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Editor:

Javier Santiso, PhD

Professor of Economics, ESADE Business School
Vice President, ESADEgeo - Center for Global Economy and Geopolitics

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Foreword

1. Foreword

The recovery of the world economy continued to make progress during 2014, although more moderately than initially predicted and showing significant heterogeneity, principally due to differing growth rates recorded in different countries. Activity in advanced economies picked up, but not all at an equal rate. Growth rates in developing economies were slightly lower than those recorded in previous years. However, they continued rising in the ranks of the world economy, advancing at rates significantly higher than developed economies and serving as a driver for the global economy.

Economies such as China, Russia or the United Arab Emirates are even more important exporters of capital, due to their comfortable fiscal positions, internal savings rates and an abundance of raw materials. In this regard these countries play an increasingly important role as sources of foreign direct investment in the world: in 2013 developing economies generated more than 33% of world outflows of foreign direct investment, when in 2000 they represented only 12%.

As reflected in previous editions of this Report, some of these countries are channelling their increasing investing power through sovereign wealth funds, whose strategic decisions have more and more of an impact on the world economy. Due to the substantial and growing role of these investment vehicles, ESADE Business School, KPMG and ICEX-INVEST IN SPAIN present the third edition of the Sovereign Wealth Fund Report, with the aim of continuing to go more in depth on the study of the strategy and worldwide trends of sovereign wealth funds.

In this edition, the report analyses the main activities carried out by sovereign wealth funds in 2013 and the beginning of 2014, as well as their strategies, investment decisions and alliances or collaboration with other funds and institutional investors. Also, three new areas are analysed in depth. Firstly, the investment strategy and asset portfolio of the world's biggest sovereign wealth fund, the Norwegian Government Pension Fund Global, is examined in detail. Secondly, a detailed study is made of North American public funds and the main Canadian pension funds. Thirdly, the presence of sovereign wealth funds in three sectors is analysed in detail: infrastructure, property, and financial services.

As in previous editions, the report focusses on Spain and Spanish companies, which in recent years have come to play an important role in Europe as recipients of investment from sovereign wealth funds and state-owned enterprises, especially those with a presence in Latin America. The strategic positioning of Spanish companies, both geographically as well as in terms of their sector, together with the knowledge and experience of their management teams, will contribute to keeping Spain an important destination for these international investors in the coming years.

We hope that you are looking forward to this new edition of the study, on the role that sovereign wealth funds are playing in the world economy.

Jaime García-Legaz
Secretary of State for Trade

Javier Solana
President, ESADEgeo

John Scott
President, KPMG España

Introduction

Javier Santiso

Professor of Economics, ESADE Business School

Vice President, ESADEgeo - Center for Global Economy and Geopolitics

2. Introduction

This Sovereign Wealth Funds 2014 report is the third such report produced by ESADEgeo, with the support of KPMG and ICEX-Invest in Spain. We should like to start by thanking both institutions for the support they have given us, enabling us to complete this third report on sovereign wealth funds. We should also like to express our particular thanks to Javier Capapé and Tomás Guerrero for their excellent analysis and coordination of the report; and lastly to Samuel Granados, for designing the internationally top-level infographics, as demonstrated by his recent appointment as senior editor with the Washington Post.

This work has not been an isolated effort. It is part of a range of activities undertaken by ESADEgeo over the past three years. In 2011, Javier Santiso advised the Colombian government together with the then Minister of Finance, Juan Carlos Echeverry and his team on the creation of their sovereign wealth fund (now dedicated to innovation). We have also launched a series of conferences on emerging markets – ESADEgeo Globalization Lab – since many of these countries have institutions of this kind. On 30 May 2011, we held a Lab on sovereign wealth funds with Victoria Barbary, then with the Monitor Group, in London. On 7 February 2012, Christopher Balding of the Peking University HSBC Business School (Shenzhen, China) was in attendance to present his latest book. In addition, we have also contributed a chapter on political bias in sovereign wealth fund investments to Sovereign Investment, a book edited by Karl Sauvant for Oxford University Press. Debe quedar: Karl Sauvant for Oxford University Press. During this past academic year 2013-2014 we took part in preparing a chapter on sovereign wealth funds and Latin America in Global Public Investors 2014, published by OMFIF, in London. We also strengthened our collaboration with the Fletcher School at Tufts University, incorporating the analysis of trends in funds carried out by Patrick Schena; also in 2014 we presented an overview of the sovereign wealth funds industry at Sciences Po, in Paris. The Report has already established itself as an international reference: it is the only source specialising in sovereign wealth funds quoted by the World Investment Report 2013, published by UNCTAD (Geneva).

This Report is divided into three themed sections. In the first of these, we address the main trends shown by sovereign wealth funds in 2013 (Patrick Schena and Neeraj Prasad). In the second, dedicated to geographical analysis, we focus on Spain and Latin America (Javier Santiso and Germán Ríos), Norway (Javier Capapé and Tomás Guerrero) and North America (Paul Rose). In the third, we study the sovereign wealth funds' activity by sector: the real estate sector (with a special spotlight on Spain by Xavier Reig), infrastructure (Victoria Barbary) and financial services (Patrick Schena).

Several conclusions can be drawn from the analysis obtained in the Sovereign Wealth Funds Report 2014:

- The phenomenon of sovereign wealth funds is continuing to spread throughout all emerging regions: not just Asia and the Middle East, but Africa and Latin America too. There are currently 84 sovereign wealth funds in operation, with assets amounting to 5.9 trillion dollars. The number of existing and potential funds exceeds one hundred. Investments continue to be concentrated, with the major funds accounting for the majority of transactions. The classical receiving sectors - real estate and financial services - attracted fresh capital. Specifically, the investment in real estate well illustrates the paradox faced by many institutional investors in the sector: the funds increase in average size, making them more competitive. However, this increased size also poses a difficulty when seeking to invest ever larger volumes of capital efficiently.

- The analysis of the funds' global trends shows two significant tendencies. Firstly, "consortium" investments are recovering: in 2013 the number of direct transactions carried out jointly by the funds (several funds co-investing in the same asset) exceeded the number of individual transactions. This had not been the case since 2009, and points to a learning process: the strengthening of mutual know-how among these funds. Secondly, the attraction of South-South investments stands out, as they again occupied a priority position for the sovereign wealth funds. In this regard, we would highlight the fact that the two biggest transactions of 2013 were carried out against the backcloth of an MoU between a government and a sovereign wealth fund; in both cases, these agreements were established with governments of emerging or frontier countries. Qatar Investment Authority committed $5 billion in Malaysia to develop a new petrochemical industrial complex in the South of the Peninsula; for its part, Mubadala (United Arab Emirates) signed an agreement valued at $5 billion to increase exports of bauxite from Guinea, as well as constructing a port and an aluminium refinery.

- In our report for 2012, we highlighted the fact that Europe had been the main recipient of investment in 2011 and that, within Europe, Spain and its companies had been the main destinations for sovereign wealth funds, receiving $8.34 billion of investment, ahead of France, the UK and Germany. In 2013, we show that Spain continued to be a priority target for the sovereign wealth funds, with the increase in the Qatar Investment Authority's equity in Iberdrola, that of Temasek's in Repsol, and the advent of the first major real estate transaction with the acquisition of Barcelona's Hotel W by Qatari Diar. In total, between 2007 and 2014, SWFs have made more than €13 billion of direct investments in Spain, 10% of total foreign investment in tangible assets, showing the capacity for counter-cyclical investment that

these long-term investors have. Prominent among the most active investors are sovereign wealth funds such as Qatar Investment Authority (through its direct investment arm Qatar Holding), Mubadala and IPIC (UAE) and Temasek and GIC (Singapore). In the period covered by this 2014 Report, from January 2013 to mid-2014, we have identified a flow of investment into Spanish companies (equity) valued at more than €2.7 billion. Most notable is the recovery of confidence in Spain on the part of the giant Norwegian Government Pension Fund Global (GPFG) which has increased its holdings in Spanish equities by 15%. Moreover, it has also started trusting Spanish debt again, increasing its positions almost fivefold to reach €3.32 billion at the end of 2013, placing Spain in the twelfth position by incoming investment in sovereign debt, ahead of Canada, Russia and Australia.

- In this report we sketch out a systematic strategy for promoting bilateral funds of funds in Spain (especially private equity, expansion capital and venture capital). To this end, we focus on the examples of countries such as Italy, France and Ireland, which have established agreements (or created new investment companies) between governments and sovereign wealth funds to finance specific sectors or cover more complex phases of investment (expansion capital in Spain being a good example). Why not take advantage of the pull of investment in Spain and its companies to establish an agreement of this type?

- The Canadian pension funds and the US sovereign wealth funds are also studied in this Report. We trace the origins, many dating back to the nineteenth century, of the US sovereign wealth funds, most of which are unknown to the public at large. We also look at the creation and strengthening of new, modern sovereign wealth funds linked to the extraction of shale gas. And we study the major Canadian public pension funds. While not being sovereign wealth funds, since they have pension commitments, these players pursue highly innovative, sophisticated and direct investment strategies, and are gaining in importance in the European market.

- The Norwegian sovereign wealth fund continues to lead in the ranking by volume of assets under management. Now very close to $900 billion, it is firmly on track to reach the trillion dollar mark. We again note the nature of the fund which, despite having the word "pension" in its name, is not a pension fund. We uncover a marked European bias in its investments in equities, which penalises investment in North American equities and makes the UK the leading destination, followed (historically) by France, Germany, Switzerland and Spain.

- Sovereign wealth funds are almost ideal players for investing in infrastructure. Given their long-term investor profile, sovereign wealth funds see in infrastructure a type of investment that diversifies their portfolios, since there is usually very little correlation with equities or bonds. Furthermore, it ensures a rate of return that matches their long-term commitments and their objectives of inter-generational wealth transfer: returns are stable and hedged against the risk of inflation. Geographically, Europe continues to dominate, and specifically the UK remains attractive in airports and utilities such as water. However, in 2013, there was a significant increase in investment in infrastructure in emerging markets (23% of the total), led by Latin America. In total, SWFs allocated $700 million to investment in infrastructure in these markets; while still far from covering investment requirements, these first steps may serve as an entry into markets such as Brazil or Mexico, as well as Africa and South-east Asia, where needs in the coming decades are patent.

- In 2013, the financial sector strengthened as a destination for investment by sovereign wealth funds. This shows that the financial sector continues to be a key investment sector for the funds; additionally, we see a new trend, in that the funds are directing their investments in the sector into new geographical regions. Some funds' strategic objective has centred on ensuring domestic financial stability and strengthening the bases of their own banking systems. As commented, for some funds, a new geographical focus can be discerned, driven by positive prospects and new demographic and socio-economic data. The sovereign wealth funds have become an important source of capital for global financial companies: almost 270 transactions in the sector since 2006, 70% of them after the global financial crisis. All this leads us to wonder about the actions of the sovereign wealth funds as investors in this sector: What strategy do the sovereign wealth funds pursue in investing in the financial sector? And what inferences can be drawn? We will respond to both questions in this chapter.

- In short, in this 2014 Report we corroborate the solid weight of the emerging sovereign wealth funds in the industry as a whole. This trend is in line with the increased weight of the emerging markets in the global economy, which is now more apparent than ever, and which is clearly demonstrated by these sovereign wealth funds. The sovereign wealth funds are developing ever greater and more sophisticated investment capabilities, establishing new agreements with governments of European, African and Asian countries, strengthening their co-investment alliances and their positioning in global sectors such as real estate and infrastructure.

Patrick J. Schena
PhD, Adjunct Assistant Professor & Senior Fellow and Co-Head SovereigNET: The Fletcher Network for Sovereign Wealth and Global Capital
The Fletcher School, Tufts University
Neeraj Prasad
PhD, The Fletcher School, Tufts University

SWF Investment 2013: The Continuing Quest for Quality Deal Flow

3. SWF Investment 2013: The Continuing Quest for Quality Deal Flow

2013 marked yet another year of steady advancement in both the number and aggregate size of sovereign wealth funds globally. Including the watershed year of 2006 when 10 new funds were established, some 25 entities have been created primarily in emerging economies[1]. Among those 25, ten funds were established in Africa, which today is home to 15 SWFs. Asset growth has likewise expanded in the intervening years, by some accounts more than doubling to current estimates of approximately $6 trillion. This brief reflection on the rapid expansion of SWFs as a class of global institutional investor is important. While it may mask the substantial differences in the size and scale of SWFs, it helps to inform the challenges of managing large and expanding pools of institutional capital and the continuing quest for quality deal flow. These challenges will become more pronounced as the average size of SWFs continues to expand and along with it competition to efficiently deploy capital in scale.

Definition and methodology

We begin our discussion with a brief, but cautionary note on definition and methodology, which, we believe, has broader applicability to research into the investment activities of SWFs. First, definitions matter[2]. In this context, our definition of "sovereign wealth fund" is broad in scope and includes what are commonly referred to as stabilization, wealth, development, and pension reserve funds. Next, our research on investment activity, described and analyzed in this chapter, is focused on those direct investments by SWFs conducted in private versus public markets, i.e. what might be described as "private equity". We do not, however, exclude transactions in which SWFs provide debt capital. Also, our research attempts to isolate the direct contribution of a SWF to a transaction. This includes estimates of capital directly contributed or earmarked for the deal. Because deal amounts or direct SWF contributions are frequently unreported or refer to capital commitments versus invested amounts, in-year estimates of SWF DFI can vary widely among researchers.

Large fund structures and concentration themes tend to dominate our analysis. This is a naturally occurring bias in the data. Thus, for 2013 we identified over 160 confirmed transactions involving SWFs expectedly concentrated among the largest funds. Earlier patterns of concentration in such industries as financial services and real estate likewise continued from prior years. With respect to investment behavior, a pattern has emerged suggesting that the average size of SWF contributions to individual transactions may be rising after several years in decline.

[1] As both the definition and count of SWFs global remains a topic of considerable debate, it is difficult to definitely scale the impact of entity growth. Nonetheless defensible estimates suggest that.

[2] Javier Capapé and Tomás Guerrero. 2013. "More layers than an onion: Looking for a definition of Sovereign Wealth Funds" SovereigNET Research Paper, The Fletcher School, Tufts University, Boston, MA.

Global deals analysis

As has been well-documented[3], the years in the immediate aftermath of the financial crisis saw large SWFs investments directed to the financial sector. These infusions were driven by the need for liquidity and prompt recapitalization in several large global banks – both domestic and foreign – to the investing funds. During the intervening period – 2010-2012 – relatively smaller deals transactions were completed with listed non-financial firms including AMD, Nova Chemicals, Daimler, Porsche, CEPSA, Frac Tech, and Siemens. SWF investment in these companies was often directed to facilitate further corporate expansion in the SWF's home country whether through the build-out of increased manufacturing capacity or to secure access to a steady supply of raw materials.

More recently, we observe sizeable SWF investments directed to large developmental projects, including townships, industrial zones, and key infrastructure, or to the development of strategic assets, such as natural resource, including extraction and refining. Many of these investments represent capital commitments that will be deployed over the coming five years, i.e. through project construction. They are typically driven by MoU signed by the state and a private company, or between two states, wherein the SWF plays key roles not only as a source of funding, but also to facilitate deal origination and structuring. Two examples will serve to illustrate.

In 2013, the largest foreign acquisitions by SWFs were two deals of $5 billion each. Both the deals involved a MoU signed between the SWF and the host national government. In the first, Mubadala signed an agreement with the Guinean government to build bauxite and an aluminum refinery in Guinea. In this deal $1 billion was earmarked to build infrastructure to extract and export bauxite, while additional $4 billion will be utilized to build an aluminum refinery and port. Similarly, QIA agreed to invest $5 billion in the Pengerang Integrated Petroleum Complex in the southern state of Johor, in Malaysia. Both transactions involve capital commitments to be made over a period of three to four years.

Focusing specifically on the largest SWF deals of 2013, of the top five, three deals where in sectors related to real estate and construction while 2 were in natural resources.

[3] See also chapter 7 on Financial Services by Patrick Schena in this Report 2014.

Table 1

Deal Concentration by Size (2013)

SWF	Target Company	Sub-Sector	US$ (Millions)
Qatar Investment Authority	Barwa's Real Estate Assets (Qatar)	Real estate - Mix	7,100
Qatar Investment Authority	Pengerang Integrated Complex Development (Malaysia)	Natural resources – Petrochemical	5,000
Mubadala Development Company	Bauxite & Aluminium infraestruture & Port (Guinea)	Natural resources & Construction	5,000
Khazanah Nasional Bhd Temasek Holdings	DUO Township (Singapore)	Real estate – Construction	3,194
GIC	Broadgate Office Complex (UK)	Real estate – Construction	2,720

Source: Fletcher SWF Transaction Database (2014).

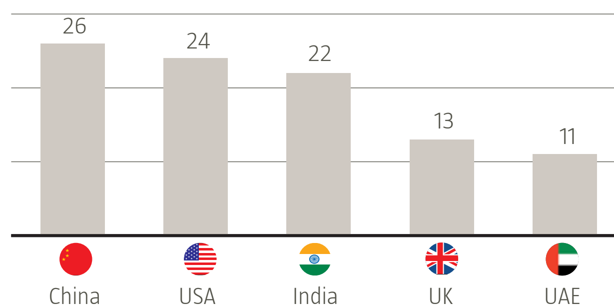
The average deal size of the top five deals in the last 5 years was approximately $3.7 billion; however, in 2013 this increased to about $4.6 billion. As many as 17 of the 25 top five annual deals since 2009 have been solo transactions. In line with this trend, three out of the top five deals of 2013 were also solo, including the largest announced, QIA's acquisition of Barwa's assets for $7.1 billion, completed through its real estate arm, Qatari Diar. Extending their tradition of active co-investment in large transactions, Temasek and Khazanah partnered to invest more than $3 billion in a township being developed in Singapore.

By fund based on number of deals completed, Temasek led the deal rankings in 2013, having completed the largest number of investments – approximately 40. It was followed by GIC with 27, Qatar Investment Authority with 20, Khazanah Nasional Bhd with 15, and China Investment Corporation with 12. Of the 67 deals completed by the two Singapore SWFs, investments in China accounted for as many as 20 deals, followed by 13 in India. By contrast, Qatar directed its attention to the Gulf-region, North America and South Asia, completing five investments in UAE and four in USA and India each. In line with their mandate, Khazanah made as many as six investments within Malaysia itself, and three investments each in Turkey and China.

Geographically, China was the target of the most deals (26) by SWFs in 2013, as followed closely by the USA and India (Chart 1). As noted, Temasek and GIC combined for 20 out of the 26 investments made in China – 14 by and 6 by GIC. Likewise, Singapore funds accounted for 12 of the 21 investments made in India. UAE made the other 9 investments in India. The US, somewhat expectedly, continued to attract the most diverse group of sovereign investors, with Singaporeans making 9 investments, followed by UAE (4), Norway (3), and one investment each from New Zealand, South Africa, Kuwait, Malaysia, and China.

Chart 1

Operations of SWFs by country in 2013



Source: Fletcher SWF Transaction Database (2014).

In Europe, Spain has been a destination for SWF investment over the last five years. While the number of investments has been limited, the deal size of each SWF investment has been relatively large on average. For example, Abu Dhabi's International Petroleum Investment Company invested twice in Spain-headquartered Compañía Española de Petróleos S. A. (CEPSA). The first investment, in 2009, involved purchase of a $4.37 billion stake in CEPSA, resulting in a 47% ownership position. In 2011, IPIC increased its holding in CEPSA by purchasing Total's stake for $5 billion. Also in 2011, now well documented, the QIA purchased a 6.1% stake in Iberdrola for about $2.8 billion. In return, Iberdrola agreed to establish a regional headquarter and a research & development unit in Qatar. In 2013, Temasek acquired a 5% stake in Spanish oil and gas giant Repsol for approximately $1.3 billion.

3. SWF Investment 2013: The Continuing Quest for Quality Deal Flow

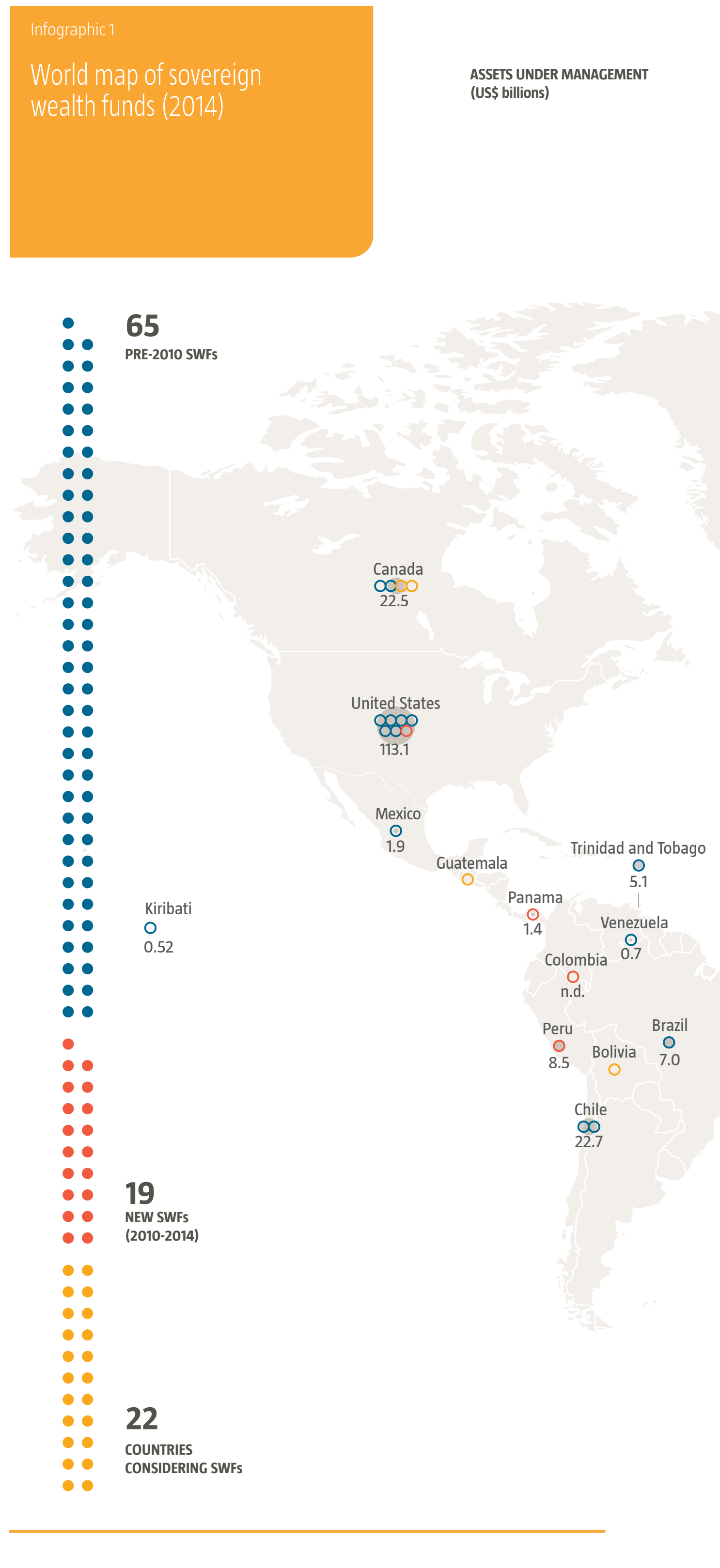
SWFs have likewise targeted Latin America for investment on a limited scale since 2009. There have been 17 identified deals in the region primarily across Brazil, Chile, Colombia, and Mexico. No clear trend emerges as a case for increased interest by SWFs in Latin America as the number of deals has varied from a few as one to as many as 7 (in 2010). In 2013, two interesting transactions of note are the team-up of Mubadala and Trafigura to invest US$ 966 million to acquire an iron-ore port – MMX Porto Sudeste - from Brazilian businessman Eike Batista and GIC's subscription to a capital increase in Aegea Saneamento e Participacoes SA, a unit of Grupo Equipav. Under the terms of the MMX Porto Sudeste deal, Trafigura will hold a 65% stake in MMX Porto Sudeste Ltda, which is currently under construction, while Mubadala will hold the remaining 35%. The GIC deal resulted in $135 million investment in the Brazilian water and sewage treatment company, which will be used to help the firm maintain its growth plans.

In 2013, of the 161 recorded deals, as many as 71 were co-investments, as SWFs partnered with other investors to form deal consortia. Over the last five years, almost 50% of the investments by count have been co-investments. As much as 65% of all partnerships are with other fund managers including private equity funds, insurance companies, and pension funds. On average, about 25% of all co-invested deals include a 'technical' partner. This trend continued in 2013, with 28% of the consortium deals having the involvement of a technical partner. SWFs will also partner directly with governments as local governments seek to attract SWF investment to their country. The previously noted Guinean government agreement with Mubadala to develop bauxite extraction and aluminum extraction capabilities is one such example. Likewise the Russian government, through Russia Direct Investment Fund, has been courting the China Investment Corporation and the Qatar Investment Authority to invest in Russian projects[4].

From a sector perspective, financial services, broadly defined, and real estate maintained their perennial lead as destination sectors for SWF investment. Out of the 49 investments in the finance sector, 11 investments were made in banks, 3 in market exchanges, 7 in insurance companies, and 22 investments were made in other investment structures, including funds and private partners such as private equity funds, REITS, etc. Such trends are much in line with SWFs investments observed over the last five years, when typically banks account for 25%, and investment funds account 40% of all investments received by finance sector. In real estate and construction we count approximately over 30 new deals; 10 out the 13 investments made in the natural resources sector were in oil, gas or coal. Lastly, investments made in the infrastructure were diversified utilities (6), power generation (2), ports (3), and transport (2).

Infographic 1

World map of sovereign wealth funds (2014)



4 Check the chapter on Spain and Latin America within this 2014 SWF Report to see more examples of these agreements between governments and SWFs.

Currently, there are 84 active sovereign wealth funds, two more than our 2013 ESADEgeo SWF Report. 55 countries have established at least one SWF. Middle East, China, Southeast Asia and Norway are the four most active centers of SWFs. Assets under management sum up to 5.86 trillion dollars. SWFs have widely spread in recent years: in the last three years 7 new funds were established and 22 countries are considering establishing one. Debates over new SWFs are growing in East and South Africa and in Latin America. Thus, in 2014, there are 105 operating or projected-SWFs.

Norway 897.6
Russia 97.62
Ireland 20.2
Kazakhstan 173.0
France 33.6
Italy 6.0
Slovenia
Mongolia n.d.
Georgia
Azerbaijan 36.6
China 1,119.8
South Korea 56.6
Japan
Tunisia
Syria n.d.
Iran 58.6
Lebanon
Israel
Kuwait 355
Palestine 0.7
Algeria 77.0
Libya 66.0
Qatar 175.0
S. Arabia 741.8
India
Oman 19
Mauritania n.d.
Senegal 1.0
Nigeria 1.0
Vietnam 0.7
Philippines
Sout. Sudan n.d.
Eq. Guinea n.d.
Bahrain 6.8
UAE 973.3
Sierra Leone
Liberia
Ghana 0.4
Uganda
Brunei 39.0
Malaysia 40.9
Kenya
Rwanda 0.03
São Tomé and Príncipe n.d.
Congo 1.7
Gabon n.d.
Indonesia n.d.
Papua New Guinea n.d.
Tanzania
East Timor 15.7
Angola 5.0
Zambia
Mozambique
Singapore 530
Mauritius n.d.
Botswana 5.1
Zimbabwe
Namibia
Australia 98.57
South Africa
New Zealand 25.51

Source: ESADEgeo SWF Tracker (2014).

3. SWF Investment 2013: The Continuing Quest for Quality Deal Flow

Global real estate focus

Elsewhere in this Report we return for a more focused look at SWF investment activity in financial services (Chapter 7). Here we will divert for a closer examination of SWF investment in real estate, which has emerged an important anchor asset class for many SWF portfolios. A closer focus on real estate in Spain involving SWFs is developed in Chapter 6.

Currently over 60% of SWFs allocate at least 5% of their portfolios to property either directly or indirectly[5]. Such patterns in asset allocation notwithstanding, it is primarily the largest SWFs who dominate led by investors in the GCC and Asia. New to this field is Norway's Government Pension Fund Global, whose mandate to deploy up to 5% of its $900 billion portfolio in global real estate, represents a sizeable overhang in global real estate markets. Such commitments reflect not only the scale of liquidity available among these investors, but also their capacity to invest over long horizons in less liquid, higher yielding assets, whose returns are less correlated with the balance of their portfolios. Market access occurs both through private real estate fund structures, as well as direct investments that include partnerships with both local and global real estate development companies. Geographically, North America and Europe, and in particular the UK, have attracted the most SWF real estate investment on the strength of asset quality. However, the pace of SWF flows into the real estate sectors of emerging economies has quickened in recent years.

Since 2006 SWF investment in global real estate markets has been dominated by 7 funds[6] that have participated in over 75% of the nearly 200 SWF transactions in the intervening period. Among these funds GIC, QIA, and Temasek have been the most active together participating in nearly 47% of the total transactions completed. NBIM, the manager of Norway's GPFG, initiated the build out of its mandate in 2011 and has dramatically expanded its scope since.

In 2013, 34 global real estate deals were completed by SWFs. The dominance of the core group - GIC, QIA, and Temasek - persisted with total deals constituting over 44% of the total. Also in 2013 GPFG established itself as an important investor in global real estate as it continued its aggressive investment program completing 5 deals or nearly 15% of the total.

As noted, SWFs have traditionally directed investment to developed markets in North America and Europe. In the US and UK alone since 2011, the portion of total SWF investment in real estate has expanded from 25% to over 40%. Interestingly, over the same period, SWFs have increased their commitment to properties in both South and Southeast Asia, where such deals have increased to over 40% of global totals. SWF geographic concentration by 2013 has therefore resulted in over 82% of all SWF investments in real estate undertaken across these four countries/regions.

Finally, with respect to market access, SWFs have exhibited flexibility by investing through both listed and unlisted structures, while the dominant SWF real estate investors also actively engage in direct transactions often in partnership with other SWFs or large institutions or with experienced property development firms. In 2013, fund or listed structures and direct commercial or office projects dominated equally, together constituting about 75% of transactions. Importantly, the volume of fund or limited partner participations appears also to have increased substantially over recent years. This is an interesting development, particularly in light of growing fee pressures on private structures and perhaps reflects a practical resolution in the trade-off between fees and capacity development among institutional investors.

As investors in this sector, SWFs certainly share the challenges of their institutional peers. Principle among these challenges today is a sizeable build up of global demand of between $350 billion and $500 billion by some estimates[7]. Similarly, the strategies they deploy are often designed to leverage potential competitive advantages to size and global reach. These include in-house capacity development to support more direct transactions, and particularly executed along side experienced local partners[8]. Several recent examples from the investment activities of SWFs in real estate will serve to illustrate.

We begin with GPFG, who has been among the most active real estate investors in the last 3 years and made its first investments in the US in 2013. For the year, GPFG returned a reported 11.8% on its real estate holdings as it continued its build out to a 5% allocation. This build-out of their continually growing portfolio will contribute directly to the above noted overhang in global real estate markets for the next several years. Karsten Kallevig, chief investment officer for real estate at NBIM has acknowledged that Norway's real estate investment program will evolve as a long-term initiative and will be challenged by the increasing growth of the overall assets of the GPFG[9].

As it builds its global portfolio, GPFG has focused on direct deals through which it could invest in scale. Its approach has to leverage the capacity and experience of local partners. In February 2013, NBIM announced a partnership with TIAA-CREF to create a joint

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[5] "Sovereign Wealth Funds Investing in Real Estate", Real Estate Spotlight, November, 2013 (Preqin); https://www.preqin.com/docs/newsletters/RE/Preqin_Real_Estate_Spotlight_November_2013.pdf

[6] The SWFs include CIC, GIC, GPFG, Istithmar World, Mubadala, QIA, and Temasek.

[7] See The Real Estate Equation: Bridging the Divide; Global to Local, Macro to Micro, PwC, October, 2013; see http://www.pwc.com/en_GX/gx/deals/swf/publications/assets/the-real-estate-equation-bridging-the-divide-global-to-local.pdf

[8] Ibid.

[9] David M. Levitt, Christopher Spillane and Jonas Bergman, "TIAA-CREF Plans More Property Deals With Norwegian Fund", Bloomberg, Feb 12, 2013; see http://www.bloomberg.com/news/2013-02-11/norway-s-wealth-fund-makes-first-u-s-real-estate-purchase.html

venture through which it will co-invest in office properties in Boston, New York and Washington. TIAA-CREF owns 50.1% and will manage the joint venture, while NBIM holds the remaining 49.9%. The partnership is rooted in a mutual focus on a long-term investment horizon and an emphasis on large, high-quality assets in gateway cities [10].

Geographically, India, among the emerging economies of South and Southeast Asia, emerged as a destination for SWF real estate investment in 2013. A key representative SWF deal is the participation of GIC, Temasek, and Oman in a real estate private equity fund launched by HDFC Property Fund, a unit of India's largest mortgage lender. This co-investment team-up will provide the three sovereign investors access to Indian real estate through the market experience of HDFC. It builds on an earlier 2010 partnership between GIC, Temasek, ADIC, and HDFC Ventures, the venture arm of HDFC that involved the acquisition of a 10% stake in a 117 floor residential tower in Mumbai, the city's tallest development [11].

Finally, we cite the Qatar Investment Authority, who has long been an active investor in global real estate markets [12]. Its experience includes both direct and indirect market access and includes active partnership with experienced local investors/developers. In 2013, Qatar Holding exercised its interest in European real estate, particularly Italy, through a strategic partnership with Hines Italia to invest in Milan's Port Nuova [13]. The project has been billed as one of the most ambitious city center mixed-use developments in Europe with a reported market value in excess of €2 billion. The central building of Porta Nuova Garibaldi, which is leased to Unicredito, is Italy's tallest structure. In the transaction, Qatar Holding will further diversify its global real estate portfolio through increased participation in the Italian real estate market, acquiring a 40% with the remaining 60% owned by the current sponsors. This transaction builds on a QIA-Hines relationship, that includes Hines partnership with Qatari Diar, the QIA's real estate development entity, to design and construct a 370-room luxury hotel -the Conrad Washington, DC- and 70,000 square feet of large-format retail space at CityCenterDC in the US capital [14].

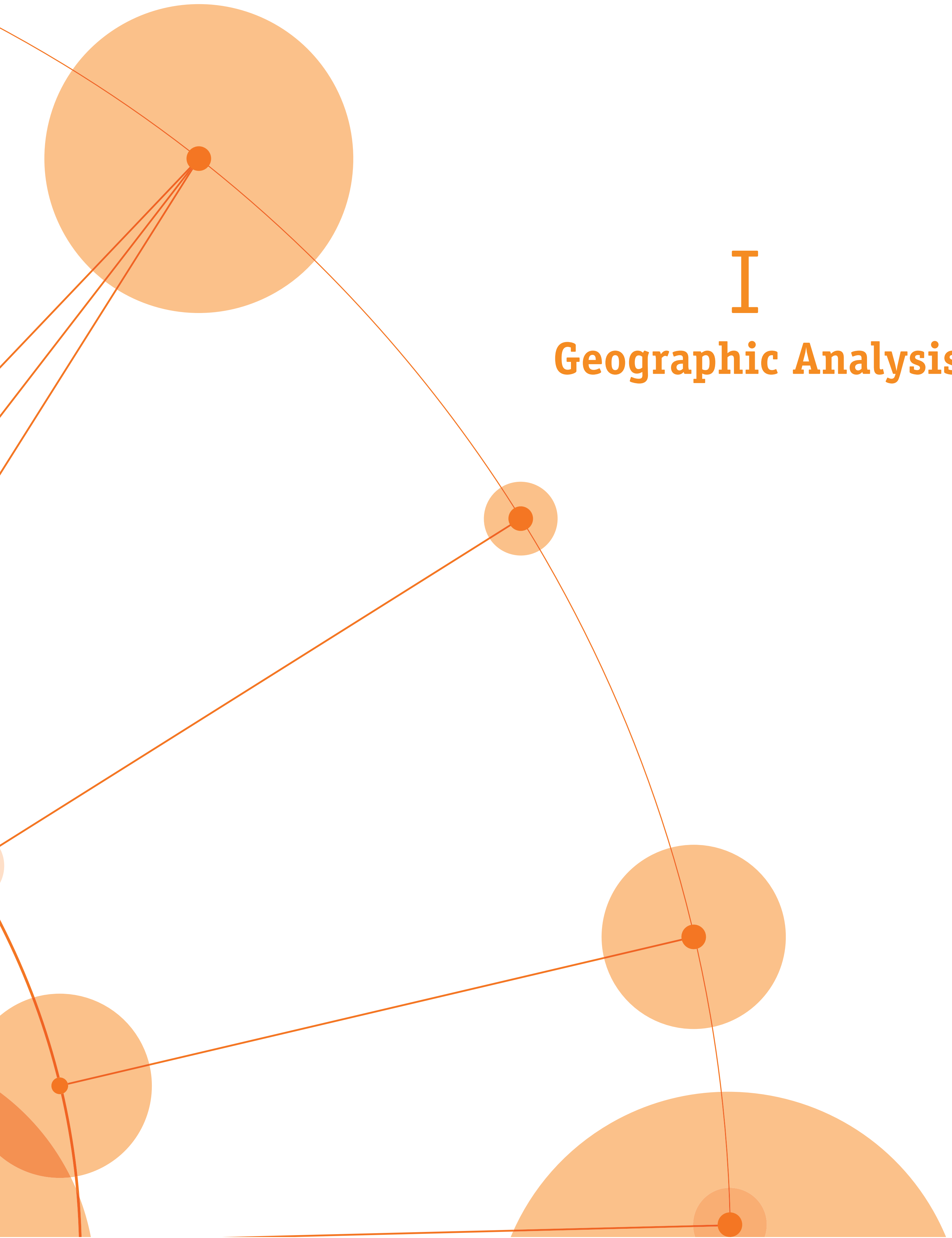
[10] See TIAA-CREF press release https://www.tiaa-cref.org/public/about/press/about_us/releases/articles/pressrelease443.html

[11] Maya Ando, "GIC, Temasek, Abu Dhabi and HDFC invest Mumbai's highest development", Asian Venture Capital Journal, 18 Aug 2010; http://www.avcj.com/avcj/news-analysis/1728403/gic-temasek-abu-dhabi-hdfc-invest-mumbais-development

[12] See Xavier Reig's "Sovereign wealth funds and real estate" in 2013 ESADEgeo SWF Report.

