

**Global Standards for Sovereign Wealth Funds:  
The Quest for Transparency**

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## I. Introduction

The Generally Accepted Principles and Practices (GAPP) for Sovereign Wealth Funds (SWF) – so called “Santiago Principles” –, published in October 2008 by the International Working Group of Sovereign Wealth Funds (IWG)<sup>1</sup>, are deemed at answering to a number of concerns raised in the past years, such as the possible political (rather than economic) considerations guiding the conduct of SWF and their impact on the stability of the international financial system<sup>2</sup>.

The tool which has been used for this purpose is the one of international standards, i.e. a particular type of global rules, set as voluntary. The drafting of this kind of rules is not an exception, tailored on the specificity of SWF, but must be understood within a general move towards the use of such standards. In the aftermath of the Asian financial crisis, in the late '90s, the identification and dissemination of international principles, standards and codes of best practice and the use of incentives to meet these international standards have been intended as one of the core reforms needed to strengthen the international financial system<sup>3</sup>. In this view, the IMF and the World Bank have established specific programs to foster the implementation of standards (such as the Reports on the Observance of Standards and Codes – ROSCs)<sup>4</sup>.

If the trust in this tool of global regulation has been ever increasing during the last decade, we are facing now a dramatic change. Due to the spread of the global financial crisis, many of the most widely accepted financial standards, such as Basel II and the international accounting standards (IAS/IFRS), have been questioned<sup>5</sup>. Some global standards haven't been criticized for their content; all the same, they were no effective tool of regulation, because of a lack of implementation or because they were not burdensome enough (for example, It is questionable whether the failure of the

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<sup>1</sup> See IWG, *Generally Accepted Principles and Practices (GAPP)—Santiago Principles*, October 2008, available at <http://www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf>.

<sup>2</sup> See E.M. Truman, *Sovereign Wealth Funds: The Need for Greater Transparency and Accountability*, Policy Brief, August 2007, available at <http://www.iie.com/publications/interstitial.cfm?ResearchID=783>.

<sup>3</sup> See G7 *Declaration of G7 Finance Ministers and Central Bank Governors*, 30 October 1998, available at <http://www.g8.utoronto.ca/finance/fm103098.htm>.

<sup>4</sup> See <http://www.imf.org/external/np/rosc/rosc.asp>.

<sup>5</sup> The debate about Basel II and IAS is huge, and remarks and criticisms vary a lot across the different authors. They go far beyond the scope of this paper. For a general analysis of their connection with the crisis, see The High Level Group on Financial Supervision in the EU, *Report* (so called De Larosi re Report), 25 February 2009, available at [http://ec.europa.eu/internal\\_market/finances/committees/index\\_en.htm#delarosierereport](http://ec.europa.eu/internal_market/finances/committees/index_en.htm#delarosierereport), in particular par. 224. For an overview of the different opinions, see [www.voxeu.org](http://www.voxeu.org).

IOSCO Code of conduct for Credit Rating Agencies (CRAs) falls in the first or in the second hypothesis)<sup>6</sup>. When assessing the likely effectiveness of the Santiago Principles, the limits of existing global standards, which emerged dramatically in the current financial turmoil, must be taken into account.

Moreover, the content of these standards is largely based on transparency and disclosure requirements, following the opinion – common to policy makers as well to many economists – which identifies transparency as a key instrument in global financial regulation, and therefore suitable to foster also the accountability of the funds. If the setting of international standards has become a common element of global regulation, transparency has allegedly become a general principle of global administrative law (GAL)<sup>7</sup>. But are transparency requirements *per se* enough or should they go hand in hand with other type of obligations? If transparency is intended as an instrument for fostering accountability, in order to assess the real capacity of these standards to achieve the expected goal, It must be clear who the global regulators should be accountable to. Thus, for instance, the relevant stakeholders involved in the SWFs' activity should be clearly identified.

The paper is divided in two parts. In the first one, the variety of the existing SWF and the problems involved in their regulation are recalled, and a general overview of the drafting and the content of the Santiago Principles is provided, with a particular focus on transparency requirements. In the second part, the Principles are framed in the context of the general spread of global financial standards. In this way, three goals are pursued: first, the differences between the Santiago Principles and other types of global standards can be pointed out; second, the possible application of the different incentives which can foster the implementation of standards to the area of SWF is taken into account; third, the potential of transparency - as a general principle of global administrative law - within this specific sector is examined.

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<sup>6</sup> In its *Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience*, April 2008, available at [www.financialstabilityboard.org/publications/r\\_0804.pdf](http://www.financialstabilityboard.org/publications/r_0804.pdf), the Financial Stability Forum (FSF, now Financial Stability Board (FSB)) recommended the IOSCO to complete the revision of the Code, its adoption by the agencies and the monitoring of such adoption by the competent domestic authorities (p. 34, recommendations IV.1 e IV.2.).

<sup>7</sup> On this point, see C. I. Fuentes, *Transparency as a Global Goal: Towards an Unity of Principles in Global Administrative Law*, September 15, 2008, available at SSRN: <http://ssrn.com/abstract=1134122>.

## II. The Santiago Principles: scope and objectives.

### A. SWW: definition and problems.

As has been pointed out, “Sovereign wealth funds” are a new label for an old phenomenon<sup>8</sup>. This term has first been used by Andrew Rozanov in 2005, referring to a generic description of governmental investment activities<sup>9</sup>. Yet, sovereign funds – which can be broadly defined as government-controlled investment vehicles, including foreign financial assets - exist at least since the '50s, when the Kuwait Investment Authority was created, with the purpose of reinvesting the surpluses of oil-revenues. Since then, SWF developed mainly in two waves. At first, during the 70s, the Singapore Tomasek Fund and the Abu Dhabi Investment Authority were established. Later on, during the 90s, a high number of funds was founded (between which the Iran Oil Stabilisation Fund and the Qatar Investment Authority)<sup>10</sup>.

Currently, more than 25 countries have these funds<sup>11</sup>. Represented geographical areas are very diverse, comprising countries such as Alaska, Norway, Russia and Trinidad and Tobago. Yet, more than a half of these assets are concentrated in countries that export oil and gas (the top five being the Abu Dhabi Investment Authority, Norway, Saudi Arabia, Kuwait and Russia). A second group of SWFs can be qualified on the basis of geographical proximity, as about one third of total assets are held by Asian and Pacific countries, such as Australia, China, Korea and Singapore<sup>12</sup>. Yet, it has been pointed out that the claim according to which SWF are «entities established by non-Western, often non-democratic governments» is the first of the popular, but poorly grounded myths about these funds, as industrial countries hold more than 40% of SWF international assets (with the US leading with 800 billion USD in SWF international assets)<sup>13</sup>.

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<sup>8</sup> S. Johnson, *The Rise of Sovereign Wealth Funds*, in *Finance and Development*, September 2007, Vol. 44, available at <http://www.imf.org/external/pubs/ft/fandd/2007/09/straight.htm>.

<sup>9</sup> E.M. Truman, *Four Myths about Sovereign Wealth Funds*, 14 August 2008, available at <http://www.voxeu.org/index.php?q=node/1539>.

<sup>10</sup> See ISAE, *Ruolo e prospettive dei fondi sovrani*, November-December 2007, p. V.

<sup>11</sup> See the list provided by E. Truman, *A Blueprint for Sovereign Wealth Fund Best Practices*, Peterson Institute for International Economics, Policy Brief No. PB08-3, 2008, available at <http://www.petersoninstitute.org/publications/pb/pb08-3.pdf>, p.2. p. 7.

<sup>12</sup> See Johnson, above n.8, at 68.

<sup>13</sup> See Truman, above n. 9, at 69.

While the IMF estimated the total amount of foreign reserves between 2 and 3 million USD as of January 2008<sup>14</sup>, SWF have unsurprisingly suffered large losses during the financial crisis, estimated as 27% of the value of their assets for Gulf foreign-reserve funds<sup>15</sup>.

SWFs can differ highly the one from the other. The most commonly used indicators are three. First, there are ‘commodity’ and ‘non-commodity’ funds: as stated above, more than half SWF are established for the purpose of reinvesting the surpluses of oil, gas or other natural resources revenues, while others are created on the basis of high current account surpluses. For example, Asian countries, like China and Korea, benefit from the low-exchange rate of their currency, making their goods attractive for export<sup>16</sup>. The existence of such a surplus is thus a precondition for the creation of a SWF: that’s why the idea of establishing European SWFs, while many European countries – such as UK, Italy, Spain and most countries of Central and Eastern Europe – are running large account deficits, seems unfeasible to many commentators<sup>17</sup>.

