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Summary

Sovereign wealth funds (SWFs) have existed for more than a century, typically as state-sponsored financial institutions to manage a country's budgetary surplus, accrue profit, and protect a country's wealth for future generations. Yet, for economies of the Organisation of Economic Co-operation and Development (OECD), SWFs only burst into public consciousness in the mid-2000s, when widespread concerns arose that SWFs with large amounts of capital could control strategically important assets and threaten the national security of countries where they deployed their investments.

In the 1990s, SWFs held $500 billion in assets, but by 2020, they had more than $7.5 trillion in assets under management (AUM), equal to about 7 percent of the global AUM of $111.2 trillion. Globally, prior to 2010, there were only fifty-eight SWFs. Today, however, SWFs have become an increasingly fashionable type of state-owned entity to set up, and there are currently 118 operating or prospective SWFs. In the African continent alone, prior to 2000, there were only two SWFs. Since 2000, sixteen new SWFs have been set up.

What is particularly concerning about this dramatic growth is that SWFs have been established not just in countries with strong rule of law and civil liberty protections but also in countries marked by high corruption risks, insecurity, violence, and weak or absent rule of law. The chapters that follow include case studies of SWFs from Africa, Asia, Europe, and the Middle East to demonstrate that there are systemic governance issues and regulatory gaps that can enable SWFs to act as conduits of corruption, money laundering, and other illicit activities. This compilation also provides a compelling narrative that highlights the need for clear policies on the management of SWFs, lending weight to the recommendations included in the closing chapter. For SWFs to achieve their full potential, this compilation urges reform not only at the institutional level of the SWF but also across the variety of entities and jurisdictions that make up the supply chain of SWF activity.

The Secret Lives of Sovereign Wealth Funds

As explained in chapter 2, the current SWF data landscape offers only selective, fragmented visibility into SWFs, and little is known about the investments, operations, or internal management of the vast majority of funds around the world. This gap creates opportunities for bad actors to abuse funds for their own interests.

As state-owned entities, SWFs in some ways are set apart from the private investment fund industry, which includes hedge funds, venture capital, and private equity. Notably, an SWF's mission can go beyond maximizing investment returns to include achieving macroeconomic stability or realizing economic development initiatives domestically. Since they do not have fiduciary duties to private investors and clients, SWFs are completely beholden to the governments that endow them.

Yet even though their home governments can exert influence over their operations, SWFs in practice behave very similarly to certain types of private investment funds. SWFs are often set up identically to private equity funds, with capital committed to the fund managed by an external general partner. In contrast to popular perception, many SWF investments do not end up in publicly traded companies that have strictly regulated transparency obligations and fiduciary responsibilities. Just like their counterparts in the venture capital, private equity, and hedge fund industries, SWFs often purchase minority stakes in unlisted, privately held companies. And because most countries require little if any transparency about fund transactions made outside of public markets, records of SWF investments in unlisted assets, whether in a private company or a real estate project, are rarely made publicly available. In the wake of the 2007–2008 global financial crisis, SWFs have even begun accruing substantial debt and using leverage to fund some investments, another trademark strategy of the private equity industry. SWFs also often act as co-investors with massive private equity funds. Furthermore, many have adopted their own arcane corporate structures called sub-funds to coordinate sectoral investments.

There are also large segments of some SWF portfolios that are almost completely absent from public view, whether it be full lists of nongovernmental investors (foreign and domestic), management fees paid to private investment funds, executive compensation, key relationships with intermediary brokers, or corporate structures facilitating investments (especially through offshore companies). Leaked documents provide perhaps the only window on these attributes. Worse, private, third-party SWF data aggregators are significantly dependent on SWFs sharing their underlying data, and access to this data is often prohibitively expensive for most researchers.

As a result, regulators, journalists, civil society activists, academics, and investors alike are left with regrettably little information about how many SWFs operate. Without detailed financial and operational information, the door is left wide open for rapacious managers and political elites to misappropriate investment earnings. Not only can this lack of transparency make SWFs susceptible to corrupt uses, but at the macroeconomic level, it also raises the specter of real destabilization risks if funds were to fail, be mismanaged, or rapidly withdraw funding from target markets. The lack of oversight into SWFs' substantial investments could also inflate dangerous equity price bubbles.

Surprisingly, the enormous rise of cross-border SWF investments has not sparked the creation of a centralized international regulatory body to oversee the industry. The closest global institution is the International Forum of Sovereign Wealth Funds (IFSWF), which set forth twenty-four voluntary principles known as the Santiago Principles. These principles aim to improve transparency and governance, but the IFSWF has no power to enforce its own standards, and naming and shaming efforts by other nongovernmental organizations have been mostly absent. As a result, only a select number of SWFs fully adhere to these basic good governance standards, while others are free to invest trillions abroad but disclose little, if any, comprehensive information on their activities to the public.

The Model Nexus of SWFs and Corruption: 1MDB

Corruption in Malaysia's 1MDB sovereign fund led to what the July 2016 original U.S. Department of Justice (DOJ) indictment called the "largest kleptocracy case to date."[1] That indictment noted, "As alleged in the complaints, the members of the conspiracy—which included officials at 1MDB, their relatives and other associates—allegedly diverted more than $3.5 billion in 1MDB funds. Using fraudulent documents and representations, the co-conspirators allegedly laundered the funds through a series of complex transactions and fraudulent shell companies with bank accounts located in Singapore, Switzerland, Luxembourg and the United States."[2]

The final tally of diverted funds ultimately came to $4.5 billion. Per the same DOJ indictment, the laundered assets of 1MDB "included high-end real estate and hotel properties in New York and Los Angeles, a $35 million jet aircraft, works of art by Vincent Van Gogh and Claude Monet, an interest in the music publishing rights of EMI Music and the production of the 2013 film *The Wolf of Wall Street*."[3] Over $1 billion went into then Malaysian prime minister Najib Razak's personal bank accounts alone.

Chapter 3 provides a comprehensive look at what happened to the Malaysian 1MDB fund between 2009 and 2015 to provide the reader a better understanding of how sovereign wealth funds can be used for gross corruption. It examines how Najib Razak, his proxy Jho Low, advisers from Goldman Sachs bank, and other willing professionals exploited overcentralized power, weak governance, and poor accountability over Malaysian public funds to steal billions for themselves and their collaborators. It also describes how, to increase its influence in Malaysia, the Chinese government was able to use Najib Razak's need to resolve the scandal and fund his reelection bid. The corruption was likewise exploited by other foreign actors, including royal figures and businessmen in the Persian Gulf to siphon billions for themselves in return for providing cover. The 1MDB case thus provides a useful foundation for making sense of the other cases in this compilation, and it underlines the transparency and accountability reforms required to minimize similar future abuse of citizens' financial security by their elites.

Oil, Sports, and COVID-19 Vaccines: Corruption Risks and Natural Resource–Based Sovereign Wealth Funds

Chapters 4 and 5 examine the mechanisms for elite capture and pathways for reform by examining evidence from two of Africa's sovereign wealth funds: Angola's Fundo Soberano de Angola (FSDEA) and Equatorial Guinea's Fund for Future Generations (FFG).

As described in chapter 4, Angola's FSDEA sovereign wealth fund—the African continent's second-largest SWF—was established in 2012 under former president Eduardo dos Santos, with an initial allocation of $5 billion. The fund was created with the country's oil revenues with a dual mandate: to invest oil revenues back into the domestic economy and to act as a savings fund to preserve Angola's oil wealth for future generations.

Conflict of interest concerns were raised when the president appointed his son, José Filomeno dos Santos (also known as Zenu), as chairman of the board, but concerns were assuaged when the fund made a remarkable forty-two-point jump (out of one hundred possible points) in the Peterson Institute's SWF Scorecard on good governance in a mere three years, plus a good score on another key SWF index. The FSDEA soon became embroiled in reports of a scandal following allegations of questionable corporate governance and investment practices, however. Media reports beginning in 2017, followed by a 2019 report by the International Monetary Fund (IMF), found that billions of dollars were illegally withdrawn from the FSDEA by an asset manager (and business partner of Zenu) using sophisticated financial transactions that were channeled through offshore financial centers and invested in projects and sectors of personal interest. That the fund gave an outward appearance of good SWF governance despite significant corruption highlights the flawed nature of the current SWF assessment tools, especially those based primarily on self-assessments.

The case in Angola can also exemplify that reform of SWFs is possible, even in fragile states. Following a change in the presidency and as a result of the scandal, the FSDEA has rolled out a number of corporate governance and regulatory reforms that better reflect international best practices to try to reposition the fund as a credible state-owned investor.

Another oil-rich African country with an SWF and a regime that international reports have found to be mired in elite capture and corruption is Equatorial Guinea. As described in chapter 5, the country had one of Africa's highest GDPs per capita at $14,600, but its level of poverty remains one of the highest in the continent, estimated at 67 percent as of 2020.

Equatorial Guinea's FFG was established in 2002 with a government commitment to deposit 0.5 percent of annual oil revenue into the fund, but it is considered to be one of the least transparent SWFs in Africa with very limited (and in most cases nonexistent) publicly available information. The FFG has no public disclosure of its objectives or mandate, no website, no publicly disclosed governance and institutional framework, no published annual reports, no publicly available information on its board of directors and management, and no publicly disclosed information on asset allocation, investment policy, or fiscal withdrawal rules. Moreover, the leadership of the country exhibits a very high degree of nepotism, and some of the country's most senior leaders have been convicted of grand corruption. Additionally, oil production long ago peaked there, and the IMF predicts the oil could run out as soon as 2030, making transparency and good governance of the fund an especially time-sensitive priority.

Sovereign wealth funds have especially entered the public consciousness lately due to their nexus with sports, and few countries and their SWFs are so intertwined with sport as Saudi Arabia's Public Investment Fund (PIF). As described in chapter 6, the emphasis placed on soccer by the PIF since 2016, coupled with the ecstatic local reception of its purchase of the English Premier League's (EPL) Newcastle United soccer team and subsequent welcome in the city, shine a spotlight on the unconventional returns on investment from such approaches, especially for autocracies like Saudi Arabia. The recent pact between the PIF's LIV Golf Invitational Series, the European (DP World) Tour sponsored by the United Arab Emirates (UAE), and the Professional Golf Association (PGA) tour has only heightened "sports-washing" concerns.

"Sports-washing" is a nebulous term that emerged in the 2010s as authoritarian regimes began to actively engage more in the infrastructure and ecosystem of global sports. Regimes engaged in sports-washing may be able to enhance their popularity through their association with ownership of sports teams or sponsoring major sporting events while de-emphasizing in the minds of the public their involvement in authoritarianism, human rights abuses, organized crime, and corruption.

SWFs are supposed to help generate economic investment at home, but owning sports clubs overseas does little to generate job creation or technology transfer in the investing country. Indeed, many sports institutions, such as the EPL, rarely post any profit, and hosting sports events is often a net financial loss. This reality suggests that financial rates of return were not necessarily uppermost in PIF considerations for its substantial sports investments. Hence, the PIF's acquisition presents a study of how an SWF may be used for purposes other than economic diversification and national development.

Emergency situations like the COVID-19 pandemic can also lead to activities by SWFs and their intermediaries that raise red flags for conflicts of interest or corruption. Chapter 7 describes the Russian Direct Investment Fund (RDIF) and its role in the creation, production, and marketing of the Sputnik V vaccine. The RDIF has been sanctioned by the U.S. Treasury Department and the European Union; the U.S. Treasury labeled the RDIF "a symbol of Russian kleptocracy" and states that it is widely considered a "slush fund for President Vladimir Putin."[4] It was established in 2011 by order of the then president of Russia, Dmitry Medvedev, and Putin, who was serving as prime minister. It is an unusual form of SWF: rather than investing the proceeds from domestic oil or other natural resources outside of Russia to help diversify the economy, as SWFs normally do, the RDIF focuses on establishing joint ventures with foreign firms and funds for investments within Russia.

The supply chain for countries to purchase the Sputnik V vaccine ran through the RDIF and a company the fund had established called Human Vaccine. Some countries, such as European Union members Slovakia and Hungary, were able to make direct deals with the RDIF's Human Vaccine subsidiary to buy Sputnik V doses for $20 for the two-dose regimen. Other countries, however, such as Ghana, Guyana, Lebanon, and Pakistan, had to go through another step in the supply chain because Human Vaccine had appointed Dubai-based Aurugulf Health Investments as the exclusive seller and distributor of Sputnik V for countries in Africa and Asia. Aurugulf was registered in October 2020, just two months after Sputnik V was authorized in Russia, and per the company's website, Sputnik V appears to be its only product. Aurugulf sold the two-shot regime at $38 per two-dose regimen, or almost double the factory price.

The transparency and accountability of funds associated with Sputnik V vaccine-related expenditures decreased when the expenditures were moved off-budget to the RDIF. This move is especially concerning given the kleptocracy associated with the inner circle of the Putin regime. The backgrounds of intermediaries involved in vaccine distribution only heighten concerns about the risks of corruption. The COVID-19 pandemic has revealed an urgent need to improve governance associated with public health—especially during emergency situations and when governance is outsourced to sovereign wealth funds.

Loans, Lottery, Shares, Passports, and Arms: Unique SWF Funding

SWFs are most commonly used as a means to invest excess funds from the proceeds of natural resource exports, as evidenced by the SWFs in Angola, Equatorial Guinea, Saudi Arabia, and Russia. But for the Türkiye Wealth Fund (TWF), the term "sovereign wealth fund" may be a misnomer: the country is chronically short of sovereign wealth because it holds no significant hydrocarbon or mineral deposits and suffers from persistent budget and current account deficits. Instead, TWF acts more like a state-owned holding fund that holds shares in state-owned enterprises (as explained in chapter 8).

When TWF started its operations in 2016 with a founding capital of merely $17 million, critics claimed that the fund would function as a "parallel budget" that the Turkish government could exploit to carry out economic and financial transactions outside of parliamentary oversight and public audits.[5] Seven years on, Turkish President Recep Tayyip Erdoğan has used it to reward individual and institutional clients, settle political scores, consolidate economic and political power, and shield his economic and financial policies from parliamentary oversight and public audits. This misuse has further deepened the country's acute governance deficit and contributed to the economy's underperformance.

In the absence of any viable revenue stream, the Turkish government transferred state-owned enterprises and assets to TWF, but the fund has failed to demonstrate any value-added through these asset transfers. In January 2017, the government issued a state-of-emergency decree to hand over the national lottery and betting rights to the fund. The Turkish

Treasury's stakes in the country's two largest public lenders, Ziraat Bank and Halkbank; the state oil company Turkish Petroleum Corporation; the flagship carrier Turkish Airlines; and the former state telecommunications monopoly Turk Telekom were also transferred to TWF shortly thereafter with another state of emergency decree. In 2020, TWF acquired a majority stake in the country's largest mobile phone operator, Turkcell, through a deal involving questionable offshore deals, conflicts of interest, and irregular transactions. As a result, according to the Sovereign Wealth Fund Institute, the fund's assets exceeded $279 billion as of 2023.

Meanwhile, the Turkish government turned TWF into a collateral instrument to take out additional loans in an economy with an already sizable debt burden of around $450 billion; there was a need to refinance $170 billion in mainly dollar-denominated loans in 2022 alone. In seeking loans, the fund competes not only with the Turkish Treasury but also with private corporations to access local and international capital markets.

Chapter 9 describes the role that China's SWFs play in underwriting China's Belt and Road Initiative (BRI), which has not only supercharged infrastructure investment worldwide but also brought long-standing questions about corruption and political influence to the fore. One key investment sector for SWFs is infrastructure. Infrastructure investment is expected to reach $79 trillion globally by 2040, but alongside extractive industries such as oil and gas, it is the economic sector that remains most strongly associated with corruption risks given that an estimated 20–30 percent of infrastructure project value is lost through corruption.

While China's policy banks and state-owned commercial banks are the front-end lenders in BRI financing of infrastructure projects, China's State Administration for Foreign Exchange (SAFE) and its associated China Investment Corporation (CIC) sovereign wealth fund have provided much of the capital, as well as the financial intermediation tools and financial management to move funds from China's foreign exchange reserves to the BRI's projects and to help oversee use of the funds.

China's SWFs have raised some corruption concerns in their own right. A 2016 probe by the Communist Party's powerful anti-graft body, the Central Commission for Discipline Inspection, reported of CIC that "there were wrongdoings in policymaking and severe problems in the tunneling of interests" and that problems of discipline "occurred frequently."[6] Both SAFE and CIC were reexamined by the commission in early 2022 as part of a broader crackdown on financial sector excess. However, these pronouncements should be treated cautiously given the politicized nature of the anti-corruption campaign.

Instead, the opacity associated with the BRI overall and the way that its financing is disbursed can both be at risk for corruption and conflicts of interest. There is no formal BRI national membership process or structure, with participation in the BRI most often signified through non–legally binding memorandums of understanding (MOUs) or other, less formal cooperation agreements between China and recipient governments. There is no official list of all BRI projects, nor are there consistent standards, certification schemes, or even branding efforts that signify individual Chinese-backed overseas infrastructure projects as being formally part of the BRI (unless they are explicitly mentioned in MOUs). Estimates of the value of BRI total investment and contract costs range from roughly $965 billion by the American Enterprise Institute as of mid-2023 to $8 trillion by the Center for Global Development as of 2018.

A major BRI corruption concern is that associated with infrastructure projects in BRI recipient countries and so-called debt-trap diplomacy. AidData found that 69 percent of official lending by China between 2000 and 2017 went to countries whose credit ratings scored below the global median and that fully 90 percent of BRI-era official lending went to countries that scored beneath the median of the World Bank's Control of Corruption index. This problem arises because, in an extension of China's stated policy of noninterference in other countries' internal affairs, it generally provides BRI loans with few or no preconditions pertaining to transparency, rule of law, or other factors that shape the wider investment climate.

Moreover, a Peterson Institute study of one hundred bilateral Chinese loans found that all loans since 2014 have included "unusual" and "far-reaching" confidentiality clauses that do not permit borrowers to disclose any of the contract terms or related information.[7] This is because, while China's pre-BRI lending was mostly provided directly to governments, nearly 70 percent is now directed to state-owned companies and banks, special purpose investment vehicles, joint ventures, and private sector firms. These debts, though often substantial, do not appear on the public books—though government liability assurances mean that the public will still be on the hook should something go awry.

One of the more unique SWF mechanisms is Malta's National Social and Development Fund (NSDF), which has been funded largely through the country's Citizenship by Investment (CBI) programs, better known as "golden passport" schemes. As evidenced in chapter 10, CBI programs have long enabled the ultra-wealthy, including the very corrupt, to evade scrutiny for misdeeds, to hide assets, and to acquire international mobility by purchasing citizenship in other countries. An SWF that runs a very high risk of being funded using corrupt, laundered, or ill-gotten wealth strikes at the very heart of what the SWF represents by creating a dependency on potentially ill-gotten gains to fund domestic development. Furthermore, for the Maltese government to use an SWF to invest such proceeds is to benefit from the misdeeds of the corrupt and the criminal. It also allows money that may be ill-gotten to move easily through the financial system under the protection that being part of an SWF entails.

Malta is a small island in the Mediterranean Sea that, despite its European Union (EU) member state status since 2004, one analyst has described as a "corrupting island in a corrupting sea."[8] It has had a "disproportionate role as a hub for transnational illicit flows and criminal activities."[9] Malta has had a variety of CBIs; the 2014 iteration was called the Individual Investment Program (IIP), whereby after payments and investments totalling 1.15 million euros ($1.52 million at the average exchange rate for 2014), an individual could become a full-fledged EU citizen with a passport and all the citizenship and travel opportunities this entails.[10] Partially in response to public criticism, in 2020, Malta launched a new CBI program with a higher minimum investment cost and more stringent real estate investment requirements.

CBI applicants are supposed to be fully vetted for security risks. These due diligence checks are vitally important given the fact that Malta is a member of the EU and its Schengen Agreement, affording visa-free travel to up to 182 countries. This travel can allow these new citizens to conduct banking and business under looser standards than would be required under their original passports. They also receive all of the rights to privacy and rule of law and protections against any expropriation that are accorded EU citizens. Moreover, the scheme also provides the potential for golden passport holders to do all of this under a new name, enabling them to bypass security checks or flags on their previous identities.

Despite a four-tier due diligence process established to vet applicants, information leaks revealed that several high-profile Russian individuals obtained citizenship through the IIP between 2016 and 2018. These names are just a few of over 700 Russians who by 2018 were able to purchase Maltese citizenship. The same leaks revealed that citizenship applicants tended to come from countries with a higher risk of money laundering. A plurality of applicants—37 percent—came from Russia, followed by China with 12 percent and Saudi Arabia with 10 percent.

In addition to concerns about who was receiving the passports, there were also concerns about potential conflicts of interest in administering the fund: the chairman of NDSF had individual interests in several companies that the fund also had stakes in.

The sale of passports was profitable for Malta's SWF, and the country's budget deficit shrank dramatically following the introduction of its CBI scheme. But funding a state's SWF through potentially illicit proceeds undermines a country's rule of law and its citizen trust in democratic institutions. The development associated with such funding mechanisms can also give ruling parties an edge in elections, helping solidify their state capture. Additionally, it can also create perverse incentives whereby states come to rely on illicit funding to stay afloat. These schemes have the potential to facilitate strategic corruption in Western states by making it easy for authoritarians to seed their crony facilitators abroad under the cover of Western residency or citizenship. In turn, these authoritarians can better help their cronies to avoid sanctions and facilitate the laundering of kleptocratic assets that help keep their regimes in power. Their money can then be used to influence Western politicians and other powerbrokers in ways that may undermine larger national security considerations.

The final case study in this report examines the UAE's use of side contracts associated with arms sales to fund one of its main SWFs, Mubadala, and SWFs associated with Tawazun—a practice that not only increases corruption risks but also risks larger efforts at peace and security worldwide, as described in chapter 11.

The defense sector has long been recognized for its association with corruption. Around the world, the shielding of large amounts of money and equipment under a veil of national security secrecy creates conditions ripe for bribes, kickbacks, and patronage. Especially worrisome to good governance and arms control advocates is a special kind of arms trade contract known as a defense offset agreement, sometimes referred to as "industrial participation" or "countertrade." These are provisions in arms contracts that promise specific benefits to the contracting country as a condition of that country purchasing defense articles or services from a nondomestic supplier. Offset contracts are a major means for defense companies to improve an arms contract proposal's standing vis-à-vis other bidders, but they can also be a pathway for kickbacks and patronage, whereby senior officials can direct offsets to their own companies or to underlings in return for loyalty. Based on an analysis of 134 defense companies worldwide by Transparency International, 90 percent of surveyed companies exhibited "limited" to "very low" commitment to combating corruption in defense offset contracts.

Countries can require offset deals to be public and transparent, but a high degree of secrecy is more often the norm. Some countries, including the UAE, declare these contracts to be secret. Others, like the United States, provide only the bare minimum of information. Because so many of these offset deals are extremely complex, even when publicized, tracking the various flows of funds and potential conflicts of interest can be a challenge.

The UAE wraps an additional layer of complexity and opacity around defense procurement arrangements by funneling much of the funds and contracts through Emirati sovereign wealth funds. The UAE is unique in that two of its major SWFs were initially established to funnel proceeds from defense offsets to Emirati companies and citizens, and they remain intimately tied to the Emirati defense industry.

Mubadala, founded in 2002 by the UAE Offsets Group, was created as a civilian adjunct to the overall defense offset program of the Emirate of Abu Dhabi's military-procurement-focused, high-tech industrial development program. A series of mergers brought its assets to $284 billion in 2018, and it is now the third-largest SWF in the UAE and the thirteenth largest in the world.

Tawazun Council (commonly referred to as Tawazun) was established in 1992 as the Offset Program Bureau. Tawazun oversees the military component of various defense offset agreements. It boasts of creating numerous companies and investment vehicles, including the EDGE Group, which is now the UAE's main state-owned defense industry conglomerate with more than twenty companies. In 2019, Tawazun's associated SWF—Tawazun Holding—was absorbed into the Mubadala SWF, and a new $680 million SWF was created under Tawazun called the Defense and Security Development Fund (also called the Strategic Development Fund).

Defense offset funds for Persian Gulf countries are supposed to be used to increase employment opportunities for their nationals, attract new technologies and foreign investment, and reduce their economies' reliance on oil and gas exports through diversification strategies. In reality, the defense offsets themselves have generally not created many actual jobs, especially compared to the large burden offsets place on state budgets. Moreover, because the purchasing countries front much of the cost of offsets through tax credits and other investment incentives, these programs can be an especially economically inefficient means of generating job growth and facilitating technology transfer.

In the UAE, the defense procurement that feeds into these offset contracts and their associated SWFs is especially susceptible to possible corruption risks. According to Transparency International's Government Defence Integrity (GDI) Index, which assesses the comprehensiveness of anti-corruption measures in national defense institutions, the UAE is considered a "very high risk" country for defense sector corruption: procurement processes are opaque, underregulated, and lack public oversight. Based on research conducted in 2019, the GDI found no laws or regulations that address the UAE's defense procurement process. Instead, acquisitions are guided by a secret strategy derived by a small team of Emirati officials and foreign consultants. The UAE has no official reporting mechanisms regarding defense acquisitions except for occasional disclosures to defense industry journalists and experts. While some basic internal auditing practices are in place, there are no external oversight bodies that can monitor the administration of the UAE's defense purchases.

Moreover, while Mubadala has signed onto the IFSWF and its Santiago Principles and has received good overall ratings by the Peterson Institute's SWF Scorecard, Tawazun's SWF has not been rated by the Peterson Institute and is not a member of the IFSWF or a signatory to its Santiago Principles.

In addition to corruption concerns, there can be an especially troubling nexus with conflict and state fragility. For example, the UAE's Horizon Flight Training Academy was founded via defense offset contracts and is under the EDGE Group umbrella. The majority of its pilots go to the Emirati military, where they have flown in highly controversial military operations in Yemen. This arrangement points to how the funding of SWFs associated with the arms trade can also undermine other global security goals.

Three Parallel Paths to SWF Reform

The cases in this compilation highlight the need for substantial reform in global SWF governance. For reform to be effective, it must follow along three simultaneous, parallel paths.

Policy Reform for Countries Where SWFs Invest and Private Sector Intermediaries Interact With SWFs

When used appropriately, SWFs can help diversify economies, save resources for future generations, help smooth potential swings in the budgets of natural-resource-based economies, and help address budget deficits, especially in hard times. The case studies in this compilation have documented, however, that there can be significant gaps in how SWFs are governed, in both the states that create the SWFs and the countries where SWFs are invested.

One significant problem is the lack of laws and regulations that mandate oversight of SWF investments. What oversight exists is almost exclusively focused on national security concerns in the countries where the investments occur, and little attention is paid to assessing and addressing corruption, money laundering, and other associated governance risks.

In the United States, for instance, federal laws do not specifically restrict SWF investments but rather look to scrutinize or restrict foreign investments that pose a national security risk. These laws operate in conjunction with sector-specific restrictions in areas like telecommunications, energy, and other specific laws that restrict foreign investment. But outside of these generalized restrictions, there appears to be no publicly available guidance on how to address or conduct anti–money laundering due diligence on SWFs.

Other countries, such as the United Kingdom, have partial, directed guidance on how to address anti–money laundering and counter threat finance (AML/CFT) risks in SWFs. To address SWF corruption, money laundering, and other associated governance risks, national governments and private sector actors must first recognize the enabling role they have in facilitating red flag behavior and then address the governance and regulatory gaps that allow this behavior.

The following policy recommendations could help address these gaps:

- National governments should establish a regulatory rubric that examines SWFs for both national security risks and significant corruption and money laundering risks. This rubric would automatically make verifiable information on particularly high-risk SWFs more readily available.

- Because SWFs often invest through private equity funds, hedge funds, and venture capital funds, jurisdictions should ensure that the private investment fund sector has requisite AML/CFT obligations such as full customer due diligence. And these obligations should be appropriately enforced.

- Jurisdictions should prioritize the creation of strong beneficial ownership registries that require a business, trust, charity, or other entity to declare who actually owns or controls it. If the beneficial owner includes an SWF, this should have to be declared as part of the registry process. This act is critical for continued information sharing and to track the movement of ill-gotten gains of political elites, gains that can move more easily via these funds.

- Financial institutions and entities obliged to implement AML/CFT frameworks should be provided detailed guidance on how to assess SWFs for AML/CFT and corruption risks. The "sovereign" nature of a fund should not provide automatic legitimacy to an SWF's financial transactions. The language in the UK's Joint Money Laundering Steering Group (JMLSG) offers a good starting point.

- Jurisdictions should implement more stringent penalties, including the loss of a license and criminal prosecution, for individuals that enable corrupt activity. Despite record fines, financial institutions, law firms, accounting firms, and other intermediaries continue to engage in bad behavior, as laid out in numerous examples throughout this report.

- Governing bodies for international sporting events should ensure that any SWFs involved are subject to the independent audit or disclosure requirements of contracts awarded, including full financial reporting to address associated corruption and money laundering risks.

- Capital market regulators, such as the U.S. Securities and Exchange Commission, should create more detailed SWF investment forms that include the name and location of all sub-funds, co-investments, and direct and indirect investments.

Policy Reform in Countries Where SWFs Are Created

Fortunately, substantive work has already been done to identify the key reforms needed to ensure that states create robust accountability mechanisms. But the absence of global assessments or enforcement mechanisms, such as through civil society or investigative journalist mechanisms, has limited the broad-based uptake of these suggested reforms. Leading experts in the field have identified four internal reform efforts that are critical to addressing SWF-related governance, corruption, and money laundering challenges. Every SWF should:

1. Establish a well-defined institutional structure for the SWF, including by setting clear fund objectives. For instance, plainly state whether the fund seeks to stabilize the budget, save for future generations, or dedicate its resources to development goals; disallow the use of vague, undefined terms that can make it hard to assess the SWF's objectives.

2. Set a rules-based investment mandate that spells out what percentage can be made in equities versus real estate versus development projects. Restricting domestic expenditure through the SWF and mandating that domestic investments follow a budgetary process are additional ways to mitigate fund losses and risks around patronage networks and crony capitalism.

3. Develop and operationalize well-defined, rational fiscal rules. The rules would dictate when and how money could be withdrawn and deposited into the fund.

For instance, Russia and Abu Dhabi do not have withdrawal and deposit rules. By contrast, Alaska and Texas in the United States, as well as Chile, Norway, and Timor-Leste, have clear rules on withdrawals and deposits and require disclosures on fund activities, transactions, and fund managers.

4. Establish independent oversight of the fund. This would ensure that there is a clear division of responsibilities between the fund manager, who has overarching authority over the SWF, and those running the day-to-day operations; it would also help create a clear mapping of the ethical and conflict of interest considerations. Additionally, it would ensure that the fund provides an exhaustive disclosure of its investments, fund managers, and audited financial statements. Independent oversight authorities within the country should monitor fund behavior and raise queries about management and performance. Alberta in Canada, North Dakota and Texas in the United States, and Norway have funds with strong independent oversight mechanisms. SWFs must also be accountable politically to a parliament or congress, accountable legally to the judiciary, and accountable operationally to the auditor general or some other supervisory body that is both formal and independent. There should also be sufficient information available for civil society, journalists, and international organizations like the IMF so that they can also serve as effective oversight mechanisms.

Revisiting and Reframing International Standards on SWFs

Since their creation, the Santiago Principles have remained entirely voluntary and have not been reviewed or updated. The fact that they are voluntary helps make the case that SWFs are ill-equipped to address and enforce the governance challenges of SWFs and the security concerns of the countries where they invest.

While the Santiago Principles have long provided clear context for studying and regulating SWFs' impact, nowhere in the drafting language is there explicit reference to the potential for abuse. Because the principles have remained static, they do not account for changes in how SWFs are used and operated.

Critics of the Santiago Principles also note that there is no explicit acknowledgment of the significant increase in "novel forms of partnership and collaboration" in "sovereign-private arrangements."[11] Explicitly recognizing this increase and enhancing disclosure requirements of these arrangements would alleviate concerns around both national security and corruption risks.

Additionally, there is no requirement to publish audited statements or send them to an international organization that can act as an independent third-party verifier of information. Other international mechanisms such as the Extractive Industry Transparency Initiative—which sets best practices for oil, gas, and mining governance—include this requirement.

The IFSWF also lacks any legal authority to enforce its standards, and unlike with money laundering and tax evasion, international organizations and civil society have shied away from naming and shaming as a way of ensuring compliance.

Self-regulation is ineffective because it is simply not in the interest of the SWFs to critically examine their frameworks. Therefore, the overhaul of international standards must involve greater dialogue and guidance from both the OECD and IMF; SWF reform will not trickle down at the country level unless there are measurable international standards against which SWFs are compared.

The following policy recommendations may help address these gaps:

- The Santiago Principles should be revised to reflect current SWF practices and risks. Any such revision effort should seek input from a wide variety of stakeholders and specifically include civil society organizations.

- The Santiago Principles should be revised to serve as both guiding principles and effective standards against which international organizations like the IMF can conduct assessments. There is precedent for this: countries allow their AML/CFT standards to be assessed by the Financial Action Task Force (FATF) or its regional bodies, and the assessment is not perceived as impinging on states' sovereignty.

- The OECD should move its focus beyond the narrow prism of security threats to investment jurisdictions and publish a comprehensive international best practices paper that addresses both the internal and external aspects of SWF corruption risk.

- SWFs that are at high risk for corruption and money laundering should be red flagged.[12]

The intention of this compilation is not to undermine the tremendous value that a well-governed SWF can provide for a country and its citizens for generations to come. Valuable lessons abound from the experience of countries that have successfully transitioned from natural-resource-dependent economies to economic diversification. At the same time, this compilation and the reforms suggested serve to highlight the need for more critical study around the governance risks of SWFs. Failure to understand these risks will lead to SWFs failing to deliver on their promise of economic security and generational citizen wealth.

Note: Citations are used only for direct quotes in this summary; all material used in this summary is fully sourced throughout the compilation.