[13] See Hines press release at http://www.hines.com/press/releases/5-16-13.aspx

[14] See Hines press release at http://www.hines.com/press/releases/692014.aspx



I
Geographic Analysis

Javier Santiso

Professor of Economics, ESADE Business School

Vice President, ESADEgeo - Center for Global Economy and Geopolitics

Germán Ríos

Director of Strategic Affairs, CAF - Development Bank of Latin America

Sovereign wealth funds in Spain and Latin America

4. Sovereign wealth funds in Spain and Latin America

4. SOVEREIGN WEALTH FUNDS IN SPAIN AND LATIN AMERICA

Spain has not disappeared from the international investor's map. On the contrary, the crisis that battered the country between 2007 and 2014 was seen as an opportunity for many companies and investors, particularly from Latin America, to enter Europe through Spain.

First-rate investors from Mexico, Colombia and Venezuela showed interest, and took stakes in banks and businesses (such as Campofrío and Bimbo, both now Mexican-owned.) Some made their Spanish base the centre for their process of European internationalisation (such is the case of Bimbo, with headquarters in Barcelona) or internationalisation into Latin America and Asia (as in the case of IPIC, based in Madrid via CEPSA.) This confirms the attraction of Spain as a global base, a strategy we have defended previously [1].

Above all, over the past few years sovereign wealth funds' interest in investing has been confirmed. In total, between 2011 and 2014, SWFs made more than €13 billion of direct investments in Spain, 10% of total foreign investment in realassets. Prominent among the most active investors are sovereign wealth funds such as Qatar Investment Authority (through its direct investment arm Qatar Holding), IPIC and Mubadala (United Arab Emirates) and Temasek and GIC (Singapore). In the period covered by this 2013 Report, from January 2013 to mid-2014, we have identified a flow of investment into Spain and Spanish companies (equity) valued at more than €2.7 billion.

The biggest investor, however, is Norway's Government Pension Fund Global (GPFG), which holds investments on the Spanish stock exchange worth more than €7.2 billion in 2014, 15% more than the year before, spread over 73 listed companies. In the latest period analysed the data is very positive for Spain in terms of government bonds, with growth of 366% and inward investment of €3.3 billion.

In this chapter we also address the development of Latin American sovereign wealth funds and investment in Latin America and the Caribbean by sovereign wealth funds from all over the world. Given the history of trading and investment exchanges with the region, Spain can focus its attention on capturing investment from Latin American sovereign wealth funds that grew in this long commodities cycle. For example, calling attention to the equity investments of the Chilean funds, which recently revised their investment strategy, or of Trinidad and Tobago; and seeking interaction so as to receive investment in debt from the Peruvian fund and the same Chilean funds.

[1] See Javier Santiso, ***The rise of the multilatinas***, Cambridge, Cambridge University Press, 2013.

More investors also appeared in sectors that were new to them (such as the Spanish real estate sector, which Asian investors ventured into during 2013-2014). We devote a section to the property sector in our chapter on global investments and a fully-devoted chapter to real estate and SWFs in Spain.

Another phenomenon that we highlight in this chapter is the strong entry of Canadian pension funds, particularly into Spanish assets. This entry is not specific to Spain, but part of a strategy of strengthening investments in Europe, as confirmed by several Canadian funds having established regional headquarters in London over the past year.

New investment sectors for some, new players for others, the map of sovereign wealth funds and (public) pension funds is being filled in and coloured in Spain. From countries as diverse as Canada, Singapore, South Korea, Qatar and the UAE, investors are entering a wide variety of sectors. Could this represent a new opportunity for Spain?

In this chapter we sketch out a systematic strategy for promoting bilateral funds of funds in Spain (especially private equity, expansion capital and venture capital). Italy, for example, has put together bilateral funds with Kuwait and Qatar to invest in medium-size companies and provide expansion capital to help them grow in international markets, including the Middle East where their strategic partners come from. France has done the same thing with sovereign wealth funds from Qatar and the UAE.

Ireland has gone even further, setting up a bilateral technology fund, in this case co-investing with China Investment Corporation. This example, as we shall see, is particularly attractive for Spain in view of the sector (technology) and the logic: CIC provides investment to Irish start-ups seeking to expand into Asia and set up a base in China, and while also encouraging the arrival of Chinese start-ups seeking to expand into Europe and set up an operational base in Ireland.

Spain could take inspiration from its French and Italian neighbours and, above all, from the Irish, and establish similar bilateral funds of funds. It has institutions that could be counterparties: ICO (Instituto de Crédito Oficial, the state-owned credit institution), CDTI (Centro para el Desarrollo Tecnológico Industrial) and ENISA (Empresa Nacional de Innovación S.A., a state-owned enterprise for the promotion of innovation). A fund of funds could be set up (for investments in private equity, expansion capital and/or venture capital) Spain-UAE, Spain-Qatar and Spain-Kuwait, with contributions of €500 million from each counterparty (one billion for each fund, i.e. €3 billion in total). Fund of funds Spain-Singapore and Spain-Malaysia, also with contributions of €500 million from each party, i.e. two more funds of funds, each of one billion. Fund of funds Spain-South Korea and Spain-China with the same amounts of participation. €7 billion in total.

Table 1

Main investments in Spanish companies (2013-2014)

Investor	Country	Company	Stake / Assets	Amount*	Seller	Sector	Year
Vodafone	United Kingdom	Ono	100%	7,200	Risk Capital	Telecommunications	2014
Crown Holding	USA	Mivisa	100%	1,200	N+1, Mercapital and Blackstone	Industry	2013
Triton Partners	United Kingdom	Befesa	100%	1,075	Abengoa	Environment	2013
Temasek	Singapore	Repsol	5%	1,036	Treasury stock	Energy	2013
Banesco	Venezuela	Novagalicia Banco	88.33%	1,000	Frob	Banking	2013
ADO	Mexico	Avanza	100%	800	Doughty Hanson	Transport	2013
Kennedy Wilson\Värde	USA	Aliseda	51%	800	Banco Popular	Real Estate	2013
Apollo	USA	Altamira	85%	700	Banco Santander	Real Estate	2014
Scor Global Life	France	Portfolio of pure life policies	90%	630	BBVA Seguros	Insurance	2013
NTT Data	Japan	Everis	100%	559	3i, Landon and Hutton Collins	Consulting	2013
Revlon	USA	Colomer	100%	486	CVC and Familia Colomer	Cosmetics	2013
Del Valle Family	Mexico	Banco Popular	6%	450	Banco Popular	Banking	2013
IPIC	Abu Dhabi	Torre Foster	-	450	Bankia	Real Estate	2013
Carrefour	France	63 commercial centres	-	380	Klépierre	Real Estate	2013
Several funds	-	Enagás	10%	360	Liberbank and other savings banks	Energy	2013
KKR	USA	-	Debt of Uralita	320	Banks	Construction	2013
Sigma Food	Mexico	Campofrío	45%	315	Oaktree, Ballvé Family and CaixaBank	Consumption	2013
Jaime Gilinski	Colombia	Banco Sabadell	5.03%	313	Capital increase	Banking	2013
Fintech	USA\Mexico	Banco Sabadell	4.94%	306	Capital increase	Banking	2013
Fibra Uno	Mexico	-	278 branches of Banco Sabadell	300	Moor Park	Real Estate	2013
Fortress	USA	Realia debt	-	284	SAREB (Spain's "bad bank")	Real Estate	2013
Emin Capital	Andorra	Torre Agbar	-	250	Agbar	Real Estate	2013
Burlington Loan Management Limited	USA	Bermuda	Colonial Loans	245	SAREB (Spain's "bad bank")	Real Estate	2013
HNA	China	NH Hoteles	20%	234.5	Capital increase	Tourism	2013
Doughty Hanson	United Kingdom	Teknon	100%	230	Magnum Capital	Healthcare	2013
Goldman Sachs and Azora	USA\Spain	-	2,935 council flats	201.2	Ivima-CAM	Real Estate	2013
Qatari Diar	Qatar	-	Hotel W	200	FCC, OHL, Comsa Ente and Godia	Real Estate	2013
TPG	USA	Servihabitat Gestión Inmobiliaria	51%	189	La Caixa	Real Estate	2013
Baupost	USA	8 shopping centres	-	180	Vastned Retail	Real Estate	2014
AndBank	Andorra	Inversis Private Banking	-	179.8	Banca March	Banking	2013
Axa Real Estate	France	-	13 buildings belonging to the Government of Catalonia	172	Government of Catalonia	Real Estate	2013
Intu\CPPIB	UK\Canada	-	Parque Principado	162	SONAE\CBRE	Real Estate	2013
Veolia	France	Proactiva	50%	150	FCC	Environment	2013
Fortress	USA	-	2,000 residential actions	150	SAREB (Spain's "bad bank")	Real Estate	2013
Orion Capital	United Kingdom	Port of Venice	50%	144.5	British Land	Real Estate	2013
Inmosan\Davinci Capital\Masaveu	Mexico\Spain	Liberbank	14%	174	Cajasur, Caja Extremadura and Caja Cantabria	Banking	2014
			Total	**21,826**			

Source: Author's estimations and data from Expansión, 2014.

* Millions of euros.

4. Sovereign wealth funds in Spain and Latin America

These funds would be allocated to private sector private equity and venture capital companies, which would compete for the mandates. Having anchor investors from emerging countries and regions would also give them all an expansion capital dimension, towards the Middle East and South or North Asia, all high-growth regions. There could be multi-sector funds of funds and others more sector-specific or themed, for example a fund of innovation funds, or a fund of funds with a water or infrastructure theme. We would also do well to draw inspiration from what some Latin American countries have done, particularly Chile, which has created Start-Up Chile [2] with a (public) fund to attract start-ups from all over the world, encouraging the import of entrepreneurs while at the same time bringing about a real silent revolution, a change of mentality whereby nowadays young Chileans no longer aspire only to be lawyers or economists, but also entrepreneurs. The programme has put Chile on the world map of start-ups in just four years.

This economic policy should be driven at the highest level to make it really operational: obtaining and coordinating mandates, and delegated execution in the agencies already operating in the field of investment in businesses (ICO, ENISA and CDTI). Clear objectives should be pursued: supporting the internationalisation of medium-size and/or high-growth companies; focusing on added value in products and processes and, as a priority, betting on innovation and technology. The final operations would fall to private equity teams and firms from the private sector, with nationwide, not regional, mandates.

In any case, many countries have already created or are creating venture capital funds of funds or funds for investing directly in start-ups, seeking to promote innovation and technology, enterprises and entrepreneurs. In the past, Israel rolled out a successful strategy in this respect: the Yozma Programme. Today, countries such as Canada, Singapore, Lebanon, Saudi Arabia, Chile, Colombia, Brazil, Ireland and Taiwan have executed or are currently executing strategies similar to Israel's. Spain too has instruments and agencies with which to take advantage of this momentum: bilateral funds of funds would add more capacity at a critical time like the present.

Spain has to reinvent itself. The crisis has shown that the low-cost, construction- and services-based growth model is not enough to generate solid, quality employment. Betting on industrial and digital niches are two possible levers, though by no means the only ones. To this end the strengths of the economy can and must also be the starting point: if Spain is a tourism powerhouse, why not opt for creating industrial groups and digital firms specifically in this sector? The same can be said of the food and nutrition sectors, seeking to link them with added-value industrial and digital processes instead of focusing solely on the base, partly or semi-transformed product.

Spain on sovereign investors' radar

Spain has seen a marked upturn in foreign investment in recent years. In 2013 and up to mid-2014, almost €22 billion came into the country (Table 1). The sources of these investments have been highly diverse, including the United States, France, Japan, Mexico, Colombia, Qatar and Singapore.

If we look at a longer period, from the onset of the crisis in 2007 until 2014, foreign investment in Spain has been quite robust. The ten biggest transactions alone amounted to almost €133 billion of investment. They included transactions involving state-owned companies such as the acquisition of Endesa by Italy's Enel, as well as private sector ones, such as Vodafone's takeover of Airtel's Spanish operation, and, in 2014, of Ono.

Table 2

Main sales of Spanish companies (2001-2014)

Company	Buyer	Value*	Year
Endesa	Enel and Acciona	43,000	2007
Airtel	Vodafone	24,000	2001
Unión Fenosa	Gas Natural	16,700	2009
Amena	Orange	10,600	2005
Endesa	Purchase by Enel of the 25% held by Acciona	9,600	2009
Ono	Vodafone	7,200	2014
Repsol	Purchase of 20% by Sacyr	6,000	2006
Iberdrola Renewables	Iberdrola floats 20% on the stock exchange	4,400	2007
AunaCable	Ono	4,200	2005
CEPSA	IPIC (53%)	4,000	2011
CEPSA	IPIC (37%)	2,869	2009
	Total	**132,569**	

Source: Author's estimations, 2014.

* Millions of euros.

[2] A total of more than 10,000 projects were presented, from 110 countries. More than 700 start-ups from 65 countries were supported. See the report on the first four years of the programme: http://www.alejandrobarros.com/media/users/1/50369/files/4363/Reporte_Startup_Chile_2013.pdf

Table 3

Main investments of sovereign wealth funds in Spanish companies (2011-2014)

Fund	Country	Company acquired/owner	Equity stake/Assets	Amount*	Year
IPIC	UAE	CEPSA	53%	4,000	2011
Qatar Holding (QIA)	Qatar	Iberdrola	6.1%	2,000	2011
Qatar Holding (QIA)	Qatar	Santander Brazil	5.1%	1,953	2010**
Temasek	Singapore	Repsol	5%	1,036	2013
Mubadala	UAE	Sener	Joint Venture (60%)	940	2011
Qatar Holding (QIA)	Qatar	Iberdrola	2.2%	620	2012
Qatar Holding (QIA)	Qatar	Ferrovial (Heathrow Airport Holdings)	10.6%	587	2012
IPIC	UAE	Bankia	Torre Foster	450***	2013
Qatar Holding (QIA)	Qatar	Société Foncière Lyonnaise (Colonial)	22.1%	391	2014
CIC	China	Abertis	7% stake in Eutelsat	385,2	2012
CIC	China	Ferrovial (Heathrow Airport Holdings)	5.7%	319	2012
QIA	Qatar	Colonial	13.1%	239	2014
Qatari Diar (QIA)	Qatar	FCC, OHL, Comsa Ente and Godia	Hotel W	200	2013
GIC	Singapore	Applus+	6.1%	127	2014
Qatari Diar (QIA)	Qatar	Sociedad Internacional Marina Tarraco	Marina Port Tarraco	64	2011
Katara Hospitality (QIA)	Qatar	GSSG	Hotel Intercontinental	60	2014
			Total	**13,371**	

Source: Author´s calculations, 2014.

* Millions of euros.

** The fund changed the convertible bonds into shares in 2013.

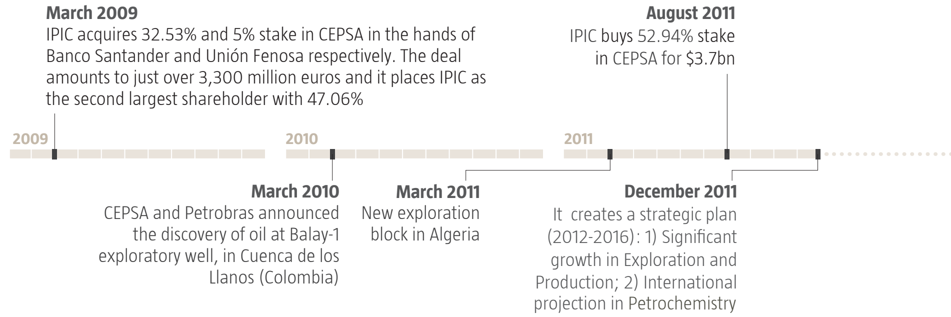
*** Value of the purchase option.

Sovereign wealth funds have remained very active in Spain and in Spanish companies. Examples are the investments by Singapore's funds Temasek and GIC in Repsol and Applus+, respectively. Moreover, Qatar's real estate transactions in Spain are on the increase: for example Qatari Diar bought Hotel W in Barcelona and Qatar Holding's new hotel arm, Katara Hospitality, acquired the Hotel Intercontinental in Madrid. For its part, IPIC, which already occupies Torre Foster in Madrid through CEPSA, holds a purchase option on the high-rise, which is one of Madrid's new iconic landmarks. Additionally, Norway's sovereign wealth fund has increased its exposure to Spain by more than $1.6 billion, to $9.99 billion. In total, in 2013 and up to mid-2014, SWFs foreign investment inward flow in Spanish companies (both portfolio or direct investments) is valued at nearly $3.65 billion.

As we have seen in previous reports, this is not a new trend. Since the onset of the financial crisis of 2007, sovereign wealth funds have shown significant interest in Spain. Between 2007 and 2014 they invested more than €13 billion in the country. Qatar has been the most active investor in terms of the number of transactions, with investments in companies such as Santander and Iberdrola, and later with acquisitions of and equity stakes in hotels, property companies and marinas. The biggest investment by a sovereign wealth fund is that of the UAE's IPIC with the acquisition of CEPSA for nearly €7 billion, in two tranches, one in 2009 and the other in 2011. Driven by IPIC, the company has thus become the group's internationalisation hub, transforming its international and sectoral presence, as we explain in Infographic 2.

Infographic 2

The metamorphosis of CEPSA



Main strategic axes

IPIC is turning the company to convert CEPSA in a global energy player.

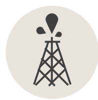
Reconversion

Technological and commercial synergies

New markets

Activities

After IPIC completed acquistion of 100% of CEPSA in 2011, CEPSA has struck out in a new direction with the intention of achieving a strong global growth, focused on Exploration and Production, and Petrochemistry business units.

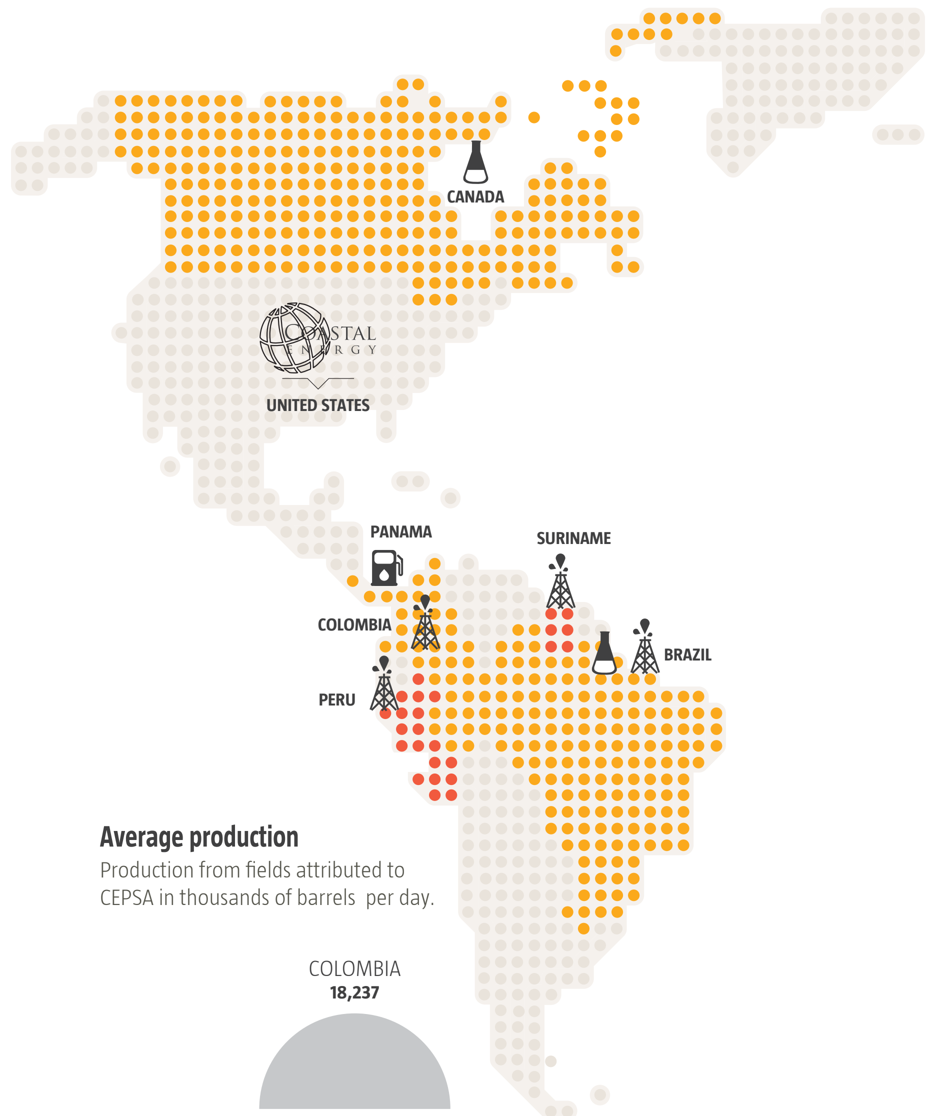

Exploration and production

Petrochemistry

Marketing

Refining

Gas and electricity



Average production

Production from fields attributed to CEPSA in thousands of barrels per day.

Source: based on annual reports of the companies (2014).

April 2012
Cepsa buys to Chevron the entirety of its subsidiary in Spain. Cepsa and Gran Tierra Energy find oil in Casanare (Colombia)

2012

Two new exploration blocks in Brazil

October 2013
CEPSA establishes its HQ at the Foster Tower in Madrid with a purchase option exercisable in 2016

2013

November 2013
It buys for 1,631 million euros the U.S. company Coastal Energy

December 2013
New exploration block in Surinam

2014

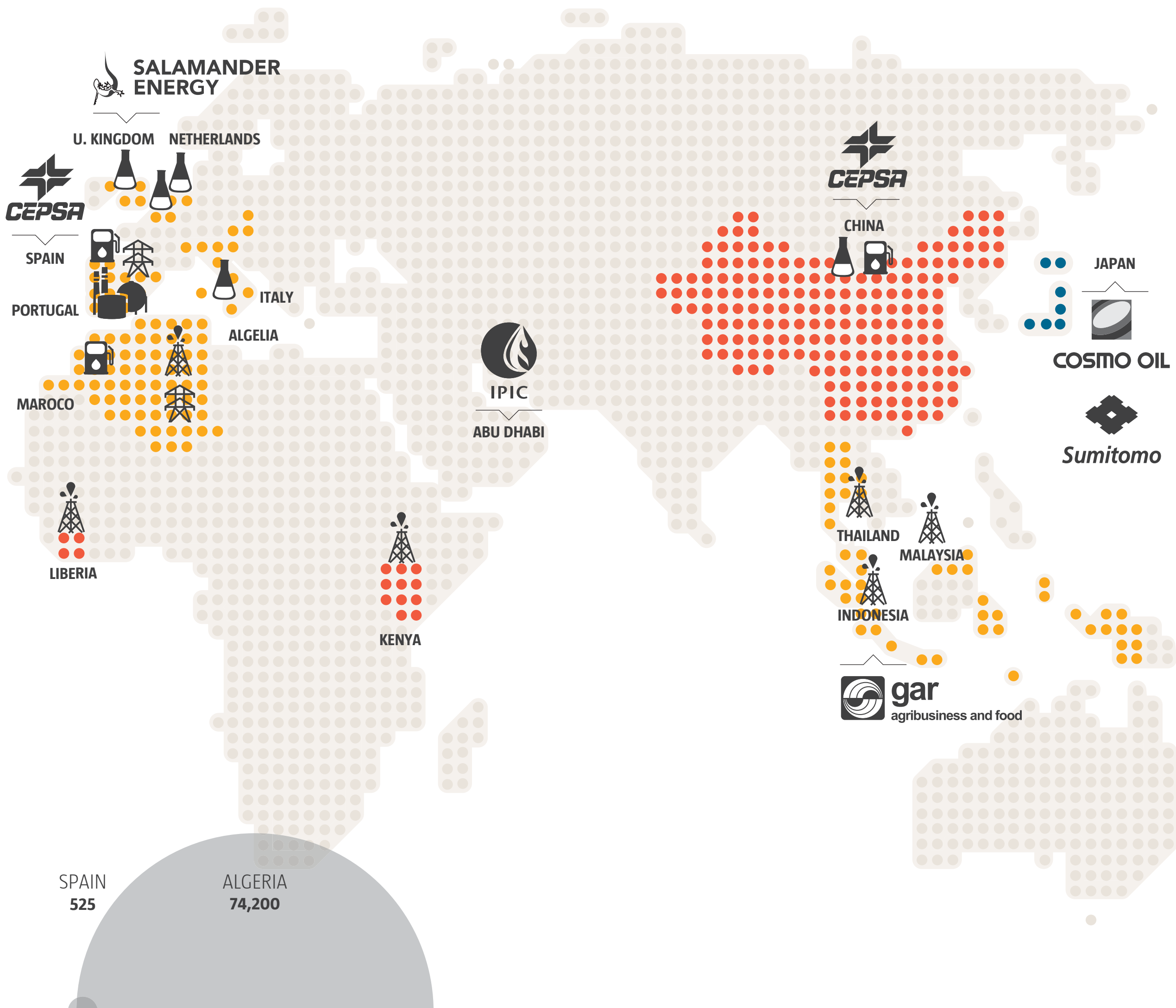
January 2014
CEPSA and COSMO sign a cooperation agreement. In addition, it comes up with some positive results when drilling into his first well in Peru

February 2014
CEPSA buys 55% of an exploration block in Kenya. It begins the marketing of lubricants in China

April 2014
The Japanese Sumitomo buys 25% stake in CEPSA Química China. CEPSA purchases 30% of an exploration block in Liberia

May 2014
CEPSA is considering a public takeover of 700 million euros for the company Salamander Energy

July 2014
CEPSA and GAR agree to create a Joint Venture for the production of Industrial alcohols



4. Sovereign wealth funds in Spain and Latin America

The funds' investments have followed several different strategies. Some, such as GIC's 2014 investment in Applus+, are purely financial equity stakes. Others, however, seek strategic synergies beyond financial returns, as we shall see in the case of IPIC with the acquisition of CEPSA, or with Temasek's stake in Repsol. The investments made by these funds in Spanish companies with a view to entering Latin American markets also deserve special attention. For example, Qatar's investments in Iberdrola and Santander.

Another piece of good news from 2013 is the recovery of Norway's investment in Spanish debt. Last year we announced that the Norwegian fund (GPFG) had reduced its exposure to Spanish debt by nearly 70%, to €712 million. By the end of 2013, the trend had completely changed. GPFG had more than €3.3 billion of Spanish sovereign debt in its portfolio. The increase, in euros, relative to 2012, was a substantial 366%. Whereas in 2012 Spain fell to 40th position in fixed income, in 2013 it was back among the Norwegian giant's leading recipients of the investments in fixed income, in 12th place, ahead of Canada, Russia and Switzerland.

Table 4

The Norwegian sovereign wealth fund is renewing its commitment to Spain and Spanish companies

Investment	2013	2012	2013/2012
Fixed Income	9,814	7,862	24.80%
Central Government Debt	3,323	712	366.70%
Equities	7,257	6,297	15.20%
Total*	20,394	14,871	**37.10%**

Source: Author's elaboration, based on NBIM data, 2014.

* Millions of euros.

Sovereign wealth funds pounce on bricks and mortar

Sovereign wealth funds' interest in the real estate sector was confirmed in 2013 and 2014 (see chapter devoted to this sector in the report). Between 2013 and 2014, the biggest property sales totalled more than €3 billion. One of the biggest transactions was the purchase of the Hotel W in Barcelona by Qatari Diar, for €200 million, another being the lease with purchase option of the Torre Foster in Madrid by IPIC, for €450 million, although the option has not yet been exercised. As shown in Table 5, investments in the sector increased notably in the past two years, and the sovereign wealth funds formed part of the trend. For the first time in recent years, Spain's real estate sector is perceived as a premium investment, something that in Europe was hitherto mainly the preserve of the UK and France, with London and Paris as magnets for these investors in search of top-grade assets.

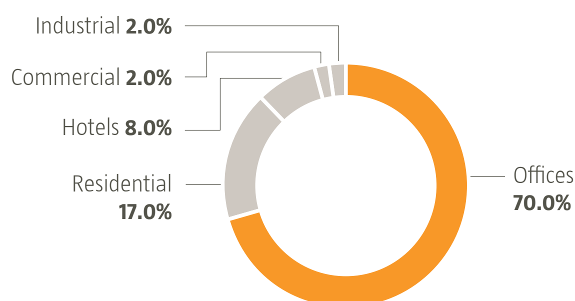
Europe is a priority real estate sector destination for Asian investors. Prominent among the most active investors are Malaysia's Permodalan Nasional Berhad, China's Gingko Capital and Australia's AMP Capital. Sovereign wealth funds such as the Hong Kong Monetary Authority, Korea Investment Corporation, China Investment Corporation and Singapore's GIC have also made inroads.

These transactions are part of the general return of foreign investors to the Spanish property market. Asian investors stand out in this segment, having invested in both offices and residential properties and hotels (see Chart 1).

Asian investment in the sector is not an entirely new phenomenon. IBM's Madrid headquarters, purchased by Morgan Stanley in 2006 for €240 million and now in the sights of Mexican magnate Carlos Slim, had been owned by Singapore's GIC since 2000. In that year it apparently paid €180 million under a sale and lease-back arrangement.

Chart 1

Asian sovereign wealth funds swoop on the Spanish real estate sector



Source: Prepared by authors, 2014.

Added to these transactions are those carried out in 2014 by the Qatar Investment Authority in Colonial and in its French subsidiary Société Foncière Lyonnaise (SFL). In the case of Colonial, QIA took part in the Spanish property company's capital increase in April, and initially took a 3.7% equity stake, increasing it a few weeks later to 13.1% (worth around €239 million), becoming the company's second biggest shareholder after the Villar Mir Group. Colombia's Santo Domingo group and Andorra's Morabank accompanied QIA, and also took advantage of the capital increase to take 7.5% and 7% shareholdings respectively in Colonial.

Table 5

Biggest property sales (2012-2014)

Assets	Buyer	Seller	Value*	Year
Torre Foster**	**IPIC**	Bankia	450	2013
278 branch offices of Sabadell	Fibra Uno Fund	Moor Park	300	2013
Colonial Loans	Burlington Loan Management Limited	SAREB (Spain's "bad bank")	245	2013
2,935 council homes	Goldman Sachs and Azora	Ivima	201	2013
NPLs	Lone Star, Fortress and Cerberus	Banco Santander	200	2012
Hotel W	**Qatari Diar**	FCC, OHL, Comsa Ente and Godia	200	2013
Servihabitat (51%)	TPG	CaixaBank	185	2013
13 public buildings	Axa Real Estate	Government of Catalonia	172	2013
Parque Principado	Intu\CPPIB	Sonoae/CBRE	162	2013
Port of Venice	Orion Capital	British Land	145	2013
Castellana 200	**PSP Investments**	Reyal Urbis/Financial institutions	140	2014
1,860 social housing units	Blackstone	Madrid City Hall	129	2013
115 Avenida de América	London & Regional	Banco Sabadell	117	2014
1,000 flats	Baupost Group	BBVA	100	2013
Centro Comercial Plaza Cataluña 23	IVA Capital Partners	El Corte Inglés	100	2013
Cartera Toro	HIG Capital	SAREB (Spain's "bad bank")	100	2013
Bankia Habitat	Cerberus	Bankia	90	2013
Edificio Banesco	Pontegadea	SAREB (Spain's "bad bank")	66	2014
Hotel Intercontinental	**Qatar Investment Authority**	GSSG	60	2014
Dorian Portfolio	Blackstone	SAREB (Spain's "bad bank")	42	2014
		Total	**3,204**	

Source: Author's estimations and data from El País, 2014.

* Millions of euros.

** Purchase option.

4. Sovereign wealth funds in Spain and Latin America

Infographic 3

The international expansion of public funds

- Operational headquarters
- Upcoming opening

SOVEREIGN WEALTH FUNDS

Logo	Fund
KIC	Korea Investment Corporation
	Kuwait Investment Authority
	China Investment Corporation
NORGES BANK INVESTMENT MANAGEMENT	Norges Bank Investment Management
GIC	Government of Singapore Investment Corp.
TEMASEK	Temasek
KHAZANAH NASIONAL	Khazanah Nasional Berhad
QATARI DIAR	Qatari Diar

CANADIAN PENSION FUNDS

Logo	Fund
TEACHERS' PENSION PLAN ONTARIO	Ontario Teachers Pension Plan
CPP INVESTMENT BOARD	Canada Pension Plan Investment Board
AIMCo	Alberta Investment Manag. Corp.
	Caisse de Depot et Placement du Quebec
OMERS	Ontario Municipal Employees Retirement Syst.

Source: ESADEgeo (2014).

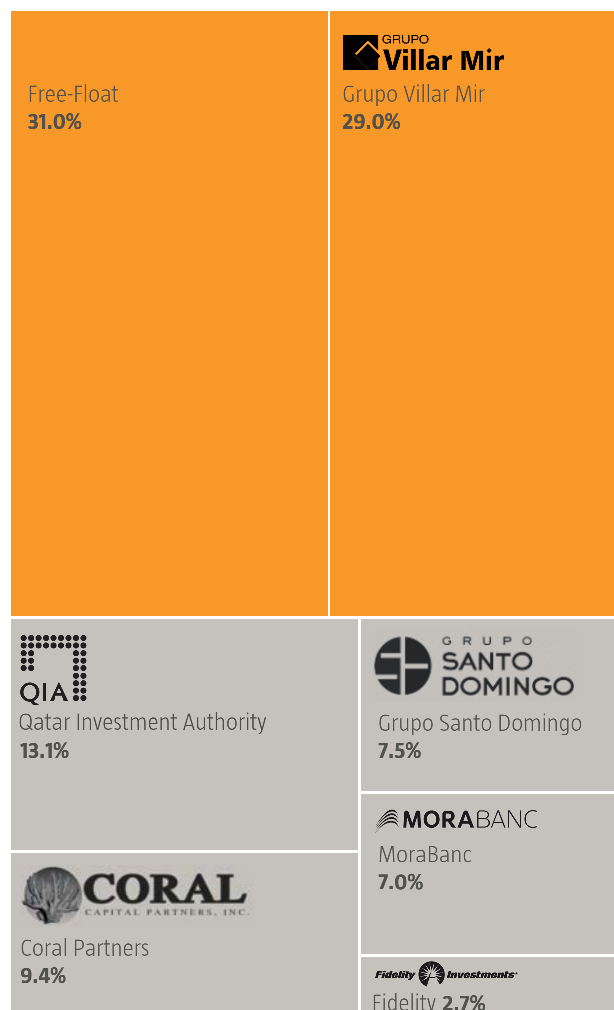
KIC
NORGES BANK
GIC
TEMASEK
AIMCo
TEACHERS' PENSION PLAN
CPP INVESTMENT BOARD
OMERS
London
NORGES BANK
Oslo
Istanbul
Damascus
Cairo
Kuwait
Lusail
Dushanbe
Tangier
Nouakchott
Khartoum
Sana'a
Mumbai
Chennai
GIC
TEMASEK
TEMASEK
GIC
TEMASEK
KIC
Beijing
KIC
GIC
Seoul
Tokyo
Shanghai
GIC
TEMASEK
Hanoi
Hong Kong
TEMASEK
Saigon
NORGES BANK
GIC
TEMASEK
TEACHERS' PENSION PLAN
CPP INVESTMENT BOARD
Kuala Lumpur
Singapore
NORGES BANK
GIC
TEMASEK

The Qatari fund's entry into SFL, in which Colonial holds a 53.1% stake, was carried out at the same time as its entry into the parent company. Qatar Holding, a subsidiary of QIA, took advantage of Royal Bank of Scotland's exit from the shareholding of SFL to take an 8.5% stake valued at some €152 million. Months later, as in the case of Colonial, Qatar Holding boosted its stake in SFL, acquiring an additional 13.6% for €239 million. As a result, Qatar Holding became SFL's second biggest shareholder, with 22.1%, ahead of French bank Crédit Agricole, which also raised its stake in the company from 5% to 12.3%. SFL has a portfolio of prime office buildings located in the centre of Paris, valued at some €4 billion.