Not only the origin of the surplus to invest, but the very objective and economic strategies of the SWF vary. From this point of view, the IMF distinguishes five types of SWFs: (i) *stabilization funds*, where the primary objective is to insulate the budget and the economy against commodity price swings; (ii) *savings funds* for future generations, which aim to convert nonrenewable assets into a more diversified portfolio of assets; (iii) *reserve investment corporations*, whose assets are often still counted as reserve assets; (iv) *development funds*, which typically help fund socio-economic projects or promote industrial policies that might raise a country’s potential output growth; and (v) *contingent pension reserve funds*, which provide (from sources other than individual pension contributions) for contingent unspecified pension liabilities on the government’s balance sheet<sup>18</sup>. Yet, it is important to point out that there might be a mixture of motivations, and that these objectives may be multiple, overlapping, or changing over time<sup>19</sup>.

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<sup>14</sup> See IMF, *Sovereign Wealth Funds—A Work Agenda*, February 2008, available at <http://www.imf.org/external/np/pp/eng/2008/022908.pdf>, p. 6.

<sup>15</sup> See B. Setser and R. Ziemba, *GCC Sovereign Funds: Reversal of Fortune*, Council on Foreign Relations Working Paper, January 2009, available at [http://www.cfr.org/content/publications/attachments/CGS\\_WorkingPaper\\_5.pdf](http://www.cfr.org/content/publications/attachments/CGS_WorkingPaper_5.pdf), p. 2.

<sup>16</sup> See B. De Meester, *International Legal Aspects of Sovereign Wealth Funds: Reconciling International Economic Law and the Law of State Immunities with a New Role of the State*, 3 November 2008, available at SSRN: <http://ssrn.com/abstract=1308542>, p. 4.

<sup>17</sup> See K. Singh, *Europe doesn’t need sovereign wealth funds*, 20 November 2008, available at [www.voxeu.org](http://www.voxeu.org).

<sup>18</sup> See IMF, above n. 14, at 5.

<sup>19</sup> See Truman, above n. 2, at 4, and IMF, above n. 14, at 5.

Third: not only SWFs' economical strategies differ but also – and most interestingly, from a legal point of view – their governance and institutional patterns<sup>20</sup>. On this basis, an index has been constructed<sup>21</sup>, which takes into account different elements, concerning the funds' structure, governance, transparency and accountability. It clearly shows that one of the common claim about SWFs – the one according to which their first shortcoming is their opacity – cannot be generalized, as there are highly differentiated patterns. For example, while a third of non pension SWF provide no information on the category of assets in which they invest<sup>22</sup>, some funds have put in place extensive disclosure practices for a long time. One such example is the Norway's Government Pension Fund-Global, which provides extensive information on its investment strategies and investment returns on a quarterly basis, while Temasek Holdings (the Singapore's holding company founded in 1974) publishes an annual report about its investments<sup>23</sup>. This point must be kept in mind when analyzing the recently approved principles, as they are addressing highly differentiated institutions.

Despite the fact that SWF are not new, criticisms about them were raised only in recent years. The growing attention given to the funds is connected with two developments. First, in the last years the number and size of the funds have increased steadily. Second, SWF from Asia and the Middle East made remarkable investments in companies in US and Europe. In the unfolding of the subprime crisis, such a trend brought the SWF coming at the rescue of banking institutions such as Merrill Lynch<sup>24</sup> to play a stabilizing role in the global financial system<sup>25</sup>.

The recent rapid growth of SWF and their massive capital infusion into financial institutions in the wake of the subprime mortgage crisis, together with the aforementioned shift in their investment strategy from primarily conservative debt instruments to higher risk/reward equity investments, have raised fears in the United States and Europe that these funds – most of which are based in the Middle East and Asia - will use their economic power to pursue political goals<sup>26</sup>.

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<sup>20</sup> See J. Aizenman, R. Glick, *Sovereign wealth funds, governance, and reserve accumulation*, 16 January 2009, available at <http://www.voxeu.org/index.php?q=node/2799>.

<sup>21</sup> See Truman, above n. 11, at 6 et seq.

<sup>22</sup> *Ib.*, at 11.

<sup>23</sup> *Id.*, at 9.

<sup>24</sup> See G.S. Allayannis, *The Case of Sovereign Wealth Funds: A New (Old) Force in the Capital Markets.*, Darden Case No. UVA-F-1564, available at SSRN: <http://ssrn.com/abstract=1418910>.

<sup>25</sup> See S. Hesse, *Sovereign Wealth Funds and Financial Stability*, 30 March 2009, available at [www.voxeu.org](http://www.voxeu.org).

<sup>26</sup> See R. A. Epstein and A. M. Rose, *The Regulation of Sovereign Wealth Funds: The Virtues of Going Slow*, in *University of Chicago Law Review*, forthcoming, available also at SSRN: <http://ssrn.com/abstract=1394370>, p. 112.

This type of concerns has led to a number of initiatives, first at the national and later on at the international level, calling for increased regulation of SWFs. Between 2007 and 2008, governments from US, Canada, Australia and Germany have restricted investments by SWF and other state-owned entities<sup>27</sup>. It has been in such a context that the Santiago Principles have been elaborated.

#### B. The drafting of the Santiago Principles.

The drafting of the Santiago Principles has been conducted under the aegis of the IMF; yet, such an initiative has been at first suggested by the G7 and received a wide support from national governments.

During their meeting on 19 October 2007, the G7 Finance Ministers recognized that SWFs are increasingly important participants in the international financial system and invited both the IMF and the OECD to identify best practices for the funds in such areas as institutional structure, risk management, transparency and accountability<sup>28</sup>. The next day, the International Monetary and Financial Committee of the Board of Governors of the IMF published a Communiqué which shared the view of the G7 about SWF<sup>29</sup>.

In May 2008, an International Working Group of Sovereign Wealth Funds (IWG) was established, to carry on the work for the drafting of the principles<sup>30</sup>. The IWG brings together representatives from twenty-five IMF member countries<sup>31</sup>, owning SWF. As stated by the IMF, the Principles are the results of a collaborative effort by SWFs across advanced, emerging and developing countries to set out a comprehensive framework, providing a clearer understanding of the operations of SWFs<sup>32</sup>. The IWG met three times, and the technical drafting work was carried on by one sub-group; as the

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<sup>27</sup> See Singh, above at 17.

<sup>28</sup> See Statement of G7 Finance Ministers and Central Bank Governors, Washington, October 19, 2007, available at <http://www.g7.utoronto.ca/finance/fm071019.htm>.

<sup>29</sup> See *Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund*, October 20, 2007, available at <http://www.imf.org/external/np/cm/2007/102007a.htm>.

<sup>30</sup> See IMF, *International Working Group of Sovereign Wealth Funds is Established to Facilitate Work on Voluntary Principles*, Press Release No. 08/97, May 1, 2008, available at <http://www.imf.org/external/np/sec/pr/2008/pr0897.htm>.

<sup>31</sup> IWG member countries are: Australia, Azerbaijan, Bahrain, Botswana, Canada, Chile, China, Equatorial Guinea, Iran, Ireland, South Korea, Kuwait, Libya, Mexico, New Zealand, Norway, Qatar, Russia, Singapore, Timor-Leste, Trinidad & Tobago, the United Arab Emirates, the United States, and Vietnam. Saudi Arabia, the OECD, and the World Bank participate as permanent observers.

<sup>32</sup> See *Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund*, October 11, 2008, available at, par. 8.



Principles were published in October, the standard setting process – based on existing best practices – was extremely quick and smooth. The IMF acted as the IWG’s secretariat<sup>33</sup>.

This international effort gained the support of both US and the EU. While the subject of SWF has been discussed during several public hearings<sup>34</sup>, the US Treasury Department endorsed the work of the IMF in March 2008<sup>35</sup>. On the European side, a Communication about SWF has been published in February 2008, with the purpose of enhancing their transparency, predictability and accountability, «while maintaining an open investment environment»<sup>36</sup>. Yet, in the European view, an international approach is needed, and a full support to the then ongoing Santiago process was stated<sup>37</sup>.

### C. Structure and overview of the content.

The Generally Accepted Principles and Practices (GAPP), so called Santiago Principles, are a set of twenty-four practices and principles, organized in three key areas: a) legal framework, objectives, and coordination with macroeconomic policies (five principles); b) institutional framework and governance structure (twelve principles); c) investment and risk management framework (seven principles). In some cases, subprinciples are set forth.

After an introduction in which the objectives of the GAPP are clearly stated (to help maintaining a stable global financial system and a free flow of capital and investment; to comply with all the applicable regulatory and disclosure requirements in

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<sup>33</sup> See IWG, *Generally Accepted Principles and Practices (GAPP)—Santiago Principles*, above n. 1, at 2.

