CHAPTER II

THEORITICAL FRAMEWORK OF SOVEREIGN WEALTH FUND AND SWF LEGAL STRUCTURE

A. Understanding and mapping Sovereign Wealth Funds.

1. Sovereign Wealth Fund

The term of "Sovereign Wealth Fund" is attributed to a paper from 2005 entitled *Who Owns the Wealth of Nations* by Andrew Rozanov.[53] However, SWFs have been around since the 1950s.[54] There is no exact definition for SWFs; they are defined a number of ways by different states and entities. Definitions and categories of SWF may depend upon varying characteristics such as source of funds, intent, geography, and size.[55] The United States Treasury defines SWFs narrowly as "Government Interest Funds, Funded by Foreign Currency reserves but managed separately from official currency reserves. They are pools of money that Governments invest for profit. This money is often used for foreign

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[53] See generally Andrew Rozanov. Who Owns the Wealth of Nations?. 15 CENT. Banking J.52 (2005).

[54] Mathias Audit, Is the Erecting of Barriers Against Foreign Sovereign Wealth Funds Compatible with International Investment Law 1 (SOC'Y of INT'L ECON.L., WORKING PAPER No.29/08, 2008).

[55] Gerard Lyons, State Capitalism: The Rise of Sovereign Wealth Funds 14L. & Bus. Rev. Am. 179, 202-08 (2008).

investment."[56] Other organizations such as the Congressional Research Service define them much more broadly as "investment funds owned and managed by National governments."[57]

Due to the considerable variation in definition it can be difficult to discuss SWFs in a precise way. A study shows that there are three characteristics in common among the varying definitions: they "have to be government controlled," they "invest in a wide variety of securities," and they "operate to effectuate a variety of goals, which largely depends on the region and status of the nation."[58] These three characteristics may vary considerably from one SWF to another. But the most commonly accepted definition of SWF so far, is the one adopted by the Sovereign Wealth Fund Institute: "state owned investment fund composed of financial assets such as stocks, bonds, real estate or other financial instruments funded by foreign exchange assets".

Even if SWFs are limited in the number, according to different sources, there are between 33[59] and 74[60]; they represent a very heterogeneous group which makes it very difficult to capture all their differences, nuances, and peculiarities into a single definition without being too generic. Some experts have

[56] see more http://www.treas.gov/offices/international-affairs/economic-exchange-rates/pdf/2007_appendix-3.pdf. Last accessed 3 January 2016

[57] U.S TREASURY DEP'T, REPORT TO CONGRESS ON INTERNATIONAL ECNONOMIC AND EXCHANGE RATE POLICIES, at app., 3 (2007), available at http://www.ustreas.gov/offices/international-affairs/economic-exchange-rates/pdf/2007_appendix-3.pdf. accessed 1 February 2016

[58] Daniel Etlinger, *Sovereign Wealth Fund Liability: Private Investors Left Out in the Cold,* 18 U. MIAMI Bus. L. Rev. 59, 62 (2010).

[59] See more http://www.bernardobortolotti.com/wp-content/uploads/2013/07/SIL_Report_2013.pdf accessed 2 February 2016

[60] See more http://www.swfinstitute.org/fund-rankings/ last accessed 2 February 2016

suggested renaming Sovereign Wealth Funds as 'democratically owned wealth funds' but also this denomination won't be able to satisfy the entire sphere of SWFs and the discussion is still in progress. In recent years there have been numerous attempts to define them. This is the reason why there are various definitions of SWF as hereafter illustrated: - "Typically, sovereign wealth funds are a by-product of national budget surpluses, accumulated over the years due to favorable macroeconomic, trade and fiscal positions, coupled with long-term budget planning and spending restraint." [61]

In general SWFs have been funded in various ways: from Central Bank reserves (China and Singapore for example); the export of State-owned resources (Botswana, Chile, Abu Dhabi, or Kuwait); taxation of exports (Russia, Alaska); Fiscal surpluses (Korea or New Zealand for example); or from privatization receipts (Malaysia or Australia). Whatever their origins, objectives or funding, the SWF model is not new, even if their number has increased sharply over recent years.[62] But among the various definitions of Sovereign Wealth Funds the most complete and exhaustive and the only one that, actually, takes into consideration aspects such as shareholders and liabilities is the recently coined definition by Clark, Dixon and Monk;

[61] Andrew Rozanov - Permal Investment Management Services Limited, 2005.

[62] According to Javier Santiso in his working paper titled Sovereign Development Funds: Key financial actors of the shifting wealth of nations. SWF are not new neither the sole largely publicly-held pools of assets that are playing an increasingly prominent role in the global investment arena. For a comparison of distinct exchange reserve funds, sovereign wealth funds, and public pension funds, see Olivia S. Mitchell, John Piggott, and Cagri Kumru, "Managing Public Investment Funds: Best Practices and New Challenges", NBER Working Paper, June 2008, No.14078.

"Sovereign Wealth Funds are government-owned and controlled (directly and indirectly) investment funds that have no outside beneficiaries or liabilities (beyond the government or the citizenry in abstract) and invest their assets, either in the short or long term, according to the interests and objectives of the sovereign sponsor." [63]

2. History and the Development of Sovereign Wealth Funds

More than half of the largest SWFs were established before the year 2000. The first sovereign wealth funds were established alongside the initial oil strikes in the Persian Gulf states in the 1950s. The Kuwait Investment Authority claims to be the oldest.[64]

KIA established in 1953, 8 years prior to Kuwait's independence, the KIA is the oldest country-owned fund in the world, predated only by two state-owned funds within the U.S. state of Texas established in 1854 and 1876.[65] It was nearly 20 years until other countries established similar funds.[66] The Emiri decree—the highest decree in Kuwait issued by the leader himself — establishing the KIA as a separate entity articulated its mission as "to achieve a long term investment return on the financial reserves... providing an alternative to oil reserves, which would enable Kuwait's future generations to face the uncertainties

[63] Clark L., Dixon D., Monk A.: "Sovereign Wealth Funds legitimacy, governance and global power", Princeton University Press, 2013.

[64] The Independent, EU to agree code of principles for sovereign wealth funds, February 26, 2008.available at http://www.independent.co.uk/ last accessed 2 february 2016.

[65] Manal R. Shehabi, AN EXTRAORDINARY RECOVERY: KUWAIT FOLLOWING THE GULF WAR, Business School, University of Western Australia, 2015, DISCUSSION PAPER 15.20.

