# Report on sovereign wealth fund

Finance, Investment

# Introduction

A sovereign wealth fund (SWF) is a government-owned investment fund that is done when there is a surplus in the balance of payment. The investment portfolio comprises of investment in financial assets such as equity or hedge funds, precious metals, stock and bonds. These funds are able to invest globally as well (Roubini, 2008). The SWF are funded by the profits that are received from foreign exchange reserves that are held by the State Bank of the country or the commodity exports. Total Assets under Management by the SWF has been increasing drastically over the last several years. The maximum estimate of Sovereign Wealth Fund states around US$ 5 trillion of Assets under Management (Abdullah, 2013).

# Different Sovereign Wealth Funds that we know today

There are five types of Sovereign Wealth Funds

Stabilization Funds

These are the funds that are arranged in order to protect the economy and budget from the volatility that result in a change in commodity prices and from external shocks. This will include Chile Economic and Social Stabilization Fund and also Iran, Russia, Timor Leste Oil Stabilization Fund. The investment portfolio and objectives along with the liquidity management concerns are similar to how a country's state bank manager will follow in case of booms and bust cycles of fiscal policies. The stabilization funds mostly invest in highly liquid asset portfolio with more than 80 percent allocation in fixed income securities (Abdullah, 2013).

## Savings Funds

Saving Funds tend to share the revenue across their own generations by transformation of non-renewable asset portfolio into financial assets. This type of fund may include Abu Dhabi Investment Authority, Libya, and Russia National Wealth Fund. The investment objective is to invest in assets that provide high risk and return profile hence more than 70 percent asset allocation is in the stock market (Abdullah, 2013).

## Development Funds

Development funds are established so that funds can be allocated to socio-economic development project, which may include mostly infrastructure development. An example will be UAE Mubadala and Iran – National Development Fund (Abdullah, 2013).

## Pension Funds

These funds are arranged for pensioners with considerable future outflow in consideration related to government liability section of balance sheet (Abdullah, 2013).

## Reserve Investment Funds

Reserve investments are created because the companies plan to reduce the negative cost they carry withholding the high returns or reserves they have. The assets that are allocated in reserves are still known as reserves. The high return and risk portfolio is created, and high allocations are done in equities and another investment (Abdullah, 2013).

## Why are Sovereign Wealth Funds Risky?

Sovereign wealth funds are a matter of concern in the international trade law because the basic value of the fund is related to the trade imbalance between the different countries that create SWF and the investment activity is mostly related to mature economic systems by emerging markets state banks (Brendon, 2009). It is important to note that SWF is an instrument in itself, and it is impossible for countries to create them all the time especially for the emerging economies. Countries that have been actively involved in creation of sovereign wealth funds have developed from being debtors to creditors regime but for countries like China if there is greater capital inflow it can result in high level inflation and appreciation of the currency that can be harmful for the economic system (Brendon, 2009).

Another risk associated with sovereign wealth funds is the control of a foreign government. The major threat is related to the critical knowledge and a country trade secrets being exported to nations that are considered as unfriendly or are not allies of another country since the countries in SWFs can exploit their position with their shareholdings in the fund. The U. S. is vulnerable in this context with its trade secrets being exported to unfriendly nations giving rise to industrial frauds and espionage along with increase cyber threats and attacks on the national and local level against the US companies (Brendon, 2009).

Third major risk associated with sovereign wealth fund is the lack of transparency. Most sovereign wealth funds do not provide their key holdings; share in asset and portfolio, investment objective and performance. This murkiness in hiding these perspectives increases their risk for their true investment objectives in the country wealth (Brendon, 2009).

## How can the government reduce the risk?

It is important that governments should ensure increased transparency of the SWF because this will lead to greater comfort between the nations as well as the target fund companies that are interested in creating sovereign wealth fund (Afonso 2011).

## Conclusion

A sovereign wealth fund (SWF) is a government-owned investment fund that is done when there is a surplus in the balance of payment. The investment portfolio comprises of investment in financial assets such as equity or hedge funds, precious metals, stock, and bonds. There are five different types of sovereign wealth funds. Sovereign wealth funds are a matter of concern in the international trade law because the basic value of the fund is related to the trade imbalance between the different countries that create SWF. Lack of transparency is another major risk associated with SWF.

## References

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