



Monitoring Study:

Middle Eastern Sovereign Wealth Funds in the British Media

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Introduction

An editorial in the Daily Express (1 November 2008) writes:

"There is mounting concern about individuals and sovereign wealth funds in the Middle East that are buying into key British businesses...Now they are buying out our assets, our country, with our own money. It is a sad, sickening prospect."

The Express is not alone in holding these views, which have been aired in other parts of the press. However, analysis of the way Middle Eastern SWFs are reported in the British press reveals that much of the coverage - and attendant suspicion - is based on dim comprehension of them as entities and "what if" scenarios, and not on fact or past performance.

Instead of reporting the available facts, many sections of the press focus on easy-to-repeat controversy, rather than examining what is still an evolving and partially understood, globally distributed phenomenon. This study sheds light on the misconceptions and grey areas reported in the media, accompanied by evidence.

Middle Eastern Sovereign Wealth Funds in the Media

Sovereign wealth funds have recently become far more prominent than ever before. Although the oldest fund was established in Kuwait in 1953, the term itself is far newer, and had never been mentioned in the mainstream national British press prior to 16 June 2007.¹ By 1 November 2008, the total number of mentions had reached 1,250.

Rather than being based on past performance, suspicion about SWFs is often conveyed in the language used to report them, which frequently is ominous or uncomplimentary. Karl West in the Daily Mail, reporting a potential investment, refers to one SWF as a "Middle Eastern stalker" of a Western institution (29 July 2007).

Ambrose Evans-Pritchard in the Daily Telegraph reports a German law designed to stop Russian, Chinese and Middle Eastern "giant locust funds" from "launching takeover raids" (23 August 2008).

There is also some geographical uncertainty regarding SWFs, with some in the media believing them to be a particularly Middle Eastern and oil-funded phenomenon. SWFs are "mainly from the Middle East," suggests Graham Hiscott in the Daily Mirror (3 September 2008).

However, these views are formulated on partial and distorted information, and do not represent reality. The problem is that a lack of facts and accuracy in reporting creates a hole that is often filled by hyperbole and overstatement. James Ashton in the Mail (21 September 2007) provides this example:

"Gushing from the Gulf states, a glut of petro-dollars is washing over British assets...As the oil price has soared, cash has been mounting up from Doha to Dubai."

The reality is that "a glut of petro-dollars" is not "washing over British assets," nor is investment "gushing from the Gulf states," and in the globalised context of the financial markets and the wide distribution of SWFs, the 230 miles "from Doha to Dubai" is not likely to have particular significance over other areas. Fact-checking would have substituted the sensationalism for sense in this statement.

The overall concern, as highlighted by the Guardian (21 December 2007), in responding to questions arising from SWFs is "avoiding knee-jerk jingoism." Unfortunately, in practice, the absence of balance and facts tends towards such jingoism.

¹ Taken to mean: Daily Express, Sunday Express, Financial Times, Guardian, Observer, Independent, Independent on Sunday, Daily Mail, Mail on Sunday, Daily Mirror, Sunday Mirror, People, Daily Star, Daily Star Sunday, Sun, News of the World, Daily Telegraph, Sunday Telegraph, Times and Sunday Times. This excludes the specialised press, where the earliest mention is July 2006 in the Global Investor. At the regional level, the Birmingham Post mentioned sovereign wealth funds on 14 June 2007, two days before the Telegraph.

Global Shift

The position of sovereign wealth funds in the media (described above) is exacerbated by a global economic shift - in which the relative financial power of the West is declining - that has been picked up by commentators in the press.

Much of the focus on SWFs belies a frustration at this shift. With Western financial markets in need of recapitalisation, economists and business leaders have started looking to SWFs as possible sources of funds.

However, bankers seeking "rescue finance from the sovereign wealth funds of the Middle East and Asia" is "humiliation," according to Jeremy Warner in the Independent (28 December 2007). Likewise, "going cap in hand to a Chinese bank or a Middle Eastern sovereign wealth fund" is "begging in front of the whole world," writes Richard Wachman in the Observer (4 May 2008).

This shift tends to charge the debate with the sense that something is being taken away from the West, but SWFs are not directly responsible for this shift. At any rate, this is often overstated - the importance of Western financial centres is set to continue.