[66] *Ibid.*

ahead with greater confidence".[67] This mission expresses two primary related concerns— (a) the exhaustibility of petroleum necessitates finding alternative sources of funds that are more secure; and (b) the inter-generational commitment to Kuwaiti citizens as the owners of the resource who, rightly, ought to benefit from the assets.[68] The KIA manages the General Reserve Fund (GRF) and the Future Generations Fund (FGF). In 1960, as Kuwait was preparing for its independence from British protection, the GRF was established to serve as a government holding fund for revenues and assets. Budget surpluses are invested in the GRF, which serves a macro-stabilization objective to smooth out short-run governmental expenditures.[69]

After KIA there were some other SWFs. In 1956, the Republic of Kiribati created the investment fund called the Revenue Equalization Reserve Fund to hold the revenues from the export of phosphate applied as fertilizer. The creation of Abu Dhabi's Investment Authority (1976), Singapore's Government Investment Corporation (1981), and Norway's Government Pension Fund (1990) show the resumption of the states' concerns for SWFs, starting with the 70s, after the first oil shock.[70] But SWFs are not the only institutions managing these nations' wealth. Central banks manage reserves but with a prudential and risk averse approach, aligning objectives with national monetary and fiscal policies. Finance ministries also manage national wealth through treasury and debt

[67] *Ibid.*
[68] *Ibid.*
[69] *Ibid.*
[70] Ioana - Iulica MIHAI, The evolution of sovereign wealth funds and their influence in the global economy. The case of China, Constantin Brancoveanu University of Pitesti, Theoritical and applied economics volume XX (2013), no.5 (582). PP.93-106.

management divisions, operations bounded by government budgeting and civil service compensation.[71] For Governments therefore the most flexible and innovative institutions are Sovereign Funds. Sometimes these answer to traditional institutions such as Finance Ministries or Central Banks – like in the cases of Chile or Norway.[72] However, in some cases new institutions were created from scratch to manage the fund: New Zealand, Korea, and above all Singapore, China or the Middle East.[73]

These institutions have often been key in helping navigate the dangers faced by resource-rich countries, helping to diversify their economic base through international portfolio diversification and foreign currency sterilization.[74] In OECD countries, Norway, through the government pension fund (formerly the petroleum fund), has been one of the most successful examples of this strategy. Similar oil funds in Kazakhstan or the Pula fund from Botswana are other examples of SWF looking to invest their wealth in asset classes outside the commodity cluster in order to reduce the macroeconomic exposure of their countries to commodity fluctuations (oil and gas in the case of Kazakhstan, diamonds in the case of Botswana).[75] In the Gulf, a number of private equity firms, funded partly or totally by Sovereign Wealth stemming from the oil bonanza, were also established in the 2000s, following the creation in the 1970s

[71] Javier Santiso, Sovereign Development Funds: Key financial actors of the shifting wealth of nations, OECD Emerging Markets Network Working Paper, 2008.
[72] *Ibid,* also see Chile, Parrado, 2008: on Norway Eriksen, 2008.
[73] *Ibid.*
[74] *Ibid.*
[75] *Ibid.*

and 1980s of the very first wave of the Gulf SWFs.[76] Since the year 2000 that the "SWF phenomenon" has gained new momentum, leading to an increase in both size and number of SWFs.[77]

The rise of these funds is causing some unease and great suspicion among investment target nations.[78] Truman notes that, "the growth of SWFs reflects a dramatic redistribution of international wealth away from traditional industrial countries like the United States to countries that historically have not been major players in international finance and have had little or no role in shaping the practices, norms, and conventions governing the international financial system."[79]

The shift in the global economic power and the current weakness in Western markets have given new impetus to the debate surrounding Sovereign Wealth Funds.[80] Forecasts on funds growth suggesting that funds' assets will reach $13.4 trillion by 2017 creating new poles of economic and possibly political

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[76] *Ibid.*

[77] IFSL, Sovereign Wealth Funds 2008; Standard Chartered, State Capitalism: the rise of sovereign wealth funds, 2007.

[78] As an article from The Economist recently put it as follows: —Sovereign-wealth funds are a way to help recycle emerging-market surpluses. And yet suspicion about their motives could make their money much less welcome. . . . You can see why a call from Canada's Alberta Heritage Savings Trust Fund may strike you differently from an offer by Venezuela's Investment Fund for Macroeconomic Stabilisation.‖ Asset Backed Insecurity, THE ECONOMIST, Jan. 17, 2008, http://www.economist.com/finance/displaystory.cfm?story_ id=10533428. Last accessed 7 February 2016.

[79] Truman, Edwin. 2007. "Sovereign Wealth Funds: the Need for Greater Transparency and Accountability," Peterson Institute for International Economics Policy Brief 07-6, August.

[80] Ingilab Ahmadova, Stela Tsanib and Kenan Aslanlic, Sovereign Wealth Funds as the emerging players in the global financial arena: Characteristics, risks and governance, Revenue Watch Institute, September 2009

influence have raised new fears on the motives of the later.[81] Criticism regards the fact that funds tend to be secretive, target political as well as financial returns and operate at the whim of governments not always sympathetic to Western economic and political interests.[82]

3. SWF Investment Strategies

A SWF does not conduct investment like MNCs. MNCs generally invests through the creation of subsidiary in the host State or through a joint venture with a local business partner,[83] SWFs often invest through the acquisition of shares in existing companies and businesses.[84] SWFs often rely on outside expertise and professional fund managers.[85]

In contrast to traditional foreign exchange reserves, SWFs invest in a much broader array of assets, including stocks, bonds, fixed assets, commodities, derivatives, and alternative investments such as real estate and hedge funds.[86] Direct investments from SWFs in developing economies are also concentrated on specific projects in (1) the services sector such as finance, real estate, construction

81 *Ibid.*

82 *Ibid.*

83 See e.g., M. Sornarajah, Sovereign Wealth Funds and the Existing Structure of the Regulation of Investments, 1(2) ASIAN J. INT'L L. 267 (2011).