<sup>34</sup> See US Senate Committee on Banking, Housing, and Urban Affairs, *Sovereign Wealth Fund Acquisitions and Other Foreign Government Investments in the U.S.: Assessing the Economic and National Security Implications*, Hearing November 14, 2007, available at [http://banking.senate.gov/public/index.cfm?Fuseaction=Hearings.Hearing&Hearing\\_ID=4c63b142-fd5c-4b82-aff9-75e254271056](http://banking.senate.gov/public/index.cfm?Fuseaction=Hearings.Hearing&Hearing_ID=4c63b142-fd5c-4b82-aff9-75e254271056); U.S. House Financial Services Committee, *Foreign Government Investment in the U.S. Economy and Financial Sector*, Hearing May 5, 2008, available at [http://www.house.gov/apps/list/hearing/financialsvcs\\_dem/hr030508.shtml](http://www.house.gov/apps/list/hearing/financialsvcs_dem/hr030508.shtml).

<sup>35</sup> Treasury Secretary Henry Paulson met representatives from the governments of Singapore and Abu Dhabi in March 2008; in that occasion, a common support for the initiatives underway at the IMF and OECD to develop best practices for sovereign wealth funds was expressed and agreement on a common set of principles was reached: see Department of the Treasury, *Treasury Reaches Agreement on Principles for Sovereign Wealth Fund Investment with Singapore and Abu Dhabi*, Press release, 20 March 2008, available at <http://ustreas.gov/press/releases/hp881.htm>. See also the opinion of the former Deputy Secretary Robert Kimmit, *Public Footprints in Private Markets. Sovereign Wealth Funds and the World Economy*, in *Foreign Affairs*, January/February 2008.

<sup>36</sup> See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, *A common European approach to Sovereign Wealth Funds*, 27 February 2008, COM/2008/ 115 final.

<sup>37</sup> *Ib.*, at 7.

which they invest; to invest on the basis of economic and financial risk; to have in place a transparent and sound governance system, that provides for adequate accountability), the document is divided into three parts. While the last one gives a definition of SWF and lists IWG members, the first part enumerates the twenty-four principles and the second one provide a short explanation of each of them. Using a terminology well established between global financial standard setters, we could say that the Santiago Principles constitute the generally accepted principles for SWF and, at the same time, provide a guidance or methodology for their practical implementation<sup>38</sup>.

#### D. The transparency requirements.

Transparency obligations are one of the main features of the Santiago principles. They can be found in each of the three main areas around which the GAPP are grouped: general legal framework, governance structure and risk management.

Some of them are very broad: as a general rule, the key features of the SWF's legal basis and structure should be publicly disclosed<sup>39</sup>, as well as their governance framework<sup>40</sup> and policy objectives<sup>41</sup>. Moreover, every relevant financial information concerning SWF should be made available to the public<sup>42</sup>, and the necessity of disclosing their sources of funding and approaches to withdrawal and spending is stressed<sup>43</sup>.

Other principles set forth more specific requirements: for example, according to GAPP 11 SWFs should publish an annual report, in a timely way and in accordance to recognized international or national accounting standards. Second, professional and ethical standards for the members of the SWG's governing body, management and staff should be clearly defined and made known<sup>44</sup>. Finally, GAPP 15 recalls that SWF activities in host countries should be conducted in compliance with all applicable regulatory and disclosure requirements of the countries in which they operate.

Many transparency obligations are deeply connected with the concerns, raised within Western countries, that SWFs' conduct could respond to political considerations. Thus, GAPP 19.1 subprinciple requires investment decisions subject to other than

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<sup>38</sup> See III.C.

<sup>39</sup> GAPP 1.2 subprinciple.

<sup>40</sup> GAPP 16.

<sup>41</sup> GAPP 2.

<sup>42</sup> GAPP 17.

<sup>43</sup> GAPP 4 and GAPP 4.1 and 4.2 subprinciples.

<sup>44</sup> GAPP 13.

economic and financial considerations to be clearly set out in the investment policy and be publicly disclosed.

A peculiar provision can be found in the commentary to the last principle, concerning GAPP implementation. The Santiago Principles are voluntary standards; yet, GAPP 24 suggests (“it is desirable”) each SWF to review its own existing arrangements through self-assessment procedures. In such a case «the owner [of the SWF] or the governing bodies may choose to publicly disclose the assessment to the extent it believes such disclosure is consistent with applicable laws and regulation and may contribute to stability in international financial markets and enhance trust in recipient countries». In this way, transparency is conceived as a value to apply not only to the SWFs’ conduct, but also to the process of implementation of the standards. It is at the same time part of the Santiago principles’ content, and a possible means to enhance their implementation.

#### E. The establishment of the International Forum of Sovereign Wealth Funds

The creation of a permanent standing group for SWF has been discussed for a long time<sup>45</sup>. In April 2009, a couple of days after the G-20 summit in London, the International Forum of Sovereign Wealth Funds (Forum) has been established<sup>46</sup>. According to the Kuwait Declaration, the purpose of the Forum is to exchange opinions between SWF on issues of common interest and to share views on the application of the Santiago Principles including operational and technical matters<sup>47</sup>. The declaration clearly states that the Forum shall not be a formal supranational authority and that its work shall not carry any legal force.

The objectives of the Forum are the same which are set forth in the Santiago Principles. Together with the task of maintaining a stable global financial system and investing on the basis of economic and financial risk, what is more interesting for the purpose of the present paper are the following two: the Forum supports compliance with all disclosure requirements in the countries in which SWF invest and the establishment

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<sup>45</sup> See IWG, *Working Group of Sovereign Wealth Funds Presents the “Santiago Principles” to the International Monetary and Financial Committee*, Press Release No. 08/06, October 11, 2008, available at <http://www.iwg-swf.org/pr/swfpr0806.htm>.

<sup>46</sup> IWG, *Working Group Announces Creation of International Forum of Sovereign Wealth Funds*, Press Release No. 09/01, April 6, 2009, available at <http://www.iwg-swf.org/pr/swfpr0901.htm>.

<sup>47</sup> See IWG, *“Kuwait Declaration”: Establishment of the International Forum of Sovereign Wealth Funds*, April 6, 2009, available at <http://www.iwg-swf.org/mis/kuwaitdec.htm>.

of a transparent and sound governance structure that provides for adequate accountability.

The Forum has already established three sub-committees, which shall work on (i) experiences in the application of Santiago Principles to date, (ii) investment and risk management practices, (iii) international investment environment and recipient country relationships. The Forum shall have a Secretariat, but the IMF is initially undertaking this role.

### III. The Santiago Principles as global standards for SWF.

#### A. The spread of global financial standards.

International standards have been developed for a long time. The Basel Committee for Banking Supervision (BCBS), which sets standards for banking supervision, was established by the G10 central-bank Governors in 1974<sup>48</sup>. Yet, recently what has been called a sort of “explosion” of global standards has been observed<sup>49</sup>: on the one hand, their number is increasing; on the other hand, what has recently been changing is the growing reference to these standards within different regulatory regimes, which therefore lend a greater legal force to the former<sup>50</sup>.

These remarks do not apply only to the financial area. The International Organization for Standardization (ISO) and the International Electro-technical Commission (IEC) have been developing technical standards since 70s<sup>51</sup>. It is to these standards that OECD is referring to, when claiming that 80% of world trade is affected

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<sup>48</sup> About BCBS’s origin and structure see D. WOOD, *Governing Global Banking. The Basel Committee and the Politics of Financial Globalization*, Ashgate Publishing, Aldershot, 2005.

<sup>49</sup> See J. KIRTON, J. TREBILCOCK, *Introduction: Hard Choices and Soft Law in Sustainable Global Governance*, in *Hard Choices, Soft Law. Voluntary Standards in Global Trade, Environment and Social Governance*, (edited by) J.KIRTON, J. TREBILCOCK, Ashgate Publishing, Aldershot, 2004, p. 3 et seq., at 4.

<sup>50</sup> This particular process is called “regime borrowing”: see D. W. LEEBRON, *Linkages*, in *American Journal of International Law*, 2002, Vol. 96, p. 5 et seq.

<sup>51</sup> About the establishment of the ISO, see E. SHAMIR-BORER, *The Evolution of Administrative-Law Norms and Mechanisms in the International Organization For Standardization (ISO)*, paper presented at the *Second Global Administrative Law Seminar*, Viterbo, 9 - 10 June 2006, available at <http://www.iilj.org/research/ViterboConferenceReports2006.html>; J.-A.YATES, C.N. MURPHY, *Coordinating International Standards: The Formation of the ISO*, January 2007, MIT Sloan Research Paper N. 4638-07, available at SSRN: <http://ssrn.com/abstract=962455>.

by global standards<sup>52</sup>. Nevertheless, financial services constitute one of the areas in which the density of global regulation may be seen most clearly<sup>53</sup>.

