on 15 April 2013, in particular Chapter 2 'Responsible Investment', available at www.nbim.no, last visited 30 December 2013; Guardians of the New Zealand Superannuation Fund, Responsible Investment Framework, September 2012, available at www.nzsuperfund.co.nz, last visited 30 December 2013.

[31] The Santiago Principle no. 19.1 states that, when a Fund's investment policy is subject also to considerations other than those having an economic and financial nature, they should be clearly set out in its investment policy and publicly disclosed.

are to be implemented.[32] First, investments cannot be made in companies which – directly or through controlled entities – produce tobacco or weapons that violate fundamental humanitarian principles.

Second, the Guidelines provide for a negative screening process of companies in which the Fund has invested. In fact, following a recommendation by the Council of Ethics, the Norwegian Ministry of Finance may decide to exclude companies from the scope of the Fund's investments whenever there is a risk that these companies contribute to or are responsible for:

> a) serious or systematic human rights violations, such as murder, torture, deprivation of liberty, forced labour, the worst forms of child labour and other child exploitation; b) serious violations of the rights of individuals in situations of war or conflict; c) severe environmental damage; d) gross corruption; e) other particularly serious violations of fundamental ethical norms.[33]

In these cases the Fund is requested to divest and sell securities in its portfolio within two months from the decision. Before a final decision is

[32] Guidelines for the observation and exclusion of companies from the Government Pension Fund Global investment universe (GPFG Ethical Guidelines), adopted by the Ministry of Finance on 1 March 2010 pursuant to Act no. 123 of 21 December 2005 relating to the Government Pension Fund, section 7, available at www.nbim.no, last visited 30 December 2013. See Simon Chesterman, 'The Turn to Ethics: Disinvestment From Multinational Corporations for Human Rights Violations: the Case of Norway's Sovereign Wealth Fund' (2008) *American University International Law Review*, 23(3) 577–615; Larry Catá Backer, 'The Norwegian Sovereign Wealth Fund: Between Private and Public' (2009) *Georgetown Journal of International Law* 40(4) 1271–1280; Antonio Gigante, 'Fondi sovrani e responsabilità sociale d'impresa, lo "strano caso" norvegese', in (2010) IANUS n. 2; Gro Nystuen, 'Disinvestment on the Basis of Corporate Contribution to Human Rights Violations: The Case of the Norwegian Government Pension Fund', in Gro Nystuen, Andreas Follesdal, Ola Mestad (eds.), *Human Rights, Corporate Complicity and Disinvestment* (CUP 2011) 16–43.

[33] GPFG Ethical Guidelines, cit., Section 2: Exclusion of companies from the Fund's investment universe, cit. above. Similar ethical values are taken into consideration by the Guardians of the New Zealand Superannuation Fund (NZSF) with a view to identifying companies that: (i) might breach, or have breached, recognized environmental, social or governance standards; (ii) manufacture and test cluster munitions, nuclear explosive devices, and anti-personnel mines; (iii) produce tobacco; (iv) are whaling; or (v) are engaged in mining activities having a negative impact on human rights and the environment.

made though, the Ministry of Finance can put a company under scrutiny for a given period of time.

The recommendations by the Council on Ethics and their reasoning are made public only after the Fund's securities have been sold. The Council of Ethics is entrusted with the task of routinely assessing whether the grounds for the exclusion of a specific company still exist and, in the light of new information, it may recommend the Ministry of Finance to reverse its decision. It should be noted that the Council of Ethics is not a judicial body and its recommendations are not legally binding. Companies under scrutiny are nevertheless given the opportunity to provide information and present their viewpoints.

Third, the Ministry of Finance may request the Norges Bank to perform an assessment to establish whether active ownership would improve the conduct of the company concerned.