84 *Ibid.*

85 See generally Martin A. Weiss, Sovereign Wealth Funds: Background and Policy Issues for Congress, CONGRESSIONAL RESEARCH SERVICE 1, (2008), http://fpc.state.gov/documents/o rganizationn/110750.pdf; Stephen Jen, Economics: How Much Assets Could SWFs Farm Out?, MORGAN STANLEY GLOBAL RESEARCH (Jan. 10, 2008), http://www.morganstanley.com/view s/gef/archive/ 2008/20080111-Fri.html. Last accessed 4 March 2016

86 Sonia Yeashou Chen, POSITIONING SOVEREIGN WEALTH FUNDS AS CLAIMANTS IN INVESTOR-STATE ARBITRATION, available at: http://ssrn.com/abstract=2397668 Last accessed 4 March 2016

and utilities, (2) the manufacturing sector such as motor vehicles and petroleum products, and (3) the primary sector such as mining.[87] They offer the scale to be able to invest in infrastructure development,[88] and the upgrading of agricultural productivity, as well as in industrial development, including the build-up of green growth industries.[89] For example, the China-Africa Development Fund (hereinafter CAD fund),[90] one of China SWFs, has once invested in the civil engineering upgrade of the Nigerian railway system.[91]

B. Legal Structure of Sovereign Wealth Fund and Position of State in Investment activity.

1. Understanding the character of SWFs.

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[87] World Investment Report 2013, Global Value Chains: Investment and Trade for Development, UNCTAD 1, 11 (2013), available at http://unctad.org/en/PublicationsLibrary/wir2013_en.pdf. Last accessed 4 March 2016

[88] For example, Indonesia's Government Investment Unit, which has 80% of its total assets allocated to infrastructure and also UAE based Abu Dhabi Investment Authority maintains a 5% target allocation to infrastructure, amounting to just over $19bn. See more at https://www.preqin.com/docs/newsletters/inf/Preqin_INFSL_Nov_13_Sovereign_Wealth_Funds.pdf Last accessed 4 March 2016

[89] World Investment Report 2012 Overview, Towards A New Generation of Investment Policies, UNCTAD 1, 6-7 (2012), http://unctad.org/en/PublicationsLibrary/wir2012overview_en.pdf. Last accessed 4 March 2016

[90] For introduction to the SWF, see China Africa Development Fund, SWF INSTITUTE, available at http://www.swfinstitute.org/swfs/china-africa-development-fund/. Last accessed 4 March 2016

[91] Katarina Kobylinski, Chinese Investment in Africa: Checking the Facts and Figures, ACADEMIA. EDU (July 2012), available at http://www.academia.edu/1798405/Chinese_Investment_in_Africa_Checking_the_Facts_and_Figures. Last accessed 4 March 2016

Although SWFs belong to their respective governments, an SWF is neither managed like a central bank nor does it form part of a country's foreign exchange reserves.[92] Unlike a central bank, SWFs do not have the day-to-day responsibility for maintaining the stability of the national currency and money supply.[93] Unlike an official foreign exchange reserve, SWFs are not held in foreign currencies. Further, compared to either central banks or an official foreign exchange reserve, SWFs are able to lengthen their investment horizons, assume greater risk, and seek higher returns despite the fact that they are investing state funds.[94]

It is difficult to generalize SWFs as a class. For example, while the majority is owned by national governments, there are also those that are owned by local governments like provinces, emirates, and states (such as in Canada, the United Arab Emirates, and the United States, respectively).[95] Some are managed semi-independently—that is, the government appoints a board to oversee the operations of the SWF (for example, the Australian Government Future Fund)—while others are managed directly by their Ministry of Finance (for example, Indonesia's Pusat Investasi Pemerintah).[96] There are also those that are managed by their central banks (for example, Kazakhstan National Fund and Nigeria—

[92] Surendranath R. Jory, Mark J. Perry, and Thomas A. Hemphill, The Role of Sovereign Wealth Funds in Global Financial Intermediation, 2010, Published online in Wiley Online Library (wileyonlinelibrary.com)last accessed 4 March 2016
[93] *Ibid.*
[94] *Ibid.*
[95] *Ibid.*
[96] *Ibid.*

Excess Crude Account).[97] A few SWFs are under the direct control of their head of state (for example, the State Oil Fund of the Republic of Azerbaijan and Venezuela's Fund for Investment of Macroeconomic Stabilization).[98] Some SWFs are set up as a private company under the Companies Act, wholly owned by the government (for example, the Government of Singapore Investment Corporation).[99]

Next, all SWFs do not invest in the same way. While some invest primarily in their local economy (for example, Khazanah Nasional BHD in Malaysia), others invest predominantly abroad (for example, the China Investment Corporation).[100] There are SWFs that invest conservatively in safe assets like government bonds, and there are also those that undertake riskier investments through participation in joint ventures and/or private-equity deals and/or buyouts (for example, Abu Dhabi Investment Authority, Abu Dhabi's Mubadala Development Company, and the China Investment Corporation).[101] A few SWFs invest as pension funds in the sense that they are set up to facilitate government savings necessary to meet public pension expenditure (for example, the Government Pension Fund-Global of Norway).[102] While some governments establish only one such fund, others establish a family of those funds (for

97 *Ibid.*
98 *Ibid.*
99 *Ibid.*
100 *Ibid.*
101 *Ibid.*
102 *Ibid.*

example, the United Arab Emirates).[103] Therefore, SWFs differ in their objectives, the way they are managed, and their investment approaches.[104]

In order to understand the character of Sovereign Wealth Funds, it need to be studied from the typology of sovereign investors. We consider here the concept of "sovereign" in the broad sense, including not just the state's budgetary institutions and monetary authorities (central bank), but also the other institutions related to it, such as pension funds, SWFs and state-owned enterprises.[105]

Table 1.1 categorizes various types of sovereign investors and situates SWFs within the following sovereign investor landscape:[106]

1. Sovereign wealth funds: stabilization and savings funds, established through the transfer of natural resource revenues, excess foreign exchange reserves or privatization windfalls.

2. Central banks: monetary authorities that typically hold national foreign exchange reserves in highly liquid, 'safe haven' fixed income securities; although there has been some marginal diversification into equities or other volatile asset classes

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[103] *Ibid.*

[104] *Ibid,*

[105] Z. Bodie, M. Briere, Sovereign Wealth and Risk Management, 2012, available at http://economix.fr/pdf/workshops/2012_sfi/Bodie_Briere.pdf last accessed 5 March 2016.

[106] Alsweilem, Khalid A.; Cummine, Angela; Rietveld, Malan; Tweedie, Katherine. "A comparative study of Sovereign investor models: Institutions and policies for managing sovereign wealth" Discussion Paper, Belfer Center for Science and International Affairs and Center for International Development, Harvard Kennedy School, April 2015.

3. Public pension reserve funds: concerns over future public liabilities – particularly in countries with unfavorable demographics – have motivated the establishment of public pension reserve funds, with more global, diversified portfolios and longer investment horizons than that of the underlying pension funds that they help pre-fund.