In 2012, Qatari Diar, the real estate arm of QIA, had already disbursed €64 million for Tarragona's luxury yacht marina Port Tarraco. Qatar also invested €78.5 million in acquiring Barcelona's Hotel Renaissance, through another fund linked to the Qatari armed forces. Qatar has a very substantial presence in Spain, a high-profile example being Qatar Airways' agreement with FC Barcelona, whereby it will inject €96 million between now and 2016.

Chart 2

Shareholding of Colonial following the entry of QIA



Source: Prepared by authors, 2014.

Chart 3

Shareholding of Société Foncière Lyonnaise following the entry of QIA

Source: Prepared by authors, 2014.

New players: Canada's pension funds

In the past few years some new players have appeared on the Spanish investor scene: pension funds, many of them public, from Canada. (For a fuller analysis of this type of investment, see Chapter 6 devoted to North American public funds in this report).

Canada's pension funds are among the World's biggest: the top four total nearly $700 billion in assets under management. In total, Canadian pension funds hold almost a trillion dollars in AUM, slightly less than Spain's GDP in 2013. Although the bulk of investments are made in fixed income and equities, the alternative investment component has grown steadily in the past few years, from 13% in 2002 to more than 23% in 2012. Ontario's fund has even established a subsidiary (OMERS Ventures) entirely dedicated to investments in expansion capital and venture capital.

Table 6

Main Canadian Pension Funds

Fund	Assets*	Region	Established
Canada Pension Plan Investment Board (CPPIB)	201.5	Federal	1997
Caisse de Dépôt et Placement du Québec	200.1	Quebec	1965
Ontario Teachers' Pension Plan (OTPP)	140.8	Ontario	1917
British Columbia Investment Management Corporation (bcIMC)	102.8	British Columbia	1999
Public Sector Pension Investment Board (PSP Investments)	76.1	Federal	1999
Alberta Investment Management Corporation (AIMCo)	68.6	Alberta	2008
Ontario Municipal Employees' Retirement System (OMERS)	65.1	Ontario	1962
Healthcare of Ontario Pension Plan (HOOPP)	51.6	Ontario	1960
Ontario Pension Board (PSPP)	18.7	Ontario	1920
OPSEU Pension Trust (OPTrust)	16	Ontario	1995
New Brunswick Investment Management Corporation (NBIMC)	10.1	New Brunswick	1996
Alberta Pensions Services Corporation	4.7	Alberta	1995
Healthcare Employees' Pension Plan (HEPP)	4.5	Manitoba	1997
Nova Scotia Pension Services Corporation	4.5	Nova Scotia	2013
Total	**965.1**		

Source: Author's elaboration, based on funds' annual reports, 2014.

*$ billions.

In 2013, several of them opened offices in London to promote their European investments. This is a general trend of pension funds, also shared by sovereign wealth funds: opening international offices in order to be closer to the markets in which they operate and to have access to more and better deal flows [3].

Europe has become one of the main destinations for Canadian pension fund investments. At the end of 2013, the national fund CPPIB had 16% of its total assets invested in Europe, OTPP more than 28% and AIMCo more than 11.5%. They all now have European offices based in London. Infographic 3 shows a complete map about where SWFs' and pension funds' are leading their expansion and set up offices around the World.

Spain and Spanish companies' assets also stimulated these funds' appetites for investment. For example, Heathrow Airport Holdings, majority held by Ferrovial, has two pension funds among its shareholders, one of them Canadian, the Caisse de Dépôt et Placement du Québec, and the UK's Universities Superannuation Scheme. Moreover, as we showed in the last report, Heathrow Airport Holdings also has three sovereign wealth funds as shareholders.

Table 7

Main investments of Canadian pension funds in Spanish companies (2010-2014)

Fund	Company acquired/owner	Equity stake/Assets	Amount*	Year
PSP Investments	Hochtief AirPort (ACS)	100%	1,100	2013
CPPIB	Cintra Ferrovial	10% of 407 ETR	640	2010
OTPP	Leighton Holdings (ACS)	70% of NextGen, Metronode and Infoplex	500	2013
PSP Investments	Isolux Infrastructure	Capital increase	500	2012
CPPIB	Dorna	39%	400	2012
CPPIB	-	Parque Principado	162	2013
PSP Investments	CLH	5%	111	2013
OPTrust	Globalvía	Recapitalisation	100	2013
		Total	**3,513**	

Source Author's elaboration, 2014.

* Millions of euros.

Chart 4

Shareholding of Heathrow Airport Holdings

ferrovial
Ferrovial
25.0%

Caisse de dépôt et placement du Québec
13.3%

Qatar Holding
20.0%

China Investment Corportión
10.0%

Government of Singapore
11.9%

Alinda Airports
11.2%

Universities Superannuation Scheme
8.7%

Source: Prepared by authors, 2014.

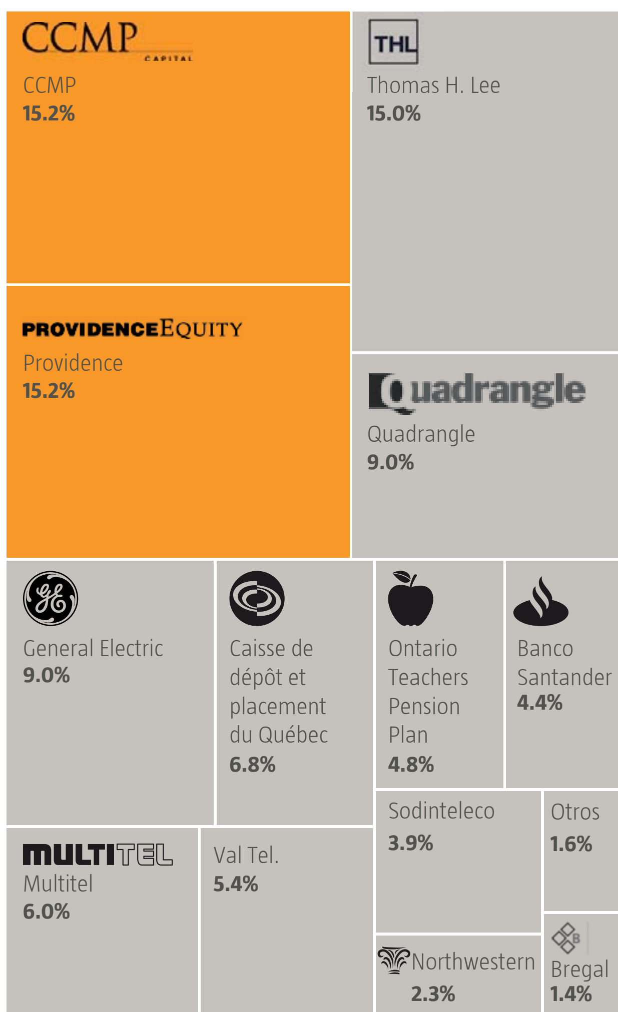
Between 2010 and 2014 Canadian pension funds' investments increased substantially. In 2013 PSP Investments bought the airports unit of Hochtief, a subsidiary of ACS, for more than €1.1 billion. CPPIB invested more than €600 million in Cintra Ferrovial, acquiring a 10% stake in the Toronto ring road. As the following table shows, although transactions were few and far between in 2010 and 2012, they increased substantially in 2013.

[3] In Europe, London is the location ***par excellence***, see Ashby Monk ***et al***. «Getting closer to the action: Why pension and sovereign funds are expanding geographically», Stanford University, Global Projects Center, 2014. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2380277.

Spanish investments generated high returns, as demonstrated by the 2014 deal in which ONO was acquired by UK telecoms operator Vodafone. ONO was 11.6% held by two Canadian funds, the Caisse de Dépôt et Placement du Québec and the OTPP.

Chart 5

Main shareholders of ONO following before the entry of Vodafone



Source: Prepared by authors, 2014.

Strategic investments versus financial investments

The 2013-14 was particularly interesting, with the return of some veteran players (Canadian pension funds) and renewed interest in forgotten sectors (real estate). It was also interesting in that it fuelled the debate about strategic assets (of host countries such as Spain) and investment motives (of home countries' funds).

Some investments have followed purely financial logic, such as Singapore's sovereign wealth fund GIC's stake in Applus+, the Barcelona-based Spanish certification firm that went public in 2014. GIC entered the company taking a 6% shareholding, a significant stake that demonstrates sovereign wealth funds' appetite for investing in listed Spanish companies.

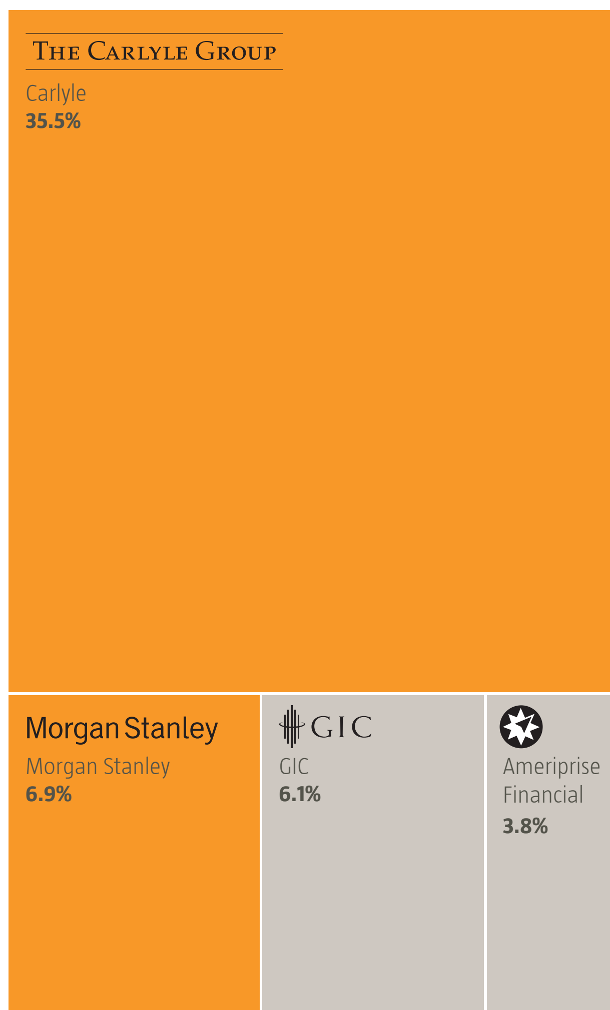
The deal involving Deoleo generated far more controversy. It was held by a large number of savings banks and banks related to savings banks. (The main shareholder was the rescued Bankia, with 16.5% of the capital). Deoleo became a very important focus of attention in 2014. Its former owners disposed of stakes equivalent to more than 31%, favouring the entry of UK private equity fund CVC.

The Spanish government reiterated on several occasions its wish to keep the company in Spain, amid fears that it would pass to Italian control. Deoleo, world leader in the olive oil market, attracted the interest of several private equity funds, but above all the Italian sovereign wealth fund Fondo Strategico Italiano (FSI), which expressed interest in bidding together with Qatar Holding.

Italy is the world's leading exporter of olive oil (and Spain's direct competitor). For its part, Deoleo is the owner of renowned Italian olive oil brands such as Bertolli, Carapelli and Sasso. The episode rang alarm bells about the possible loss of a «strategic asset» to a direct competitor. And yet no such concern was seen regarding the acquisition of Campofrío by Mexican and Chinese investors, another transaction in the food sector. In the end the company was sold to UK private equity fund CVC, which took control of it in April 2014.

Chart 6

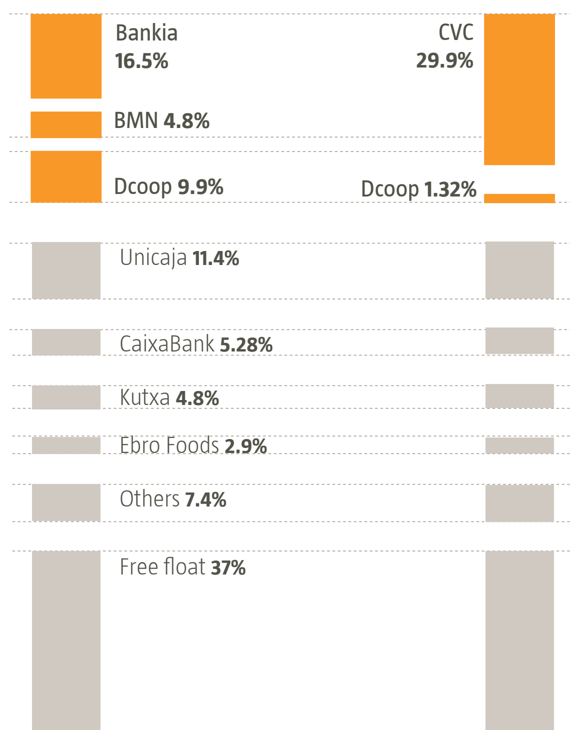
Major shareholders of Applus+



Source: Prepared by authors, 2014.

Chart 7

Shareholding of Deoleo following the entry of CVC



Source: Prepared by authors, 2014.

The Deoleo episode underlines the growing role of the sovereign wealth funds as strategic funds too. Attention focused on a primary sector (vegetable oils) representing barely 0.8% of Spain's total exports, albeit highly symbolic, perhaps more from a political than an economic point of view.

Spain is the world's leading producer of olive oil, but more than a third of its exports go to Italy, in the form of low added value bulk oil. In Italy, they increase the value of the raw material, they build brands and supply oils at higher margins when they are re-exported to other markets. Just as Spain has managed to move up the value chain in the wine sector (another transformed raw material), so work remains to be done in the olive oil sector.

It is possible that this valorisation will now come from the new British owners. Indeed, olive oil is considered a luxury product in the UK. Moving up the value chain should be the aim of all Spanish industries, something that iconic companies in the sector such as Osborne are doing for example in the field of Iberian AOC (designation of origin)-labelled ham. Interestingly, Osborne was established by English settlers in Cadiz and Jerez in the nineteenth century, and now it is allied, as a symbol of the new times, with Fosun, China's leading private industrial conglomerate.

Despite the worldwide success of brands such as Zara, Massimo Dutti, Pull&Bear (Inditex), Mango and Desigual, there are also cases such as the bags made in the workshops of Ubrique, with top-quality material and craftsmanship but subsequently sold by French or Italian brands. In all these sectors, the main Spanish brands were transferred to foreign banners, be it Loewe in the luxury goods sector (now French) or Campofrío in food (now Chinese and Mexican). We clearly have a long way to go before «Made in Spain» is a globally recognised quality standard. And not just among our European neighbours, but also in the most remote emerging countries such as Mexico, Brazil and China.

A strategic fund for Spain?

Spain lacks the usual resources that nourish sovereign wealth funds (generally raw materials such as oil, natural gas or copper) and so proposing a sovereign wealth fund for Spain may be considered somewhat paradoxical. However, Spain has public financing instruments that could be reinvented.

The ICO played an important role in providing financial «oxygenation» for many businesses throughout the 2007-2014 crisis. But above all it did something that deserves special attention: it created and promoted a fund of funds for private equity and venture capital. With €1.2 billion of capital, this fund of funds has played a fundamental role in fuelling and reactivating the dormant alternative investment market and in particular investment in innovation, i.e. venture capital [4].

In 2013 and 2014 several competitive bidding processes were carried out to capitalise the venture capital funds. This enabled fourteen teams to consolidate or be created and to become a driving force in Spain's entrepreneurial ecosystem. Although in 2010 the volume of venture capital in Spain represented barely €2 of investment per inhabitant (compared with $70 in the US, or $140 in Israel), by 2014 this figure had more than doubled. Admittedly there is still a long way to go, but here as in other countries few would expect to adopt an interventionist stance, such as Chile, Israel or Singapore, the state's involvement has been decisive. Such is the case of Israel, where the funds of funds strategy also allows private

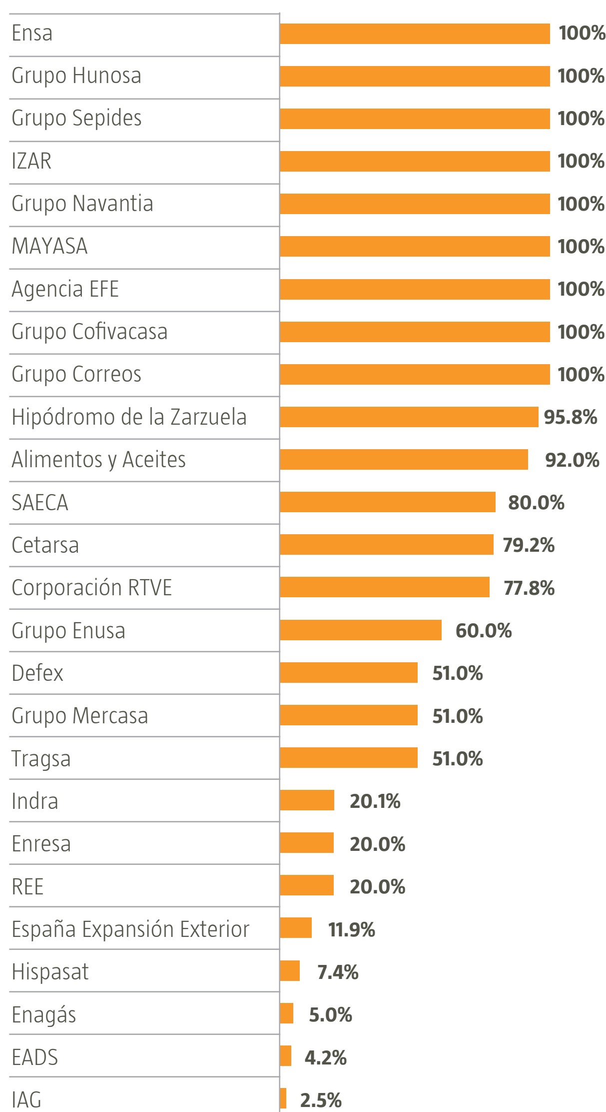
[4] On FOND-ICO see: http://www.ico.es/web/ico/fond-ico-global.

rather than public initiative to be promoted and driven so that it can lead investments in search of returns, income and value creation.

Funds of funds such as Amerigo were also promoted during the crisis, via CDTI and ENISA. Driven in Spain by Telefónica, it had the decisive support of the CDTI -with equal contributions of €50 million [5]- and enabled two venture capital funds to be formed in the country, one of them completely new. These initiatives, led by the CDTI, ENISA and the ICO, allowed Spain to start consolidating itself as a focus of attention in the start-up ecosystems. Much remains to be done, but who would have thought, when the crisis burst, that Spanish start-ups would raise tens of millions of euros in capital, as Scytl did in 2014, from American and English international investors?

Looking to the future, the funds of funds of the ICO, CDTI and ENISA constitute a triptych to consolidate, perhaps with some adjustments, but the heading seems appropriate if the objective is to achieve a more innovative 'Spain 3.0'.

At the time, Sociedad Española de Participaciones Industriales (SEPI) also played an important and sometimes controversial role. This is another public entity with financial capacity that could take a fresh look at its strategy. SEPI still holds a portfolio of highly disparate companies. Some of them are remarkable, such as the now small minority stakes in airlines (IAG), the space and aviation sector (Hispasat and EADS), communications (RTVE, EFE and Correos) and more recently the technology sector, headed by Indra, in which SEPI has a 20% stake. All these sectors are high added value, and some face significant challenges by way of transformation and innovation. In any case, all point towards a 3.0 country.



Source: Prepared by authors, 2014.

[5] In 2013, Global Corporate Venturing recognised Amerigo for this public-private, open innovation approach focused on Europe and Latin America.

Bilateral sovereign wealth funds?

As we have commented, both Italy and France have reached investment agreements with sovereign wealth funds to invest in their countries' companies. Admittedly these agreements do not yet have any real effect on their economies, being more precisely expressions of intention to co-invest rather than actual investments. Nevertheless, they open the door to possible collaborations in Spain which would be extremely attractive: with the creation of bilateral funds.

One could imagine the ICO setting up a fund together with a co-investor from the Middle East, the CDTI doing likewise with a partner from South-east Asia and ENISA with one from North Asia (South Korea might be a good partner). They would establish funds of funds which would also seek to mobilise smart capital. In other words, not only would they contribute capital but also expansion capital to regions where we need to open up new markets, specifically Asia.

Thus, one could think in terms of a bilateral Spain-Qatar (or Spain-UAE) fund of funds, for medium-size companies with annual sales of between €100 million and €5 billion. The fund would contribute capital, but also the ability to provide international support in the Middle East through a major local investor. A bilateral Spain-Singapore (or Spain-Korea) fund of funds, also for companies of the same type, would provide expansion capital for South (or North) Asia.

Italy uses its sovereign wealth fund, Fondo Strategico Italiano, with $6 billion under management, to establish relations with other sovereign wealth funds (so far with Qatar, Kuwait and Russia, apart from its historical country linkage with Libya and its Libyan Investment Autority) and to strengthen the financing of Italian companies [6]. In the case of Qatar, the agreement, signed in March 2013 as a joint venture agreement, established a new company (IQ Made in Italy) jointly managed by Qatar Holding and the FSI, to invest in sectors linked to «Made in Italy»: brands, furniture and design, food and tourism. Each partner contributed €1 billion.

In the case of Russia, as part of the 2013 bilateral Italy-Russia meeting, the FSI signed an agreement to commit €1 billion (€500 million each) for investment in enterprises and projects favouring greater economic cooperation between Italy and Russia.

Relations with Kuwait provide an additional push in this direction. Signed in July 2014, the co-investment agreement involved the incorporation of a new investment company (FSI Investimenti) with assets valued at nearly €2.19 billion [7]. Among the assets that FSI transferred to this new company were notably its equity holdings in Metroweb Italia (optic fibre), Kedrion Group (bio-pharmaceuticals), Valvitalia (equipment) and, above all, IQ Made in Italy. Thus, the new joint venture created with Qatar is included under the umbrella of FSI Investimenti, in which Kuwait holds a stake. As well as the assets contributed by the FSI (totalling €1,185 million), each partner committed to contribute a further €500 million. The company's capital is 77% held by FSI, with KIA holding the remaining 23%. FSI Investimenti has exactly the same investment mission as its parent FSI, although it excludes companies in the alcoholic drinks and gambling segments, given KIA's presence.

We should point out that, in spite of the figures, in the majority of cases these are still commitments to invest that have not yet materialised in deals. Nonetheless, the objective is clear, as is the need, so the transactions will shortly increase. Italy has a limited fabric of medium-size companies. It has barely 1,400 companies selling more than €200 million a year, compared with more than 3,000 in France and over 5,000 in Germany. Like Spain, it needs more companies of this size, and it needs them to then grow bigger. It comes as no surprise to find that Italy accounts for barely 5% of European private equity whereas its economy represents 18% of the EU total [8]. Thus, these agreements with Qatar, Kuwait and Russia could cover these shortfalls in non-bank financing suffered by Italian companies seeking to grow.

France too has set up a bilateral fund. In 2013, together with Qatar, it set up a fund similar to the Italian one, a €300 million vehicle designed to invest in medium-sized French companies. France was a pioneer among OECD countries in this respect when in 2009 it put together a co-investment fund between the Fonds Stratégique d'Investissement as the French sovereign wealth was then called (now Banque Publique d'Investissement), and Mubadala, one of Abu Dhabi's sovereign wealth funds. The fund, with $150 million in assets, focuses on added-value investments, technology, biotechnology and renewable energy sources. Mubadala has already built up some experience in this field with the creation of similar funds to invest in Russia: two private equity funds in 2010 ($100 million) and 2013 ($900 million); and a co-investment fund with the Russian government for $2 billion.

Ireland is a particularly interesting case for Spain, in that it has gone even further, establishing a bilateral fund to play on rapid-growth technology start-ups. Created in 2014, the fund has two (private) managers and two promoters, the Irish and Chinese governments. With a total of $100 million, the China Ireland Technology Capital Fund seeks to invest in Irish start-ups (which are also seeking to expand into Asia and could use China as an entry-point) and in

[6] See the list of agreements and JVs at http://www.fondostrategico.it/en/joint-venture/joint-venture.html
[7] See https://www.zawya.com/story/Italys_FSI_and_Kuwaits_KIA_create_investment_firm_with_USD298bn_in_assets-TR20140701nL6N0PC6OKX2/

[8] On the venture capital ecosystem in Italy, see Valerio Vacca's study «Financing innovation in Italy: an analysis of venture capital and private equity in Italy», Banca d'Italia, Occasional Papers, October 2013. Available at: http://www.bancaditalia.it/studiricerche/convegni/atti/innovation-in-Italy/Vacca.pdf

Chinese start-ups (which are also seeking to expand into Europe and could use Ireland as an entry-point). The Irish government, via the National Pension Reserve Fund (about to be replaced), contributed $50 million, and the Chinese government, through China Investment Corporation (CIC), contributed another $50 million [9].

Many countries are pushing «sovereign» funds in order to promote their entrepreneurial ecosystems, favouring local investment [10]. For example, Canada recently created a fund of $300 million to promote investments in start-ups (Northleaf Venture Catalyst Fund [11]), by means of investments in venture capital funds and/or directly in start-ups. One year earlier, Lebanon, through its central bank, launched a fund of up to $400 million to invest in start-ups. China for its part is seeking to expand into Palo Alto, investing $400 million in American start-ups since 2012 via WestSummit Capital. The latest country to implement a public fund dedicated to venture capital and start-ups is Taiwan, whose National Development Fund has mobilised up to $400 million for this sector. The fund will co-invest with venture capital investors up to a maximum of 40% of the shares of the selected start-ups.

«Traditional» sovereign wealth funds are increasingly betting on technology and innovation in their investments. In 2013-2014, we have again observed this trend in investment in technology start-ups (as we anticipated in the special chapter of the 2013 Report on Sovereign Wealth Funds).

Temasek continues to be the most active sovereign wealth fund in start-ups. In 2013 it paid $500 million for a 10% stake in financial information services provider Markit. Markit was listed on the NASDAQ stock exchange in 2014. Together with China's Alibaba, Temasek also invested more than $100 million in TutorGroup, a language-education start-up. This company is headquartered in Asia, its R&D centre is in Silicon Valley and it has 2,000 teachers in 30 countries and students in more than 40. In 2014 Temasek also invested in a round of more than $10 million in Singaporean start-up GrabTaxi, established by two Harvard students from Malaysia, and took part in a round of $30 million to invest in Mydala, an Indian start-up.

Temasek's investments in 2013-2014 also include stakes in financing rounds for start-ups such as Krux ($35 million), Snapdeal ($10 million), Jasper ($50 million, FirstCry ($15 million), 21Vianet ($100 million) and Cloudary ($110 million). In 2014, Temasek invested $100 million in Vertex, the venture capital arm of the sovereign wealth fund, in order to invest more in start-ups, particularly in Singapore. Singapore's other sovereign wealth fund, GIC, is also now becoming involved in investments in start-ups, even in emerging markets. It has invested in Brazil's Netshoes, together with Temasek and other investors, in a round of $170 million. In mid-2014 it also took part in a round of $1 billion in Flipkart, an Indian start-up.

In these kinds of investments, too, sovereign wealth funds are increasingly collaborating, creating formal alliances to invest in companies in the expansion phases. Thus, in 2012, two sovereign wealth funds, the New Zealand Superannuation Fund and the Abu Dhabi Investment Authority, and a Canadian pension fund, Alberta Investment Management Corporation, created the «Innovation Alliance» to invest jointly in businesses supported by the best venture capital funds. Investments vary between $100 million and $200 million per company, with a total fund of $1 billion (to carry out between 5 and 10 investments) [12].

Moreover, these alliances in investment in early phases (venture capital) form part of a wider alliance: the sovereign wealth funds are increasing co-investments, as we have identified in our «trends chapter» before, while at the same time creating common vehicles [13]. Whereas in the mid 2000s they made the bulk of investments in private equity alone, by 2010 the trend was co-investment, whether through private equity funds or with other sovereign wealth funds that set up teams specialising in this field, especially in these past ten years. Temasek, for example, has created a whole series of private equity country funds with local players: in 2005 it promoted a $150 million fund with Troika Dialog (for investments in Russia); in 2012, a $1.9 billion fund with Pavillon Capital (to invest in China); and another of nearly $250 million with Dymon (for Asia); in 2013 it entered Latin America together with other investors with a $450 million fund called Oro Negro. Nor did it forget Africa, with the $300 million Tana Africa Fund being created in 2011.

Creating bilateral sovereign wealth funds would enable Spanish companies to boost their penetration of those emerging regions, as Osborne and NH have done thanks to their alliances with foreign (in this case Chinese) investors. It would also allow the size of Spanish companies to be consolidated. We need more start-ups - high-growth, technology-based businesses, whether biotech, clean energy or new technologies, in particular digital and/or digital-industrial. But we also need our companies, in whatever sector, to be able to grow, in size, in revenues, employees and in profits, and

[9] See http://www.finance.gov.ie/news-centre/press-releases/nprf-and-china's-cic-establish-100-million-china-ireland-technology

[10] An interesting study by the MIT shows that the closer a venture capital fund is to its investee, the greater the transfer of knowledge and support. See Xavier Giroud et al. «The impact of venture capital monitoring: Evidence from a natural experiment», MIT Sloan School of Management, February 2013. See http://www.mit.edu/~xgiroud/VC.pdf

[11] See http://www.fin.gc.ca/n14/14-007-eng.asp

[12] See Ashby Monk et al. «The Valley of opportunity: rethinking venture capital for long term investors», Stanford University, February 2014. See http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2391005

[13] See Josh Lerner and Lily Eang, «The Disintermediation of Financial Markets: Direct Investing in Private Equity», Harvard University and NBER; INSEAD and Victoria Ivashina Harvard University and NBER, 2014. On co-investments see also: https://www.preqin.com/docs/newsletters/pe/Preqin_PESL_Mar_14_Co_Investments.pdf

to that end we need them to internationalise and innovate. The sooner the better; and the more far-reaching the better, too.

Strategic partners for international expansion

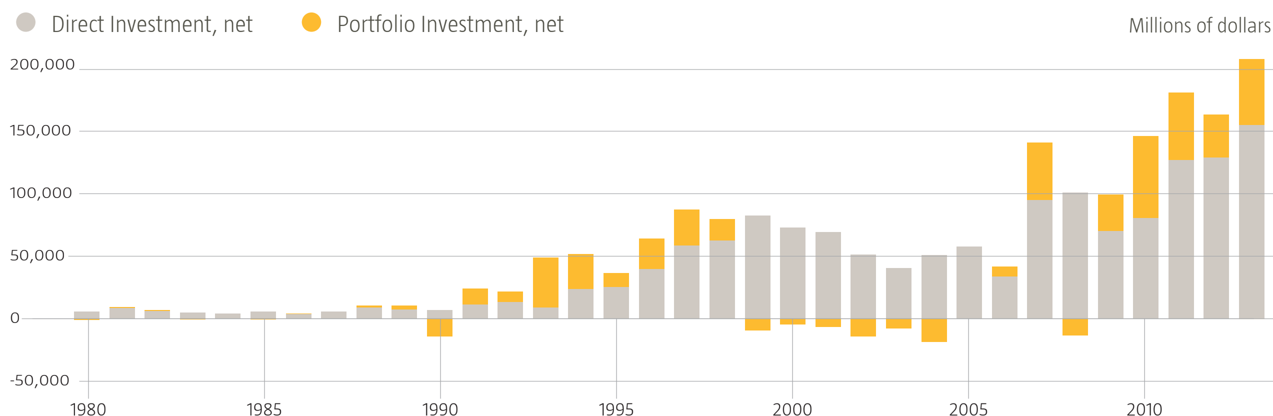
Sovereign wealth funds' stakes sometimes work in favour of Spanish companies. An interesting example is that of Abertis, which in 2014 embarked on a major offensive in Australia. The Spanish company tendered for Queensland Motorways, a concession valued at some €4 billion. On this occasion Abertis was accompanied in its bidding by some heavyweight partners, Australia's Hastings Funds Management, the Dutch pension fund APG and the Kuwaiti sovereign wealth fund KIA. For its part, Abertis' rival (led by a local consortium which eventually won the concession) also tendered together with other investors, one of which was another sovereign wealth fund, ADIA.

In 2014, FCC also made its mark in Qatar, with a €500 million contract for the construction of the Doha metro. It had previously also won the contract to build the Riyadh metro. Other companies such as Acciona, Abengoa and Indra also managed to consolidate stable relationships with sovereign wealth funds and investors in the region, although these did not always materialise in the form of equity stakes or financing schemes like that of Abertis in Australia.

In any case it is interesting to see how global transactions are increasingly configured with industrial operators allied directly with sovereign wealth funds, proof that SWFs are carrying out more and more direct investment transactions (not just through funds of funds or third-party funds). In the case of Spain it also provides access to long-term financing, with banks increasingly being replaced by this type of investor.

Chart 9

Flow of foreign capital by type (1980-2013)



Source: IMF, 2014.

4. Sovereign wealth funds in Spain and Latin America

In many African and Latin American, not to mention Asian, countries, we are likely to see more transactions of this kind. Having financial and strategic teams that handle not just the financial but also the industrial dimension and the operational business proposition will be increasingly decisive for the major IBEX companies. Some are achieving notable transactions, as we have seen (Iberdrola, Repsol and Abertis), but they are still the exception. Many markets still remain to be explored: in Africa, to mention just one continent, numerous and powerful sovereign wealth funds and quasi-SWFs are springing up.

In Angola, for example, oil represents more than 97% of exports and 80% of the country's revenues. Angola now has its own sovereign wealth fund. The same applies to Nigeria, currently the continent's biggest economy, with a GDP still behind Norway's but already ahead of Belgium's. In South Africa, the Public Investment Corporation already has more than $150 billion under management. Today it is Africa's biggest asset manager, a hundred-year-old institution with a structure, strategy and functioning of which more closely resemble those of the major Canadian or US public pension funds than those of the sovereign wealth funds. It recently started to expand outside the country, carrying out investments in Nigeria ($290 million invested in Nigerian cement works Dangote, the biggest transaction of 2013 on the Nigerian stock exchange). In 2010 it took the decision to invest 10% of its assets outside South Africa. Half of the $15 billion went into global investment funds such as BlackRock, the other half went to other African countries.

Botswana, for its part, has set up a similar fund, the Botswana Public Officers Pension Fund (it also has a sovereign wealth fund handled by the Central Bank, Pula Fund) which already has more than $4 billion under management, with 60% invested outside the country. Further north, the Revenue Regulation Fund of Algeria has more than $77 billion in assets, more than Libya's SWF ($65 billion), the Pula Fund of Botswana, the Fundo Soberano of Angola ($5 million), or that of Nigeria ($1 billion). And of all of them have great growth potential in terms of assets under management which will place them among the biggest in the world in a couple of decades.

In all these cases (Angola, Nigeria, South Africa, Botswana and Algeria), the infrastructure needs should also inspire future alliances similar to those of Abertis in Australia. This could also go hand in hand with Spanish companies taking root in Africa, where they currently have very little presence. The same could be done in Asia, together with sovereign wealth funds from Malaysia, Singapore or South Korea, this being another region where Spain's business presence is rather lacking. To these countries we could also add Indonesia, another major emerging country that is considering setting up a sovereign wealth fund.

Business diplomacy could find a priority here: focusing on countries, particularly emerging ones, with sovereign wealth funds that could partner Spanish companies (perhaps turning, as in the past, to the new head of state and royal family). This action should be coordinated, i.e. under Spanish government auspices, so as to avoid any contradictory or confusing signals and thus maximise the impact and benefit for the country as a whole.

Sovereign wealth funds' investments in Latin America.

Latin America has become an attractive region for foreign investment, both portfolio and direct. This is mainly due to the past few years of economic growth, accompanied by the expansion of the middle class, greater regional macroeconomic stability, increased opportunities offered by the traditional natural resource sectors and new developments in the areas of infrastructure, manufacturing and technology. In fact, flows of foreign direct investment went from $33.82 billion in 2006 to $154.68 billion in 2013, while flows of portfolio investment increased from $8.18 billion to $53.05 billion during the same period (see Chart 9). There is clearly enormous investor interest in such dynamic regions as Latin America, and the sovereign wealth funds are no exception.