Historical Context

"Sovereign wealth fund" is a recently coined term. Prior to 16 June 2007, SWFs had never before been mentioned in the British daily press, despite a few examples of funds having existed for over 50 years - both the Kuwait Investment Authority and the Kiribati (then known as the Gilbert Islands) SWFs were established in 1953.

The Monitor Group, a professional services advisory group, identifies three waves in which SWFs have been established: firstly during the 1950s; then in the 1970s and 1980s, which "reflected a spike in energy prices and the rise of the Asian tiger economies"; and finally a major wave starting in 2000, "most of which are funded by capital inflows based either on high energy prices (especially in the Middle East but also in Russia) or continued large trade surpluses (e.g., in China)."

What has brought these Funds out of their Relative Obscurity?

There are a number of reasons why sovereign wealth funds have attracted so much recent attention. One obvious point is that, given the huge financial losses suffered in Western markets, there is a need for capital, causing people to look in places they had not needed to before.

Ronald J. Gilson (professor of law and business, Columbia University) and Curtis J. Milhaupt (professor of law, Columbia Law School) identify several interrelated factors in a changing economic landscape:

"One is the spike in world oil prices, which has brought massive revenues to oil exporters such as Norway, Russia and the Middle East. A second factor is the enormous accumulation of foreign exchange reserves by Asian central banks, a portion of which has been split off and invested separately in SWFs."

Past Performance

A Declaration by the Organization for Economic Cooperation and Development, adopted at Ministerial Level on 5 June 2008, "welcomed the constructive contribution that Sovereign Wealth Funds (SWFs) make to the economic development of home and host countries. To date they have been reliable, long-term, commercially-driven investors and a force for global financial stability."

However, the opposite position is common in the British media:

"The most fruitful source of cash so far have been the Asian and Middle Eastern sovereign wealth funds, which rightly have aroused suspicion in the West." (*Alex Brummer, Daily Mail, 26 February 2008*)

Nonetheless, although uncommon, parts of the media do report an unblemished track record on the part of SWFs:

"The longest-established sovereign funds, such as that of Kuwait, have been far-sighted and honourable investors, seeking to act in the interests of both themselves, of course, but also of the host countries in which they invest." (*Hamish McRae, Independent, 28 November 2007*)

Political Objectives

"There is mounting concern about individuals and sovereign wealth funds in the Middle East that are buying into key British businesses..." (*Daily Express, 1 November 2008*)

Suspicion about would-be investors being motivated by political objectives - instead of purely financial objectives - is a common concern.

Ronald J. Gilson (professor of law and business, Columbia University) and Curtis J. Milhaupt (professor of law, Columbia Law School) note that the interests of a foreign government may differ from those of an ordinary shareholder which, in the worst-case scenario, can prompt national security concerns - for example industrial espionage, securing technology for the investor nation's domestic marketplace.

However, the International Monetary Fund comments:

"There is no clear evidence that SWF investments have been motivated by narrow political objectives. Thus far, it has not been evident that SWF governments have directly interfered with individual investment decisions of their funds or used them for political objectives."

Not all coverage in the media pigeonholes SWFs uniformly, with differences in behaviour according to geographical origin of the SWFs occasionally noted:

"Few countries worry that Qatar or the Gulf states have disturbing political agendas. But what of Russia and China? Might they not use sovereign wealth, and especially giant state industries, to acquire political leverage?" (*Times, 26 June 2008*)

Transparency

Certainly, there are issues and concerns that need addressing, with transparency being the most frequently cited. There is no uniform public disclosure of the assets, strategies and governance of sovereign wealth funds, although, as the International Monetary Fund notes:

"...some SWFs are leading the way in disclosure (Canada and Norway) and others are already taking steps to increase the amount of information they disclose (for example, in 2007, the Kuwait Investment Authority disclosed its total assets)."

The disclosure by the KIA of its total assets in fact proved that several authorities had overestimated their worth by up to 50%.²

Furthermore, lack of transparency cannot be a uniform criticism because each SWF operates differently. Alex Brummer, city editor of the Daily Mail (30 November 2007), states:

"No one can accuse Dubai International Capital, one of the most active of the sovereign wealth funds, from shying away from better governance."