4. Development banks, funds and agencies: there is a large and varied group of sovereign investors whose primary function is to invest in projects and sectors with high expected social and economic returns, particularly in context of private sector financing gaps.

Table 1: typology of sovereign investors[107]

SOVEREIGN INVESTOR TYPE	MAIN SOURCES OF CAPITAL	MAIN FUNCTIONS TYPICAL	INVESTMENT MODELS	EXAMPLES
Sovereign wealth funds	Resource revenues Excess foreign exchange reserves	Investing national wealth (surpluses and savings), typically through by an independent entity Promoting macroeconomic and fiscal stability	Savings funds: diversified portfolios with long-term horizons stabilization funds: highly liquid, fixed-income denominated portfolios	Norwegian Government Pension Fund Global, Abu Dhabi Investment Authority, China Investment Corporation, Kuwait Investment Authority
Central banks	Foreign exchange reserves	Held predominantly for exchange-rate management and intervention purposes	Highly liquid, fixed-income denominated portfolios Limited diversification into liquid equities, equity indexes and alternatives	National central banks Some equity exposure: Swiss National Bank, People's Bank of China, Hong Kong Monetary Authority, Saudi Arabian Monetary Agency

[107] *Ibid.*

Public pension reserve funds	Earmarked fiscal provisions and/or surplus contributions	Dedicated asset pools without short-term liabilities, promoting long-term solvency of national pension and social security systems (anticipation of rising entitlements)	Diversified portfolios with long-term horizons and ability to hold illiquid assets	Swedish AP Funds, Australia Future Fund, National Pension Fund Korea, Government Pension Investment Fund of Japan, Canadian Public Pension Investment Board
Sovereign development funds, banks and agencies	Government transfers, debt and equity-financing using own balance sheet	Investing in projects and sectors with high expected social and economic returns, particularly in context of financing gaps (commercial versus developmental orientation differs)	Large variation in assets and portfolios, with assets that may include debt, public and private equity, infrastructure and public private partnerships	National and Regional Development Banks Mubadala (UAE), Temasek (Singapore), SamrukKazyna (Kazakhstan), Khazanah (Malaysia), Public Investment Fund (Saudi Arabia)

The focus on the character of the ownership of these investment vehicles produces an identity between the sovereign and the investment vehicle.[108] Because the state is the owner, the fund is the state.[109] The perception of the close ties between state sovereign activity and the investment of its assets through a variety of vehicle including SWF become the discussion on how sovereign immunity effects of SWFs in host states.[110]

2. State Owned Enterprises as Vehicle of Sovereign Investment

According to OECD Guidelines on Corporate Governance of State-Owned Enterprises, any corporate entity recognized by national law as an

[108] Larry Cata Backer, 'Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State Owned Enterprises and the Chinese Experience', Transnational Law and Contemporary Problems, available at http://ssrn.com/abstract=1444190 2009. last accessed 5 March 2016

[109] *Ibid.*

[110] *Ibid.*

enterprise, and in which the state exercises ownership, should be considered as an SOE.[111] This includes joint stock companies, limited liability companies and partnerships limited by shares.[112] Moreover statutory corporations, with their legal personality established through specific legislation, should be considered as SOEs if their purpose and activities, or parts of their activities, are of a largely economic nature.[113]

State-owned enterprises (SOEs) is another vehicle of sovereign foreign direct investment, differ from SWFs by their sources of funding as well as by their mandate.[114] Typically, SOEs are funded through the proceeds of their activities-although some may receive subsidies-rather than by foreign reserves of the sovereign, and they are focused on their respective industry.[115]

Generally, SOEs are more prone than their private sector competitors to goal ambiguity, and they tend to have limited internal and external constraints on management.[116] These governance characteristics may, to a certain extent, support the empirical evidence pointing to the underperformance of SOEs from developed economies, compared to their private sector competitors. The evidence from emerging market SOEs, however, seems to present a more mixed

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[111] OECD Guidelines on Corporate Governance of State-Owned Enterprises - 2015 EDITION, available at http://www.oecd.org/daf/ca/OECD-Guidelines-Corporate-Governance-SOEs-2015.pdf - 2015 EDITION, available at http://www.oecd.org/daf/ca/OECD-Guidelines-Corporate-Governance-SOEs-2015.pdf last accessed 5 March 2016

[112] *Ibid.*

[113] *Ibid.*

[114] Editors Karl P. Sauvant, Lisa E. Sachs, Wouter P.F. Schmit, Jongbloed, Sovereign Investment - CONCERNS AND POLICY REACTIONS, Oxford University Press, 2012.

[115] *Ibid.*

[116] *Ibid.*

performance.[117] Outward FDI by SOEs is important both because of its magnitude and because SOEs, like SWFs, are owned and controlled by the state. The heightened attention toward FDI by SWFs is, therefore, directly relevant for FDI by SOEs.[118]

Traditionally, the government often used SOEs to provide public goods and services,[119] and State-owned enterprises are often required to implement multiple and sometimes conflicting objectives, i.e., to achieve loss-making public policy goals (e.g. universal service obligations, uniform tariffs irrespective of the costs of provision) while operating commercially.[120]

The role of SOEs has seen large changes over the past hundred years, in response to and following U.S. Government responses to the Great Depression (and again to the Western financial crisis), European and Japanese Government-led approaches to postwar reconstruction, import-substitution industrialization of

[117] Thorsten Nestman and Daria Orlova, Russia's Outward Investment (Deutsche Bank Research, Apr. 30, 2008), available at http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/ PROD0000000000224964.pdf; Daisuke Hiratsuka, Outward FDI From and Intraregional FDI in ASEAN: Trends and Drivers (Inst. of Dev. Econ. Discussion Paper No. 77, 2006), available at http://www.ide. go.jp/English/Publish/Download/Dp/pdf/077.pdf last accessed 5 March 2016

[118] Sovereign Investment, loc. cit.