CHAPTER 1

Sovereign Wealth Funds and Ongoing Corruption, Illicit Finance, and Governance Risks

Lakshmi Kumar

Sovereign wealth funds (SWFs) have existed for more than a century, typically as state-sponsored financial institutions that manage a country's budgetary surplus, accrue profit, and protect a country's wealth for future generations.[13] Yet, for the economies in the Organisation for Economic Co-operation and Development (OECD), SWFs only burst into public consciousness in the mid-2000s, when widespread concerns arose that SWFs with large amounts of capital could control strategically important assets and threaten the national security of countries where they deployed their investments.[14]

The term SWF itself refers to money that is invested by a country in order to protect it from economic shocks or to save it for future generations. The institutions featured in this paper have been included and classified as SWFs if they are members of the International Forum of Sovereign Wealth Funds (IFSWF), if leading investor subscription services like the Sovereign Wealth Fund Institute have categorized them as SWFs, or if cases or investigations have referenced them as SWFs. Only vehicles owned by a country's national government have been included.

Early SWFs were set up in countries whose economies were reliant on exporting natural resources like oil, phosphate, and copper (for example, Chile, Kiribati, Kuwait, and Norway). Governments wanted to create a mechanism by which excess revenues generated when commodity prices were high could act as a buffer when there was an economic downturn. SWF investments also helped smooth out budgets, as the prices of those exports could rise and fall on international markets. SWF funding sources have expanded to include any surplus from foreign reserves, budgets, a country's central bank reserves, public-private partnerships, or citizenship-by-investment schemes.

In the 1990s, SWFs held merely $500 billion in assets,[15] but by 2020, they had more than $7.5 trillion in assets under management (AUM), equal to about 7 percent of the global AUM of $111.2 trillion.[16] This exponential growth in SWF investments has seemingly ignored many potential systemic corruption and other governance challenges. As outlined in this chapter and those that follow, SWFs are often found in countries with high risks of corruption and significant governance challenges including poor rule of law. And because SWFs are usually completely under the control of governments, they can be used to pursue purely political goals. Moreover, SWFs often have no fiduciary responsibilities or minimal reporting obligations, making it difficult to understand where a country's money is invested. Despite SWFs being publicly financed entities, they are not subject to rigorous international financial disclosure and accountability mechanisms that would check for issues such as corruption. There is also a substantial network of intermediaries (financial experts and professionals) that help SWFs invest, which, as this paper documents, can raise the risk of corruption and other governance challenges, if there is poor oversight and accountability. Basically, SWFs are only subject to voluntary self-regulation, and so far, as of 2021 twenty-nine SWFs—which account for roughly 80 percent of all SWF assets—are only in partial compliance with the self-assessment standards set out by IFSWF.[17]

Public consciousness of SWFs, their roles in economies, and their potential political impact grew during the 2007–2008 global financial crisis. Some SWFs played a "white knight" role to several Western financial institutions, providing large capital infusions to banks facing bankruptcy.[18] In the first six months of 2008, SWFs injected more than $80 billion into Barclays, Merrill Lynch, Morgan Stanley, and UBS, stabilizing the global credit market.[19] At the same time, however, these large investments drew much more public scrutiny to SWFs. Yet, most of the international, government, and academic discourse since then has centered around the impact of SWFs on corporate governance, financial market stability, and national security risks—with corruption risks rarely being discussed.

The potential for SWFs to be used for grand corruption and kleptocracy first gained widespread attention in the early 2010s due to a scandal involving a Malaysian SWF called 1Malaysia Development Berhad (1MDB), which is described in detail in chapter 3. Under former Malaysian prime minister Najib Razak and a financier named Jho Low, a series of con artists, bankers, Malaysian elites, and even Hollywood movie stars benefited from the diversion of more than $4 billion in funds from Malaysia's 1MDB SWF.[20] As media reports began to highlight troubling issues with the fund and as the U.S. Department of Justice launched an investigation, 1MDB found it difficult to use the international banking system. However, elites from Saudi Arabia and the United Arab Emirates came to the rescue, using their personal reputations and their own SWFs to help 1MDB continue to launder funds.

In the wake of that headline-grabbing corruption scandal, the question that remains unanswered is whether current research, government regulation, and international standards can adequately deal with the corruption and other governance risks that SWFs present. Using case studies of SWFs from Africa, Asia, Europe, and the Middle East, the chapters in this compilation demonstrate that enduring systemic governance issues and regulatory gaps have enabled SWFs to act as conduits of corruption, money laundering, and other illicit activities. For SWFs to achieve their full potential, reform is needed not only at the institutional level of the SWF but also across the variety of actors and jurisdictions that make up the supply chain of SWF activity.

This introductory chapter is intended to help set the scene for what is a complex topic. The chapter presents an overview of SWFs, the potential risks of corruption and rent-seeking activities, and the impact these behaviors can have on a country's citizens. The chapter also demonstrates how SWFs have evolved, how they are funded, where and how they invest, and the current international and domestic regulatory landscape. Finally, it summarizes the different SWFs examined and the recommendations for helping them reach their potential.

What's in a Name: Challenges With Defining a SWF

Any discussion of SWFs is incomplete without addressing an ever-present definitional conundrum. Though recognized SWFs like the Kuwait Investment Authority (KIA) have been around since the 1950s,[21] the term "sovereign wealth fund" emerged only in 2005,[22] when it was coined by financial analyst Andrew Rozanov as a way to differentiate SWFs from other institutional investors.[23] Since then, however, international organizations, governments, and academics have all created and employed slightly different definitions of the term SWF.[24] The lack of a clear, single definition makes monitoring SWFs for money laundering, corruption, and other rent-seeking especially challenging because there is no uniform way to provide guidance on potential risks and to identify what financial behavior should be monitored and assessed. The differences in SWF definitions have also prevented states from maximizing their combined efforts in countering illicit acts.

Perhaps the best-recognized definition is the one contained in the Generally Accepted Principles and Practices (GAPP) that govern SWFs, otherwise known as the Santiago Principles. Drafted by the International Working Group on SWFs, the Santiago Principles define SWFs as "special-purpose investment funds or arrangements that are owned by the general government."[25] Created for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives and employ a set of investment strategies that include investing in foreign financial assets. SWFs are commonly established out of balance-of-payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports.

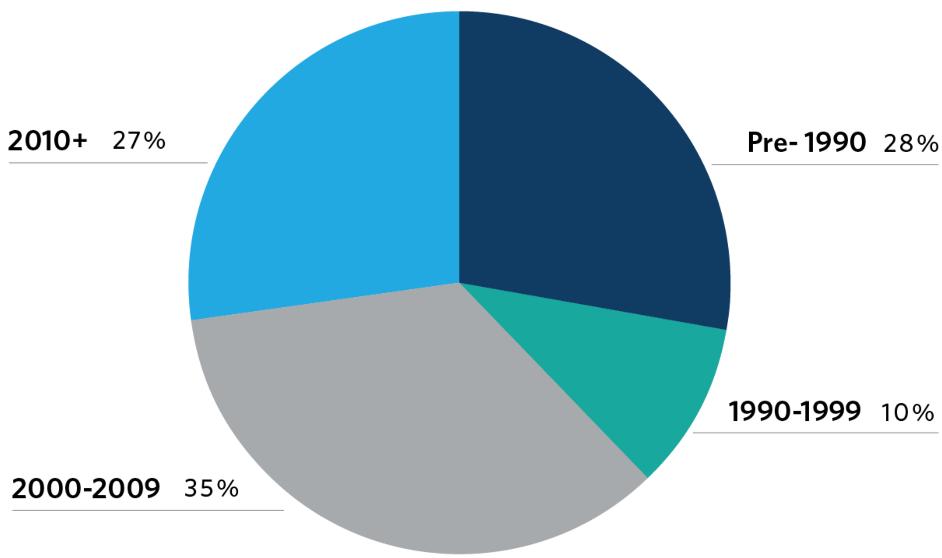
The Santiago Principles are considered global foundational standards under which SWFs have committed themselves to operate. A key element of the SWF definition is that the fund must be owned by a national or subregional government. For example, a fund owned by the state of Alaska would qualify as an SWF because it was owned by a state government within the United States. The next criterion is that the vehicle's investments must include foreign investments. Therefore, any fund with a mandate to invest all its money domestically would not be considered an SWF. By that measure, the Türkiye Wealth Fund (discussed in chapter

8 of this compilation) would not usually be considered a SWF, as it has a purely domestic mandate. But to ensure consistency across the cases presented here, entities treated as SWFs in practice, such as the Turkish fund, are also included. Appendix A provides a more detailed discussion of various SWF definitions.

The Growth and Evolution of SWFs

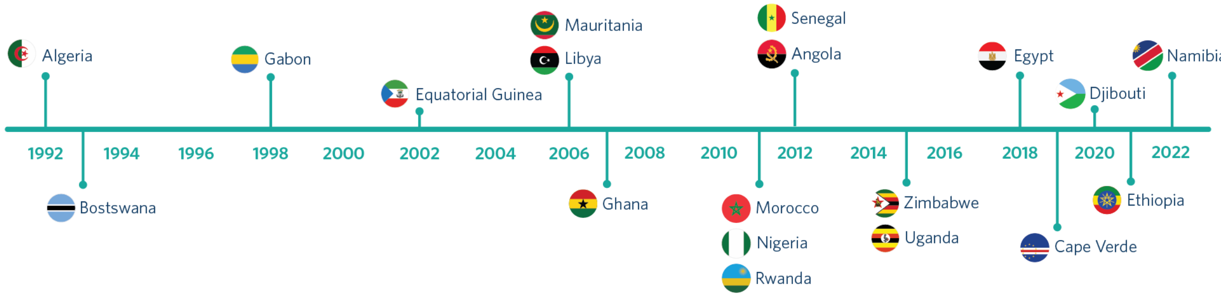
Charting the story of SWF growth provides important evidence for why so many SWFs appear to have serious corruption, money laundering, and other governance risks. Globally, prior to 2010, there were only fifty-eight SWFs.[26] Today, however, SWFs have become an increasingly "fashionable" type of state-owned entity (see figure 1), and there are currently 118 operating or prospective SWFs.[27] In the African continent alone, prior to 2000, there were only two SWFs. Since 2000, sixteen new SWFs have been set up (see figure 2). This increase in the number of SWFs has also meant a dramatic increase in the value of the assets that they own or control.

Figure 1. Percentage of SWFs Launched Across Time Periods



Source: Adapted from the graphic found in "The UK as a Leading Centre for International Wealth Funds," The CityUK, June 8, 2021, 11, https://www.thecityuk.com/our-work/the-uk-as-a-leading-centre-for-international-sovereign-wealth-funds.

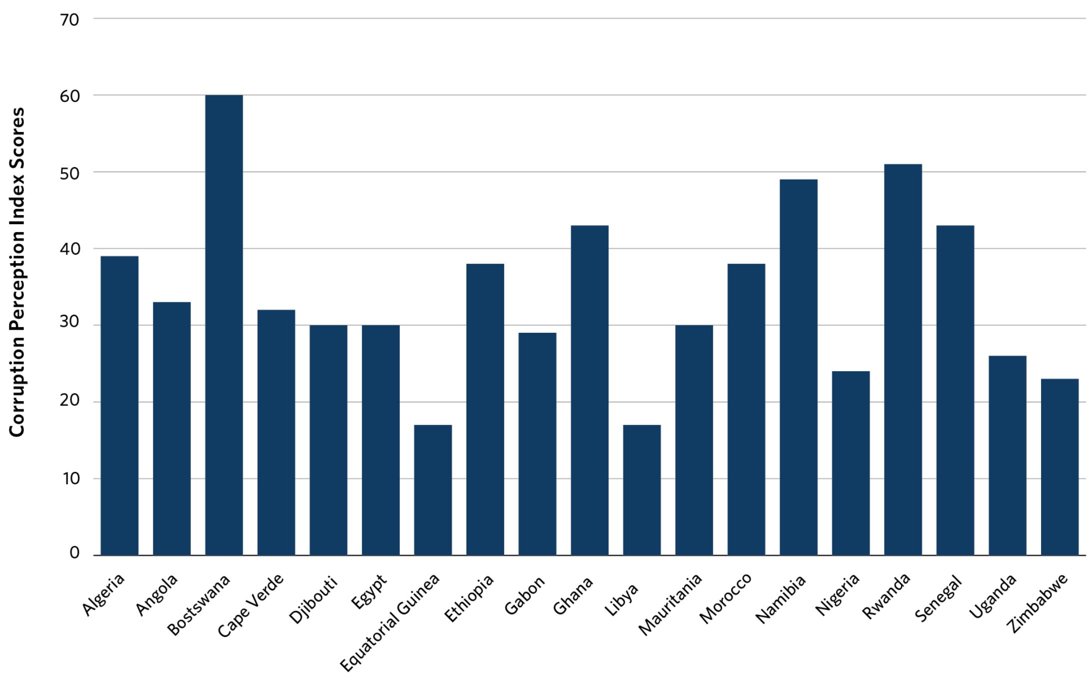
Figure 2. SWFs in the African Continent, By Year Established



Source: Author's analysis

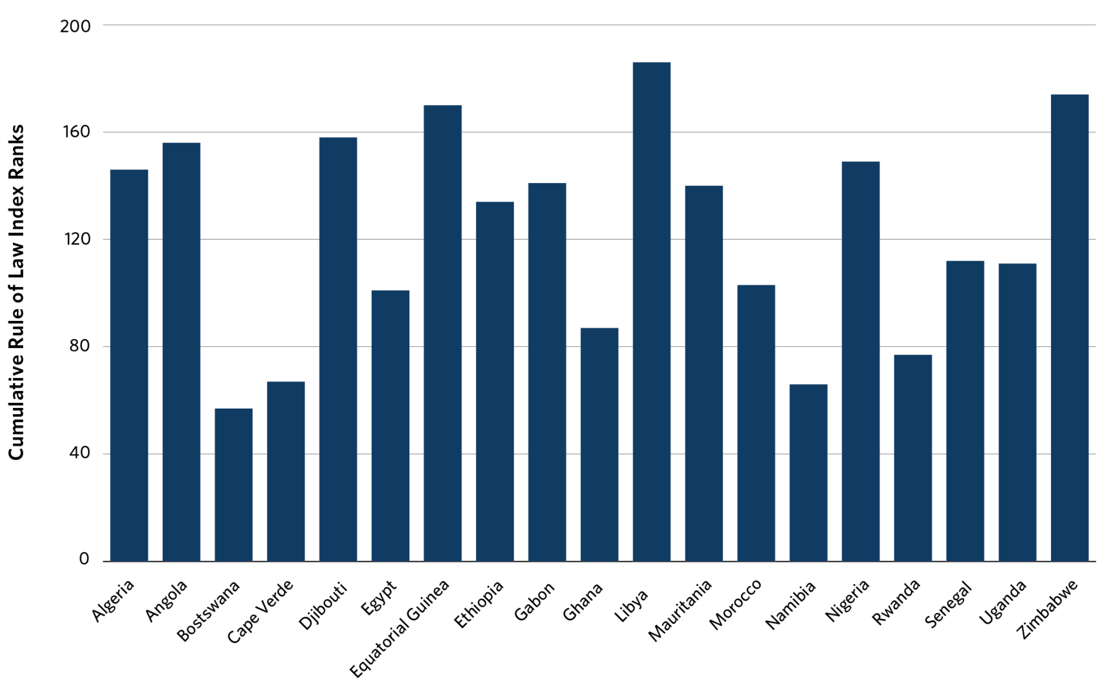
This dramatic growth in SWFs is concerning because they have been established not just in countries with strong rule of law and civil liberty protections but also in countries marked by high corruption risks, insecurity, violence, and weak or absent rule of law. For example, in 1999, the State Oil Fund of the Republic of Azerbaijan was set up, and as of April 2023, it reportedly had $53.4 billion in AUM.[28] Meanwhile, in 2022, Transparency International's (TI) Corruption Perceptions Index (CPI) gave Azerbaijan a failing score of 23 out of 100, ranking the country 157 out of 180 countries; in 2021, the World Bank's Rule of Law Index (ROLI) ranked the country 131 out of 192 countries.[29] In another example, in 2002, Equatorial Guinea's Fund for Future Generations was set up (see chapter 4), and now it reportedly has $165 million in AUM.[30] Yet the CPI gave Equatorial Guinea a failing score of 17 out of 100, ranking the country 171 out of 180 countries; the ROLI ranked the country 175 out of 192 countries.[31] Figures 3 and 4 demonstrate the CPI and ROLI index scores of African countries where SWFs have been established.[32] With few exceptions, like Botswana and Namibia, the vast majority of countries on the continent that have or plan to set up SWFs have significant corruption risks and weak rule of law systems. Can SWFs that are meant to safeguard wealth for future generations successfully operate in a corruption-rich environment? The evidence that unfolds in the following chapters raises serious concerns about the state of play of existing governance norms and enforcement efforts. It also provides a compelling narrative on the need for clear policies related to the management of SWFs and lends weight to the recommendations included at the end of this compilation.

Figure 3. Corruption Perception Index Scores of African Countries with SWFs African countries, 2022



Note: Transparency International assesses that a CPI score below 50 indicates that the country has a serious corruption problem.
Source: Transparency International Corruption Perception Index, https://www.transparency.org/en/cpi/2022.

Figure 4. Cumulative Rule of Law Index Ranks of African Countries with SWFs (1996–2021)



Source: World Bank Rule of Law Index, https://databank.worldbank.org/databases/rule-of-law; and The Global Economy.com, https://www.theglobaleconomy.com/rankings/wb_ruleoflaw/.

This dramatic growth in SWFs is also concerning because the sources of funding, objectives, mandates, investment portfolios, and the legal mechanisms through which SWFs have been set up vary significantly, making it more difficult to monitor and assess SWF behavior. Early SWFs could be broadly divided into three categories based on their unique objectives: (1) stabilization funds established to insulate a country's economy from both internal and external shocks; (2) capital maximization funds established to transform natural resource revenues into longer-term wealth for future generations; and (3) strategic development funds established to help create jobs, improve infrastructure and development within the country, and ultimately help diversify the economy by moving it away from reliance on a particular sector or natural resource. Today, SWFs often have multiple objectives and mandates, and governments can alter the objectives based on changing priorities.

For instance, the KIA was set up in 1953 with the objective to invest the Kuwait's excess oil revenues and preserve the country's oil wealth for future generations, and its mission has not changed.[33] Similar to the KIA, the Revenue Equalization Reserve Fund of Kiribati was created in 1956 to act as a store of wealth for the country's earnings from phosphate mining.[34] Early funds of this type were conservative in their investment strategies, primarily focused on investing in a mix of money market instruments.[35]

However, later SWFs—such as Bpifrance, Singapore's GIC, the Türkiye Wealth Fund, and the Maltese National Development and Social Fund—were set up as noncommodity funds financed through the respective country's foreign reserves or as existing public equity interests or assets financed through the sale of state-owned assets (or in Malta's case, through the sale of the country's passports).[36] As the sources of funding have changed, so have the investments, objectives, and mandates of the funds.

According to the case studies in this compilation, SWFs have been used to amass large art collections (see chapter 3); acquire global sports teams and sponsor international sporting events (chapter 4); fund the development of, and manage the profits from, a national COVID-19 vaccine program (chapter 7); and route payments for defense contracts (chapter 11). All these investments are supposed to further the SWF's stated goals of capital maximization, macroeconomic stability, or economic development. However, in reality, they are commonly linked to an array of potentially unlawful activities. And as each of the case studies in this compilation highlight, one need not probe far to reveal a pattern of troubling behavior. But, as this compilation will also lay out, domestic and international standards lack the language necessary to identify risks that lead to this behavior. Additionally, the discussion around SWF risks is seemingly divorced from the wider discourse on anti-corruption, anti–money laundering, and other norms associated with other types of state-owned entities.

Figure 5 illustrates that SWFs exist across a range of categories. Coupled with the aforementioned definitional issue, these variations in type make identifying atypical SWF behavior or SWFs at risk for corruption and money laundering all the more challenging.

Figure 5. Characteristics of SWFs With Examples

Characteristic	Category	Examples		
Source of funding	Commodity	Fundo Soberano de Angola	ADIA (UAE)	ESSF (Chile)
	Non-commodity	BPI (France)	SAFE (China)	Temasek (Singapore)
Entity status	Central bank account	Hong Kong Monetary Authority		
	Government-sponsored agency	Brunei Investment Agency	Montana Board of Investments (USA)	
	Independent public entity	GIC (Singapore)		
Age of institution	Recent	Fundo Mexicano del Petróleo para la Establilización y el Desarollo (Mexico, 2014)	Northwest Territories Heritage Fund (Canada, 2013)	NSIA (Nigeria, 2011)
	Established	NPS (South Korea, 1988)	New Mexico State Investment Council (USA, 1958)	KIA (Kuwait, 1953)
Objective	Capital maximization	KIC (South Korea)		
	Macro economic stability	Taiwan National Stabilisation Fund	Fundo Soberano de Brasil	
	Economic development	Mubadala (UAE)		
Mandate	Domestic	1 Malaysia Development Berhad	Samruk Kazyna (Kazakhstan)	FSI (Italy)
	International	CalPERS (USA)	NZ Super Fund	Government Pension Fund Global (Norway)
Investment portfolio	Liquid assets*	Pula Fund (Botswana)	Fonds de vicillissement/Zilverlonds (Belgium)	Reserve Fund (Russia)
	Non-liquid assets*	Future Fund (Australia)	Alaska Permanent Fund Corporation	Sixth AP Fund (Sweden)

*Liquid assets includes equities, fixed income, cash, and money markets. Non-liquid assets includes alternative private equity, infrastructure, real estate, and hedge funds.

Source: "Sovereign Investors 2020: A Growing Force," PwC, 2020, 5, https://www.pwc.com/gx/en/sovereign-wealth-investment-funds/publications/assets/sovereign-investors-2020.pdf.

In addition to the aforementioned factors, how an SWF's objectives are fulfilled can contribute to governance and illicit finance risks. The mechanics of these investments and the network of actors and jurisdictions that facilitate these investments provide additional context on why corruption and broader governance risks of SWFs are allowed to thrive. As complex investment vehicles, SWFs and their investment strategies can be mapped in myriad ways; however, because the intention of this compilation is to address the corruption and money laundering pathways of SWFs, this paper will focus on answering three questions: How do SWFs invest? Who helps SWFs invest? And where do SWFs invest?

How Do SWFs Invest?

The purpose and objective of a fund determine how its investments are directed. For instance, capital maximization funds like the KIA—which tend to be the most "risk-seeking"—invest in hedge funds, real estate, private equity, and infrastructure (known collectively as "alternatives") and other so-called yield-generating assets to meet their objectives. These assets aim to bring an investor short-to-medium-term returns by paying out dividends, providing an interest, or generating similar financial income.

Stabilization funds like the Mexico Oil Revenues Stabilization Fund have short investment time horizons and tend to be very liquid. As a result, they are looking for investment opportunities, such as bonds, treasury bills, and guaranteed investment certificates, otherwise known as long-term fixed income securities.[37] Finally, sitting in the middle, economic development funds like Mubadala in the United Arab Emirates (UAE) invest in alternatives and other safer assets—such as short-term fixed income securities—to ensure a stable stream of lower-risk financing and to provide the SWF with consistent returns (see figure 5).[38]

These neat demarcations are useful in categorizing the overall mode of operations of SWFs, but they do not reflect all the ways in which a country uses an SWF or how the SWF's priorities can shift over time.[39] Stabilization funds, which tend to be the most risk averse, invest their money in cash, shares listed on a stock exchange, or investments that will provide a fixed income to the SWF through the life cycle of the investment.

For instance, the Malaysian 1MDB fund was set up as an economic development fund, and its investments were apparently intended to further the country's development goals. But as chapter 3 discusses, these investments were merely a front to divert $4.5 billion with the assistance of numerous individuals, including government officials from Malaysia, Saudi Arabia, and the UAE. The investment mechanism was seemingly legitimate—involving financial institutions with world-class reputations, such as Goldman Sachs—but, in reality, it was laundering stolen money to fund the individuals' lavish lifestyles.

Saudi Arabia's Public Investment Fund (PIF) has a similar global footprint and now supposedly has about $700 billion in AUM (see chapter 6 and figure 6).[40] However, officials within the PIF have reportedly voiced concerns about the riskiness of PIF's $2

Figure 6. Investment Fund Map of Saudi Arabia's PIF

Source: "PIF Investments: The Fund's Investments Map," https://www.pif.gov.sa/en/Pages/OurInvestments-Map.aspx.

billion investment into Affinity Partners, a private equity fund owned and operated by Jared Kushner.[41] Investments like this and the recent pact between Saudi Arabia's LIV golf tournament with the Professional Golf Association (PGA) Tour blur the line between pursuing economic development and purchasing economic or political influence, thus making assessments around corruption and other governance risks more challenging.

The way these SWF investments are carried out presents another difficulty in tracking them. SWF investment methods broadly fall into three types:

Indirect SWF investment (the most traditional method), in which the SWF provides capital to another investment fund and allows that fund to manage the SWF's money.[42] This method accounted for the bulk of SWF activity in 2020 and 33 percent of all SWF allocations.[43]

Direct SWF investment, such as the Qatar Investment Authority's (QIA) purchase of the French soccer club Paris Saint-Germain in 2011–2012.[44]

SWF and partner co-investment, such as the complicated 2016 deal between QIA and the commodity trading firm Glencore to invest in Russian oil giant Rosneft.[45]

Each investment method has an impact on profitability and its own corruption, money laundering, and governance risks. On the face of it, direct SWF investment may appear the easiest to track and therefore the easiest for public oversight and for authorities to check for money laundering or corruption risks. However, financial institutions and government agencies still need to explicitly evaluate and differentiate these risks based on the SWF's location and the governance and transparency levels within the fund. With much of the discourse focused on the national security risks of SWFs, there appears to be little scrutiny of a variety of other types of risks. For instance, a lawsuit filed in Massachusetts alleges that $3.5 billion was stolen from the Saudi PIF and some of it was used to purchase eight condos in Boston.[46] Yet prior to the lawsuit filed by the Saudi government, the transaction did not raise any red flags from financial institutions within the United States.

Still, indirect SWF investment may be more challenging to track and monitor. SWFs can often invest in a private equity fund and then use the private equity fund to make further purchases. This obscures the SWF's identity and creates corruption, money laundering, and national security risks. For instance, a 2018 report from the U.S. Department of Defense stated that through such investment strategies, the Chinese government has been able to gain access to numerous cutting-edge, sensitive technologies from U.S. companies, which the department called "the crown jewels of U.S. innovation."[47] Similarly, another report from leading anti-corruption and financial transparency advocacy groups highlighted how municipal governments in China funded numerous Chinese venture capital firms that were then able to invest in sensitive U.S. technology sectors without drawing attention to their government connections.[48]

Finally, SWF and partner co-investment may present even more of a challenge. The deal in 2016 between the QIA and Glencore helped the two institutions together secure a 19.5 percent stake in Russian oil giant Rosneft for $11.3 billion.[49] This investment was designed to give Russia a much-needed cash infusion in response to U.S. and European sanctions on Russia following its 2014 invasion of Crimea, which left the Russian economy and national budget struggling.[50] The deal explicitly allowed Rosneft to repurchase the shares and allowed Glencore to purchase 220,000 barrels of oil a day from Rosneft; furthermore, the deal was primarily financed through Russian banks due to the ongoing U.S. and European sanctions.[51] In 2017, Glencore and Rosneft sold 14.16 percent of the shares to China's CEFC energy conglomerate. At the time, the Jamestown Foundation, a leading defense policy think tank, posited that this complex structuring would give China the opportunity to extend its influence over Rosneft, obtain a reliable oil supply that could not be "interdicted by foreign maritime powers," and strengthen the credibility of the Belt and Road Initiative (BRI).[52]

The foundation also argued that the deal would give China "a functional (and opaque) way to essentially 'bribe' high-level Russian officials with cash that Moscow desperately needs." Regarding Russia, it further stated that the deal would allow Rosneft, which has close to ties to Putin, to create "shady privatization schemes and what essentially amounts to a sophisticated version of money laundering via VTB."[53] Additionally, it said that the deal would allow Russia and President Vladimir Putin to create close relationships with "opaque business entities that enjoy state support in the Gulf and China."

Who Helps SWFs Invest?

SWFs require an army of people to help guide and inform their investment strategies. For example, Norway's Government Pension Fund–Global, one of the world's largest SWFs, has a direct staff of more than 500 people from thirty-five countries and operates out of offices in Oslo, London, New York, Singapore, and Shanghai.[54] Other smaller or less experienced SWFs may appoint an external investment manager. The chain of actors that help SWFs make investment decisions include the staff of the SWF, financial institutions, various private equity funds, consultants that provide expertise on sector-specific investments, external fund managers, and various other intermediaries vying for a lucrative piece of the SWF pie.

Many worrying patterns of behavior that repeatedly emerge when examining instances of SWF malfeasance and corruption come from weak governance norms that surround these external relationships, such as when private sector entities are either looking to gain the SWF as a client or are responsible for managing the SWF's investment portfolio. In reading this compilation, the problematic nature of these relationships quickly becomes evident. In the case of the Angolan SWF (see chapter 4), the fund's asset manager, Jean-Claude Bastos de Morais, advised the SWF to invest in at least four different opportunities where Bastos himself held an interest.[55] In another case, the French bank Société Générale agreed to a settlement of 963 million euros ($1.05 billion) with the Libyan Investment Authority (LIA) for allegedly bribing Libyan officials for the chance to manage the LIA's investments.[56]

The case studies in this compilation demonstrate that a troubling relationship can exist between corrupt political regimes and private sector institutions that seek to maximize profit or personal gain but may give little consideration to what happens to citizens if the SWF's resources are lost. However, all of this is not to suggest that external advisers should be disallowed; rather, stronger governance rules both within SWFs and private sector entities are necessary for SWFs to actually benefit from robust, external financial sector expertise.

Where Do They Invest?

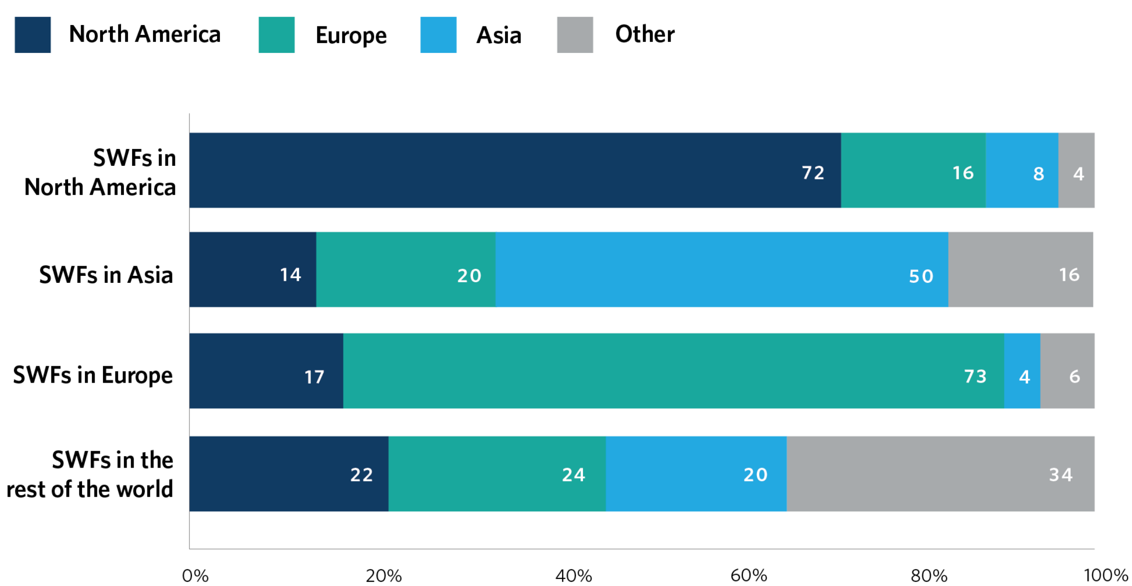
The illicit finance and governance risks within SWFs do not exist in a silo. Almost always, SWFs invest outside their home country. Therefore, understanding where SWFs invest can be valuable in determining how best to address potential governance risks, including risks of corruption and money laundering. A 2021 analysis of a sample of SWF investment patterns found that in 2020–2021, the United States, India, China, the United Kingdom, Singapore, Russia, and Brazil collectively represented the destination for 73 percent of all direct investments. The United States accounted for the largest direct SWF investment at 28.8 percent, followed by India at 14.7 percent and China at 10.5 percent.[57]

This pattern of investment, however, is only true of direct SWF investments. When including indirect investments, the amount invested in the United States, while significant, is not as large as the investment in the geographic region where the SWF is based. For instance, SWFs based in North America make 72 percent of their investments there, while SWFs in Asia make 50 percent of their investments in Asia and only 14 percent of their investments in North America (see figure 7).

These patterns of investment mean that countries serious about preventing their economies from being used as a conduit or safe haven for the proceeds of corruption and money laundering are in a prime position to scrutinize SWF investments for such risks.

Yet the case studies in this compilation show that despite the corruption, money laundering, and other governance risks associated with this significant pool of capital, SWFs or the legal structures through which SWFs invest appear to face minimal oversight when traversing the international financial system. For instance, as described in chapter 9, there appears to be little scrutiny of the Maltese SWF's equity and bond investments in the United States as well as in emerging markets, even though that SWF is funded primarily through a controversial citizenship-by-investment program. Likewise, the 1MDB fund discussed in chapter 3 was able to invest in real estate, art, and movies in the United States with minimal scrutiny.

Figure 7. Geographic Focus of SWF Investments Based on Origin of SWFs, 2020



Source: "Sovereign Wealth Funds in Motion," Preqin, May 26, 2021, 20, https://www.preqin.com/insights/research/reports/sovereign-wealth-funds-in-motion.