Further corroboration comes from Ronald J. Gilson (professor of law and business, Columbia University) and Curtis J. Milhaupt (professor of law, Columbia Law School), who argue:

"...regardless of how many times it is invoked, the lack of transparency cannot itself be the problem, and as a result greater transparency cannot itself be the solution. The fact is that all shareholdings are non-transparent unless the disclosure regime of a particular jurisdiction imposes a disclosure obligation."

They also note that "an equity sale by a public company of a significant equity stake, even if less than five percent, must be promptly disclosed. This was the case with the Abu Dhabi SWF investment in Citigroup."³

Therefore, transparency does exist within many SWFs to varying and non-uniform degrees, as has been seen in many cases, but at any rate, a lack of transparency is more likely to be a symptom rather than a cause. Research by the Monitor Group, a professional services advisory group, found that:

"Greater transparency will facilitate a better understanding of SWF financial objectives and performance and help inform the markets, but it will not put to rest the underlying political concerns in some nations about investments made by funds owned by particular foreign governments."

² The Institute of International Finance had estimated around twice the actual disclosed value of \$213 billion.

³ In which the Abu Dhabi Investment Authority took a \$7.5 billion stake (4.9% ownership) in November 2007.

"What if" Scenarios

Fears regarding sovereign wealth funds are sometimes expressed in "what if" scenarios.

"...consider this: Middle Eastern sovereign wealth funds by their very presence as major owners of US and Western banks deter boards from funding entrepreneurs in Israel, or companies developing alternatives to oil-based fuels." (*Irwin Stelzer, Daily Telegraph, 6 February 2008*)

However, these are by definition speculative, and it is unreasonable to condemn a group or class due to events that have not taken place. As the Monitor Group, a professional services advisory group, confirms:

"Much of the SWF debate so far has been characterized by 'what if' speculation that, as our database of SWF transactions shows, is not well grounded in the reality of fund behaviors to date."

Examples of Legally Enforced Protection

"Sovereign wealth funds...have been snapping up businesses across the globe." (*Stephen Foley, Independent, 4 September 2008*)

Frequently, the ease and scale of investment by SWFs are exaggerated. It is necessary to point out that a number of laws and agencies already exist in most countries which address concerns regarding foreign ownership, and which encompass political motives and national security. For example, any SWF stake above 5% in the US, and 10% in the EU, comes before the regulator and requires prior approval.

Examples of investments rejected under these rules are:

- In 2005, Dubai Ports floated a possible takeover through British company P&O of the operations at several US ports, which failed.
- In 1988, the Kuwait Investment Authority, having acquired 20% of shares in British Petroleum, was obliged to reduce the share to under 10%.

Investments Originating with Funds Based in the Middle East

"Middle Eastern" sovereign wealth funds usually means those in Gulf Cooperation Council countries, but there are also much less financially significant funds in Algeria and Libya. Some analyses suggest there are small funds in Syria and Mauritania.

It is not representative to suggest that Western businesses are the sole recipients of investment from the Middle East; it is a globally distributed phenomenon. The McKinsey Global Institute reports that 55% of capital outflows from the Gulf (2002-2006) went to America, 18% went to Europe, 11% to Asia, 11% to the Middle East and North Africa, and 4% other.

The Monitor Group, a professional services advisory group, agreed with these figures, adding that "fewer than half the deals by number occurred in North America and Europe, with the majority elsewhere." Furthermore, SWFs demonstrate a keen interest in domestic and emerging markets.

However, that Middle Eastern SWFs have invested in the West should not logically incur greater suspicion on the region. The International Monetary Fund states:

"The information that is available suggests SWFs have been largely conservative investors...Some of the larger funds from the Middle East are known to behave as portfolio investors, investing relative to a market index, and holding only small stakes in individual companies."

McKinsey reports similar findings:

"Oil sovereign wealth funds [*the category into which Middle Eastern SWFs fit*] have for the most part invested very discreetly through professional external asset managers, an arrangement that creates an arm's-length relationship with the companies they take stakes in."

Effects of the Financial Crisis

Middle Eastern sovereign wealth fund investment patterns have been significantly affected by the 2008 financial crisis. Middle Eastern stock indices have fallen during the turmoil, in line with the rest of the world; the biggest, Saudi Arabia's, has fallen by 45% from the start of 2008 to November.