[119] Public Service Obligations or PSOs—(i) goods and services produced and supplied below cost, (ii) public sector infrastructure projects contracted at prices below cost, (iii) services provided without compensation, and (iv) social services such as education and health for non-employees—are the noncommercial programs and activities of SOEs designed to meet community and social objectives determined by the Government. Their provision is the result of specific government directives to SOEs regarding the conditions (e.g., price) of their supply. PSOs would not be supplied by SOEs, or at least not on the same terms, if they were acting primarily in their own commercial interest. Instances of "good corporate citizenship" such as sponsorship are not PSOs. See Asian Development Bank – Completion Report, Indonesia: State-Owned Enterprise Governance and Privatization Program, 2008

[120] The Role of State Owned Enterprises: Providing Infrastructure and Supporting Economic Recovery, Forfás, Dublin, 2010, available at www.forfas.ie last accessed 5 March 2016

many developing countries, and atcher-era privatizations.[121] Although the trend toward market liberalization and privatization has replaced the traditional industrial-style SOEs of the Soviet era, SOEs have in the past years ramped up their international expansion, markedly buying assets in many economies and pursuing green field opportunities.[122]

3. Indonesia State Companies/State-owned Enterprises (BUMN)

In Indonesia, State Company established through Rule No. 19/1960 : the State Companies, it defined State companies as the production unit to provide the services, public need and seek profit. The objective is to support the national economic development while serving the public need and the company's going concern priorities.

The BUMN term appeared after Government Regulation Number 3 of 1983 issued, it explained about assisted model and BUMN supervision.[123] Along the way, BUMN or SOEs performances generally decline from year to year, and this was the major reason for President Soeharto in 1997 started to find the right concept to managed BUMN.[124]

[121] Sovereign Investment, loc. cit.
[122] *Ibid.*
[123] Prasetio, Dilema BUMN – Benturan Penerapan Business Judgment Rule (BJR) Dalam Keputusan Bisnis Direksi BUMN, Rayyana Komunikasindo, 2014.
[124] *Ibid.*

if we refer to Article 2, Law concerning BUMN[125], the purposes of BUMN establishment as follows:[126]

a) Contributed to national economic development in general and state economic in particular. BUMN be expected can improve the services quality to society and at the same time giving contributions in national economic growth and helped the revenue receipts of State Government.

b) Profit oriented. Even though, the purposes of Corporation establishment is profit oriented, in certain thing also doing Public Service Obligations or PSOs, Corporation can received some special task with keeping the healthy financial management principles. Therefore, Government assignment have to be along with its financing (compensation) based on commercial calculation.

c) Organize the public service in form of provisions of high quality goods and services adequately for fulfillment of the lives of many people. With these, every return from BUMN/SOEs, in form of goods or services, can fulfill people needs.

d) Become the pioneer of businesses which has not been carried out by private sector and cooperation (koperasi). This pilot project is an effort to provide goods and services that needed by society, but that kind of activity has not

[125] Law Number 19 of 2003.
[126] Prasetio, loc. cit.

been carried out by private and cooperation (koperasi) because commercially not profitable. Therefore, the task can be done by assigned the BUMN to do that things. In term of there is an urgent needs from society, government can also assigned one of BUMN/SOE that have specific function to give public services in order to do the partnership program with small-medium business actors.

e) Actively involved in giving assistance and help towards small-medium economic actors, cooperative (koperasi), and society. Thereby, the purposes of BUMN establishment that related with role of the state in participating in nation economic development which widely and individually. Like what have stipulated by Arnold Hertje, that the economic improvement of some individual and member of society not only depends on market and the existence of private economic organizations, but also it depends on the role of the State.[127]

Role of the State become more vital when a lot of experts on welfare economics believed that market system or market mechanism can not entirely solved the economic problems. The presence of the State is required in order to reduce the effect of market failure, price rigidities, and externality impact towards environment and social.[128]

3. State as Investor

[127] J.M Keynes, 1953, The General Theory of Employment, Interest, and Money, A Harvest, HBJ Book, London, p. 34-35.
[128] *Ibid.*

The state has historically served not as a meddler in the private sector but as a key partner of it—and often a more daring one, willing to take the risks that businesses won't.[129] Across the entire innovation chain, from basic research to commercialization, governments have stepped up with needed investment that the private sector has been too scared to provide.[130] In U.S.A the spending has proved transformative, creating entirely new markets and sectors, including the Internet, nanotechnology, biotechnology, and clean energy.[131] Indonesian government can do the same thing, as it is stipulated in Law Number 25 Year 2007 concerning Capital Investment, Article 1 point (9) *Domestic Capital is capital owned by the State of the Republic of Indonesia, individual Indonesian citizens, or business entities, which (may be) in the form of a corporate legal entity or not a corporate legal entity.* It is only a matter of priority and strategy, in what sectors Indonesia Government investing.

The financial crisis of 2007 has brought into sharper focus a set of rising global financial actor—the sovereign investor.[132] In the form of sovereign wealth funds (SWFs), sovereigns have become an important player in global financial markets and its stability.[133]

In case of SWFs do not have a legal personality separate from the State, the State itself that makes the investment, because the central and common

[129] Mariana Mazzucato, The Innovative State: Governments should make markets, not just fix them, published in the January / February issue of Foreign Affairs on Schumpeter's heirs, "Here come the Disrupters" (pp 61 – 68).

[130] *Ibid.*

[131] *Ibid.*

[132] *Ibid.*

[133] *Ibid.*

feature of all SWFs is their origin as investment vehicles established and controlled by a sovereign political entity.[134] The essential idea at play is captured by SWF observer - Edwin Truman of the Peterson Institute: 'A government is a different type of animal in the investing world.... We call them sovereign wealth funds, but once you're operating outside your own borders, you're not sovereign in the same sense.'[135]

It is obvious, sovereign investors have an issues related with the immunity. Therefore, it needs to be determined whether the acts performed by the State are of a commercial nature.[136] The UN Convention on Jurisdictional Immunities of States and Their Property provides important indications in this respect. While the Convention has not yet entered into force, it is nevertheless relevant as a codification of customary international law relating to State immunities.[137]

According to Article 2 (1) (c) of the Convention, a 'commercial transaction' means "(i) any commercial contract or transaction for the sale of goods or supply of services; (ii) any contract for a loan or other transaction of a financial nature [...]; (iii) any other contract or transaction of a commercial,

[134] INT'L MONETARY FUND, SOVEREIGN WEALTH FUNDS—A WORK AGENDA 4 (2008), available at http://www.imf.org/external/np/pp/eng/2008/022908.pdf. Last accessed 5 March 2016

[135] Steven R. Weisman (2007) 'A Fear of Foreign Investments,' New York Times, 21 August 2007.

[136] Article 10 UN Convention on State Immunities.

