NEW ZEALAND
INSTITUTE FOR
PACIFIC RESEARCH

Assessment Framework for Sovereign Funds in Pacific Island Nations

About NZIPR

The New Zealand Institute for Pacific Research (NZIPR) was launched in March 2016. Its primary role is to promote and support excellence in Pacific research. The NZIPR incorporates a wide network of researchers, research institutions and other sources of expertise in the Pacific Islands. The University of Auckland, Auckland University of Technology and Otago University lead the NZIPR. Its support partners include the New Zealand Institute of Economic Research, the University of the South Pacific, the Australian National University, Peking University, the University of Hawaii, the Secretariat for the Pacific Community, the Ministry of Foreign Affairs and Trade and the Pacific Cooperation Foundation.

About NZIER

NZIER is a specialist consulting firm that uses applied economic research and analysis to provide a wide range of strategic advice to clients in the public and private sectors, throughout New Zealand and Australia, and further afield.

Each year NZIER devotes resources to undertake and make freely available economic research and thinking aimed at promoting a better understanding of New Zealand's important economic challenges.

NZIER was established in 1958.

Authorship

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The New Zealand Institute for Pacific Research (NZIPR) was launched in March 2016. Its primary role is to promote and support excellence in Pacific research. The NZIPR incorporates a wide network of researchers, research institutions and other sources of expertise in the Pacific Islands. The University of Auckland, Auckland University of Technology and Otago University lead the NZIPR. Its support partners include the New Zealand Institute of Economic Research, the University of the South Pacific, the Australian National University, Peking University, the University of Hawaii, the Secretariat for the Pacific Community, the Ministry of Foreign Affairs and Trade and the Pacific Cooperation Foundation.

One of the five key first-year projects for the NZIPR is examining the roles of Sovereign Funds (SFs) in the Pacific Islands. This reflects the fact that SFs are often the largest single asset owner and investor in the Pacific Islands, and the income stream from these funds can also be a large part of fiscal revenues. They can be an important part of Pacific Island wealth, and may help promote economic development and buffer Pacific Island economies from shocks such as natural disasters.

Pacific Island Funds are amongst the longest established SFs in the World (e.g. Kiribati's Revenue Equalisation Reserve Fund was established in 1956), and Pacific Island SFs tend to have much more dispersed and innovative funding sources than Funds established by larger nations.

We believe there are insights and lessons from the Pacific Islands experience that will be of interest to other small economies considering the role of SFs (for example in the Caribbean), and the wider SF research community. Despite this, research attention on Pacific Island SFs has been limited, and published cross-country studies tend to be dated. Our research aims to provide an updated and comprehensive review of the role of the Pacific Island SFs.

This report is the second in a series of papers on the role of SFs. Our first report set the context of Pacific Island SF and their roles and responsibilities. Key findings included that many Pacific Island SFs appear to have multiple economic purposes in practice if not in legislation, and that the historical success rate of them meeting these purposes have been quite mixed.

Some funds have been broadly successful over a long period, but in others poor governance and investment management, along with a lack of fiscal policy control, have led to very poor fund and fiscal outcomes that have had broader negative repercussion for living standards. This highlights the need for more research and assessments of Pacific Island SFs to better understand their investment processes and how they are meeting their legislative purposes.

In this report we develop an assessment framework we believe respects the circumstances and constraints of Pacific Island Funds. The aim of this framework is to provide Pacific Island Fund staff and their stakeholders with a useful and practical guide that can be used to examine a fund's governance, its investment process, and its integration within the broader government budgeting process and policy objectives. It is not intended as a “scorecard” to be applied from afar, and the key objective is to help funds improve over time to deliver higher living standards for their populations.

In Section 2 of this report we provide a helicopter, stylised view of what best practice looks like for SFs management, drawing upon the substantial literature on fund governance and investment management.

In Section 3 we describe our assessment framework and approach to applying the framework. The starting-point for our framework is the work that the International Monetary Fund and SFs themselves have done to develop the “Santiago Principles” for SFs (see Appendix A). This outlines a set of high level principles and practices around the legal establishment of a fund and its objectives; its governance structure; investment and risk management; and a fund’s coordination with broader macroeconomic policies.

We use these principles as a guideline to develop a set of questions that can be used to assess how close a fund is to best practice standards.

2. What is best practice for Sovereign Funds Management?

Best Practice Principles

Best practice for a SF is probably best thought of an aspirational goal – it is very unlikely that any fund will be at "best practice" across all of the dimensions that matter. In addition, the notion of "best practice" is highly subjective; there is no clear consensus, for example, on the best approach to evaluate external manager performance, or to characterise fund risk levels.

While we can't be definitive on "best practice", what we can say is that common practice often falls short. For example, it is common practice for a fund (Sovereign or otherwise) to "bucket fill" (allocate to) its strategic asset allocation even when certain asset classes are very expensive and the implied risk-return trade-off is poor. It is also relatively common practice for a SF to be established without a government necessarily undertaking rigorous analysis to establish that a fund is the preferred policy instrument for dealing with the economic issue of concern.

We can also outline at a high level what the key elements involved in aiming for best practice are for a SF, drawing upon Lipsky (2008), the "Santiago Principles" established by IWG (2008), and Al-Hassan *et. al.* 2013. In short, these key elements are:

- The establishment of a clear purpose for the fund which is enshrined in legislation;
- A clear and consistent integration of the fund into macro policy settings and the government's budgeting process;
- A commitment to good internal and external fund governance, including clear lines of decision-making authorities between and across the main parties involved in managing it;
- A good investment process, guided by a clear and comprehensive set of investment and risk policies and procedures;
- A commitment to providing clear and timely communication of the fund's purpose, performance and investment activities with key stakeholders and the broader public.