The portfolio losses sustained by the Gulf's SWFs are estimated to be around \$400 billion, which is near the figure that the Gulf Cooperation Council earned from oil sales in 2007. For example, since the Abu Dhabi Investment Authority staked \$7.5 billion in Citigroup in November 2007, it has taken a 44% loss on its investment, which is highly unattractive to any investor, no matter what the motivations may be.

It is necessary to point out that amid the financial turbulence, SWFs are actively sought as investors. Notably, it was reported in November 2008 that Gulf investors have invested £5.8 billion in Barclays. This deal had as much to do with a choice by the British bank to avoid domestic government investment - thereby maintaining its independence - as it did with anything else.

International Working Group of Sovereign Wealth Funds

The IWG, comprising 26 countries with SWFs, was put together under the auspices of the International Monetary Fund to help address some of the concerns held about SWFs.⁴ Following a series of meetings, the IWG released the "Santiago Principles," a document that stipulated the Generally Accepted Principles and Practices for SWFs.

<http://www.iwg-swf.org/pubs/santiagoprinciples.pdf>

This is a voluntary framework guiding the appropriate governance and accountability arrangements, as well as the conduct of appropriate investment practices by SWFs.

The Middle East is well represented, with Bahrain, Kuwait, Libya, Qatar and the United Arab Emirates being members, while Oman and Saudi Arabia have permanent observer status. The IWG is co-chaired by Hamad Al Hurr Al Suwaidi of the Abu Dhabi Finance Department. The Working Group states:

"As investment institutions, SWFs operate on a good faith basis, and invest on the basis of economic and financial risk and return-related considerations. In doing so, they comply with applicable regulatory and disclosure requirements in their home countries and in the countries in which they invest."

What Size Sum is "Significant"?

The Abu Dhabi Investment Authority is routinely mentioned as the largest sovereign wealth fund, with estimates ranging from \$650 billion to \$875 billion in assets. Out of the 10 largest funds in terms of assets held, Saudi Arabia and Kuwait also feature.

However, assets held is not the same as having that sum of money free to invest, so the large sums of money often quoted can be misleading. In fact, the combined value of global SWFs (thought to be \$3-\$4 trillion) can be made to appear small compared to total global financial assets, and when compared to other institutional investors. The Monitor Group, a professional services advisory group, states:

"Treated as a distinct investor group, SWFs are relatively small compared with other global financial asset classes such as pension funds, mutual funds, insurance funds, and bank assets."

By comparison, it is estimated in November 2008 that Gulf Cooperation Council countries have some \$2 trillion worth of mainly publicly funded projects planned or under way (i.e. projects that have nothing to do with overseas investment).⁵

⁴ IWG members are Australia, Azerbaijan, Bahrain, Botswana, Canada, Chile, China, Equatorial Guinea, Iran, Ireland, Korea, Kuwait, Libya, Mexico, New Zealand, Norway, Qatar, Russia, Singapore, East Timor, Trinidad and Tobago, the United Arab Emirates and the US. Permanent observers are Oman, Saudi Arabia, Vietnam, the Organization for Economic Cooperation and Development, and the World Bank.

⁵ http://www.economist.com/world/mideast-africa/displaystory.cfm?story_id=12573339

Alternatively, the US is currently estimated to spend around \$1 trillion on defence - including the mandated defence budget, and other things funded from other areas such as nuclear weapons research and maintenance, or the wars in Iraq and Afghanistan.⁶

Need for Caveats

Caveats are required when reporting the figures involved. Estimates reported make use of several sources, such as media reports, and other publicly available data, such as the International Monetary Fund's international financial statistics database, and sometimes the websites of the sovereign wealth funds or the companies they have bought stakes in. However, these sources are not necessarily accurate.

The effect of this uncertainty can greatly affect the figures that are quoted. An IMF study provides a table detailing the minimum and maximum estimated value of assets managed by SWFs collected from various publicly available sources. The study suggests that the combined assets of SWFs worldwide range from \$2,093 - \$2,968 billion; those in the Middle East range from \$877 - \$1,522 billion.

This demonstrates the large range of variables involved, and thus the need for caveats when quoting sums of money. One concrete example is the disclosure by the Kuwait Investment Authority of its total assets, which proved that several authorities had overestimated their worth by up to 50%.⁷

⁶ <http://www.independent.org/newsroom/article.asp?id=1941>

⁷ The Institute of International Finance had estimated around twice the actual disclosed value of \$213 billion.