As mentioned above, in the aftermath of the Asian financial crisis, precisely the tool of international financial standards, together with the establishment of two new institutions (such as the G20 and the Financial Stability Forum (FSF)), was intended to become the architrave of a 'new international financial architecture'<sup>54</sup>. The consensus on the point was widespread. On the one hand, the G7 expressed its support for the work which was carried out in the BCBS, in the International Organization for Securities Commissioners (IOSCO) and the private organization International Accounting Standard Committee (IASC), to be renamed (and reorganized) in the following years as International Accounting Standard Board (IASB)<sup>55</sup>. On the other hand, the international financial institutions, namely the IMF and the World Bank, started a specific program for the assessment of States' compliance with international financial standards, especially through the drafting of the Reports on the Observance of Standards and Codes (ROSCs). Thus, intergovernmental international organizations started encouraging States to implement rules first established by transnational regulators<sup>56</sup>.

But what are the main features of global standards? What do the Santiago Principles have in common with other global financial standards and which incentives, well known in other sectors, can be used to foster the implementation of global standards for SWF?

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<sup>52</sup> OECD, *Regulatory Reform and International Standardization*, 29 January 1999, TD/TC/WP(98)36/FINAL, p. 4: «The impact of standards on trade is so widespread that, on purely economic grounds, almost all sectors would justify attention; one estimate claims that up to 80% of trade (equivalent to around \$4 trillion annually) is affected by standards or associated technical regulations».

<sup>53</sup> As regards the spread of global regulatory systems, see S. CASSESE, *Le droit administratif global: une introduction*, in *Droit administratif*, 2007 p. 17 et seq.

<sup>54</sup> After the Asian financial crisis, the stress on the emergence of a new international financial architecture is particularly frequent: see B. Eichengreen, *Toward a New Financial Architecture. A Practical Post-Asia Agenda*, Washington D. C., Institute for International Economics, 1999; B. Thirkell-White, *The IMF and the Politics of Financial Globalization: from the Asian Crisis to a New Financial Architecture?*, New York, Palgrave MacMillan, 2005; J.A. Ocampo, *Reforming the International Financial Architecture: Consensus and Divergence*, in *Governing Globalization*, edited by D. Nayyar, Oxford University Press, 2002, p. 287 et seq.; D.K. Tarullo, *Rules, Discretion, and Authority in International Financial Reform*, 4 JOURNAL OF INTERNATIONAL ECONOMIC LAW 613 (2001); M. Kahler, *The New International Financial Architecture and its Limits*, in *The Asian Financial Crisis and the Architecture of Global Finance*, edited by G.W Noble and J.Ravenhill, Cambridge, Cambridge University Press, 2000, p.235 et seq.

<sup>55</sup> See G7, above n.3.

<sup>56</sup> I examined this point elsewhere: see M. DE BELLIS, *Global Standards for Domestic Financial Regulations: Concourse, Competition and Mutual Reinforcement between Different Types of Global Administration*, in *Global Jurist Advances*, 2006, Vol. 6, Iss. 3, Article 6. available at <http://www.bepress.com/gj/advances/vol6/iss3/art6>.

## B. The lack of a definition.

As the setting of international standards has become an increasingly significant issue, social scientists and legal scholars have been paying more attention to this phenomenon, previously regarded as being highly technical.

Economists started studying the impact of international standards on trade, especially of technical standards, as they can work as powerful non-tariff barriers to trade<sup>57</sup>. On the other hand, political scientists have pointed out that there is a political struggle behind the technical appearance of standards<sup>58</sup>. Legal scholars started studying this subject as well, with a systematic analysis for technical standards<sup>59</sup>, and examining more specific aspects in other sectors<sup>60</sup>.

Yet, there is no agreement about the definition of international standards, neither within the international standard setters, nor within scholars. For example, one of WTO agreements, the Technical Barriers to Trade agreement (TBT)<sup>61</sup>, is drawing on definitions first drafted by the ISO and the IEC, but differs from the two latter for one,

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<sup>57</sup> See K. BLIND, *The Economics of Standards. Theory, Evidence, Policy*, Cheltenham, Edward Elgar.

<sup>58</sup> W. MATTLI AND T. BUTHE, *Setting International Standards: Technological Rationality or Primacy of Power?*, in *World Politics*, Vol. 56, n. 1, 2003, p. 1, quoting a Federal Reserve Commission report, *Standards and Certification: Proposed Rules, and Staff Report*, FTC, Washington D.C., 1978, p. 94, according to which «although the considerations of the standard tend to be expressed in rather technical language, behind this façade of engineering argon, what is actually happening is an economic fight, often of the most savage type imaginable because the stakes are so high». Between the recent political sciences studies about international standards, see the essays in *Governance and International Standards Setting*, edited by W. MATTLI, in *Journal of European Public Policy*, Special Issue, v. 8, n. 3, 2001, p. 345 et seq. and in *Legalization and World Politics*, edited by J. GOLDSTEIN, M. KAHLER, R. KEHOANE, A.M. SLAUGHTER, in *International Organization*, Special Issue, 2001; see also N. BRUNSSON, B. JACOBSSON (eds.), *A world of standards*, Oxford University Press, Oxford, 2000 and KERWER D., *Rules That May Use: Standards and Global Regulation*, in *Governance*, Vol. 18, n. 4, 2005, p. 611 et seq.

<sup>59</sup> On the subject of technical standards, the most recent study is H. SCHEPEL, *The Constitution of Private Governance. Product Standards in the Regulation of Integrating Markets*, Hart Publishing, Oxford, 2005.

<sup>60</sup> See S. CASSESE, *Global Standards For National Administrative Procedure*, in *Law & Contemp. Probs*, Vol. 68, p. 109 et seq., examining global administrative law issues connected with standard; about the different types of international standards, see. H.V. MORAIS, *The Quest for International Standards: Global Governance vs. Sovereignty*, in *University of Kansas Law Review*, 2002, Vol. 50, p. 779 et seq. and S. CHARNOVITZ, *International Standards and the WTO*, *The George Washington Law School Public Law and Legal Theory Working Paper No. 133*, available at <http://ssrn.com/abstract=694346>. For international standards in the financial services sector, see R. DELONIS, *International Financial Standards and Codes: Mandatory Regulation Without Representation*, in *International Law and Politics*, 2004, vol. 36, p. 563 et seq. and D. ZARING, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations*, in *Texas International Law Journal*, Vol. 33, 1998, p. 281.

<sup>61</sup> TBT Agreement, Annex 2, par. 2. provides the following definition of standard: «Document approved by a recognized body, that provides, for common and repeated use, rules, guidelines or characteristics for products or related processes and production methods, with which compliance is not mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method».

yet pivotal, point: while the WTO agreement contrasts standards, which are deemed to be voluntary, from technical regulations, that are, on the contrary, mandatory, the two private standard setters consider as standards also mandatory rules<sup>62</sup>.

### C. Principles, standards and methodologies.

International standards seem to have features which can vary a lot.

First, the object of standards may vary. TBT addresses standards for products or related processes and production methods, but standards can also relate to services or administrative processes<sup>63</sup>. In the financial services sector, for instance, standards concern banking supervision, securities regulation, accounting, auditing or, as in the Santiago Principles, investment funds.

Second, the content of standards is usually deemed to be quite broad<sup>64</sup>: global standards set principles, and thus leave enough space to States' autonomy<sup>65</sup>. But also this feature is not a permanent one, as there are standards which set quite specific rules<sup>66</sup>. We find different degrees of specificity in the financial sector. For example, the Financial Stability Forum (FSF) classifies standards by their specificity into simple principles, "practices" and "methodologies". Whereas principles are set out in a general way and therefore allow a greater degree of flexibility in implementation, "practices" are more specific and "methodologies" or "guidelines" provide detailed guidance on

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<sup>62</sup> According to a footnote to TBT, Annex 2, par. 2 «The terms as defined in ISO/IEC Guide 2 cover products, processes and services. This Agreement deals only with technical regulations, standards and conformity assessment procedures related to products or processes and production methods. Standards as defined by ISO/IEC Guide 2 may be mandatory or voluntary. For the purpose of this Agreement standards are defined as voluntary and technical regulations as mandatory documents. Standards prepared by the international standardization community are based on consensus. This Agreement covers also documents that are not based on consensus» (italics added). For a comment, see OECD, Regulatory Reform and International Standardization, p. 7, stating that «Definitions are less unanimous on the voluntary or mandatory nature of standards, since WTO and EU definitions stress their voluntary nature, while ISO definitions encompass both voluntary and mandatory requirements».

<sup>63</sup> See S. CHARNOVITZ, *International Standards and the WTO*, cit., p. 5.

<sup>64</sup> The criteria of specificity is taken into account, together with those of *obligation* and *delegation* in order to distinguish between hard and soft law by K.W. ABBOTT, R. KEHOANE, A. MORAVCSIK, A.M. SLAUGHTER, D. SNIDAL, *The Concept of Legalization*, in *International Organization*, 2000, Vol. 54, *Special Issue*, p. 401 et seq.