Importantly, these elements are not just the responsibility of a fund's staff and Board – they involve to varying degrees all of the main parties involved in the establishment and operation of a fund. This includes key policy agencies (e.g. a central bank and/or Treasury), the judicial and executive arms of government, a fund's Board or oversight committee, and a fund's investment and operational staff.

In the case of many Pacific Island Trust Funds, as discussed in our previous report (Drew 2016), another significant set of stakeholders are foreign governments and supra-national agencies that have contributed towards the establishment of a fund, and are often represented as part of a fund's governance.

When there isn't commitment to these elements by all parties the risk is that a fund will ultimately fail to meet its economic purpose. In our previous report we highlighted several Pacific Island Funds that failed due to poor governance, including a lack of boundary between government and fund management, and a poor investment process.

But even a fund that is well-run with a good performance track record may have its economic purpose compromised if its capital or contributions are diverted by government for other purposes. This occurred to many SFs over the GFC period, including the New Zealand Superannuation Fund. We also observe that many SFs in the world today still do not have a strong commitment to transparency, which means they do not enjoy broad public support and can face difficulties investing in offshore "sensitive" assets.

Establishment of Best Practice

Given the key elements for best practice described above, our view is that a fund is likely to be operating towards or near best practice if all of the following have occurred and/or are in place today:

1. There is an established, published set of historical analyses by key policy agencies that outline the policy need for a fund.
2. That this need and any analyses have been subject to independent academic scrutiny and policy and political debate.
3. That the fund has been established through clear, concise legislation that at a minimum outlines the purpose(s) for a fund, its funding sources and distributional parameters, decision-making authorities, appointment processes for a fund's executive team (e.g. Board and CEO), financial objectives, and any non-financial objectives and/or constraints (e.g. the requirement to invest a fraction of the fund domestically, or the requirement for a Fund to hold minimum levels of liquidity).
4. That there is a clear separation of decision-making authority between Government, a fund's Board, fund staff, and external suppliers. As part of this, a fund's investment decision-making is not subject to political interference and external supplier relationships (e.g. external asset managers, custodians and consultants) are contestable and selected in a transparent manner that maximises the interest of the fund.
5. That a fund has a clear and comprehensive set of policy documents that outlines how a fund is formulated, implemented, monitored and reviewed.
6. That fund staff and its Board or oversight group 'own' these documents - there is a demonstrable commitment to following them; they are not mere "box ticking" exercises.
7. That there is a commitment to providing timely and relevant information about the fund to external stakeholders. This will include, for example, policy documents that are not commercially sensitive, and performance measures.

8. That there is a commitment by fund staff and management to continually challenge, and at times refine, their investment process in response to internal incidents, staff capability changes, changes in the external investment opportunity set, academic research, technologies, and other relevant forces. A best practice SF will still "make mistakes" and have periods of poor investment performance, the key is that the fund is a learning organisation.
9. That there is a commitment to communicate a fund's objective(s), approach and investment activities with the broader public, as a mechanism to engender ongoing public awareness and support of the fund.
10. That there is an ongoing commitment by Government to transfer any resources to the fund, and use the fund to meet its economic purpose or purposes, according to the legislative terms on which the fund was established.
11. In relation, that there is no fundamental change to (8) until such time that steps (1) to (3) have been undertaken.
12. That as a consequence of meeting the terms above, the fund is seen by the investment community and broader public as a safe and trusted pair of hands for managing a part of the nation's wealth.

The list above suggests that for the purpose of assessing a fund and its "gaps" to best practice we need an assessment framework and process that seek to uncover whether these elements are in place. We present our framework in the next section.

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3. Assessment framework

The purpose of our assessment framework is to establish whether a fund is likely to be aiming for best practice, and if not what the opportunities for improvement are. The framework involves three steps:

I. It requires that all relevant information (policy documents, legislation, external reports, *etc*) are identified and collected.

II. It requires that this information is assessed against clear criteria in order to form an initial assessment of how the fund is meeting these criteria.

III. It requires that there is substantial engagement with fund staff, stakeholders, and other parties to test and refine findings – the assessment will include objective and subjective criteria, and will involve a degree of iteration with stakeholders to arrive at a final conclusion.

Below we start with identifying the set of information that needs to be collected or developed as a starting point to assess a fund. We then outline a series of questions we would use to assess a fund's practices. Our questions are grouped under the key elements that are seen as necessary for best practice outlined in Section 2. We also cross-reference these questions with the Santiago Principles' generally accepted principles and practices (GAPP), as provided in Appendix A.

We note that not all of these questions will be applicable for all funds. For example, for some Pacific Island Funds much of the investment strategy and execution is outsourced to third, usually offshore, parties given the lack of domestic expertise and local capital markets. Hence questions around internal investment processes are less relevant. Instead, of more critical importance are the processes that the fund undergoes to select, monitor and review its external suppliers. The questions we have developed in this regard in part draw upon the guidelines for outsourcing that have been developed by the Australian Prudential Regulation Authority (APRA).