Sovereign Wealth Fund Regulation

Understanding the nature of existing international standards applicable to SWFs provides much-needed context on how corruption, illicit finance, and other governance risks within SWFs have emerged. The International Working Group of SWFs established the Santiago Principles in 2008 as a result of the tension between maintaining open investment policies in developed economies and protecting against the national security risks that SWF investments bring. The goal was to ensure the "domestic and international legitimacy" of SWFs.[58] Today, the group's successor, the International Forum of SWFs (IFSWF), champions the principles that specifically require SWFs to be transparent, accountable, independent, and commercially oriented.[59] While laudable, the principles are not binding and only serve as guiding norms for SWF governance. Moreover, they do not acknowledge that many SWFs operate in environments with high corruption risks and weak rule of law, and they therefore fail to provide any guidance on how best to operate an SWF in such environments.[60]

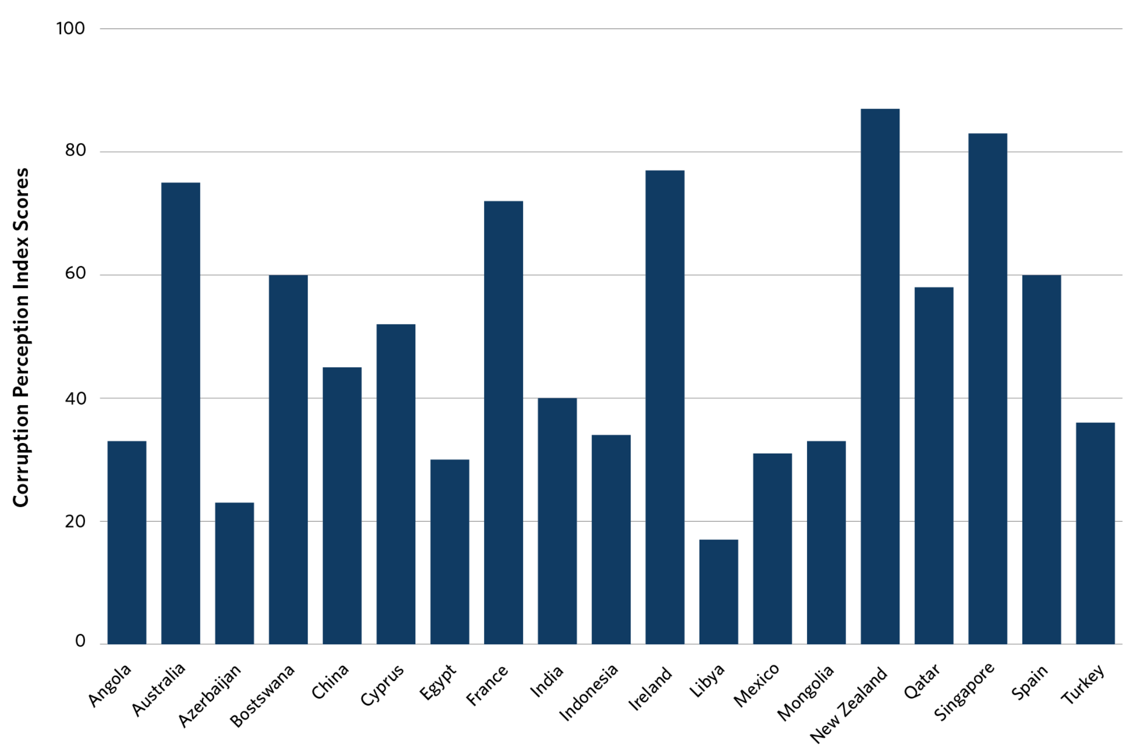
The OECD has also provided several guidance documents on SWFs.[61] However, to date, all of the documents have been designed to help countries where SWFs invest their funds address the national security concerns that first brought SWFs to prominence.[62] These documents and those written by other international organizations such as the World Bank conspicuously shy away from using the term "corruption" in matters relating to SWFs. This is in sharp contrast to their guidance documents on state-owned enterprises—which explicitly address the issue of corruption.[63]

This fixation with national security has trickled down into domestic legislation. Across both the United States and Europe, numerous laws limit or scrutinize SWF investments for potential national or economic security risks but not for corruption and money laundering risks. A 2009 report from the U.S. Government Accountability Office laid out the various national security restrictions in place across sectors, including transportation, technology, communications, national security, and energy (including nuclear energy). However, neither the report nor any subsequent public U.S. government agency report has dealt with the danger that SWFs could use the United States as a money laundering conduit or a destination for corrupt funds.[64]

In the absence of binding international standards, greater transparency through public information disclosure would help ensure accountability and reduce the risks of corruption and other types of illicit finance. This is a model particularly favored by the extractives sector to reduce corruption and associated money laundering risks. In many countries, foreign aid and investment into the extractives sector is contingent on meeting standards set forth by the Extractives Industries Transparency Initiative, the Open Contracting Partnership, and other similar efforts.[65] However, SWFs have thus far largely succeeded in keeping their operations and investments shrouded in secrecy. Exceptions like Norway's Government Pension Fund, which has robust transparency and disclosure practices, have not shifted the overall SWF culture toward transparency. Gaps in transparency and data limit the ability of researchers and governments to better capture and track corruption and money laundering in SWFs (see chapters 2 and 12).

Finally, in the absence of clear regulations, industries often set up self-regulatory bodies to ensure standards and good governance. The IFSWF is the closest organization that exists to fulfilling that role for sovereign wealth funds. The organization was incorporated in 2014 to strengthen the SWF "community through dialogue, research and self-assessment."[66] The IFSWF model permits members to self-assess the robustness of their governance standards. Needless to say, this has not created the necessary incentives for SWFs to critically examine their operations. Several funds mentioned in this report are IFSWF members and have given themselves strong self-assessment scores despite the publication of news stories that raise legitimate concerns about the operations of these funds. An analysis of IFSWF members' and associate members' CPI scores reveals that a significant number of SWFs operate in corruption-rich environments (see figure 8). It thus remains an open question whether IFSWF membership provides some of these funds, whose behavior may raise red flags, a reputational benefit and added credibility.

Figure 8. CPI Scores of Countries With SWFs That Are Members of IFSWF, 2022



Note: Palestine is a member of the IFSWF. However, there are no data available on its CPI score, and hence it was omitted from this chart.

Sources: IFSWF, https://www.ifswf.org/our-members; and Transparency International Corruption Perception Index, https://www.transparency.org/en/cpi/2022.

Compilation Overview

Against this backdrop, the eleven chapters in this compilation examine specific cases that demonstrate SWFs' susceptibility to corruption, money laundering, and other governance issues and the enabling environment that stymies efforts at detection and public oversight.

Chapter 2 further describes the potential corruption risks associated with SWFs, including how the current voluntary standards fall short. It also documents how the lack of free, publicly available data on SWFs prevents oversight and accountability by governments, civil society, and the media. It notes that the opacity of SWFs can lead to fears that funds are being used for political goals or being co-opted, rather than being used for their stated purpose.

Chapter 3 describes one of the most famous and egregious examples of corruption associated with SWFs: the so-called 1MDB scandal. 1MDB was a sovereign development fund intended to improve the infrastructure and investment environment of Malaysia. Instead, $4.5 billion was siphoned off by senior Malaysian elites, politically connected individuals, and bankers to purchase everything from yachts to art to real estate. This case thus provides a model for how SWF-associated corruption and money laundering schemes can work and how their financial complexity can enable corruption and other malfeasance to continue for years largely undetected.

As noted in this introduction chapter, states have traditionally used SWFs to diversify the proceeds from natural resources and ensure that the proceeds can be saved for future generations. Chapters 4 and 5 highlight potential governance risks associated with natural-resource-based funds. In the case of Angola in chapter 4, a highly autocratic regime used its control over the government to divert oil funds to relatives and friends of the president, even though at the time it was ranked as having relatively good SWF governance by various indices. The Angola case also highlights how reforms can create cleaner and more resilient SWFs.

The case of Equatorial Guinea in chapter 5 then describes how an extreme lack of available information about SWF activity increases the risks that money will be illegally diverted. The well-documented grand corruption associated with the country and the fact that the oil—upon which the country's export revenue depends—is due to begin to run out within a decade heighten the need for the highest levels of transparency and good governance of the SWF to be instituted in a most timely manner.

Chapter 6 further describes Saudi Arabia's PIF, one of the world's largest SWFs. The PIF, and especially its associated Vision 2030 fund, has been used to acquire world-famous sports teams and even establish an entirely new golf franchise through its pact with the PGA, giving Saudi Arabia significant control over the elite-level tournaments associated with an entire sport. Such investments provide a means for authoritarian leaders such as Saudi Crown Prince Mohammed bin Salman to launder their reputations through sports using the proceeds of their country's natural resources.

Even SWF funds disbursed to help in an emergency like the coronavirus pandemic are not immune from allegations of diversion and corruption. Chapter 7 describes how Russia's leadership gave the funding for and marketing of Russia's Sputnik V COVID-19 vaccines to the Russian Direct Investment Fund (RDIF), an unusual form of SWF. The chapter describes how the RDIF forced some countries to purchase Sputnik V vaccines through a series of shell companies that eventually raised the price to double what it should have been.[67]

SWFs are usually established to invest and diversify a country's natural resource wealth, but some countries establish their SWF via loans or taxpayer funds from the state budget instead. This means that such funds can become a parallel budget that is out of reach of oversight by parliaments and citizens, as illustrated by the case of Türkiye's SWF in chapter 8.

Scholars and policymakers have long worried that China's BRI is a mechanism for opaque deals designed to help China further its global ambitions, especially through so-called debt-trap diplomacy. Chapter 9 describes how Chinese SWFs undergird the BRI, providing funds to help enable the BRI's overseas investments.

One of the more unusual means of funding a state's SWF is covered in chapter 10 and features Malta's SWF. The country uses the proceeds from the sale of Maltese visas and citizenship—so-called golden visas and golden passports—to fund its SWF. Numerous investigations by the European Union (EU) and investigative journalists have documented that this has enabled some corrupt and criminal actors to receive EU residency and/or citizenship and the benefits that go with it. Such funding can create a conflict of interest for Malta because tightening its residency and citizenship requirements could undermine its SWF.

A few countries use the international arms trade to help fund their SWFs, most notably the UAE. One of its most famous SWFs, Mubadala, was founded with money from side contracts for arms purchases from Western defense firms. The arms sector is notoriously fraught with corruption, and the extreme opacity of defense procurement contracts carried out through the veil of sovereign wealth funds makes accountability even more difficult. Because these SWFs are associated with the arms trade, their activities can also have larger ramifications for peace and security, as chapter 11 describes.

Finally, chapter 12 looks at what concrete measures are needed to address the systemic challenges in identifying and responding to corruption, illicit finance, and associated governance risks associated with SWFs. The chapter examines in greater detail the ongoing accountability mechanisms designed to improve SWF governance in their countries of origin, the current legal framework in investment destinations, and what more can be done to make these legal environments meaningful and robust. It also documents what greater transparency among SWFs could mean for both internal and external accountability and, finally, explores whether SWFs should be subject to international evaluations on anti–money laundering, similar to how many other aspects of the financial system are.

CHAPTER 2

Corruption Risks Within Sovereign Wealth Funds

David Szakonyi

As sources of long-term, patient capital, sovereign wealth funds (SWFs) offer immense potential for countries to achieve their national development goals. Yet as the extensive list of examples in this compilation will document, SWFs are at grave risk of embezzlement, fraud, political manipulation, and other corrupt uses. At the center of the problem is a lack of transparency and accountability, which limits access to comprehensive, accurate data. Available data on SWFs is extremely limited, which creates opportunities for bad actors to abuse funds for their own interests. Little is known about the investments, operations, or internal management of the vast majority of funds around the world, which collectively manage over $11.5 trillion in assets.[68] Without this detailed financial and operational information, the door is being left wide open for rapacious managers and political elites to misappropriate investment earnings. Their actions deprive citizens and other stakeholders of the opportunity to equally and justly benefit from fund proceeds.

This chapter highlights the many types of corruption and political risks inherent to the SWF industry and demonstrates that recent efforts to improve transparency have fallen woefully short. SWFs should be required to disclose far more extensive and detailed information about the way they develop strategies, manage assets, compensate executives, engage financial intermediaries, and report to political overseers. Only by expanding the availability of this critical data can SWFs become truly accountable to their public constituents.

The Secret Lives of SWFs

Operating as government-owned or government-controlled investment vehicles, SWFs acquire assets in private and public financial markets both in their home countries and abroad. Having state ownership in some ways sets the SWF industry apart from the private investment fund industry, which includes hedge funds, venture capital, and private equity.

First, the stated missions of SWFs can go beyond maximizing investment returns; for example, they can aim to achieve macroeconomic stability or realize economic development initiatives domestically. Rather than pursuing speedy exits, SWFs often have long-term horizons and operate as passive investors that take minority rather than controlling stakes in target companies. Finally, there is an explicit political layer that distinguishes SWFs from private investment funds. Without having fiduciary duties to private investors and clients, SWFs are completely beholden to the governments that endow them. Politicians have considerable power to shape SWF investment strategies to pursue explicit political goals.

Yet even though their home governments can exert influence over their operations, SWFs in practice behave very similarly to certain types of private investment funds. Structurally, SWFs are often set up identically to private equity funds, with capital committed to the fund managed by an external general partner. This investment model endows the general partner with greater autonomy to apply expertise and develop portfolio strategies, but it also can result in bloated financial fees and crony relationships that undermine the fund's financial performance. In contrast to popular perceptions, many SWF investments do not end up in publicly traded companies that have strictly regulated transparency obligations and fiduciary responsibilities. Just like their counterparts in the venture capital, private equity, and hedge funds industries, SWFs often purchase minority stakes in unlisted, privately held companies.[69]

This shared investment preference results in clear similarities in how both SWFs and investment funds are regulated. Most countries require little, if any, transparency from investment funds (including SWFs) about transactions made outside of public markets. In the United States, for example, SWFs are held to the exact same regulatory requirements as private pools of capital.[70] SWFs are only required to publicly disclose equity stakes equal or greater to 5 percent of publicly traded companies. Any remaining investments in privately held companies need not be disclosed to shareholders, the general public, or regulatory authorities; for these investments, SWFs are on their own to decide what information to disclose. SWFs have adopted a number of rationales to justify preserving this opacity around their investments, including the threat of domestic political short-term pressures that could undermine their long-term investment strategies. The end result is that with few exceptions, records of SWF investments in unlisted assets—whether a private company or a real estate project—are not publicly available.

The overlap between SWFs and private investment funds is even more pronounced by the fact that many SWFs have become increasingly large investors in private equity, a sector notorious for its opacity.[71] From 1984 to 2007, twenty-nine SWFs made more than 2,500 direct private equity investments worth a total of $198 billion.[72] Indeed, SWFs comprise nineteen of the top forty institutional investors in private equity worldwide.[73] In the wake of the 2007–2008 global financial crisis, SWFs have even begun accruing substantial debt and using leverage to fund some investments—another trademark strategy of the private equity industry. SWFs also often act as coinvestors with massive private equity funds. Furthermore, SWFs have adopted their own arcane corporate structures called subfunds to coordinate sectoral investments. For example, Egypt's SWF includes four subfunds, each with its own governance, legal structure, investment process, and independent board.[74] These vehicles add a layer of opacity and complicate outside analysts' ability to understand the true extent of their holdings.

Instead of enforcing transparency, regulators work to limit the "control" SWFs can exert over the companies they acquire stakes in. The majority of SWF investments, whether through private equity or other direct investments, are made in international markets rather than domestic markets. The extensive use of government-owned assets to buy foreign companies has given rise to suspicions about the political motives behind SWF decisions, which could disrupt markets in support of government interests.[75] Countries such as France, Germany, and the United States are putting in place increasingly strict protocols for evaluating whether SWF investments are being made in sensitive sectors and therefore could generate national security or corporate espionage concerns. Yet many of these protectionist procedures are classified, and it can be difficult for investors to learn when government scrutiny of SWFs investments is ongoing. SWFs operate in a climate of secrecy, with few if any windows into their operating behavior.

Voluntary Self-Regulation Has Made Only Minimal Progress

Surprisingly, the enormous rise of cross-border SWF investments has not sparked the creation of a centralized international regulatory body to oversee the industry. Instead, growing nervousness among countries hosting SWF investments compelled representatives from twenty-three leading funds to found the International Working Group of SWFs in 2008. The group worked together to develop a set of twenty-four voluntary principles, known as the Santiago Principles, to improve transparency and governance. These voluntary standards ask SWFs to define their policy purposes, government arrangements, roles and responsibilities, and ownership rights, among other issues.[76] Widespread adoption of such principles was intended to discipline SWF behavior and reassure host countries and the general public about the intentions behind these investments, as well as potentially forestall protectionist actions.[77] However, voluntary participants' compliance with the Santiago Principles still leaves much to be desired. The International Forum of Sovereign Wealth Funds (IFSWF) has no power to enforce its own standards, and naming and shaming efforts by other nongovernmental organizations have been mostly absent. This means that only a few SWFs fully adhere with these basic good governance standards.

Moreover, even those SWFs adhering to the Santiago Principles still fall short of ensuring needed transparency. According to the principles, publicly declaring fund objectives does not entail the release of annual reports that provide in-depth information on how the SWF plans to achieve its objectives. Moreover, there is no clause requiring SWFs to disclose essential information on their financial positions, such as audited statements, that could shed light on the volume of assets under management or on the use of debt instruments and leverage. Although most SWFs report that information to their host-country governments, it is not sent to any international body, such as the International Monetary Fund, that could impartially validate and share the data with third parties. What is left is a highly decentralized system, where SWFs are free to invest trillions abroad but are not required to disclose any comprehensive information on their activities to the public.

The uneven progress toward full transparency is best illustrated through an analysis of the SWF Scoreboard. Developed and run by Edwin M. Truman and colleagues for more than a decade, the SWF Scoreboard aggregates publicly available information ("fund websites, annual reports, and ministries of finance, and other public sources such as IMF reports") and ranks SWFs on thirty-three elements that cover structure, governance, transparency, and accountability. A higher score indicates that a SWF is implementing more robust governance reforms and disclosing more about its investment activities. Table 1 lists the top ten and the bottom ten SWFs according to the 2019 scores, which range from 11 to 100.

Table 1. 2019 SWF Scoreboard Rankings

Top Ten			Bottom Ten		
Country	**Fund**	**Score**	**Country**	**Fund**	**Score**
Norway	Government Pension Fund Global	100	Qatar	Qatar Investment Authority	46
New Zealand	New Zealand Superannuation Fund	94	Saudi Arabia	Public Investment Fund	39
United States	Permanent Wyoming Mineral Trust Fund	93	Russia	Russian Direct Investment Fund	37
Chile	Economic and Social Stabilization Fund	92	United Arab Emirates	Emirates Investment Authority	36
Azerbaijan	State Oil Fund of the Republic of Azerbaijan	92	Kiribati	Revenue Equalization Reserve Fund	35
Canada	Alberta Heritage Savings Trust Fund	91	Brunei	Brunei Investment Agency	30
Timor-Leste	Petroleum Fund of Timor-Leste	91	Algeria	Revenue Regulation Fund	26
Chile	Pension Reserve Fund	89	United Arab Emirates	Dubai World	24
United States	Alaska Permanent Fund Corporation	88	Libya	Libyan Investment Authority	23
Australia	Future Fund	87	Equatorial Guinea	Fund for Future Generations	11

Source: Julien Maire, Adnan Mazarei, and Edwin M. Truman, "Sovereign Wealth Funds Are Growing More Slowly, and Governance Issues Remain," Peterson Institute for International Economics, February 2021, https://www.piie.com/publications/policy-briefs/sovereign-wealth-funds-are-growing-more-slowly-and-governance-issues.

At the top of the list is Norway's Government Pension Fund Global, which has consistently demonstrated a world-leading commitment to transparency. The fund's portfolio value is updated in real time on its website, and it publishes a lengthy annual report detailing board votes, shareholder resolutions, and engagement with target companies, especially on environmental, social, and corporate governance.[78] Other SWFs have instituted best practices that hold them accountable to elected officials. Both Australia and New Zealand require managers of their respective SWFs to submit reports regularly to their ministers of finance and, in turn, members of their national parliaments.[79] The funds themselves are still completely separate from political institutions and intended solely to pursue profit, but they do not operate in a black hole and are accountable to regulators and monitors.

It is the more advanced democracies that enact stronger arrangements to ensure that SWFs release necessary information. Several funds based in the Middle East, such as the Qatar Investment Authority, have been reducing the amount of information available on their websites and in their annual reports. Singapore's SWF, Temasek, prioritizes private deals across Asia, either through private equity funds or direct investments in fast-growing sectors such as real estate. Both investment strategies thrive on opacity.[80]

One of the most important predictors of strong transparency scores on the SWF Scoreboard is a country's rank on other indexes of good governance. For example, research into SWFs has found a strong correlation between a country's scoreboard results and the World Bank's Worldwide Governance Indicator of Voice and Accountability; Transparency International's Corruption Perceptions Index; and the Polity IV indicator of democracy.[81] SWF management may often be a reflection of other wider institutional reforms: where democracy and good governance are weak, SWFs will likely fail to disclose the necessary information to track their operations.[82]

Parsing the Data Crumbs

The end result is that regulators, journalists, civil society activists, academics, and investors alike are left with regrettably little information about how a large number of SWFs from around the world operate. The little data that are available remain incomplete and prohibitively expensive for most researchers. The first stop for most analysts is third-party aggregators, such as PitchBook, Preqin, and FactSet. These services pull together both publicly available data and insider information to construct a detailed profile of each SWF, including estimated size, investment behavior, performance, intermediary relationship, and governance structure. Because SWFs are government-connected entities, much of the data concern what might be considered public finances, thereby requiring openness and transparency. The global Sovereign Wealth Fund Institute offers similar coverage of self-reported investment patterns through its pricey subscription service. Yet third-party aggregators impose pricey subscriptions on accessing the data, limiting the ability of law enforcement authorities around the world to track how money flows in and out of SWFs.

In the United States, the Securities and Exchange Commission collects and makes publicly available basic information about the private investment fund industry (which includes a small number of SWFs), including manager information and fund size. Funds must fill out somewhat detailed forms about their makeup, but they do not have to reveal their actual investments or performance. Regulators, including those tasked with monitoring foreign investments, are often completely reliant on the private, third-party aggregators mentioned above to gain visibility into SWF activities, increasing the financial and logistical obstacles to undertaking proper due diligence. Only in rare cases are data freely available about how SWFs are managing their assets. For example, the Sovereign Investment Lab based at Bocconi University in Italy has built a database on the investments of twenty-nine SWFs, but this includes those equity stakes in publicly traded companies since they appear in public disclosures released in various jurisdictions.

Moreover, private, third-party aggregators are significantly dependent on SWFs sharing their underlying data. If an SWF, particularly one operating in a nondemocratic country, chooses not to disclose an equity investment, it is unlikely that any of the aggregators will be able to pick up, much less monitor, that activity. In addition, there are large segments of SWF portfolios that are almost completely absent. Bond markets remain mostly opaque, as are investments in domestic asset classes, which for some funds comprise the bulk of assets under management (such as in Russia).[83] There are finally few mechanisms for verifying whether the self-reported data are accurate.

Home country regulators presumably collect these data on investments, but only in rare instances (such as in Norway) is any of that information made public. Instead, analysts often glean information on fund objectives and governance from some SWF annual reports and websites. For example, a recent study demonstrates the evolution of declared investment strategies over time as well as innovation and collaboration between SWFs.[84] However, annual reports do not contain audited financial statements, nor do they outline in any detail the breadth of investments pursued by funds. Learning about more sensitive topics from these reports is next to impossible, whether it be full lists of nongovernmental investors (foreign and domestic), management fees paid to private investment funds, executive compensation, key relationships with intermediary brokers, or corporate structures facilitating investments (especially through offshore companies).

Leaked documents provide perhaps the only window into some SWFs. In 2018, the global Paradise Papers leak revealed rampant cronyism and corruption within Angola's SWF, Fundo Soberano de Angola (see chapter 4). The fund paid millions of dollars in management fees through uncompetitive tenders to investment managers closely linked to the country's ruling elites.[85] Even supposedly better-governed funds have been implicated in serious scandals following documents being leaked into the public sphere. A trove of tens of thousands of internal documents from Australia's Future Fund led to accusations of tax avoidance and exorbitant fees paid out to external fund managers.[86] However, such leaks rely on whistleblowers sharing the truth about SWF activities with the wider public—thus, leaks are welcome but highly imperfect mechanisms for ensuring transparency.

The Risks of Opacity

The risks of this opacity persisting within the SWF industry are immediate and serious. Collectively, SWFs invest trillions of dollars across a host of developing and developed countries. At the macroeconomic level, a lack of transparency raises the specter of real destabilization risks if funds were to fail, be mismanaged, or rapidly withdraw funding from target markets. Lack of oversight into SWFs' substantial investments could inflate dangerous equity price bubbles.[87]

Opacity also carries political consequences. Over the past two decades, much of the push to better regulate the SWF industry has been spurred by concerns about political motivations driving investment behavior. To what degree are SWFs independent from the governments that create them? Without transparency, it becomes significantly more difficult to differentiate whether investment decisions are being made on a purely financial basis or with political aims in mind, such as the transfer of corporate intellectual property to domestic companies. In the aftermath of the 2007–2008 financial crisis, an array of SWFs began sweeping up highly discounted assets in troubled developed economies and were credited with partially bailing out the U.S. and European banking systems to the tune of $63 billion.[88] Although protectionist sentiments globally have led to more restrictive regulations around SWF investments, a growing body of evidence is revealing that the motivations behind these investments are sometimes geared toward the pursuit of other political goals. U.S. policymakers, for example, have passed much stricter protocols for assessing foreign investments in sensitive sectors in part because of fears that SWFs could be exploiting opacity to acquire information and technology critical to national security.

Some of those fears have not gone unfounded. In examining a dataset of equity stakes taken in U.S. publicly traded firms, research has shown that SWFs have become increasingly attracted to investing in politically active companies.[89] Their investments help provide a type of "foreign state insurance," shielding their home government from possible potential risk but also opening up lobbying opportunities within the U.S. political process.

SWFs that fail to disclose proper information to regulators and the general public are uniquely vulnerable to political co-optation, mismanagement, and outright corruption. The vast sums of money tied up in these funds offer an array of personal and political dividends to the government elites that create them. As the assets of SWFs surged in 2011, nearly three-quarters of all assets under SWF management were held by nondemocratic governments.[90] These financial assets can be used to keep incumbent governments in power, for example, by buying citizens' loyalty and co-opting or neutralizing domestic competitors.[91] Therefore, the shield of opacity can hide the use of SWFs as a strategic financial tool designed to aid ruling elites.

A good example of this is Libya's SWF. Established in 2006, the Libyan Investment Authority's (LIA) mandate was to invest substantial Libyan financial assets earned from its oil industry into a more diversified portfolio that could function as a reserve fund.[92] Even though the fund was carefully managed in near complete secrecy by Muammar al-Qaddafi and his family, it received an influx of foreign capital and took numerous positions in Western companies, such as General Electric, AT&T, and Juventus Football Club.[93]

It was not until internal fund documents were leaked to the British nongovernmental organization Global Witness that the world began to learn about of the full extent of the LIA's investment behavior, including the $64 billion amassed.[94] A later audit by Deloitte suggested that upward of 20 percent of the fund's value had disappeared into a black hole, presumably lining the pockets of the ruling elite.[95] Accusations were also leveled at Goldman Sachs, whose investment managers allegedly paid prostitutes and bought private jets and stays in five-star hotels in an attempt to woo business from the LIA.[96] Ultimately, the fund became one of the first targets of sanctions imposed by the UN Security Council amid rampant accusations from insiders of corruption and misappropriation by the Qaddafi government and its external partners.[97]

Recent work on African states has drawn attention to a new category of unofficial SWFs that behave almost identically to their official counterparts but disclose even less information to the general public.[98] Known as extra-budgetary resource funds, these vehicles operate in near complete secrecy; they do not appear in annual budgets or comply with even basic reporting or audit standards. These funds provide nondemocratic governments with the ability to invest in projects that can pad the pockets of loyal elites and help the regime stay in power longer.

In sum, the corruption risks inherent to SWFs are enormous, as several of the chapters in this compilation attest. At least $4.5 billion was stolen from Malaysia's SWF (see chapter 3), in what became the "world's biggest financial scandal."[99] The scandal wound up snaring individuals from over ten countries, including the then Malaysian prime minister. In 2020, the prime minister was sentenced to twelve years in prison for engaging in corruption and abuse of power. A recent investigation of Uzbekistan's SWF implicates the country's leadership in directing tens of millions of dollars to a corporation run by a relative of President Shavkat Mirziyoyev.[100] As more and more countries begin the process of creating their own funds, there is a real threat of continued corruption unless good governance standards are put in place.

Strengthening Transparency Will Improve Accountability

Given the macroeconomic, political, and corruption risks associated with SWFs, there must be greater transparency across the industry as a whole. What types of information should SWFs disclose? First, fundamental information on SWF finances needs to be disclosed: the value of assets under management; the short- and long-term performance indicators; the allocations across markets and investments; the benchmarks; and the environmental, social, and corporate governance metrics. Ideally, these data points would be validated through external audits. This type of information should be required from the entire pooled investment industry, which thrives on the same opacity that SWFs do and is vulnerable to many of the same problems.

Organizationally, SWFs should also better identify their key policy objectives as well as their governance structures, including board selection and responsibilities and the fund's relationships with policymakers and regulators. Alongside releasing more information about SWF internal operations, countries need to carve out a greater role for popularly elected legislatures and independent agencies to supervise those activities and ensure that investments are being made in the national interest. Improving reporting mechanisms is a key step along that path, but those in charge of public oversight must also be empowered to hold SWF managers accountable. Transparency fosters accountability only when stakeholders and other observers can act on the disclosed information and prevent the co-optation of SWFs for political motivations.

Voluntary disclosure is not enough. Although the Santiago Principles provide a template for cooperation between funds, until a major international organization steps in to publish true third-party evaluations, compliance and disclosure practices will likely remain incomplete. So far, fragmented efforts to name and shame SWFs for neglecting good governance principles have not led to real and durable change. Given the importance of cross-border investments within SWF portfolios, the international community must take a stronger stance and empower a body to monitor SWF governance.

SWFs have much to gain by being more transparent about their operations and investment decisions. Companies targeted by more transparent SWFs typically generate higher investment returns, suggesting that transparency can be a strong signal of quality due diligence and monitoring on the part of SWFs.[101] Transparency also allows for more objective evaluations on whether SWFs are actually meeting their policy and performance objectives, which should improve funds' abilities to raise and borrow capital. Conversely, SWFs that are vulnerable to political interference see lower returns on their investments and more negative deterioration of long-term performance in targeted companies.[102] Investors have expressed frustration with a lack of access to timely statistics from SWFs based in Middle East, particularly when large withdrawals occurred shortly after oil prices fell.[103] In that regard, transparency is a win-win for the vast majority of SWF stakeholders. If entrenched elites are allowed to monopolize management and disclosure decisions, corruption will thrive.

CHAPTER 3

Sovereign Wealth Funds as Vehicles for Money Laundering: The Case of 1MDB

Clare Rewcastle Brown and Caleb Diamond

The infamous 1Malaysia Development Berhad (1MDB) scandal is an exemplary case of how sovereign wealth funds can be used to facilitate corruption and money laundering. The U.S. Department of Justice (DOJ), in a July 2016 indictment, called it the "largest kleptocracy case to date."[104] The 1MDB, a sovereign investment and development fund, was supposedly designed to use money borrowed by the Malaysian Ministry of Finance to raise funds for development through global investments. Instead, as noted in the DOJ indictment and "as alleged in the complaints, the members of the conspiracy—which included officials at 1MDB, their relatives and other associates—allegedly diverted more than $3.5 billion in 1MDB funds. Using fraudulent documents and representations, the co-conspirators allegedly laundered the funds through a series of complex transactions and fraudulent shell companies with bank accounts located in Singapore, Switzerland, Luxembourg and the United States."[105]

The final tally of diverted funds ultimately came to $4.5 billion.[106] Per the same DOJ indictment, the laundered assets of 1MDB "allegedly included high-end real estate and hotel properties in New York and Los Angeles, a $35 million jet aircraft, works of art by Vincent Van Gogh and Claude Monet, an interest in the music publishing rights of EMI Music and the production of the 2013 film *The Wolf of Wall Street*."[107] Over $1 billion reportedly went into then Malaysian prime minister Najib Razak's personal bank accounts alone.[108]

The perpetrators seemingly got away with the heist by leveraging the permissive, secretive nature of offshore companies and the immense wealth of the Gulf states and their sovereign wealth funds. These funds, which oversee vast cash resources, are on the surface professionally administered for the purposes of investment in the global marketplace. However, in the 1MDB case, they were ultimately at the whim of a handful of members from autocratic ruling families and some of their key enablers.

1MDB was purportedly "based on the Mubadala (Sovereign Wealth Fund) concept" in Abu Dhabi.[109] (The Mubadala fund is examined more closely in chapter 11.) The money was obtained not from accumulated public funds, however, but through a series of bond offerings ultimately guaranteed by Malaysian taxpayers. As a result, a 2020 Malaysian government report assessed that the fund was still in arrears after several repayments, $7.8 billion in debt from a height of over $11 billion when the scandal exploded in 2015.[110]

This chapter provides a comprehensive look at what happened to the 1MDB fund between 2009 and 2015 to illustrate how sovereign wealth funds can be used for gross corruption. It examines how Najib Razak, a Malaysian kleptocrat, and his proxy, Jho Low, with advisers from Goldman Sachs bank and other willing professionals, exploited overly centralized power structures, weak governance, and feeble accountability mechanisms to steal billions for themselves and their collaborators. It also describes how the Chinese government exploited Najib Razak's need to resolve the scandal and fund his reelection bid to bolster China's influence in Malaysia. The corruption was likewise exploited by other foreign actors, including royal figures and businessmen in the Gulf, to siphon billions in return for providing cover.

Much of the 1MDB deception was made possible due to high-level collaborators at the International Petroleum Investment Fund (IPIC) in the United Arab Emirates (UAE) and at funds in Saudi Arabia and Kuwait. The 1MDB case provides a useful foundation for making sense of the other cases in this compilation, and it underscores the transparency and accountability reforms required to minimize similar, future abuse of citizens' financial security by political elites.

The Roots of Corruption

The 1MDB heists occurred from 2009 to 2014, during Najib Razak's first term. Malaysia is a resource-rich nation, where high-level corruption has flourished for decades. The prime minister's ruling United Malays National Organisation (UMNO) party had enjoyed an uninterrupted grip on power since independence in 1957, largely through an extensive patronage system. But toward the end of the prime minister's first term, he—and the UMNO more broadly—faced credible opposition for the first time.

The UMNO playbook under such circumstances was to amass an invincible election war chest. Najib Razak appointed himself as finance minister to ensure complete control over the country's highly centralized economy. This context alone should have raised red flags for financial institutions involved with 1MDB.