<sup>65</sup> See K. W. ABBOTT, D. SNIDAL, *Hard and Soft in International Governance*, in *International Organization*, 2000, Vol. 54, p. 421 et seq., at 436 – 440 and D. SHELTON, *Introduction: Law, Non-Law and the Problem of 'Soft Law'*, in *Commitment and Compliance. The Role of Non-Binding Norms in the International Legal System*, edited by D. Shelton, Oxford University Press, Oxford, UK, 1999, p. 1 ss., at 14.

<sup>66</sup> See U. MORTH, *Introduction*, in U. MORTH (ED.), *Soft Law in Governance and Regulation. An Interdisciplinary Analysis*, Cheltenham, UK – Northampton, MA, USA, 2004, p. 6 and N. BRUNSSON, B. JACOBSSON, *The Contemporary Expansion of Standardization*, in Id. (ed.), *A world of standards*, above n. 58, at 4-6.

requirements to be met for an effective implementation, thereby allowing an objective evaluation on the level of observance<sup>67</sup>. Also the International Association of Insurance Supervisors (IAIS) distinguishes between *principles*, *standards* e *guidance papers*<sup>68</sup>. Moreover, if we look at the concrete content of standards, and not only at the way they have been called, we can see that there can be standards setting more specific requirements than some guidance papers<sup>69</sup>.

Notwithstanding their name, the Santiago Principles can be placed somewhere in the middle within the degrees of specificity mentioned above. Even though most of the GAPP have a very broad formulation, some of them set more specific requirements (it is the case of the provisions requiring the SWF to publish an annual report and to adopt professional and ethical codes of conduct for their management and staff). Moreover, the fact that the second part of the document provides an explanation of each principle shows the purpose of giving some guidance for their practical implementation.

#### D. The different types of global regulators.

The other two features which must be taken into account when examining standards are the type of standard setter and their voluntary or mandatory character.

Standards can be developed by bodies traceable to different models of global administration: international intergovernmental organizations, transnational networks, hybrid and private organizations all develop international standards<sup>70</sup>.

Bodies traceable to the “international administration” model (i.e. intergovernmental international organizations) intervene within the financial services sector. Indeed, the International Monetary Fund, the World Bank and the OECD (Organization for Economic Co-operation and Development) all establish standards for monetary and fiscal transparency, insolvency and corporate governance.

In the second place, transnational regulatory networks such as Basel, the International Organization of Securities Commissioners (IOSCO – 1983) and the

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<sup>67</sup> See [http://www.fsforum.org/compendium/what\\_are\\_standards.html](http://www.fsforum.org/compendium/what_are_standards.html)

<sup>68</sup> See [http://www.iaisweb.org/133\\_ENU\\_HTML.asp](http://www.iaisweb.org/133_ENU_HTML.asp)

<sup>69</sup> See M. DE BELLIS, *Global Standards for Domestic Financial Regulations*, cit.

<sup>70</sup> About the different types of global regulators, see B. Kingsbury, N. Krisch and R. Stewart, *The Emergence of Global Administrative Law*, in *Law and Contemporary Problems*, 2005, Vol. 68, p. 15 et seq., at 20, who divide the models of global administration into five types (administration by formal international organizations; administration based on collective action by transnational networks of governmental officials; distributed administration; hybrid intergovernmental/private administration and administration by private institutions with regulatory functions).



International Association of Insurance Supervisors (IAIS – 1994) develop rules for banking, securities and insurance supervision respectively<sup>71</sup>.

Third, financial standard-setting bodies also include some hybrid organisms (corresponding to the hybrid intergovernmental-private administration) amongst their number. One such example is the Financial Stability Forum (FSF), now Financial stability Board (FSB)<sup>72</sup>, which brings together not only the transnational regulatory networks for banking, securities and insurance supervision (BCBS, IOSCO and IAIS, respectively), but also intergovernmental international organisations (the IMF, the World Bank, the OECD and the Financial Action Task Force on Money Laundering - FATF belong to it<sup>73</sup>), the Bank for International Settlements (BIS) together with its committees (the Committee on Payment and Settlement Systems - CPSS and the Committee on the Global Financial System - CGFS), the ECB and national administrative authorities, such as central banks, supervisory authorities and treasury departments. Domestic authorities from the G7 countries and Australia, The Netherlands, Hong Kong and Singapore were admitted from the very constitution of the FSF, while, after its transformation in FSB, also its membership has been enhanced, and authorities from all the G20 countries are admitted<sup>74</sup>.

Finally, some private organizations, such as the International Accounting Standards Board (IASB) and the International Auditing and Assurance Standards Board (IAASB), one of the International Federation of Accountants' (IFAC) technical committees, draft global standards for accounting and auditing, and are therefore examples of private global governance (whilst, according to some commentators, even credit rating agencies are financial standard-setting bodies)<sup>75</sup>.

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<sup>71</sup> For a broad discussion about transnational regulatory networks. their role and significance, A.M. Slaughter, *A New World Order* (2004).

<sup>72</sup> Along with the establishment of G20, the founding of the Financial Stability Forum in 1999 upon G7's initiative is part of a wider process of re-thinking international financial architecture after the Asian financial crisis of 1997 – 1998: see R. Germain, *Global Financial Governance and the Problem of Inclusion*, in *Global Governance*, 2001, vol. 7, p. 411 et seq. and T. Porter, *The Democratic Deficit in the Institutional Arrangements for Regulating Global Finance*, in *Global Governance*, 2001, vol. 7, p. 427 et seq.

<sup>73</sup> Founded by G7.

<sup>74</sup> See FSF, *The Financial Stability Forum decides to broaden its membership*, Press Release, 12 March 2009, available at <http://www.financialstabilityboard.org/>.

<sup>75</sup> On this point, see D. Kerwer, *Standardising as Governance: the Case of Credit Rating Agencies*, Max Planck Projektgruppe (2001), available at [http://www.mpp-rdg.mpg.de/pdf\\_dat/001\\_3.pdf](http://www.mpp-rdg.mpg.de/pdf_dat/001_3.pdf). See also T. Sinclair, *The Infrastructure of Global Governance: Quasi-Regulatory Mechanisms and the New Global Finance*, in *Global Governance*, 2001, vol. 7, p. 441 et seq.; M.R. Das Gupta, *The External Accountability Gap of Private Regulators: Accountability Paradoxes and Mitigation Strategies. The Case of Credit Rating Agencies*, in *International Public Policy Review*, 2005, I, n. 1, p. 37 et seq.; D. Kerwer, *Holding Global Regulators Accountable: the Case of Credit Rating Agencies*, in *Governance*, 2005, 18, p. 453 et seq.;

If we examine the drafting of the Santiago Principles, we find that it is not easy to frame this case within the above mentioned models or types of global regulators. Even though elaborated under the aegis of an international organization such as the IMF, they fall short of being an example of truly international regulation: as the composition of the IWG, the Group which practically drafted the Principles, merely reflects the number of SWF, these principles could rather be classified as self-regulation. The recent creation of the International Forum of Sovereign Wealth Funds, in which the same SWF which participated in the IWG and all those which meet the Santiago Principles take part, and which aims at interpreting core issues concerning the application of the principles, seems to point in the same direction.

Yet, the initial G7's support to this initiative and, even more, the IMF's involvement, cannot be ignored; because of the involvement of these international organizations, the principles could also be intended as a case of hybrid regulation. This type of involvement must be taken into account when examining the incentives which can foster the implementation of the principles.

#### E. Incentives for standards' implementation.

One of the main disagreement on the definition of standards between standard setters concerns the point whether standards may be defined as such if they are, even from a purely formal point of view, mandatory. As mentioned above, the TBT bases the distinction between standards and technical regulations on the fact that the latter are mandatory, while ISO and IEC do not take into account such a distinction. The scientific debate looks divided as well: on the one hand, some political scientists tend to contrast standardization and regulation on the basis of the binding force of the latter<sup>76</sup>; on the other hand, another part of political scholars<sup>77</sup> and legal scholars<sup>78</sup> tend to refuse such a restrictive definition of standards.

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<sup>76</sup> See D. KERWER, *Rules That May Use: Standards and Global Regulation*, cit., p. 612 e N. BRUNSSON, B. JACOBSSON, *The Contemporary Expansion of Standardization*, cit., p. 3.

<sup>77</sup> See, between the first formulating this idea, K. W. ABBOTT e D. SNIDAL, *Hard and Soft in International Governance*, cit., p. 422 et seq.; see also D. SHELTON, *Introduction: Law, Non-Law and the Problem of 'Soft Law'*, cit., p. 10, and U. MORTH, *Introduction*, cit., p. 5.