A further distinguishing feature of Pacific Island Funds is that they often have multiple economic purposes (see Appendix B). This largely reflects the Islands' limited resource base, which makes it unfeasible to create separate fund organisations and funds to meet different purposes. Our assessment framework includes questions that are designed to assess how these different purposes are reflected in governing legislation and policy documents, how the boundaries between these purposes are formally set within a fund, and how they are taken into consideration by fund staff and its stakeholders.

Finally, it is probably even more important for local PI communities to understand the purpose of their funds than what is the case in larger nations. Funds can be crucial mechanisms to support Islander's inter-generational planning and development aspirations. The more the local community understands the importance of the fund and its role, the less the funds will be susceptible to undue influence. For these reasons the assessment framework includes questions around public support and understanding of a Fund.

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Documents and information gathering requirements

1. **Establishment information**
    1.1. Policy papers outlining case for a fund (could be from national and/or supra-national and foreign government agencies)
    1.2. Record of public debate on establishment of fund
    1.3. Political party positions on the fund (if appropriate)
    1.4. Establishment legislation
    1.5. Amendments or variations
    1.6. Legislation or regulations affecting funding and spending policy (withdrawal)
    1.7. Powers of appointment

2. **Existing Fund policy documents (may include)**
    2.1. Investment Policy Statement 'IPS' or 'Investment Strategy' or 'SIPO'
    2.2. Sub-policies e.g. Philosophy and Beliefs statement; Ethics, etc
    2.3. Sub-committee bylaws or delegation policy

3. **Service agreements**
    3.1. Between Government and internal operational entities
    3.2. Statements of intent (SOI) or Memorandum of Understanding (MOU) (if any)
    3.3. Related to external service providers including
        3.3.1. Asset consultants
        3.3.2. Actuaries
        3.3.3. Custodians
        3.3.4. Fund Managers
        3.3.5. Any other external parties undertaking key fiduciary roles

4. **Provider due diligence files including**
    4.1. Request for proposal (RFP) responses
    4.2. Summaries of findings by external consultants
    4.3. Summaries prepared for board decisions on provider appointment and minutes

5. **Most recent asset allocation study**

6. **Sample quarterly reporting including**
    6.1. Individual provider reports
    6.2. Combined board report on provider and portfolio overall performance and overall asset allocation, rebalancing etc
    6.3. Board minutes – evaluation and decision sample reports

7. **Annual reports**

8. **Website documents relevant to policy/strategy, performance and governance**

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Assessment of the political and economic context

(GAPP 2)

1. Are there policy papers that outline the case for a fund?
Establishment of a fund involves sacrificing current consumption or spending plans for a future benefit. Ideally, the case for a fund should develop why it is a preferred policy instrument for the economic purpose or purposes, and the opportunity costs involved in establishment of the fund.

2. Is there evidence that the case for a fund has been debated and considered by government and the broader public?
A fund is more likely to be successful and enjoy enduring support if its establishment was subject to broader public debate and scrutiny.

3. Do political parties support the fund as part of their official policy positions?
A fund is more likely to be successful and enjoy enduring support if it is supported by parties across the political spectrum.

Assessment of Integration with Government Policy

(GAPP 3, 4, 5)

4. Are there clear rules and arrangements established with regards the funding, withdrawal and spending from the fund?
These are critical for any type of SF and need to be robust to meet the purpose of the fund. Robustness is more assured if funding and withdrawal rules are publically disclosed and enshrined in legislation, with clear mechanisms outlining how both current and future governments are 'bound' by the rules.

5. If the fund's activities have significant macroeconomic implications (i.e. a fund with a stabilisation purpose), is there coordination with other macro agencies?
Coordination requires that fund staff and agencies share resources and information as appropriate (e.g. in the budgeting process). In smaller PI nations, coordination could also include the deployment of flexible working groups drawn from fund and other government staff to work through issues.

6. If the fund has a macro stabilisation purpose, is there a shared understanding of how the fund is to be used for this purpose, including in times of stress, between policy agencies and government?
A fund is more likely to be successful in meeting its macro stabilisation purpose if there is a shared understanding and "plan of action" in times of stress given how time critical these events can be. .

7. Are decision-making authorities and processes clear for the fund and macro agencies?
Clear and efficient decision making authorities and processes are required to ensure procedural matters do not dominate or unnecessarily delay deployment of capital from a fund when it is needed for macro stabilisation purposes.

8. Are assets and other data the fund manages reported on a timely basis to statistical authorities?

Assessment of enabling legislation

Legislative Framework for Entities and Fund Objectives (GAPP 1, 2)

9. Does enabling legislation clearly establish the fund and its purpose?
Legislation should clearly define the specific purpose or purposes that funds will be utilised for, the source of funding and beneficial interests.

10. Has the fund been established as a separate legal entity and if so, what is the nature of the entity?
The nature of the entity established will determine the impact of governing legislation and the level of discretion likely to be held. This may include the fund remaining within government or being established as a corporate entity etc.

11. Is the ownership of the fund clearly established in the legislation and articulated in other governing documentation and policy?
It is important that the ownership is clear so that all parties know who has ultimate responsibility for the assets and that other agencies or government entities may only be agents for the fund.

12. Does the establishing legislation clearly define the roles and responsibilities of all parties (i.e. a Fund's board, its executive management, and external parties) including levels of discretion?
Reference to roles and responsibilities detailed in legislation should be cross checked with developed policy documents and service agreements for consistency and fiduciary standards.