Since the introduction of the Ethical Guidelines, the Norwegian Ministry of Finance has adopted numerous decisions that have excluded certain companies from the scope of investments, including companies manufacturing cluster ammunitions, nuclear weapons or tobacco, or those involved in the worst forms of child labour and environmental pollution. The Norwegian Ethical Guidelines stem from the works of the 2001 Advisory Commission on International Law for the Petroleum Fund and of the Council on Ethics. The Commission was instructed to assess whether investments made by the Fund could conflict with Norway's commitments under international law.[34] In 2002 the government also appointed the so-called Graver Committee to propose ethical guidelines for the Norwegian sovereign fund.[35]

[34] Reference is made to a letter from the Ministry of Finance to the Petroleum Fund Advisory Commission on International Law dated 7 January 2001. See Petroleum Fund Advisory Commission on International Law, Memorandum to the Ministry of Finance: Question of whether an investment through the Petroleum Fund can constitute a human rights violation for Norway, Oslo, 22 March 2002, which focused on the concept of jurisdiction, arguing that even if 'States only have responsibility for human rights fulfilments where they have jurisdiction … , when States are obliged to participate in international cooperation to prevent a certain activity, it could be claimed that this obligation is not honoured if the same state provides financial support to companies which are involved in the kind of production or other activity that the state has undertaken to combat'. Therefore, there could be 'weighty reasons, also of a legal character, to prevent or withdraw investments which are contrary to the content of the activity obligation in question'.

[35] See the Report from the Graver Committee, 7 November 2003, available at www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/

The adoption of the Ethical Guidelines was triggered by the international debate on the activities of multinational enterprises and their corporate social responsibility, which resulted in the adoption of soft law instruments to drive corporations to implement standards in the fields of human rights, environmental protection, bribery and corruption, as well as consumer interests protection and competition.[36]

Furthermore the Norwegian Ethical Guidelines are based on the following considerations:[37] being the GPFG a State organ, its conduct can trigger Norway's international legal responsibility;[38] however, investments in multinational corporations involved in human rights violations do not *per se* lead to responsibility under international law;[39] moreover,

responsible-investments/The-Graver-Committee – documents/Report-on-ethical-guidelines.html?id=420232 (last visited 30 December 2013).

[36] Reference can be made to the OECD Guidelines for Multinational Enterprises (first adopted in 1976 and last updated in 2011), to the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (adopted in 1977 and last revised in 2006), as well as to the 1999 UN Global Compact and to the Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights drafted by the UN Sub-Commission on Human Rights, Doc. E/CN.4/Sub.2/2003/12/Rev.2, 2003. But see also the more recent Guiding Principles on Business and Human Rights endorsed by the UN Human Rights Council on 16 June 2011, UN Doc. A/HCR/RES/17/4, 2011.

[37] See Bruno Demeyere, 'Sovereign Wealth Funds and (Un)ethical Investment: Using "Due Diligence" to Avoid Contributing to Human Rights Violations Committed by Companies in the Investment Portfolio', in Nystuen et al. (n 32) 183–220.

[38] This is certainly the case when the central bank manages the assets on behalf of the Ministry of Finance: the Norwegian GPFG is a deposit account with the Norwegian Central Bank, its assets are managed by Norges Bank Investment Management (NBIM) which is responsible to the Bank's Governor and Board and, ultimately, to the Minister of Finance.

When a different institutional set up is adopted, it should be carefully assessed whether the SWF can be considered as an organ of State according to Art. 5 (Conduct of persons or entities exercising elements of governmental authority) of the ILC Draft Articles on Responsibility of States for Internationally Wrongful Acts (2001), in ILC, Report of the International Law Commission on the Work of Its Fifty-third Session, UN Doc. A/56/10. In particular, this assessment should be made when a government-owned separate entity is formed to manage the Fund in accordance with a mandate defined by the Ministry of Finance or when the government sets up an investment company that owns and manages the Fund.

[39] In fact, it should be carefully assessed when the conduct of the multinational enterprise in which the SWF invested is to be construed as attributable to the SWF (and therefore to the State to which it belongs). See Arts. 5, 8 and 11 of the ILC Draft Articles on Responsibility of States for Internationally Wrongful Acts (2001), in ILC, *Report of the International Law Commission on the Work of Its Fifty-third Session*, UN Doc. A/56/10.

the fact that the conduct of the multinational corporation takes place abroad should also be taken into account.[40] Rather than entering the field of State responsibility, the Ethical Guidelines consider that acts or omissions of a company may pose unacceptable 'risks' of involving the GPFG in violations of human rights and of environmental, social or governance standards.[41] Large investments by SWFs have a positive impact on the development of host countries, but concerns over the activities in which the funds are invested in are legitimate. Ethical guidelines are the tool that reconciles the profitability objectives of an SWF with its public accountability with respect to international social and environmental standards. The guidelines combine a naming and shaming policy with the fund's commitment to exert its shareholder rights responsibly.[42] In this sense, both the GFPG and the NZSF rely on