Malaysian politicians have often used local, long-established Chinese business proxies to facilitate corruption. In this case, Najib Razak worked with a young, Chinese Malaysian financier named Jho Low. Low's family members were well established in the business community in Penang Province. By the time his ambitious parents sent him to the elite Harrow School outside of London and the University of Pennsylvania's prestigious Wharton School, Low was well versed in offshore accounts and shell companies—as well as Malaysia's pervasive culture of cronyism. His first introduction to the future prime minister came during a business deal with one of the prime minister's brothers, Nizam Razak.[111] His later narrative would be that he had connected with Najib Razak's influential wife Rosmah Mansor through her son Riza Aziz, whom he claimed to have befriended in the United Kingdom.[112]

Low operated during a period of major investment by sovereign wealth funds in the Gulf, from which Malaysian leaders were eager to benefit. What set Low apart was his contacts—though often exaggerated—with sons of Middle Eastern power brokers formed during his schooling. Through lavish parties, Low skillfully introduced "titled" friends from the Gulf to impress his connections in Kuala Lumpur. Some of these introductions were bogus. For example, one Wharton School contact, Hamad al-Wazzan, found himself invited as a star guest to a dinner held for Najib Razak on the false pretense of being the son of a Kuwaiti construction magnate with a similar name.

In 2005, Low's Wynton Group, a private equity firm, established an office in Kuala Lumpur in partnership with Nizam Razak and embarked on its first major project, the development of a major condominium, the Oval Residences.[113] Funding for the project came from the Kuwaiti Investment House, which was connected to Low through al-Wazzan, who would become close to Sheikh Sabah, a grandson of the emir of Kuwait. Low would later tout the sheikh as one of the Middle Eastern investors behind his shadowy British Virgin Islands–based vehicle, the Abu Dhabi-Kuwait-Malaysia Investment Corporation (ADKMIC). This corporation later embarked on major projects in Malaysia under the banner of having investments from the Middle East.[114]

Listed as ADKMIC's key shareholders were ADIA Investment Corp and KIA Investment Corp, which appeared to be subsidiaries of the Abu Dhabi Investment Authority and the Kuwait Investment Authority, two major Gulf sovereign wealth funds. However, as the anonymous bearer shareholdings made clear, they were not actually linked to those Gulf funds. Instead, they were entities Low had created and registered in the Seychelles. He employed this ruse repeatedly, exploiting the secrecy of offshore havens and plagiarizing major names to disguise shell companies as legitimate subsidiaries to more easily transfer huge sums of money through the banking system.[115]

In 2007, the main opportunities for state investment in Malaysia were connected to the government-backed Iskandar Development Project in the south of the country. Thanks to his political connections, Low attained special access and was empowered to secure a "master developer" for the project.[116] Touting this access, the young Malaysian reached out to a major player in Abu Dhabi, Sheikh Yousef al-Otaiba. Otaiba, who would later be appointed ambassador to the United States, was supremely well connected as the son of the former president of the Organization of the Petroleum Exporting Countries. Name-dropping him as a "friend" (to Otaiba's evident annoyance) cemented Low's reputation as someone with access to Gulf money.[117]

While Malaysia's sovereign wealth fund, Khazanah, ostensibly oversaw the Iskandar project, a leaked email from Low to Otaiba confirmed that Malaysian politicians really pulled the strings. As the email noted, "Khazanah is a separately managed investment arm of the Government of Malaysia. Having said that, the key target partners are cleared at our board level, which is chaired by the Prime Minister of Malaysia."[118]

On his end, Otaiba mobilized his connection to Khaldoon al-Mubarak, the chief executive officer of Abu Dhabi's Mubadala sovereign wealth fund, to engage with Low's project. Mubadala invested in Iskandar as part of a government-to-government enterprise, illustrating the importance of political connections in determining investment decisions.[119]

Leaked details reveal that Low paid Otaiba handsomely, including a 10 percent stake in ADKMIC.[120] Despite Otaiba's alarm at the Malaysians' garrulous use of his name and ostentatious spending at nightclubs and casinos, the two men developed several future joint ventures from which Otaiba allegedly received at least $66 million, according to *Wall Street Journal* estimates.[121]

In 2008, Low also took credit for an investment made by Abu Dhabi Commercial Bank in Malaysia's RHB Bank at double the stock price.[122] Once again, Otaiba's influence likely helped finalize the deal. The agreement led Low, Nizam Razak, and ADKMIC to enter into business directly with Abdul Taib Mahmud, Nizam's in-law and chief minister of the Malaysian province of Sarawak. The RHB holding originally belonged to Taib's UBG consortium, providing him with major profits. Low then persuaded the chief minister to invest the windfall into various assets he had himself acquired in Iskandar. This enabled Low to earn large fees by flipping Iskandar assets at inflated prices while also steering contracts to support his construction investments.[123] But when some of these investments subsequently failed, the Sarawak chief minister pressured Low to bail out the project. As a result, as executive director of the merged company, Low steered UBG to direct more cash into the purchase of two local construction companies to purportedly work on the development.[124] Low did so via a secretive injection of stolen cash from 1MDB in 2010.[125]

Connections in High Places

It was through these engagements in Sarawak that Low connected with another set of actors who became key to the evolution of the 1MDB heists: Goldman Sachs banker Roger Ng and his boss, Tim Leissner. At Ng's later trial in New York, it emerged that upon meeting Ng in Sarawak, Low boasted of his contacts in the Middle East and the Razak government. Goldman Sachs was looking to make government connections, so in January 2009, Ng introduced his boss to Low. The partnership between Leissner and Low transformed Low's ventures into a global enterprise by linking them to the credibility and clout of a major bank.[126]

Other partners in Low's ventures in Sarawak were members of the royal house of the Malaysian state of Terengganu, whose sultan was serving as the rotating federal head of state at the time. Low had placed the sultan's sister onto the board of one of his construction subsidiaries, and he worked closely with her husband, Abdul Aziz Mohd Akhir.[127] The sultan, in his role as chairman of the newly formed Terengganu Investment Authority (TIA), touted TIA as a sovereign wealth fund to be based on oil royalties owed to the state, appointing Aziz and Low as advisers.[128]

At an initial meeting with the sultan, however, Low explained that his strategy was primarily to raise funds by issuing bonds. As an adviser who attended that meeting explained, "What I understood . . . was that TIA would create a fund through issuance of bonds for overseas investment. It was expected to reap profits for the company, which would be channelled back to the people through government community service programmes."[129] This excuse of raising money for foreign investment to fund development would be repeated several times after the fund was rebranded as 1MDB under Najib Razak's direct control. Instead, money went straight into the pockets of the prime minister and his family, Low, and their collaborators.

Low used his influence to ensure that Goldman Sachs was selected to advise on raising an initial bond issue worth $1.4 billion for TIA.[130] The reputational advantages of partnering with a major U.S. bank were significant. With Najib Razak's backing (but against the wishes of the Terengganu sultan and his chief minister, who felt increasingly sidelined), the Goldman Sachs team worked with Low and TIA's chief executive officer, Shahrol Halmi, to swiftly raise the funds through the local AmBank.[131] On this occasion, Goldman Sachs did not handle the offer directly. AmBank (which has since been fined), via highly questionable practices, initially discounted the bonds through two companies that Low controlled, earning him and his associate Eric Tan some $125 million before the bonds reached the open market in May 2009.[132]

For various reasons, including the clash over the controversial bonds, Terengganu's leadership then withdrew from the fund. Najib Razak, by now prime minister as well as finance minister, swiftly remodeled the fund under his government's control. Goldman Sachs would describe the resulting structure in future bond offers as "professionally managed and governed by global best practices" with a board of directors "independent from undue political influence" and a senior international advisory board.[133] But the entire arrangement contained a secret amendment that established the minister of finance (Najib Razak) as the sole signatory and shareholder of the company with veto power over appointments and expenditures. Most of the key management appointments in senior legal and finance positions were connected to Low, in particular the general counsel Jasmine Loo, business development director Casey Tang, chief investment officer Nik Faisal Ariff Kamil and executive director of finance Terence Geh.[134]

Directors soon found that management acted on the orders of Low in his capacity as proxy to the finance minister, in contravention of their own directives.[135] The first chairman almost immediately resigned, protesting that the board's objections had been overruled after the entire equity of the fund was invested in an obscure offshore entity named PetroSaudi International. An ally of Najib Razak replaced the chairman.[136] By the time the fund was rebranded as 1MDB in July 2009, three months into Najib Razak's premiership, it was structured as a perfect vehicle for the kleptocratic plunder that would soon take place.

Laundering the TIA Bond Through PetroSaudi

Leissner testified that Goldman Sachs had hoped to advise on possible investments around a planned 1MDB joint venture with a Saudi state petroleum fund. Low, however, had a different ploy in mind.

He had connected with a young, party-going Saudi named Tarek Obaid, who was in business with Prince Turki bin Abdullah Al Saud, the seventh son of the then ruler of Saudi Arabia, King Abdullah. Prince Turki had little personal wealth, but his proximity to power proved ideal for Low's schemes. In August 2009, aboard a yacht off the coast of Monaco, Najib Razak signed 1MDB's first investment deal, plunging the entire $1 billion sitting in 1MDB's account into one of Obaid and Turki's jointly held shell companies, PetroSaudi International.[137] As with so many of Low's offshore vehicles, the name had a grandiose official ring; however, the company held no connection to the Saudi state and had few assets and little human capital.[138]

Returning to New York in early September 2009, Low sought to finalize the deal by the last day of the month—in a haste that should have raised red flags. Nonetheless, White & Case, a major London law firm, and several banks, including JP Morgan Suisse, RBS Coutts Zurich, and Deutsche Bank Kuala Lumpur, signed off on it, providing a facade of legitimacy that got the deal past regulators. In addition, an investment adviser friendly with Obaid named Patrick Mahony assisted PetroSaudi in "acting as a front" on deals for 1MDB. The "ask" from Low was to help siphon out $700 million from the billion-dollar joint venture in return for $300 million that would be invested in the fledgling PetroSaudi's various ventures.[139]

Mahony requested that White & Case manage the entire process in coordination with Low's team in New York within the now-three-week deadline. The legal teams outlined a plan to transfer the assets of an offshore holding company in the Cayman Islands, PetroSaudi International Holdings, into a new subsidiary, 1MDB PetroSaudi Ltd, registered in the British Virgin Islands—and in the process, advance the subsidiary what was now described as a "loan" as opposed to a fee.[140] 1MDB was due to buy a 40 percent share of 1MDB PetroSaudi Ltd under a joint venture agreement that stipulated in veiled language that it would immediately repay any debts owed by the company in hard cash.[141]

The justification later given by Najib Razak was that the payment was made in recognition of the value of the injected $1.5 billion in fictional assets, a Turkmenistan oil field that PetroSaudi did not really own. According to the U.S. Department of Justice, White & Case issued the loan agreement that purportedly paid the $700 million into 1MDB PetroSaudi Ltd before the new subsidiary had even established a bank account.[142] (The Carnegie Endowment for International Peace approached White & Case for comment on this purported payment, but they failed to respond.)

The deal was pushed through under immense political pressure in early October 2009. The payments were nonetheless delayed as anxious banks, and the 1MDB's own law firm, Wong & Partners, requested information as to why the immediate $700 million "loan" repayment was scheduled to be transferred not to the 1MDB PetroSaudi Ltd account just set up at JP Morgan Suisse but to a mysterious Good Star Limited account at Coutts bank in Zurich. The White & Case team confirmed to 1MDB's own lawyers that Good Star Limited was a PetroSaudi subsidiary, despite the fact that it appeared nowhere in the structures they had drawn up for the deal.[143] It was in fact an account owned by Low.[144]

1MDB management made plain to its Deutsche Bank bankers that the finance minister/prime minister was becoming impatient and that delays would bring consequences. So, the transfers were agreed. The beneficial ownership for Good Star was merely provided in the form of a PO Box address in the Seychelles.[145]

Following the successful transfer of funds to Good Star, Low and Mahony, again with the assistance of White & Case, constructed a second $500 million "Islamic loan" from 1MDB to PetroSaudi Ltd and then made a further $330 million in foreign "investments" that were likewise misused for the benefit of the conspirators. Obaid received a payment of $85 million for his services, from which he paid Mahony $35 million and Turki $77 million.[146] Much of the rest funded PetroSaudi Ltd's new venture, the purchase of drill ships off the coast of Venezuela through a highly lucrative contract achieved by bribing officials from the state oil company PDVSA. 1MDB was not included in the profits from this enterprise (totalling $340 million) despite the "joint venture investment" it had made.[147] In April 2023, Turki and Mahoney were indicted by Swiss officials for their role in the 1MDB corruption scandal.[148]

Low then ploughed around $360 million from the Islamic loan into what was presented as a separate buyout of UBG (one of Low's companies) by PetroSaudi Ltd. But in reality, he set up an entity named PetroSaudi International in the Seychelles, ostensibly owned by Obaid but secretly controlled by Low through an "investment management" agreement with a Panama shell company.[149] Malaysia's controlled media obediently relayed the official version of events, but it also reported on the growing opposition clamor over such blatantly suspicious activities.[150]

Post-Petro Saudi 2011

Within days of the Good Star heist, Low embarked on a stunningly excessive spending spree in several U.S. cities—splashing hundreds of thousands of dollars at nightclubs in Los Angeles; hiring supermodels to attend his parties; purchasing mansions in Hollywood and New York City, along with a jet, sports cars, and a yacht; and gambling huge sums in high-end casinos in Las Vegas.[151] He spent $85 million between October 2009 and June 2010 alone, sparking comments about the ostentatious "Nightclub Whale" and "Malaysian Man of Mystery" in the New York press.[152] Goldman Sachs' Business Intelligence Group, in tandem with other reputation-wary finance divisions, began to flag Low as a person of unexplained means to watch and avoid doing open business with.[153] Leissner's Southeast Asia team, however, with the knowing approval of his immediate senior partners at the bank, continued to court business with Low as Najib Razak's proxy.[154] Shortly after Low's publicity provoked suspicions within Goldman Sachs' compliance divisions, the bank's chief executive officer, Lloyd Blankfein, sat down with Najib Razak and Low in New York in a meeting that Leissner had arranged.[155]

During this period, Low developed a key connection with a fellow extravagant spender, Khadem al-Qubaisi, the right-hand man to Abu Dhabi's Sheikh Mansour bin Zayed Al Nahyan, whose brother was then crown prince and deputy prime minister of the UAE. Al-Qubaisi was the chief executive officer of IPIC, one of the Emirate of Abu Dhabi's sovereign wealth funds. Sheikh Mansour was its chairman, as well as the chairman of a new IPIC subsidiary, Aabar.[156]

Both Low and al-Qubaisi exploited their position as trusted proxies at sovereign wealth funds to benefit themselves and the politically connected officials who employed them. It has been reported that al-Qubaisi steered the funds he controlled to projects he privately had money in.[157] By early 2011, Low had embarked on a number of deals with al-Qubaisi, including a failed bid to take over London's Maybourne hotel group, although Low had claimed he had severed all connections with the fund.[158] The two even hatched a plot to buy the same share of Malaysia's RHB Bank that the Abu Dhabi Commercial Bank had bought back in 2008, based on inside knowledge of a projected takeover bid that Najib Razak, in his second role as finance minister, would have been aware of. Low suggested that Aabar could flip the shares and make half a billion dollars on the resale within six months. Aabar bought the shares from its own national bank. The entourage that swept into Kuala Lumpur in April 2011 to sign the deal included the then crown prince (now Emirati president) himself, Mohammed bin Zayed Al Nahyan. In the end, the gambit failed, as Aabar's outrageous sell-on price meant to maximize its illegal profits caused the merger to collapse.[159]

The Goldman Sachs Bonds

Two years after the Good Star deal, critics of 1MDB increasingly honed in on the fund's burgeoning debt, audit delays, inactivity, and a series of highly suspicious restructurings. Nonetheless, in June 2012, 1MDB reinvested proceeds from its relationship with PetroSaudi International into a Cayman Islands–registered investment vehicle.[160] The accounting firm KPMG refused to sign off on the audit without proof of the profits, however. Najib Razak sacked the firm in retaliation.[161] Despite these concerns, Goldman Sachs continued its relationship with the fund. In January 2012, Low contacted his connections at the bank for investment ideas to justify a new bond issue for 1MDB. Low was able to offer this business to Goldman Sachs without requiring a public tender. Leissner suggested purchasing an aging power plant that another of his Malaysian clients wished to sell, and Low invited Leissner and Ng to meet in London to discuss the deal.

Goldman Sachs agreed to launch a bond offering of $1.75 billion to purchase the plant for $650 million and to cover "other operating expenses." The bank would raise the entire amount and then sell on the bonds to its private customers, thereby keeping the process "below radar" in terms of market scrutiny. In return, Goldman Sachs demanded massive fees of just over 9 percent, over 100 times the market rate.[162]

Why the high fees and secretive process? As Leissner would later testify to U.S. authorities following his arrest in 2017 and then in court, Low had confided at the 2012 London meeting that he planned to steal the bulk of the money. Low told the bankers they would be bribed over and above any bonuses they could expect. The biggest bribes would need to be paid to Najib Razak and his wife and to Abu Dhabi's Sheikh Mansour.[163] Likewise, al-Qubaisi and his deputy at Aabar, Mohammed al-Husseiny, would need bribes, as would Otaiba for his role in making sure matters were handled smoothly in the UAE.[164] The recipients of these payments were reaffirmed in court papers for a Swiss trial of a senior official of the Lombard Odier bank in June 2023. The official had been charged with laundering a total of $50 million from one of Low's offshore companies into newly opened accounts at the bank (said to belong to Otaiba and his Emirati business partner Shaher Awartani).[165]

Leissner and Ng confirmed that they would bring Goldman Sachs into the deal, but to maneuver around compliance officials, they kept their communications with Low off the bank's official email channels. Leissner testified that his immediate superiors were aware of this deceit. However, the bank's position is that "none of the past or current members of senior management were involved in or aware" of illicit activity.[166] The bank's position, however, fails to address the anomalies over the $6.5 billion in bonds that would eventually be issued by the bank for very little identifiable purpose and the very high fees they received for it. More than half of the money raised would ultimately be stolen.[167]

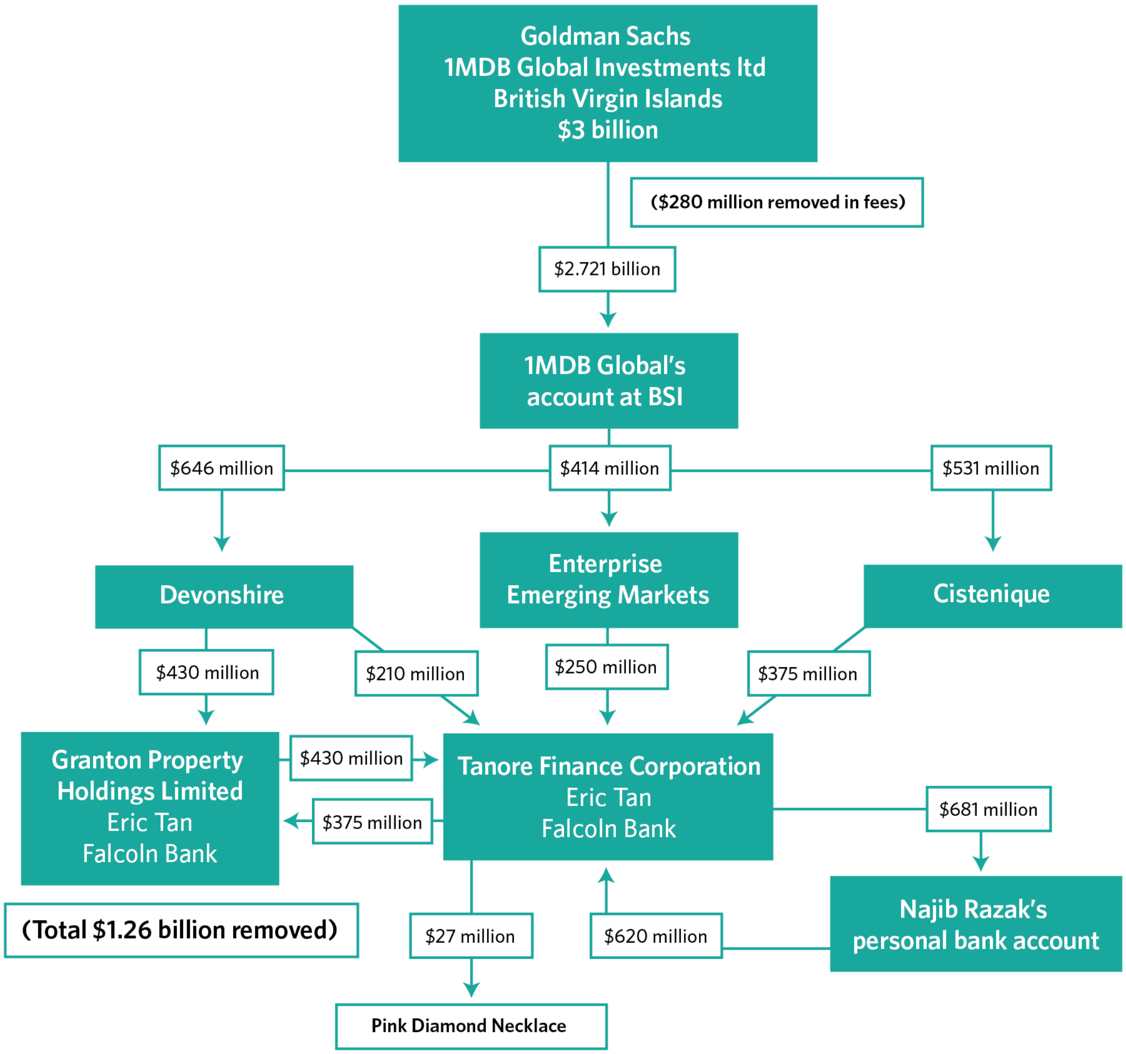
In February 2012, the bankers and Low flew to Abu Dhabi, bearing a formal proposal from Najib Razak to Sheikh Mansour. One month later, the same team reconvened in the United States to finalize the terms. A final piece of the plan was put in place in Singapore at an April meeting between the two Goldman Sachs bankers and Low's local personal wealth management team from the Swiss bank BSI. (Low, officially absent, communicated from a nearby room.)[168]

IPIC would "co-guarantee" the bonds. Describing a "strategic alliance between 1MDB Guarantor and IPIC group," the offer document referred to an options agreement in return for IPIC's collaboration in underwriting the venture. In fact, the ultimate guarantor of the project was still the government of Malaysia.[169]

Meanwhile, however, BSI had opened an account for a new offshore British Virgin Islands subsidiary of Aabar Investments PJS for 1MDB to make a payment for the guarantee. There was no mention of such a payment in the formal offer document that would be provided to Goldman Sachs' clients, but a bogus contract signed between the same executives (Al Husseiny for Aabar and the management of 1MDB) was presented to the BSI bankers and said that the agreed terms between the two sovereign wealth funds for the service was $577 million.[170] At the meeting, the BSI team queried the Goldman Sachs bankers as to why the Abu Dhabi sovereign fund would employ an offshore vehicle for such a purpose or use a tiny bank like theirs. They claim Leissner responded by directing the BSI team to conduct its own due diligence and then abruptly left the meeting.[171] The bank, which had already performed a series of dubious transactions for Low related to the Good Star scheme, agreed to open the account.[172] (BSI later collapsed over its role in the 1MDB scandal.[173])

But Aabar Investments PJS in the British Virgin Islands was not owned by 1MDB, although its shareholders were al-Qubaisi and al-Husseiny. As a secret signatory, Low controlled it.[174] Thus, by planned agreement, straight after the bond (code-named Project Magnolia) was issued in May 2012, a major chunk of the cash was siphoned off and used to pay the conspirators.

Figure 1. Distribution of the 2013 "Structural Joint Venture" Bond



Source: Authors' illustration.

The Swiss bank BSI held the account of a new subsidiary—1MDB Global—into which, after subtracting a $280 million fee for itself, Goldman Sachs passed the remaining $2.721 billion (see figure 1). Within twenty-four hours, BSI had transferred $1.6 billion to Enterprise Emerging Markets, Cistenique, and another "investment fund" called Devonshire. These funds then forwarded the cash to two newly opened offshore company accounts with Falcon Bank—Tanore Finance Corporation and Granton Property Holdings Limited—that were under Eric Tan's name but controlled by Low.[175]

Tanore and Granton received $835 million and $430 million, respectively. A total of $1.26 billion was therefore removed from the bond issue. Shoddy paperwork and the weak cover story alerted the Swiss hierarchy at Falcon Bank, which was being asked to forward $681 million of that money into one of Najib Razak's personal bank accounts. Falcon chief executive officer Eduardo Leeman, himself formerly of Goldman Sachs, would have been aware that Najib Razak had signed off on the 1MDB bond issued just forty-eight hours earlier.[176]

The U.S. Federal Bureau of Investigation (FBI) obtained recordings of Leeman's panicked calls to Falcon's chairman, al-Husseiny. Leeman told him, "This is . . . gonna get everybody in trouble. This is done not professionally, unprepared, amateurish at best," and would later admonish Low directly.[177] However, al-Husseiny overruled his concerns and the transfer went through.[178] A month later, Falcon signed off on an additional $27 million from the same Tanore account, which paid for a Lorraine Schwarz pink diamond necklace that Low arranged to be personally fitted and gifted to Najib Razak's wife Rosmah.[179] While a Swiss court in 2021 acquitted Leeman of money laundering charges, he was fined $3.8 million for his role in the scandal.[180]

The End Game

Najib Razak, with Low's aid, would engage in numerous subsequent scandals, primarily to cover up the original looting from 1MDB as debt payments loomed but also for personal gain. In 2014, 1MDB raised two syndicated loans totaling $1.2 billion from a consortium led by Deutsche Bank in Singapore, allegedly to buy back the options offered to Aabar in return for the guarantee.[181] These options purportedly needed to be liquidated in advance of a planned flotation that Goldman Sachs would manage. In fact, the prime minister hoped to sell the worthless stock to state-controlled entities to write off a debt that now exceeded $11 billion.[182] As collateral, 1MDB misrepresented the value of the Cayman Islands "special purpose vehicle" to Deutsche Bank, claiming it had $2.3 billion realized from the PetroSaudi joint venture under the management of a bogus fund, Bridge Partners Investment Management, including $1 billion held at BSI under a company named Brazen Sky. Najib Razak provided a letter of support for the loan.[183]

Deustche Bank was directed to send the money to the fake Aabar British Virgin Islands account on the understanding that 1MDB was paying the Abu Dhabi sovereign wealth fund to release rights retained under the bond offer document. To reinforce that narrative, Low procured a bogus "agreement related to option agreements" signed by al-Husseiny.[184] Money was then sent to more of Low's offshore shell companies that appeared to be linked to major funds. Low used this money not to pay off debts but to buy luxury goods, including a superyacht, private jet, and artwork. Meanwhile, 1MDB officials carried out complex money transfers with the loaned money to give the impression there was money at Brazen Sky being redeemed from the Cayman Island fund.[185] However, the schemers were getting increasingly desperate. When Deutsche Bank asked for copies of the statements of the Brazen Sky account, 1MDB officers first claimed the BSI servers had crashed and then sent an allegedly forged bank statement.[186]

The entire scheme collapsed on February 28, 2015, when leaked documents from PetroSaudi International were made public by the website Sarawak Report and the *Sunday Times*, followed by another report in March detailing payments to al-Qubaisi's Vasco trust fund set up at a bank in Luxembourg from Blackstone Asia Real Estate Partners Limited, a company Low owned.[187] Sarawak Report would later reveal information about Good Star and other questionable accounts at BSI Singapore.[188] Law enforcement agencies soon launched investigations, spearheaded by the FBI and U.S. Department of Justice's kleptocracy unit. With a global enquiry underway, law enforcement in Malaysia and Abu Dhabi could no longer turn a blind eye to the abuses of their sovereign wealth funds.

In July 2015, Sarawak Report obtained documentation revealing the $681 million transfer from Falcon Bank into Najib Razak's personal account. Despite increasing global outrage and multiple investigations, Najib did not back down, denying everything through a controlled domestic media and cracking down on opponents with new "fake news" laws.[189]

After the United States announced it was seeking to recover stolen assets, Najib Razak turned to then Abu Dhabi Crown Prince (now Emirati President) Mohammed bin Zayed, whom he reminded in a private call that Zayed's brother, Sheikh Mansour, was implicated in the scandal.[190] Abu Dhabi agreed to honor the bogus guarantee as a temporary cover-up to meet 1MDB's escalating $11 billion in debts. After 1MDB failed to meet the repayment deadline the following year, Abu Dhabi and Malaysia agreed to a secret arbitration agreement in which the emirate continued to shoulder the debt but in return punished Malaysia with a penalty of $8 billion, which Najib Razak promised to pay after the election.[191]

The prime minister also turned to China, using Low as an intermediary to plug the debt gap. He renegotiated the major East Coast Rail Link infrastructure project with China Communications Construction Company (CCCC), doubling the budget in return for Chinese assistance in repaying 1MDB's debts.[192] Although the agreement immediately leaked, Najib Razak signed the deal in Beijing in November 2015.

The prime minister next engaged another Chinese state-owned enterprise for a gas pipeline project, agreeing to pay 88 percent up front.[193] The cash immediately passed through a CCCC subsidiary to a bogus Cayman Island company called Silk Road Real Estate Investment Limited (SRREIL), owned by the Kuwaiti royal Sheikh Jaber al-Mubarak al-Sabah. He covered Low's legal expenses and other bills while Low was on the run, in return for a money transfer of $1 billion.[194] SRREIL returned the bulk of the pipeline money to Malaysia to buy a chunk of land from 1MDB at an inflated cost (land originally gifted by Najib Razak's Ministry of Finance). That payment was immediately forwarded to Abu Dhabi to meet payments owed under the arbitration agreement. The relationship was later leaked, leading to several arrests and an ongoing money laundering case in Kuwait.[195]

Thanks in part to the relentless publicity and international investigations, Najib Razak's UMNO party lost an election for the first time in 2018.[196] The incoming government filed several cases against Najib over 1MDB's schemes, and the following year, a Malaysian court found him guilty on several initial counts and sentenced him to twelve years in prison. That judgement was upheld on August 23, 2022, when he was sent to jail; further cases are ongoing.[197]

Najib Razak reaped $756 million from the Goldman Sachs bond offerings alone, per an FBI forensic accountant's court testimony.[198] His stepson received $238 million, and over half a billion dollars' worth of jewelry was purchased for Najib's wife. Low fled into hiding in China, having stolen $1.42 billion from the fund, according to the same FBI testimony. He remains a fugitive, although some of his key collaborators who fled with him have since surrendered to Malaysian authorities.[199] He traveled on a passport issued by Grenada and by way of Dubai.[200] Al-Qubaisi received $472.8 million in all.[201] Ng received $35.1 million from two of the three bonds that had been issued.[202] Leissner received $73.4 million, of which he forfeited $43.7 million as part of his deal with the U.S. government.[203] Al-Qubaisi and al-Husseiny were arrested and imprisoned in 2015, and al-Quabaisi received a fifteen-year sentence in 2019 in the UAE.[204] However, no actions have been undertaken to investigate Sheikh Mansour's involvement or the $160 million in payments for his yacht. Goldman Sachs' Malaysia branch plead guilty and agreed to pay $5 billion in fines to the U.S. government; the DOJ fined its parent bank an additional $2.9 billion.[205]

This complex case involving multiple sovereign wealth funds highlights some of the structural issues that enabled gross corruption. These issues included poor overall governance of the fund, with its management ultimately resting with the prime minister. Moreover, 1MDB and its subsidiaries used a variety of financial secrecy jurisdictions and tax havens, undermining transparency. There was also a significant failure of oversight by banks, as well as extensive complicity across a wide range of institutions. Similar themes will emerge in the subsequent chapters of this compilation, underlining the need for substantial reforms to many sovereign wealth funds.

The opinions and research expressed are those of the authors alone and do not reflect that of their current employers.

CHAPTER 4

Angola's FSDEA—Corruption Scandal and Reform

Jodi Vittori

In 2014, Angola's sovereign wealth fund (SWF), the Fundo Soberano de Angola (FSDEA), was considered largely in compliance with the Santiago Principles—the gold standard for SWF governance as laid out in chapters 1 and 2. The fund had achieved a forty-two-point jump in three years on the Peterson Institute's SWF Scorecard and received a remarkable 8 out of 10 on the Sovereign Wealth Fund Institute's Linaburg-Maduell Transparency Index. But it was later revealed that while the FSDEA was receiving such positive ratings, it was also involved in corrupt activities. The head of the FSDEA, who was also the president's son, had contracted management of the fund's investments to a business partner. In turn, the business partner invested the funds in companies where the partner himself had an interest.[206]

The case of the FSDEA highlights the inadequacy of current standards for evaluating transparency and overall good governance of SWFs, as described in chapters 1, 2, and 12. It also sheds light on the need for independent, third-party auditing and reporting of SWFs.

This case also illustrates how funds with reputations for corruption can be reformed. After the FSDEA scandal broke and the perpetrators were brought to trial, the Angolan government implemented several reforms, which put the FSDEA on a more solid footing. While there is a long way to go for the fund to fully comply with the highest standards of good governance, the current reforms should be applauded. At the same time, the implementation of more credible external evaluation standards could highlight Angola's reform shortcomings. It could also improve public transparency, which could help push even greater reforms throughout the SWF industry.

