

The “*Santiago Principles*”: A Diversionary Tactic by Sovereign Wealth Funds?

Workshop on Sovereign Wealth Funds and Globalization

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Introduction

- The need for an international standard
- Hard law *versus* Soft law options
- An international standard?
 - Inclusiveness and ownership
 - **WTO, SPS Agreement, Annex A (3(d))**
 - *“appropriate standards, guidelines and recommendations promulgated by other relevant international organizations open for membership to all Members, as identified by the Committee”*
 - **WTO, GATS, Article VI(6)**
 - *“international standards of (...) international bodies whose membership is open to the relevant bodies of at least all Members of the WTO”*
- An IMF standard?
- Self-regulation / International regulation

Introduction

- 1. A Suspect Drafting Process**
- 2. An Inadequate Regulation**
- 3. A Flawed Implementation**

1. A Suspect Drafting Process

- **The US context: An asymmetry**
 - **Legislative branch: reluctance**
 - 2007: Foreign Investment and National Security Act (FINSA)
 - New criterion: « *foreign government controlled entity* »
 - **Executive branch: will to openness**
 - 2007-2008 subprime crisis and capital shortage
 - Key person: Henry Paulson (Secretary of Treasury)
- **SWFs on the G7 agenda**
 - G7, Statement of G7 Finance Ministers and Central Bank Governors, Washington, 19 October 2007
 - “SWFs are increasingly important participants in the international financial system and [...] our economies can benefit from openness to SWF investment flows. **We see merit in identifying best practices for SWFs in such areas as institutional structure, risk management, transparency and accountability.** For recipients of government-controlled investments, we think it is important to build on principles such as nondiscrimination, transparency, and predictability [...]. We ask the IMF, World Bank, and OECD to examine these issues [...]”

1. A Suspect Drafting Process

- World Bank
- OECD
- IMF
 - legitimacy called into question
 - International Monetary and Financial Committee, *Statement by Statement by His Excellency Sultan N. Al-Suwaidi Governor of the United Arab Emirates Central Bank (On behalf of Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Maldives, Oman, Qatar, Syria, United Arab Emirates, and Yemen)*, 12 April 2008
 - “[w]e reiterate our **misgivings regarding the Fund’s involvement in setting best practices for SWFs. The Fund does not have the requisite expertise in the areas of governance and transparency to take the lead in producing a set of best practices for SWFs. We are also concerned that the treatment of SWFs, to the exclusion of other types of institutional investors with proven track record of excessive risk taking and destabilizing behavior, would introduce a severe element of bias and lack evenhandedness in financial surveillance. Finally, the timing of this exercise and its political dimensions could inadvertently disrupt the flow of much needed long-term capital from SWFs to institutions in the U.S. and elsewhere that face both liquidity and capital shortage issues**”

1. A Suspect Drafting Process

- May 2008: The International Working Group of Sovereign Wealth Funds (IWGSWF)
- October 2008: Adoption of the “Santiago Principles”
 - IMF, Executive Board Meeting 08/87, 3 October 2008
 - *“The development of the Santiago Principles as a good example of collaborative engagement between countries with SWFs and the recipient countries”*
 - However, recipient countries : observers only
- Not an “international standard” or an “IMF standard”
 - *“IMF Guidelines Spur Steps Towards Transparency”, Financial Times, 13 March 2010*
 - *“This led the International Monetary Fund to develop “best practices” for SWFs to improve their transparency and governance”*

2. An Inadequate Regulation

- Do the Santiago Principles respond to concerns stemming from SWFs activities?
 - Political agenda / Anti-competitive practices / Insider trading / etc.
- The "corporate governance" & "financial intermediary" matrix

| Corporation | SWFs | Private investment funds |
|--------------------|---------------------------------|--------------------------|
| Shareholders | States owning the SWF | Fund providers |
| Board + Executives | Board + Executives | Fund manager |
| Stakeholders | Recipient States of investments | Stakeholders? |

- Majority of rules concerning the relationship between the State owning the SWF and the fund management

2. An Inadequate Regulation

- Rules concerning SWF risk exposure
- Rules concerning the relationship between the SWF management and the SWF owner (*lato sensu*)
- Rules concerning the relationship between the SWF owner and recipient States

- Rules concerning the relationship between the SWF management and the SWF owner (*lato sensu*)
 - **Principle 2:** “*The policy purpose of the SWF should be clearly defined and publicly disclosed*”
 - **Principle 4:** “*There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF’s general approach to funding, withdrawal, and spending operations*”
 - **Principle 5:** “*The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner (...)*”
 - **Principle 7:** “*The owner should set the objectives of the SWF, appoint the members of its governing body(ies) (...), and exercise oversight over the SWF’s operations*”

