ANNEX

3 Sovereign Wealth Funds

A country's assets managed by sovereign wealth funds (SWFs) are closely related to its foreign exchange reserves, because these assets are generally carved out from existing reserves or built from foreign exchange earnings emanating from exports of nonrenewable commodities. SWFs have been receiving increased attention since 2007, though they have existed in different forms for more than six decades. There is still a lack of agreement on the number of SWFs and the size of their assets. According to the latest data available in the IMF, there are 31 SWFs in 29 countries estimated to hold between US$2.2 trillion and US$3.1 trillion of foreign assets as of February 2008.[31] SWFs' holdings were nearly a third of total global foreign exchange reserves as of end-February 2008.

A SWF can formally be defined as an entity that manages specially designated state-owned financial assets, and is legally structured as a separate fund or fund manager owned by the state. The management of SWFs is not always transparent and among the cases that are known, different practices have been followed in different countries. In some countries, international reserves allocated to SWFs are held in the balance sheet of the central banks and in many instances are also managed by the central bank itself. In others, SWFs are separated from the central bank but hold and manage reserves on behalf of the central bank. In still some other cases, SWFs are totally separate from the central bank and managed by the ministry of finance.

SWFs have been established with one or more of the following objectives: insulate the budget and the economy from excess volatility in revenues; help monetary authorities sterilize unwanted liquidity; build up savings for future generations; promote economic and social development; and improve returns on investment. The investment strategies followed by some SWFs are not in the public domain.[32]

The nontransparent structure of some SWFs and different country practices regarding the treatment of SWF assets in relation to reserves can make it difficult to assess reserve adequacy and to compare reserve levels across countries.[33] Also, the availability of SWF assets for intervention purposes during times of crisis is not always clear, rendering reserve adequacy assessments difficult. Furthermore, in view of their large size, SWFs are likely to have a significant impact on a country's public finances, monetary conditions, balance of payments, and balance sheet linkages.

[31]See IMF (2008).

[32]Some SWFs transparently declare their investment strategies. SWFs generally follow heterogeneous investment policies reflecting their different objectives. Some SWFs invest solely in publicly listed financial assets (bonds and equities), while others invest in all major asset classes. Some SWFs invest relative to market indices, while others aim at maximizing absolute returns over a specified time horizon.

[33]The Santiago Principles are expected to result in improved transparency in the objectives and accounting principles underpinning the operations of SWFs (IWG, 2008).