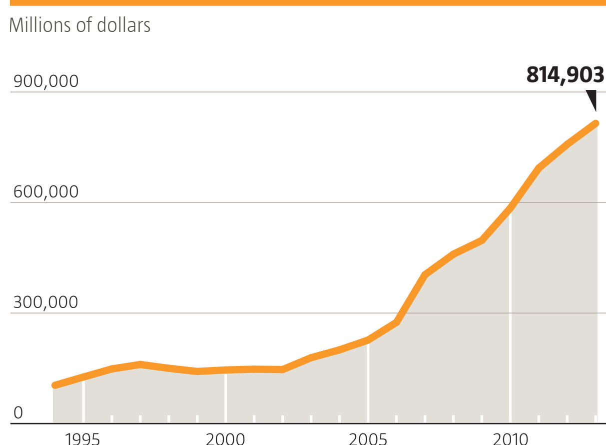
Other interesting phenomena seen in Latin America are the significant financial savings and the increases in foreign exchange reserves in most countries, thanks to the substantial price increases of the main raw materials exported by the region. Part of the surplus savings has been channelled into creating new savings mechanisms. Thus, Latin America's foreign exchange reserves grew from $146.63 billion in 2002 to $814.90 billion in 2013 (see Chart 10). As well as reflecting the strength of the region's balance of trade, several countries have decided to establish mechanisms to channel savings from the positive external shock due to the increase in commodity prices. One of these mechanisms consists in establishing their own sovereign wealth funds.

While it is true that the region has had significant achievements, such as greater macroeconomic stability and progress on the reform agenda, there still remain significant challenges for development, especially at the microeconomic level. Two of the most pressing problems to be overcome are low productivity and the gap in infrastructure. It is estimated that Latin America invests about 3% of its GDP in infrastructure, and that this is only half of what is needed to close the gap and maintain the pace of economic growth. Available public funds and multilateral financing are not enough to attain this objective, so the private sector's participation is essential. Sovereign wealth funds can play a fundamental role in providing the necessary financing to take on many of the infrastructure projects that the region requires in order to clear bottlenecks and promote regional integration. Furthermore, as we explained in the 2013 report, sovereign wealth funds can serve as «anchor investors» for other institutional investors and co-invest in very large projects.

Chart 10

Changes in Latin American and Caribbean foreign exchange reserves (1994-2013)

Millions of dollars



Source: IAD and CAF, 2014.

Recent sovereign wealth fund activity in Latin America.

In this section we briefly describe the main activities of some of the sovereign wealth funds that are active in the region. In 2013, the Norway's GPFG showed confidence in the region's good performance, investing in 71 new Latin American companies. In this way it consolidated its stock of investments in more than 338 companies and maintained in portfolio more than 150 different types of bonds issued by 42 companies operating in Latin America. We should point out that the market value of its assets in the region grew by 26%, reaching $21.2 billion. This fund has been very active in Colombia, where it invested $800 million, and in Mexico, where its position in sovereign debt amounts to $5.39 billion.

For its part, Singapore's GIC, which recently made changes to its investment strategy, focusing on long-term growth factors to manage its investment portfolio; it has 4% of its portfolio invested in Latin America, an amount equivalent to $12.4 billion. This fund has positioned itself mainly in Brazil, where it holds significant investments in companies operating in a wide variety of sectors (see Table 8).

Table 8

GIC´s holdings in Brazilian companies

Company	Stake	Country	Type
Linx SA	5.02%	Brazil	Technology/Communications
BRF SA	4.40%	Brazil	Food processing
CETIP SA	4.00%	Brazil	Clearing house
Aliansce Shopping Centers SA	5.90%	Brazil	Development and management of shopping centres
Direcional Engenharia SA	5.00%	Brazil	Development and construction of properties and buildings

Source: Bloomberg and ESADEgeo 2013.

* Millions of dollars.

This fund recently invested $135 million in Brazil's Aegea Saneamiento e Participações SA, which is involved in water and sanitation, and it is also the leader in the $170 million investment in Netshoes, a manufacturer that sells sports articles online. Other participants in this investment were Temasek Holdings, another Singapore sovereign wealth fund, Tiger Global Management, Iconiq Capital and Kszed Ventures.

Temasek, through its new investments and by revaluing existing ones, increased its consolidated position in the region, reaching $3.43 billion in 2013, compared with $1.58 billion at the end of 2012. These investments were made in a variety of sectors, such as energy, technology, industry and transport, etc. (see table 9).

Table 9

Recent investments by Temasek Holdings

Company	Investment	Country
Integradora de Servicios Petroleros Oro Negro	126	Mexico
Hidrovias do Brasil	20	Brazil
Amyris Biotechnologies	20	Brazil

Source: Bloomberg y ESADEgeo 2013.

* Millions of dollars.

We would also highlight the investment made in 2012 in Banco Bajío, Mexico's eighth biggest bank at the time. Another transaction worth mentioning was Temasek Holdings' participation in the $86 million capital increase of Virgin Mobile Latinoamérica, which

operates in Chile and Colombia and which, through this investment, plans to expand to Brazil and Mexico.

The Alaska Permanent Fund is another major fund that has increased its positions in the region. In 2013 it already dedicated 4% of its investments to Latin America, equivalent to $1.9 billion. Another active fund, in this case a pension fund, is the Canada Pension Plan Investment Board (CPPIB), which opened an office in São Paulo to seek attractive investment opportunities in the region. This fund has a stock of investments in Latin America of nearly $4.6 billion, mainly concentrated in real estate and infrastructure. CPPIB has been very active, participating in the capital of both public and private companies. For example it recently invested in the Peruvian company Transportadora de Gas del Perú S.A.

Latin American and Caribbean sovereign wealth funds

Latin America has not only consolidated itself as an attractive region for capturing investments by the world's biggest sovereign wealth funds, as reflected both in the increase in positions in the region and the growing number of transactions carried out, but we should also highlight the significant number of Latin American countries that have allocated resources to their own sovereign wealth funds or to creating new funds [14].

The strategy used varies from country to country, with different objectives in each case, but in general their mission is stabilisation, given their dependency on raw materials and the volatility of commodity prices. They also pursue an objective of inter-generational wealth transfer, or at least endeavour to ensure that there are national savings with which to face negative external shocks. Sovereign wealth funds can also function as a mechanism for handling the effects of new capital inflows on domestic currency markets, complementing other measures used previously such as accumulating reserves or imposing taxes to control capital inflows.

As part of its strategy to preserve its macroeconomic stability, Colombia recently approved a series of tax measures, including the creation of a sovereign wealth fund. This fund will receive resources from royalties obtained from the oil and mining sector. The objective of this fund is to avoid the negative effects of excessive capital inflows that might cause the currency to appreciate, making the country's industry less competitive through the phenomenon of «Dutch disease». It is estimated that this fund will save in the order of $2 billion in resources a year.

Panama created its Fondo de Ahorro de Panamá, with the objective of serving as a long-term savings mechanism for the Panamanian State and to be used in situations of economic recession or natural disasters. This sovereign wealth fund has resources that come from the total assets transferred from the Fondo Fiduciario para el Desarrollo (or Fiduciary Fund for Development, for approximately $1.3 billion), as well as the contributions of the Panama Canal Authority to the National Treasury, which are more than 3.5% of this year's GDP, plus the inheritances, legacies and donations corresponding by law.

[14] See Javier Capapé and Javier Santiso (2014), Latin American Linkages, in Global Public Investor, 2014 (London: OMFIF).

Mexico, for its part plans to create a new instrument this year, called Fondo Mexicano para la Estabilización y el Desarrollo (Mexican Fund for Stabilisation and Development), to administer oil revenues more transparently and effectively. Within the extensive programme of reforms undertaken by the country, the application of this instrument will contribute to preserving national macroeconomic stability, ensuring financial discipline by limiting the dependence of public finances on oil revenues, ensuring benefits for future generations and safeguarding a source of resources for the development of national infrastructure.

Lastly, the Chilean funds are undergoing significant changes in their investment policies. As we announced in the 2013 Report, Chile has revised its funds' benchmarks. The year before, only the Fondo de Reservas de Pensiones had included a percentage of investment in equities. This year, the Fondo de Estabilización Económica y Social also opened up the possibility of investing in equities: up to 7.5% of its portfolio may now be invested in foreign equities. These changes in investment policies show the dynamic nature of sovereign wealth funds, which, far from being static organisations, evolve and adapt to their environment.

Table 10

Latin American and Caribbean Sovereign Wealth Funds

Ranking	Country	Name of Fund	Assets*	Year established	Source
1	Chile	Fondo de Estabilización Económica y Social	15,419	2007	Copper
2	Peru	Fondo de Estabilización Fiscal	8,600	1999	Non-Commodities
3	Chile	Fondo de Reserva de Pensiones	7,400	2006	Copper
4	Brazil	Fondo Soberano de Brasil	6,600	2008	Non-Commodities
5	Mexico	Fondo de Estabilización de Ingresos Petroleros	6,000	2000	Oil
6	Trinidad and Tobago	Heritage and Stabilization Fund	4,700	2000	Oil
7	Venezuela**	Fondo de Estabilización Macroeconómica	1,800	1998	Oil
8	Panama	Fondo de Ahorro de Panamá	1,300	2012	Non-Commodities
9	Colombia	Fondo de Estabilización Petrolera	0.7	1993	Oil

Source: ESADEgeo (2013 and 2014).

* Millions of dollars.

** Estimate by Miguel Octavio's blog on the Venezuelan economy.

The virtues of sovereign wealth funds

In conclusion, we may highlight a few more attractions and even virtues that sovereign wealth funds are, in some cases, bringing to Spain and could bring to Latin America, too. It is not merely a question of capital. although this is their main contribution, but also capital that allows and helps companies to gain a foothold in emerging regions, where they will need to expand if they want to continue (or start) growing and aspire to greater size. Spain has barely a hundred companies with annual sales of more than €1 billion.

The presence of the Norway fund in the capital of more than 70 listed Spanish companies is helping to improve the corporate governance of orthodox capitalism, case by case or potentially. As more and more institutional investors appear (such as Norway, Canada, or others from the English-speaking world like Australia or New Zealand) previously automatic validations of director appointments, compensation or corporate practices, which used to be carried out in private, among friends, are increasingly becoming an uncertain and open exercise, subjected to the scrutiny of ever more sophisticated investors.

Make no mistake: with close to $900 billion under management, Norway's sovereign wealth fund is not just the World's biggest, but also one of the most sophisticated and most determined to improve corporate governance practices. The increasing presence of this type of fund in the Spanish economy can only be good news: it confirms the attractiveness of the country's companies and of Spain in general; but it also brings with it hidden benefits, over and above the influx of capital: increased pressure on listed companies to improve their corporate practices.

If we want a Spain 3.0, also more modern in its corporate practices, perhaps we should applaud and do more to encourage the arrival of these institutional investors. Beyond that, maybe we need to think seriously about rolling out co-investment strategies with them, in particular to promote investments as an alternative to the bank financing on which Spain and its companies have depended so much in the past few decades.

Table 11

Norway's GPFG: an active shareholder for the companies listed in the Ibex-35

Company	Holding (%)	Agenda Items of the Annual General Meetings on which it voted against
Abengoa	3.16	Re-election of directors and capital increase excluding the preferential right to subscribe.
Abertis	0.72	Re-election of directors and Report on remuneration.
Acciona	1.29	Share allocation plan and Remuneration Report.
Acerinox	1.85	Re-election of directors and Report on remuneration.
ACS	1.12	Remuneration Report.
Atresmedia	0.72	Remuneration Report.
Bankia	0.30	Board of Director's conduct of business from 1 January to 25 May 2012. Capital increase and issue of other instruments excluding shareholders' preferential right to subscribe.
Bankinter	1.52	Re-election of directors.
BME	1.89	Re-election of directors.
B. Popular	1.15	Re-election of directors and issue of instruments excluding shareholders' preferential right to subscribe.
CaixaBank	0.53	Ratification of the appointment of directors by co-optation. Capital increase and issue of other instruments excluding shareholders' preferential right to subscribe.
Ebro Foods	1.67	Ratification of the appointment of a director by co-optation.
Endesa	0.24	Re-election of directors and Report on remuneration.
FCC	0.81	Remuneration Report.
Ferrovial	2.17	Re-election of a director and share-based remuneration for senior management.
Gas Natural	0.87	Re-election of directors and Report on remuneration.
Grifols	1.08	Remuneration Report.
Indra	2.98	Re-election of directors.
Mapfre	0.99	Re-election of directors. Remuneration Report. Capital increase without preferential right to subscribe.
OHL	1.94	Inclusion of executive directors in the share incentive scheme.
Prisa	0.89	Capital increase and issue of other instruments excluding shareholders' preferential right to subscribe.
Repsol	1.24	Re-election of directors and Report on remuneration.
Sacyr	0.94	Re-election of directors. Remuneration Report. Remuneration received by the executive board in 2012.
Santander	1.70	Re-election of directors.
T. Reunidas	1.61	Appointment of auditor and report on remuneration.
Telefónica	1.78	Re-election of directors and issue of instruments excluding shareholders' preferential right to subscribe.

Source: In-house, with data from NBIM and Expansión, 2014.

Javier Capapé

PhD Candidate, ESADE Business School and Researcher, ESADEgeo-Center for Global Economy and Geopolitics

Tomás Guerrero

PhD Candidate, Universidad Carlos III and Researcher, ESADEgeo-Center for Global Economy and Geopolitics

Equity investments of Norway´s GPFG: A European sovereign wealth fund for Europe

5. Equity investments of the Norway's GPFG: A European sovereign wealth fund for Europe

The Norway Government Pension Fund Global (GPFG) is the World's biggest sovereign wealth fund. Managed by an investment unit of the central bank (NBIM) it counts with $900 billion under management. To give you some sense of the size of the Fund, it owns 1.3% of all World's listed companies. In this chapter we show the origins of the fund. We also explain something very important: why the GPFG, despite having the word "pension" in its name, is not a pension fund. We analyse the investment model peculiar to the Norwegian fund (already being referred to as the 'Norway model') and we compare it with the better-known Yale model. Our analysis of the equity fund's portfolio from 1998 to 2014 is one of a kind: the first time the fund's investments have been analysed from its inception at microeconomic (company) level and also at sector, country and continent level. The analysis reveals a fundamental bias: The GPFG is a European fund for Europe. The fund has taken a deliberate decision to give preference to investments in European companies and to penalise stakes in North American, especially US, companies. The chapter also addresses matters such as the governance of the fund, its investments in the BRICS, how its Spanish investments have evolved and its presence in tax havens.

History of the world's biggest sovereign wealth fund

In 1990, the Norwegian government established a fiscal policy instrument to improve the long-term management of the revenues from its abundant oil resources: the Petroleum Fund.

Its establishment was the result of years of deliberations in the *Storting* (Norwegian parliament). These deliberations had started in 1974 when the Minister of Finance presented the parliamentary report "*The role of petroleum activity in Norwegian society*", which posited different uses for the country's oil wealth, and ended in 1983 with the Tempo Committee's approval of Report NOU 1983:27, which proposed the creation of a fund in which the government would be able to store the profits arising from the exploitation of the oil resources and spend only the real profitability deriving from them.

Following its establishment, the fund received its first transfer of capital from the Ministry of Finance in 1996. Until 1997, its investment strategy was the same as that of the Norwegian central bank with its foreign currency reserves. The fund, which at that time managed $20 billion, was invested entirely in fixed income.

In 1997, following a gruelling parliamentary debate, the Ministry of Finance redefined the fund's investment strategy and decided to invest 40% of its assets in equities. Consequently, on 1 January 1998 Norges Bank Investment Management (NBIM) was established to manage the fund under the supervision of the Ministry of Finance. In that first year it made 7,851 investments, most of them in the US (2,265), Japan (1,363) and the UK (454).

In the period from 2000 to 2008, higher oil prices led to more and bigger transfers of capital from the Ministry of Finance, causing the fund to grow more than expected (from $44 billion to $322 billion). During this period the fund also changed its name to Government Pension Fund Global (GPFG), and the Ministry of Finance decided to increase the weight of equities in the portfolio by 20% to 60%.

In 2009 the fund's ethical standards were evaluated, investments in equities reached 60% of the portfolio in June, and the fund published a return of 25.6%, a record at the time.

In the past four years the fund has reoriented its investment strategy, taking in more sophisticated assets and emerging market equities. In 2010 it introduced a mandate for the fund to be allowed to invest up to 5% in the real estate sector[1], and in 2012 the Ministry of Finance announced a plan to gradually reduce its European exposure to 40% and increase investments in emerging markets to 10%. The fund recently took a further step in its strategy of diversification by announcing that it would allocate around 1% to investments in frontier markets[2] such as Nigeria and Pakistan. This is aimed not only at diversifying the portfolio, but also at generating greater returns in the coming years.

Clarification: The Government Pension Fund Global is NOT a pension fund

In 2006 the fund changed its name to Government Pension Fund Global. With this change the Norwegian government was hinting at the fund's possible role in a future characterised by an ageing population: defraying the increased costs of public pensions. And yet despite the change of name and the declaration of intent implicit therein, the fund has never operated as a pension fund.

Unlike the traditional pension funds, such as those of Canada or Japan, the GPFG has no pension obligations. In fact the Norwegian government has not yet taken any decision on how to finance its existing pension commitments. It has not even decided the date from which the fund can be used to cover the costs arising from future pensions. This, together with the limitations on the Norwegian executive's use of the fund's resources, not only ensure the fund's long-term view but also determine the nature of the vehicle: For many commentators, this absence of pension commitments is what defines a sovereign wealth fund[3].

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[1] Last August, GPFG changed its investment units aiming to increase in-house investment capabilities. It named three new CIOs and strengthened its real estate team (See http://www.ipe.com/norwegian-oil-fund-restructures-investment-team-grows-property/10002781.fullarticle)

[2] See http://blogs.ft.com/beyond-brics/2014/05/22/guest-post-frontier-markets-more-profitable-less-volatile/

[3] Capapé, Javier and Guerrero, Tomás, "More Layers than an Onion: Looking for a Definition of Sovereign Wealth Funds" (June 1, 2013). SovereigNET Research Papers; ESADE Business School Research Paper No. 21. Available at SSRN: http://ssrn.com/abstract=2391165 or http://dx.doi.org/10.2139/ssrn.2391165.

However, the absence of current pension obligations does not prevent some sovereign wealth funds from aiming to meet future pension contingencies (what in 2008 the IMF called 'contingent pension reserve funds'). Two clear examples of this type of sovereign wealth funds are in Australia and New Zealand. Australia's Future Fund ($97.57 billion) and New Zealand's sovereign wealth fund, New Zealand Superannuation Fund ($25.51 billion) were set up with the purpose of serving as a deposit to face future pension obligations, although they do not currently pay any pensions. The Irish sovereign wealth fund (National Pensions Reserve Fund) was also created with this intention of accumulating returns to face the future cost of pensions. However, following the serious crisis the country has come through, in 2009 the Ministry of Finance decided to change the purpose of the NPRF as reserve for pensions and to use it to recapitalise the two stricken major banks: Allied Irish Banks (AIB) and Bank of Ireland. They invested $20.7 billion in this operation. At the end of 2013, the positions and cash generated by the sale of stakes in the two banks were valued at €15.4 billion[4]. They lost 26% of the value of the initial investment in the transaction. The question that still hangs in the air is: Will Australia, New Zealand or Chile resist the temptation to apply short-term economic policies if their economies or key sectors run into serious problems?

From the Yale to the Norway model

The workings of the GPFG and the returns it obtains have not gone unnoticed by institutional investors around the world. In the past few years, the management of the Norwegian fund has not only become a reference in terms of transparency and corporate governance for other sovereign wealth funds, but an exemplary model of asset management for private investors, given the track record.

But what investment principles can private investors incorporate in order to follow a strategy similar to that of the Norwegian fund? The white paper[5] "Yale versus Norway"[6] published in September 2012 by Curtis Greycourt, addresses this matter, comparing the investment strategies followed by David Swensen at the head of the Yale endowment portfolio with those of Yngve Slyngstad at the head of Norges Bank Investment Management.

The Yale model bases its strategy on concentrating its investments in illiquid assets such as property, infrastructure and private equity. This investment model, designed by David Swensen, has generated an average annual return of 13.7% for the Yale endowment over the past twenty years. As a result, the Yale model, which also informs the investment style of the Harvard and Stanford endowments, has consolidated its position in recent decades as the main investment strategy among institutional investors.

However, the model appears to be exhausted, or at least not to have successfully come through the crisis and its consequences. The Yale endowment has posted returns below the S&P 500 for five years in a row, and we are seeing a change of paradigm. The poor results being posted by the asset management industry since the onset of the crisis have led many investors to explore new models. One of those gaining most favour is the model behind the workings of the Government Pension Fund Global. The Norwegian model, unlike the Yale one, is showing that attractive returns can be obtained by investing a good part of the portfolio in equities (more than 60%), and with a reduced exposure to illiquid assets (up to 5% in real estate).

From the comparison carried out by Greycourt, we can draw several conclusions allowing us to pinpoint the differences and similarities between the two models. In fact the two models are not so very different, sharing as they do a number of investment principles such as:

> (1) Markets are mostly efficient (2) diversification is one of the best ways of controlling risk (3) the profitability of equities is the main source of returns (4) the fund must be administered on the basis of a specific benchmark and (5) external managers are important.

Nonetheless, the Norwegian model presents a series of differences compared with the Yale model:

> (1) It stresses risk reduction though diversification (2) it has very little or no exposure to short-term bonds (3) it has a much smaller exposure to illiquid assets such as real estate or investments in timber (4) it has rigorous allocation of assets, which significantly reduces tracking error and protects the investment strategy (5) it follows socially responsible investment criteria (6) it plays the role of activist shareholder to improve the governance of the companies in which it invests (7) it has less complex management and significantly lower costs (8) it has a governance structure designed to follow a clear investment strategy, avoiding improvised changes (9) it reduces possible principal-agent problems (between the owner and the manager of the assets) since the valuation of the assets is carried out by the market and is easily identifiable.

Furthermore, as we noted in the second difference, the majority of sovereign wealth funds do not have defined liabilities (pensions) and therefore do not suffer the problems of asset and liability mismatch seen in the Yale model. It therefore seems logical for sovereign wealth funds to follow the Norwegian model rather than the Yale one. In other words, to follow the model designed by one

[4] More information on the website of the (still existent) NPRF on its transition to a public strategic investment fund: http://www.nprf.ie/DirectedInvestments/directedInvestments.htm
[5] Based on Chambers, Dimson and Ilmanen's *"The Norway Model"* http://www.iijournals.com/doi/full/10.3905/jpm.2012.38.2.067
[6] http://www.greycourt.com/wp-content/uploads/2012/09/WhitePaperNo55-YaleVersusNorway.pdf

of their peers, which also does not face defined commitments and which has a long-term investment horizon.

Of course, the Norwegian model, despite being behind the management of what is considered to be one of the world's most transparent sovereign wealth funds and with the best corporate governance[7], is neither perfect nor universally applicable. Not all investors can adopt the investment principles followed by the fund, because among other things they do not have the institutional and organisational framework of the Norwegian fund (parliamentary support or in-house investment teams). Nor can these principles be applied unaltered by managers who have to meet recurring short-term obligations. Even so, the model presents a number of advantages compared with the Yale one, which could be used by institutional investors to improve and modernise their investment strategies.

Corporate governance

The Norwegian fund is a world reference for good governance. As well as heading the ranking of sovereign wealth funds by assets under management, the GPFG is a reference for good governance, both corporate (with regard to the manager, NBIM) and in its relations with its other stakeholders: parliament, central bank, ministry of finance and Norwegian society.

Moreover, the GPFG is also a reference as regards transparency. None of the other funds in the top ten by volume of assets has a similar level of transparency. This is in stark contrast to the opaqueness of its counterparts in the Middle East or South-east Asia. The Norwegian fund publishes information, updated in real time on the value of its portfolio. Every year it also discloses the content of its portfolio in detail, with the names of all companies and bodies receiving its fixed income and equity investments. It also recently started to provide breakdowns of its activity in the real estate sector. In the case of equities, on which we focus in this chapter, it has equity investments in 8,213 companies in 74 different countries. For each one of them it details the volume of the investment, the percentage of the capital that it represents, and the percentage of voting rights it can exercise. The fund has an upper limit of 10 percent of ownership in any given listed company. As at 31 December 2013 the five companies in which GPFG holds the largest ownership positions were Irish packaging Smurfit Kappa Group (9.40%), British property and development Great Portland Estates (8.86%), two Finnish companies in the paper, bio and forestry industries, Stora Enso (8.16%) and UPM-Kymmene (7.76%); lastly, American financial giant BlackRock (7.08%).

This same transparency extends to the rules governing entries to and exits from the fund's capital. Norway is one of the world's biggest exporters of oil (seventh) and natural gas (third, behind Russia and Canada). Therefore clear rules on contributions to the fund are essential. Specifically, since 2001 the fund's "spending rule" establishes that not more than 4% of the fund may be spent on the government's annual budget.

Together with this transparency and good corporate governance it used to be argued that the Norwegian fund was an example for other funds as regards the non-interference of political considerations in the NBIM's investment decisions. However, even the Norwegian fund is subject to this political interference.

In October 2008 in Santiago de Chile, the then members of the International Working Group of Sovereign Wealth Funds signed a declaration of 24 Principles on the practices that should govern sovereign wealth funds. This non-binding declaration, known since then as the 'Santiago Principles', had a clear intention: to dispel the fears that many governments then had about sovereign wealth funds' possibly investing for political reasons. Balance, to date appears satisfactory, given Heathrow airport's current shareholders (including three SWFs) or Qatar Holding's leading role in the $66 billion Glencore Xstrata mega-merge in 2012 (the fifth-largest in the history of the natural resources sector).

However, this same declaration leaves room for discretionality in many highly significant aspects. Specifically, sub-principle 19.1 stipulates that "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." When a fund, for example Mubadala, decides to serve as a financial lever in changing its country's production base, it does not specify which activities are in pursuit of a purely economic and/or financial objective and which serve a political interest that facilitates (or in some cases hinders) this diversification.

By this we do not mean to assert that there is necessarily anything wrong with pursuing objectives that go beyond economic-financial ones. Sometimes funds can be used as instruments in international relations, for example, establishing alliances with globally influential governments so as to facilitate the establishment of trading, learning and investment relations, for example.

It is therefore logical that the finance industry, multilateral bodies, receiving countries and regulators should seek to minimise the effect of these other objectives of the sovereign wealth funds. However, isolating public entities, which in the final analysis are governed by politicians, from political interests, is something really hard to achieve. Furthermore, it will be difficult to correct in the context of this new "state capitalism" on which many emerging

[7] Truman, E. M. (2011). Sovereign Wealth Funds: Threat or Salvation? Peterson Institute for International Economics.

economies have embarked, in which the connections between governments and corporate managers are so ingrained: former politicians managing state companies, former managers of state companies going on to manage public investment agencies, etc.

In the case of Norway, the risk of political interference is limited, but it does exist. The procedures and accountability to which the NBIM-managed fund is subject, both to the Ministry of Finance itself and ultimately to Parliament, ensure that investment policies are not dictated by short-term political considerations. Furthermore, in Norway, the fact that the fund does not invest in any domestic assets (equities, debt or real estate), reduces the incentive to interfere in particular industries or companies for political reasons.[8]

However, the Norwegian fund's determination to become a global reference as a "responsible investor" exposes it to non-economic-financial interference or influence. In 2002, the Parliament set up a committee of experts, the Graver Committee, to implement a mechanism to ensure responsible investment by the fund. Two years later, the fund's lines of action in the field of ethics were defined and the Board of Ethics was set up. The Board, composed of five persons with varied profiles (a lawyer, an engineering agronomist, a biologist and two economists from different fields), is charged with reviewing all the GPFG's investments and assessing which, if any, are inconsistent with the fund's ethical approach. These recommendations are submitted to the Ministry of Finance, which decides, based on the recommendations received, whether to exclude these investments or place them on a watch list.

The Committee's recommendations have led to the exclusion of 21 companies in the tobacco sector. Moreover, those which the Ethics Committee described as causing serious environmental damage (as in the case of Rio Tinto in 2008), or having seriously or systematically violated human rights (Walmart being the best-known case, with its exclusion in May 2006), or producing nuclear weapons (EADS, Boeing and Lockheed Martin), have also been excluded from the GPFG's investment universe by the Ministry of Finance.

It is in this area that the Committee, and ultimately the GPFG may be or may have been subject to significant political or other influence. In fact, when the new government came to power, it attempted to dissolve this independent Committee and incorporate it into the central bank (where NBIM operates). Although this move was not approved, because it did not receive majority parliamentary support, a significant reform has nevertheless been proposed. The recommendations of the Committee, which will continue to operate independently, would be submitted directly to the central bank, not passing through the Ministry of Finance. The main reason given in support of this change is to avoid projecting an image of the fund as an instrument of Norway's foreign policy. If this change comes about based on the reason put forward, then it is hard to avoid thinking that at some time in the past the fund has been used as an instrument of foreign policy.

Therefore we may conclude that at least the "responsible investment" decisions are not necessarily based on strictly economic or financial considerations. The case of the Norwegian fund demonstrates that the "risk" of being subjected to non-economic influence in its investment decisions is real; whether to exclude individual companies or certain entire sectors, or to include mandates in 'responsible' investment sectors. And all this in the context of a fund that operates with very well defined and transparent internal policies. Therefore, in light of the Norwegian case, we may conclude that the likelihood of a public financial instrument's being used as a tool of the country in the pursuit of other (more or less laudable) objectives is still very significant.

Investment strategy: long-term investor, the European bias and external managers

The GPFG was created in order to provide the Norwegian government with an instrument with which to handle the country's fiscal policy in the event that oil prices should fall or Norway's onshore economy (i.e. excluding oil and gas) should contract.

In order to safeguard the fund's founding mandate, the Ministry of Finance established a clear investment strategy from the outset, with the objective of taking advantage of its long-term view to generate high profitability and preserve the country's wealth for future generations.

The long-term view is the cornerstone on which the Norwegian sovereign wealth fund's investment strategy rests. The NBIM has no short-term commitments. It identifies long-term investment opportunities in sectors and specific companies, invests in assets that it expects to generate high returns over time, and is able to withstand periods of high volatility in the capital markets. It thus takes advantage of opportunities that arise, while other investors find themselves constrained to take short-term decisions.

Geographical spread of the fund's investments: preference for Europe

Another of the key elements in the fund's strategy is the setting of benchmarks for its investments. The fund's investments are valued against the benchmark indices for equities, bonds and real estate compiled by FTSE Group, Barclays Capital and Investment Property Databank (IPD) respectively. At present, the fund holds 60% of its assets in equities, 35% in fixed income and up to 5% in real estate. All GPFG's investments are made outside Norway.

[8] For more information on how political interference affects funds' returns and investment decisions, see Bernstein, S., Lerner, J., & Schoar, A. (2013). The Investment Strategies of Sovereign Wealth Funds. Journal of Economic Perspectives, 27(2), 219–238.

Infographic 4

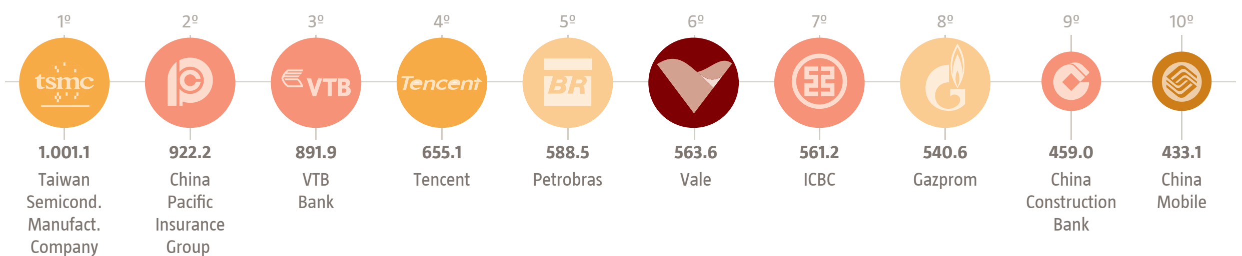
GPFG Top 10: Conquering the world´s largest companies

Basic materials | Consumer goods | Consumer services | Financials | Health care | Industrials | Oil&gas | Technology | Telecommunications | Utilities

1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005

Rank	Value
1º	108.9
2º	92.9
3º	89.3
4º	87.9
5º	87.7
6º	80.9
7º	79.1
8º	71.9
9º	67.4
10º	61.5

Major investments in emerging-markets companies in 2013



Source: ESADEgeo (2014).

Holdings (milion $) <500 500-2.000 >2000

Spanish companies

2006 2007 2008 2009 2010 2011 2012 2013

Nestlé 6,412.4

Shell 4,728.8

Novartis 4,258.5

HSBC 4,077.2

Vodafone 4,019.3

Roche 3,949.1

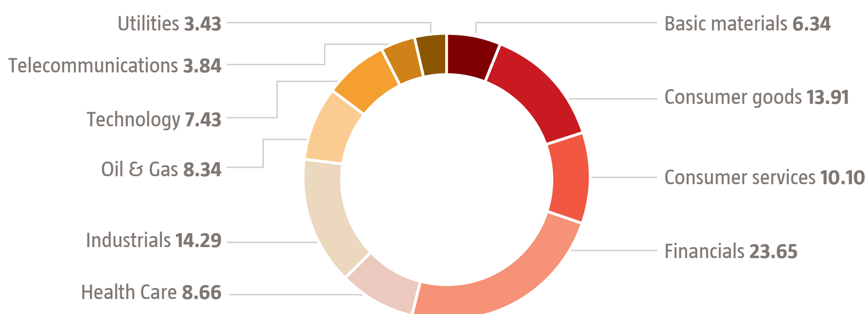
BlackRock 3,709.7

BG Group 3,615.7

Apple 3,441.6

BP 3,290.6

Volume of GPFG investments by sector in 2013



5. Equity investments of the Norway's GPFG: A European sovereign wealth fund for Europe

According to the latest annual report of the NBIM (31 December 2013), the fund measures the relative returns of its portfolio against the FTSE Global All Cap index, which contains 7,476 large-, mid- and small-cap companies from 47 countries. It includes frontier markets such as Pakistan, Morocco and the Philippines (with a total weight in the portfolio of less than 1%).

The analysis of the NBIM's portfolio at the end of 2013 also allows us to evaluate the geographical distribution of the shares. The Fund held shares in 8,213 different companies in 74 countries (or territories, as we shall see).

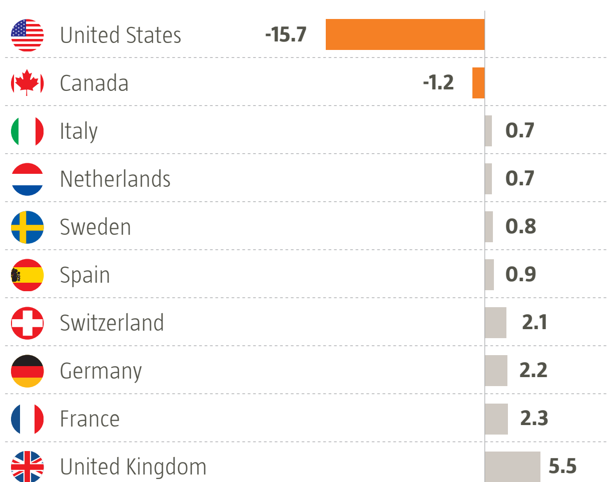
From this group of 8,000 companies we have filtered the Top 10 investments yearly since 1998 (See Infographic 4). Many trends can be identified. First, some telecoms simply disappear from the Top 10 (the most prominent case is Nokia which topped in 1999, but British Telecom, NTT, Cisco, Ericsson, fell too). Second, The oil company BP is the only firm which endured in the Top 10 since the beginning of the Fund's activity in 1998 (the trend shows that most probably it will not be the case in 2014). Third, two pharmaceutical Swiss companies represent well the Swiss GPFG's preference, now including consumer goods Nestle as top investment destination, too. Fourth, analyzing sectors, many conclusions arise but current diversification remains on top. This diversification is even more evident now if compared with recent 2008, when four over five largest holdings were oil&gas companies.

If we compare the geographical distribution of the FTSE index with that of the NBIM, we find some very significant differences. Most of these differences are explained by deliberate decisions: NBIM applies a different geographical weighting from that of the FTSE Global All Cap index. NBIM receives the investment mandate drawn up by the Ministry of Finance and applies it to its management of the GPFG. Specifically, NBIM applies an over-weighting of 2.5 to European equities, relative to the weight assigned by the FTSE index. It does likewise with "other developed markets" (1.5) and "emerging markets" (1.5). However it maintains the weighting of the US and Canada unchanged. In other words, according to the FTSE index, Europe should account for 23% of the portfolio. However, applying the NBIM's weighting, it must represent 40% of its portfolio. The current weight of Europe in the portfolio is 40.3%. So in aggregate terms, the GPFG maintains its European investment in excess of its benchmark. In the opposite extreme is the US, with a weight of 49% in the FTSE index, assigned just 34% in the new weighting and accounting for only 29% of the GPFG's investment.

The following figures show the deviations. First, we compare the FTSE benchmarks with those of the NBIM (Chart 1). We see an almost perfect offsetting between the extra weight allocated to Europe and the penalisation of the US. Specifically, the UK, with 5.52% more, is the clear winner from the adjusted index used by the NBIM. In monetary terms, the new index increases exposure to the UK by more than $28.2 billion given the Fund's current market value. France, Germany and Switzerland also gain in this respect. At the other extreme, the US sees its benchmark reduced by just over 15%, which in monetary terms is more than €79.5 billion. In terms of the benchmark then, the European bias is patent.