What Went Wrong With the FSDEA

Angola established the FSDEA in 2012 with an initial investment from a prior Angolan SWF of $5 billion,[207] the only cash infusion it has ever received.[208] The fund's goal was "to promote growth, prosperity, and social and economic development."[209] That year, Angola's president, José Eduardo dos Santos, appointed his son, José Filomeno dos Santos (also known as Zenu), as the chairman of the board of the FSDEA.[210] Zenu contracted a firm called Quantum Capital that belonged to his friend Jean-Claude Bastos de Morais to manage the FSDEA's capital.[211]

Files leaked from the Appleby law firm as part of the so-called Paradise Papers in 2017 revealed that Bastos invested hundreds of millions of dollars in his own companies, in addition to his firm Quantum Global receiving $90 million over a twenty-month period in 2014 and 2015 to manage the FSDEA.[212] The company, which also managed funds for the Angolan central bank, received the FSDEA contract without a competitive tender.[213] Separately, when he was appointed chairman of the FSDEA, Zenu resigned from his role as a director at an investment bank owned by Bastos, Banco Kwanza Invest, and sold his shares, which itself is not corrupt but could be a red flag for conflict of interest.[214]

Media stories based on the Paradise Papers alleged that Appleby set up seven offshore entities in Mauritius that were used by Quantum Global to invest Angolan funds. In four of those entities, Bastos was a major shareholder. In one case, as part of an investment in a five-star hotel in Angola, Quantum Global assumed debt and made cash payments worth $157 million to two firms, but the beneficial owner of both firms was Bastos.[215] In another case, the FSDEA invested in a deepwater port in Angola that was being built by Bastos's company.[216]

This was hardly the first corruption scandal associated with Angola and the dos Santos government. A complex series of swaps of promissory notes for Angolan debts to Russia handled by Swiss bank UBS in the late 1990s and early 2000s allegedly netted then president dos Santos $36 million and a former Angolan ambassador $17.5 million, while the Angolan treasury paid $1.78 billion on a debt of $1.5 billion.[217] As part of scandals in 2010 and 2011, the state-owned oil company, Sonangol, required firms to subcontract with local entities linked to the government's inner circle to receive oil-related contracts.[218] In 2020, a leak of documents accused the Angolan president's daughter, Isabel dos Santos (whom the president appointed to take over Sonangol in 2016), of looting the oil company and corruptly creating a business empire in diamonds, telecoms, banks, and the country's biggest cement maker. Despite an INTERPOL red notice being issued for her arrest in November 2022, she continued to live in Dubai as of February 2023 and has claimed the investigations are a "witch hunt."[219]

Initiation of Reforms

In early 2018, the new president of Angola, João Lourenço (who had previously been dos Santos's defense minister before becoming president in 2017),[220] fired Zenu from the FSDEA's board.[221] In July 2019, the government issued a new legal framework for the fund via presidential decrees to establish "an organizational model of sound governance, with clear and effective division of functions and responsibilities, compatible with the nature of [its] activities."[222] The decrees stated that the FSDEA would maintain its role as a savings and development fund, but a new fund would be established for stabilizing the economy.[223] The decrees also strengthened the criteria for selecting board members and members of other FSDEA governing bodies, better specified the responsibilities of the fund's various governing bodies,[224] and boosted the required qualifications for asset managers. In addition, the decrees improved risk management of investments and changed the allocations of the fund's assets.[225]

As the FSDEA management was being overhauled and new governance measures instituted, Angolan prosecutors charged Zenu in 2018 in a separate incident of attempting to steal $500 million (though the Angolan Ministry of Finance later determined that those involved in the scheme had planned to eventually transfer $1.5 billion) by creating a fake $35 billion investment fund and fake paperwork to justify the large transfer of funds from the Angolan treasury.[226] Both Zenu and Bastos were arrested later that year.[227] The Angolan government alleged that as Zenu's father was stepping down as president in 2017, Zenu and collaborators created a fake $35 billion investment fund. Using that fake fund, they allegedly arranged to send $500 million from a government account to a shell company's private bank account held by a collaborator at HSBC in London.[228] Forged documents, including some claiming to be from Credit Suisse, were also reportedly used.[229] Though the transfer to the bank went through, a teller filed a suspicious activity report and the Angolan government began to investigate.[230] After this scandal, Swiss and British authorities also raided associated offices, froze bank accounts, and opened their own investigations into Bastos's companies associated with the FSDEA.[231]

In 2019, there was a confidential agreement between the FSDEA and Bastos's firm whereby the Angolan government claimed it had recovered from Bastos's firm $3 billion associated with the FSDEA investments. At that time, Swiss and British authorities dropped their cases and the Angolan government dropped the charges against Zenu related to the fund.[232] In 2020, Zenu was convicted of fraud in Angola (but was acquitted of money laundering charges) for the $500 million fraudulent transfer and sentenced to five years in prison, though he remains free on bail and maintains his innocence.[233]

The Context of the FSDEA Scandals

Dos Santos served as head of state for decades and, though Angola calls itself a democracy, ruled as an authoritarian. Freedom House rated Angola "not free" in its *Freedom in the World 2023* report.[234] Per Angolan law, the president is not directly elected; they are the candidate of the party or coalition that wins an election. Human Rights Watch notes that while voting has largely been peaceful in Angola, there are severe restrictions on voting and freedom of assembly and significant state censorship, with ruling party officials controlling private media outlets.[235] The state controls all nationwide media.[236]

Since independence, Angola has appeared to have rapid economic growth on paper, but in reality there existed a tiny, very wealthy elite amid a sea of poverty. When dos Santos took over as Angola's second president in 1979, the country produced 146,000 barrels of oil per day.[237] The end of the country's civil war in 2002, in conjunction with new offshore discoveries in the 1990s, allowed oil production to more than double.[238] By 2008, Angola was producing 1.9 million barrels per day.[239] Today, the country's real gross domestic product (GDP) per capita is $5,900[240] and its Gini coefficient (which measures income inequality) is 51.3, making it the ninth-most unequal country in the world.[241] A third of the population lives below the poverty line, youth unemployment is almost 20 percent, 70 percent of the population is literate, and the country has almost no economic growth.[242] Life expectancy is only sixty-two years.[243] Only half the population has electricity and a third has internet access.[244]

One of the ironies of the scandals associated with the FSDEA is that they occurred while the fund was undergoing significant reforms in governance and transparency, at least on paper. In 2012, Angola scored 15 out of 100 on the SWF Scorecard (the first year the FSDEA was scored), making it the third-worst-scoring fund on the index that year.[245] But by 2015, it had achieved a score of 67, putting it in the middle of the SWFs that were ranked.[246] Moreover, in 2014, the fund was rated for the first time by the Sovereign Wealth Fund Institute and earned an 8 out of 10 on its Linaburg-Maduell Transparency Index.[247] This rating put Angola in the top thirty of eighty rated SWFs and behind only Nigeria for African funds.[248] The media leaks and associated investigations and trials that emerged three years after Angola received these high scores would demonstrate that these scores likely had not been warranted.

Yet even at that time, there were warning signs that something was amiss. First, the Linaburg-Maduell Transparency Index is based primarily on self-reporting by the funds rather than information from an independent third party.[249] The Economist Intelligence Unit (EIU), the risk analysis and research arm of the Economist Group, pointed out a number of concerns in 2015, including that Bastos was a close business associate of Zenu and that he had previously held part ownership of Angola's first investment bank, Banco Kwanza Invest.[250] Regarding the FSDEA's public transparency, the EIU noted, "The fund's website, although better than most linked to Angolan government institutions, is not particularly detailed, and while the FSDEA announced in 2014 that its accounts had been audited, it has to date only published basic details of the fund's transactions and not shared a photocopy of the accounts signed by its auditor, Deloitte."[251] In response to a 2014 report by the International Monetary Fund (IMF) that stated that the FSDEA was falling short on transparency, Zenu noted that the fund was submitting detailed quarterly reports to Parliament and that the fund was independently audited.[252]

Some Signs of Improvement

Nonetheless, there have been some signs of improvement for Angola overall and for the governance of its SWF. The Rule of Law Index noted that Angola moved from a score of 0.41 in 2019 to 0.43 in 2022 (on a scale of 0 to 1, where a 1 indicates perfect levels of rule of law).[253] Its Corruption Perceptions Index score rose fourteen points to 33 (out of a possible 100) between 2018 and 2022.[254] As the U.S. State Department noted in its most recent investment climate assessment of Angola, "Despite its reputation as a challenging place to do business, Angola is seeking to improve its investment climate and improve in the areas of anti-corruption, democracy, governance, and human rights."[255] Angola joined the Extractive Industry Transparency Initiative in June 2022, which should help to increase transparency in its oil, gas, and mining sectors.[256]

Moreover, though Lourenço won a second term in 2022, his party won with only 51.4 percent of the vote.[257] A stronger opposition party and the loss of the ruling party's supermajority may lead to additional governmental accountability in Parliament, though the election process itself was described as "dodgy" by the *Economist*, with speculation that Lourenço's party may have actually lost to the opposition.[258]

The SWF reforms started in 2019 also seem to be taking root. For instance, the FSDEA's SWF Scorecard score from the Peterson Institute rose another ten points since 2015 and is now at 77 out of 100, tying it with Australia's NSW Generations Fund, Spain's COFIDES, and the state of Texas' Permanent University Fund.[259]

These are all positive starts, though Angola has a way to go to improve governance overall. While a 2019 report by the IMF lauded the SWF reforms, it also made a significant number of recommendations to align the FSDEA with international good SWF practices. These included more clearly defining the FSDEA's development function and further clarifying its investment guidelines.[260] The IMF also recommended that Chile and Norway may be good examples of a well-designed fiscal framework for the fund.[261] Given that Angola is a highly indebted commodity exporter, the IMF suggested that the fund be used to reduce the country's expensive external debt before it transfers funds to a short-term stabilization fund; once funds are transferred to the stabilization fund, these transfers should be according to predetermined rules.[262]

Although the new FSDEA governance rules provide for a more varied series of governing boards, more diverse and independent management and advisory committees that include participation by independent and nongovernmental experts would help it meet the Santiago Principles requirements on the independence of SWF operational management and public disclosure of the governance framework.[263] The IMF further noted that FSDEA's investment policy would be improved if there were clearer guidelines for investments or perhaps even a prohibition on domestic investments. And while the IMF said that the FSDEA publishes its audited annual reports online and provides more robust regular reports to the Ministry of Finance, the IMF asserted that these more robust reports should also be available to the public, along with the laws and regulations associated with the fund's governance, investment, and risk management strategies. Independent advisory or oversight bodies should also publish public opinions on the FSDEA's operations and performance.[264]

Angola has made some commendable progress on SWF governance. This case demonstrates that even highly authoritarian and fragile states can make meaningful reforms. It highlights both the need for reforms in the standards by which SWF governance is judged and how important the implementation of those reforms can be to the citizens of the SWF originating state.

CHAPTER 5

Equatorial Guinea—The Invisible Sovereign Wealth Fund

Jodi Vittori

Equatorial Guinea's opportunity to profit from its hydrocarbon revenues is running out.[265] The International Monetary Fund (IMF) reported in 2018 that by 2030 Equatorial Guinea's oil fields—which make up the bulk of its export earnings—will be exhausted, though its gas revenues will remain until 2075.[266] A well-managed sovereign wealth fund (SWF) could thus be an important institution for ensuring that the country's natural resource wealth benefits future generations and is not squandered.

However, the country's Fund for Future Generations (FFG) is considered one of the least transparent SWFs in the world. The U.S. State Department's 2023 assessment of Equatorial Guinea's investment climate noted that "there is no publicly available information on [the FFG's] allocations or the regulations directing its maintenance and management."[267] The extraordinary lack of transparency associated with the FFG, combined with the country's well-documented lack of good governance and high levels of corruption, could mean that average citizens may see few benefits from those natural resources in the future.

Natural gas in Equatorial Guinea was discovered in 1983 and production began in 1992; oil production started in 1996.[268] The FFG, established in 2002, has an estimated $165 million in assets under management,[269] and at inception the fund promised to deposit 0.5 percent of annual oil revenues into a special account at the central bank, the Banques des États de l'Afrique Centrale (BEAC).[270] In 2008, the World Bank confirmed that the government had been putting money into the account, but as early as 2005 the IMF voiced concerns that the fiscal rules of the FFG were unclear and poorly observed.[271] Moreover, while 0.5 percent is a good start, it is much smaller than the percentage deposited by other oil-rich countries, such as Kuwait, which puts 10 percent of its oil revenues in its SWF.[272]

The Unseen SWF

Today, there is almost no information available on the FFG. It is not a member of the International Forum of Sovereign Wealth Funds (IFSWF),[273] and the 2019 SWF Report Card (the latest year available) gave Equatorial Guinea the lowest score of all countries: 11 out of 100.[274] The assessors could not find any recent report on the fund's performance.[275] The IMF releases numbers on the BEAC, but it does not break out specific numbers for the FFG.[276] Nonetheless, the IMF reports that Equatorial Guinea had a negative balance on its net foreign assets even when the government was bringing in higher hydrocarbon earnings,[277] as the Equatorial Guinean government's funds at BEAC have been drawn down to support government spending.[278] This is a red flag that the FFG may not be fully funded.

The lack of transparency combines with well-documented corruption associated with the governing family and overall poor governance within Equatorial Guinea. As the IMF noted, "The [country's] existing anti-corruption institutions are assessed to be highly vulnerable to political interference, have limited resources and some have not been established as prescribed by law."[279] The 2021 Open Budget Survey—which measures participation, oversight, and transparency of national budgets—gave Equatorial Guinea a score of 0 out of 100 for its public participation and budget transparency and an 18 out of 100 on budgetary oversight.[280] Transparency International gave the country a 17 out of 100 in its 2022 Corruption Perceptions Index.[281]

Evidence of Grand Corruption in Equatorial Guinea

This chapter does not allege that there has been any wrongdoing associated with Equatorial Guinea's SWF, but the government's well-documented history of grand corruption points to a need for greater scrutiny and accountability for the SWF to ensure that funds are not diverted for personal gain.

Officially a democracy, Equatorial Guinea is governed by the Obiang family. Teodoro Obiang Nguema Mbasogo has been president since 1979, when he seized power in a military coup.[282] The country is rated "not free" by Freedom House and received a score of 0 for political rights in 2023.[283]

The president's eldest son, Teodoro Nguema Obiang Mangue (referred to here by his surname Nguema[284]) has been the first vice president since November 2022.[285] Before his promotion, he served as the forestry minister. The U.S. Department of Justice (DOJ) estimated that between 2005 and 2007, Ngeuma funneled into the United States at least $75 million, which was almost half of the annual education budget in Equatorial Guinea.[286] In 2014, the DOJ seized over $30 million in his assets, including two mansions, a private jet, luxury vehicles, and various Michael Jackson memorabilia (including seven life-sized statues of the singer, one of his diamond-studded gloves, and the red jacket worn in the "Thriller" music video).[287] In 2016, Switzerland seized eleven luxury cars worth $8 million and a $120 million superyacht from Nguema.[288] In 2018, Brazilian police seized $16.5 million in watches and cash.[289]

Perhaps the most notorious case against Nguema was the decade-long Biens Mal Acquis ("Ill-Gotten Gains") case, which was resolved in 2021 when France's highest appeals court upheld the guilty verdict against him. Ngeuma was the first foreign senior official to be tried in a French court of diverting corruptly acquired funds into investments on French territory.[290] An estimated $150 million of property was seized—including a French mansion worth $120 million and eleven luxury cars (a Maserati, an Aston Martin, a Rolls Royce, a Porsche, two Bugattis, two Ferraris, and two Bentleys).[291] Based on evidence from the French court, the British government also sanctioned Nguema with asset freezes and a travel ban.[292] Throughout the trial, the Equatoguinean government asserted that, as vice president, Ngeuma enjoyed immunity from criminal prosecution and it filed legal action against France in the International Court of Justice.[293]

Another of the president's sons, Gabriel Mbaga Obiang Lima (commonly referred to as Gabriel), is the minister of mines and hydrocarbons. Media reporting by the Organized Crime and Reporting Project (OCCRP)—a global network of investigative journalists—alleged that Gabriel "often extorted money from businesses by demanding payments for events that are already funded by the government" and that companies linked to him "often make money by renting out residences to foreign oil companies or even the government."[294] For instance, the OCCRP report alleged that a contract to create the National Institute of Hydrocarbons massively inflated the institute's construction costs. Kickbacks allegedly included free renovations and construction work on hotels linked to Gabriel.[295]

Beyond the immediate Obiang family, there have been media reports of repeated scandals involved with the state oil company, GEPetrol. In 2021, the OCCRP, working with the Equatoguinean online news site Diario Rombe, reported that GEPetrol's managing director, Antonio Oburu Ondo, had used offshore firms to skim profits for himself from oil deals he set up. Part of this emerged via a $339 million oil corruption lawsuit that has been making its way through British and Swiss courts since 2015. The lawsuit claimed that fake companies were inserted into oil cargo sales to skim money.[296] Oburu is married to Candida Okomo Nsue Mensa, who is the niece of the first lady of Equatorial Guinea and the daughter of the president's chief of protocol.[297] Okomo was named the deputy general director of GEPetrol in 2017.[298] Oburu and Okomo bought Cypriot citizenship in 2017 for 2.5 million euros ($2.6 million), and they own properties in Limassol, Cyprus; Accra, Ghana; Houston, United States; and Madrid, Spain. Some of these properties were bought via shell companies in the financial secrecy jurisdiction of the British Virgin Islands and using a bank account in Lebanon.[299]

No Improvements on the Horizon

Under the Obiangs, Equatorial Guinea's economic development has been phenomenal—on paper. In 1979, Equatorial Guinea had an estimated gross domestic product (GDP) per capita of $170. By 2021, GDP per capita had risen to $14,600,[300] after the country experienced an average 23.6 percent real GDP growth rate per year between 1996 and 2008.[301] Despite these figures, two-thirds of the population lives below the poverty line, and Equatorial Guinea has the fourth-highest infant mortality rate in the world at 77.85 per 1,000 live births.[302] Only 67 percent of the population has electricity, and there are thirty-nine mobile phones per 100 inhabitants (and less than one fixed line phone per 100 inhabitants).[303] Perhaps as a result, it had the fifth-highest net migration rate in the world, with thirteen migrants per 1,000 of the population per year.[304]

Investigative journalism by local reporters trying to provide oversight of the FFG, or anything in Equatorial Guinea, has been difficult. Equatorial Guinea has one state-owned TV and radio station, plus a private TV and a private radio station, which are both owned by the president's eldest son, Nguema.[305] Receiving news from abroad can also be difficult since there are only 1,000 fixed broadband subscriptions in the country and only about half of the population has access to the internet.[306] Obiang and his associates own the phone and internet companies, allowing them to control what information is shared. Especially during elections—including during the 2022 elections[307]—or violent government attacks against opposition parties, the regime shuts down access to the internet and/or social media. The government also blocks websites of media and nongovernmental organizations it considers critical of the regime.[308] The Natural Resource Governance Institute noted that anti-corruption and good governance advocates are regularly targeted for harassment and arbitrary arrest. The judiciary lacks independence and includes such violations of rule of law as mass trials, trumped-up charges, and confessions obtained through torture.[309]

Equatorial Guinea's economy is not expected to improve soon. As the IMF noted in 2022, "the economy is projected to contract in 2023 and through the medium term, reflecting a reduction in hydrocarbon output together with a stalled structural reform agenda, weak governance and significant corruption vulnerabilities, subdued business confidence, and a weak banking sector."[310] The IMF assessed that "hydrocarbon revenues in Equatorial Guinea have passed their peak" and that the country has about $105.6 billion in hydrocarbon wealth remaining.[311]

Although there has not been any documented wrongdoing associated with Equatorial Guinea's SWF, the Obiang family's history of authoritarian governance and grand corruption, combined with the lack of transparency in the fund and the anticipated short time line for the country to profit from natural resource revenues, highlights the need for greatly improved governance for the SWF.

Chapter 2 highlighted the lack of transparency in SWFs overall, while chapter 12 asserts the need for countries that receive investments from SWFs to establish guidelines to conduct due diligence on the sources of that money. Though none of the seizures of Obiang property associated with corruption in France, Switzerland, Brazil, and the United States were explicitly linked to the SWF, it nonetheless highlights the importance for recipient countries of requiring such due diligence should a similarly kleptocratic regime seek to move ill-gotten gains through an SWF.

CHAPTER 6

The Public Investment Fund and Saudi Arabia's Engagement in Global Sport

Kristian Coates Ulrichsen

In October 2021, the English Premier League (EPL) approved the takeover of Newcastle United Football Club by the Public Investment Fund (PIF) of Saudi Arabia and two other parties. As the PIF acquired 80 percent of the 130-year-old club, it became the majority owner.[312] Within minutes of the announcement of the takeover, thousands of jubilant Newcastle United supporters flooded the streets outside the St James' Park stadium, celebrating and chanting slogans in support of the new Saudi owners.[313] Ten days later, a sellout crowd at the first home game under PIF ownership saw many fans don Saudi thobes and Arab headscarves, while human rights advocates protested outside the stadium with images of murdered Saudi columnist Jamal Khashoggi.[314]

The emphasis placed on soccer (and sport more broadly) by the PIF—and, by extension, the Kingdom of Saudi Arabia—since 2016, coupled with the rapturous nature of their welcome in Newcastle, shines a spotlight on the unconventional returns on such investments. Owning sports clubs overseas does little to generate job creation or technology transfer in the investing country; and professional soccer teams in the EPL have only recorded pre-tax profits four times in the last two decades (the twenty teams collectively lost, pre-tax, nearly £1 billion ($1.3 billion) in the 2019–2020 season alone).[315] This reality suggests that financial rates of return were not necessarily uppermost in the PIF's considerations. And, hence, the PIF's acquisition presents a useful case study of how a sovereign wealth fund can pursue other objectives besides economic diversification and national development.

Moreover, the scale of the PIF's (and the Saudi state's) turn toward investment in a range of sports since 2018 indicates that Saudi Arabia will exercise growing influence across the global sporting landscape in ways that are increasingly visible and direct, whether through the ownership of teams and franchises or by hosting global events that position the Kingdom as a destination.[316] Media reports suggest, for example, that Saudi authorities are aiming to win the hosting rights to twenty-five world championships across a range of sports by 2030, and as the sole bidder, Saudi Arabia is now expected to host the 2034 World Cup, too.[317] Already, the Kingdom has secured the right to host the 2023 FIFA Club World Cup, the 2027 AFC Asian Cup, and the 2029 Asian Winter Games, with the latter set to take place at Trojena, a futuristic ski resort to be developed as part of the PIF's Neom giga-project in northwest Saudi Arabia.[318]

No specific links to issues of corruption have emerged in the Public Investment Fund's nascent foray into the sporting landscape, although questions have been raised about the process of decisionmaking within the PIF and the overspill of political considerations into investment policy.[319] The proximity of the PIF to Crown Prince Mohammed bin Salman and its central role in the redistribution of political authority in Saudi Arabia since 2015 has ensured that "the PIF's structure and investment strategy are enmeshed in elite politics" and injected "political drivers" associated with the personal policy preferences of the heir to the throne.[320] Personalized aspects of decisionmaking, together with the unconventional and frequently intangible returns associated with sports-related investments, may well define and indeed distort the PIF's mandate as 2030 approaches, especially if progress on developing the giga-projects is perceived to be lagging or underwhelming, and policymakers believe themselves to be under pressure to show results.[321]

Emergence of the PIF as the Saudi Sovereign Wealth Fund

When sovereign wealth funds began to attract international attention during the 2007–2008 global financial crisis, it was often noted that Saudi Arabia did not have a sovereign fund, at least by comparison with the externally focused investment authorities in Kuwait, Qatar, and the United Arab Emirates (UAE). According to a 2008 study of Gulf-based sovereign wealth funds, the Saudi Arabian Monetary Agency managed the Kingdom's assets and the PIF was one of three state funds that invested locally and were not "standard" sovereign wealth funds (in other words, they did not emphasize external investment portfolios or priorities).[322] From its formation in 1971 until 2015, when responsibility for its operations was transferred to the Council of Economic and Development Affairs (CEDA), the PIF was part of the Ministry of Finance and maintained a domestic-focused and largely low-key profile.[323]

This changed in March 2015, two months after the succession from King Abdullah to King Salman and the rise to prominence of the new king's then twenty-nine-year-old son, Mohammed bin Salman. Appointed minister of defense and chairman of CEDA as part of the restructuring of the Saudi cabinet in January 2015, Mohammed bin Salman entered the line of succession in April when his father appointed him deputy crown prince (and, in

June 2017, crown prince, displacing his cousin, Mohammed bin Nayef).[324] He immediately began to accumulate decisionmaking authority on a scale unprecedented in post-1953 Saudi Arabia.[325] He assumed oversight of investment policy in March 2015, when the PIF was transferred from the ministry of finance to CEDA, as well as of energy policy, when he became chairman of a new supreme council for the state-run oil company Saudi Aramco in May 2015, just days after becoming deputy crown prince.[326]

In April 2016, Mohammed bin Salman unveiled Vision 2030, an ambitious plan to transform and diversify the Saudi economy, and entrusted the PIF with much of its project delivery, including associated giga-projects such as Neom. In his introduction to Vision 2030, Mohammed bin Salman stated that Saudi Arabia would "transform the Public Investment Fund into the world's largest sovereign wealth fund," in part by transferring ownership of Saudi Aramco to the PIF and listing a proportion of its shares.[327] Sport, entertainment, and tourism have all featured heavily in Vision 2030 and the six giga-projects launched by Mohammed bin Salman since 2017. In addition to Neom, these projects include Qiddiya, a large-scale entertainment, sports, and cultural complex near the capital Riyadh, as well as other large-scale developments along the Red Sea coastline.[328]

The extent to which Vision 2030 and the giga-projects will be realized is yet to be determined and may not become fully apparent for many years to come. The degree to which Vision 2030 (and PIF investment ventures) can develop and diversify the domestic economic and industrial base and create sufficient new jobs for Saudi citizens as they enter the labor market will be the ultimate test of its success. Media reports in the *Wall Street Journal* have painted a picture of a less than harmonious working environment that seemingly has impacted Mohammed bin Salman's initiatives.[329] And yet the PIF remains integral to his plans to remake the Saudi state, both before and after he becomes king, as evidenced by the decision to transfer an additional 4 percent of Saudi Aramco shares, potentially worth some $80 billion, to PIF coffers in April 2023.[330] Moreover, sport has emerged as an area of intense focus for the Saudi authorities, combining domestic and international considerations as well as large-scale and increasing commitment of resources.

Leveraging the Global Appeal of Sport

Under Mohammed bin Salman, Saudi Arabia has become far more active in trying to harness the power of culture and sport to burnish its international image and move the narrative about the Kingdom away from issues such as human rights violations and the war in Yemen. This effort took on added importance after the October 2018 killing of *Washington Post* journalist Jamal Khashoggi by agents of the Saudi state who acted, according to U.S. intelligence agencies, with the approval of Mohammed bin Salman.[331] Some of the initial Saudi engagement with international sport was driven by Turki Al Sheikh, a close adviser to the crown prince, in both his professional capacity as chairman of the General Entertainment Authority and his private capacity as an investor in soccer clubs in Egypt, Spain, and Sudan.[332]

The scope and intensity of Saudi Arabia's involvement in sporting initiatives, as a host and participant, quickened considerably after 2018. That year, the General Entertainment Authority signed a ten-year agreement with World Wrestling Entertainment to host two "crown jewel" events each year in the Kingdom, and the first one took place only a month after Khashoggi's death.[333] Multiyear agreements were also signed with the Italian and Spanish soccer federations to host each country's super cup in Saudi Arabia in 2018 and 2019 and in 2020 and 2022 respectively. In addition, major boxing matches took place in the town of Diriyah, the ancestral home of the House of Saud, and the inaugural Saudi Arabian Grand Prix was organized on a street circuit along the Jeddah Corniche in 2021 as part of a ten-year deal with Formula One.[334] The PIF also began to invest significantly in gaming and esports in 2022 through a subsidiary, the Savvy Games Group, established as part of the PIF's new 2021–2025 strategy to build on a string of previous investments in various esports and gaming platforms and companies.[335]

The EPL's global profile and the contentious nature of the Newcastle United takeover process brought Saudi Arabia's sporting outreach into even greater focus. The lengthy process lasted from April 2020 to October 2021, largely because the EPL sought assurances that the PIF was separate from the Saudi state and that the latter would not have control over the club.[336] Proving the separation of the PIF and the Saudi state was a challenge, given that the PIF functioned as the sovereign wealth fund of Saudi Arabia and answered to the crown prince as chairman of the fund's board. The board itself comprises six members of the Council of Ministers (the Saudi cabinet) and two advisers to the Royal Court.[337] Evidence of separation was deemed necessary because the Saudi state was implicated in the pirating of regional broadcasting rights held by beIN Sports, a Qatar-based media group, including the illegal airing of matches from the EPL itself. In June 2020, a ruling by the World Trade Organization (WTO) linked the Kingdom to beoutQ, a shadowy entity that appeared in 2017 during the blockade of Qatar by Saudi Arabia, Bahrain, Egypt, and the UAE.[338] The fact that beIN Sports held the rights to broadcast EPL games in the Middle East and North Africa complicated the takeover of Newcastle United, as the WTO ruling established that the Saudi authorities had failed to act against the theft of those rights by an entity or individual operating under Saudi jurisdiction.

An October 2021 decision by Saudi authorities to restore beIN's access to Saudi Arabia proved to be the key to breaking the impasse over the PIF-led takeover of Newcastle United, which was approved by the EPL the following day.[339] The alacrity with which the EPL announced it had received, and accepted, "legally binding assurances" that the Saudi state would not control Newcastle United (without disclosing what those assurances were) seemed to indicate that the real holdup to the takeover had been the piracy issue affecting beIN, the EPL's regional broadcast partner in the Middle East and North Africa.[340] Newcastle United's fortunes on the field went on to improve markedly, helped by a lavish outlay on new players. Ties between the club and Saudi Arabia also proliferated, evidenced by, for example, a mid-season warm-weather training week in Jeddah and a new jersey that, perhaps not uncoincidentally, resembled that of the Saudi Arabian national team.[341]

Critics of the Newcastle United acquisition have accused Saudi Arabia of "sportswashing"—a nebulous term that emerged in the 2010s as authoritarian regimes began to actively engage more in the infrastructure and ecosystem of global sport and, in turn, challenge the historically Western-centric dominance of sporting institutions and mega-event hosting.[342] But it could also be said that governments are engaging in forms of nation branding and soft power projection to reach new audiences and channel narratives in new and (for them) more benign directions. The PIF has played an active role in this phenomenon through its involvement with Newcastle and, since 2022, its financial support of more than $2 billion for a breakaway golf tour, the LIV Golf Invitational Series.[343]

Multiple PIF Objectives

PIF leaders have tended to maintain a discreet silence about the decisionmaking process around putting the fund's broad objectives—spelled out to great fanfare by Mohammed bin Salman—into practice. For example, in announcing the PIF's new five-year strategy for 2021–2025, the crown prince (and board chairman) declared that the fund would invest $40 billion each year domestically and create 1.8 million new jobs in Saudi Arabia, but he did not provide any specific details. In equally broad terms, PIF governor Yasir bin Othman al-Rumayyan added that the fund's mandate was to "enable the private sector" in part by working with "innovative, transformative and disruptive companies around the world" to develop "the industries and opportunities of the future."[344]

Some investments in clear support of this mandate include the PIF's investment of $1 billion in the American electric vehicle manufacturer Lucid Motors in 2019, and the February 2022 announcement that Lucid would open a new assembly plant in Saudi Arabia and provide between 50,000 and 100,000 locally produced electric cars for the Saudi market over a ten-year period.[345]

Other conventional investments include esports and gaming, in terms of the investments' compatibility with the mandate to contribute to the economic development and diversification of Saudi Arabia. This emerging and rapidly growing sector appears to be consistent with al-Rumayyan's earmarking of "innovative, transformative and disruptive" companies and technologies as targets for PIF investments with the goal of establishing leadership in new economic sectors and positioning the Kingdom as a "growth engine."[346] Also consistent is a separate PIF investment made in 2021—the acquisition of a minority stake in the McLaren Group—that was followed in 2022 by a "strategic title partnership" that saw Neom brand itself on McLaren's Formula E and Extreme E racing cars and saw McLaren become a founding partner in an advanced and clean industries initiative to be based at a Neom research and innovation campus.[347]

Less conventional or clear, however, are the PIF's investments in Newcastle United and LIV Golf. These appear to be more about the projection of soft power and the use of sport to reach new constituencies outside the Kingdom's borders. The global profile and mass appeal of the EPL could make Newcastle United a potent brand for Saudi Arabia, especially if the team performs well and if the jerseys ever feature advertisements for Saudi companies.[348] Other indirect benefits may contribute to aspects of Vision 2030, such as the promotion of Saudi Arabia as a tourism destination, an approach seen also in the 2022 unveiling of Argentinian soccer superstar Lionel Messi as a brand ambassador for the Saudi Tourism Authority.[349] It is these less tangible (and hard-to-measure) outcomes of PIF investments that have motivated the accusations of "sports-washing"—just as the term has become popularized by events such as the 2022 FIFA World Cup in neighboring Qatar.

The PIF's decision to associate itself with, and finance, LIV Golf not only reflects al-Rumayyan's personal interest in golf but also suggests a very different approach to Saudi Arabia's engagement in sport.[350] It is one thing to own one of twenty teams in the EPL or organize one of twenty-two grand prix in the Formula One World Championship but quite another to back a breakaway golf tour that has positioned itself as a direct rival to the existing institutional structure, in this case the Professional Golfers' Association (PGA) and DP World (European) Tour.[351] The PIF's backing of LIV Golf in 2022 and eventual agreement to combine commercial operations with the PGA and DP World Tour in June 2023 represented a striking breakthrough against the status quo in a notoriously conservative sport, consistent with al-Rumayyan's enthusiasm for disruptive and transformative challengers.[352] The fact that two of the eight tournaments in the inaugural season took place at courses owned by former U.S. president Donald Trump suggests that political motives could potentially be at play. Also seemingly political in nature is the PIF's decision—reportedly against the advice of its investment committee—to invest $2 billion in Affinity Partners, a private equity firm established by Trump's son-in-law and former senior adviser, Jared Kushner.[353]

Speaking to the media after unveiling plans for a smart city called The Line as part of the Neom project in 2022, Mohammed bin Salman asserted that Saudi Arabia would have a population of more than 50 million by 2030.[354] The scale of increase (from a current population of 35.96 million in 2023[355]) suggests that a majority of the arrivals will be residents or visitors from overseas. It may be that, over the period leading up to 2030, investment into sport, through ownership, sponsorship, or event hosting, will create awareness of Saudi Arabia (and particularly the giga-projects) as a place to visit or live. Tapping into the mass global appeal of sport could in this way generate, over the long term, development of Saudi Arabia as a market for tourism, entertainment, and hospitality.[356] Whether this transpires or not will only become clear over years, but the PIF established a dedicated sports investment company (SRJ Sports Investments) in August 2023 as a statement of intent with a mandate to accelerate the growth of the sport sector in Saudi Arabia, localize partnerships, and contribute "to a more vibrant society," however that may be measured.[357]

Conclusion

PIF and Saudi Arabia may be relatively late entrants into sport, especially by comparison with the states around them, such as Qatar, the UAE (both Dubai and Abu Dhabi), and even Bahrain, which first hosted a Formula One Grand Prix as far back as 2004.[358] Sovereign wealth funds and the resource-rich states that they represent have become increasingly visible investors and participants in global sport over the past decade. Gulf states' investments in European soccer teams such as Manchester City (owned since 2008 by the brother of the ruler of Abu Dhabi, also the president of the UAE) and Paris Saint-Germain (owned by Qatar Sports Investments since 2011) have reshaped the playing field and financial landscape and attracted criticism from fans and owners of other clubs. The Union of European Football Associations, the governing body of soccer in Europe, has investigated both Manchester City and Paris Saint-Germain for alleged breaches of financial fair play rules, suggesting that the clubs may have benefited from inflated sponsorship contracts with state-linked entities.[359] The trend of sovereign wealth investment looks set to grow in tandem with the globalization of sport and the rebalancing of the sporting landscape beyond the traditional powerhouses of Europe and North America, and with the levels of resources now put forward by the PIF. Further study of the engagement of sovereign wealth funds in global sport is therefore important to shed light on possible motivations or objectives that seem to align with profit maximization or national development and diversification.