13. Does the legislation clarify the relationships between those entities or parties responsible for governance and operational activities of the fund?
It should be clear how parties are legally contracted or bound e.g. service agreements, statement of intent, and that there is no conflict between these documents and the intent of the legislation or fiduciary responsibility.

14. Does the jurisdiction have established trust law that will provide guidance on appropriate application of investment principles?
If there is established trust law then it should be reviewed to establish if there are any inconsistencies with the establishing legislation or fund policy.

15. If established trust law does not exist, do the enabling legislation and formal relationship documents adequately address fiduciary requirements?
Generally trust law will be principle based rather than detailed but it may address constraints relevant to the fund in areas such as diversification and domestic investing.

16. Is the governance of the fund affected by, or addressed in, other established legislation such as company or superannuation law and if so does this provide adequate guidance on fiduciary requirements?
Depending on the nature and purpose(s) of the fund, other legislation may provide guidance on the governance and implementation of investments.

17. Do the establishment legislation and governing documents clearly articulate the objectives of the fund in such a way as to guide the development of appropriate investment policy and strategy?
There may be single or multiple purposes intended for the fund but these should be explicitly mandated, to enable aligned strategy and management resources.

18. Are there any areas where the operational activities delegated to other parties are in conflict with, or undertaken without due regard to, the enabling legislation?
Originating legislation may be at odds with the evolutionary nature of fund purpose, policy and implementation. It is important that all governing documents are in tune with establishment legislation.

19. Do public disclosure, informational documents or website materials accurately reflect the governing documents including legislative requirements and purpose?
It is a matter of confidence that available documents and representations accurately reflect the above issues and relationships.

Assessment of Fund Governance

Roles and responsibilities (GAPP 6, 7, 8)

20. Are all parties with governance roles and responsibilities clearly identified in policy documentation, trust deeds and legislation?
Discretion and accountability may be at an entity or individual title level e.g. the central bank or alternatively the chief executive of the central bank.

21. Are their responsibilities and delegations clearly outlined in policy documentation, trust deeds and legislation?
In addition to being clearly identified it is important their specific duties are defined. Note that different governance models and levels of delegation will be appropriate for different types of fund purposes and capabilities (see Drew and Walk, 2016 and Clark and Urwin, 2007).

22. Is there effective, operational independence for any internal governance or investment functions?
It is important for efficient governance that all parties are clear on delegations, discretion and reporting requirements.

23. Do service agreements or equivalent documents adequately describe and address the roles, responsibilities, delegations and accountability of all internal fiduciary roles?
Accountability is a critical function of service agreements and omission or lack of clarity in roles is arguably a primary cause of poor governance and potentially breaches of fiduciary responsibility.

24. Is the owner of the fund effective in addressing all required responsibilities; including but not limited to setting the purpose of the fund; approving investment policy; approving internal and external service providers; approving appointments or provider replacements; monitoring provider performance?
While there may be delegations of operational responsibilities, inevitably these depend on efficient evaluation and approval of recommendations, adequate time being allocated to approvals and providers having the appropriate skills.

25. Are there clear procedures addressing the removal and replacement of individuals in investment governance roles?
Appointment, removal or replacement of key decision-makers are important functions that need to be clearly documented.

26. Are there any overlaps in governance roles?
It can create unnecessary expense and confusion if there are overlaps in assigned governance roles; e.g. if there are multiple sets of advisers advising a fund's board or management on asset allocation and investment strategy.

Operational management (GAPP 9)

27. Is there a separate legal entity for the operational management of the fund?
This may be an established bank or financial institution that has its own board and fiduciary accountability. Any entity conflicts need to be clarified and a sense of the priority of reporting lines verified.

28. Does the operational entity have clear autonomy in its role, free from political influence?
Ad-hoc influence outside the formal requirements of legislation and service agreements can compromise effective and professional efforts on governance.

29. Is the level of discretion exercised by the operational entity in keeping with the description of role?
Often the operational entity develops capacity to undertake discretionary activities but it is critical that this is not beyond the anticipated scope of the role.

30. Is there more than one party responsible for operational activity? E.g. a central bank for listed assets and another government entity for real assets?
Where more than one government entity is responsible for implementation, it needs to be determined how oversight across these will be undertaken.

31. Are systems and procedures adequate to effectively coordinate separate accountability of multiple operational entities? (if applicable)

32. Does the process underpinning funding of the operational entity allow for growth and capacity development, particularly where internal mandates and discretion are applied or will be applied in the future?
If additional capacity is required to meet the operational expectations then adequate resources need to be available.

33. Does the operational entity have adequate procedures and controls in place that address their duty of care and loyalty to the fund?
This may include internal conflicts of interest policy; acknowledgment of fiduciary roles; procedure manuals; secure data and file storage systems.

34. Is the level of transparency provided by the operational entity in keeping with international expectations and stated requirements of legislation and policy?
This is an area critical to establishing and maintaining trust and confidence in the fund governance. The public websites and currency of information are important aspects.

35. Does the operational entity (and other internal parties) contribute to a comprehensive, centralised set of files that are appropriate to a fiduciary entity?
New political appointments, changes in key personnel, criticism of policy or adequacy of due diligence and monitoring make the establishment and maintenance of a central, comprehensive file critical. Confidence can only be established if there is genuine evidence available that processes have been followed. This is a key resource to ensure efficient governance.

36. Are these files available to all internal decision-makers?

37. Are these files secure?
Encryption of servers and policy for overall fund security (including member personal information) is increasingly critical for fund integrity.