Chart 1

Gap between FTSE and NBIM benchmarks for selected countries



Source: Prepared by the authors, with data from FTSE and NBIM (2014).

We can also see the fund's real position in comparison with the adjusted benchmark (Chart 2). In other words, we can see which countries receive greater or lesser amounts than those determined by the adjusted benchmark. In this regard, the US again comes out as the main loser. The gap or difference between the benchmark and the amount invested in the country is $23 billion. Japan and Australia ($5 billion and $4.4 billion respectively), are the other two countries affected by this. We should also highlight two European countries receiving less investment than envisaged in 2013. These are Spain, with a negative gap of $1.1 billion, and Denmark, with $544 million. At the other extreme, the UK ($8.3 billion), Germany ($7.4 billion), France ($5.7 billion), Switzerland ($4.7 billion) and Sweden ($4.1 billion), received a "surplus" in 2013. Also notable on the "surplus" side are investments in two emerging countries, China and Russia, with "surpluses" of $2.6 billion and $1.05 billion respectively.

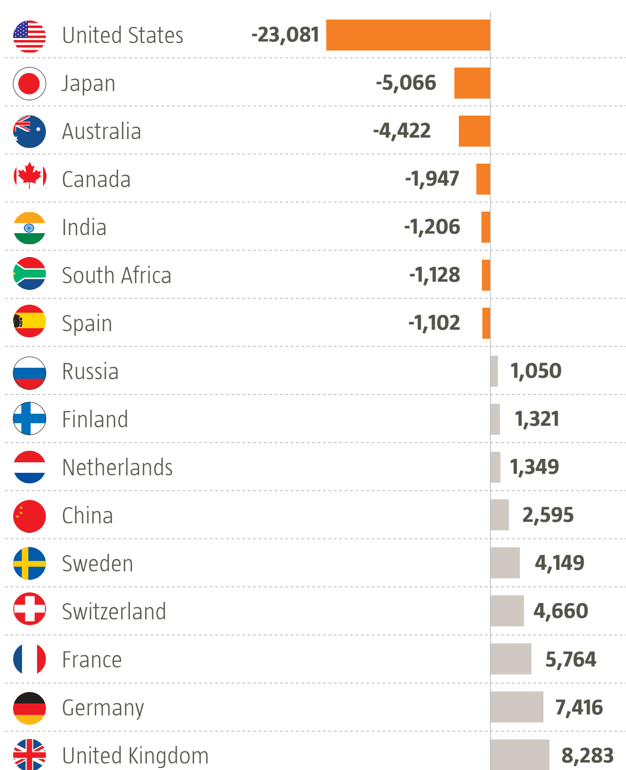
This therefore constitutes a deliberate play on investment in Europe. This domestic (regional) bias is also seen in other institutional

investors. The pursuit of an "adjusted" diversification which, in terms of portfolio weighting, "favours" markets that are culturally, and above all geographically, close, while "penalising" more distant markets, specifically the US. Moreover, as we have seen, the actual investments made further emphasise this weighting. In general terms, the countries with the greatest positive benchmark gaps to start with are also those that subsequently receive investments in excess of the adjusted benchmark.

Chart 2

Gap between NBIM's adjusted benchmark and investment received

Millions of euros



Source: Prepared by the authors, with data from FTSE and NBIM (2014).

Additionally, the map showing the geographical spread of the NBIM's equity portfolio shows some other interesting facts. One is struck by the presence of "tax havens" among some of the Fund's portfolio companies' holdings. Thus, the Cayman Islands (0.2%) have more investment from Norway than does Greece or Colombia; Bermuda (0.06%) has a higher percentage of the portfolio than the United Arab Emirates or New Zealand; other tax havens, accounting for less than 0.05% of the fund's portfolio, are Guernsey, Jersey and the British Virgin Islands. In view of the Fund's wish to become a reference for "responsible investment", it is not clear how that objective meshes with the fund's positions in these tax havens. It seems reasonable to suppose that it will withdraw from positions in these territories, as has been seen with sensitive sectors such as tobacco, nuclear weapons and palm oil.

External Managers

The GPFG uses external managers to administer part of the fund's investments in fixed income and equities. The fund grants investment mandates to entities with experience and a positive track record in clearly defined areas for which it is not appropriate to develop in-house skills and teams. Through them, the fund looks for managers to outperform the markets in which they operate and obtain a differential return for the fund. The mandates usually cover investments in emerging markets and small-caps in developed markets.

At the end of 2013 the fund had $31 billion (3.8% of its total assets, compared to 2.9% a year before) in hands of external managers. This was 30% more than at the beginning of the year. To date, the fund has granted a total of 70 investment mandates to 59 institutions. Of the 70 mandates granted, 50 have been to administer investments in equities in emerging and frontier markets, 13 for investments in equities of small-caps in developed markets, 5 for investments relating to the environment and 2 for fixed income in emerging markets.

Historical analysis: GPFG's equity investments from 1998 to 2013

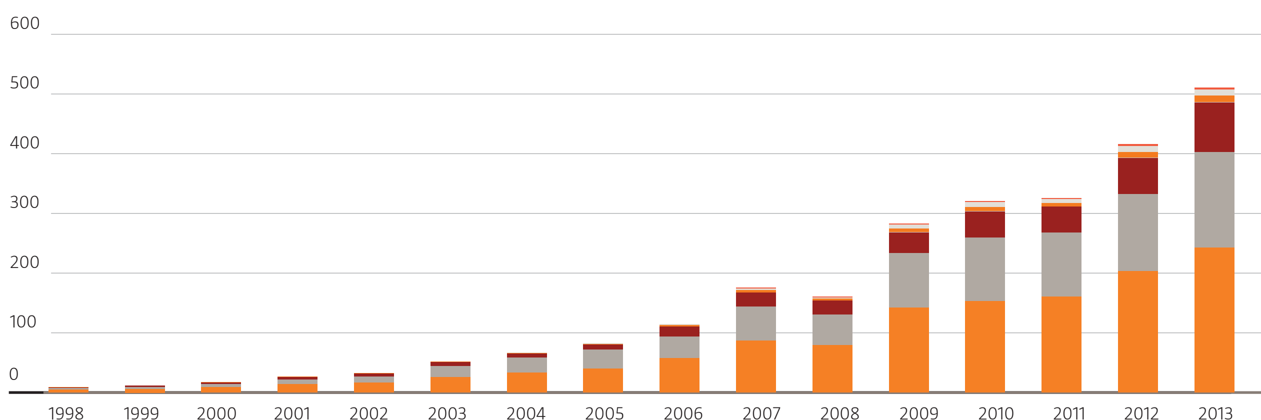
The GPGF shows a European bias in 2013, as discussed previously. This bias is nothing new: The Norwegian fund's investment history contains a permanent bias in favour of European companies. To date, GFPF owns 2.5% of Europe's listed companies.

In Chart 3 we show the changes in GPFG's equity portfolio from inception until the end of last year. We see a relatively stable history, with Europe dominating throughout, followed by the US and Asia and to a lesser extent Australasia. In 2001 it incorporated Latin America (Brazil and Mexico) and in 2004: Africa (South Africa) and the Middle East (Israel dominates investments in the region, with UAE and Qatar joining later).

5. Equity investments of the Norway's GPFG: A European sovereign wealth fund for Europe

Chart 3

Distribution of the portfolio by continents



Source: Prepared by the authors, with annual report data from NBIM.

A more detailed analysis of changes in European investments can be found in Figure 4. Dominated by the UK from the outset, the European portfolio presents some peculiarities: among them, the historical preponderance of France over Germany, although in 2013 France fell to fourth place, behind Switzerland. Moreover, the domestic bias puts Sweden in seventh place by cumulative investment (stock). Within Europe, Italy is relegated to eighth position, in contradiction to the weight of its GDP in Europe's economy, which is far greater than that of Switzerland, the Netherlands or Sweden, all of which are ahead of it in the ranking.

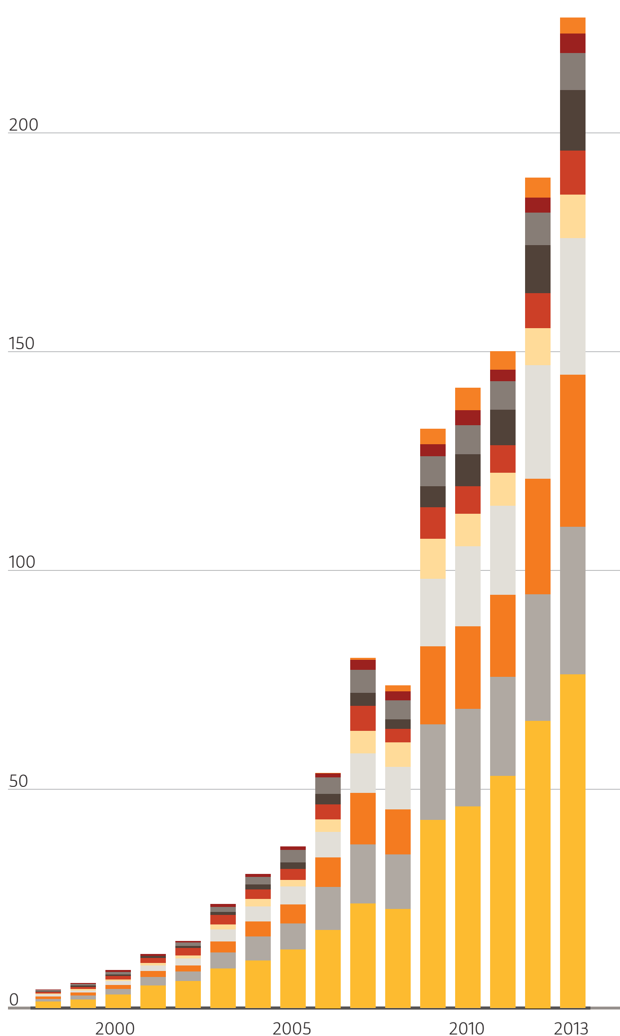
We sought to ascertain the Norwegian fund's exposure to the BRICS (Figure 5). In this case, as has already been said, both Brazil and South Africa are reference countries in their respective regions: They served as entry points for their continents and continue to lead the fund's investment. In the case of South African companies, for example, Naspers receives more investment than Alcatel-Lucent (France), Aviva (UK) or Commerzbank (Germany); likewise with the MTN Group, which has investments ahead of those in Vestas (Denmark), EDP (Portugal) and Fiat (Italy). In the case of Brazil, giants such as Petrobras, Vale and Itaú also have more investment than many European and North American companies.

In the case of Russia, already analysed under Europe, banking (VTB Bank and Sberbank) and commodities (Gazprom, Lukoil and Surgutneftegas) are the GPFG's managers' priority destinations. In any case, it will be interesting to see whether there is any reaction to the conflict in Ukraine and whether the successive sanctions and embargoes between Russia and the rest of the world have any repercussions for the Norwegian fund's portfolio selection in 2014.

In Asia, India and mainland China entered the fund's investment universe in 2005. This was some years after Japan, Hong Kong and South Korea. However, China's growth is far greater than that of India. Investments were made in 45 Chinese companies in 2005, 116 in 2007 and 941 in 2009. In 2011, GPGF invested in almost as many Chinese companies as Japanese ones. The investments are headed up by insurer China Pacific Insurance Group, the major state banks ICBC and CCB and telecoms groups China Mobile and China Unicom. India for its part shows no particular increase, maintaining a steady number of investments in around 200 different companies and a volume of around $2.5 billion, heavily concentrated in Infosys, Bharti Airtel, financial groups Axis Bank, ICICI and Housing Development Finance Corporation and natural resources, through Reliance Industries for example.

Chart 4

Changes in top ten investments in Europe



Source: Prepared by the authors, with annual report data from NBIM.

GPGF ups its play on Spanish companies

Since the Norwegian Ministry of Finance redefined the fund's investment strategy in 1997, allowing it to allocate 40% of its assets to investments in equities, Spain and its companies have been one of the main destinations for the fund's investments in Europe.

Unlike our main European neighbours, the Norwegian fund's entry into Spanish companies was timid, with an investment barely surpassing $200 million (spread among 34 companies) in 1998. For its initial foray, the fund plumped for multinationals well-established in Spain and with a strong presence in Latin America. Essentially, these were financial institutions such as BBVA and Banco Santander, and energy companies such as Endesa and Gas Natural. Prominent among the first batch of investments in Spanish companies were Telefónica, in which the fund initially invested nearly $38 million, and BBVA and Endesa, in each of which it invested more than $22 million.

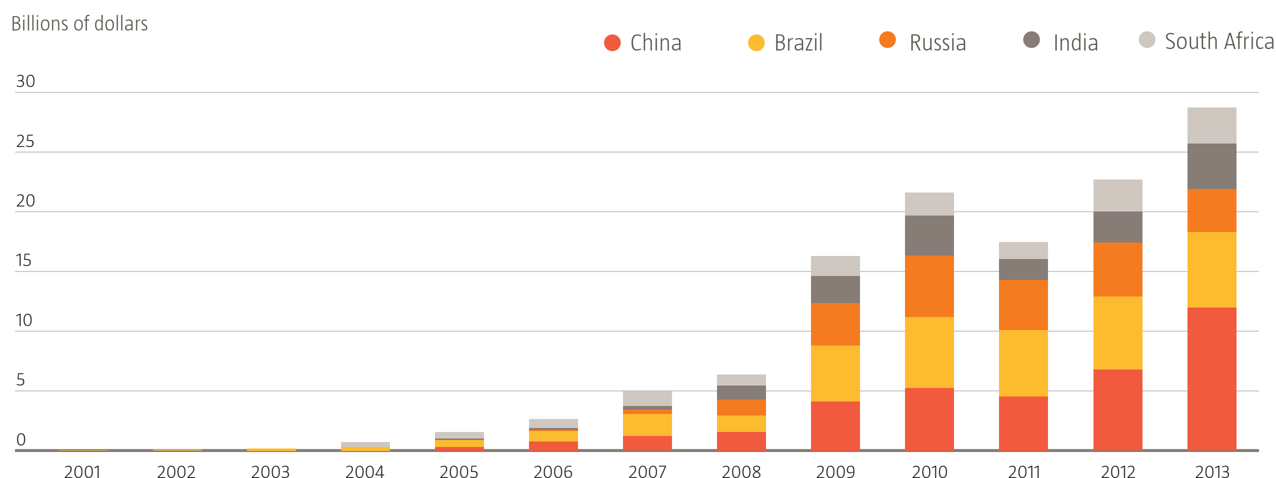
During the first few years of the twenty-first century, the fund's play on Spain and its companies grew continuously, reaching $1.1 billion in 2003. In that year, the fund's plays were still headed up by Telefónica, and the main investments were still being channelled into financial institutions and energy companies. However, companies from other sectors were beginning to make their appearances, such as Altadis (the result of the merger between Tabacalera and France's Seita in 1999) with an investment of nearly $106 million, Inditex and construction companies such as ACS, with investments of close to $50 million.

At the onset of the financial crisis, the fund kept its faith in Spanish companies, and in 2008 it invested $5.63 billion in 83 different Spanish companies, for the first time surpassing its investment in Italian companies, with Spain thus becoming the fund's fifth biggest European investment destination. In 2009, the fund's stock of investment in Spanish companies reached a new new record, surpassing $9.2 billion and becoming the second biggest year behind last year's $9.99 billion. In 2010 and 2011 the fund considerably reduced its exposure to Spanish equities, bringing its stock down to less than $7.5 billion. Also, in 2011 the fund granted an investment mandate to the Spanish firm Bestinver Gestión. With this mandate, the NBIM not only entrusted to Bestinver the management of a substantial part of its Spanish portfolio, but also charged it with overseeing the fund's investments in listed Spanish mid-caps.

5. Equity investments of the Norway's GPFG: A European sovereign wealth fund for Europe

Chart 5

GPFG investment in the BRICS



Source: Prepared by the authors, with annual report data from NBIM.

In 2012 the fund regained its appetite for Spanish equities and again reached $8 billion in investment, in Banco Santander, Telefónica and BBVA, each with investments of more than $1 billion. There were also significant investments in R&D&I-intensive companies such as Amadeus, with more than $173 million, and Grifols, with $140 million. This shows the Norwegian fund's interest in investing beyond the usual suspects: financial, construction and energy.

In 2013 the GPFG increased its investment in Spanish equities by 20.1%, from $8.32 billion in 2012 to $9.99 billion in 2013. In total, at the end of 2013, the Norwegian fund had investments in 73 listed Spanish companies, compared with 69 in 2012.

Within the IBEX 35 (see following table in euros) the main investments continue to be concentrated in Banco Santander (€1.245 billion), Telefónica (€952 million) and BBVA (€840 million). However the only one of these in which the fund increased its stake relative to 2012 was BBVA (up by 0.8%). These multinationals are followed by others such as Inditex (€651 million), Iberdrola (€471 million) and Repsol (€272 million). The fund increased its investments in these three relative to 2012.

However the fund did not confine itself to the usual suspects in the IBEX 35, but took positions beyond them. For example, it made a strong play on Gamesa, one of the stocks that has performed best so far in 2014, increasing its investment by 3,150%. Today, GPFG owns 2.58%, which represents the largest equity holding (relative to the market capitalization) within Top 20, followed by Ferrovial or DIA (it controls 1.92%) and Telefónica (1.73%). It also bet on financial institutions such as Bankinter and CaixaBank, reaching €67 million and €97 million of investment respectively, and Mapfre, which has a strong presence in Latin America, in which its investment increased by 102.2% compared with 2012. Furthermore, the fund also took a position in the group resulting from the merger of Iberia and British Airways, IAG, in which it invested €100 million.

Table 1

Main Spanish investments of the GPFG

Top 20	Company / Bank	2013	2012	2013/2012
1	Santander	1,245	1,389	-10.4%
2	Telefónica	952	990	-3.8%
3	BBVA	840	833	0.8%
4	Inditex	651	600	8.5%
5	Iberdrola	471	447	5.4%
6	Repsol	292	240	21.7%
7	Ferrovial	222	181	22.7%
8	Amadeus	172	131	31.3%
9	Gas Natural	160	123	30.1%
10	Grifols	127	106	19.8%
11	Banco de Sabadell	109	90	21.1%
12	IAG	100	-	-
13	Abertis	98	93	5.4%
14	CaixaBank	97	38	155.3%
15	Banco Popular	95	53	79.2%
16	Mapfre	93	46	102.2%
17	ACS	87	77	13%
18	DIA	76	70	8.6%
19	Bankinter	67	24	179%
20	Gamesa	65	2	3.150%
	Total*	**6,019**	**5,533**	**8.7%**

Source: In-house with NBIM data as at 31 December 2013.

* Millions of euros.

Paul Rose

Executive Director, Law, Finance & Governance @ Ohio State

Professor of Law, Ohio State University – Moritz College of Law

North American Dream: U.S. and Canadian Public Funds

6. North American Dream: U.S. and Canadian Public Funds

Introduction

On March 8, 2014, the West Virginia Legislature approved the creation of a West Virginia "Future Fund," the latest in a series of North American sovereign wealth funds (SWFs) created in recent decades. Following a model used by other states and provinces, 3% of all funds received from severance taxes on coal, oil, natural gas, minerals and timber extracted in West Virginia will be diverted to a permanent trust fund[1]. West Virginia's fund will almost certainly not be the last SWF: recent estimates by the U.S. Energy Information Administration place the amount of technically recoverable shale oil in the United States at 48 billion barrels, and technically recoverable shale gas at 1,161 trillion cubic feet, in deposits from New York to California, while Canada has technically recoverable shale oil deposits of 9 billion barrels, and technically recoverable shale gas at 573 trillion cubic feet[2]. Using revenues from some of the same natural resource reserves enjoyed by their U.S. neighbors, Saskatchewan and the Northwest Territories are preparing to launch wealth funds.

Meanwhile, some of the most important recent innovations in investment management of public funds are being developed north of the border. Large Canadian funds and managers, including the Canada Pension Plan Investment Board (CPPIB), Ontario Teachers' Pension Plan (OTTP), PSP Investments and the Ontario Municipal Employees Retirement System (OMERS), are developing strong in-house expertise and investing directly in private equity, infrastructure and property deals. Not only does this style of investing save billions in fees that would otherwise go to external asset managers, but the funds are also able to take advantage of their natural time horizon advantages over other large investors, exercise more control over their investments, and reap higher returns. OTTP, for example, reports the highest 10-year returns among global peer funds for the years 2010, 2011 and 2012.

The governance structures and investment policies employed by North American public funds vary from state to state and from province to province. With respect to structure and payouts, some jurisdictions retain the principal funds in a central account and use interest generated to supplement the state budget. Others create separate funds for specific social and economic programs. And Alaska, in an innovative model befitting its image as a frontier state, distributes income generated from its wealth fund directly to Alaska residents. With respect to investment policies, some funds have limitations on the types of assets in which they can invest, following the "legal list" methodology that has been a common feature of public pension fund investing for decades. Others simply hold their fiduciaries to a "prudent person" standard without requiring or prohibiting specific investment or setting specific asset allocation targets, allowing the funds to operate at the cutting edge of investment policy and practice.

This article will briefly discuss some of the innovations developed by North American public funds, with a particular focus on their distribution policies, governance and investment decision-making. This is a story decades in the making. Although the creation of new funds like West Virginia's Future Fund and North Dakota's Legacy Fund have received significant popular attention in recent years, many North American funds have existed for decades, and the legislative history of some funds dates back to two years prior to the adoption of the U.S. Constitution. And, with significant oil, natural gas and mineral wealth remaining to be tapped in the United States and Canada, West Virginia, the Northwest Territories and Saskatchewan's funds may just be the latest in a continuing wave of North American public funds.

A Short History of North American Public Funds

Recently created wealth funds like Quebec's Generations Fund, North Dakota's Legacy Fund and West Virginia's Future Fund, as well as funds that are now a few decades old, such as the Alaska Permanent Fund and the Alberta Heritage Fund, typically have a common funding source: a percentage of the severance taxes paid on natural resource extraction[3]. However, as described in this section, many of these funds are not the result of newly-discovered petroleum wealth. Indeed, the oldest North American sovereign wealth funds trace their origins to the early days of the United States itself.

Permanent School Trust Funds

The history of North American sovereign wealth begins with the Land Ordinance Act of 1785 and the Northwest Ordinance Act of 1787. Congress intended these two legislative acts to provide a funding mechanism for U.S. territories that would support public school systems and other vital governmental services. Indeed, the acts had a crucial political purpose; some members of the Continental Congress feared that as settlements expanded in the new territories under federal control, land speculation would quickly ensue, natural resources would deplete and, most worryingly, "the fragile new Union might fracture if settlements decided to secede or establish non-democratic governments"[4].

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[1] Under the provisions of the S. B. 461, the Future Fund will only receive its 3% when West Virginia's "Rainy Day" fund is equal to at least 13.5% of the general revenue. The state also may not draw from the fund until 2019. S. B. 461 (W. Va. 2014).

[2] U.S. Energy Information Administration, Technically Recoverable Shale Oil and Shale Gas Resources: An Assessment of 137 Shale Formations in 41 Countries Outside the United States (June 2013), available at http://www.eia.gov/analysis/studies/worldshalegas/pdf/fullreport.pdf.

[3] Quebec's funding is more diverse than other funds, however, as it includes "the revenue resulting from indexing the price of heritage electricity as of 2014; all mining royalties as of 2015-2016; the revenue of $215 million per year, as of 2017-2018, stemming from the increase in Hydro-Québec's net earnings resulting from the closure of the Gentilly-2 nuclear power plant; as of 2014-2015, $100 million per year arising from the increase in the specific tax on alcoholic beverages." Québec, 2013 Economic and Financial Profile of Québec 19 (2013), *available at* http://www.finances.gouv.qc.ca/documents/Autres/en/AUTEN_profile2013.pdf.

[4] Ctr. on Educ. Policy, Public Schools and the Original Federal Land Grant Program: A Background Paper from the Center on Education Policy 5 (2011), *available at* http://www.cep-dc.org/cfcontent_file.cfm?Attachment=Usher_Paper_FederalLandGrants_041311.pdf.

Table 1

Permanent School Trust Funds

Fund	Primary Income Source(s)	AUM (millions USD)	Inception
The Texas Permanent School Fund	Oil & gas	$30,600	1854
The Texas Permanent University Fund	Oil & gas	$15,300	1876
New Mexico Land Grant Permanent Fund	Oil & gas	$5,932	1912
Wyoming Permanent Land Funds	Oil, gas, coal & minerals	$2,696	1890
The Oklahoma Permanent Funds	Investments and oil & gas	$2,000	1906
Utah Permanent State School & Institutional Trust Funds	Oil & Gas	$1,600	1896
The Oregon Common School Funds	Investments	$1,200	1859
Minnesota Permanent School Fund	Mineral lease	$1,000	1849

Source: Funds' websites.

Through the Land Ordinance Act, lot No. 16 of every township—physically located at the center of each township—was reserved for the maintenance of public schools within each township, thereby providing the critical funding mechanism for state public schools. The Northwest Ordinance of 1787 next provided more formal mechanisms by which states would apply for statehood to be achieved through the passage of an Enabling Act for each state, which would set out the specific land grant. The typical structure involved a land grant for the benefit of the state's schools.

During these early years, when many states were created and subsequently joined the Union, no state set aside income from the lands in a permanent trust fund. Many states sold off the land and immediately used the money for the benefit of the local schools. It was not until 1835 that the first permanent fund was created by the territory of Michigan, coincident with its entry into the Union in 1837. Other states followed Michigan's model, although it was not until the Colorado Enabling Act of 1875, when the U.S. Congress itself specifically placed restrictions on the sale of lands set aside for public schools, that the sales of such lands would constitute a "permanent school fund."

Many of the original grant lands have been sold, with most states taking the view that the pressing needs of fledgling school systems required substantial and immediate funding through sales, rather than a trickle of funding through leasing of the trust lands. In Oregon, for example, the state engaged in a systematic liquidation of state trust lands "based on the theory that once this property was in private hands, the lands would generate more revenue for the state in property taxes than it would in public ownership"[5]. Most of the states formed prior to 1850 have sold the majority of their holdings. California, for example, retains only about 10% of its original grant. A few other states, however, hold a majority of their grant lands, including Nevada (87%) and Arizona (75%). For those states with significant trust lands, revenue generated from the lands can provide a significant portion of the state's overall budget. As an example, in New Mexico, state funds make up approximately 67% of the revenue for public schools, and trust lands provide approximately 14% of this funding. Although there are many state land grant funds in operation, only the funds in Table 1 have assets under management of a billion dollars or more.

Severance Tax Funds

In 1973, New Mexico was the first state to use severance tax revenues on natural resources to establish a permanent fund. A number of other states followed. As states created these funds, one of the primary arguments for the creation of the funds was not only (or perhaps even predominantly) to generate revenue, but rather to offset costs associated with resource extraction, such as damage to water systems, air quality, or loss of arable land or natural habitats. Not all states with natural resource wealth have used severance taxes to create permanent funds, however, and many resource extractors and other beneficiaries of the resources have argued that severance taxes are merely a form of rent extraction by politicians of resource-rich states. Notwithstanding these complaints, however, many severance tax funds have reached or are approaching 40 years of continued operation, and form an important part of many states' budget systems. The largest severance tax funds—with assets greater than $2 billion—are shown in Table 2. With the exception of the Alaska Permanent fund, most severance tax funds are relatively small.

[5] Peter W. Culp et al., Lincoln Inst of Land Policy & Sonoran Inst. Joint Venture on State Land Trusts, Trust Lands in the American West: A Legal Overview and Policy Assessment (2005), *available at* https://www.lincolninst.edu/subcenters/managing-state-trust-lands/publications/trustlands-report.pdf.

6. North American Dream: U.S. and Canadian Public Funds

Table 2

U.S. State Wealth Funds

Fund	Primary Income Source(s)	AUM (millions USD)	Inception
The Alaska Permanent Fund	Oil	$46,800	1976
Permanent Wyoming Mineral Trust Fund	Oil & Gas	$5,889	1974
The North Dakota Legacy Fund (Trust Lands Permanent Fund)	Oil & Gas	$2,600	2011
The Alabama Trust Fund	Oil & Gas	$2,500	1985
New Mexico Severance Tax Permanent Fund	Oil & Gas	$2,194	1973

Source: Funds' websites.

Table 3

Canadian Sovereign Wealth Funds

Fund	Primary Income Source(s)	AUM (millions USD)	Inception
The Generations Fund	Mining royalties	$4,700	2006
Alberta Heritage Savings Trust Fund	Oil	$15,170	1976

Source: Funds' websites.

Public Pension Funds

The origins of the giant Canadian public pensions are much more recent than the U.S. land grant funds. For example, the Ontario Municipal Employees Retirement System Act, passed in 1962, created OMERS. The nationwide Canadian Pension Plan, which is managed by the CPPIB, was created in 1964. The CPP operates in every province except Quebec, which has its own Quebec Pension Plan operating in much the same way as the CPP.

Notwithstanding their relatively recent creation, many of the Canadian pension funds are giants compared to most state land grant funds. Many U.S. public pension funds are equally large (and some, like CalPERS, among the largest funds in the world). However, the governance and investment policies of most of the U.S. funds tend to resemble U.S. wealth funds much more than Canadian public pension funds because they are built on the same statutory structures as state-wealth funds, with similar types of asset class restrictions and fiduciary standards. As a result, only the Canadian pension funds will be described in this report to highlight important differences from U.S. funds with respect to legal and regulatory structures and investment policies.

Table 4

Canadian Public Pension Funds

Fund	AUM (millones de USD)
The Canada Pension Plan Investment Board (CPPIB)	$201,500
The Caisse de dépôt et placement du Québec (Caisse)	$200,100
The Ontario Teachers' Pension Plan Board (OTPP)	$140,800
The British Columbia Investment Management Corporation (bcIMC)	$110,000
The Public Sector Pension Investment Board (PSP Investments)	$76,100
The Alberta Investment Management Corp. (AIMCo) [7]	$74,700
The Ontario Municipal Employees Retirement System (OMERS)	$65,100
The Healthcare of Ontario Pension Plan (HOOPP)	$51,600
The Ontario Pension Board (OPB)	$21,000
The OPSEU Pension Trust (OPTrust)	$16,000

Source: Funds' websites.

[6] In each case, this article makes use of the most recently available data on asset management size from annual reports or press releases of the funds.
[7] AIMco manages assets for many Alberta government funds and pension plans, including the Alberta Heritage Savings Trust and the Public Service Pension Plan.

Innovation in Distribution Policy: the Alaska Permanent Fund

For public pension funds, distribution goals are relatively simple in theory (but often difficult to implement in practice); public pensions must be able to pay liabilities of pensioners as they become due. By contrast, sovereign wealth funds typically do not have specific liabilities [8]. What, then, are SWFs designed to do? Much of the writing on SWFs explains them in terms of political risk or the potential use of SWFs as political tools. The use of a SWF as a political tool is but one among many explanations for the existence of SWFs, and while it may be true that some SWFs are used for political purposes on occasion—though there exists scant evidence of this—less nefarious purposes drive the creation of most SWFs, whether at the national or state level. Although the specific reasons justifying the existence of a SWF are expressed in unique ways, the various justifications may be grouped together under several general categories, including revenue smoothing, protecting against Dutch Disease, or providing intergenerational welfare. Because these policy goals have been discussed at length elsewhere, this article will address only one innovative means of achieving an essential fund goal: the Alaska Permanent Fund's unique distribution policy [9].

Alaska's SWF, like many others, was designed to be a mechanism for ensuring intergenerational equity. The term intergenerational equity is somewhat ambiguous, as it can refer both to an imperative to save present capital in order to use it to satisfy future commitments, such as pension benefits, or to an imperative to save it specifically for the benefit of future generations, irrespective of commitments to present generations. In ageing populations, intergenerational equity suggests a fairness concern that if a citizen has paid taxes and social security or equivalent public pension payments, they have a proper claim against the government for a reasonable income in their retirement. Intergenerational equity can also refer to a principle of distributive justice. The primary concern in this sense of the term is not that present generations may enjoy some of the fruits of their life's work through government benefits in retirement, but that future generations should be able to enjoy the fruits of the nation's resources just as present generations. Thus, a natural resource fund is not created so that (or merely that) it may provide a present generation with an acceptable standard of retirement benefits, but also that future generations should also benefit from the sale of a finite store of resources taken from the land that they are to inherit.

The decision to set up a fund for future generations is a crucial economic decision because it may well be the case that economic development initiatives could pay greater dividends than the benefits offered by a SWF that merely pays its interest back into state coffers. Alternatively, a state may decide that it will instead pay out a dividend, as Alaska does, rather than leave the determination of how funds should be spent to the government. The debate in Alaska over the issue of how best to serve future generations is instructive. Proponents of the Alaska Permanent Fund offered several rationales for the creation of the Alaska Permanent Fund: first, the Fund would "help to create an investment base from which to generate future income. Then, when oil revenues ran out, there would still be a major source of state revenues to pay out the costs of government services"; second, the APF would "remove a significant portion of the oil revenues from the legislative spending stream, thus reducing the opportunities for excessive spending by the Legislature"; and third, the fund would prudently "transform" oil wealth into a "renewable source of wealth for future generations" [10].

Although the APF had several clear purposes for its existence, the particular means of achieving these general goals had not yet crystallized by the time the APF began receiving funds. The debate focused on generational issues: should the APF be managed as an investment fund that would distribute income over the long-term, or should it be managed as a development bank and used to "force-feed" Alaska's economy in the short-term? [11]. This second possibility is not necessarily inconsistent with the third rationale, intergenerational wealth transfer, justifying the creation of the APF. By using the APF as a development bank that provides loans and grants to Alaskan businesses, the fund could increase the number of small businesses in Alaska, which would serve to increase the number of jobs and broaden the economy, thereby ultimately decreasing the dependence of the state on oil and other natural resource revenues. On the other hand, a development bank would increase the possibility of political mischief as the Fund could be used as a mechanism for political patronage.

Those arguing in favor of the investment fund model were motivated by the protection of the principal managed by the APF. They believed the APF should manage the funds in accordance with the prudent investor rule and only make investments that were of "trust-grade quality" at market rates. Ultimately, the proponents of the investment fund model prevailed, although the state allocated some funds that were not part of the 25% of revenues dedicated to the APF to create several state agencies [12] charged with achieving some of the short-term goals envisioned by the proponents of the development bank model.

[8] Admittedly, this is not a universally accepted statement. *See* Javier Capapé & Tomas Guerrero Blanco, *More Layers than an Onion: Looking for a Definition of Sovereign Wealth Funds* (ESADE Bus. Sch. Research Paper No. 21, 2013), *available at* http://ssrn.com/abstract=2391165**.**

[9] Some of the following observations were first developed in Paul Rose, *Managing Public Natural Resource Wealth*, Revista Brasileira de Políticas Publicas (2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2220218.

[10] Gordon L. Clark & Eric R. W. Knight, *Temptation and the Virtues of Long-Term Commitment: The Governance of Sovereign Wealth Fund Investment*, 1 Asian J. Int'l L. 321, 335 (2011).

[11] *Id*. at 328.

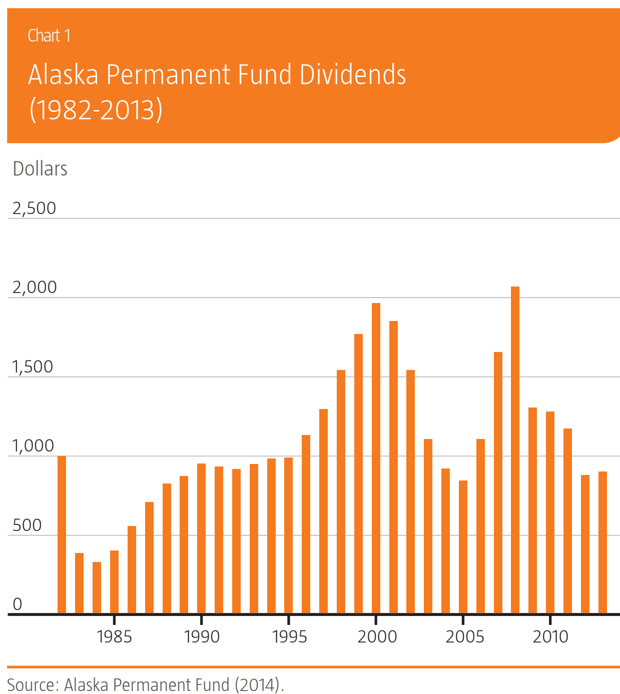
[12] These agencies include the Alaska Housing Finance Corporation, the Alaska Industrial Development and Export Authority and the Alaska Renewable Resources Corporation.

The APF dividend, the distinctive feature of Alaska's SWF model, is paid out to every resident [13] according to a specific formula as set out by statute [14]. After the formula's calculation, a determination is made as to whether there are sufficient funds in the earnings reserve account to pay the dividend. The dividend may not be paid out of the principal.