2. An Inadequate Regulation

- **Rules concerning the relationship between the SWF management and the SWF owner (*lato sensu*)**
(...)
 - **Principle 8:** “*The governing body(ies) should act in the best interests of the SWF (...)*”
 - **Principle 12:** “*The SWF’s operations and financial statements should be audited annually*”
 - **Principle 23:** “The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner”
 - « *Sovereign Wealth Funds Starting to Embrace Transparency* », *Institutional Investor Magazine*, 1 September 2011
 - “*Botswana’s Pula Fund observed that transparency mitigated the potential use of the fund by politicians for development projects “against the spirit of saving for future generations” and has helped create “the checks and balances needed for preservation of capital”*”

2. An Inadequate Regulation

- **Distinction between SWFs and other types of private investment funds**
 - Private investment funds :
 - contractual link – Private Law Framework
 - Several fund providers
 - Non-proprietary model
 - SWFs
 - Institutional link – Public Law framework
 - One fund provider
 - Proprietary model
- **Management independence or Management loyalty?**
 - Example: *Nigeria Sovereign Investment Authority*

2. An Inadequate Regulation

- **Rules concerning the relationship between the SWF owner and recipient States**
 - Loose regulations
 - Good intentions at first sight
 - **Principle 14:** *"Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures"*
 - **Principle 19:** *"The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds"*
- ... However, some "false friends"
 - **Principle 14 (Commentary):** *"To ensure good governance and efficient use of resources, it is important that the SWF, its owners, or the entities in charge of the SWF's operational management establish clear rules and procedures for dealing with third parties"*

2. An Inadequate Regulation

- **Rules concerning the relationship between the SWF owner and recipient States**
 - ... However, some "false friends"
(...)
 - **Principle 19 (Commentary)**
 - **Sub-Principle 19-1:** *"if investment decisions are subject to other than economic and financial considerations, these should be clearly set out in the investment policy and be publicly disclosed"*
 - international sanctions and social, ethical, or religious reasons
 - **Sub-Principle 19-2 (Commentary):** *"The management of an SWF's assets should be consistent with what is generally accepted as sound asset management principles"*
 - Equivalent to Principle 14
 - **Principle 15**
 - *"Principle SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate"*
 - Unnecessary

2. An Inadequate Regulation

- **Rules concerning the relationship between the SWF owner and recipient States**
 - ... However, some "false friends"
(...)
 - **Principle 20**
 - ***"The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities"***
 - But, **Principle 20 (Commentary, Footnote 35)**: ***"However, recipient countries may grant to SWFs certain privileges based on their governmental status, such as sovereign immunity and sovereign tax treatment »***
 - *Jure gestionis / jure imperii*
 - **Appropriate commitments : some proposals**
 - Real-time disclosure of all investments
 - Limit shareholder participation
 - Waiver of all privileges and immunities

3. A Flawed Implementation

- Soft law nature
 - *“The GAPP is a voluntary set of principles and practices that the members of the IWG support and either have implemented or aspire to implement”*
- International Forum of Sovereign Wealth Funds (IFSFW)
 - *“the Forum shall not be a formal supranational authority and its work shall not carry any legal force”*
 - IWGSWF, Kuwait Declaration: Establishment of the International Forum of SWFs, 6 April 2009
 - A curious Membership
 - Example : CIC but not SAFE
 - *“the Forum members shall be the SWFs who [...] endorsed the Santiago Principles”*
 - But : Abu Dhabi, Kuwait, Iran, Libya, etc.

3. A Flawed Implementation

- The IFSWF: a very strange international forum
 - May 2010 – April 2011 : Silence
 - Although: **UNSC, Resolution 1973 (2011)**
 - Supposedly neutral ... but with a political agenda
 - Exemple : Jin Liqun (formerly with CIC and Chair of the IFSWF)
 - September 2011: “ ***China cannot be expected to bail out the eurozone unless it opens hurdles to China and other high-growth markets***”
 - October 2011: “*if you look at the troubles which happened in European countries, this is purely because of the accumulated troubles of the worn-out welfare society. I think the labor laws are outdated. The labor laws induce sloth, indolence, rather than hard [work]*”

3. A Flawed Implementation

- The IFSWF as the SWF “country club”
- The Santiago Principles: not a genuine international regulation
- A public relations strategy?
 - *Institutional Investor*, 15 September 2011
 - **“implementing the Santiago Principles can help a particular sovereign wealth fund to be better understood and accepted by the countries in which it invests”**
 - *Secretary Clinton’s Speech at Economic Club of New York*, 14 October 2011
 - **“[w]hen the international community grew worried about sovereign wealth funds, countries, institutions, and the funds themselves came together to agree on the Santiago Principles, a code of conduct designed to reassure all stakeholders that these funds would act responsibly”**
- The key issue: not SWFs but State capitalism

Thank you for your attention

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