[137] See the Preamble of the Convention. The extent to which the provisions form a codification of Customary International Law can be derived from the discussions of the International Law (ILC). The Convention is indeed based on the 'draft articles' that were elaborated by the ILC. (See: ILC, 'Jurisdictional Immunities of States and their property', Yearbook of the International Law Commission 1991, Vol. II/2, at 12-63.)

industrial, trading or professional nature, but not including a contract of employment of persons." It requires not much effort to fit an investment by a State by means of an SWF within this definition. Article 2 (2) of the Convention defines further that in determining whether a contract or transaction is a 'commercial transaction', attention should mainly be paid to the nature of the transaction.

However, the Convention adds that one should also take into account the purpose of the transaction if the parties to the contract or transaction have so agreed, "or if, in the practice of the State of the forum, that purpose is relevant to determining the non-commercial character of the contract or transaction."[138] It seems undesirable, however, to rely on the purpose of a transaction to determine whether a State (or the SWF) has performed a commercial transaction when making an investment and thus whether it could enjoy immunity.[139] In any event, Article 15 (1) of the Convention provides that a State cannot invoke immunity if

[138] See J. Foakes and E. Wilmshurst, 'State Immunity: The United Nations Convention and its effect', Chatham House Briefing Paper, May 2005, at 4.

[139] In theory, it thus seems possible that a court recognizes the immunity because the purpose of the investment (or of e.g. the sudden withdrawal of an investment to disrupt the market of a State) had a political purpose. This would imply that a State or an SWF can escape the enforcement of applicable rules (e.g. on 'insider trading') because it violates the rules precisely with a political purpose! (For a discussion of the problems relating to using the 'purpose' of a transaction as a criterion, see M. Shaw, International Law, (Cambridge, Cambridge University Press 2003) at 633-638. See also L. Catá Backer, 'The Private Law of Public Law: Public Authorities as Shareholders, Golden Shares, Sovereign Wealth Funds, and the Public Law Element in Private Choice of Law', 82 Tulane Law Review 1801 (2008) at 1867, arguing that there may be a class of activity namely "sovereign activity to which sovereign immunity does not apply".) However, as I discuss further, in the UN Convention on State Immunities, it is explicitly indicated that States cannot enjoy immunity for proceedings that relate to a participation in a company.

the proceeding relates to the participation of a State in a company or other collective body.[140]

4. SWFs as Investors

For entities (like SWFs) that have a separate legal personality (whether or not under the form of a corporation), it seems accepted that they can enjoy immunity, provided that the State controls the entity.[141] However, the immunity is again restricted. It only applies as far as sovereign powers are exercised.[142] As has been indicated, a commercial transaction is considered to be an acta jure gestionis for which immunity does not apply.[143] Thus, State enterprises or other entities established by a State which have an independent legal personality do not enjoy immunity when they are engaged in a commercial transaction.[144] If an SWF acquires a stake in a company or undertakes further actions in this respect, it does not enjoy immunity from adjudicative jurisdiction. Given the fact that the SWF has in this case a legal personality that is independent

[140] The company or the collective body cannot be composed only of States or International Organizations and has to be incorporated or constituted under the law of the State of the forum or has its seat or principal place of business in that State. (See also Article 6 EU Convention on State Immunity.)

[141] See I. Brownlie, above n 158, at 337.

[142] See Article 2 (1) (b) (iii) UN Convention on State Immunities and Article 27 (2) EU Convention on State Immunity.

[143] Article 10 (1) UN Convention on State Immunities.

[144] Ibid., Article 10 (3). See also Article 10 (1) UN Convention on State Immunities.

from the State, the immunity from jurisdiction enjoyed by the State shall not be affected.[145]

Nevertheless, an Understanding in the Annex to the Convention determines that it is sometimes possible to look beyond the corporate structure ('piercing the corporate veil') and to sue the State itself if "the State entity has deliberately misrepresented its financial position or subsequently reduced its assets to avoid satisfying a claim, or other related issues."[146]

In sum, it appears that the SWF will not be able to rely on State immunity to escape claims brought before the courts in the recipient State. Participation in companies by means of SWFs can be considered acta iure gestionis for which no immunity can be claimed. This is all the more the case because SWFs always state that the investments they make are for purely economic and financial reasons.[147] According to the Santiago Principles, if other objectives would be pursued, this should be disclosed.[148]

[145] See Article 10 (3), in fine, UN Convention on State Immunities.

[146] See Understanding with respect to article 10, Annex to the UN Convention on State Immunities.

[147] Santiago Principle GAPP 19.

[148] Santiago Sub-principle GAPP 19.1. It seems not desirable, however, to rely on the purpose of an action to determine whether the State (or SWF) performs a commercial transaction and thus does not enjoy immunity. It would mean that a State that makes investments specifically political reasons would enjoy immunity.

5. State Immunity

State immunity is an institution that at its basis belongs to public international law.[149] Under the doctrine of foreign state immunity, one State is not subject to the full force of rules applicable in another State; the doctrine bars a national court from adjudicating or enforcing certain claims against foreign States.[150] It is not a defense in the sense that it removes liability.[151] The defendant State can still be held responsible for its actions if it submits to the jurisdiction of the foreign court or if an exception to immunity applies in the circumstances of a particular case. Non-State parties may also take steps to enforce the obligations of a foreign State in ways (e.g. by exercising a right of set-off) which do not require recourse to judicial proceedings. Equally, if the State's actions constitute a breach of its obligations under international law, it will remain responsible on the international plane.[152] For example, one State could espouse the claim of an

[149] R. Nowosielski, 'State Immunity and the Right of Access to Court. The Natoniewski Case Before the Polish Courts'. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=217303 last accessed 6 March 2016

[150] D. Gaukrodger, 'Foreign State Immunity and Foreign Government Controlled Investors', OECD Working Papers on International Investment, 2010/2, OECD Publishing. doi: 10.1787/5km91p0ksqs7-en

[151] Clifford Chance, State Immunity and State-Owned Enterprises, Report Prepared for the Special Representative of the UN Secretary-general on business and human rights, December 2008

[152] Draft articles on Responsibility of States for Internationally Wrongful Acts (2001). See text adopted by the International Law Commission at its fifty-third session, in 2001, and submitted to the General Assembly as a part of the Commission's report covering the work of that session (A/56/10), available at: http://untreaty.un.org/ilc/texts/instruments/english/commentaries/9_6_2001.pdf. Under Art. 4 of the draft Articles, a State is responsible in international law for the acts of its organs. Under Art. 5, "The conduct of a person or entity which is not an organ of the State under article 4 but which is empowered by the law of that State to exercise elements of the governmental authority shall be considered an act of the State under international law, provided the person or entity is acting in that capacity in the particular instance." According to the accompanying commentary (Art. 5, para. (2): "The generic term 'entity' reflects the wide variety of bodies which, though not organs, may be empowered by the law of a State to exercise elements of governmental authority. They

injured person falling under its protection and exercise diplomatic protection on that person's behalf vis-à-vis another State which is claimed to be internationally responsible for that injury.[153] Whether it would be prepared to do so and whether the negotiations would result in any prompt or satisfactory outcome for the claimant is, however, uncertain.[154]