CHAPTER 7

Sputnik V and the Russian Direct Investment Fund: Profiting From Coronavirus

Jodi Vittori

Coronavirus was running rampant through Ghana in early 2021. Exacerbating the crisis was a worldwide shortage of vaccines, especially for low-income countries. After India halted exports of the AstraZeneca coronavirus vaccine, no producer could promise deliveries before August 2021,[360] imperiling the Ghanaian president's goal of having every eligible citizen vaccinated by October of that year.[361] The only vaccine Ghana's minister of health, Kwaku Agyeman-Manu, found that could be delivered sooner was Russia's Sputnik V vaccine, leading him to sign dubious contracts for it at double the going price.

In front of a Ghanaian parliamentary commission, Agyeman-Manu testified that he tried to buy the vaccines directly from its producer, Russia's Gamaleya Research Institute of Epidemiology and Microbiology, at the factory price of $20 per two-dose regimen.[362] Unfortunately, he could not use this more direct and cheaper route because Russia's leading sovereign wealth fund, the Russian Direct Investment Fund (RDIF), had been tasked by Russian President Vladimir Putin with marketing the vaccine. The RDIF, in turn, had given the exclusive resale rights for exporting Sputnik V to a new company based in the United Arab Emirates (UAE), Aurugulf Health Investments.[363]

Aurugulf, in turn, used a colorful cast of intermediaries and agents, including a member of an Emirati royal family and a convicted Norwegian fraudster, to sell the vaccine to many developing countries at double the cost to produce it. Agyeman-Manu testified that, because of the critical need for the vaccine, he reluctantly signed contracts for $38 per two-shot regimen rather than the $20 factory price.[364] Fortunately, Ghana was able to get its money back after Aurugulf was unable to fulfill the contract, but it was hardly the only country to find itself paying well above market prices for this potentially life-saving vaccine.

This report highlights several means that elites exploit to abuse sovereign wealth funds for private gain. One might not expect such rent-seeking activity around the provision of vital vaccines during a global pandemic. Nonetheless, investigative journalism and government inquiries have both documented the RDIF's role in marketing Sputnik V at overinflated prices through a series of controversial intermediaries. There is no information about why some countries were charged more for the Sputnik V vaccine than others nor about how this additional money was distributed. Higher prices and the use of middlemen do not necessarily mean that corruption occurred. This case demonstrates, however, that contracts associated with emergency situations such as a pandemic that are further enmeshed in opaque sovereign wealth funds—especially a fund with a reputation as a "slush fund for President Vladimir Putin"[365]—can raise red flags for possible corrupt activity.

Sputnik V

Putin himself launched the Sputnik V vaccine with great fanfare via a videoconference in August 2020, describing it as effective and so safe that one of his own daughters had been vaccinated.[366] (Putin himself would not be vaccinated with Sputnik V until March 2021, and this was not disclosed until June 2021. The vaccination occurred privately and without a photo op.)[367] The vaccine was advertised as having an efficacy of over 90 percent and a price half that of similarly effective vaccines. Russia also emphasized that it would be easier to transport and store since it would not require cold storage like mRNA vaccines, such as those produced by Pfizer or Moderna, making Sputnik V ideal for the developing world.[368]

Sputnik V was developed by the Gamaleya Research Institute of Epidemiology and Microbiology, a 140-year-old research center that had been involved in vaccinations for everything from inoculating Soviet citizens against smallpox to, more recently, producing experimental vaccines for Ebola and Middle East Respiratory Syndrome.[369] But despite Putin's assertions about the safety of Sputnik V, at the time, scientists had not published data from the vaccine's Phase I and II trials and had not even started Phase III trials.[370]

It was nonetheless marketed extensively internationally, with Russian officials claiming that it had been approved in seventy countries by September 2021.[371] An early peer-reviewed report in the respected medical journal *The Lancet* stated that the vaccine was 91.6 percent effective and deemed it safe, boosting its appeal.[372] Russian state networks RT and Sputnik News provided expansive coverage of the vaccine receiving positive receptions in countries like Argentina, Brazil, India, the Philippines, Thailand, and Venezuela.[373] Russia's exports were prioritized over domestic distribution—with millions of doses pledged to countries such as Hungary and Serbia—even while there were still substantial shortages within Russia.[374]

Despite the rhetoric of Russian vaccine diplomacy, the vaccine was provided almost solely on a commercial basis and without Russia providing doses through COVAX, the global initiative to distribute vaccines to low-income countries.[375] At $20 for the two-dose vaccine, it cost much more than AstraZeneca at $3 per dose, Pfizer at $6.75, or Johnson & Johnson's single-dose vaccine at $10.[376] Moreover, production capacity never came close to living up to the hype. For instance, a January 2021 story on Russian television claimed that hundreds of thousands of doses were being delivered daily across Russia; in reality, the numbers were only a few thousand per week.[377] Moscow also developed an information campaign, touting Sputnik V while attacking Western vaccines' safety, side effects, and approval procedures.[378] Any criticism of the vaccine was dismissed by Russia as Russophobic attacks.[379]

The Russian Direct Investment Fund

Putin assigned the RDIF the task of funding and marketing Sputnik V. The RDIF was established in 2011 by order of the former Russian president Dmitry Medvedev and also Putin, who was then serving as prime minister. It is an unusual form of sovereign wealth fund: rather than investing the proceeds from domestic oil or other natural resources outside of Russia to help diversify the economy, the RDIF focuses on establishing joint ventures with foreign firms and funds for investments within Russia. The Russian state matches other investors' funds.[380] The $40 billion fund has facilitated over 100 deals, with only about 10 percent of the investment money coming from Russia.[381]

Since its inception, the fund had been closely linked with the elite financiers. Inaugural investors included Blackstone Group's Stephen Schwarzman, TPG Capital's David Bonderman, and Apollo Global Management's Leon Black, among others. (These three withdrew their names from a published list of advisers after Russia's 2014 invasion of Ukraine.)[382] At that time, the RDIF was part of Vnesheconombank (VEB), a Russian development fund linked to Russia's security services that was partially sanctioned by the United States in 2015.[383] The RDIF separated from VEB in 2016 and was not resanctioned until the February 2022 Russian invasion of Ukraine.[384]

Other investors filled in, however, and have remained with the RDIF even as sanctions have increased. In 2015, Saudi Arabia's Public Investment Fund committed $10 billion to the RDIF and the China Investment Corporation (a Chinese sovereign wealth fund) invested another $10 billion two years later.[385] Since 2013, the United Arab Emirates' Mubadala fund has also been a prominent investor.[386] As Matthew Murray, an adviser on ethics for the RDIF in its early days, noted, "[The RDIF] started making alliances with China and other countries that were not going to hold them to basic corporate governance, business ethics and anti-corruption standards."[387]

Kirill Dmitriev, the RDIF's director, came up with the name Sputnik V (the V stands for vaccine), likening the vaccine's discovery to the Soviet Union's launch of the world's first artificial satellite.[388] Dmitriev has been one of the key public backers of the vaccine in the media.[389] He has long ties with the United States: he studied at Stanford University and Harvard Business School and has worked for Goldman Sachs and McKinsey & Co.[390]

Dmitriev is married to Natalia Popova, the deputy director of a scientific institute called Innopraktika, which is part of a $1.5 billion project to build a technology hub at Moscow State University.[391] Innopraktika is run by Putin's younger daughter Katerina Tikhonova, who studied at university with Popova. It is their relationship that was presumably Dmitriev's entrée into Putin's inner circle. Some have even floated Dmitriev's name as a future deputy prime minister and a potential successor to Putin.[392] Thus, "this combination of official and unofficial duties makes Dmitriev a crucial figure in the Sputnik V story, acting at the intersection of the public and nonpublic interests of the Putin regime."[393]

The Sputnik V Supply Chain

One would expect that Russia's Ministry of Foreign Affairs or perhaps its Ministry of Health would lead vaccine diplomacy. Instead, the supply chain for countries to purchase Sputnik V ran through the RDIF and a company called Human Vaccine that the fund had established to handle Sputnik V marketing.[394] Some countries, such as European Union members Hungary and Slovakia, were able to make direct deals with Human Vaccine to buy Sputnik V doses for $20 for the two-dose regimen.[395] Other countries, however, such as Ghana, Guyana, Lebanon, and Pakistan, had to go through another step in the supply chain because Human Vaccine had appointed Dubai-based Aurugulf as the "exclusive seller and distributor of Human Vaccine's Sputnik V" for several countries in Africa and Asia.[396]

Aurugulf was registered in October 2020, just two months after Sputnik V was authorized in Russia.[397] Rather than allowing government-to-government sales of the vaccine, Russian authorities told developing country governments—including Ghana's—that they must use Aurugulf as a middleman in the transactions when those countries tried to deal directly with Russia. Russian officials were in some cases not even aware of this vaccine distribution agreement. A Russian diplomat in Kenya, for instance, stated that the Russian Embassy there was not involved in vaccine distribution at all.[398]

Aurugulf's company "agent" assigned to "develop, distribute and market" Sputnik V is a relatively minor member of the royal family of Dubai, His Highness Sheikh Ahmed Dalmook al-Maktoum.[399] Per reporting by the *Moscow Times*, al-Maktoum received explicit approval from Moscow to sell Sputnik V in the developing world.[400] Invoices for the vaccine sent to Pakistan and published by the *Moscow Times* were on the letterhead of his private office, leaving little doubt of his personal involvement.[401] Payments for the vaccines Ghana bought (worth $64.6 million) were to go to al-Maktoum's private office,[402] and the deal with Ghana for the 3.4 million doses at $38 per two-shot regime would have netted Aurugulf $30 million.[403] Per the company's website, Sputnik V appears to be its only product.

According to corporate registry documents seen by the *Moscow Times*, a conglomerate called Royal Group is one of the two entities that control Aurugulf.[404] Royal Group is run by the UAE's national security adviser (and brother of the UAE president) Sheikh Tahnoon bin Zayed al-Nahyan.[405]

Another company that is part of Royal Group and linked to Aurugulf is Chimera Investment.[406] It was involved in deals with private sector providers in Lebanon and Pakistan.[407] Founded in 2017, Chimera Investment is an Abu Dhabi–based venture capital firm.[408] As recently as October 2021, Mubadala was a major investor in Chimera's main investment fund.[409] (See Chapter 11 for more information on Mubadala.)

In addition to al-Maktoum's investments with the RDIF, Mubadala has had a co-investment program with the RDIF since 2013, whereby each contributed $1 billion to pursue investments in Russia.[410] As of January 2022, Mubadala, the RDIF, and Sberinvest (a venture capital arm of Russia's largest bank, Sberbank) had jointly invested $190 million in commercial data center operator IXcellerate, located in Moscow.[411] In March 2022, Mubadala's chief executive officer, Khaldoon Khalifa al-Mubarak, announced that the fund was pausing its investments in Russia because of Russia's invasion of Ukraine. At the time, Mubadala claimed it had invested about $3 billion in fifty companies via the RDIF, but that its investment was down to less than 1 percent of its $243 billion portfolio.[412]

In at least one case, Mubadala's investments seemed to run in parallel with those of al-Maktoum's vaccine business activities. In October 2021, the president of Guyana, Irfaan Ali, visited an Emirati vaccine storage facility in Abu Dhabi with the chief executive officer of Abu Dhabi Ports, Mohamed Juma al-Shamisi, to discuss the possibility of creating a new logistics hub for the UAE in Guyana. Al-Maktoum was also in attendance. The day prior, the Guyanese minister of finance had attended a meeting in the Emirate of Dubai with a delegation from Mubadala regarding possible future investments in the country.[413] Guyana, too, had purchased Sputnik V vaccines from Aurugulf in March 2021, also at double the factory price per dose.[414]

One of the few explanations given for the steep markup in some Sputnik V vaccine prices was transportation. The vaccine was being transshipped through the UAE rather than directly from Russia, per Sputnik V shipping documents. Nonetheless, the *Moscow Times* cites transportation costs as being about $0.10 per dose, so this should not have added substantially to the cost of the vaccination series.[415] As a report by the Institute of Modern Russia points out, "Given the fact that the key person behind the Sputnik V market drive is a member of Putin's inner circle, the lucrative market opportunities also suggest that Putin or his associates stand to gain personally from this effort."[416]

Sputnik V's Anomalous Intermediaries

While the trade network for many countries such as Hungary was straightforward—countries purchased the vaccine directly from Human Vaccine LLC—other countries, like Ghana, were forced to use a complex network in which many of the intermediaries had unique business backgrounds.

The head of the company designated as the intermediary for many of the purchases, Aurugulf Health Investment's Sheikh Ahmed Dalmook al-Maktoum, had no medical or pharmaceutical background. Al-Maktoum is second cousin to the ruler of Dubai, Sheikh Mohammed bin Rashid al-Maktoum, who is also the vice president, prime minister, and minister of defense of the UAE.[417] Sheikh Ahmed Dalmook al-Maktoum is also the chairman of the board of the Dubai-based Africa and Middle East Resources Investment (Ameri) Group, whose website claims that it owns and operates electrical equipment around the world.[418] However, Ameri Group has had a controversial past, including in Ghana. In 2015, Norwegian investigative journalists documented that the group had signed a $510 million agreement with Ghana's minister of power for a BOOT (build, own, operate, and transfer) deal for ten gas turbines that would actually have been worth about $220 million if they had been bought directly from the producer, General Electric.[419] Per al-Maktoum's website, he signed a new agreement for "power projects" with Ghana's Ministry of Energy on January 2, 2019.

Another affiliate associated with Sputnik V is Norwegian Per Morten Hansen. A Norwegian newspaper has alleged that Hansen and al-Maktoum have been involved in pump-and-dump shares scams on the London Stock Exchange.[420] Over the years, Hansen has had several (some unsuccessful) careers in nightclub ownership, debt collection, noodles sales, diamond cultivation in Sierra Leone, cannabis oil production, and Bitcoin mining in Sweden.[421] He also has developed a lengthy rap sheet. In 1992, he was convicted by a Norwegian court of receiving the proceeds of a crime (including a stolen lithograph created by the famous painter Edvard Munch), and in 2003, he was sentenced to eighteen months in prison for fraud for not paying customs duties. In 2010, he assisted then seventeen-year-old Arkadiy Abramovich, the son of Russian oligarch Roman Abramovich, in his failed bid to buy the FC Copenhagen soccer team.[422] He was arrested again in November 2019 in Copenhagen for money laundering at the request of Norwegian authorities; in March 2023, he was convicted and sentenced to two years and five months, which Hansen's lawyer said he plans to appeal. In 2020, Norwegian authorities also seized two of his properties to settle a tax evasion.[423]

Another controversial person associated with al-Maktoum and Hansen is Umar Farooq Zahoor, the former chief executive of Ameri Group. He is a Pakistani national who grew up in Norway. In 2003, Zahoor was convicted of embezzlement in Norway. He has also been accused by the Oslo police of being a ringleader of the Nordea bank swindle, in which he and a partner allegedly emptied $10 million from the bank account of a rich widow.[424] Zahoor denies he is guilty, and the Emirates has refused to extradite him back to Norway.[425] He is also wanted by Swiss authorities for allegations that he was running a fake bank there. His business partner was sentenced to more than three years in prison, but Zahoor escaped to Pakistan and then Dubai before he could be arrested; the statute of limitations in the case has since expired.[426] Al-Maktoum's office frequently denies that Zahoor works for him, but newspaper reports mention him signing contracts and employees have previously confirmed to journalists that Zahoor is indeed an employee, though his current position with the company is unclear.[427] Zahoor accompanied al-Maktoum to Ghana in March 2021 to sign the contract for the Sputnik V vaccine.[428] Zahoor has repeatedly denied all allegations.[429]

Hansen denies any involvement in upselling the Sputnik V vaccine to Ghana without Ghanian parliamentary approval despite audio recordings obtained by the Norwegian newspaper *VG* of Hansen discussing his role in the sale.[430] Hansen also denied his relationship with al-Maktoum to another Norwegian newspaper, saying, "I have no relationship with Sheikh Ahmed Dalmook al-Maktoum other than that I have invested in parallel with the sheikh on a couple of occasions."[431] Zahoor claimed to the same newspaper that the details of the Ghanaian contracts could not be disclosed because of nondisclosure agreements and that he was not involved in the negotiations for the contract.[432] Al-Maktoum never responded to *VG*'s questions, but there is a letter purportedly signed by him as chairman of Ameri Group rebutting *VG's* allegations on the website opensourceinvestigations.com.[433]

Conclusion

Despite the lack of public comment from those involved in Sputnik V sales, there may be several reasons why the Russian government used such an indirect route for vaccine shipments, which were supposed to be a centerpiece of their vaccine diplomacy. The government may have wanted to limit liability or perhaps curry favor with the UAE, for instance.[434] But the choice of intermediaries and the upselling of the vaccine raises concerns. Ghana was hardly the only country to pay an exorbitant price for vaccines. The RDIF and its intermediaries have also upsold the vaccine to Guyana, Iraq, and Pakistan.[435] Like Ghana, Guyana was charged double the manufacturing price per Sputnik V dose by Ameri Group.[436] In Pakistan, a private company bought the vaccine for $45 per two-shot regimen and then sold it to patients for $78.[437] Kenya paid the same $19 per dose as Ghana and Guyana but then sold it to clinics for $42 per dose, with some patients then paying as much as $70 per dose. Kenyan authorities paused the vaccine's use due to health and safety concerns.[438]

The global market for coronavirus vaccines was estimated to be worth $75 billion in 2020 and $90 billion in 2021.[439] Russia was supposed to provide enough doses for 700 million people,[440] which at $20 per two-shot regimen would have been worth $14 billion. But even without the upselling concerns, delivery problems plagued Sputnik V exports, making the Russian vaccine more of an afterthought in the global market than a major player.[441] Guatemala ordered 8 million doses in April 2021 and put down an advance payment for half of them, but by July, it had only received 150,000 doses.[442] Iran contracted for 5 million doses as part of a "first phase" agreement in February 2021 but had only received 920,000 by July.[443] Bolivia contracted for 5.2 million doses in December 2020 but had only received 745,000 doses by the end of May 2021.[444] Mexico contracted for 24 million doses in January 2021 but received only 4.1 million by July. The list goes on.[445]

Ghana was fortunate that it received its money back from al-Maktoum after the country received only 20,000 of the 300,000 expected doses.[446] Despite Ghana's parliament finding that the health minister had breached the country's constitution by not receiving approval for the contract from the cabinet or the Public Procurement Authority, he did not lose his job and remained in his post until February 2024 despite calls for his resignation.[447] In the end, Ghanaians ended up having to wait for the AstraZeneca and Pfizer vaccine deliveries to resume in August 2021.[448]

Aurugulf was not the only intermediary for Sputnik V. *Forbes* has reported that the San Juan province of Argentina attempted to purchase the Sputnik V vaccine at double the standard price through a German intermediary called RuL AG and deposited 18 million euros ($21 million per the exchange rate in March 2021) in escrow to pay for the doses, but said the contract was breached after delays and incomplete documentation.[449] Like Sheikh Ahmed Dalmook, RuL AG specializes in the energy business rather than the medical sector. The company is run by Stephan Guth, who is also the director of the German lower-division soccer team FC Lokomotive Leipzig and sits on the board of a firm called PHC Torpedo Leipzig that promotes ice hockey in Leipzig.[450] Guth's various business enterprises have a limited presence online.[451]

Meanwhile, Sputnik V never received World Health Organization (WHO) approval, and countries like Brazil, Kenya, Namibia, and South Africa have discontinued its use over safety concerns.[452] In response to the Russian invasion of Ukraine, the U.S. Treasury Department and the European Union sanctioned the RDIF;[453] the U.S. Treasury labeled the RDIF "a symbol of Russian kleptocracy" and stated that it is widely considered a "slush fund for President Vladimir Putin."[454] In a statement on the official Sputnik V English-language website, the RDIF responded that it "was never involved in any political activities" and that the sanctions could deprive many in the world of access to Russian vaccines.[455] The statement also claims that the RDIF "always fully complies with laws of the countries where it conducts its investments" and that "defamatory and denigrating statements made by the Biden administration about RDIF have absolutely no basis and represent blatant violation of its [the fund's] rights."[456] In response to sanctions and the lack of WHO approval, the head of the Gamaleya Research Institute of Epidemiology and Microbiology, Alexander Gintsburg, argued that approval had deliberately not been granted to Sputnik V to prevent a large share of the world's vaccine market from shifting to the Russian Federation.

Fortunately, in early 2022, the medical journal *Lancet Regional Health—Americas* announced that other vaccines that use mRNA technology, such as the Moderna, Pfizer, and AstraZeneca vaccines, could be used as second doses for Sputnik V based on a study from Argentina.[457] Only about 2.5 percent of those vaccinated worldwide received the Sputnik V shot, and only about 300 million doses were sold.[458]

During a pandemic, the public might reasonably expect a country's government to allocate money to relevant health authorities to develop a vaccine and its foreign affairs ministry to be in charge of arranging deals with other countries, especially if those deals are part of much-touted vaccine diplomacy. In the case of Sputnik V, however, the development, marketing, and export of Sputnik V were assigned to the country's sovereign wealth fund. This decreased the potential transparency and accountability around vaccine-related expenditures, especially given the notorious links to corruption among associates of the RDIF. The cast of shadowy intermediaries involved with the Sputnik V export network only heightens concerns about rent-seeking and outright corruption. The coronavirus pandemic has revealed an urgent need to improve governance associated with public health—especially during emergency situations and when governance is outsourced to sovereign wealth funds.

CHAPTER 8

Sovereign Wealth Funds When There Is No Sovereign Wealth: The Case of Turkey

Aykan Erdemir

Sovereign wealth funds come in different shapes and sizes. While some act as savings and stabilization funds, others function as strategic investment funds that make equity investments or as national development banks that create loans. In contrast, Türkiye's sovereign wealth fund, Türkiye Wealth Fund (TWF), primarily falls into the category of a state-owned fund that holds shares in state-owned enterprises.

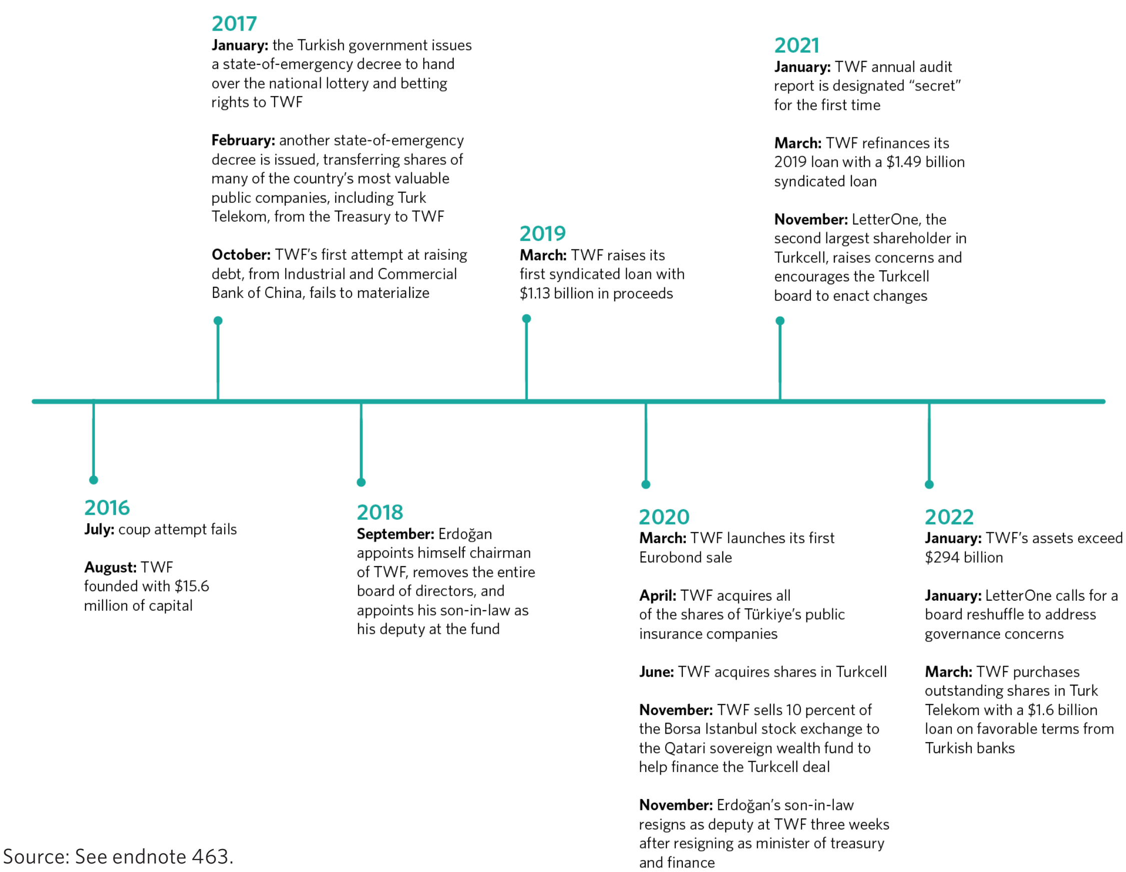
When TWF started its operations in 2016 with a founding capital of merely $15.6 million, critics claimed that the fund would function as a "parallel budget" that the Turkish government could exploit to carry out economic and financial transactions outside of parliamentary oversight and public audits.[459] Eight years on, TWF has become a telling case: Turkish President Recep Tayyip Erdoğan has used the fund to reward individual and institutional clients, settle political scores, consolidate economic and political power, and shield his economic and financial policies from parliamentary oversight and public audits. This misuse has further deepened the country's acute governance deficit and contributed to the economy's underperformance. And TWF has failed to demonstrate any value-added by transferring state shares of various enterprises from the Treasury to the sovereign wealth fund. On the contrary, TWF's takeover of these enterprises and assets has received repeated criticism for exacerbating Türkiye's transparency, accountability, and governance deficits.

The Motive: The Rush to Consolidate Political and Economic Power

The draft bill that fifteen lawmakers of Türkiye's ruling Justice and Development Party (AKP) submitted to the Turkish parliament in August 2016 to establish a sovereign wealth fund could not have come at a more awkward time.[460] Less than a month before, a rogue faction within the Turkish military failed to overthrow the government in a bloody coup attempt that left nearly 300 dead and thousands injured.[461] Thus, the Turkish government's rush to establish a sovereign wealth fund in the midst of a draconian state of emergency and without relevant stakeholder deliberations likely had more to do with Erdoğan's need to consolidate his political and economic power.[462] The envisioned TWF would bring state-owned enterprises and their assets more firmly under the presidential office's direct control.

As documented in the TWF timeline in figure 1,[463] on July 27, 2016—only twelve days after the failed coup attempt—Türkiye's Council of Ministers decided to prepare a government proposal to set up a sovereign wealth fund and submitted its draft to parliament five days later as part of a much larger omnibus bill.[464] After pushback by opposition lawmakers against using such an omnibus bill to establish a sovereign wealth fund, the government walked back and hastily made arrangements to resubmit the proposal as a draft bill.[465] A new, final bill was rushed through parliament and passed on August 19,[466] coming into effect on August 26.[467]

Figure 1. Timeline of the Türkiye Wealth Fund



Source: See endnote 463.

The Revenue Deficit: The Scramble for Resources

The key challenge TWF faced at the outset was finding the funds to manage. Although the founding capital of TWF was only $15.6 million, Türkiye's then finance minister Nihat Zeybekçi said in August 2016 that the Turkish government's target was to manage $200 billion "as soon as possible," although he did not specify from where such a sum would come.[468] (Türkiye, which imported 99 percent of its gas and 93 percent of its oil as of 2020, suffers from a chronic trade deficit.[469])

Furthermore, since the country had not had a budget surplus since 1970, there was neither commodity export revenue nor a budget surplus that the government could provide to TWF.[470] In the absence of any viable revenue stream, the Turkish government transferred state-owned enterprises and assets to TWF. In January 2017, the government issued a state-of-emergency decree to hand over the national lottery and betting rights to the fund.[471] The next month, the government used another state-of-emergency decree to transfer its holdings in the country's most valuable publicly owned companies to TWF.[472] This transfer included the Treasury's stakes in the country's two largest public lenders, Ziraat Bank and Halkbank; the state oil company Turkish Petroleum Corporation; the flagship carrier Turkish Airlines; and the former state telecommunications monopoly Turk Telekom.

The transfers moved many of Türkiye's most valuable assets more firmly under Erdoğan's direct control. As a result, TWF not only gives Erdoğan—who appointed himself the TWF chair in September 2018—greater control over the management, finances, and appointments at state-owned enterprises but also the ability to evade the oversight of Türkiye's parliament and the Court of Accounts.[473]

The transfers also drew criticism from experts. Refet Gürkaynak, one of Türkiye's leading economists, criticized the government's move by saying, "A wealth fund is established to utilize public resources that grow with budget surpluses. Ours is to squander public capital that has been accumulated in the past."[474] He added, "The establishment of a wealth fund for Turkey, which does not have a budget surplus, is like getting a lighthouse for landlocked Ankara."

In April 2020, TWF acquired all shares of Türkiye's public insurance and pension companies for $938 million.[475] As of October 2023 the fund stated on its website that its portfolio includes a range of domestic assets, including "30 companies, 2 [betting] licenses and real estates in 7 sectors," with 79 percent in financial services, 9 percent in transport and logistics, 7 percent in energy, and 4 percent in technology and telecom.[476] Through these acquisitions, TWF amassed $240 billion in assets, including $33 billion in equity, by the end of 2019.[477] According to the Sovereign Wealth Fund Institute, TWF's assets exceeded $279 billion as of 2023.[478]

Meanwhile, the Turkish government turned TWF into a collateral instrument to take out additional loans despite the country's already sizable debt burden of around $450 billion; there was a need to refinance $170 billion in mainly dollar-denominated loans in 2022 alone.[479] TWF's first attempt to borrow funds in October 2017—a ten-year loan of $5 billion from the Industrial and Commercial Bank of China—did not materialize.[480] But in March 2019, the fund received its first syndicated loan of 1 billion euros ($1.13 billion) for a two-year term via a consortium of ten banks.[481] The following year, TWF availed the services of four international lenders for its debut Eurobond sale.[482] In March 2021, the fund took advantage of the government's guarantee on 95 percent of the facility to refinance its 2019 loan with a 1.25 billion euro ($1.49 billion) syndicated loan, increasing the number of participants to fourteen banks from eleven countries.[483]

During the brief deliberations on TWF at the Turkish parliament in 2016, Türkiye's opposition politicians warned about the risks that would be posed by TWF emerging as an alternative institution for taking out sovereign debt—competing with the ability of not only the Treasury but also private corporations to access local and international capital markets.[484] In January 2021, the Turkish daily *Sözcü* reported, "The wealth fund turned into a debt fund."[485] One of the finance experts quoted in the piece warned that TWF, which would have already gone bankrupt if it were a private entity, had turned into a second Treasury, whose constant need for loans was unsustainable.

The use of TWF as part of a flurry of international borrowing has coincided with the downgrade of the country's sovereign debt. In September 2016, less than a month after TWF's establishment, credit ratings agency Moody's downgraded Türkiye's sovereign credit rating from investment grade Baa3 to noninvestment grade Ba1, citing concerns about the erosion of the rule of law following the country's abortive coup.[486] Two years later, Moody's cut the country's credit rating further, citing Ankara's increasing reliance on external capital flows and rising risk of government default.[487]

TWF's bond rating has also suffered. In December 2021, the global rating agency Fitch revised its outlook on TWF from stable to negative, rating it BB-, which implies "an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time."[488] The continued decline in TWF's credit ratings, alongside Türkiye's sovereign credit rating, will make it more challenging and costly for TWF to find the additional loans required to roll over its debt and keep the fund afloat.