Since its creation, the APF has paid out nearly $20 billion in dividends. Last year the APF paid a dividend of $900 to 631,470 applicants, or approximately 86% of the total population of 736,399. For many Alaskans, particularly native Alaskans and those in rural Alaska, the dividend is a major source of income.

Chart 1

Alaska Permanent Fund Dividends (1982-2013)



Source: Alaska Permanent Fund (2014).

Alaska's model is the only one of its kind in North America, although it does have proponents in other jurisdictions. In Alberta, for example, the Canada West Foundation has argued that over a suitable period, the principal of the Alberta Heritage Fund could be built up; after sufficient income is produced to enable the fund to pay out a significant dividend, the fund could adopt the Alaska dividend model [15]. As in Alaska, the argument has both economic and governance rationales:

In contrast to the Alaska model, a mixed-objective model has prevailed in most other states and provinces. In these jurisdictions, legislators retain a large part of the funds in a permanent trust for future generations, while also spending a portion of the severance tax revenues on development projects designed to create a broader economic base. A mixed-objective model indicates political compromise (with some wanting the funds spent on pressing current needs, while others wanting to save the funds), but also complicates the goal of using a natural resource fund to promote intergenerational equity. The mixed-objective model requires a jurisdiction to make bets on present funding opportunities in the hope these will pay out for both present and future generations. Or, in the case of some government agency recipients of natural resource fund dollars, there may in fact be no particular goal of providing for future generations or for the general economic welfare of the jurisdiction; in these cases, short-term regional or local needs may control.

Aside from jurisdiction-level concerns about the appropriate means of providing for future generations—whether to use a natural resource fund as a development fund or an investment vehicle, for example—significant federal concerns come into play. When combined with a fiscal federalism in which states and provinces receive increasingly large federal subsidies, the issue of intergenerational equity includes not merely whether and how present citizens of natural resource fund sponsor-states should subsidize future citizens, but also whether other jurisdictions' citizens should subsidize present and future sponsor-state citizens despite the existence of a state or provincial SWF.

[13] Parents are also able to claim a dividend for each of the unemancipated children. For the 2014 dividend, for example, residents may establish eligibility for the dividend by showing they were residents of Alaska during all of calendar year 2013; that they intend to remain an Alaska resident indefinitely; that they have not claimed residency in any other state or country or obtained a benefit as a result of a claim of residency in another state or country at any time since December 31, 2012; and that they were not sentenced or incarcerated as a result of a felony conviction during 2013, or incarcerated at any time during 2013 as the result of a misdemeanor conviction in Alaska if convicted of a prior felony or two or more prior misdemeanors since January 1, 1997. If the resident was absent from Alaska for more than 180 days, the absence must have been an "allowable" absence (such as attending college or in military service). Finally, the resident must have been physically present in Alaska for at least 72 consecutive hours at some time during 2012 or 2013. Alaska Permanent fund Corporation, Basic eligibility Requirements, *available at* http://pfd.alaska.gov/Eligibility/EligibilityRequirements.

[14] The dividend is calculated by averaging the net income of the APF over the past five years, multiplied by 21 percent, divided by 2, then divided by the number of eligible applicants. In 2010, for example, the amount was calculated as follows (amounts in thousands, except individual dividend amount): Net income from previous five years, $8,171; multiplied by 21% = $1,716, divided in half = $858, then after various minor adjustment are made, the total is divided by the estimated number of dividend applicants: $822,100,000/641,595 = $1281.00 (rounded to nearest whole dollar). *See* Alaska Permanent Fund Corporation, *The Permanent Fund Dividend*, *available at* http://www.apfc.org/home/Content/dividend/dividend.cfm.

[15] Can. W. Found., Alberta's Energy Legacy: Ideas for the Future 79 (2007), *available at* http://cwf.ca/pdf-docs/projects/ael-chapt-dyedlin.pdf. As in Alaska, the argument has both economic and governance rationales: "There is a governance rationale that sees citizens instead of government making decisions about their "piece of the pie." Instead of politicians and bureaucrats deciding what is best, why not individuals and families? There are both right-leaning and left-leaning rationales favouring public dividends being available such that individual residents and their families can make their own spending decisions. Thus a broad-based public consensus likely is feasible." *Id*.

Chart 2

Politicized Public Fund

Source: Author's elaboration.

Innovation in Investment Policy: The Canadian Public Pension Funds

Of critical importance to the success of a public fund is the legal and governance framework in which it operates; without the proper framework, the fund is less likely to achieve its stated goals, and, of even more concern, is at risk of becoming a tool for corruption. A large part of the governance structure is written into the investment policies of the funds, but the policies themselves depend on the political framework in which the fund operates. Transferring high-level justifications for public funds into sound fund investment decision-making is exceedingly difficult, and state and provincial funds differ significantly in their governance and investment philosophies.

The management and investment policies of the Canadian funds differ significantly from the U.S. state wealth funds in several crucial ways. First, the Canadian funds tend to be much larger than the U.S. funds. Economies of scale play a significant role in determining whether a fund will be able to justify and support a large in-house management team. Second (and in part a function of their comparatively large size), Canadian funds tend to invest very differently from their American counterparts. As others have noted (and the Canadian funds themselves have pointed out), Canadian funds tend not to have explicit statutory restrictions on their investments. The size and flexibility of Canadian funds allows them to make direct alternative investments in infrastructure, venture capital, or private equity that many other public funds, including U.S. state wealth funds, could not make.

Finally, Canadian funds differ in the way in which they are governed. Canadian funds are well-insulated from political pressure, and tend to have independent, professional boards rather than, as The Economist bluntly stated, boards "stuffed with politicians, cronies and union hacks"[16]. Also, compared to their U.S. counterparts, Canadian funds tend to pay much closer to the compensation rates of external asset managers.

Although economies of scale explain much of the differences in investment policy between large Canadian funds and smaller pension funds, political independence also appears to play a significant role. U.S. funds—wealth funds, to some extent, but particularly public pension funds—suffer from a lack of political independence, and this lack of independence has serious consequences for investment policies. This is certainly not to say that funds are corrupt, but that public fund managers must regularly contend with political pressures from legislatures and interest groups; this is particularly true for funds that are tightly controlled by state legislatures. How investment policies are connected to political forces is best understood by considering the incentives of the elected government officials that create and supervise the fund. Politicians are faced with difficult choices about how the government will ensure that the public fund remains accountable. There may also be political gamesmanship that occurs as the various constituencies with an interest in the fund's performance (such as public employee union officials or elected officials such as state treasurers) vie for a seat at the board table. Thus, boards are staffed with politicians or their appointees, rather than professional managers. The incentives of appointed or elected policy-makers can reasonably be expected to differ from professional managers along several dimensions. First, they may be concerned with representing their political constituency, such as unionized employees or a particular political party, in addition to (or in egregious cases, rather than) the beneficiaries of the fund. Politicians may also be concerned that the fund could serve as a vehicle to advance the interests of rival political parties or interest groups. And, because

[16] *Canada's Pension Funds: Maple Revolutionaries*, Econ. (Mar. 3, 2012), http://www.economist.com/node/21548970.

6. North American Dream: U.S. and Canadian Public Funds

Chart 3

Depoliticized Public Fund

Source: Author's elaboration.

The compromise that has often resulted from these incentives is a politically-connected board that is restricted by statute in its investment activities. The staff of the funds are typically paid salaries commensurate with public employee status, and as a result the fund may not be able to hire qualified staff with the capability to manage many of the fund's assets in-house. Thus, some assets, and particularly alternative investments, must be managed externally. Unfortunately, investment restrictions have not served to eliminate corruption, as several high-profile pay-to-play scandals in the U.S. attest. On the other hand, the restrictions have resulted in a decreased universe of investment opportunities and large fees for external managers. The process of how politicization ultimately leads to less innovation and higher costs for public funds can be summarized in Chart 2.

Politicized public funds can buy innovative strategies, of course, but those strategies come at a price: traditionally, a management fee of 2% and 20% of the profits. U.S. public funds have increasingly invested in alternative investments in recent years, but they typically pay dearly for the privilege.

By contrast, the Canadian giants tend to operate under a more politically-insulated model. By changing the level of political involvement in the fund, politicians reduce the availability of the fund for their own political purposes, but they also reduce the availability of the fund's use for political rivals. They are also less directly accountable for the fund's performance. As a result, they have less need to restrict the scope of investments available to the fund. Because the board that manages the fund is well insulated from political pressures, they are able to ask their managers to do more and to pay them more. The net result is higher internal fees, but much lower overall fees, which, all other things equal, leads to higher returns, as summarized in Chart 3.

What makes the Canadian funds innovative is not so much the fact that they are investing in alternative investments, but *how* they are investing. As shown in the case studies in the next section, Canadian pensions' innovation is in their ability—owing to their political independence—to disintermediate the investment process. And, even more impressively, at least one fund is now serving as an intermediary for other institutional investors.

Case Studies: U. S State Wealth Funds and Canadian Pension Funds

The following case studies show how U.S. state wealth funds and Canadian pension funds differ in the ways in which they are regulated by statute, how they are governed and how their investments are managed. Although U.S. funds do not in each case suffer lower returns than their Canadian counterparts, they are hampered by regulatory and policy structures that make achieving high returns more difficult.

U.S. State Wealth Funds

This section first looks at several of the largest state SWFs—the Alaska Permanent Fund (APF), the New Mexico Severance Tax Permanent Fund (NMSTPF), the Texas Permanent School Fund (TPSF) and the Wyoming Permanent Mineral Trust Fund (WPMTF)—and describes the investment policies of the funds. Most state natural resource funds use outside investment managers to help invest some or all of their funds, and fiduciary standards and asset allocation requirements serve to constrain the behavior of the funds and their investment managers. Aside from these similarities, the funds discussed in these case studies have considerably different investment goals, ranging from an aggressive, total return-focused management style that produces a large annual cash dividend for Alaskans, to mixed total

return and social investment strategies in Wyoming and New Mexico. A large percentage of assets are managed by external managers.

Some states may have more than one fund in operation. For example, a state may have both a land grant SWF and a severance tax SWF. State trust lands are typically invested through an investment division operating within the state's land management department or the state's education department, or, in the case of states with a severance tax fund, both of the state's natural resource funds are managed by a single investment entity that may operate as a stand-alone entity. In Texas, for example, the Permanent School Fund (PSF) is managed by the State Board of Education, while the administrative activities for the PSF are handled by an investment division of the Texas Education Agency. In New Mexico, on the other hand, both the Land Grant Permanent Fund and the Severance Tax Permanent Fund investments are managed by the State Investment Council (SIC).

Because the income generated by the funds is typically dedicated to various public entity beneficiaries, land grant funds traditionally do not invest funds in social programs. Texas is an exception to this rule, however, as legislation passed in 2007 allows the State Land Commissioner to designate some funds that would have been deposited in the PSF to be redirected to a "real estate special fund account," and also expanded the PSF's investment authority, allowing the PSF to invest in "land; interests in real property for biological, commercial, geological, cultural or recreational purposes... [to make investments] to protect, maintain, or enhance the value of public school lands; [or, to make investments to] acquire... an investment or interest in public infrastructure, or other interests"[17].

The New Mexico Severance Tax Permanent Fund

Target Asset Allocation[18]

Broad U.S. Equity	31%
Broad International Equity	15%
Fixed Income	16%
Real Return	10%
Core Real Estate	10%
Absolute Return	8%
Private Equity	10%

New Mexico's State Investment Council (SIC) is tasked with management of the NMSTPF. As is generally true for state and provincial SWFs, the SIC and its external managers are obligated by statute to apply a "prudent investor" standard of care. The SIC "seeks to manage the Funds to ensure that future generations receive the same or greater benefits as current beneficiaries, while maximizing current distributions through time to provide current revenue sources to the state's General Fund. Total return, which includes realized and unrealized gains, plus income, less expenses, is the primary goal of the Funds"[19].

Notwithstanding this basic total return focus, the investment activities of the SIC from STPF funds are complicated by numerous statutory imperatives. When the STPF was formed, New Mexico's legislature created a patchwork of investment targets for the STPF, with a specific social policy associated with each type of investment target. While most investments are designed to maximize a risk-adjusted rate of return, these economically targeted investments are designed to "first obtain a risk-adjusted rate of return under the Prudent Investor Rule, and second, to enhance the economy of New Mexico"[20]. To make sure these objectives are achieved while minimizing the risk of wasteful or corrupt investments, the fund managers are required, among other things, to ensure that the investments will stimulate the economy of New Mexico on a continuing basis, expand business activity in the state, and promote the creation and preservation of jobs.

The investment criteria for the NMSTPF's other investments are relatively standard and similar to those employed by other large institutional investors. The investment policies set out a list of "permitted investments," for example, and set asset allocation targets. The investment policies place limitations on the type of equity securities that may be owned, for instance, and restrict the percentage of ownership of any given company. On the other hand, the list of economically-targeted investments over the course of the life of the fund reveals a remarkable effort at social engineering on the state level, with some of the investments paralleling federal efforts. Among other things, the SIC has invested in mortgage pass-through securities (stimulating the mortgage market and increasing home ownership levels), New Mexico small businesses and the New Mexico film industry (which one clever observer has dubbed "Tamalewood").

[17] Tex. Nat. Res. Code Ann. § 51.402 (West 2007).
[18] N. M. STATE INV. COUNCIL, JANUARY 2014-JUNE 2015 ANNUAL INVESTMENT PLAN (2014), available at http://www.sic.state.nm.us/uploads/files/2014%20Annual%20Plan%20Public.pdf.

[19] N. M. State Inv. Council, Investment Policy Statement (2012), *available at* http://www.sic.state.nm.us/uploads/FileLinks/47799e8b33064817a9838767216d86af/2012_07_24_NM_SIC_Investment_Policy.pdf.
[20] *Id*. at 25.

The Wyoming Permanent Mineral Trust Fund

Target Asset Allocation[21]

Large Cap U.S. Equity	15.0%
Small Cap U.S. Equity	3.0%
International Equity	13.0%
Private Equity	4.0%
Real Estate	7.5%
Absolute Return	7.5%
Convertibles	2.0%
Fixed Income	45.0%
Cash Equivalents	3.0%

Wyoming also has multiple objectives for its severance tax fund investment program. The general policy for Wyoming trust funds requires the State Loan and Investment Board and its external managers to invest public funds "in a manner that strives for maximum safety, provides adequate liquidity to meet all operating requirements, and achieves the highest possible investment return consistent with the primary objectives of safety and liquidity"[22].

Wyoming has set out by statute a set of permissible investments and investment allocations, but the statutes contain only two minor restrictions on investments. First, only up to 55% of the fund may be invested in common stocks. Second, prior board approval must be obtained before the state is allowed to invest in "alternative investments." The Board's investment policy adds to these restrictions by prohibiting self-dealing transactions, floating rate securities, individual certificates of deposit, letter stock and other unregistered equity, commodities (if not part of an alternative investment), most real estate transactions, natural resource properties, and short sales and margin transactions. Derivatives may be used to manage risk, but "managers must review their use of derivatives with the Board prior to employing derivative tactics"[23].

Like New Mexico, Wyoming's statutes also expressly permit state natural resource funds to invest in various investments that further targeted social policies. Among other things, the state treasurer is permitted to invest (or in some cases, pledge) up to $25 million in non-delinquent federally guaranteed or insured higher education loans from any nonprofit Wyoming corporation organized to acquire such loans; up to $300 million from the common school account in the permanent land fund to guarantee school district bonds; up to $100 million to guarantee local government bonds; and, "to promote economic development," the state treasurer may invest up to $100 million in industrial development bonds issued by joint powers boards, municipalities or counties. The state treasurer may not invest more than $50 million "for a specific public purpose authorized or directed by the legislature"[24], although the amount may be adjusted by recommendation of the state treasurer and approval by a Board subcommittee on capital financing and investments.

The state investment policy also sets out various portfolio guidelines. For example, the state may only own 1% or less of the common stock of any corporation, and only up to 1.5% of the total book value of the funds may be invested in the common stock of any corporation. Like many funds—and particularly state-owned funds—Wyoming also faces the challenge of matching its investment policy to its fiduciary duties when a higher return may be generated with investments that are at odds with other social, ethical and political goals. In a somewhat convoluted provision, the state investment policy states that "while the Board cannot make investments based on social or political objectives, it does consider the economic effects of social and humanitarian issues in the analysis of investments. The Board seeks to avoid investments that support terrorism or the violation of human rights."

The Alaska Permanent Fund

The Alaska Permanent Fund is directly overseen by the Alaska Permanent Fund Corporation (APFC), a state-owned entity that operates as a "quasi-independent state entity, designed to be insulated from political decisions yet accountable to the people as a whole"[25]. The APFC retains direct political accountability through an annual APFC report to the Legislative Budget and Audit Committee, and through approval of the APFC budget by the Alaska Legislature. As discussed above, the distinguishing feature of Alaska's fund is that a significant portion of the income generated by the fund is paid out to Alaskan citizens in the form of an annual dividend. The dividend is paid out according to a specific formula set out by statute[26]. After this calculation, a determination is made as to whether there are sufficient funds in the earnings reserve account to pay the dividend. The dividend may not be paid out of the principal. For many Alaskans, particularly native Alaskans and those in rural Alaska, the dividend is a major source of income.

[21] STATE LOAN & INV. BD., WYO., MASTER INVESTMENT POLICY AND SUB-POLICIES 23 (2012), available at http://treasurer.state.wy.us/pdf/investmentpolicy120612.pdf
[22] *Id.* at 1.
[23] *Id.* at 9.
[24] Wyo. Stat. Ann. § 9-4-715(n) (West 1977).
[25] Alaska Permanent Fund Corp., An Alaskan's Guide to the Permanent Fund 31 (2009), *available at* http://www.apfc.org/home/Media/publications/2009AlaskansGuide.pdf.
[26] Roughly speaking, the dividend is calculated by averaging the net income of the APF over the past 5 years, multiplied by 21%, divided by 2, then divided by the number of eligible applicants.

Target Asset Allocation (APF) [27]

Risk Class	Asset Class	Risk Class Target	Asset Class Target
Cash and Interest Rates		6%	
	Cash		1.2%
	U.S. Government Bonds and International Developed Government Bonds (currency hedged)		4.8%
Company Exposure		55%	
	Global Credit		11%
	Public/Private Credit		2%
	Global Equity		36%
	Private Equity		6%
Real Assets		19%	
	Real Estate		12%
	Infrastructure		4%
	U.S. Treasury Inflation Protected Securities		3%
Special Opportunities		20%	
	Absolute Return Mandate		6%
	Real Return Mandate		7%
	Emerging Markets Multi-Asset		2%
	Fixed-income Domestic Aggregate		2%
	Other (debt opportunities and true special opportunities)		2%

In the early years of the APF, the fund's investment policy was based on traditional asset allocation techniques, and was heavily invested in bonds. However, in 2009, the Board of Trustees "recognized that some investments might have more in common with investments from other asset classes with regard to their expected levels of risk and return." For example, corporate bonds may not act like U.S. Treasuries as much as they act like stock; "this makes sense when you consider that the companies that issue these corporate bonds are the same companies traded in the stock markets." Under its new strategy, the Board thus determined to group assets by risk characteristics, rather than by asset class. So rather than grouping assets as stocks, bonds, cash, etc., the APF now classifies investments as "Cash," "Interest Rates," "Company Exposure," "Real Assets," and "Special Opportunities." "Cash" includes liquid instruments with durations of less than twelve months. "Interest rates" includes low credit-risk securities such as U.S. Treasury bonds and non-U.S. government bonds. "Company Exposure" includes investment grade and high-yield bonds, U.S. and foreign stocks, bank loans and private equity investments. "Real Assets" includes real estate, infrastructure and Treasury inflation protected securities (TIPS). The "Special Opportunities" category includes, among other things, absolute return assets, distressed debt and commercial mortgage-backed securities.

The Texas Permanent School Fund

The investment policies of the TPSF, the largest North American fund next to the Alaska Permanent Fund, are limited by what seems to be a fairly restrictive statutory framework. Under the Texas Administrative Code, the TPSF may only invest in certain "permissible investments." However, the definition lists fairly standard, modern and broad categories of investments, including stocks on national or well-known exchanges, fixed income, private equity, "absolute return" investments, "real return" investments, "risk parity" investments and cash equivalents. The State Board of Education, which has fiduciary responsibility for the management of the TPSF, may allow for other investments, provided the investment is consistent with TPSF goals and objectives. The target asset allocation in 2013 reflected a high number of alternative investments.

[27] ALASKA PERMANENT FUND CORP., ALASKA PERMANENT FUND CORPORATION INVESTMENT POLICY 8-9 (2014), available at http://www.apfc.org/home/Media/investments/20140521InvestmentPolicy.pdf.

Target Asset Allocation (TPSF) [28]

EQUITY		
	Domestic Small/Mid Cap	7%
	Domestic Large Cap	18%
Total Domestic Equity		**25%**
	International Developed and Emerging Large Cap	18%
	International Small/Mid Cap	0%
	Emerging International Equities	3%
Total International Equity		**21%**
Total Public Market Equity		**46%**
FIXED INCOME		
	Core Fixed Income	12%
	Emerging Market Debt	5%
Total Fixed Income		**17%**
ALTERNATIVE INVESTMENTS		
	Absolute Return	10%
	Real Estate	8%
	Private Equity Investments	6%
	Risk Parity	7%
	Real Return	6%
Total Alternative Investments		**37%**

The statute also sets out a list of prohibited investments, including, among other things, short sales, restricted stock, buying or selling on margin, options, commodities futures, precious metals, or buying common stock or fixed income securities in a single corporation in an amount exceeding 2.5% of the TPSF total market value or 5.0% of the manager's total portfolio market value.

While the TPSF statutory framework seems firmly entrenched in the legal list era of public fund investing, it is important to note that the TPSF does not have a statutorily mandated asset allocation, which allows it more freedom in selecting investments. In the pension fund statutes of many jurisdictions, on the other hand, legal lists of permitted and prohibited investments were coupled with strict asset allocation standards in an effort to reduce the risk of mismanagement and loss. This risk reduction comes at a price, however, as managers are constrained in their investment choices and may actually have more difficulty in meeting their fiduciary duties to prudently manage the fund. Managers cannot easily alter poorly performing investment strategies particularly when investment restrictions are enshrined in statutes. This inflexibility costs many funds dearly during the Financial Crisis, as traditional asset allocation strategies, often mandated by statute, proved disastrously inappropriate. CalPERS, for example, lost an astounding $100 billion in eighteen months when its asset allocation strategy failed [29].

Canadian Public Pensions

Although the Canadian giants have fewer explicit restrictions than the U.S. wealth funds described above, the pension funds employ asset allocations targets as a part of good fund governance practice. The striking difference is, of course, in the Canadian funds' direct (rather than intermediated) use of alternative investments and direct investments, as described below.

[28] TEXAS PERMANENT SCHOOL FUND, COMPREHENSIVE ANNUAL FINANCIAL REPORT 20 (2013), available at http://www.tea.state.tx.us/index4.aspx?id=2147489178&.

[29] Ashby Monk, *Factor Based Allocation Strategies* (Feb. 10, 2011), http://www.investmentreview.com/expert-opinion/factor-based-allocation-strategies-5128.

Ontario Teachers' Pension Plan

The OTPP diversifies its investments across four broad asset classes: equities, fixed income, natural resources (including commodity derivatives and physical assets such as timber and oil) and real assets (including real estate and infrastructure). As a pension fund, OTPP must maintain adequate liquidity to ensure that it is able to meet its current liabilities. However, it also maintains liquidity and to "opportunistically acquire assets in a cost-effective manner[30]."

Target Asset Allocation (OTPP)[31]

Asset Class	Minimum	Goal	Maximum
Equities	39%	44%	49%
Fixed income	36%	48%	56%
Natural resources	3%	8%	13%
Real assets	18%	23%	28%
Money market*	(26)%	(23)%	(16)%

* Money-market activity provides funding for investments in all asset classes, and is comparable to a treasury department in a corporation.

The OTPP is also one of the best-known "responsible" investors in the world. It is a signatory to the UN Principles for Responsible Investment and objectively evaluates investments against "financial and non-financial factors, including risks associated with environmental, social and governance (ESG) issues, because we believe they can materially impact the value of our investments[32]." One of the most surprising investments by OTPP in recent years—and yet, completely consistent with its commitment to corporate governance issues—is its acquisition of proxy advisor Glass Lewis, the number two competitor in the corporate governance industry behind market leader Institutional Shareholder Services. And unsurprisingly, when OTPP looked to diversify the ownership base of Glass Lewis in 2013 by selling a 20% stake in the firm, it looked to a like-minded, Canadian public fund investor: AIMCo.

PSP Investments

PSP's statutory mandate is to "manage the amounts transferred to it in the best interests of contributors and beneficiaries under the Plans; and to maximize returns without undue risk of loss, having regard to the funding, policies and requirements of the Plans and the ability of those Plans to meet their financial obligations[33]." PSP's guiding philosophy consists of two pillars: the Policy Portfolio, which sets the strategic asset allocation for the fund, and active management activities. The Policy Portfolio sets out the following target allocations.

PSP defines active management as those activities that deviate from the approved Policy Portfolio, and that are used to supplement the returns of the Policy Portfolio within an active risk budget. The active management program can be thought of as an internal hedging strategy, because PSP "seeks to minimize over time the correlation of returns between the Active Portfolio and the Policy Portfolio[34]." Reviewing the Policy Portfolio allocations, it is clear that PSP does not engage in alternative investments as a sideshow to a larger, standardized asset allocation strategy. Instead, alternative investments are baked in to the Policy Portfolio itself, and PSP then uses active management strategies to further diversify its investments and risk allocation.

Target Asset Allocation (PSP)[35]

	Asset Class	Target Weight
World Equity		
	Public Market Equity	40%
	Private Equity	14%
Real Return Assets		
	Real Estate	13%
	Infrastructure	13%
	World Inflation-Linked Bonds	5%
	Renewable Resources	2%
Nominal Fixed Income		
	Fixed Income	11%
	Cash & Cash Equivalents	2%

[30] Ontario Teachers' Pension Plan, 2013 Annual Report 20 (2013).
[31] Ontario Teachers' Pension Plan, Statement of Investment Policies and Procedures for Ontario Teachers' Pension Plan 6 (2014), Available at http://www.otpp.com/documents/10179/20940/-/72Ae966f-7Aa9-40Ae-B8fa-3642E76597df/Statement%20Of%20Investment%20Policies%20&%20Procedures%202013.pdf.
[32] *Id* at 21. OTPP notes that "[w]hile responsible investing does not preclude ownership of assets that some plan members may find objectionable, it does mean Teachers' considers all material ESG risks and opportunities in selecting and managing assets." *Id*.

[33] Pub. Sector Pension Inv. Bd., 2013 Annual Report 12 (2013).
[34] Id at 6.
[35] Pub. Sector Pension Invs., STATEMENT OF INVESTMENT POLICIES, STANDARDS AND PROCEDURES FOR ASSETS MANAGED BY THE PUBLIC SECTOR PENSION INVESTMENT BOARD 14 (2013).

An example of how PSP differs from its Southern neighbors can be seen in the recent co-investment by PSP with CPPIB and private equity firm Apax Partners in Kinetic Concepts, a U.S.-based medical device company. The deal was valued at approximately $6.3 billion, and PSP and its partners intend to "work actively in partnership with the management of KCI to further invest in the global medical products sector to expand the company's core business, develop innovative products and extend into new geographies where significant opportunities exist [36]." Taken together, three things make the deal possible in Canada and nearly impossible for most U.S. wealth funds: the type of deal (private equity investment), the size of the deal ($6.3 billion) and an ongoing management relationship with the portfolio company (disintermediated investment). While U.S. funds can and do invest in private equity, they do so indirectly, through external managers, and thus pay external managers fees. PSP and other large Canadian funds, by contrast, are competing with private equity firms directly. Gordon Fyfe, PSP's CEO, recently stated that "We're competing against every other investor in the world... there's a limited amount of returns and if you're going to win and you're going to earn returns, you're taking them from someone else [37]."

Ontario Municipal Employee Retirement System

Finally, the OMERS has a simple asset allocation strategy that belies a sophisticated and innovative investment policy. For its Primary Plan, OMERS breaks its asset allocation strategy into two basic categories: a Public Investment asset group and a Non-Public Investment asset group, as shown in the table below.

Target Asset Allocation (OMERS) [38]

Asset Group	Minimum	Target	Maximum
Public Investments	41.0%	53.0%	65.0%
Non-Public Investments	35.0%	47.0%	59.0%

OMERS defines public investments as "securities that are generally traded on a recognized public exchange or on an over-the-counter basis [39]." Non-public investments include private equity, infrastructure, real estate and other strategic investments. OMERS' commitment to innovative investment is evident in its creation of investment arms to manage various asset classes, including OMERS Capital Markets, Oxford Properties, Borealis Infrastructure, OMERS Strategic Investments (with a VC arm, OMERS Venture Capital) and OMERS Private Equity. And as evidence that large Canadian pensions are willing to compete toe-to-toe with Wall Street, in 2009 OMERS was granted legislative authority to provide third-party investment offerings and services to Canadian public and private sector pension plans, governments and their agencies, colleges, universities and their endowments, and Canadian registered charities. Amazingly, then, OMERS is not only competing with Wall Street for investment opportunities, but for *clients*.

[36] Press Release, Pub. Sector Pension Invs., Apax Partners, CPPIB and PSP Investments to Acquire Kinetic Concepts, Inc. for $68.50 Per Share (July 31, 2011), *available at* http://www.investpsp.ca/pdf/pr-psp-kci-acquisition-en.pdf.

[37] Katia Dmitrieva & Matthew Campbell, Bloomberg News, *How Canada's Pension Funds Changed Their Conservative Ways to Become Global Buyout Kings*, Fin. Post (Nov. 28, 2013, 7:32 AM), http://business.financialpost.com/2013/11/28/how-canadas-pension-funds-changed-their-conservative-ways-to-become-global-buyout-kings/.

[38] ONTARIO MUN. EMP'T RET. SYS., ENTERPRISE STATEMENT OF INVESTMENT POLICIES AND PROCEDURES – SUPPLEMENTAL PLAN 3 (2013), available at http://www.omers.com/pdf/Supplemental_Plan_SIPP.pdf.

[39] Id. at 4.

Conclusion

While North American public funds share a common goal of maximizing risk-adjusted returns, they show a remarkable diversity in how they are regulated, how they invest and—at least in the case of Alaska—how they pay out their earnings. In a well-known corporate law text, Yale law professor Roberta Romano argued that the "genius of American corporate law is in its federalist organization[40]." A central point of her argument was that the diversity of approaches from state to state—the experimentation in governance and legal frameworks—provides a useful benefit to society. States and citizens can evaluate the effects of other jurisdictions' regulatory systems. Efficient and fair approaches can be adopted, and wasteful and unsuccessful approaches abandoned.

The same can be said for North American public funds. Provinces and states use a variety of governance and investment approaches, and by examining and discussing the performance of these approaches, the legislators and fund fiduciaries can learn from one another how to best serve their current and future citizens. This knowledge will be essential as states and provinces struggle to pay retirement and healthcare benefits, and more states and provinces consider the creation of SWFs to smooth revenues, stimulate local economies and provide for future generations.

[40] Roberta Romano, The Genius of American Corporate Law 1 (1993).

II
Sector Analysis

Victoria Barbary

Director, Institutional Investor's Sovereign Wealth Center

Non-Resident Fellow, ESADEgeo - Center for Global Economy and Geopolitics (ESADEgeo)

Sovereign Wealth Fund Investment in Infrastructure

7. Sovereign Wealth Fund Investment in Infrastructure

Introduction

Sovereign wealth funds have invested in infrastructure for over 20 years, but since 2006 they have become more interested in the sector. Sovereign wealth funds believe the return profiles of infrastructure investments match their long-term liabilities and intergenerational savings mandates, while the inelastic demand for infrastructure service implies bond-like, steady and inflation-hedged cash flows. Most importantly, the risk-return characteristics of infrastructure are intended to be a source of portfolio diversification as the asset class has an apparently low correlation with traditional assets like stocks and bonds.

This chapter addresses how sovereign wealth funds approach infrastructure investing. The analysis excludes other state investment vehicles and sovereign funds that have been established to invest at home to develop the local economy. These have to take into account a whole other set of considerations, which have to offset financial returns with the impact it has on citizen welfare and local economic development [1].

Challenges Faced by Sovereign Wealth Funds in Infrastructure

Traditionally, sovereign wealth funds have gained exposure to infrastructure through private-equity style funds. But as they have become more experienced players in the sector they have become aware of the shortcomings of this type of vehicle for investing in infrastructure.

At the top of the list of sovereign wealth funds' gripes about the private equity-style structure is a potential mismatch in interests between investors and fund managers. The role of managers is to package infrastructure assets in a way that aligns with institutional investors' risk and volatility tolerances, as well as delivering returns over timeframes that match their investment horizons. But in the mid-2000s boom it was not uncommon for managers to ramp up leverage and the number of riskier assets in the portfolio to increase the value of their options, rather than prioritizing the interests of their investors [2]. Consequently, according to research undertaken for the European Investment Bank, investors "felt 'mis-sold' when they were looking for stable, long-term income... but ended up with a highly leveraged, high-risk fund" [3]. This concern exacerbated sovereign funds' downward pressure on management fees, which many believe do not accurately reflect the value the managers add to the portfolio.

Sovereign wealth funds have also highlighted that there is a mismatch between the 10-year duration of most private-equity-style infrastructure funds and the longer return horizons of some of the assets [4]. John McCarthy, ADIA's global head of infrastructure, told Institutional Investor's Sovereign Wealth Center that "One of the benefits of being a long-term investor, with different liabilities from more-traditional investors, is the tremendous flexibility you have to buy and sell when the time is right, not when you are forced to [5]." Disconnecting the timespan of the fund from the return profile of the assets undermines sovereign wealth funds' competitive advantage in this space and limits their ability to realize the maximum gain from the assets over their investment horizon.

The obvious alternative to committing to funds is investing directly, which provides the sovereign wealth fund a greater degree of control without having to pay high management fees. Insourcing infrastructure allocation and management has been a growing trend among sovereign funds, for instance the Abu Dhabi Investment Authority (ADIA) and Singapore's GIC, are large-scale, direct infrastructure investors. ADIA's strategy in the sector –to acquire "minority equity stakes alongside proven partners, with an emphasis on developed markets [6]" – is a stark contrast to the management of its traditional assets, which is largely outsourced. ADIA now holds stakes in London's Gatwick Airport, Norway's Gassled gas pipelines, Open Grid Europe, which operates about 12,000 kilometers (7,450 miles) of gas transmission pipes in Germany, and three major ports in Australia.

There are, however, many challenges to investing directly in infrastructure. Although sovereign wealth funds can easily mobilize enough resources to invest in large infrastructure projects, at a strategic level, they must consider whether the portfolio concentration and illiquidity risk of a single big-ticket infrastructure asset can be tolerated by their liabilities, liquidity needs and mandated risk profile. An important part of this decision is an assessment of the hurdle rate: What return does an investment need to make to compensate for these factors? Most sovereign funds will be looking for internal rates of return of between 8 percent and 9 percent, but outside of the energy sector, such returns are often difficult to find particularly as the valuations of high-quality assets increases with competition [7].

At a practical level sovereign wealth funds need to be able to attract the talent to become a world-class infrastructure investor. ADIA and GIC have had the money and reputation to build a department with

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[1] Walt Schubert, "Sovereign Wealth Funds and Dedicated Infrastructure Investment," *Journal of Applied Business and Economics* 12(6), pp.32-39 (2011).

[2] Further analysis of this challenge can be found in Gordon Clark, Ashby HB Monk, Ryan Orr and William Scott, "The New Era of Infrastructure Investing", *Pensions: An International Journal*, 17, pp. 103-111 (May 2012).

[3] Georg Inderst, "Infrastructure as an Asset Class", EIB Papers 15(1), p.97 (2010).

[4] Georg Inderst, "Infrastructure as an Asset Class", EIB Papers 15(1), p.97 (2010).

[5] Victoria Barbary, "Building Bridges: Sovereign Wealth Fund Partnerships in Real Estate and Infrastructure Development Projects," *Institutional Investor's Sovereign Wealth Center*, March 17, 2014. http://www.sovereignwealthcenter.com/Article/3320082/portfolio-strategy/Building-Bridges-Sovereign-Wealth-Fund-Partnerships-in-Real-Estate-and-Infrastructure-Development.html

[6] Abu Dhabi Investment Authority, *2011 Review*.

[7] Edward Russell-Walling, "Infrastructure Goes Down the Capital Markets Road," *Financial News*, January 13, 2014.

broad mix of experienced professionals since they started investing in infrastructure in 2007 and 2006 respectively. But finding and securing the right people with appropriate skills, often on public-servant salaries, can be challenging. Moreover, when trying to attract talent, sovereign wealth funds have to be careful not to replicate the principal-agent problems apparent in the third-party management model, by ensuring incentives are aligned with the desired returns and the aims of the broader organization.