The law of state immunity has been subject to numerous proceedings before domestic courts. When the courts of one state assume jurisdiction over another state or its representatives, the authority of the forum state to adjudicate the dispute conflicts with the principle of state equality, often expressed by the maxim "*par in parem non habet imperium*".[155] The principles of international law regarding jurisdictional immunities of states have derived mainly from the judicial practice of individual nation.[156]

The doctrine of foreign state immunity has evolved over time. From the doctrinal approach, there are two opposite doctrines regarding state immunity:

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may include public corporations, semi-public entities, public agencies of various kinds and even, in special cases, private companies, provided that in each case the entity is empowered by the law of the State to exercise functions of a public character normally exercised by State organs, and the conduct of the entity relates to the exercise of the governmental authority concerned. For example, in some countries private security firms may be contracted to act as prison guards and in that capacity may exercise public powers such as powers of detention and discipline pursuant to a judicial sentence or to prison regulations. Private or State-owned airlines may have delegated to them certain powers in relation to immigration control or quarantine."

[153] Clifford Chance, op. cit.

[154] See P Okova, ch. 16 in M Evans (ed.), International Law (Oxford University Press, 2nd ed., 2006).

[155] S. Knuchel, 'State Immunity and the Promise of Jus Cogens'. Northwestern University School of Law Volume 9, Number 2 (Spring 2011) Northwestern Journal of International Human Rights.

[156] F. J. Nicholson, 'Sucharitkul: State Immunities and Trading Activities', 2 B.C.L. Rev. 459 (1961), available at http://lawdigitalcommons.bc.edu/bclr/vol2/iss2/42 last accesed 7 March 2016

the absolute doctrine and the restricted doctrine.[157] The first period, covering the eighteenth and nineteenth centuries, has been called the period of absolute immunity, because foreign states are said to have enjoyed complete immunity from domestic legal proceedings.[158] The idea of absolute state immunity was generally accepted by domestic courts in the 19th century.[159] But absolute immunity caused unjust and unfair circumstances on private enterprises trading with governmental entities.[160]

The second period emerged during the early twentieth century, when Western nations adopted a restrictive approach to immunity in response to the increased participation of state governments in international trade.[161] So-called "restrictive" doctrine of state immunity is more suitable: a foreign state will be able to use immunity only for claims arising out of sovereign acts (acta jure imperii), but there will not be a possibility to use immunity to the claims arising out of "private law" acts (acta jure gestionis).[162] As States became involved in commercial activities, national courts began to apply a restrictive law of immunity.[163]

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157 M. Maw, 'Recent Trends In The Principle of State Immunity'. Available at http://dspace.lib.niigata-u.ac.jp:8080/dspace/bitstream/10191/1055/1/18. Last accessed 7 March 2016

158 Neringa Toleikytė, THE CONCEPT OF STATE IMMUNITY AND THE MAIN CHALLENGES, available at http://www.tf.vu.lt/dokumentai/Admin/Doktorant%C5%B3_konferencija/Toleikyte.pdf last accessed 7 March 2016.

159 *Ibid.*

160 *Ibid.*

161 L. M. Caplan, 'State Immunity, Human Rights, and Jus Cogens: A Critique of the Normative Hierarchy Theory', AJIL 97 (2003), 741 et seq. (745).

162 Neringa Toleikytė, op. Cit.

163 *Ibid.*

One purpose of the commercial exception is to protect the legitimate expectations of business partners that engage in commercial transactions with foreign States.[164] The restrictive approach is now widely reflected in case law, national statutes and international conventions, although it cannot yet be said to be universally recognized.[165] Under this theory, states are immune from suit in respect of acts of government, but not in respect of commercial activities.[166] But the biggest problem is that there is no clear boundary between commercial acts and acts of government.[167]

The doctrine of State immunity has three aspects.[168] First, subject to various exceptions, the courts of one State have no jurisdiction to determine a claim brought against another State or (in specified circumstances) other related persons.[169] This can be termed "immunity from jurisdiction".[170] Secondly, again subject to various exceptions, no measures of prejudgment or post-judgment constraint, such as attachment or arrest, may be taken by the courts or authorities of one State against the assets of another State or certain related persons.[171] This can be termed "immunity from enforcement".[172] Thirdly, foreign States and

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164 *Ibid.*
165 D. Gaukrodger, loc. cit.
166 Neringa Toleikytė, loc. cit.
167 *Ibid.*
168 Clifford Chance, op. cit.
169 *Ibid.*
170 *Ibid.*
171 *Ibid,*
172 *Ibid.*

certain related persons enjoy certain procedural privileges in court proceedings, in particular in relation to service of process.[173]

Two additional points may briefly be made concerning the jurisdiction of national courts in claims against foreign States and related persons.[174] First, a State may normally[175] consent, by agreement or by appearing otherwise than to assert its immunity, to participate in proceedings before courts of another State.[176] It may, thereby, "waive" its immunities either expressly or by implication.[177] Since immunity from jurisdiction and immunity from enforcement are treated as separate immunities, a waiver of immunity from adjudication is not taken automatically also to be a waiver of immunity from execution.[178] Secondly, in many legal systems (but not the United States[179]), the non-availability for a particular claim of State immunity does not mean that a national court will have jurisdiction to determine that.[180] This aspect of the competence of the courts of the forum State must be determined separately by rules of private international law, not rules of immunity.[181]

6. Institutional Framework

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173 *Ibid.*

174 *Ibid.*

175 According to Clifford Chance, unless the subject matter of proceedings is not justiciable before a domestic court (see, e.g., Buttes Gas and Oil Co. v Hammer [1982] AC 888 (HL)).

176 See UK SIA, s. 2; US FSIA, 28 USC s 1605(a)(1); 2004 UN Convention, Arts. 7-9.

177 Clifford Chance, op. cit.

178 See, e.g., UK SIA, s. 13(3); 2004 UN Convention, Art. 20.

179 See US FSIA, 28 USC s 1330.

180 See Sir L Collins and others (eds.), Dicey, Morris & Collins, The Conflict of Laws (Thomson, Sweet & Maxwell, 14th ed., 2006) ("Dicey"), para. 10.007.