Accountability (GAPP 10 - 13)

38. Do all entities have clear lines of accountability established in legislation, policy and service agreements?
It is not uncommon for individuals within the governing and operational entities to be focused on their own areas of activity whereas they need to also appreciate the roles and information requirements of other roles. Ensuring that required accountability is clearly defined and acknowledged provides for more effective governance.

39. Do all parties acknowledge their roles and fiduciary responsibilities in writing?
Clarity in service agreements as to the fiduciary status of agents or external consultants is critical. Some relationships are informational only and others are recommendations only, not specific, comprehensive advice. Those in governance roles need to be aware of the status of all parties.

40. Are there any conflicts or omissions between the respective governing documents?

41. Has the ownership entity (or its representative) developed a strategy to support capacity development for the board, sub-committee and internal executive involved with investment governance?
Support for decision-makers, especially those not well versed with investment management and governance is important. Newly appointed or elected individuals need capacity support in order to be actively engaged in their role.

42. Are the annual accounts prepared in a timely manner and made available in a formal format?

43. Are annual accounts audited by a suitable external party?
Ideally, audits should be prepared by a competent and independent party who does not supply other consulting or managerial services to the fund to reduce potential conflicts of interest.

44. Do all entities have and utilise appropriate codes of conduct and ethics policies?

45. Has a process been developed to demonstrate a governance framework has been defined and is effectively being applied?
Such verification is best completed on an independent basis and it should be undertaken relative to a defined standard of best practice.

46. Are all parties actively engaged in supporting a periodic assessment of the fund governance effectiveness?
Effective governance is in part about confidence that all parties are addressing their responsibilities competently and diligently. Concerns about protecting IP or reticence in allowing operational procedures to be scrutinised can result in a lack of engagement.

External Relationships (GAPP 14 – 15, 18, 20)

47. Does the fund, including owner, operational and executive teams have clarity of roles with respect to establishment and supervision of functional fiduciary relationships?
External fiduciary services will typically be of a continuous and comprehensive nature that address core fiduciary activities. Providers need to be confident that they are contracted to the appropriate internal entity, with clear reporting lines. Providers seeking new appointment or to influence decision-makers should be directed to the appropriate internal entities.

48. Does the fund, including owner, operational and executive teams have clarity of roles with respect to non-fiduciary relationships?
These will typically be related to one-off projects or services of a non-fiduciary nature e.g. information or education services that may include custodial services.

49. Does the fund have an outsourcing policy?
An outsourcing policy can be useful to define what type of business activities, functions or services are covered under the policy, the selection and due diligence process, how conflicts of interest are managed, and how providers are monitored and reviewed.

50. Does the fund have an independent custodian?
An independent custodian is critical to help safeguard a fund's assets and the veracity of asset and portfolio values. Some Pacific Island and global fund failures may have been avoided through appointment of an independent custodian.

51. In relation to the two service provider groups, are the service agreements comprehensive and tailored to the funds circumstances and needs?
Rather than accepting standard service agreements it is preferable for a fund to modify provider agreements or to have developed its own agreements, recognising legislative and jurisdictional issues, internal roles and its level of sophistication. Areas of practical application to focus on include reporting for monitoring purposes and internal capacity building requirements.

52. Are external relationships established after appropriate due diligence and evaluation using (where appropriate) a competitive approach?
Ideally an RFP approach to selection is appropriate as it evidences the consideration of appropriate information. Evidence that the information has then been evaluated is critical. Focus areas are level of service, security, costs and disclosure.

53. Are the due diligence records and service agreements appropriately recorded and retrievable?
Public entities are subject to criticism and scrutiny from a variety of sources as a result of increasing transparency requirements. This may even include new appointments to key roles. Claims of conflicts or poor selection criteria and procedures are best managed by evidential material otherwise the presumption is that it was not completed.

54. Is the level of outsourcing appropriate?
An operational entity needs to balance its internal capability and outsourcing requirements to avoid inadvertently becoming influenced by, or over reliant on, external consultants or managers. In relation, it is not cost effective and can confuse if there are multiple consultants serving Board and internal management.

55. Are the external relationships appropriately reviewed on a periodic basis?
Operational needs will change and service levels will evolve therefore regular reviews are prudent.

56. If the fund has operational activities in other jurisdictions, does it seek to understand and comply with the regulatory requirements of that jurisdiction?

57. If the fund receives privileged information from government, are there procedures in place to ensure that this is not used to the disadvantage of competitive private entities?

Transparency (GAPP 16 – 17)

58. Does the fund and its operational entities actively provide transparency on objectives, policy and procedures that meet expectations to foster trust and confidence in its purpose?
Typically this should be publication of all documents that are not sensitive.

59. Is published investment information relative to fund strategy and performance adequate to foster confidence and trust in its purpose and activities?
This would typically include asset allocation, performance and benchmarks plus any independent reviews of the fund's effectiveness in meeting international standards of governance.

Assessment of Investment Process

Objective, Implementation and Investment Decisions (GAPP 18, 19)

60. Does the fund have a clear objective that states its purpose and priorities?
The investment policy should clearly state the purpose of the fund and how it aims to achieve its purpose. If a fund has multiple objectives, clear statements should be provided around how assets will be allocated to meet these purposes, and how it will prioritise these objectives.

61. Does the fund have clarity on what it views as longer run success and risk?
Standard risk and return performance metrics may not be sufficient to describe success or risk. For example, for a Fund with a development purpose success will involve contributing to economic development in a way that appropriately balances return and development objectives. Risk might involve the economic opportunity cost of failing to support economic development when it could do so.