Such financial headwinds were one of the reasons behind what Bloomberg reported as TWF's reluctance to "rely on the bond market or use its own cash" to finance its controversial January 2022 attempt to buy a majority stake at Turk Telekom, the country's second-largest telecom company.[489] TWF's interest in Turk Telekom first became public in September 2021, which Bloomberg analysts presented as the latest episode of the "creeping re-nationalization of Turkey's telecommunications industry."[490] Fifty-five percent of Turk Telekom's shares were under the control of a consortium of Türkiye's leading banks, who had taken over the company in December 2018 following a massive default.[491]

The Turkish government owned only a minority share, but it exerted outsized control over Turk Telekom through its ownership of what investors call a "golden share," which allowed the government to veto any change in Turk Telekom's management or sale.[492] Hence, when TWF approached private lenders (who together held 55 percent of the company's shares) with a request for loans for TWF's planned buyout of those very same banks' shares, TWF was making demands from a position of immense political and economic power. The banks have a strong interest in resolving what Bloomberg calls "the years-long saga surrounding the ownership structure" at Turk Telekom and closing the chapter on the biggest nonperforming loan in Turkish history, which poses significant financial risks to the banks' profitability.[493]

The power Erdoğan and TWF had to hurt these banks financially (through the government's golden share at Turk Telekom) provided TWF with significant leverage to persuade the banks to provide a $1.6 billion loan on favorable terms to TWF.[494] The fund then purchased the banks' shares in Turk Telekom in March 2022. This move set a controversial precedent for financing the TWF through not only syndicated loans from international financial institutions but also loans from local banks. These banks had to offer favorable terms on loans and sales, including "a two-year payment-free grace period with repayment over the following four years."[495]

The Governance Deficit: A Family Enterprise

When TWF was accepted as a member of the International Forum of Sovereign Wealth Funds (IFSWF) less than nine months after its establishment, TWF's then chairman Mehmet Bostan claimed that "admission to a prestigious international community such as IFSWF is an indication that [the fund's] management structure and transparency has been designed using the world's best governance principles."[496] TWF's membership in the IFSWF, however, was merely a fig leaf that failed to hide the governance and transparency deficit marring the fund since its launch. The Linaburg-Maduell Transparency Index developed at the Sovereign Wealth Fund Institute in 2008 recommends a minimum rating of 8 out 10 for a sovereign wealth fund to claim "adequate transparency,"[497] and TWF is rated a 6 out of 10. Although this rating places TWF above nineteen other sovereign wealth funds in an index of fifty-two funds worldwide, the fund has long been marred by inadequate transparency, arbitrary rule, and a severe lack of accountability.

The composition of TWF's board highlights the potential conflicts of interest and close links with the Erdoğan regime. Though the Turkish government reportedly worked with international executive search firms to recruit senior bankers for senior TWF board positions,[498] its initial board appointed in 2017 nonetheless demonstrated a meritocracy deficit. One of the five board members was Erdoğan's senior adviser Yiğit Bulut, a controversial figure who alleged at the height of the 2013 Gezi Park protests—countrywide protests that shook the Erdoğan regime—that foreign powers tried to kill the Turkish leader by telekinesis.[499] He also claimed that Germany's flag carrier Lufthansa was behind a conspiracy to provoke mass protests in Türkiye to eliminate competition from Turkish Airlines.[500] Although the other four board members were two finance professionals and two academics known for their loyalty to the government, Erdoğan's desire for more direct control led to a complete reshuffle in less than two years.

In September 2018, three months after becoming executive president under Türkiye's newly launched presidential system, Erdoğan removed the entire TWF board from office and appointed himself as chairman of TWF.[501] He also designated his son-in-law Berat Albayrak—whom he had appointed as minister of treasury and finance two months earlier—as his deputy at the fund.[502] Another board member appointed by Erdoğan was Erişah Arıcan, who was Albayrak's PhD thesis adviser and—according to Albrayrak's leaked emails—drafted his doctoral thesis on his behalf.[503] As opposition presidential contender Muharrem İnce remarked, "The man who has captured the state . . . has now taken public companies prisoners."[504] As another opposition politician, Selin Sayek-Böke, has noted, TWF is "essentially a family company" through which the Turkish "people's property, the nation's income is taken out of the budget and transferred to the (presidential) palace's company."[505]

In November 2020, Albayrak left his position in TWF—three weeks after his resignation as minister of treasury and finance amid rumors of a rift with his father-in-law Erdoğan.[506] The nepotism and political favoritism demonstrated in TWF's board appointments, and the possible conflicts of interests involved, not only represent an abuse of public position for private gain but also hurt the public since these individuals are not able to fully perform their fiduciary duties in the best interest of the Turkish taxpayers.

The Accountability Deficit: Top-Secret Public Finances

In addition to potential conflicts of interest in its leadership, newly established secrecy rules regarding TWF hamper public transparency and accountability. The Turkish parliament has the constitutional right to oversee all enterprises where the state directly or indirectly controls at least half the shares. Nonetheless, in January 2021, when the Turkish parliament's Plan and Budget Committee convened to deliberate on TWF's annual audit report prepared by the State Supervisory Council, the report included a "secret" designation, in contrast to the report's earlier public iterations.[507] This meant that if parliamentarians were to make any statements about the report in a public committee hearing, they could potentially land in court for breaching official secrets. Consequently, several opposition members of the committee left the January meeting, protesting that proper parliamentary oversight of TWF under these conditions was not possible.[508]

TWF is also exempt from oversight by Türkiye's Court of Accounts, which issues public audit reports. Instead, independent audits are conducted by a company of TWF's choice. Meanwhile, Türkiye's government officials, as reported by Bloomberg, have been trumpeting "the formation of such a large pool of capital outside the budget as a kind of cure-all, piquing investor interest with pledges to use it for everything from defending the lira and buoying the stock market to recapitalizing banks and cutting borrowing costs."[509] Experts therefore continue to warn about the potential risks of such opaque and unaccountable interventions in Türkiye's financial markets. They cite the ways in which TWF hurts the country's private sector, including by undermining competition through the provision of unfair advantages to companies under its control and by raising borrowing costs for others, thus exacerbating financial volatility rather than curbing it.[510]

Conflicts of Interest: Settling Political Scores

Türkiye's largest mobile phone company Turkcell is one case that best illustrates the conflicts of interest and how the Erdoğan government has used TWF to settle political scores and consolidate power.[511] On June 28, 2020, TWF disclosed its intent to acquire 26.2 percent of Turkcell's shares by entering agreements with four firms: Sweden's multinational telecommunications firm, Telia Company; Russian billionaire Mikhail Fridman's LetterOne;[512] then Turkish billionaire Mehmet Emin Karamehmet's Çukurova Holding;[513] and Türkiye's largest public lender, Ziraat Bank.[514]

Exhausted by what Bloomberg called a "15-year-old feud for control" over Turkcell that resulted in "spats over board representation, dividends, and other issues," Telia Company sold its 24 percent indirect share in Turkcell for $530 million.[515] This dollar figure represented a 54 percent discount compared to Turkcell's market value and amounted to a $322 million loss for Telia.[516]

What prompted the Swedish company to exit Turkcell at a loss was a bitter campaign Erdoğan had been waging against Türkiye's secular business elites since his Islamist-rooted party, the AKP, came to power in 2002, long before the establishment of TWF.

Çukurova Holding is a Turkish conglomerate with subsidiaries in industrial, construction, information, and communication technologies as well as media, transportation, trade, energy, and financial services.[517] In 2011, *Forbes Turkey* listed Çukurova Holding's chairman, Mehmet Emin Karamehmet—a pro-secular and liberal figure—as Türkiye's richest man, with a net worth of $4 billion.[518] That year, however, the *Wall Street Journal* reported that Karamehmet was "fighting to survive" as he struggled with the financial and legal fallout from Türkiye's 2001 banking crisis and the AKP's growing pressure on pro-secular media bosses.[519] Karamehmet was not only battling "Swedish and Russian shareholders to keep his stake in Turkcell" but also fighting "a nearly 12-year prison sentence for fraud" and the government's freezing of "$1 billion of [Çukurova Holding's] assets as collateral for allegedly unpaid taxes." In 2015, *Forbes* reported that his net worth had declined to $1.15 billion and dropped him from its billionaires list the following year.[520]

Erdoğan's efforts to solidify his control over the country's leading telecommunications company while also sidelining a secular businessperson culminated with TWF's acquisition of Turkcell shares in 2020. The resulting reshuffle allowed Erdoğan to appoint five out of Turkcell's nine board members.[521] This was made possible when Ziraat Bank, fully owned by TWF, received Karamehmet's shares in exchange for the $1.6 billion debt Karamehmet's companies owed to the public lender.[522]

As a result of Karamehmet's deal with Ziraat Bank, TWF needed to pay "$1.6 billion to Ziraat Bank and $530 million to Telia," a sum that would have forced the fund to issue debt securities, since that amount was not available in its coffers.[523] Five months later, TWF sold 10 percent of the Borsa Istanbul stock exchange to the Qatari sovereign wealth fund for $200 million in another opaque deal criticized by the Turkish opposition.[524] (Qatari Emir Sheikh Tamim bin Hamad Al Thani is one of Erdoğan's closest political allies.[525])

When TWF relieved Ziraat Bank of its nonperforming $1.6 billion loan to Karamehmet's companies, it also injected about $3 billion into Ziraat alongside two other Turkish public lenders.[526] Since TWF was cash-strapped, it turned to borrowing from these three public lenders to fund its cash injections into the very same banks, as disclosed by TWF's May 2020 plans to "issue debt securities" for state-owned banks to "purchase at market price."[527] It appears that Ziraat Bank's purchase of TWF's debt securities, which in turn funded a capital injection in Ziraat Bank, also helped TWF relieve Ziraat Bank of its $1.6 billion nonperforming loan to Turkcell. What made this government attempt to solidify control over Turkcell even more controversial was an apparent conflict of interest of one of the key decisionmakers in the process: Hüseyin Aydın, then chief executive officer of Ziraat Bank, who also sat on the boards of TWF and Turkcell; all three entities were involved in this troubling chain of financial transactions.

Meanwhile, Turkcell shares acquired from Telia and Karamehmet's Cukurova Finance were placed with a new subsidiary of TWF instead of with the sovereign wealth fund itself.[528] That subsidiary, TVF Bilgi Teknolojileri İletişim Hizmetleri Yatırım Sanayi ve Ticaret Anonim Şirketi (TVF BTIH), is an Istanbul-based joint stock company established on June 5, 2020, with a registered capital of only 5 million Turkish liras ($740,000). Thus, a company with less than $1 million of registered capital came to control Turkcell, which had a market capitalization of $4.2 billion as of August 2023.[529]

As part of this new structure, a new class of privileged shares was created, comprising 15 percent of Turkcell's total shares. These are owned entirely by TWF through TVF BTIH and grant TWF the power to elect five out of nine members of Turkcell's board. TWF claims this will improve governance and protect minority shareholders.[530] This assertion is highly questionable. The Turkish government's majority control of the board does not reassure minority shareholders, whose concerns about corporate governance deficits were exacerbated by the irregularities and conflicts of interest resulting from the various dealings among TWF, Ziraat Bank, and Turkcell.

The governance deficit at TWF-controlled Turkcell again made headlines in January 2022, when Fridman's LetterOne, the second-largest shareholder at Turkcell after TWF with 19.8 percent of the shares, called for a board reshuffle.[531] LetterOne's push for a governance overhaul included a proposal to appoint four unaffiliated board members to replace Erdoğan's political appointees, three of whom lacked competences in the telecommunications field; this was a move aimed at attracting international investors. LetterOne's latest call followed earlier attempts in November 2021 to encourage the board to enact changes, including "setting up a new board committee to review costs, asset monetization, and capital allocation."[532] LetterOne Managing Director Ben Babcock expressed his frustration by stating, "We sought to engage constructively with the Turkcell board to address our legitimate concerns but the board has chosen not to engage with us."[533] This provides further evidence of the governance problems haunting TWF-controlled Turkcell.

Conclusion: TWF, A Showcase of Worst Practices

The transfer of state shares from the Turkish Treasury to TWF has exacerbated Türkiye's transparency, accountability, and governance deficits. TWF's financial transactions and corporate manipulation have caused far-reaching economic problems and raised concerns over possible mismanagement and corruption.

Furthermore, the Turkish president's use of TWF for political gain—rewarding clients, manipulating transactions, assigning board members, and shielding policies from parliamentary oversight and audit—highlights the potential for a sovereign wealth fund to be manipulated and stresses the need for greater transparency and oversight.

None of these developments should come as a surprise. Shortly after the establishment of TWF, a Turkish journalist warned that the fund could end up being a "poverty fund," triggering an economic crisis rather than preventing one.[534] Since 2018, the Turkish lira has lost three-quarters of its value against the U.S. dollar, and inflation has reached 80 percent as of August 2022.[535] As prices skyrocketed, the *New York Times* reported that scores of Turkish citizens were lining up in long queues to buy government-subsidized bread, as people's "salaries and pensions no longer cover even the staples of life."[536]

The problematic role TWF plays in the Turkish economy goes hand in hand with Erdoğan's unorthodox economic experiment that tries to lower inflation by lowering interest rates.[537] And, meanwhile, corruption in the country is increasing, as evidenced by the country's dramatic decline in rank from 54 to 101 in the Corruption Perceptions Index of Transparency International within the last decade.[538] TWF is therefore emblematic of a larger malaise in Türkiye, as rising authoritarianism undermines democratic governance, transparency, accountability, free markets, and a rules-based economy.

Thus, during its first five years in action, TWF hurt the Turkish economy rather than attracting capital and boosting the country's development. As of 2020, the Erdoğan government's financial mismanagement had already prompted the most significant outflows from Türkiye's debt and equity markets in more than a decade and dried up foreign direct investment from Ankara's traditional economic partners in the West.[539] The London-based chief economist of a global investment bank stated in October 2021 that Türkiye had become "an irrelevance to global emerging market investors" since the country comprised only "0.2% of the Global Emerging Market MSCI equity index."[540] MSCI, the world's largest index provider, warned the previous year that it was considering ejecting Türkiye from its emerging market index and reclassifying the country as a "frontier" or "standalone" market.[541]

The case of TWF highlights how poor governance and transparency can exacerbate state capture and create further debt burdens that current and future citizens must bear. Ultimately, TWF, instead of pushing an emerging market economy closer to the level of a developed economy, has acted as the final nail in the coffin. Türkiye remains a struggling emerging market economy, with much less appeal to foreign investors. And it therefore greatly risks relegation, as its transparency, accountability, and governance deficits resemble those of a frontier market economy more and more with each passing day.

CHAPTER 9

Sovereign Wealth Funds and Infrastructure: China's Belt and Road Initiative

Nate Sibley

Infrastructure investment is expected to reach $79 trillion globally by 2040, but alongside extractive industries such as oil and gas, it is the economic sector that remains most strongly associated with corruption risks.[542] The significant funds involved in major projects may present a tempting target for corrupt officials and private sector fraudsters alike. Complicated and opaque contractual arrangements, a lack of transparency and accountability mechanisms for public funds, and the need to maintain political patronage networks can all contribute to creating the ideal conditions for bribery and embezzlement.

The consequences are especially serious for developing countries, most of which can ill afford the 20–30 percent of project value often estimated to be lost through corruption.[543] The International Monetary Fund's analysis suggests that low-income developing countries in particular lose, on average, 53 percent of project resources to inefficiencies, including corruption.[544]

These heightened corruption risks have been widely understood for decades. It is for this reason that major international lenders frequently attach conditions related to good governance when providing loans or grants for infrastructure projects. In fact, the importance of infrastructure development and the vast sums of money involved often provide external donors or investors with considerable influence over decisions made by recipient governments. This has led many to criticize international lenders for imposing measures that are too constrictive, impinging on recipient countries' sovereignty; some critics have gone as far as to level accusations of neocolonialism.[545]

In 2013, China's newly ascended President Xi Jinping announced a global infrastructure plan that promised to upend the entire sector. China's Belt and Road Initiative (BRI) has not only supercharged infrastructure investment worldwide but has brought these long-standing questions about corruption and political influence to the fore.

To bankroll the BRI's launch and expansion, Xi turned to the rising might of China's sovereign wealth funds (SWFs), policy banks, and other state-owned financial institutions. This chapter provides a brief overview of these entities' role in funding BRI projects worldwide and examines whether this behavior has exacerbated vulnerabilities to corruption and Chinese political pressure in recipient countries.

The Belt and Road Initiative

The BRI is China's flagship overseas infrastructure investment program and an amalgamation of the Silk Road Economic Belt scheme and the 21st Century Maritime Silk Road scheme. The BRI was known initially as One Belt One Road, but after a period of policy shuffling, it emerged in its current form in 2015.

The BRI is not an entirely new concept for China but rather a reorganization and expansion of existing initiatives that grew out of China's Going Out policy that had encouraged Chinese companies to invest overseas since 1999. Many existing overseas development projects were simply repackaged under the BRI umbrella.

China's Objectives

In 2013, Xi identified "five connectivities" that embodied his aspirations for what the BRI would become: "We hope to achieve policy, infrastructure, trade, financial, and people-to-people connectivity and thus build a new platform for international co-operation to create new drivers of shared development."[546] To date, however, the BRI's expansion has been spearheaded almost exclusively by infrastructure deals.

While Xi and senior Chinese Communist Party (CCP) leaders set the overall policy goals for the BRI, these were broadly framed from the outset and delegated to a wide range of state entities with very different, and sometimes conflicting or competing, priorities. But generally, the BRI aims to advance Chinese priorities regarding economic growth, national security, and global influence.[547]

There were compelling domestic reasons for embarking upon what was touted at the time as a Chinese Marshall Plan. The government policies that propelled China's extraordinary economic growth had also created severe overcapacity in some sectors. Access to new trade routes and export markets was sought to ease the pressure valve that constrained China's economy, alleviating the prospect of economic meltdown and political instability. Beijing also hoped that propelling the BRI overland through China into Central Asia would spark development in the country's poorer western regions, including the increasingly restive Xinjiang.[548]

Sustaining economic growth may have been China's primary impetus for launching the BRI, but political and security concerns also featured prominently in early policy planning. Beijing believed a major infrastructure investment program that could replicate China's own poverty alleviation efforts around the world—providing an alternative development model from the prevailing dependence on Western concessional lenders—would be a prestigious achievement befitting a rising power.

Chinese officials were also concerned with countering the United States' 2010 "pivot to Asia." Beijing sought to intensify periphery diplomacy to engage neighboring countries, as well as to create economic ties that would bring them politically closer to China and expand its regional hegemony.[549]

China's security considerations also included protecting and diversifying its critical supply routes. Developing the China-Pakistan economic corridor and opening Gwadar Port to Chinese shipping, for example, was meant to resolve the "Malacca Dilemma," whereby almost 80 percent of China's oil imports and 40 percent of its total trade in goods pass through a narrow shipping channel that is highly vulnerable to naval blockade.[550]

Given these political and security considerations—and China's aggressive push for global influence—many observers have questioned whether Beijing's underlying plan was to deliberately entrap recipient countries by entangling their leaders in corruption scandals and saddling them with unsustainable debt; this would render them vulnerable to Chinese political pressure or even force them to surrender strategically valuable land. The evidence for and against this idea of "debt-trap diplomacy" is considered in detail below.

Composition and Structure

Officially, the BRI consists of six overland economic corridors that cross through Central Asia and additional sea trade routes extending through the Indo-Pacific. Yet there is no formal national membership process or structure, with participation most often signified through non–legally binding memorandums of understanding (MOUs) or other less formal cooperation agreements between China and the recipient government. The number of BRI participants was just thirty-one in the period 2013–2016 but exploded to 120 in 2017–2019 and has grown again to 140 since 2019.[551] The BRI is also no longer geographically confined to its six stated economic corridors, with participants popping up in the Caribbean and Latin America.

Neither is there any official list of all BRI projects. There are no consistent standards, certification schemes, or even branding efforts that signify whether individual Chinese-backed overseas infrastructure projects are formally part of the BRI or not (unless they are explicitly mentioned in MOUs).

Unsurprisingly, efforts to understand what the BRI actually *is*, let alone to monitor its expansion and measure its impact, have often proven difficult for external observers. This includes estimates of how much China has actually spent, or committed to spending, on BRI projects worldwide. As of mid-2023, the American Enterprise Institute put total investment and construction costs at roughly $965 billion.[552] The Center for

Global Development, meanwhile, counted total announced investments at $8 trillion in 2018.[553] These are both sound attempts to measure unreliable information that resulted in staggeringly different figures.

The BRI is best understood as an organizing concept and guiding plan for China's overseas infrastructure investment. The absence of clear objectives and an institutional framework creates inherent risks regarding oversight and accountability. This applies particularly to how BRI expansion has been financed.

How the BRI Is Financed

China's rapid ascent to become the world's second-largest economy and leading trading partner had placed it in possession of some $1.5 trillion in foreign currency reserves in 2007, a figure unprecedented in global history but one that would continue surging to nearly $4 trillion in 2014.[554] Instead of continuing to pile these funds into the low-yielding, default investment instrument—U.S. Treasury bonds—Xi sought to put China's foreign exchange holdings to work in advancing his many domestic and overseas policy priorities. This included launching and expanding the BRI.

The institutional infrastructure around BRI lending is complex, fragmented, and not particularly transparent.[555] As noted in figure 1,[556] at the apex sits the State Council, which approves major decisions, with the Ministry of Finance and the recently created Chinese International Development Cooperation Agency also directly involved in oversight and approvals. The Ministries of Commerce and Foreign Affairs coordinate the overseas activities of Chinese companies working under the BRI.

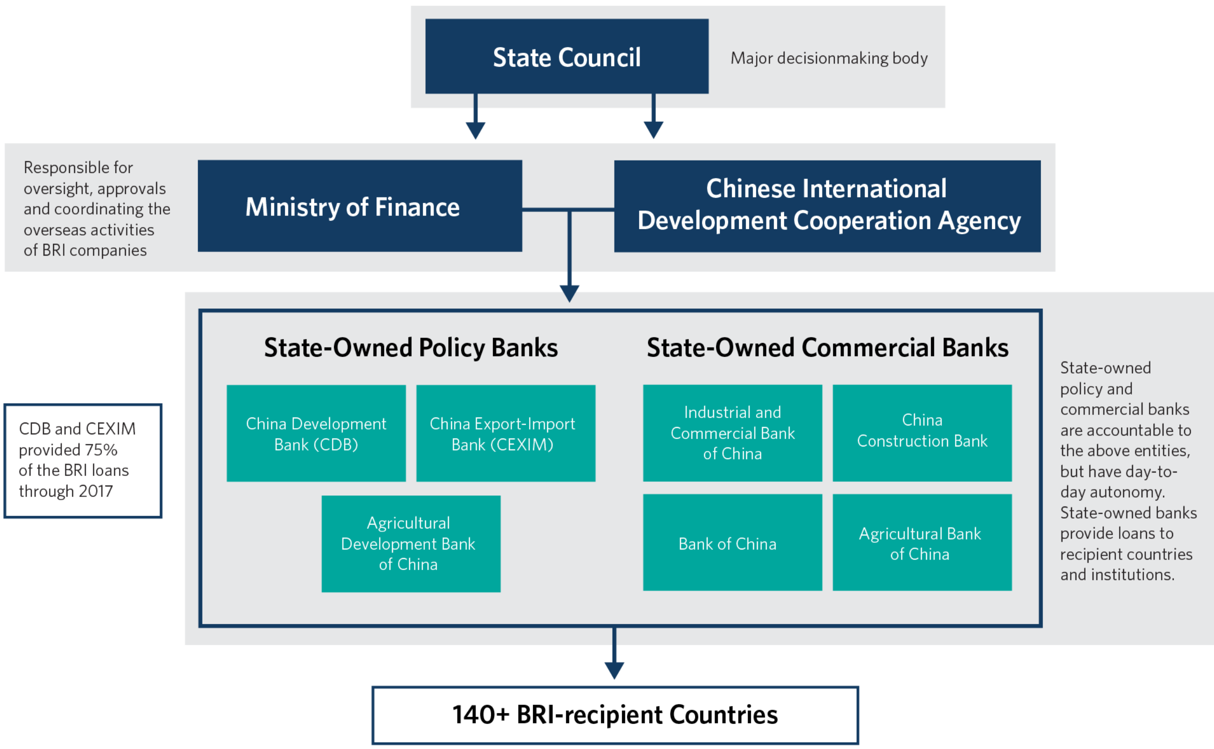
The vast majority of BRI loans are negotiated and provided by China's state-owned policy banks and, increasingly, its state-owned commercial banks. These institutions are accountable to the political bodies listed above, but they appear to have relative autonomy in the day-to-day business of BRI lending. Created to help drive China's economic liberalization reforms, Chinese policy and commercial banks have played a critical role in shaping the country's financial sector and emergence as a global economic power.

The People's Bank of China, China's central bank, dominated the country's financial sector until the 1990s, when what are now known as the "big five" state-owned banks were commercialized and began lending on a more competitive basis: the Industrial and Commercial Bank of China, China Construction Bank, Bank of China, Bank of Communications, and Agricultural Bank of China.

China's policy banks—the Agricultural Development Bank of China, China Development Bank (CDB), and the Export-Import Bank of China (Exim Bank)—were established in 1994 with a different mandate. The policy banks exist explicitly to implement the government's economic and financial agenda.

Of these institutions, by far the most important for BRI purposes are CDB and the Exim Bank. According to a recent report on BRI financing by AidData, these two policy banks provided around three-quarters of all BRI loans as of 2017.[557] However, the commercial banks have assumed an increasingly prominent role throughout the BRI's lifespan, with lending activities increasing fivefold during the BRI's first five years.[558]

Figure 1. Decisionmaking Authority Within the Belt and Road Initiative



Source: Author's illustration

Two trends are important to note. First, there has been a shift toward more commercially oriented lending during the BRI's lifespan, reflecting growing concerns in Beijing about rising debt levels and the long-term viability of the initiative.[559] Second, there has been a sharp decline in new BRI loans since 2017. Lending from CDB and the Exim Bank dropped from a peak of $75 billion in 2016 to just $4 billion in 2019.[560] This does not suggest that the BRI will end anytime soon, but rather that Beijing is rethinking its approach in light of various challenges discussed in the sections below. Gone is the era of easy money for ambitious infrastructure megaprojects; the BRI label is now increasingly being applied to less expensive initiatives in academia, green energy, telecommunications, and other sectors more aligned with the other four BRI "connectivities" originally outlined by Xi.[561]

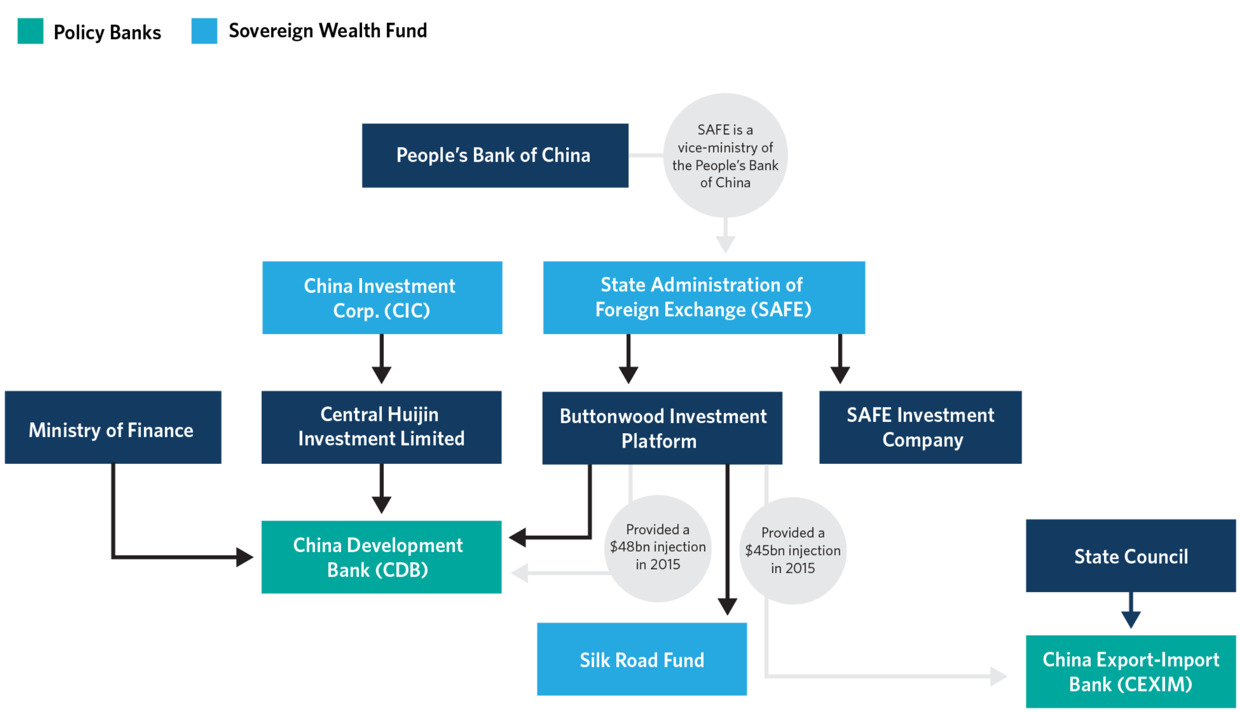
The Role of China's Sovereign Wealth Funds

As figure 2 demonstrates, China's policy banks and state-owned commercial banks are the front-end lenders in BRI financing. But it is the SWFs responsible for managing foreign exchange reserves that, through the state-owned banks, have ultimately provided much of the financing for the BRI.[562] The funds rarely appear by name in external studies of BRI project financing, however, because for the most part, they have not tended to make direct investments in BRI projects.

CDB's major shareholders are the Ministry of Finance, Central Huijin Investment, and Buttonwood Investment Holding. The Exim Bank is wholly owned by the Chinese government and subordinate to the State Council. Central Huijin and Buttonwood are companies that serve as investment vehicles for two Chinese SWFs: the China Investment Corporation (CIC) and the State Administration of Foreign Exchange (SAFE) respectively.

These are the means through which the policy banks are capitalized with foreign exchange reserves. Notably, Buttonwood was established by SAFE specifically to finance the creation of the Silk Road Fund, a Chinese SWF intended exclusively to support BRI expansion (though it currently accounts for just a fraction of total investments). But through Buttonwood, SAFE also provided CDB and the Exim Bank with major injections of $48 billion and $45 billion respectively in 2015.[563]

Figure 2. Control of China's Two Largest Policy Banks



Source: Author's illustration

State Administration of Foreign Exchange

SAFE is a vice-ministry that has also been a subsidiary department of the People's Bank of China since 1998. As the name suggests, its primary duty is managing and investing China's foreign exchange reserves.

Relatively little is known about SAFE's corporate governance beyond its basic organizational structure and senior personnel. Nor does it publicly disclose information about the nature of its investments. These are managed through corporate subsidiaries, including the SAFE Investment Company, based in Hong Kong (the existence of which SAFE did not admit until 2008), and more recently, the Buttonwood investment platform.[564] As the scholar William Norris suggests, "such a predilection for secrecy, a lack of public accountability, and an absence of transparency make SAFE well-suited to be used to pursue noncommercial activities."[565]

China Investment Corporation

CIC is China's only officially acknowledged SWF. It was launched in 2007 with $200 billion in initial funding and a mission to diversify China's foreign exchange holdings and seek maximum returns.[566] CIC is a company under Chinese law and operates in a more transparent manner than SAFE. It oversees both domestic investments and a vast overseas portfolio, with reported total assets of around $1.2 trillion as of the end of 2020.[567] It is the second-largest SWF globally after the Government Pension Fund of Norway, though it is fast closing on the latter for the top spot.

CIC was created by the Chinese government partly as a response to criticisms that SAFE had made imprudent overseas investments and was not an efficient guardian of China's foreign exchange holdings. CIC therefore competes with SAFE within the framework of China's financial bureaucracy, having assumed control of some of the latter's historical responsibilities.

CIC began operations just months before the onset of the 2007–2008 global financial crisis and initially sustained heavy losses from having taken major direct stakes in U.S. financial institutions such as Blackstone and Morgan Stanley.[568] These losses, and the criticism leveled at CIC by Chinese officials and the public, reportedly brought CIC under stricter control and prompted it to refocus on other sectors, including energy and natural resources.[569]

Whereas SAFE has always conducted itself in the manner of a policy bank, CIC is generally considered to have operated, initially at least, primarily in line with its commercial mission and largely in compliance with international standards pertaining to corporate governance.[570] In 2008, for example, CIC joined the International Forum of SWFs, and its officials were actively involved in drawing up the Santiago Principles.

After Xi's accession and the launch of the BRI, however, CIC's focus changed, adopting more of a policy orientation to support its expansion. The fund has invested directly, and through consortiums, in several major overseas deals in the infrastructure and real estate sectors, including under the BRI.[571] In 2015, for example, CIC acquired a controlling stake in the Kumport Terminal, Türkiye's third-largest container port.[572] Just one year later, it participated in a consortium to purchase a fifty-year lease on the Port of Melbourne, Australia's main cargo and container port.[573]

CIC's sudden interest in commercial assets that also possessed potential strategic value began to attract scrutiny from Western governments. As Zongyuan Zoe Liu has observed, this forced CIC to become "innovative in structuring deals in such a way as to pass scrutiny and receive approval that otherwise would be nearly impossible to obtain."[574]

In early 2023, for example, a new register of real estate ownership by foreign entities in the United Kingdom (which is not part of the BRI) revealed that CIC had used offshore shell companies to acquire more than 250 properties, including critical regional infrastructure and food supply chain facilities.[575]

In late 2019, CIC's executive vice president Zhao Haiying estimated total CIC investments in BRI countries to be worth approximately $28.1 billion.[576] However, the truth is that CIC's complicated investment structures make it impossible to understand the full nature and extent of its involvement.

What is clear, however, is that—as Stephen Thomas and Ji Chen conclude—SAFE and CIC "have provided much of the capital, as well as the financial intermediation tools and financial management to move funds from China's foreign exchange reserves to President Xi's BRI projects and to help oversee the use of the funds. These new roles . . . have required more of a policy orientation for China's SWFs . . . [as well as] significant changes in personnel, business practices, and investment goals."[577]

BRI Corruption Risks

Despite Beijing's lofty intentions for the BRI, it has been plagued from the outset by opaque deals and corruption scandals. This is partly because China's state-owned financial institutions have consistently engaged in lending practices that are indiscriminate, opaque, and unaccountable. Xi himself has acknowledged the scale of the problem, telling a 2019 summit of participant countries that "everything should be done in a transparent way and we should have zero tolerance for corruption."[578]

Before examining how China's state lenders may have influenced corruption and political risks associated with the BRI, it is helpful (and indeed, only fair) to look briefly at these issues within China itself. After all, China is a partner in every BRI deal.

Despite China's meteoric economic growth, corruption remains a serious and widespread problem. This apparent paradox arises because while many other developing countries have continued to struggle with petty and acquisitive forms of corruption, China has generally cracked down on these growth-inhibiting forms of graft.[579]

Instead, Chinese corruption is characterized by the prevalence of what the academic Yuen Yuen Ang calls "access money": bribes that enable entrepreneurs not only to secure a permit or other one-off bureaucratic favor but to also build relationships with influential officials capable of repeatedly creating new business opportunities (and who themselves are given strong incentives to foster economic growth by China's central government).