181 Clifford Chance, loc. cit.

The institutional frameworks across SWFs differ.[182] Regardless of the governance framework, the operational management of an SWF should be conducted on an independent basis to minimize potential political influence or interference that could hinder the achievement of the SWF's objectives.[183] The —manager model and the —investment company model are the two dominant forms of institutional setup for SWFs. In the manager model, the legal owner of the pool of assets constituting the SWF (usually the ministry of finance) gives an investment mandate to an asset manager, and within this model, there are three main sub-categories:[184]

a. The central bank manages the assets under a mandate given by the ministry of finance (e.g., Norwegian Government Pension Fund Global, Botswana, and Chile). In this case, the central bank may choose to use one or more external (private) funds for parts of the portfolio.

b. A separate fund management entity, owned by the government, is set up to manage assets under a mandate given by the ministry of finance, such as the Government Investment Corporation (GIC) of Singapore. In this case, the manager may also have other asset management mandates from the public sector. For instance, GIC manages parts of the reserves of the Monetary Authority of Singapore.

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182 Al-Hassan, Abdullah and Papaioannou, Michael G. and Skancke, Martin and Sung, Cheng Chih, Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management (November 2013). IMF Working Paper No. 13/231. Available at SSRN: http://ssrn.com/abstract=2365868 last accessed 7 March 2016

183 *Ibid.*

184 *Ibid.*

c. The ministry of finance gives mandates directly to one or more external (private) fund managers. This model is generally not recommended, since awarding contracts to external fund managers is in itself an investment decision that should be carried out at arm's length from a political body, and the evaluation, monitoring and termination of management contracts requires specialized skills more likely to be found in a dedicated investment organization. However, for countries with severe human capital constraints, it can be the only feasible solution.

In the investment company model, the government as owner sets up an investment company that in turn owns the assets of the fund.[185] This model is typically employed when the investment strategy implies more concentrated investments and active ownership in individual companies (Temasek, Singapore), or the fund has a development objective in addition to a financial return objective.[186]

The institutional arrangements for a natural resource or other fund should be appropriate and commensurate for its objectives and the nature of its investments. Funds that function operationally as separate legal entities (e.g., Trinidad and Tobago and China) usually have a governance structure that differentiates an owner, a board, and the operational management of the SWF.[187] Where the fund is a unit within the central bank (e.g., Saudi Arabia and Algeria)

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185 *Ibid.*
186 *Ibid.*
187 *Ibid.*

operational independence could be embedded in a clear legal foundation and internal governance structure in which the decision making framework and oversight functions are clear and the relationship between the principal (owner) and its agent (central bank) is well established. An important consideration in adopting either approach is the cost. Setting up a fund as a separate legal entity has costs, while a unit in the central bank makes use of existing infrastructure and human resources.[188]

In the organizational structure of a SWF, it is useful to distinguish between governing and supervisory bodies.[189] The governing bodies constitute a system of delegated asset management responsibilities. The authority to invest is delegated from the top entity of the governance system, through the various governing bodies down, to the individual (internal or external) managers of assets. The delegation implies a gradual increase in the granularity of regulations pertaining to responsibilities as we move down the ladder of the organizational system. Each governing body should establish a supervisory body to assist in supervising the governing body directly below. The role of the supervisory body is to verify that the supervised unit is acting in accordance with the regulations set by the governing body immediately above it in the governance structure.

[188] *Ibid.*
[189] *Ibid.*

In a generic SWF setup, we can distinguish between five governing bodies at different levels with specific roles and responsibilities:[190]

a) The owner of the SWF, which is typically the central government. The parliament approves the laws that establish the legal structure of the SWF and, thus, the legal basis for its operations. Depending on the general division of authority between the parliament and the executive branch of government, parliament may also have a role in determining the appropriate aggregate risk level of the SWF.

b) In most cases, the government (i.e., the cabinet or the council of ministers) or the minister of finance will be carrying out the functions of the owner of the SWF. This role implies inter alia the task of setting a mandate for the investment organization, within the general framework provided by parliament.

c) The executive board is the highest governing body inside the legal structure of the SWF management organization. It sets internal rules and regulations (e.g., investment guidelines), within the mandate and legal constraints set by the owner. It also appoints the chief executive officer (CEO) of the investment organization.

d) The CEO is the administrative head of the investment organization. He/she is responsible for day-to-day operations within the guidelines set by the executive board.

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190 *Ibid.*

e) The individual managers (internal and external) operate within risk limits set by the CEO and his/her staff. Normally, the CEO will delegate the running of the investment department to a chief investment officer (CIO) that operates within the investment guidelines, with each level down in the hierarchy having a narrower investment mandate until the individual manager level.

The governing bodies have supervisory bodies working for them to verify that the level immediately below them operates within the rules and regulations that have been set for them. These typically include:[191]

a) The auditor general is, in most countries, appointed by the parliament to audit and control the activities of the executive branch of the government. One of its roles is to verify that the ministry of finance (or any other body acting as formal owner) operates within the laws and regulations laid down by the parliament and that any associated reporting to the parliament is correct and relevant.

b) The external auditor will usually be appointed by the governing body representing the owner (often the ministry of finance). The external auditor audits the accounts of the SWF and verifies that the SWF is managed within the rules and regulations set by the owner. The external auditor can also, on an ad hoc basis, perform other control activities (e.g., assess the quality of the internal control system).

[191] *Ibid.*

c) The internal auditor is appointed by the executive board and reports to it. The internal auditor supports the board in supervising the management of the SWF and verifying that internal regulations are adhered to.

d) The compliance unit is established by the CEO and serves as a tool for the CEO to verify that all activities are in compliance with the rules and regulations governing the SWF's operations.

While governance models may differ, inter alia due to differences in political institutions, there are some common principles that must be considered essential to any well-governed SWF.[192] The starting point in establishing the governance structure of an SWF should be to recognize that the bodies established to manage the assets of the SWF are essentially trustees on behalf of the people. One fundamental concern is, therefore, to establish a structure that will underpin the legitimacy of the SWF's operations and ensure that the decisions taken in the management of the SWF reflect the best interests of the people as ultimate owners of its assets. This requires a solid legal basis for the SWF and the establishment of a chain of governing bodies from the legislature down to the individual asset managers with accountability at every level.[193]

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192 *Ibid.*
193 *Ibid.*