[40] In only a limited number of circumstances, a State has the duty to respect, protect and fulfil its human rights obligations also outside its territory. In particular, according to the 2011 Maastricht Principles (International Commission of Jurists, *Maastricht Principles on Extraterritorial Obligations of States in the area of Economic, Social and Cultural Rights*, September 2011, available at www.icj.org/dwn/database/Maastricht%20ETO%20Principles%20-%20FINAL.pdf), extraterritorial obligations of a State in the area of economic, social and cultural rights arise whenever: (i) the State exercises authority or effective control abroad; (ii) acts or omissions will foreseeably nullify or impair the enjoyment and exercise of rights outside its territory; and (iii) the State is in a position to exercise decisive influence or take measures to realize economic, social and cultural rights extraterritorially, in accordance with international law.

[41] For instance, in a recent recommendation concerning a company involved in child labour, the Council stated that: 'Even if it is States, as opposed to companies, that are obligated by international human rights conventions, companies can nevertheless be said to contribute to human rights violations. The Council does not take a position on the extent to which the State is responsible for any human rights violations; it is sufficient to establish that the company in question is acting in a manner that links it to serious or systematic violations of internationally recognized human rights. This applies regardless of whether the State where the violations are taking place has ratified the conventions against which the circumstances are assessed' (GPFG Council on Ethics, Recommendation to the Ministry of Finance on the exclusion of Zuari Agro Chemicals Ltd. from the Government Pension Fund Global's investment universe, 18 April 2013).

[42] The GPFG and NZSF responsible investment frameworks are aligned with the 2006 UN Principles for Responsible Investment and the UN Global Compact, and other universally recognized standards. The Principles for Responsible

active ownership to influence the decision-making process within the companies they have invested in. Rather than excluding a company from the scope of their investment portfolios, the funds exert their voting rights including on environmental, social and corporate governance issues. Only when active ownership is likely to be ineffective, will the Funds divest to avoid involvement in unethical activities. Divestment recommendations by the ethical boards of both the GPFG and the NZSF are disclosed to the public to mark a distance from the divested company in order to avoid any allegations and also to raise awareness in the broader investors' community.

It would be misleading to describe the SWFs' activities as philanthropic though. Their investments are always profit oriented. Nevertheless, by excluding highly unethical investments, SWFs will indirectly provide social, environmental and good governance returns to the host State, thus contributing to its sustainable development.

In practice, the GPFG and the NZSF are still two special and quite isolated cases in the overall landscape of SWFs. They nevertheless represent a valid example to be followed, especially by SWFs based in Western countries and that are not only profit oriented.

5. SWFS' PARTNERSHIP WITH THE WORLD BANK AND REGIONAL DEVELOPMENT BANKS

In 2008, the President of the World Bank Robert Zoellick called for SWFs to invest 1 per cent of their assets in equity investments in Africa through platforms created by the WB Group.[43] A debate on the innovative use of SWFs financing followed and in 2010 some funds committed a small part of their portfolios to the asset management company of the International Finance Corporation (IFC). This was the first form of cooperation between a World Bank agency and SWFs.

The Asset Management Company is an IFC subsidiary and manages assets on behalf of large institutional investors – among which some

Investment (PRI) were developed by an international group of institutional investors to incorporate environmental, social and corporate governance issues into investment practices. The PRI initiative was launched in 2005 by the UN Secretary-General Kofi Annan and it was supported by the UNEP Finance Initiative and the UN Global Compact (see www.unpri.org).

[43] Robert Zoellick, 'A Challenge for Global Statecraft', remarks delivered at the Center for Global Development, 2 April 2008.

SWFs are present – through six different funds: the IFC Global Capitalization Fund, which invests in emerging markets' systemically important banks; the IFC Africa Capitalization Fund, which invests in northern and Sub-Saharan Africa's systemically important commercial banking institutions; the IFC Russian Bank Capitalization Fund, which invests in Russian mid-sized commercial banks; the IFC Catalyst Fund, which makes investments in emerging markets' private equity funds; the IFC African, Latin American, and Caribbean Fund, which invests in various industrial sectors in Sub-Saharan Africa, Latin America, and the Caribbean; and the IFC Global Infrastructure Fund (GIF), which makes equity and equity-related investments in the infrastructure sector in global emerging markets.