62. If the fund has objectives other than maximising risk-adjusted returns (e.g. for social or developmental reasons), is there a clear statement that specifies these objectives and their impacts?
Does the fund clearly specify how it selects investments if it is not a pure risk/return decision? What level of developmental/social benefits are traded off for expected returns?

63. Does the fund have a clear statement of its "investment philosophy" or beliefs?

A clear statement of a fund's investment philosophy and beliefs that is owned by fund staff and its Board is important for defining the scope of a fund's investment activities and how it views the investment opportunity set. Beliefs should both be grounded in empirical research, and be relevant for the purpose and scope and scale of a fund, to be useful for guiding actual investment activities.

64. Does the fund specify how it interprets the investment objectives in terms of risk-return profile, asset classes in scope, definition of benchmarks, active versus passive management, and responsible investment considerations?
There are clear statements regarding the asset classes that the fund will consider in its investments. There is a clear discussion around selection and appropriateness of benchmarks. There is a clear discussion around the investment approach adopted and a clear justification/motivation for why such an approach is believed to be appropriate. There is a clear discussion around the funds approach to responsible investing and how this impacts benchmarks and investment decisions.

65. Has the fund identified a clear and well-defined implementation of the investment objective?
There are clear and well-documented procedures that detail how investment strategy(s) are implemented. Ideally this is aligned with the fund's investment philosophy.

66. Does the implementation take into account fund staff capabilities and resourcing?
More complex investment solutions are more demanding in terms of staff investment knowledge, implementation, monitoring and review.

67. Have good processes been established for external manager selection, monitoring, and hiring and firing?
There are contestable process for selecting external managers to help meet the funds mandates and managers are regularly reviewed, as per the outsourcing considerations outlined in the External Relationships section.

68. If the fund has a legislative requirement to invest domestically (in whole or part) have investment strategies been developed that are appropriate to meet the domestic investment requirement?
Strategies should consider the domestic opportunity set, return hurdles, how it can be accessed, scale, the cost and time of implementation, and internal resource requirements.

69. Is there a common investment framework the fund utilises to make investment and divestment decisions?
A common investment framework is critical to ensure that investment decisions are made over time on a consistent and logical basis.

70. Does the fund have clear policies around the review of its asset allocation and investment objectives?
There are clear policies around the review of the asset allocation of the fund, including frequency, scope and whether reviews involve external consultants as well as internal staff.

71. Does the fund specify which financial instruments it can invest in?
This is important from the point of leverage and hedging, and should also reflect the internal capabilities of the fund to understand, monitor and review the instruments.

Risk Management (GAPP 14, 22)

72. Does the fund have a clear and complete description of the risks that the fund is exposed to (e.g. market, financial, operational, legal, liquidity and other)?

73. Does the fund have clear policies and procedures on the management of these risks?
Fund staff and its Board should have a clear understanding of the fund's risk management approach and their responsibilities for managing these risks.

74. Is there a risk register and a process to learn from incidents?
Incidents and breaches are inevitable for a fund, the critical element is that breaches are seen as an opportunity to learn and improve processes, rather than as a punitive mechanism.

75. Is there an independent party to whom fund staff, Board members or suppliers in a "fiduciary" role can report to if there is concern that illegal, unethical or gross breaches of standards are occurring?
The independent party should be well-known by all fund staff and representatives. A "whistle blower" policy ideally is in place to protect the identity and potential for future discrimination of people who expose information and behaviours.

76. Does the fund produce a high level risk report for its Board?

77. Are the financial risk management practices appropriate for the fund?

78. Does the fund have clear policies and rules around dealing with third party supplier risks? Are these policies appropriate for the fund?

79. Are there policies around the management of operational (e.g. business continuity) and key person risks?
Can the fund continue to operate effectively if key people or office facilities are not available for any reason?

80. Does the fund have a liquidity management policy?

81. If the fund uses derivative instruments, does the fund have a derivatives policy and monitor counter-party risks?

82. Does the fund regularly stress test its portfolio and (if applicable) does this include other arms of government?
Portfolio stress testing can be a useful exercise for fund staff to help understand how the portfolio is exposed to market and non-market risks. It is particularly important for a macro stabilisation fund and for this type of fund the exercise should involve key policy agencies.

Monitoring and Performance (GAPP 23)

83. Are portfolio performance measures and metrics aligned with views on longer run success and risk?

Clarity on success and risk will help determine appropriate performance metrics and measures. For example, for Funds with an explicit pension liability streams metrics will include funding ratio measures. For funds with an intergenerational wealth purpose metrics could include growing the real value of the Fund x% above inflation, and/or on a per-capita basis.

84. Are clear metrics established to assess the value/performance of an investment?

Are there clear definitions regarding how performance is measured and over what timeframes? In the case of non-listed and/or illiquid assets, how is the value of the asset determined so that performance of that asset or asset class can be measured?

85. Is there a clear criteria for the selection of benchmarks and are appropriate benchmarks being used to assess relative performance?

86. Are clear and appropriate metrics defined to measure the relative performance versus the benchmark?

The fund should clearly specify what metrics are used and how these are computed/implemented.

87. Are clear measures in place to determine whether an investment is meeting its target?

88. Are clear policies in place for action when an investment is not meeting its target?

For instance, when an investment class within the fund's strategy is not meeting its target (e.g. its tracking error exceeds limits), what policies does the fund have in place to address such issues? What actions will be taken? Will those actions be sufficient to resolve the issue?