Securing assets is also becoming harder for sovereign wealth funds as competition heats up. From 2006 to 2012 sovereign wealth funds faced little competition when they looked to invest directly in established infrastructure assets in developed markets. The high financial barriers to entry – infrastructure projects are big-ticket items – meant that a relatively small pool of investors could play in this space, particularly following the financial crisis when the previously dominant investment banks pulled back to shrink their balance sheets to meet Basel III requirements.

The landscape changed during 2013. With bond yields remaining at historic lows, other institutional investors, like pension funds and endowments, turned to infrastructure to generate higher low-risk, consistent, long-term returns. Sovereign wealth funds also stated facing competition from commercial enterprises in the sector. Many companies have been sitting on cash reserves since the financial crisis as they have struggled to find attractive investment opportunities, and are now seeking to deploy this capital. As a result, sovereign wealth funds foreign direct infrastructure investment more than halved from $7.5 billion in 2012 to $3.0 billion in 2013.

The increased competition has driven valuations up. In April 2014, a consortium led by Australian toll road operator Transurban Group, which included ADIA, agreed to acquire Queensland Motorways, which operates less than 40 miles of toll roads in the Australian state. The company's sale by the Queensland government attracted bids from four consortiums, each of which had the backing of a sovereign wealth fund, which ratcheted up the price. Ultimately the Transurban consortium agreed to pay $7.05 billion ($6.55 billion) for the company – 28 times annual earnings before interest, tax, depreciation and amortization [8].

The experience of the Kuwait Investment Authority (KIA) offers a good example of the challenges sovereign wealth funds face when investing directly in infrastructure. In April 2013 the fund established a new London-based company, Wren House Infrastructure Management, to invest directly in infrastructure. KIA staffed Wren House with two former Bank of America Merrill Lynch investment bankers: Hakim Drissi-Kaitouni as head of the new subsidiary and Marc Keller as associate.

Despite hiring top-notch talent, the Kuwaiti fund has yet to secure a single direct infrastructure investment. It partnered with pension funds in two failed public-to-private buyouts – one for London-listed water utility Severn Trent and another for Sydney Airport Holdings – and has lost out to its regional peers in two major Australian deals in 2014. KIA-supported investor groups lost out to an Abu Dhabi Investment Council-backed consortium for Royal Dutch Shell's Australian oil refinery and filling stations, and to the Transurban-led consortium part-funded by ADIA for Queensland Motorways [9].

KIA's experience illustrates the challenges sovereign wealth funds face when identifying appropriate targets and selecting the right partners, even with an experienced team. The fund's failure to secure a direct investment in developed markets has also shown how rising competition for infrastructure in these economies has made assets harder to secure than they were two years ago.

Sovereign wealth funds also face asset-related challenges to investing directly. There are many attractive long-term infrastructure opportunities in demanding emerging markets, for example in sub-Saharan Africa, where there is a substantial infrastructure deficit, a fast-growing economy, rapid urbanization and an increasing and more-affluent population. These opportunities have strong fundamentals but require local knowledge and contacts to navigate local bureaucracy, legal jurisdiction and political networks. For many sovereign funds, such opportunities remain shut without the help of local specialists.

In some developed markets there are also other barriers to entry, particularly in more strategic infrastructure sectors such as telecommunications, where direct foreign state-owned investors are not welcomed. For instance, in the U.S., the China Investment Corporation (CIC) has been "politely asked to look elsewhere, even when the investment represents only a small stake of an infrastructure asset," according to Gao Xiqing, CIC's former vice chairman and president, speaking at the Economic Club of New York in October 2012.

In such situations, if sovereign funds want exposure in these markets, often the best way is through third-party managed funds. Sovereign Wealth Center data appears to support the hypothesis that sovereign wealth funds appear to favor gaining U.S. infrastructure exposure through externally managed funds: 36 percent of all sovereign wealth fund allocations to infrastructure

[8] Brett Cole, "Transurban group to pay $7.05bn for Qld Motorways," *The Australian*, April 23, 2014.

[9] Institutional Investor's Sovereign Wealth Center, *Prisoners of Fortune: Sovereign Wealth Fund Investment Trends in 2013*. http://www.sovereignwealthcenter.com/quarterly-reports.html

managers since 2006 were for U.S.-focused strategies, a stark contrast to the 11 percent that targeted European infrastructure.

But sovereign funds do not face a simple choice between private-equity style funds and direct investing. As the infrastructure market has become more challenging over the past year, some sovereign wealth funds have started changing the way they invest in infrastructure. Instead of simply awarding mandates or committing to commingled investment vehicles, they are creating strategic partnerships with commercial partners.

Partnerships in the infrastructure space have benefits to both sides, enabling the sovereign wealth fund to leverage the manager's expertise, while the commercial partner has a guaranteed backer over the period of the investment. But perhaps the greatest advantage of this arrangement is that it helps align interests, thereby relieving tensions over fee arrangements. In a partnership, the manager will usually commit a large proportion of the overall capital; for example, in the case of the Goodman Japan Development Partnership, a collaboration between Sydney-based industrial property investor, developer and manager Goodman Group and the Abu Dhabi Investment Council, each party has committed $400 million of equity [10].

Partnerships also give sovereign wealth funds greater transparency into, and control over, the assets that form the portfolio and how they are managed. This visibility allays anxiety on the part of the sovereign wealth fund by ensuring that only assets it is comfortable with become part of its portfolio. Such transparency enables the fund to manage the risk of the partnership's investments in relation to the rest of its portfolio more effectively, ensuring that risks are not concentrated in any single geography or sector, for example [11].

Another way that sovereign wealth funds have sought to increase transparency and reduce fee burdens is by setting up co-investment partnerships. For instance, the Alaska Permanent Fund, the U.S. state's oil revenue savings fund, has established an infrastructure co-investment program with New York–based Global Infrastructure Partners. In 2013, the fund made its first co-investment alongside GIP when the two investors acquired 35 percent of Netherlands-based Terminal Investment, which invests and operates container terminals around the world.

But such partnerships and co-investment arrangements are not for all sovereign wealth funds. There are funds that value liquidity, due to ongoing liabilities, or are prohibited from investing in unlisted assets under their founding legislation — for example Norway's giant Government Pension Fund Global. In these cases, the sovereign wealth fund may choose to invest in publicly listed infrastructure funds, including mutual and exchange-traded funds, or in publicly listed infrastructure companies. Equities in companies that operate in the infrastructure sector appear to have relative stability in comparison to other major asset classes [12], and can provide sovereign wealth funds with tailored and liquid exposure to infrastructure.

However, listed infrastructure allocations also have their challenges. Since the financial crisis correlations across asset classes have risen. Analysts widely considered that infrastructure had escaped this convergence, but research from Zürich-based investment bank Credit Suisse and the University of Regensburg (Germany) shows that while infrastructure is an important asset for portfolio diversification, particularly in low- and medium-risk portfolios like those of many sovereign wealth funds [13], it exhibits a high positive correlation with large-cap stocks [14]. This makes an investment less attractive when a certain proportion of total assets are already allocated to large-cap stocks, as in many sovereign wealth fund portfolios.

Finally, with investor appetite growing through the entire infrastructure lifecycle, more recently sovereign wealth funds have shown an interest in infrastructure debt. As investment banks have been forced to withdraw from financing large projects to comply with Basel III regulations, the infrastructure sector has started tapping the capital markets for financing. Sovereign Wealth Center has observed sovereign wealth funds buying infrastructure bonds and underwriting loans directly as well as allocating to infrastructure debt funds. Infrastructure debt has the advantage of providing an ongoing coupon for the investment and enables sovereign funds to get exposure to assets at the appropriate time in each project's evolution. Debt securities are now being structured to separate the higher-yield, higher-risk construction period of an asset from operating cashflows, which are longer term, safer and lower yield. Such innovative structures enable sovereign funds to tailor their exposure to an asset and provide a degree of liquidity to the investment [15].

[10] Victoria Barbary, "Building Bridges: Sovereign Wealth Fund Partnerships in Real Estate and Infrastructure Development Projects" *Institutional Investor's Sovereign Wealth Center*, March 17, 2014.

[11] For more detail see Elizabeth Pfeuti, "Escaping the Establishment", *aiCIO*, April 2014.

[12] See for example, LPX Group's NMX Infrastructure index funds, http://www.lpx-group.com/nmx/36-month-chart/indices/nmx-composite.html

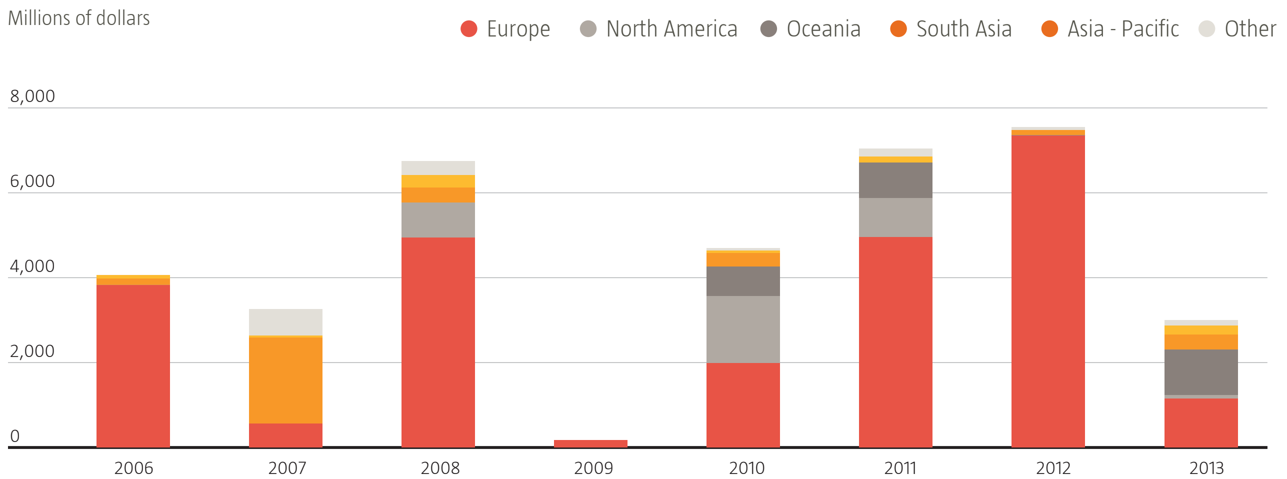
[13] See, for example, David Russ, Yogi Thambiah and Nicolo Foscari, "Can Infrastructure Investing Enhance Portfolio Efficiency?" *Credit Suisse White Paper*, May 2010.

[14] Tobias Dechant, Konrad Finkenzeller, "The Role of Infrastructure Investments in a Multi-Asset Portfolio – Answers from Dynamic Asset Allocation", http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1992520 (2012)

[15] Edward Russell-Walling, "Infrastructure Goes Down the Capital Markets Road," *Financial News*, January 13, 2014.

Chart 1

Sovereign wealth fund foreign direct investment in infrastructure by region 2006-2013



Source: Sovereign Wealth Center (2014).

Trends in SWF Investment in Infrastructure 2006-Present

With the exception of 2007, since 2006, sovereign wealth fund infrastructure investments have been biased towards European markets. Between 2006 and 2013, Europe accounted for 68 percent of all sovereign wealth funds' foreign direct investment into infrastructure, a total of $25 billion. Europe has been an attractive infrastructure market for sovereign wealth funds, due to strong and stable regulatory regimes. In particular, sovereign wealth funds favored the U.K. with its privatized market. For example, sovereign wealth funds hold shares in Reading-based Kemble Water Holdings, the owner of Thames Water, which serves London and the South East of England; London's Gatwick Airport and major port operator Associated British Ports. However, the U.K. is losing its shine as the government has changed the regulatory framework of water provision, and the opposition Labour Party suggested a price freeze for domestic electricity prices until 2017. Increased uncertainty about the U.K.'s future regulatory regimes has spooked sovereign investors; for example, Leo de Bever, the outgoing CEO of the Alberta Investment Management Corporation (AIMCo), which manages the Canadian province's sovereign wealth fund and state pension funds, told that he is wary of investing in U.K. infrastructure because he thinks British regulators are less consistent than they were five years ago.

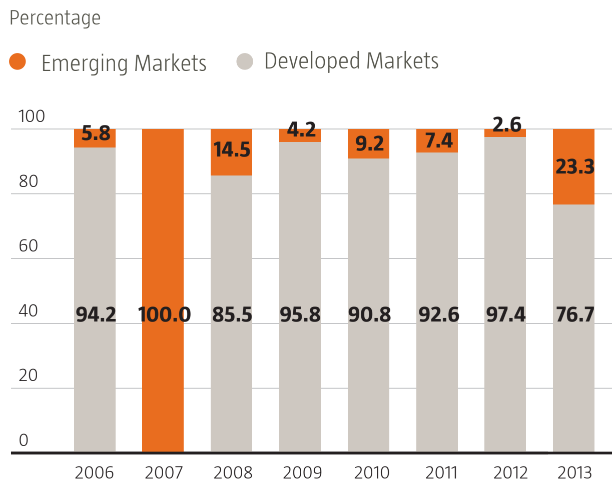
In continental Europe, where there are more nationalized infrastructure monopolies, sovereign fund investments tend to be in listed infrastructure companies, such as the Qatar Investment Authority (QIA)'s 2010 purchase of 5 percent of Paris-based utility company Veolia Environnement through its property development arm, Qatari Diar Real Estate Investment Co. Australia has also been a target for sovereign wealth funds, with investments in ports and toll roads both directly and through unlisted funds.

Sovereign wealth funds' cautious approach to infrastructure has been evident in their investments in emerging markets, where they have tended to invest in European companies with large emerging-market exposure. For example QIA has invested in Spanish energy company Iberdrola and Portuguese power distributor Energias de Portugal, not because of these companies' position in Europe, but because both generate substantial revenues in Latin America [16]. The only exception to this rule was at the height of the pre-crisis boom in 2007, when all the infrastructure investments Sovereign Wealth Center recorded were in emerging markets. Even then, however, large established players dominated the transactions. Major investments that year included Singapore's Temasek Holdings' $2 billion investment in Indian telecoms provider Bharti Airtel, and KIA's investment in Turkish airports operator Havalimanlari Holding.

[16] See Javier Santiso "Sovereign Wealth Funds in Spain and Latin America" in ESADEgeo Sovereign Wealth Funds Report 2013 and "Sovereign Wealth Funds and Spain: (re) thinking opportunities" in ESADEgeo Sovereign Wealth Funds Report 2012.

Chart 2

Sovereign wealth fund foreign direct investment in infrastructure: Developed vs. Emerging Markets



Source: Sovereign Wealth Center (2014).

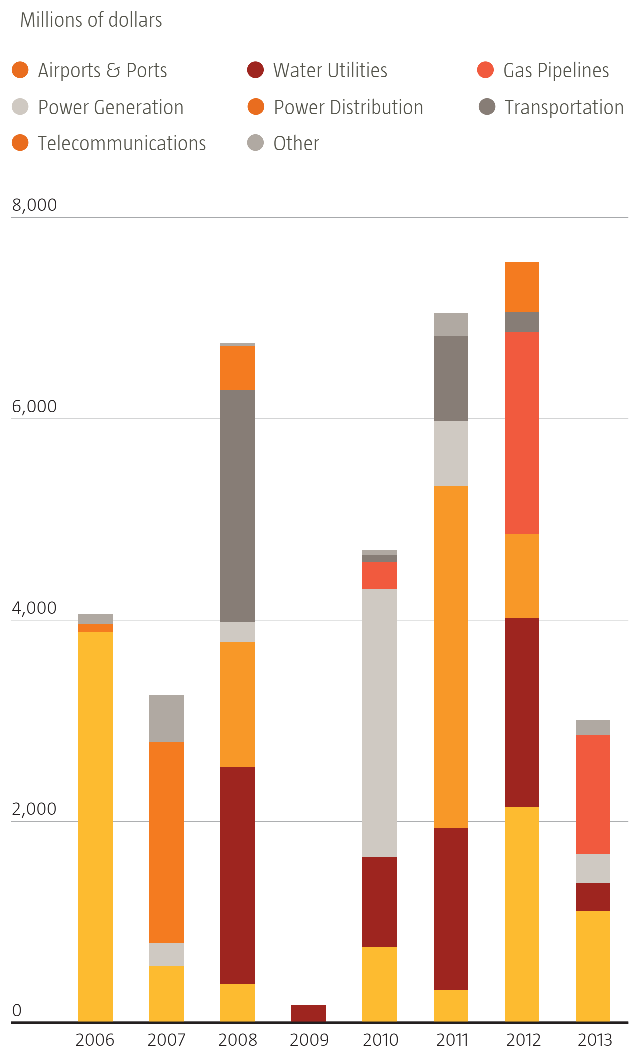
Recently, however, sovereign funds have once more started taking an interest in emerging-market infrastructure. Last year, according to Sovereign Wealth Center data, the proportion of sovereign wealth fund foreign direct investment in emerging-market infrastructure reached 23.3 percent ($700 million) of the total committed to the sector, up from only 2.6 percent ($196 million) the previous year. Latin America, where the regulatory regimes are considered stable and transparent, and competition is less fierce, has been a particularly attractive region. For example, Temasek invested almost $70 million in waterways operator Hidrovias do Brasil alongside AIMCo and P2 Brazil Infrastructure Fund, managed by local firm P2Brasil in 2012; the following year its sister fund GIC injected 300 million Brazilian reais ($135 million) into Agea Saneamento, the wastewater management unit of local sanitation company Grupo Equipav.

Sovereign wealth funds appear to be fairly opportunistic in terms of the infrastructure sectors in which they invest. Since 2006, the funds have collectively invested $9.1 billion in ports and airports globally, $7.0 billion in water utilities (primarily in the U.K.), $5.5 billion in power distribution grids and $4 billion in power generation companies and approximately $3.5 billion in both gas pipelines and transportation assets, such as toll roads and railroads.

Such wide-ranging interests may be due to the fact that most infrastructure assets are sold through a competitive bidding process. As competition has increased, sovereign wealth funds have become less likely to win the assets for which they bid. The upshot of increased competition is that sovereign wealth funds have to target a wider range of assets to gain the exposure they want and have less control over the assets they win.

Chart 3

Sector of sovereign wealth fund foreign direct investment in infrastructure 2006-2013



Source: Sovereign Wealth Center (2014).

The only sector that is relatively underrepresented in sovereign wealth funds' foreign direct infrastructure investments is telecommunications. Sovereign funds did target this sector, particularly in emerging markets, before the financial crisis as

mobile telephony took off in Africa and Asia. But increasing competition in emerging economies and consolidation in developed markets has led to more strategic mergers and acquisitions activity by trade buyers, which has made telecoms a challenging industry for sovereign wealth funds. That is not to say that they're not interested. In April 2014, GIC joined a consortium that planned to commit a total of €2.85 billion ($3.9 billion) to back an unsuccessful bid by Paris-based Bouygues Telecom for French conglomerate Vivendi's SFR unit. A month later, Temasek led a capital raising by Virgin Mobile Latin America, which provides operates mobile telecoms networks in Chile and Colombia, and is seeking to expand into Mexico and Brazil.

Table 1

Largest Direct Sovereign Wealth Fund Investments in Infrastructure since 2006

Fund	Investment	Country	Sector	Year	Value ($ Millions)
Qatar Investment Authority	Iberdrola	Spain	Power Distribution	2011	2,811
GIC	Heathrow Airport Holdings	U.K.	Ports and Airports	2006	2,389
Temasek Holdings	Bharti Airtel	India	Telecoms	2007	2,000
GIC	Kelda Group	U.K.	Water Utilities	2008	1,985
Abu Dhabi Investment Authority	Thames Water	U.K.	Water Utilities	2011	1,608
China Investment Corp.	AES Corp.	U.S.A.	Power Distribution	2010	1,581
GIC	Associated British Ports Holdings	U.K.	Ports and Airports	2006	1,437
Qatar Investment Authority	Heathrow Airport Holdings	U.K.	Transportation	2012	1,413
China Investment Corp.	Thames Water	U.K.	Water Utilities	2012	1,349
GIC	Sintonia	Italy	Transportation	2008	1,343
GIC	Transport et Infrastructures Gaz France	France	Gas Pipelines	2013	1,086
Abu Dhabi Investment Authority	Gassled	Norway	Gas Pipelines	2012	1,085
Abu Dhabi Investment Authority	Port Kembla, Port Botany	Australia	Ports and Airports	2013	1,065

Source: Sovereign Wealth Center (2014).

Conclusions

Over the past eight years, sovereign wealth funds have become more canny investors in infrastructure as the sector has become more competitive. This has led them to change the way they access the sector. While some established sovereign wealth funds have successfully built in-house infrastructure teams, others have struggled, or have decided against taking this course. Instead, some sovereign wealth funds have forged partnerships with commercial investors that enable them to access markets and sectors where there is less competition, by leveraging their partners' expertise.

While sovereign wealth funds' interest in infrastructure is increasing, they are finding it harder to source and secure assets with an attractive risk-return profile at an acceptable price, resulting in a drop-off of direct sovereign wealth fund expenditure in this sector in 2013.

As a result we may see more sovereign funds returning to asset managers – albeit with a greater degree of transparency and control over the portfolio – or to listed equities to secure assets in more challenging but less competitive geographies than Europe.

Xavier Reig

CEO and Co-Founder, Black Capital

Sovereign wealth funds and real estate: Spain's awakening

8. Sovereign wealth funds and real estate: Spain's awakening

In our previous report we explained that there was too much timidity and not enough liquidity in the Spanish real estate market, given that international investors were bidding below sellers' expectations. We also mentioned that there was a need for the market to change gear, i.e. for a series of consecutive transactions by prominent players to instil confidence by establishing credible market prices.

Well, that gear-change has happened, the timidity has been dispelled and liquidity has returned. Between the time we completed the previous report in June 2013 and the time of writing this one, July 2014, the Spanish real estate market has become an international reference.

As a result, the Iberian Peninsula has been shaken by a first wave of mainly opportunistic investors, taking positions in the two main cities, Barcelona and Madrid, reaching a total of €6.63 billion [1] in 2013 and representing 32% of the total for all sectors invested in Spain. That is three times the €2.1 billion invested in the sector in 2012 which we referred to in our last report.

This exuberant awakening was brought about by a new climate of confidence, combined with the distress situation and the excess of the various players, which we will explain presently, all fuelled by eagerness to return to the fray following five years of paralysis in the sector.

Thus, on the sellers' side, we have the following panorama: private sector companies with an imperative need to reduce their liabilities to clean up their balance sheets; banks obliged to provide for the impairment of the assets on their books; government bodies needing cash to meet payroll and other obligations and, lastly, the so-called bad bank, the SAREB [2], with more than €50.78 billion [3] in assets and the objective of offloading approximately 45% of them in the next five years. On the buyers' side, we find mainly international investors with plenty of cash, eager to enter the Spanish market in view of its current dimensions and propitious circumstances.

During the first wave of investment, the market fundamentals, and in particular the occupancy ratio and the pressure on rentals, were still in a critical state, with no signs of recovery. Also, the investments had more to do with expectations based on European exuberance, together with increased liquidity. Now the scenario is significantly different. The fundamentals have not changed, admittedly, but both the negative dynamic and the negative expectations are largely dissipating, and indeed the first green shoots are appearing in very specific areas and products. For example, the slight upturn in rentals [4] in the market for offices in the business districts of Barcelona and Madrid during the early part of 2014 allow new prices to settle around €15/m^2 and €23/m^2 respectively, following a continuous correction of as much as 40% since 2007. These are only small upturns in a market that has been completely paralysed until now, but this is where we see green shoots.

The best example to illustrate the new situation of the real estate investment market is to be found in Barcelona, with one of the transactions that brought about the change of gear in the market. In June 2013 the regional Catalonian government auctioned off thirteen buildings [5] which went into AXA Real Estate's portfolio for €174 million, giving a yield of 9.5%. Well, twelve months later, insurance group Zurich acquired a second lot for €201 million, but in this case the yield fell to 6.5% as a result of the increased competition from bidders.

We anticipated in our previous report that the greatest opportunities were to be found in asset conversion and, in this particular case, seeking the potential offered by high-end tourism. Right now there are three stellar projects increasing the supply in the high-end segment, with iconic buildings in Madrid and Barcelona. Firstly, Madrid's Edificio España, sold to the Chinese group Dailan Wanda for €265 million by Santander, which will be converted into 300 luxury apartments, a shopping centre and a hotel. Secondly, Torre Agbar in Barcelona, acquired for €150 million, which will be converted into a Grand Hyatt hotel. And lastly, the Deutsche Bank building, also in Barcelona, acquired for €90 million and to be converted into a Four Seasons hotel. Both Barcelona transactions were conducted via a local fund.

In Barcelona, the bulk of transactions concern the hotel sector. Investment in the hotel sector in 2013 reached €511 million, compared with the €303 million [6] invested in offices. Again, we should not forget the city's growing attractiveness as a tourist destination. In 2013, 7.5 million tourists visited it, and in spite of the increased hotel capacity, with 77 new hotels since 2008, the occupancy ratio has increased year after year, reaching 75%. In the case of offices, the limited supply of quality office space in the CBD is forcing up prices and shifting interest towards other areas such as the 22@ innovation district.

The case of Madrid is completely different. Offices have captured the major part of investments: €488 million, representing 70% of the €697 million invested in the two cities during the first half of 2014. When all is said and done, Madrid is Madrid, the political and financial capital. At present the offices in the CBD are practically

[1] See Expansión, 2 January 2014.
[2] SAREB - Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria ("Management Company for Assets Arising from the Banking Sector Reorganisation").
[3] Data from SAREB (valued at transfer price).
[4] See Aguirre Newman, IMAN - Spanish Real Estate Market, 13-14.
[5] Lettable area: 105,000 m^2
[6] Source: Jones Lang Lasalle

obsolete and in need of renovation in the hope that economic recovery will resume pressure on sluggish vacancy rates and rentals. The potential for recovery in rentals is what is arousing the appetite of investors, who are hoping for revaluations of between 15% and 20% in the next three to four years.

We should also mention shopping centres, which, though there has been no resurgence in consumer spending, have also seen a change in expectations. Partly also as a result of several funds such as British Land and Vastned needing to disinvest, shopping centres accounted for a large number of transactions in these first four months of 2014, totalling €1.42 billion and thus surpassing in just four months the total for the whole year 2013. The biggest transaction in shopping centres so far this year was the purchase of the Diagonal Mar shopping mall in Barcelona by Northwood Investors, for an estimated €150 million, from NAMA, the Irish counterpart of Spain's SAREB. The previous owner had paid €300 million for it in 2007. Yields on offer for prime assets in the first four months of 2014 have been around 6.5%.

The logistics segment is also feeling the effects of investors' excitement, although so far only in the initial stages. No doubt this will be the next segment to be shaken up by market logic if there are expectations of increased consumption and therefore economic activity. In 2013 investment reached €98 million spread between the two main cities, double the figure for 2012. The biggest transaction last year was carried out by the US fund Blackstone, which bought various assets in Madrid and Barcelona for €47 million, and in 2014 it also acquired a European portfolio including four logistics platforms in Spain.

As has happened in other European countries, Spanish banks have also found themselves obliged to start deleveraging in the sector. This has led to innumerable transactions involving the sale of packages of mortgage debt, real estate management platforms and other assets. The opportunistic US fund Lone Star was one of the first to appear on the scene in February 2013, with the purchase of Banco Santander's real estate bad debt portfolio for €200 million. It has also been one of the star funds so far in 2014 acquiring, together with JP Morgan, Commerzbank's Spanish real estate portfolio, the so-called EuroHypo, for €3.5 billion. This was followed by Blackstone's successful bid to acquire from Spain's bank restructuring fund, known by its Spanish acronym FROB, €6.37 billion of toxic mortgage loans previously held by Catalunya Banc, covering 40,000 properties, for which the fund will pay some €3.5 billion.

One of the main tax reforms introduced by the Spanish executive is proving crucial as a catalyst for investment in the sector. We are referring to Spain's new REITs, known as SOCIMIS, created in 2009, which since the latest amendment [7] now have a number of tax advantages, paying a 0% rate, and are becoming a very important factor in oxygenating the sector.

It is precisely through a SOCIMI that George Soros, one of the international investors with most experience in our market, has returned to the fray, with €92 million becoming one of the reference investors in the SOCIMI, Hispania, through his vehicle Quantum Fund. Hispania, with the participation of other international investors, went public in March 2014, reaching a total capitalisation of €500 million. The company is 100% controlled by the local asset manager Azora, and has as its objective investment in high-quality assets, where possible unlisted.

The case of the SOCICMI, Hispania, is not the only one. Six companies with similar profiles have been listed in the first half of 2014. The biggest of them, Merlin Properties, with a final capitalisation of €1.25 billion, is partly held by UBS (11.5%) and Goldman Sachs (6%). As in the previous case, it is managed by a Spanish shareholder, Magic Real Estate. Its first acquisition was of BBVA's 880 offices for €740 million. The remaining €510 million will be invested in the services sector, offices and logistics.

The sovereign wealth funds have not missed out on all this movement, but have so far focused their direct investment efforts on very specific transactions. The most active funds in the past few months have been on the one hand the more personalistic Arab funds, and on the other, the Canadian pension funds.

We ended the 2013 report with the purchase of Barcelona's Hotel W by Qatari Diar, which was without doubt one of the triggers of the step-change in the investment market, together with the auction previously referenced. The next transaction by a government fund was the purchase by the Canadian pension fund CPPIB, together with the U.K.'s retail leader Intu Properties, of the Parque Príncipe shopping mall in Oviedo, in October 2013 for €162 million. The new owners' expected yield is 7.2%. This is a very high-quality asset, in which the Canadian fund served as a financial lung for the U.K. one, with equity of €40 million in the transaction.

In the next case the protagonist was IPIC, from Abu Dhabi, which in November 2013 acquired a purchase option until 2016 for €450 million on the Torre Foster in Madrid, which belongs to the nationalised bank Bankia. This option was a consequence of Bankia's recently having leased practically all of the Torre Foster to CEPSA, the Spanish oil company owned by IPIC.

If the purchase option is eventually exercised, the asset could end up in the portfolio of Aabar Properties, a subsidiary of IPIC with real

[7] Act 16/2012, in force since 1 January 2013.

estate projects in its domestic market as well as in Jordan and New York. Another option would be to transfer the asset to Abu Dhabi's parent sovereign wealth fund, ADIA, which already has a presence in Spain with various office and commercial properties.

This asset, given its absolutely singular nature and its total vacancy prior to the contract with CEPSA, could only be acquired by a sovereign wealth fund giving great weight to the very long term or else for emotional reasons beyond market criteria; no other fund, whether public or private, having to render account to a board of directors would have been able to allow itself to do so. In any case, the needs of its Spanish subsidiary CEPSA provided the opportunity of expanding the sovereign wealth fund's portfolio.

Qatar was back on stage in January 2014, first buying the Hotel Renaissance in Barcelona for €78.5 million from the Marriott chain. The transaction was carried out through the investing arm QAFIP (Qatar Armed Forces Investment Portfolio) by paying €44 million and transferring obligations valued at €33 million. The sale agreement included a long-term contract for Marriott to continue operating the hotel. Together with QIA, QAFIP is one of the founders of and current investors in Qatar's main Islamic bank, Masraf Al Rayan.

The second transaction of the year was carried out by Qatar Holding's new hotel division brand, Katara Hospitality[8], with the purchase of a portfolio of five European hotels including Madrid's Intercontinental. valued at €70 million, which belonged to a former manager of Barwa Real Estate, another state enterprise of Qatari Diar, both of which are extensively dealt with in the 2013 ESADEgeo report.

However, the most significant transaction was without doubt Qatar's taking up a position as the second biggest shareholder in Colonial, a listed company. This Spanish property company, with €5.3 billion in real estate assets in Barcelona, Madrid and Paris, has been a reliable reflector of the sector's state of health. The fact that international funds are once more betting on it in 2014 is the best sign of a credible economic recovery.

Qatar first invested in Colonial at the beginning of April 2013, with a 3.7% stake, subsequently increased to 13.1% before the end of the month when it reaffirmed its position by subscribing to the €1.2 billion capital increase. The capital increase was carried out in order to restructure the Spanish company's liabilities, reducing them to €1 billion. The issue of debt also attracted the attention of other sovereign wealth funds such as Singapore's GIC, which subscribed 16%. Returning to Qatar, its play on Colonial is a double one.

[8] Both vehicles are described in detail in the 2013 ESADEgeo Sovereign Wealth Funds Report, in the chapter devoted to the real estate sector.

Colonial controls 53% of the French SIIC (REIT) SFL, in which the Qatari sovereign wealth fund acquired a 22% shareholding in the same month of April. In both cases, Qatar used its investment vehicle Qatar Holding as well as DIC Holding to attain its objectives.

The latest public transaction was carried out by Canadian pension fund PSP, together with Spain's Drago Capital, with the purchase of the Castellana 200 shopping and office complex in Madrid, in the first half of 2014. The Canadian fund had already had a Spanish presence since 2011, when it bought part of the so-called "Prisa portfolio" with three buildings in Barcelona and Madrid[9], one of which was sold last year.

Sovereign wealth funds may have taken part in more transactions during this period, since in many cases they hide behind screening vehicles of other funds or asset managers, both in order to conduct the transaction without driving the price up and simply to avoid publicity.

We should also point out that the sovereign wealth funds do not fit into the profile of "vulture funds" in the biggest transactions carried out to date, particularly those relating to "toxic" assets. On the other hand, the fact that they might not have participated directly does not mean that they are not interested, simply that they prefer to take part by investing in the various funds specialising in this type of product, such as Blackstone, Cerberus, Lone Star or Apollo, among others. Moreover, once the asset, whether real estate or financial, has been recovered, these same entities can transfer it to a fund with a more conservative profile, whether institutional or sovereign.

Let us remember that the core strategy is the preferred one for direct investment. Assets in prime zones, with solvent (triple A) tenants, preferably corporate, with long-term contracts. To which variables we must add a minimum investment volume of €100 million, as well as a liquid market. The objective is to minimise the need for management, and the risk, and to obtain economies of scale, given that the most conservative sovereign wealth funds consider real estate investment as just another financial transaction, competing with government bonds; at present, with current interest rates, bricks and mortar clearly come out on top.

Thus we can affirm that the institutional and sovereign funds have had and continue to have Spain firmly in their sights. Nevertheless there are several characteristics impeding a greater presence on the part of international investors: firstly, the structural scarcity of core-profile large-scale products; secondly, the fact that current transactions are mainly opportunistic and require subsequent management by a local team, something to which these giants of

[9] Gran Vía, 32 and Miguel Yuste, 40 in Madrid and Caspe, 6-20 in Barcelona.

investment are not accustomed; and thirdly, the slow recovery of the fundamentals. These three factors have so far prevented international investors from having a greater presence. We can therefore conclude that it is still too soon for most of them, and that we shall see them appearing as we move ahead in the economic cycle.

All the same, despite their preference for core product, sovereign wealth funds are increasingly entering at earlier stages of the value creation chain, especially in transactions involving conversion and promotion or development, but always through specific individual actions in search of high-quality assets. The exception is Nigeria's NSIA, with social housing development projects. To date, this non-core investment has not extended to Spain, but we do not discount the possibility of its happening, as it is in other European centres such as London, Paris and Milan.

Barcelona has an old thermal power station called Besós, with its three iconic chimneys. With an area of 28 hectares and more than a kilometre of shore-front, it is the city's last remaining free shore-front space. Various institutions are already working on having a proposed director plan for the end of 2014.

It is impossible to think of this old industrial site without evoking the image of the current development of London's 15-hectare Battersea Park Power Station. The old power station and its surroundings at this iconic site on the banks of the Thames are being transformed into a new urban district, preserving the power station's chimneys and structure as its main icon. The promoters are a consortium of Malaysian public-private enterprises [10], together with the Malaysian government pension fund EPF, which won the bidding against strong competition from Arab funds.

In the case of Besós, the first sovereign wealth fund that comes to mind to form part of the project would not be Malaysian, but Qatar Holding and Qatari Diar, given their string play on Barcelona in recent years.

We should remember that Qatar is currently the world's leading producer of LNG, and its real estate investment policy may be conditioned in some cases by energy interests. Spain accounted for 4.5% of its gas exports in 2011, and Qatar supplied Spain with 20% of its consumption. Given its location, Spain could play a key role at geopolitical level in reducing European dependence on Russian gas, becoming Europe's point of entry for LNG. Spain already has six regasification plants (Barcelona, Valencia, Cartagena, Huelva, La Coruña and Bilbao) and it would be necessary to extend the existing ones and improve the energy interconnection with France. Spain, as an importer of LNG, and Qatar as its biggest producer, should join forces to make this vision come true, which could also lead to an increase in Qatar's investments in Spain. In this case real estate.

Staying on the Mediterranean coast, we find the future leisure and entertainment city Barcelona World, located next to the Port Aventura amusement park in Tarragona, which receives four million visitors a year, the expansion of which, with the second Ferrari theme park after that of Abu Dhabi, Ferrari Land, will be completed in 2016. The merger of these three enclaves could also become a focus of attraction. In this case however it is unlikely that an Arab or Malaysian sovereign wealth fund would become involved specifically in the gaming industry. Although there is already a precedent: in 2007, Dubai World took a stake in MGM Resorts International, which has hotels and iconic casinos such as the Mirage in Las Vegas.