The GIF was established in 2011 with a view to mobilizing additional resources for infrastructure investments in developing countries in sectors that include transport, energy and telecommunications. The GIF is a tool to overcome the constraints suffered by emerging countries in attracting long-term private sector equity capital for large infrastructures, which are key to economic growth and the improvement of living standards. Additionally, by leveraging the IFC's investment expertise and organizational networks, the GIF offers institutional investors a cost-efficient platform to make direct infrastructure investments in markets where entry barriers and transaction costs are a significant deterrent.

In October 2013 the IFC completed fundraising for the GIF, receiving capital commitments from 11 investors, including the SWF of Singapore (as anchor investor) and nine other sovereign and pension funds from Asia, the Middle East, Europe and North America.

Further partnerships of this kind are foreseeable in the future. This innovative mechanism of financing for development could contribute to the achievement of the Millennium Development Goals.

Another way in which the World Bank and regional development banks (in particular the African Development Bank – AfDB) could intervene is to provide technical assistance for the setting up of new SWFs in developing countries. For instance the Chad Future Generation Fund was created following the requests by the World Bank to establish a petroleum revenue management law in Chad as a condition to disburse a loan to fund the Dubai oil fields and the Chad–Cameroon pipeline.[44]

Technical assistance provided by international organizations, and especially by the World Bank, can therefore be crucial in promoting the

[44] However, from the outset, many problems have arisen in relation to this project. See www.brettonwoodsproject.org/2006/01/art-507557/.

establishment of SWFs in emerging and developing economies. In fact, the best and most lasting results in the fight against poverty can be achieved through the valorization and release of local resources, rather than through foreign investments. The recent creation of SWFs in various African countries is therefore an important step and a positive sign for the future.

14. Social investing without legal imprimatur: The latent possibilities for SWFs

Benjamin J. Richardson and Angela Lee

1. SOCIALLY RESPONSIBLE INVESTING

This chapter examines socially responsible investing (SRI) by sovereign wealth funds (SWFs), focusing on the contrasting experiences of three funds seemingly lacking a legal mandate to do so. Most scholarship on this topic has focused on funds with legal duties or powers to invest ethically, as is the case with the SWFs from Norway, France and New Zealand.[1] We have little knowledge about whether or how other SWFs consider social and environmental issues when investing, and we 'lack ... empirical studies assessing the impact of fund type on likelihood of being a responsible investor.'[2] So far, only the Norwegian Government Pension Fund-Global (NGPF-G) has been scrutinized closely for its SRI policies and practices.[3]

This chapter enhances our understanding of these issues by evaluating whether and how SWFs may practice SRI where they lack the requisite legal imprimatur. It selectively examines examples from Australia (Future Fund), Ireland (National Pensions Reserve Fund) and the United States

[1] See, e.g., Benjamin J. Richardson, 'Sovereign Wealth Funds and the Quest for Sustainability: Insights from Norway and New Zealand' *Nordic Journal of Commercial Law*, Fall(2) (2011): 1–27; Benjamin J. Richardson, 'Sovereign Wealth Funds and Socially Responsible Investing: An Emerging Public Fiduciary' *Global Journal of Comparative Law* 2 (2013): 125–162; Eva van Der Zee, 'Sovereign Wealth Funds and Socially Responsible Investment: Dos and Don'ts' *European Company Law* 9(2) (2012): 141–150.

[2] Hugues Létourneau, *The Responsible Investment Practices of the World's Largest Government Sponsored Investment Funds* (MA thesis, Carleton University, 2013), 28.

[3] Danyel Reiche, 'Sovereign Wealth Funds as a New Instrument of Climate Protection Policy? A Study of Norway as a Pioneer of Ethical Guidelines for Investment Policy' *Energy* 35 (2010): 3569–3577; Gordon Clark and Ashby Monk, 'The Legitimacy and Governance of Norway's Sovereign Wealth Fund: The Ethics of Global Investment' *Environment and Planning* 42(7) (2010): 1723–1738.