<sup>78</sup> See S. CHARNOVITZ, *International Standards and the WTO*, cit., p. 6 (arguing the opportunity of using a definition of standards which also covers mandatory ones); the same approach seems to have been adopted (even if not explicitly) by H.V. MORAIS, *The Quest for International Standards: Global Governance vs. Sovereignty*, cit., p. 779 et seq. and D. ZARING, *International Law by Other Means*, cit., p. 281 et seq..

Yet, in the global legal order it is the very distinction between mandatory and voluntary rules, between hard and soft, which has blurred. From a formal point of view, compliance with global financial standards is generally voluntary<sup>79</sup>. National authorities may choose to implement global rules, or not, according to the standard setting bodies' expertise<sup>80</sup> and capacity of persuasion<sup>81</sup>. But things are not so simple. According to some commentators, international organisations' methods to improve implementation of global financial standards "make their adoption essentially mandatory"<sup>82</sup>. Slaughter reminds us that transnational regulators' soft law, such as codes of best practices and international guidance, can have a "hard impact"<sup>83</sup>.

Instead of identifying standards as soft law<sup>84</sup> *ex ante*, or, on the contrary, stating that they «have gradually made the transition from 'soft law' to 'hard law'»<sup>85</sup>, it seems necessary to evaluate global rules' impact on domestic legal orders on a case by case basis. In so doing, a plurality of factors affecting the implementation process need to be considered.

The debate on factors and mechanisms which affect compliance with global standards is open. Dinah Shelton argues factors fostering compliance with standards are the openness of the standard setting procedure, the content of the standard (arguing that the more precise the content, the more probable its implementation, as there will be no uncertainty on which is the required behavior; on the contrary, the higher the implementation costs, the lower the compliance), the institutional context (if there are assessment mechanisms) and the existence of follow up procedures<sup>86</sup>. Jonathan Charney explains some more elements can influence the implementation process, such as the

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<sup>79</sup> I. BORRELLO, *L'organizzazione sovranazionale ed internazionale della vigilanza sul credito*, in *Riv. Trim. Dir. Pubbl.*, fasc. 2, 1999, p. 423 et seq., at 433 and 441.

<sup>80</sup> D. KERWER, *Standardising as Governance: the Case of Credit Rating Agencies*, in *Common Goods: Reinventing European and International Governance* edited by A. HERITIER, Rowman & Littlefield Publishers, Lanham, UK 2002, accepts the definition of a *standard* as "any rule based on expertise that can be adopted voluntarily". The fact that they may be based on competences of a technical nature, however, does not exclude the possibility that such rules have important political consequences. In this sense, see, generally, W. MATTLI AND T. BÜTHE, *Setting International Standards: Technological Rationality or Primacy of Power?*, cit., p. 1 et seq. See T. PORTER, *The Democratic Deficit in the Institutional Arrangements for Regulating Global Finance*, in *Global Governance*, Vol. 7, 2001, p. 427 et seq., at 428, for an examination of the political consequences of a prudential regulation of financial services.

<sup>81</sup> A. M. SLAUGHTER, *A New World Order*, Princeton University Press, Princeton e Oxford, UK, 2004, at 213.

<sup>82</sup> R. DELONIS, *International financial standards and codes*, cit., p. 563.

<sup>83</sup> A. M. SLAUGHTER, *A New World Order*, cit., p. 224.

<sup>84</sup> M. GIOVANIOLI, *Reflections on International Financial Standards as 'Soft Law'*, *Essays in International Financial and Economic Law*, No. 37, *The London Institute of International Banking, Finance and Development Law*, 2002, p. 5 et seq.

<sup>85</sup> Così H.V. MORAIS, *The Quest for International Standards: Global Governance vs. Sovereignty*, cit., p. 781.

<sup>86</sup> D. SHELTON, *Introduction: Law, Non-Law and the Problem of 'Soft Law'*, cit., p. 13 et seq.

existence of links between a given standard and other soft law or hard law rules, the transparency of the rule, the existence of interest groups supporting the implementation, the formal acceptance by the community and the foreseeable consequences in case of non-compliance<sup>87</sup>.

For purposes of this study, a useful distinction between the various factors fostering the standards implementation process is the one used in the context of the first project for the assessment of compliance with global financial standards developed by the *Financial Stability Forum* (FSF)<sup>88</sup>, and later on used by scholars of international financial law<sup>89</sup> and economists<sup>90</sup>. Mechanisms affecting standards implementation in two broad categories: those of an institutional nature and those that depend, rather, on market dynamics.

Of the institutional mechanisms, at least five can be mentioned. First, standards drafted as voluntary can turn out to be mandatory because of their formal incorporation into a piece of legislation. One such example is the incorporation of Basel II in the Capital Requirement Directive (CRD)<sup>91</sup>.

A second mechanism, which can also end up with making a standard mandatory, is an endorsement procedure: this is the case of European policy for accounting. Regulation CE n. 1606/2002 (so called IAS Regulation)<sup>92</sup>, requires all publicly traded EU companies to prepare their consolidated accounts using IAS/IFRS, as *endorsed* in the EU, since 2005. According to IAS Regulation, when deciding on the applicability of IAS/IFRS, the European Commission – assisted by a set of committees - must evaluate if the international standards correspond to the criteria set out in the Regulation itself: in particular, IAS/IFRS standards can be endorsed only if they are conducive to the European public good, and if they meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making

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<sup>87</sup> J. L. CHARNEY, *Commentary: Compliance with International Soft Law*, in *Compliance and Commitment*, cit., p. 115 et seq..

<sup>88</sup> Cfr., *ex multis*, FINANCIAL STABILITY FORUM, *Final Report of the Follow-Up Group on Incentives to Foster Implementation of Standards*, Report for the meeting of the Fsf on 6/7 September 2001, available at [http://www.fsforum.org/publications/Final\\_Incentives01.pdf](http://www.fsforum.org/publications/Final_Incentives01.pdf).

<sup>89</sup> See M. GIOVANIOLI, *Reflections on International Financial Standards as 'Soft Law'*, cit., p. 20.

<sup>90</sup> See J. WARD, *The new Basel Accord and developing countries: problems and alternatives*, available at <http://www.bis.org/bcbs/qis/resp3jward.pdf>, p. 32 et seq.

<sup>91</sup> See Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions in Official Journal of the European Union L 177, 30 June 2006, p. 1 et seq.

<sup>92</sup> Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, in Official Journal of the European Union L 243, 11 September 2002, p. 1 et seq.

economic decisions and assessing the stewardship of management. In this way, global accounting standards, first established by private entities, gain binding force through European recognition.

The third one is the case which has been named “regime borrowing”: the reference to standards within different regulatory regimes, which therefore lend greater legal force to the former<sup>93</sup>. One example is the TBT obligation for WTO members to use “international standards” as a basis for their technical regulations<sup>94</sup>. Another case is the SPS reference to the Codex Alimentarius Commission standards<sup>95</sup>.

A fourth mechanism is the existence of an assessment procedure. Such an example are the frequently mentioned ROSCs or “Reports on the Observance of Standards and Codes”. These are a part of the Financial Sector Assessment Program (FSAP), founded in 1999 by the IMF and the World Bank. They are reports on countries’ degree of compliance with some global financial standards, wholly coinciding with the FSF *Compendium*’s 12 Key Standards<sup>96</sup>. The reports are prepared by the IMF’s or the World Bank’s staff at the request of the State concerned. Thus the compilation of a ROSC is voluntary just as the report’s publication depends on the State’s consent. At the same time, a State’s refusal to publish a ROSC may negatively affect market operators’ judgements<sup>97</sup>. The IMF and the World Bank, as well as the FSF, have all placed a notable emphasis on the importance on these assessment instruments. The number of ROSCs that have been completed to date (six years after the program was activated) is considerable: by the end of December 2004, 605 ROSC modules had been completed for over 116 States and 74 per cent of them have been

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<sup>93</sup> See Leebron, above n. 50.

<sup>94</sup> Art. 2.4, TBT: «Where technical regulations are required and relevant international standards exist or their completion is imminent, Members shall use them, or the relevant parts of them, as a basis for their technical regulations». For a fuller discussion of the point, R. Howse, *A new device for creating international legal normativity: the WTO technical barriers to trade and international standards*, in *Constitutionalism, Multilevel Trade Governance and Social Regulation*, edited by C. Joerges and E.-U. Petersmann, p. 383 et seq.

<sup>95</sup> Art. 3.1. SPS: « To harmonize sanitary and phytosanitary measures on as wide a basis as possible, Members shall base their sanitary or phytosanitary measures on international standards, guidelines or recommendations, where they exist, except as otherwise provided for in this Agreement, and in particular in paragraph 3». About SPS reference to other international organizations’ activity, see T. P. Stewart e D. S. Johanson, *The SPS Agreement of the World Trade Organization and International Organizations: The Roles of the Codex Alimentarius Commission, the International Plant Protection Convention, and the International Office of Epizootics*, in *Syracuse Journal of International Law and Commerce*, 1998, Vol. 26, p. 27 et seq.