89. Are clear policies in place to assess the how externally managed funds are meeting their mandates and actions that will be taken if not?

As well as relative returns and risk levels, a fund should keep track of how an externally managed fund is meeting its broader mandate (e.g. incorporation of any ESG considerations). Processes should be in place that outline actions to be taken if a fund breaches this mandate. Ideally, this should be on a "no surprise" basis – the fund manager should be in regular communication with the SF.

Assessment of Public and Government Support

Disclosure and transparency (GAPP 4, 17)

90. Does the fund promote transparency around its operations?

91. Does the fund publicly disclose its investment objectives, policies and procedures?

Are these documents made publicly available through a website or by other means of dissemination? What information is made publicly available (investment statement; policies; procedures; asset allocation reviews; monitoring reports)?

92. Does the fund publicly disclose its performance on a regular basis?

Many SF do not provide regular performance reporting out of concern that low or negative returns might be seen as indicating poor management, rather than it simply being a function of the market. The experience of funds that do provide regular reporting is that the public come to accept volatility is normal.

93. Does the Fund benchmark and disclose its responsible investment practices?

This could include a formal external assessment for a Fund that is a signatory to the United Nations Principles for Responsible Investment. At a minimum, it should disclose any type of investments that have been excluded from the Fund on Responsible Investing criteria. For PI funds this could well include a particular focus on climate change considerations given their extreme vulnerability to rising sea levels and incursions into fresh water supplies.

Governmental Support

94. Is there evidence of a long-term commitment of the government/funding agent to support the fund?

Are there any documents that specify the long-term commitments of the government and/or funding agencies in support of the fund? How long are commitments for?

95. Is there widespread governmental support of the fund across political entities?

Is the fund broadly supported by the political entities in a country?

96. Is there evidence of governments "excessively" withdrawing funding and/or capital from the fund?

Evidence of government or government agencies withdrawing money from the fund beyond the levels that are stated in the agreement between the government and the fund may indicate a lack of support, or mis-alignment between the fund's purpose and government objectives.

Public Support (this would ideally be based on a short survey that should be conducted among the general public)

97. Does the general public have a clear understanding of the purpose or purposes of the fund?

98. Does the general public see the need for/benefits of having the fund?

99. Does the general public find that the contributions to the fund are appropriate?
Public opinion on the level of contributions to the fund may affect the level of public support.

100. Does the general public have confidence in the ability of the fund to deliver on its objectives?

5. Summary

The paper suggest an assessment framework for Pacific Island Sovereign funds. The aim of the framework is to provide a practical and impartial evidence base that can be used by a fund to improve its investment process and integration within the broader policy context. It is not intended as an academic exercise to be applied from afar.

The backbone of our framework is the high level Santiago principles developed for Sovereign funds. We put flesh on the bones to this by developing a set of information requirements and questions designed to uncover how formally (and informally) a fund is organised, formulated, implemented and monitored against these principles. As mentioned, not all of the questions we have developed will be relevant for all Pacific Island funds, but we expect that the majority will be useful.

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Appendix A Santiago Principles

The Santiago Principles are a set of 24 voluntary guidelines that assign generally accepted principles and practices (GAPP) for the operations of Sovereign Wealth Funds (SWFs). The principles were adopted in 2008 through a joint effort between the International Monetary Fund (IMF) and 26 IMF member countries with SFs, including Australia, New Zealand and Timor-Leste (IWG, 2008). In 2009, this working group became the International Forum of Sovereign Wealth Funds (IFSWF), which today comprises 30 members.[1]

The objectives of the Principles are:

- To help maintain a stable global financial system and free flow of capital and investment;
- To comply with all applicable regulatory and disclosure requirements in the countries in which SWFs invest;
- To ensure that SWFs invest on the basis of economic and financial risk and return-related considerations; and
- To ensure that SWFs have in place a transparent and sound governance structure that provides adequate operational controls, risk management, and accountability.

While the GAPP are not described by IFSWFs in any place as "best practice" they are seen as a set of practices that *"would enable SWFs, especially newly established ones, to develop, review, or strengthen their organization, policies, and investment practices"* (IWG 2008, page 4). They are also seen as mechanisms to improve the transparency of SWF structures and their operations.

The GAPP are deliberately set at fairly high level, rather than being detailed and prescriptive. As such, IFSWF expects they can be achieved by countries regardless of their level of development and domestic legal and regulatory requirements. The framework also recognises that implementation of the GAPP can take time.

The GAPP covers three key areas:

(i) legal framework, objectives, and coordination with macroeconomic policies;
(ii) institutional framework and governance structure; and
(iii) the investment and risk management framework.

As discussed in the main text, these areas broadly overlap with the areas of focus in our assessment framework.

Sound practices and principles in the first area underpin a robust institutional framework and governance structure of the SWF, and facilitate formulation of appropriate investment strategies consistent with the SWF's stated policy objectives.

[1] See http://www.ifswf.org/members

A sound governance structure that separates the functions of the owner, governing bodies, and management facilitates operational independence in the management of the SWF to pursue investment decisions and investment operations free of political influence.

A clear investment policy shows a SWF's commitment to a disciplined investment plan and practices. Also, a reliable risk management framework promotes the soundness of its investment operations and accountability.