Continuing with the Arab funds, the Malaga region offers various enclaves where residential and hotel complexes focusing on luxury for their compatriots could be developed. It is all a matter of time.

Spain is in the middle of a change of cycle, and both the private sector (banks and companies) and the public sector will continue to need to convert assets into cash, offering the market a constant drip-feed of unique opportunities. At the same time, current investors will unwind positions, leaving clean assets ready to be taken by less intrepid, more institutional, and in some cases sovereign investors.

Now we can assert that 2014 was the year in which the Spanish economy left hospital and set out on the road to recovery. The Spain brand is back, and with it, capital.

[10] For more details, please refer to the 2013 ESADEgeo Sovereign Wealth Funds Report.

Patrick J. Schena
PhD, Adjunct Assistant Professor & Senior Fellow and Co-Head SovereigNET: The Fletcher Network for Sovereign Wealth and Global Capital
The Fletcher School, Tufts University

Looking Back and Launching Forward: SWF Investment in Financial Services

9. Looking Back and Launching Forward: SWF Investment in Financial Services

Introduction

It is inevitable that we begin a review of the 2013 investment trends of SWFs in banking and financial services with one an eye on the past. While seemingly far distant, the throes of the financial crisis of 2008-09 in some ways reoriented our thinking about the role of SWFs as strategic global investors. In the few years prior to the crisis, the world had become captivated by these amassing pools of state-controlled wealth, but with growing concern for their impacts on capital markets and global financial stability [1]. As the economies gasped for liquidity, deep pools of long horizon capital were sought out to arrest the fleeting capital base of large global financial institutions.

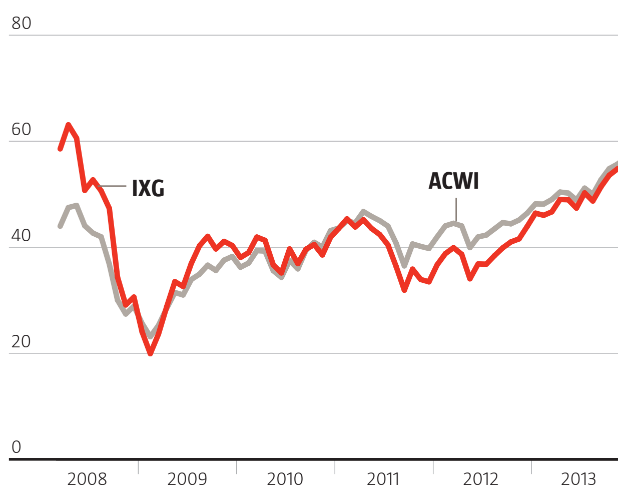
Whether cross border –as in the case of GIC or Temasek– or to stabilize a domestic banking sector –as in the case of Ireland– SWFs nimbly anchored over $70 billion in recapitalizations and emerged as among the largest investors in global financial services. With nearly 270 deals in the sector since 2006, over 70% of these were completed after the onset of the global financial crises (from now on referred as GFC) in many cases representing follow-on commitments. Rather than destabilize, these transactions represent a base of long-term capital that has contributed to the stability of the global financial system and some respects forced a reconsideration of the SWF from that of "powerbroker" [2] to sophisticated strategic financier. As the memory of the Global and Euro crises begins to fade the legacy of these investments continues to define the portfolios of SWFs. This poses an important question about the future role of SWFs as investors in the sector: What defines the current strategic objectives of SWFs in global financial services and what are the resulting implications?

Financial services without question remains the largest sector into which SWFs invest, representing over 30% of all transactions since 2006. In the years preceding the GFC, SWF investment in financial services increased steadily, peaked in 2010 at 50 transactions, dropped precipitously by over 40% in 2011, and has been recovering since. SWF investment activity in 2013 in particular marked resurgence in financial services, driven largely by investments in banks and various forms of fund or privately intermediated structures. Of the 45 deals completed in financial services in 2013, 13 were investments in commercial and investment banks, 6 in insurance firms, and 2 in exchanges. In addition, 20 investments were made in intermediary vehicles or fund structures, heavily dominated by real estate, infrastructure, and private equity funds.

A key driver of investment in this sector, we suggest, has been a recovery of returns to global financial services generally. As a proxy for SWF returns in the sector we take as a benchmark an ETF indexed to the S&P Global Financials Sector. When measured since the second quarter of 2008, i.e. in the midst of the GFC, the sector has significantly underperformed the MSCI All Country World Index on a cumulative basis. This is clearly discernible in Chart 1 as both indices drop to lows in the first quarter of 2009. The global financial services index has yet to return to 2008 levels on an adjusted basis, suggesting that holding period returns on some SWF global financial positions remain flat. However, the recovery in global equities since the GFC, and with it the financial sector, has offered opportunities to enhance performance. Importantly, informing the sector investment focus by SWFs since 2012, the global financial services index returned over 31% in 2012 compared to a 16.7% return in the same period for the MSCI all countries index. In 2013, returns were respectively 26% versus 22%, i.e. continued though more modest outperformance.

Chart 1

Relative Price Movement of the S&P Global Financials (IXG) against the MSCI All Country World Index (ACWI)



Source: Yahoo Finance (2014) and author's calculations.

Traditionally, the most active SWFs in the financial sector are among the largest each with considerable scale and commitment to a long-term investing horizon. These have included ADIC, CIC, GIC, KIA, QIA, and Temasek, who together have been responsible for almost 60%

[1] See for example McKinsey 2014, "The new power brokers: How oil, Asia, hedge funds, and private equity are shaping global capital markets …" accessible via http://www.mckinsey.com/insights/global_capital_markets/how_the_new_power_brokers_are_shaping_global_capital_markets
[2] Ibid

of SWF transactions in financial services since 2006. As a result they hold sizeable legacy positions in global banking institutions. In 2013 Malaysia's Khazanah, an active investor in the insurance sector, joined this cohort, which as a whole combined for 78% of the financial sector deals by SWFs.

The legacy of SWF in financial services has perhaps been most pronounced and effectual in the banking sector specifically. In global markets their list of active engagement is long: Citigroup by among others Kuwait and ADIA; Morgan Stanley by CIC among others; European banking sector, including UBS by GIC; Barclays by International Petroleum Investment and Qatar; Credit Suisse and Greek banks, EFG Eurobank and Alpha Bank, by Qatar; in Unicredito by LIA. And, of course, the Chinese state banking sector by any number of funds including GIC and Temasek.

In domestic markets, SWF investments in financial services, and banking in particularly, have reflected the complex realities of the strategic links between the financial and real economies. In some cases, China for example, the role of the SWF in domestic banking has been institutionalized through the establishment of a discrete subsidiary or holding company whose mandate is to administer the state's investment in the domestic banking sector. In other cases, the assets of an existing sovereign entity without such a mandate have been actively deployed to recapitalize elements of the domestic banking sector in some cases with significant structural implications for the fund itself. In 2013 we were able examine this dichotomy as it unfolds in a present day tale of two cities: Beijing and Dublin.

Beijing and Dublin: A tale of two cities

In Beijing, the China Investment Corporation (CIC) directs investment in China's banking sector through Central Huijin Investment, whose responsibility it is to manage the Chinese government's ownership in the national banking sector. Huijin was established in 2003 and, along with its holdings of Chinese bank shares, was later acquired by CIC. Its current positions include the Chinese state government's ownership interests in Agricultural Bank of China, Bank of China, China Construction Bank, and Industrial and Commercial Bank of China among other banks and non-bank financial institutions. Huijin's positions in these four banks constituted on average 50% of their share capital (ranging from approximately 35% in the case of ICBC to over 67% for the Bank of China). The total book value of its holdings as of December 2013 was approximately $136 billion [3].

In Dublin, the Irish government also holds substantial ownership interests in two key national banking institutions: Allied Irish Banks and the Bank of Ireland. Share ownership is through what was originally the National Pensions Reserve Fund of Ireland from the assets of which the banks were —somewhat by fiat— re-capitalized. Here however, the similarities end.

Huijin's management style might be described as decidedly macro-policy driven and proactive. Huijin has been an active acquirer of shares in Chinese state banks through what have amounted to open market operations that are design not only to provide price support to Chinese bank shares, but also -through a form of forward guidance- to signal government support for Chinese equity values more generally. Beginning in 2011 and continuing through four consecutive quarters into the fall of 2012, Huijin added to its sizeable positions in Chinese banks [4].

In June, 2013, Huijin resumed this share purchase program and again formally announced its intention to increase its equity stake it all four Chinese state-owned banks over the succeeding six months. The operation, executed through purchases of free float shares on the Shanghai stock exchange, left the banks' registered capital levels unaffected [5]. Once completed in mid-December, Huijin had increased in stakes in ICBC by 175 million A-shares or to a share ownership position of about 35.36 percent. Likewise, Huijin acquired 103 million A-shares of CCB resulting in ownership of 57.26 percent. Huijin also bought 113 million of its A-shares of Bank of China to increase its stake to 67.75 percent. Lastly, it acquired 179 million A-shares of Agricultural Bank of China resulting in an ownership position of 40.28 percent [6]. In a similar program executed simultaneously, Huijin also acquired additional shares in China Everbright Bank and New China Life Insurance Co [7].

During the three years period ending December 31, 2013, depicted in the chart 2, the Shanghai index *declined* cumulatively nearly 25%, while the shares of these Chinese four state-owned banks (SOBs) remained relatively flat, returning -0.5%. Nonetheless, the impact of Huijin's share purchase programs can casually discernible when tracing the relative price movements of the Shanghai index and those of China's four largest state-owned banks. During the period of the 2013 Huijin share purchase operation from June through mid-December, the Shanghai indexed increased in value by approximately 7%.

[3] To put this number into context, at December 31, 2013 the CIC, in its annual financial statements, reported total assets of $653B and specifically the value of its "financial assets at fair value" as $205B and the value of its "long-term equity investments" as $412B. See http://www.china-inv.cn/wps/wcm/connect/5c337c13-8677-4862-aa36-4efbc1b243ae/中投年报电子书文件－英文.pdf?MOD=AJPERES&CACHEID=5c337c13-8677-4862-aa36-4efbc1b243ae

[4] "Central Huijin continues purchase of bank shares," China Daily, 10 October 2012.

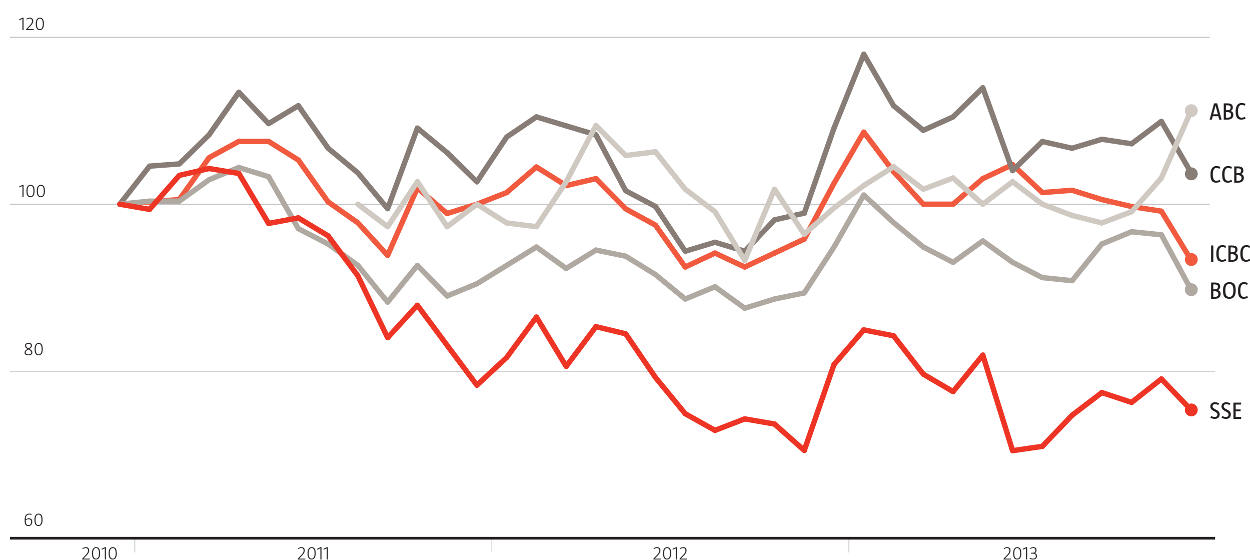
[5] "China sovereign fund Huijin completes purchase of bank shares", Reuters, 16 December 2013.

[6] "Central Huijin raises stake in four state banks", Xinhua, 17 December 2013 at http://news.xinhuanet.com/english/china/2013-12/17/c_132974582.htm

[7] "China Central Huijin adds to Big Four bank stakes", MarketWatch, 17 June 2013 at http://www.marketwatch.com/story/china-central-huijin-adds-to-big-four-bank-stakes-2013-06-17

Chart 2

Relative Price Movement of China's Four Leading State-owned Banks (A-Shares) against the Shanghai Index (SSE)



Source: Yahoo Finance (2014) and authors calculations.

The share prices of Chinese leading SOBs all experience positive price movements in the late spring in apparent response to the purchase programs, but underperformed the index (returning -1.6%) during the balance of 2013. While anecdotal, these share price movements suggest that discrete interventions by Huijin can in fact provide price support to share values of Chinese banks and as well may contribute to broader macro-economic policy objectives of the Chinese government related specifically to asset values [8].

In sharp relief to Huijin, are the remnants of Ireland's National Pensions Reserve Fund (NPRF). The NPRF was established in 2001 to prefund social welfare and public service pensions of Irish citizens. For many years the NPRF maintained a broadly diversified portfolio of global securities. However, in 2009, in response to threats to the financial viability of Allied Irish Banks (AIB) and Bank of Ireland, the Funds, at the direction of the Minister for Finance, began to invest directly in both banks. In the intervening years, investments by the Fund in both banks have totaled €20.7 billion [9]. The first of these investments - €7 billion – was used to acquire preference shares issued by AIB and Bank of Ireland in order to recapitalize them. In 2010 the NPRF participated in a share and rights issue of Bank of Ireland. Also in 2010 made a follow-on investment of €3.7 billion in the ordinary shares of AIB increasing its to 92.8%. In July 2011 an additional €10 billion was again made in both banks. In July 2012 began to trim some of its bank holdings. This continued in December 2013. However at year end 2013 of the nearly €20 billion in NPRF asset, over €13 billion remained committed to the Irish banking sector and specifically AIB and Bank of Ireland.

The Irish experience of SWF investment in financial services has indeed been transformative for the NPRF. In June 2013 the Irish government announced the establishment of the Ireland Strategic Investment Fund (ISIF). This newly created entity has absorbed the assets of the NPRF. Perhaps as importantly, its mandate, unlike that of a pension reserve fund, has been entirely restructured in order to contribute directly to promote economic activity and employment in Ireland [10]. Accordingly, the approximately €7 billion in fund assets not invested in banks will be directed to commercial investment opportunity *in Ireland itself*.

[8] Definitive causal effects on the broader market in China related to the impact of SOB share purchases awaits a more robust analysis of joint share price movements.
[9] See http://www.nprf.ie/DirectedInvestments/directedInvestments.htm for further details of the timing of the capital infusions.

[10] See http://www.nprf.ie/ISIF/IrishStrategicInvestmentFund.htm

Even as the Irish government is forced to continual revisit its legacy investments in AIB and Bank of Ireland and their impact on its strategic objectives as global investor, it has launched ahead with a new investment program that over time will be financed in part by privatizing its strategic bank holdings. It is this strategic eye to the future, which also emerges as a second key theme in the investment activity of SWFs in 2013, focused not as in the past on developed market banks, but rather on emerging market financial institutions, specifically banks in South and Southeast Asia and Russia, and motivated by a steadily rise in middle income families and an increased demand for housing and other forms of consumer finance. Several examples will serve to illustrate.

Investing on emerging markets financial institutions: Philippines, India, Cambodia and Russia

We begin with GIC in Singapore, who along with Temasek, have been active, knowledgeable investors in Asia for a number of years. In 2013, GIC combined with the Philippine conglomerate Ayala Corp to acquire 9.9% stake in Bank of the Philippine Islands from Singapore's DBS Group Holdings Ltd. The target is the third largest lender in the Philippines and the investment was valued at $680 million, making it the largest banking deal in the Philippines since 2006. Under the structure of the co-investment, GIC will acquire a 5.6% ownership position in Bank of the Philippine Islands. Ayala, already a major shareholder in the bank, will increase its existing position by 4.3% to hold 48.3% in total. For GIC, the deal strengthens its position in the banking sector in Southeast Asia and allows it to access both the stability and potential growth rooted in the positive demographics of a rapidly growing middle class among its population of more than 600 million [11].

This Philippine deal complements a second Asia banking transaction completed by GIC in April 2013 in India. Heliconia Pte Ltd, an affiliate of GIC, subscribed to 20 million shares - about 2.6% of outstanding shares of Kotak Mahindra Bank at price of Rs 648 per share or a total of Rs 1,296 crore ($237 million). The deal was intend to strengthen the bank's Tier I capital to position it to take better advance of near-term growth opportunities [12].

Not to be undone, Temasek, Singapore's second wealth fund, likewise investment turned to the financial sector in Southeast Asia in what may have been its first deal in Cambodia. The SWF became a minority partner in commercial bank established in cooperation with Canadia Bank PLC and Cambodia's postal service. Temasek's investment was placed though its subsidiary - Fullerton Financial Holdings. Temasek, through Fullerton, was expected to holding a 45% stake in Cambodia Post Bank, while Canadia Bank will hold an effective majority 50% position [13].

Lastly, we turn to Russia, where Qatari, Norwegian, Azerbaijani funds jointly participated in a $3.3 billion offering by VTB, the proceeds of which the bank intends to invest to expand its domestic market share [14]. VTB, Russia's second-largest bank, is state-controlled. Together the SWFs –all from oil producing countries- contributed approximately $1 billion of the new capital raised. While certainly not a transaction that would offer strategic diversification benefits, the deal rather was reported as a motivated as a proxy, i.e. a channel through which to gain increased exposure to Russia's positive demographics: 140 million raising middle class consumers [15].

Conclusions

We close here with a brief reflection on an important, but sometimes neglected linked between SWFs and the global financial services industry: capacity building. In 2013 there appeared an increased number of reports that SWFs had begun more actively to move away from civil-service pay structures - higher base pay versus bonuses - and were changing compensation schemes to more effectively compete with international financial services firms for top banking talent. [16] Despite being both clients to and competitors of global financial institutions, it is often easy to overlook the expanding network effects of SWFs as they become even more integrated into the fabric of global finance. Whether through enhanced training, relationships with investment partners, co-investment or employment mobility, many SWFs took another step forward in 2013 to build and acquire the advance capacity that will serve them well as strategic global investors, particularly in banking and finance.

The financial services investment activity by SWF in 2013 was marked as a year of growth and increased sector penetration that reflected legacy themes, but also a launch forward into new regions, motivated in part by positive outlooks for growth spurred by advancing socio-economic demographics. Certainly, for some sovereign investors, strategic objectives remain very much centered on preserving domestic financial stability and strengthening the foundations of their domestic banking systems. However, as the negative effects of the GFC slide further into our past, the question of SWF strategic engagement in financial services takes on new meaning. Rather than rescue and recapitalization, perhaps the time is soon approaching to focus on innovation and growth.

[11] "GIC, Ayala Pay $680 Million for Philippine Bank Stake", Wall Street Journal, 11 November 2013 at http://online.wsj.com/news/articles/SB10001424052702304644104579192802149415082

[12] "Kotak Mahindra Bank gains on preferential issue to Heliconia", Business Standard, 12 April 2013 at http://www.business-standard.com/article/markets/kotak-mahindra-bank-gains-on-preferential-issue-to-heliconia-113041200215_1.html

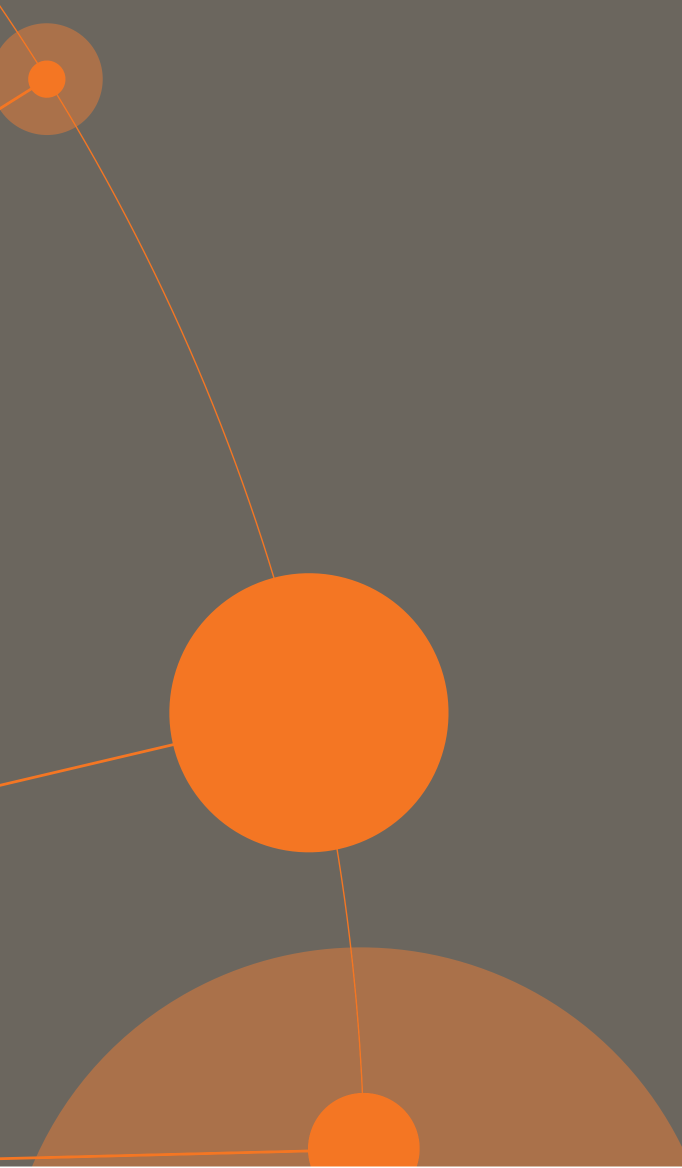
[13] "Singapore Invests in New Cambodian Bank", The Cambodian Daily, 11 September 2013 at http://www.cambodiadaily.com/archives/singapore-invests-in-new-cambodian-bank-42137/

[14] "Russia's VTB wins sovereign backing for $3.3 billion share issue", Reuters, 29 April 2013 at http://www.reuters.com/article/2013/04/29/us-russia-vtb-idUSBRE93S04820130429

[15] Ibid.

[16] See http://news.efinancialcareers.com/us-en/150642/working-for-a-sovereign-wealth-fund-has-the-potential-to-be-extremely-lucrative/

Appendix. ESADEgeo Sovereign Wealth Funds Ranking 2014



ESADEgeo Sovereign Wealth Funds Ranking 2014

Table 1

ESADEgeo Sovereign Wealth Funds Ranking 2014*

Ranking	Sovereign Wealth Fund	Assets under Management ($bn)	Country	Established
1	Government Pension Fund Global	897.60	Norway	1990
2	SAMA Foreign Holdings	741.80	Saudi Arabia	1952
3	Abu Dhabi Investment Authority	589.00	UAE	1976
4	China Investment Corporation	575.10	China	2007
5	Kuwait Investment Authority	355.00	Kuwait	1953
6	GIC	315.00	Singapore	1981
7	State Administration of Foreign Exchange (SAFE)	300.00	China	1997
8	Temasek Holdings	215.00	Singapore	1974
9	National Social Security Fund	179.60	China	2000
10	Qatar Investment Authority	175.00	Qatar	2005
11	Investment Corporation of Dubai ^	160.00	UAE	2006
12	Samruk-Kazyna ^	103.30	Kazakhstan	2008
13	Dubai World	100.00	UAE	2006
14	Australia Future Fund	97.57	Australia	2004
15	National Wealth Fund	87.62	Russia	2008
16	Revenue Regulation Fund ^	77.00	Algeria	2000
17	National Oil Fund of Republic of Kazakhstan	72.70	Kazakhstan	2000
18	Libyan Investment Authority	66.00	Libya	2006
19	Hong Kong Monetary Authority Inv.	65.10	Hong Kong (China)	1993
20	International Petroleum Investment Company	63.40	UAE	2000
21	Mubadala Development Company PJSC	60.90	UAE	2002
22	National Development	58.60	Iran	2011
23	Korea Investment Corporation	56.60	South Korea	2005
24	Alaska Permanent Fund	51.10	USA – Alaska	1976
25	Khazanah Nasional Berhard	40.90	Malaysia	1993
26	Brunei Investment Agency	39.00	Brunei	1983
27	State Oil Fund of Azerbaijan (SOFAZ)	36.60	Azerbaijan	1999
28	Banque Publique d'Investissement ^	33.60	France	2008
29	Texas Permanent School Fund	30.60	USA – Texas	1854
30	New Zealand Superannuation Fund	25.51	New Zealand	2001
31	National Pensions Reserve Fund	20.20	Ireland	2001
32	New Mexico State Investment Council	19.10	USA – New Mexico	1958
33	Alberta Heritage Savings Trust Fund	17.30	Canada	1976
34	Timor-Leste Petroleum Fund	15.70	Timor-Leste	2005
35	Fondo de Estabilidad Económica y Social (FEES)	15.20	Chile	2007
36	State General Reserve Fund	13.00	Oman	1980
37	Russian Direct Investment Fund	10.00	Russia	2011
38	Fondo de Estabilización Fiscal ^	8.50	Peru	2011
39	Fondo de Reserva de Pensiones	7.50	Chile	2006
40	Sovereign Fund of Brazil	7.00	Brazil	2008
41	Bahrain Mumtalakat Holding Company BSC	6.80	Bahrain	2006
42	Permanent Wyoming Mineral Trust Fund	6.70	USA – Wyoming	1974
43	Fondo Strategico Italiano ^	6.00	Italy	2011
44	Oman Investment Fund	6.00	Oman	2006
45	Quebec's Generations Fund ^	5.20	Canada	2006
46	Pula Fund ^	5.10	Botswana	1994
47	Heritage and Stabilization Fund	5.10	Trinidad and Tobago	2000
48	Fundo Soberano de Angola	5.00	Angola	2012
49	Alabama Trust Fund	2.20	USA – Alabama	1985
50	Oil Revenues Stabilization Fund of Mexico ^	1.90	Mexico	2000
51	Fonds de Stabilisation des Recettes Budgétaires ^	1.70	Dem. Rep. Congo	2005
52	Idaho Endowment Fund	1.70	USA – Idaho	1969
53	North Dakota Legacy Fund	1.70	USA – North Dakota	2011
54	Fondo de Ahorro de Panamá (FAP)	1.40	Panama	2011
55	Nigerian Sovereign Investment Authority	1.00	Nigeria	2011
56	Western Australia Future Fund	1.00	Australia	2012
57	Fonds souverain d'investissement stratégiques (FONSIS) ^	1.00	Senegal	2012
58	Fondo para la Estabilización Macroeconímica (FEM) ^	0.70	Venezuela	1998
59	Palestine Investment Fund	0.70	Palestine	2003
60	State Capital Investment Corporation	0.70	Vietnam	2006

Ranking	Sovereign Wealth Fund	Assets under Management ($bn)	Country	Established
61	Revenue Equalization Reserve Fund	0,52	Kiribati	1956
62	Ghana Stabilization Fund ^	0,30	Ghana	2011
63	Ghana Heritage Fund ^	0,10	Ghana	2011
64	Agaciro Development Fund	0,03	Rwanda	2014
65	National Investment Corporation	N/A	Kazakhstan	2012
66	Emirates Investment Authority	N/A	UAE	2007
67	Abu Dhabi Investment Council	N/A	UAE	1999
68	China-Africa Development Fund	N/A	China	2007
69	Public Investment Fund	N/A	Saudi Arabia	2008
70	1Malaysia Development Fund Bhd (1MDB)	N/A	Malaysia	2009
71	Mauritius Sovereign Wealth Fund	N/A	Mauritius	2010
72	Ras Al Khaimah (RAK) Investment Authority	N/A	UAE	2005
73	Colombia Sovereign Wealth Fund	N/A	Colombia	2011
74	Sovereign Fund of the Gabonese Republic ^	N/A	Gabon	1998
75	Government Investment Unit ^	N/A	Indonesia	2006
76	National Fund for Hydrocarbon Reserves ^	N/A	Mauritania	2006
77	Oil Revenue Stabilization Fund (ORSF)	N/A	South Sudan	2008
78	Fund for Future Generations ^	N/A	Equatorial Guinea	2002
79	Human Development Fund ^	N/A	Mongolia	2008
80	National Investment Fund ^	N/A	Syria	2012
81	Permanent Fund for Future Generation	N/A	Santo Tomé y Principe	2004
82	Stabilization Fund ^	N/A	Mongolia	2011
83	Oman Investment Corporation	N/A	Oman	2005
84	Papua New Guinea SWF	N/A	Papua New Guinea	2011
	Total ($bn)	**5,865**		

Source: ESADEgeo (2014) with information obtained from funds' annual reports and websites. In their absence we relied inter alia on the estimates of SovereigNet (The Fletcher School-Tufts University), Sovereign Wealth Center, Ashby Monk (Institutional Investor) and Preqin.

* This list contains the 84 active sovereign wealth funds as at September 2014.

^ Using a stricter definition (see Capapé and Guerrero, 2013), these sovereign wealth funds would be excluded from the ranking. For example funds dedicated exclusively to stabilisation, with 100% domestic portfolios, or investing only in fixed income.

Table 2

Potential new funds

Ranking	Sovereign Wealth Fund	Assets under Management ($bn)	Country	Established
83	Slovenia SWF	N/A	Slovenia	N/A
84	Northwest Territories SWF	N/A	Canada	N/A
85	Japan SWF	N/A	Japan	N/A
86	India SWF	N/A	India	N/A
87	Israel SWF	N/A	Israel	N/A
88	Philippines SWF	N/A	Philippines	N/A
89	South Africa SWF	N/A	South Africa	N/A
90	Lebanon SWF	N/A	Lebanon	N/A
91	Bolivia SWF	N/A	Bolivia	N/A
92	Georgia SWF	N/A	Georgia	N/A
93	Sierra Leone SWF	N/A	Sierra Leone	N/A
94	Tunisia SWF	N/A	Tunisia	N/A
95	Kenya SWF	N/A	Kenya	N/A
96	Uganda SWF	N/A	Uganda	N/A
97	Zambia SWF	N/A	Zambia	N/A
98	Mozambique SWF	N/A	Mozambique	N/A
99	Namibia SWF	N/A	Namibia	N/A
100	Zimbabue SWF	N/A	Zimbabwe	N/A
101	Tanzania SWF	N/A	Tanzania	N/A
102	Liberia SWF	N/A	Liberia	N/A
103	Guatemala SWF	N/A	Guatemala	N/A
104	Saskatchewan SWF	N/A	Canada	N/A

Note: These 22 funds were not active when this edition went to press. Their establishent is currently being discussed in the various States.

This report was developed by ICEX Spain Trade & Investment initiative by:

- Javier Santiso (Editor) Professor of Economics, ESADE Business School
  Vice President, ESADEgeo Center for Global Economy and Geopolitics
- Germán Ríos Director of Strategic Affairs, CAF - Development Bank of Latin America
- Patrick Schena Adjunct Assistant Professor, The Fletcher School, Tufts University
  Senior Fellow and Co-Head, SovereigNet, The Fletcher School, Tufts University
- Neeraj Prasad PhD Candidate, The Fletcher School, Tufts University
- Javier Capapé PhD Candidate, ESADE Business School
  Researcher, ESADEgeo Center for Global Economy and Geopolitics
- Tomás Guerrero PhD Candidate, University Carlos III Madrid
  Researcher, ESADEgeo Center for Global Economy and Geopolitics
- Paul Rose Professor of Law, Ohio State University – Moritz College of Law
  Executive Director, Law, Finance & Governance @ Ohio State
  Non-Resident Fellow, ESADEgeo Center for Global Economy and Geopolitics
- Victoria Barbary Director, Sovereign Wealth Center.
  Non-Resident Fellow, ESADEgeo Center for Global Economy and Geopolitics
- Xavier Reig CEO & Co-Founder, Black Capital

Analysis and Coordination

Javier Capapé & Tomás Guerrero

Infographics and Design

Samuel Granados

Yolanda Clemente & Irene de la Torre (Infographic #4 and Charts)

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The Wyoming Permanent Mineral Trust Fund

Target Asset Allocation[21]

Asset Class	Allocation
Large Cap U.S. Equity	15.0%
Small Cap U.S. Equity	3.0%
International Equity	13.0%
Private Equity	4.0%
Real Estate	7.5%
Absolute Return	7.5%
Convertibles	2.0%
Fixed Income	45.0%
Cash Equivalents	3.0%

Wyoming also has multiple objectives for its severance tax fund investment program. The general policy for Wyoming trust funds requires the State Loan and Investment Board and its external managers to invest public funds "in a manner that strives for maximum safety, provides adequate liquidity to meet all operating requirements, and achieves the highest possible investment return consistent with the primary objectives of safety and liquidity" [22].

Wyoming has set out by statute a set of permissible investments and investment allocations, but the statutes contain only two minor restrictions on investments. First, only up to 55% of the fund may be invested in common stocks. Second, prior board approval must be obtained before the state is allowed to invest in "alternative investments." The Board's investment policy adds to these restrictions by prohibiting self-dealing transactions, floating rate securities, individual certificates of deposit, letter stock and other unregistered equity, commodities (if not part of an alternative investment), most real estate transactions, natural resource properties, and short sales and margin transactions. Derivatives may be used to manage risk, but "managers must review their use of derivatives with the Board prior to employing derivative tactics" [23].

Like New Mexico, Wyoming's statutes also expressly permit state natural resource funds to invest in various investments that further targeted social policies. Among other things, the state treasurer is permitted to invest (or in some cases, pledge) up to $25 million in non-delinquent federally guaranteed or insured higher education loans from any nonprofit Wyoming corporation organized to acquire such loans; up to $300 million from the common school account in the permanent land fund to guarantee school district bonds; up to $100 million to guarantee local government bonds; and, "to promote economic development," the state treasurer may invest up to $100 million in industrial development bonds issued by joint powers boards, municipalities or counties. The state treasurer may not invest more than $50 million "for a specific public purpose authorized or directed by the legislature" [24], although the amount may be adjusted by recommendation of the state treasurer and approval by a Board subcommittee on capital financing and investments.

The state investment policy also sets out various portfolio guidelines. For example, the state may only own 1% or less of the common stock of any corporation, and only up to 1.5% of the total book value of the funds may be invested in the common stock of any corporation. Like many funds—and particularly state-owned funds—Wyoming also faces the challenge of matching its investment policy to its fiduciary duties when a higher return may be generated with investments that are at odds with other social, ethical and political goals. In a somewhat convoluted provision, the state investment policy states that "while the Board cannot make investments based on social or political objectives, it does consider the economic effects of social and humanitarian issues in the analysis of investments. The Board seeks to avoid investments that support terrorism or the violation of human rights."

The Alaska Permanent Fund

The Alaska Permanent Fund is directly overseen by the Alaska Permanent Fund Corporation (APFC), a state-owned entity that operates as a "quasi-independent state entity, designed to be insulated from political decisions yet accountable to the people as a whole" [25]. The APFC retains direct political accountability through an annual APFC report to the Legislative Budget and Audit Committee, and through approval of the APFC budget by the Alaska Legislature. As discussed above, the distinguishing feature of Alaska's fund is that a significant portion of the income generated by the fund is paid out to Alaskan citizens in the form of an annual dividend. The dividend is paid out according to a specific formula set out by statute [26]. After this calculation, a determination is made as to whether there are sufficient funds in the earnings reserve account to pay the dividend. The dividend may not be paid out of the principal. For many Alaskans, particularly native Alaskans and those in rural Alaska, the dividend is a major source of income.

[21] STATE LOAN & INV. BD., WYO., MASTER INVESTMENT POLICY AND SUB-POLICIES 23 (2012), available at http://treasurer.state.wy.us/pdf/investmentpolicy120612.pdf
[22] *Id.* at 1.
[23] *Id.* at 9.
[24] Wyo. Stat. Ann. § 9-4-715(n) (West 1977).
[25] ALASKA PERMANENT FUND CORP., AN ALASKAN'S GUIDE TO THE PERMANENT FUND 31 (2009), *available at* http://www.apfc.org/home/Media/publications/2009AlaskansGuide.pdf.
[26] Roughly speaking, the dividend is calculated by averaging the net income of the APF over the past 5 years, multiplied by 21%, divided by 2, then divided by the number of eligible applicants.

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