<sup>96</sup> That standards indicated as the parameter for assessment procedures correspond to the FSF’s Key Standards does not follow from the explicit use of the cross-reference technique: a further list is then drawn up which does wholly correspond to that of the 12 Key Standards.

<sup>97</sup> *Follow-Up Group on Incentives to Foster Implementation of Standards, Report for the meeting of the FSF on 6/7 September 2001*, p. 9, note 22.

published on the IMF's web site<sup>98</sup>. Yet, the G20 Washington Communiqué, asking for all G20 States to complete a FSAP, implicitly recognizes that the voluntary nature of this tool has been one of its limits<sup>99</sup>. Recent proposals stress how some States (for example, the US) were powerful enough to ignore these programs, and call for them to become mandatory<sup>100</sup>.

In any case, the external assessment programs run by the IMF and the World Bank must be distinguished from the other instruments that the same parties can use to push States to implement particular global standards. Indeed, it must be emphasized that the IMF can include standards and codes compliance as a part of loan *conditionality* (i.e. conditions which can be imposed on a State that borrows Fund resources) and that it often makes this<sup>101</sup>.

Some institutional incentives (such as incorporation and endorsement) make standards first established as voluntary become mandatory also from a formal point of view. On the contrary, the impact of other institutional incentives may vary, according to interpretation by a Court (It is the case of TBT obligation to use international standards in WTO case law) or to the type of addressee (the impact of ROSC/FSAP and conditionality is different for developing and developed countries).

In addition, or as an alternative, to institutional mechanisms, the implementation of global standards is influenced also by market incentives. For example, a stronger credit risk may be perceived in cases where observance of global standards is poor, whereas borrowing costs can be lower where the implementation of global rules is more advanced<sup>102</sup>. Some data show that market operators' awareness of global standards has markedly increased over the last few years and that they have been using the data resulting from the ROSCs for their financial choices<sup>103</sup>.

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<sup>98</sup> FSF *Ongoing and Recent Work Relevant to Sound Financial Systems. Note by the FSF Secretariat (with inputs from various bodies) for the FSF Meeting on 11 March 2005*, p. 12.

<sup>99</sup> See G20, *Action Plan to Implement Principles for Reform*, annex to *Leaders Declaration on Financial Markets and the World Economy*, Washington DC, 15 November 2008, [www.g20.org/Documents/g20\\_summit\\_declaration.pdf](http://www.g20.org/Documents/g20_summit_declaration.pdf), p. 2, where It is asked all G20 members commit to undertake one Financial Sector Assessment Program (FSAP).

<sup>100</sup> See W. Dobson, *Delivering Change. Together*, in *What G20 leaders must do to stabilise our economy and fix the financial system*, ed. by Barry Eichengreen and Richard Baldwin, available at [http://www.voxeu.org/reports/G20\\_Summit.pdf](http://www.voxeu.org/reports/G20_Summit.pdf), p. 45 et seq., at 46.

<sup>101</sup> See J. WARD, *The new Basel Accord and developing countries: problems and alternatives*, cit., p. 33 and R. DELONIS, *International financial standards and codes: mandatory regulation without representation*, cit., p. 596, for a close examination of the cases in which some of the Key Standards have been included in loan packages.

<sup>102</sup> *Follow-Up Group on Incentives to Foster Implementation of Standards, Report for the meeting of the FSF on 6/7 September 2001*, para. 20.

<sup>103</sup> IMF/World Bank, *International Standards: Strengthening Surveillance, Domestic Institutions and International Markets*, 5 March 2003, p. 12 et seq. and the data set out in Appendix II.

Private sector involvement affects the implementation of global financial standards for another reason as well. There have been some private initiatives directed at providing information on the extent to which global rules have been implemented. The “e-Standards Forum” is a private entity that carries out a genuine monitoring of global financial standards. It summarizes the data on each country’s compliance on its web site<sup>104</sup>.

The Santiago Principles are explicitly defined as voluntary rules. Which ones, of the incentives mentioned above, can be applied more effectively to the case of global standards for SWF?

First of all, market incentives can apply to the case in point. Market operators can take into account compliance with the Principles for their investment choices.

A second incentive is mentioned within the Principles. As pointed out above, GAPP 24 suggests that each SWF should review its own existing arrangements, through self-assessment procedures, and should publicly disclose the result of this kind of assessment. Disclosure of self-assessments could, on the one hand, reinforce market incentives; on the other hand, it could lead to peer review, a mutual evaluation between the SWF.

For the time being, no other type of institutional incentive seem to be in place, as there are no example of incorporation of the principles within pieces of national legislation, nor cases of “regime borrowing” within other international regimes. Yet, even if no formal institutional mechanism is in place, this international initiative has been promoted from the very beginning by the G7 and the IMF, and their influence might affect the process of implementation as well. Moreover, an institutional incentive could be established if the mandate of the International Forum of Sovereign Wealth Funds were to be broadened, in order to focus more specifically on the assessment of the compliance with the principles of its members.

The problem of implementation must be kept in mind especially when analyzing the likely effectiveness of the transparency requirements set forth in the Santiago Principles.

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CalPERS, the California Public Employees’ Retirement System, provides a specific example. It is one of the largest pension funds in America and takes account of the implementation of global financial codes and standards when determining its investment list: see IMF *Quarterly Report on the Assessments of Standards and Codes – August 2003*, para. 7.

<sup>104</sup> See [www.estandardsforum.com](http://www.estandardsforum.com). PricewaterhouseCoopers also publishes an Opacity Index in relation to 35 States on its web site: see *Follow-Up Group on Incentives to Foster Implementation of Standards, Report for the meeting of the FSF on 6/7 September 2001*, para. 23.

## F. Transparency, accountability and SWF.

The present exam has shown the number of transparency provisions which can be found within the GAPP. According to commentators<sup>105</sup>, as well as in the view of the institutions involved<sup>106</sup>, this trend is strictly connected with the aim of fostering the accountability of the funds. Yet, the capacity of transparency to act as an effective tool to strengthen accountability has to be examined carefully, in order to check that It doesn't work as a general but ineffective catchphrase<sup>107</sup>.

Both transparency and accountability have multiple facets, and have been used within different contexts and disciplines<sup>108</sup>.

A call for greater transparency and other forms of public information provision in order to promote accountability has become a common claim in global governance literature<sup>109</sup>. As mentioned above, transparency has allegedly become a general principle of global administrative law (GAL)<sup>110</sup>. Transparency provisions can be found in many international treaties, even if they don't apply in the same way to all the actors involved. For example, the World Trade Organization (WTO) agreements set forth transparency requirements for their member States and for other international standard

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<sup>105</sup> See Truman, above n. 2.

<sup>106</sup> See G7 above n. 3, at; EU *Communication*, above n. 36.

<sup>107</sup> See *Full disclosure. The case for transparency in financial markets is not clear-cut*, in *The Economist* February 19th 2009.

<sup>108</sup> About the ambiguity of the term 'accountability', see J. Black, *Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes*, IILJ Working Paper 2007/12, available at <http://www.iilj.org/publications/2007-12Black.asp>, in particular p. 21 («There are almost as many definitions of accountability as there are articles on the subject, if not more»). See also A. Ebrahim, E. Weisband, *Introduction: forging global accountabilities*, in Id. (eds.), *Global Accountabilities: Participation, Pluralism, and Public Ethics*, Cambridge University Press, 2007, p. 1 et seq., claiming that «Accountability is a confusing term, one that readily confounds efforts at precise definition or application. [...] the analytical domains of accountability have become so extended that the very precision once conveyed by the concept has become eroded». Transparency, in its turn, «as a diamond, [...] has many facets»: see D. P. Steger, *Introduction to the Mini-symposium on transparency in the WTO*, in J. Int'l Econ. L., 2008, 11, p. 705 et seq. See also D. Kaufmann and A. Bellver, *Transparenting Transparency: Initial Empirics and Policy Applications*, August 2005, available at SSRN: <http://ssrn.com/abstract=808664>, at 4, stating that there is no commonly agreed definition of transparency.

<sup>109</sup> For an overview, see R. B. Mitchell, *Sources of Transparency: Information Systems in International Regimes*, in *International Studies Quarterly*, 1998, Vol. 42, p. 109 et seq., at 111.