GAPP 1. Principle
The legal framework for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).
GAPP 1.1. Subprinciple. The legal framework for the SWF should ensure legal soundness of the SWF and its transactions.
GAPP 1.2. Subprinciple. The key features of the SWF's legal basis and structure, as well as the legal relationship between the SWF and other state bodies, should be publicly disclosed.

GAPP 2. Principle The policy purpose of the SWF should be clearly defined and publicly disclosed.

GAPP 3. Principle Where the SWF's activities have significant direct domestic macroeconomic implications, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.

GAPP 4. Principle
There should be clear and publicly disclosed policies, rules, procedures, or arrangements in relation to the SWF's general approach to funding, withdrawal, and spending operations.
GAPP 4.1. Subprinciple. The source of SWF funding should be publicly disclosed.
GAPP 4.2. Subprinciple. The general approach to withdrawals from the SWF and spending on behalf of the government should be publicly disclosed.

GAPP 5. Principle
The relevant statistical data pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.

GAPP 6. Principle
The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.

GAPP 7. Principle
The owner should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.

GAPP 8. Principle
The governing body(ies) should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.

GAPP 9. Principle
The operational management of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.

GAPP 10. Principle
The accountability framework for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.

GAPP 11. Principle
An annual report and accompanying financial statements on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.

GAPP 12. Principle
The SWF's operations and financial statements should be audited annually in accordance with recognized international or national auditing standards in a consistent manner.

GAPP 13. Principle
Professional and ethical standards should be clearly defined and made known to the members of the SWF's governing body(ies), management, and staff.

GAPP 14. Principle
Dealing with third parties for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.

GAPP 15. Principle
SWF operations and activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

GAPP 16. Principle
The governance framework and objectives, as well as the manner in which the SWF's management is operationally independent from the owner, should be publicly disclosed.

GAPP 17. Principle
Relevant financial information regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.

GAPP 18. Principle
The SWF's investment policy should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.
GAPP 18.1. Subprinciple. The investment policy should guide the SWF's financial risk exposures and the possible use of leverage.

GAPP 18.2. Subprinciple. The investment policy should address the extent to which internal and/or external investment managers are used, the range of their activities and authority, and the process by which they are selected and their performance monitored.
GAPP 18.3. Subprinciple. A description of the investment policy of the SWF should be publicly disclosed.

GAPP 19. Principle
The SWF's investment decisions should aim to maximize risk-adjusted financial returns in a manner consistent with its investment policy, and based on economic and financial grounds.
GAPP 19.1. Subprinciple. 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.
GAPP 19.2. Subprinciple. The management of an SWF's assets should be consistent with what is generally accepted as sound asset management principles.

GAPP 20. Principle
The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in competing with private entities.

GAPP 21. Principle
SWFs view shareholder ownership rights as a fundamental element of their equity investments' value. If an SWF chooses to exercise its ownership rights, it should do so in a manner that is consistent with its investment policy and protects the financial value of its investments. The SWF should publicly disclose its general approach to voting securities of listed entities, including the key factors guiding its exercise of ownership rights.

GAPP 22. Principle
The SWF should have a framework that identifies, assesses, and manages the risks of its operations.
GAPP 22.1. Subprinciple. The risk management framework should include reliable information and timely reporting systems, which should enable the adequate monitoring and management of relevant risks within acceptable parameters and levels, control and incentive mechanisms, codes of conduct, business continuity planning, and an independent audit function.
GAPP 22.2. Subprinciple. The general approach to the SWF's risk management framework should be publicly disclosed.

GAPP 23. Principle
The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to clearly defined principles or standards.

GAPP 24. Principle
A process of regular review of the implementation of the GAPP should be engaged in by or on behalf of the SWF.

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Appendix B Pacific Island Sovereign Funds

The table below provides a summary of the main purposes of Pacific Island SFs, as discussed in Drew (2016).

The key distinguishing features of these funds compared to most of the World's SFs are their relatively small size and the heterogeneity of their funding sources (including mineral royalties, employer and employee contributions, donor aid, and internet licensing fees).

Table 1 Economic Purposes of Current Pacific Island Sovereign Funds

Nation	Macro stabilisation	Inter-generational wealth	Pension Reserves	Economic development
Cook Islands	No	No	Yes	No
Fiji	No	No	Yes	Via pension funds
Kiribati	Yes	Yes	Yes	No
Marshall Islands	Yes (from 2024)	No	No	No
Micronesia (FSM)	Yes (from 2024)	No	No	No
New Zealand	No	No	Yes	Via pension funds
Niue	Yes	Yes	No	Yes
Nauru	No	No longer	No	No
Papua New Guinea	Yes[1]	Yes[1]	Yes	Via pension funds
Samoa	No	No	Yes	Via pension funds
Solomon Islands	No	No	Yes	Via pension funds
Timor-Leste[2]	Yes	Yes	No	No
Tonga	No	No	Yes	Via pension funds
Tokelau	Yes	Yes	No	Yes
Tuvalu	Yes	Yes[3]	No	No
Vanuatu	No	No	Yes	Via pension funds

Source: Al-Hassan et al. 2013, various other

1. The newly minted SWF for Papua New Guinea has stabilisation and wealth objectives.
2. Timor-Leste is included in the sample despite not usually being grouped as a Pacific Island nation given its cultural linkages to Melanesia and Polynesia and the similarity of its economic challenges to the large Melanesian islands.
3. The Tuvalu Trust Fund is focussed on macro stabilisation but is broadly seen as also having an inter-generational wealth purpose.

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