<sup>110</sup> On this point, see C. I. Fuentes, *Transparency as a Global Goal: Towards an Unity of Principles in Global Administrative Law*, September 15, 2008, available at SSRN: <http://ssrn.com/abstract=1134122>. About procedural principals and global administrative law, see B. Kingsbury, N. Krisch and R.B. Stewart, *The Emergence of Global Administrative Law, Law and Contemporary Problems*, 2005, Vol. 68, p. 15 et seq. See also *Global Administrative Law: Cases, Materials, Issues*, edited by S. Cassese et al. (second edition 2008) ([www.iilj.org/GAL/GALCasebook.asp](http://www.iilj.org/GAL/GALCasebook.asp)); Symposium, *The Emergence of Global Administrative Law*, in *Law and Contemporary Problems*, Summer-Autumn 2005, Vol. 68, pp. 1-385; Symposium, *Global Governance and Global Administrative Law in the International Legal Order*, in *European Journal of International Law*, 2006, vol. 17, pp. 1-278; Global Administrative Law Symposium, *NYU Journal of International Law and Politics*, 2005, Vol. 37.



setters, even though WTO institutions seem to follow a rather opaque decision-making process<sup>111</sup>. Moreover, this general principle is increasingly shaping global standard setters' current practices. One such example is the Basel Committee on Banking Supervision (BCBS): from a tradition of secrecy, It has recently moved to an extensive use of notice and comment procedures<sup>112</sup>.

Yet, the content of these transparency provisions, aimed at shaping public or semi-public actors' conduct, is quite complex, and usually deeply intertwined with participation requirements<sup>113</sup>. The obligations we find in the Santiago Principles, on the contrary, are more narrowly shaped, and identify transparency with access to information. As mentioned above, they request SWF to provide public information concerning their legal basis, structure and governance patterns, policy and financing decisions. The purpose of these disclosure obligations is thus the one of allowing public scrutiny over every aspect of the funds' structure and decision-making process.

How far do these provisions go in helping to foster the funds' accountability? The concept of accountability is maybe even more ambiguous than the definition of transparency. For purposes of this study, a core, principal-agent theory based concept can be used. «At its core, accountability is a particular type of relationship between different actors in which one gives account and another has the power or authority to impose consequences as a result»<sup>114</sup>. The term 'consequences' is being used in a neutral sense, as the possibility of formal sanctions is not necessary for an accountability relation to exist<sup>115</sup>.

But whom do SWFs have to render account to? A core point to bear in mind to assess the type (or types) of accountability we are facing is the identification of the possible stakeholders. As Edwin Truman puts it, there are four groups who can be affected by a government's decision concerning the management of its international investments: first, the citizens of a country have an interest in how their own governments manages the collective assets of their country; secondly, the government

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<sup>111</sup> See S. Charnovitz, *Transparency and Participation in the World Trade Organization*, 56 Rutgers L. Rev. 927 (2003-2004) and Mini-symposium on transparency in the WTO, J. Int'l Econ. L., 2008, p. 705 et seq. See also S. Battini and G. Vesperini, *Introduction*, in *Global and European Constraints Upon National Right to Regulate: The Services Sector*, February 29, 2008, edited by S. Battini and G. Vesperini, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1099844](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1099844), p. 1 et seq., in particular p. 2.

<sup>112</sup> See M. S. Barr and G. P. Miller, *Global Administrative Law: The View from Basel*, in *European Journal of International Law*, 2006 17(1), p. 15 et seq.

<sup>113</sup> See Steger, above n. 108.

<sup>114</sup> See Black, above n. 108, at 21. See also J. Ferejohn, *Accountability in a Global Context*, IILJ Working Papers 2007/5, available at <http://www.iilj.org/publications/2007-5Ferejohn.asp> at 2.

<sup>115</sup> See M. Bovens, *Analysing and Assessing Accountability: A Conceptual Framework*, in *European Law Journal*, 2007, Vol. 13, p. 447 et seq., at 457.

itself might have its own distinct policy interest; in the third place, financial market participants in general; in the fourth place, the authorities and the citizens of the jurisdictions in which the investments are made<sup>116</sup>.

Transparency requirements as set in the Santiago Principles seem to foster different types of accountability, according to the stakeholder/accountee involved. In the first two cases, *supervisory* accountability (i.e. a relation in which one organization acts as a principal with respect to a specified agent) applies: in the first one, citizens could sanction their government's decision on foreign investments through the political process (in this case, the consequences do not affect directly SWF, but the governments involved); in the second one, the government's reaction might depend a lot on the governance and structure arrangements of the funds. In the other two cases, we have examples of *market* and *public reputational* accountability<sup>117</sup>.

A last type of accountability relation has to be taken into account. While all the aforementioned are examples of *external* accountability, also *internal* accountability mechanisms can be put in place<sup>118</sup>. The requirement set forth in the Santiago Principles to identify and disclose professional and ethical standards for the funds' staff and management seems to point in this direction<sup>119</sup>.

#### IV. Concluding remarks.

The drafting of the Santiago Principles must be framed in the context of a general move to the setting of global financial standards. In the aftermath of the Asian financial crisis, international financial institutions started placing standards drafted by networks (BCBCS, IOSCO, IAIS) and private organizations (IASB, IFAC) at the core of a new financial architecture. Fostering the implementation of these standards became part of specific programs and initiatives. The core idea has been that this type of rules - voluntary norms, usually conceived as being very broadly drafted - was the best suited to foster financial stability. Yet, the debate on the roots of the global financial crisis of 2007-9 has been focusing, between other factors, also on the controversial content of

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<sup>116</sup> See Truman, above n. 2, at 6.

<sup>117</sup> In the text, I'm following the typology first suggested by R. W. Grant and R.O. Keohane, *Accountability and Abuses of Power in World Politics*, in *American Political Science Review*, 2005, Vol. 99, p. 1 et seq., at 7-9. See also, using the same typology, S. Chesterman, *Globalization Rules: Accountability, Power, and the Prospects for Global Administrative Law*, in *Global Governance*, 2008, Vol. 14, p. 39 et seq., at 44-5.

<sup>118</sup> See Black, above n. 108, at 21.

<sup>119</sup> GAPP 13.

some standards (Basel II, IAS/IFRS) and on the lack of implementation of other standards (IOSCO Code of Conduct for Credit Rating Agencies). These concerns shed a new light on this type of regulation, so that some commentators have been calling for the hardening of the soft law of financial regulation<sup>120</sup>.

In examining the Santiago Principles, some distinctive features have been pointed out. The content of international standards varies a lot, as some of them, despite the common opinion, might be quite specific (this is the case, for example, of many Methodologies, of Basel II, and IAS/IFRS). The Santiago Principles are quite broadly drafted; yet, there are provisions which establish more precise obligations (such as the ones requiring SWF to publish an annual report and to adopt a code of ethics). Moreover, there is a specific explanation for each principle, which seems to take into account the experience of some transnational regulatory networks, which have been drafting appropriate methodologies to give guidance for the application of their own standards.

Secondly, global standards are being drafted by different types of global regulators: international or transnational administration, private regulator, etc. Given the composition of the IWG, which has been carrying on the drafting of the Santiago principles, they seem to constitute a case of self-regulation. Nevertheless, the involvement of the IMF and the support given by the G7 suggest they could be also a type of hybrid regulation.

Third, the Principles provide for a plurality of transparency provisions, aimed at subjecting to public scrutiny the information concerning the legal basis, governance structure, policy and every financial information concerning the SWF. In this way, GAPP aim at fostering both the *internal* and *external* accountability of the SWF, with regard to a number of different stakeholders.

The Santiago Principles seem thus to be well placed to achieve their expected goal, i.e. greater accountability. Yet, their effectiveness might be impaired by the lack of strong incentives for implementation, and especially for the implementation of its core provisions, setting the transparency requirements.

The incentives which can foster the implementation of standards can be of an institutional type or market driven. In the area of SWF, *market* incentives can apply. Second, GAPP 24 suggests that each SWF should conduct *self-assessment* procedures.

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<sup>120</sup> See D. W. Arner, and M. W. Taylor, *The Global Financial Crisis and the Financial Stability Board: Hardening the Soft Law of International Financial Regulation?*, 2009, AIIFL Working Paper No. 6, available at SSRN: <http://ssrn.com/abstract=1427084>.

A public disclosure of these self-assessments could, on the one hand, reinforce market incentives; on the other hand, it could lead to peer review between the SWF. Third, even if no formal institutional mechanism is in place, this international initiative has been promoted from the very beginning by the G7 and the IMF, and their influence might affect the process of implementation as well.

Anyway, as the recent financial turmoil shows, the implementation process can prove highly problematic in strategic areas (the IOSCO Code of Conduct for Credit Rating Agencies is a case in point). From this point of view, putting in place some appropriate institutional incentives would be highly recommended. An intermediate solution might be the one of broadening the mandate of the recently established International Forum of Sovereign Wealth Funds. The Forum could focus on gathering and publishing all the information concerning self-assessments conducted by its own members, so as to foster peer review and public reputational accountability.