While uniquely capable of spurring short-term growth, particularly in investment-heavy sectors such as housing and infrastructure, "access money" is ultimately not beneficial because it creates perverse incentives and encourages risk-taking with consequences that quickly become apparent during periods of economic difficulty. Ang does not directly address the BRI, but it is helpful to bear these issues in mind when thinking about the development model China has sought to promote through it and how China's state-owned lenders and companies have conducted themselves during BRI projects.

Like other major Chinese financial institutions, the SWFs and the policy and commercial banks involved in BRI financing have found themselves in the crosshairs of Xi's sweeping anti-corruption campaign. Launched in 2013, the initiative aims to reduce corruption, strengthen party "discipline," and consolidate Xi's powerbase. It has reportedly investigated and punished more than 4 million cadres and nearly 500 senior officials to date.[580]

A 2016 probe by the CCP's powerful anti-graft body, the Central Commission for Discipline Inspection, reported of CIC that "there were wrongdoings in policymaking and severe problems in the tunnelling of interests" and that problems of discipline "occurred frequently."[581]

Both CIC and SAFE were reexamined by the commission in early 2022 as part of a broader crackdown on financial sector excess.[582] However, these pronouncements should be treated cautiously given the politicized nature of the anti-corruption campaign. It is entirely possible that those targeted were perceived to have demonstrated ideological disloyalty to Xi or the CCP, or had simply engaged in corporate expenditure or other conduct that was not illegal but deemed to be excessive by image-conscious party bosses.

Profligate Lending

China's policy banks are the vehicle through which Beijing has unleashed hundreds of billions of dollars into some of the most corrupt countries on Earth. Of course, many of these countries are also among the world's poorest and consequently have the greatest need for infrastructure investment on the scale promised by the BRI. In 2019, the World Bank estimated that trade in BRI corridor economies was 30 percent below potential and foreign direct investment was 70 percent below potential. BRI transport projects alone, if properly implemented, could help to lift 7.6 million people from extreme poverty and 32 million people from moderate poverty.[583]

But there are good reasons why many BRI countries are not attractive prospects for international donors and investors, especially in risk-prone sectors like infrastructure.

Brookings Institution research indicates that BRI participant countries are overwhelmingly "less democratic, politically stable, and economically developed" than nonparticipants.[584] AidData found that 69 percent of official lending by China between 2000 and 2017 went to countries whose credit ratings scored below the global median and that 90 percent of BRI-era official lending went to countries that scored beneath the median of the World Bank's Control of Corruption index.[585]

And this is problematic because, in an extension of China's stated policy of noninterference in other countries' internal affairs, the country generally provides BRI loans with few or no preconditions pertaining to transparency, rule of law, or other factors that shape the wider investment climate. By way of illustration, Xi outlined China's "five nos" in its policy toward Africa in a 2018 speech: "No interference in the way African countries pursue their development paths according to their national conditions; no interference in a country's internal affairs; no imposition of China's will on African countries; no attachment of political strings to assistance to Africa; and no seeking of selfish political gains in investment and financing cooperation."[586]

The promise of abundant easy money made the BRI an irresistible alternative to Western development financing for many governments, who had long bristled at what they saw as burdensome conditions that interfered with their sovereignty (or perhaps threatened their kleptocracy). In some cases, the prospect of BRI money provided a popularity boost to autocrats who otherwise struggled to maintain legitimacy.[587]

Beyond a general affinity for democracy and human rights, there is a practical reason Western concessional lenders routinely insist on governance preconditions: they make infrastructure projects less likely to fail. AidData found that 35 percent of BRI projects had run into major implementation problems of some kind, such as corruption scandals, labor violations, environmental hazards, or public protests.[588] Interestingly, China's non-BRI infrastructure project portfolio encountered far fewer such problems, suggesting that this propensity for trouble is baked into the BRI itself.

In the longer term, this kind of indiscriminate lending poses a problem for China as much as for recipient countries. Despite concerns about debt diplomacy, sovereign lending is a legally undeveloped area that lacks effective enforcement mechanisms. Beijing has taken on extraordinary levels of financial risk by exporting its state-led, debt-fueled development model to governments with track records of mismanagement and default and then relying on those governments to uphold implicit liability guarantees for private sector borrowers.

As noted above, recognition of these risks in Beijing is partly why BRI lending has slowed significantly in recent years. But the scale of debt associated with the BRI will continue to present significant risks for the global financial system and economy for the foreseeable future.

Opaque Negotiations

The corruption risks surrounding BRI projects have also been exacerbated by deliberate lack of transparency on the part of China's state-owned lenders. Typically, BRI financing is arranged through bilateral agreements between the Chinese state banks and recipient governments. A Peterson Institute study of 100 bilateral Chinese loans found that all loans since 2014 have included "unusual" and "far-reaching" confidentiality clauses that do not permit borrowers to disclose any of the contract terms or related information.[589]

The Maldives' Sinamalé Bridge and related BRI projects illustrate how secretive terms can catch initially supportive populations unawares. Upon meeting with the Chinese ambassador in 2018, incoming President Ibrahim Mohamed Solih discovered that his country's BRI debt was not $1.5 billion as he feared, but rather $3 billion—more than twice the government's annual revenue at the time.[590]

It is often unclear not only how much is being lent, but to whom. AidData director Brad Parks has observed that the BRI is actually "a story about the rise of hidden debt and the fall of sovereign debt."[591] AidData estimated that, as of 2021, BRI countries collectively owed some $385 billion to China that was not being reported to international financial institutions in the normal way, warping key statistics about the global financial system. This is because, while China's pre-BRI lending was mostly provided directly to governments, nearly 70 percent is now directed to state-owned companies and banks, special purpose investment vehicles, joint ventures, and private sector firms. These debts, though often substantial, do not appear on the public books—though government liability assurances mean that the public will still be on the hook should something go awry.

Lack of Accountability

Finally, the backing of China's state-owned banks means that corrupt local elites and Chinese companies engaged in BRI projects face little or no accountability for wrongdoing.

China introduced a foreign bribery law in 2011 but, despite the immense exposure of its companies overseas, has never initiated any enforcement proceedings.[592] Coupled with China's repressive media and civil society environment, this means that Chinese companies engaged in BRI projects are not subject to policing and public scrutiny in the same way that, for example, U.S. companies are supposed to be under the Foreign Corrupt Practices Act.

This in turn makes Chinese lenders and contractors more attractive partners for corrupt local elites—not only because they can freely distribute bribes, but also because there is less chance of being implicated in legal trouble later on.

This pattern has not gone unnoticed, and several major Chinese contractors involved in BRI projects have been debarred by the World Bank for alleged financial malpractice and "misconduct during the procurement process."[593] Such high-profile censure might prove reputationally and financially fatal for many Western competitors. But many Chinese firms can ignore such concerns because they are ultimately backed not by commercially minded investors but by China's state-owned banks.

Debt-Trap Diplomacy

China ostensibly maintains a policy of noninterference in other countries' internal affairs. But as the corruption scandals and debt levels piled up, many observers began to question whether China was using the BRI as a vehicle for "debt-trap diplomacy"—both in order to exert political pressure on recipient countries and to acquire land and other strategically valuable assets in cases of default.

There is evidence to support the debt-trap theory, but it derives from a small number of cases that are regularly cited as reflecting wider systemic issues.

Sri Lanka's Hambantota port in particular has become the poster child for BRI misadventures. According to a *New York Times* investigation, Sri Lankan officials claimed that their Chinese counterparts discussed the intelligence and strategic possibilities of the port's location throughout loan negotiations. When Sri Lanka sought to renegotiate the repayment timeline and obtain more financing, Chinese officials refused to ease the terms and insisted instead on the transfer of equity in the port, leading to its effective surrender in the form of a ninety-nine-year lease.[594] It is impossible to know how many BRI contracts include such terms because they are kept secret. To date, however, this kind of predatory enforcement by China has in fact occurred relatively rarely.

The preponderance of expert opinion has therefore shifted against the idea that the BRI's underlying grand strategy was always one of deliberate entrapment. Analysis by Chatham House—not only of the Sri Lanka case but of China's role in Malaysia's 1MDB scandal (see Chapter 3), where then Malaysian prime minister Najib Razak solicited help from Chinese BRI firms and officials to cover up the alleged theft of around $4.5 billion from the country's sovereign development fund—illustrates how it is often local elites that negotiate unfavorable terms and instigate corruption schemes in order to service their domestic agendas.[595] The authors also suggest that China's state-owned financial institutions are simply too fragmented, poorly coordinated, and prone to in-fighting to coherently advance China's geopolitical aims.

Informed opinion within BRI recipient countries also provides a more nuanced picture than prevailing Western representations of the BRI. A recent survey of policymakers, academics, and business and media leaders in BRI recipient countries found that 41.6 percent of respondents believed that the BRI represented a net benefit for their countries, with just 17.8 percent viewing it as a net cost. On whether they felt China had deliberately set out to entrap their leaders, about 30 percent felt so but about 42 percent did not.[596] Many blamed domestic factors, such as corruption and reckless borrowing habits, for rising debt levels rather than participation in the BRI.

Yet the fact remains that China retains tremendous potential leverage over many BRI countries. As economist Megan Greene points out, the BRI coincided with a relatively benign period of easy monetary policy and ample liquidity.[597] Amid growing unease within China over the state of the economy, and particularly financial institutions' role in fueling a real estate bubble, there is significant public sensitivity to debt-related issues and presumably little patience for China's foreign debtors.[598]

The feeling appears to be mutual in many BRI recipient countries. AidData notes that concerns over corruption and changing public sentiment toward China have led to more BRI projects being canceled.[599] The BRI also faces growing political opposition from China's major rivals. These include India, whose regional interests the BRI most directly threatens, and the G7, which has announced a rival Build Back Better World infrastructure plan to mobilize private sector investment.[600]

There are several reasons to be concerned that BRI debt could soon be enforced more ruthlessly or even activated as political leverage: Chinese domestic concerns, the potential end of China's political honeymoon with major BRI recipient countries, and the intensification of U.S.-China competition globally. As always with the BRI, questions about corruption and political interference do not lend themselves to a simple narrative. What is certain is that the state-owned banks' lending practices as described above—indiscriminate, opaque, and unaccountable—set the BRI up to become, as the scholar Jonathan Hillman has observed, "a global trail of trouble."[601]

Conclusion

Unlike some of the other SWFs examined in this report, China's SAFE and CIC were not created or captured by political elites for the purposes of illicit self-enrichment—nor are their personnel directly involved in the day-to-day graft that afflicts so many BRI projects. On the contrary, they are major players in the global financial system in their own right.

But beyond their commercial mission to profitably invest China's vast foreign exchange reserves, China's SWFs and other state-owned financial institutions are also instruments of the CCP and its bid for global influence. In that role, they have provided and directed massive surges of capital that have flowed through the policy banks into BRI projects worldwide. This financing was arranged, in the vast majority of cases, without serious regard for due diligence or commercial viability, using secret contracts that have concealed the scale and seriousness of recipient countries' potential liabilities.

China's profligate use of its vast sovereign wealth to advance economic and political objectives has raised corruption risks not in just one country but 140 countries. Though the notion of deliberate debt-trap diplomacy has been brought into question, there remains a real and growing risk that China will exploit its financial leverage over BRI partners—whether to claim what it is owed while its own economy falters or to seize strategic advantages in its global race for influence against the United States.

CHAPTER 10

Golden Passports and Visas: The Case of Malta's SWF

Lakshmi Kumar

Citizenship by Investment (CBI) programs, better known as "golden passport" schemes, are not new. They have long enabled the ultra-wealthy, including the very corrupt, to evade scrutiny for misdeeds, hide assets, and acquire international mobility. Cyprus, the United Kingdom, the United States, and much of the Caribbean have citizenship or residency programs through investments.[602] What sets the Maltese CBI program apart is that the revenues generated from passport sales have been used to fund its sovereign wealth fund (SWF).[603]

To fully understand why an SWF that is financed through the sale of passports is an especially high-risk investment vehicle for corruption, this chapter first examines the strength and transparency of the Maltese CBI program, as well as the reputation that similar programs in other countries have garnered. An SWF that runs a high risk of being funded using corrupt, laundered, or ill-gotten wealth strikes at the heart of what the SWF represents by creating a dependency on potential ill-gotten gains to fund domestic development. Furthermore, for the Maltese government, to use an SWF to invest such proceeds is to benefit from the misdeeds of the corrupt and the criminal. It also allows money that may be ill-gotten to move easily through the financial system under the protection that an SWF provides.

A "Corrupting Island in a Corrupting Sea"

Malta is a small island in the Mediterranean Sea, which, despite its EU member state status since 2004, has been referred to as a "corrupting island in a 'corrupting sea'" and has had a "disproportionate role as a hub for transnational illicit flows and criminal activities."[604] This is in part due to its low level of law enforcement resources and its location as a gateway between North Africa and Europe,[605] which have given it a long history as a smuggling "logistical hub"[606] and "smugglers' hideout."[607] But Malta's reputation also stems from its documented history of state capture by elites networked into long-standing organized crime and corruption networks.[608] Its Corruption Perceptions Index score (54 out of a possible 100) is far below the Western European average of 66.[609]

Malta's notoriety as a corrupt country with declining rule of law norms came into international prominence on October 16, 2017, when Maltese investigative journalist Daphne Caruana Galizia was assassinated by a hitman using a car bomb. Galizia's murder brought the extent and scope of corruption in Malta to the attention of a much wider public.[610] Starting in 2016, when she was able to access information from the law firm Mossack Fonseca as a part of the Panama Papers leak, Galizia had begun to map out corrupt networks that she and other investigative journalists alleged went all the way to the top of the Maltese elite—including Joseph Muscat, who was prime minister from 2013 to 2020.[611]

Among the various corruption and organized crime–related cases she was investigating at the time of her death was Malta's sale of so-called golden passports,[612] which Muscat had been actively promoting, especially at "citizenship seminars" in numerous locations, including Beirut and Dubai.[613]

Malta has had a variety of CBI programs; the 2014 iteration was called the Individual Investment Program (IIP). An individual could be eligible for Maltese citizenship and a passport if they invested 650,000 euros ($864,500) into Malta's SWF; purchased 150,000 euros ($199,500) of Maltese stocks or shares; bought a property worth at least €350,000 ($465,500); or paid at least €16,000 ($21,280) to rent one, in addition to maintaining resident status in Malta for at least twelve months (though they were not required to actually live in Malta during those twelve months). Citizenship for family members required further investments. From mid-2017 to mid-2018 alone, the scheme brought in €162 million ($186.3 million), which was about 1.38 percent of Malta's gross domestic product.[614]

After payments and investments totaling €1.15 million, one could become a full-fledged citizen of the European Union (EU) with a passport and all the accompanying citizenship and travel opportunities.[615] Applicants were supposed to be fully vetted for security risks. These due diligence checks were vitally important given that Malta is a member of both the EU and its Schengen Agreement. From 2014 to 2019, Malta granted citizenship to 833 investors and 2,109 family members.[616]

Citizenship by Investment Schemes and Residency by Investment Schemes

As this compilation has repeatedly noted, SWFs are normally used to take excess funds—usually from the sale of natural resources—and invest them outside of the country as a means to diversify the economy, create jobs and other opportunities for the country's citizens, and generate wealth for future generations. However, the cases of both Malta and Türkiye (see chapter 8) highlight the unique potential for funds established without sovereign wealth to be exploited. Türkiye has funded its SWF via the takeover of state-owned enterprises and debt, and Malta has funded its SWF in large part through its CBI scheme.

CBI schemes—as well as Residency by Investment (RBI), or "golden visa," schemes—aim to attract foreign investment from high-net-worth individuals in return for citizenship and residency rights, respectively.[617] The earliest adopters of these types of schemes were Tonga and the Caribbean nation of Saint Kitts and Nevis.[618] Today, many countries offer such programs, including Australia, the United Kingdom, and the United States.[619]

Although each country's schemes are unique in terms of participation requirements and the rights granted in exchange, they all share a common goal of boosting the domestic economy.[620] CBI and RBI programs became increasingly attractive to EU member states following the 2007–2008 global financial crisis as a seemingly easy way to support local economies.

For outsiders, EU citizenship affords visa-free travel to up to 182 countries.[621] It is these rights, in particular the freedom of movement of persons and capital, that are often advertised as the main attractive features of such schemes. The rationale, according to investment advisory firm Renascence Capital, is that "investment migration enables wealthy individuals to transcend the constraints imposed on them by their passport and country of origin, tapping into financial, career, and educational opportunities on a global scale."[622]

Supporters argue that there are legitimate reasons for golden passport schemes. While this may be true, paying just over €1 million for all the benefits that an EU passport entails can also be a very good deal for the criminal and corrupt. Individuals involved in organized crime and corruption who obtain an EU passport are then able to travel throughout the world. Their EU citizenship status may allow them to conduct banking and business under looser standards than would be required under their original passports. These individuals receive all of the rights to privacy and rule of law and protections against any expropriations that are accorded to EU citizens. The scheme also provides the potential for golden passport holders to do all of this under a new name, enabling them to bypass security checks or flags on their previous identities.

Because of the significant risks associated with CBI and RBI programs, SWFs capitalized through these structures can become conduits for bypassing standard transparency checks applied in normal financial transactions and banking relationships, thereby serving as a mechanism for tainted funds to enter the domestic and international financial systems.

Funds transferred from Malta, an EU country, to a third country such as the United Kingdom or United States may be deemed lower risk than they would be if the same transfer was made from the CBI holder's original country of nationality, which facilitates the laundering or transfer of illicitly obtained funds. In this way, the reputation of the individual may be rehabilitated and any risk based on their nationality may be concealed, allowing for the placement, layering, and integration of funds that would otherwise be unable to enter the EU's financial system.

Investment flows from CBI and RBI schemes can also hurt financial stability and raise the demand for and prices of real estate for locals.[623] In a 2018 report, the European Parliament stated that the social impacts from CBI programs could also make it more difficult for low-income sections of the population to access housing as property prices increase.[624]

The national security and money laundering risks are even greater. Current criminal background checks and other due diligence performed on the applicants for golden passports or visas and the sources of their funds have been "questionable" at best.[625] The European Parliament noted that "CBI/RBI schemes tend to be located in Member States that are particularly prone to risks related to financial secrecy, such as tax avoidance and money laundering, and corruption."[626]

Despite the four-tier due diligence process established to vet applicants, several high-profile Russian individuals with political ties to Russia obtained citizenship through Malta's IIP between 2016 and 2018.[627] For example, in 2016, Arkady Volozh, the founder and chief executive officer of Russia's top search engine, Yandex (known as the "Google of Russia"), purchased Maltese citizenship for himself and his family.[628] Also that year, Alexey Alexandrovich Marey, the former chief executive officer of now sanctioned Alfa-Bank Russia (the largest private bank in Russia), and his family became Maltese citizens.[629] Maxim Shubarev, chairman of Setl Group (one of Russia's largest financial and industrial associations), was also able to buy a Maltese passport in 2018.[630] Pavel Grachev, the chief executive officer of Polyus Gold (the largest producer of gold in Russia and one of the world's largest gold mining companies), purchased Maltese passports for himself and his family in 2017.[631] According to a news report, "almost half of his declared net worth of €42 million [$47.46 million] is derived from a single 'bonus payment' of €20 million [$22.6 million] paid to him by a BVI shell company, Ninelco Investments Ltd."[632] These names are just a few of the over 700 Russians that by 2018 were able to purchase Maltese citizenship.[633]

The EU has recognized the risks of CBI programs, as noted in its fifth anti–money laundering directive. The directive notes that CBI schemes demonstrate a potentially "higher risk" for money laundering.[634] And the European Parliament has specifically warned about the risks associated with Malta's IIP, including the likelihood of money laundering, the Maltese authorities' lack of appetite for taking action, and the program's inadequate due diligence process.

These concerns gained more visibility in 2022 following the Russian invasion of Ukraine, as the public has become more aware of the estimated 3 billion or more euros invested into Europe by Russian nationals using these schemes. These investments resulted in more than 4,000 Russian nationals receiving residency or citizenship in the EU.[635] Most EU member states, Malta included, ceased accepting applications for golden passports or visas from Russian nationals following the invasion.[636]

Malta's Citizenship by Investment Programs

Following scrutiny from the European Commission and domestic pressures linked to the murder of Galizia, Malta closed its IIP in 2020, stating it had reached its application cap.[637] However, in November 2020, Malta launched a new CBI program that offers citizenship through extraordinary service to Malta or through investments. In addition to a cap of 400 certificates of naturalization per annum and 1,500 in total, excluding dependents, the new program has slightly more robust residency requirements.[638]

Yet the closing of the IIP did not put an end to the scrutiny. In April 2021, a series of investigative journalism stories were published based on leaks from the citizenship advisory firm Henley & Partners, which has been intimately linked with Malta's CBI programs since the program's inception. These leaks revealed, for instance, that Saudi Prince Bandar Al Saud's name was never published in Malta's citizenship registry after he received citizenship in 2017.[639] Saudis cannot receive dual citizenship without Saudi government permission, which is rarely granted. As a result, this case has called the accuracy of Malta's public citizenship registry into question.[640]

The same leaks revealed that citizenship applicants tended to come from states with a higher risk of money laundering. A plurality of applicants came from Russia (37 percent), followed by China (12 percent) and Saudi Arabia (10 percent).[641] Some applicants already held second passports, including citizenship from Saint Kitts and Nevis.

The leaks also revealed that one of Henley & Partners' highest-profile clients was Low Taek Jho, better known as Jho Low, the mastermind behind the Malaysia 1MDB corruption scandal (see chapter 3). Henley & Partners denied that Low was their client; while he sought a Maltese passport through the firm, they stated that he was not eligible for their programs due to the reputational risk of having him as a client. Yet a subsidiary of the firm reportedly helped Low purchase real estate in Cyprus through a Cypriot CBI scheme, and in return, the subsidiary company received a €650,000 ($721,500) commission for the purchase plus at least €60,000 ($66,600) in other fees.[642]

Moreover, many applicants spent only a few days total in Malta or rented empty apartments. In one case, an individual from the United Arab Emirates was able to arrive in the morning, take his oath of allegiance as a new citizen, and leave the country again all within a mere nine hours.[643] Another citizenship applicant asked the law firm for the cheapest possible citizenship options that would meet the program's demands. A yacht could be rented in Malta to prove a residency link.[644] Henley & Partners has responded that it is not their responsibility to vet applicants—that is up to the receiving country.[645] Other news reports from 2018 and 2019 revealed that a "Russian who was allegedly at the center of a money laundering scheme" and an Egyptian "arrested in New York on alleged fraud charges"[646] were both given Maltese citizenship.[647] In 2018, the European Parliamentary Research Service calculated that from 2014 to 2016 "more than 38% of all naturalisations in Malta were obtained via their CBI scheme."[648]

In October 2020, the European Union sent Malta an official notice to end the scheme, citing the lack of genuine link requirements for applicants as a violation of EU law.[649] In April 2022, the EU threatened legal action because, unlike other countries with CBI programs, Malta had not ceased its program, though it had blocked Russians and Belarusians from applying.[650]

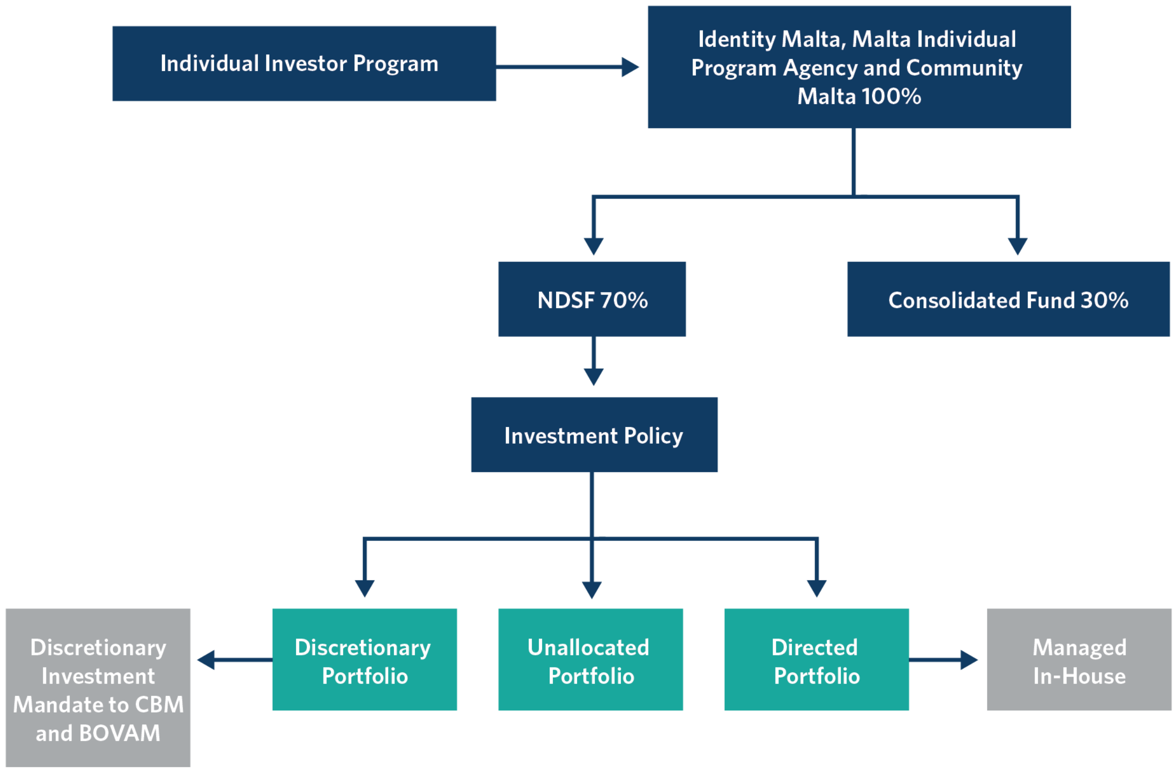
The Maltese National Development and Social Fund

It is against this backdrop that the money laundering and corruption risks associated with channeling money from the CBI program into Malta's SWF must be examined. Malta's SWF, the Maltese National Development and Social Fund (NDSF), was established in 2015 as part of the 2014 IIP program.[651]

The NDSF was created with broad national development and social goals. These include contributing to major projects of national importance; promoting and supporting the advancement of education, research, innovation, justice and the rule of law, employment, and public health; encouraging gender equality; preventing discrimination; and respecting human rights.[652]

Despite these laudable aims, what bears scrutiny is the source of money by which Malta's national development and social goals are funded. According to the NDSF's website, until April 2020, when the IIP program was wound down, 70 percent of all contributions received through passport sales were managed and administered by the NDSF (see figure 1).[653]

Figure 1. Individual Investor Program Funding of the NDSF



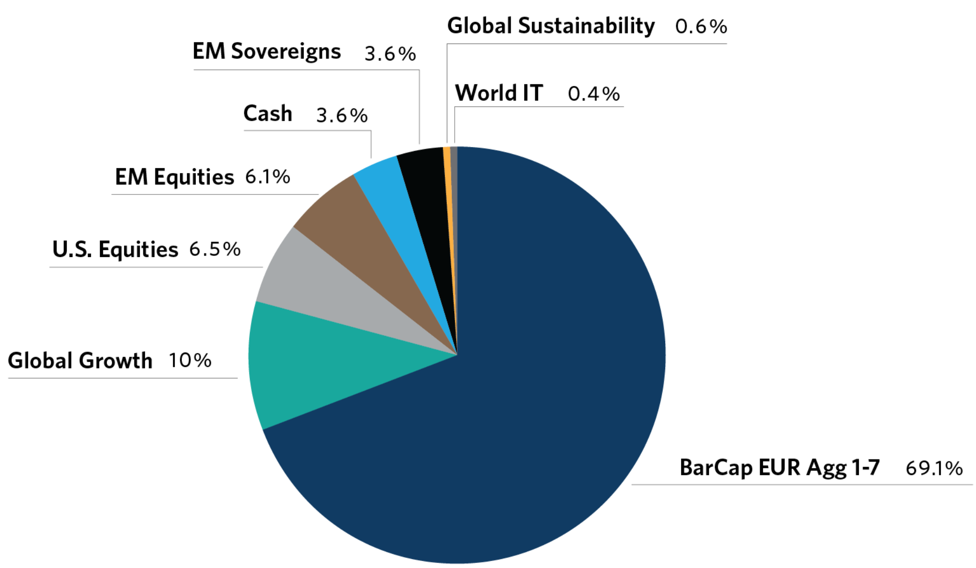
Note: Abbreviations are Central Bank of Malta (CBM) and BOV Asset Management (BOVAM).
Source: Adapted from "Annual Report 2020," National Development and Social Fund, 2021, 7, https://ndsf.com.mt/en/Documents/Annual-Reports/Annual-Report-2020.pdf.

The NDSF's most recent publicly available financial statements show net assets that total €598.1 million.[654] These proceeds are allocated across three portfolios: a directed portfolio (70 percent), a discretionary portfolio (30 percent), and an unallocated portfolio (cash balances).[655] Each portfolio has its own unique management structures.

The discretionary portfolio receives 30 percent of all funds from the CBI program. Management of the portfolio, according to the NDSF annual report, has been assigned to an unnamed "leading global investment manager" by the Central Bank of Malta.[656] This is atypical for SWFs (at least those that follow best practices). Both Norway's SWF and Singapore's GIC fund name their investment managers on their websites.[657] Even Angola's SWF (see chapter 4) publicly named Quantum Global as the fund's asset manager. Providing basic information about the investment manager would give assurance of the reputation and standards that will be in place for NDSF investments. Additionally, providing the manager's name allows for independent oversight, as it did in the case of Angola's SWF, where journalists were able to expose the many conflicts of interest and poor financial integrity standards surrounding the fund's former asset manager.

From a money laundering standpoint, what is relevant is that the discretionary portfolio includes "solely investments in high-quality foreign instruments."[658] As a state-sponsored investment vehicle, the fund has easy access to North American and EU assets with few questions asked despite the numerous risks associated with NDSF money. Typically, 80 percent of the discretionary portfolio is allocated to foreign bonds, with the remainder allocated to foreign equity.[659] In 2020, 6.5 percent of these funds were directly invested in U.S. equities with a similar amount directed into emerging market (EM) equity funds (see figure 2).

Figure 2. Allocation of the NDSF's Discretionary Portfolio, December 2020



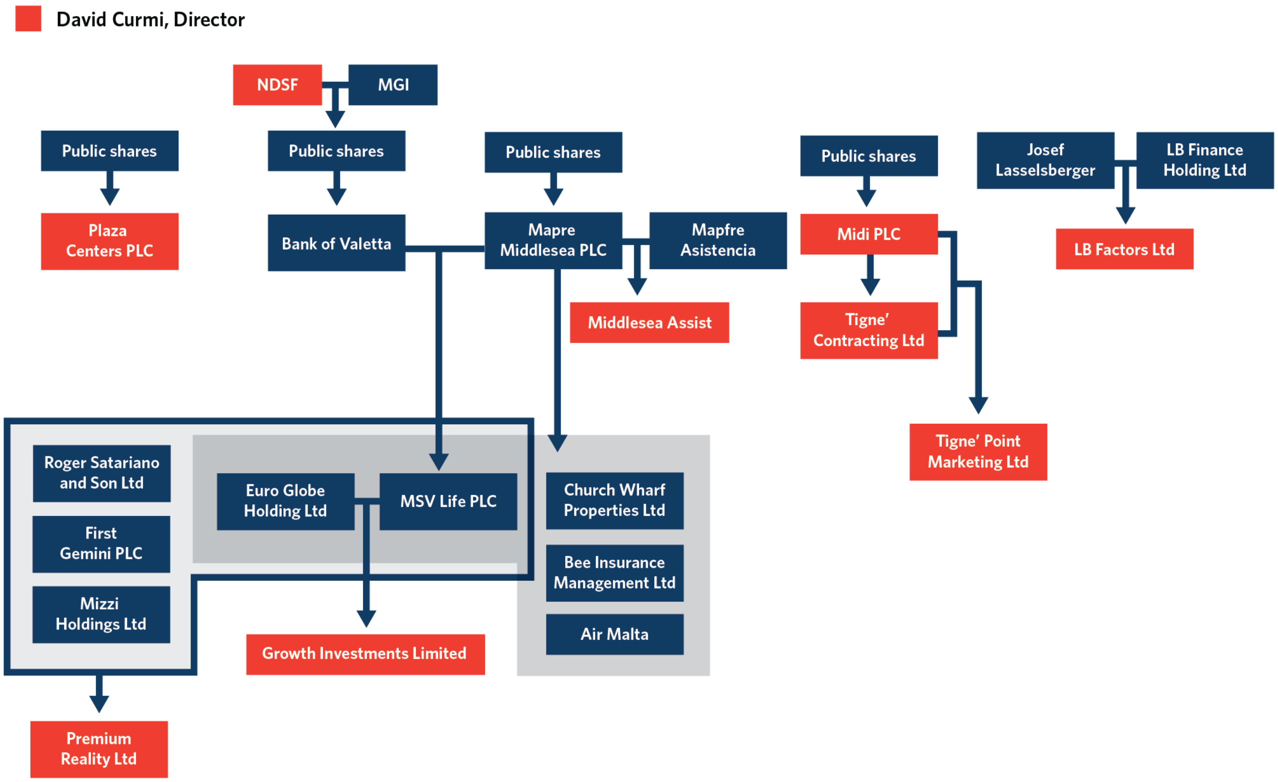
Source: Adapted from "Annual Report 2020," National Development and Social Fund, 2021, 11, https://ndsf.com.mt/en/Documents/Annual-Reports/Annual-Report-2020.pdf.

The directed portfolio, which contains 70 percent of the funds that the NDSF receives from the CBI program, is supposed to be used for social and development purposes. The fund acknowledges that these investments may not necessarily provide a direct financial return to the NDSF.[660] As of December 31, 2020, this portfolio had a market value of €260 million ($297 million) and consisted solely of domestic assets listed on the Malta Stock Exchange.[661] The total market capitalization of the Maltese stock exchange is $4.34 billion, meaning that the NDSF owns close to 6 percent of all of the value in the stock exchange. This is worrying, as a significant chunk of domestic investment and, in turn, the strength and stability of Malta's stock market comes from money obtained through passport sales in a program that is at high risk for corruption.

Despite the stated allocations of funds to be held in the directed, and discretionary portfolio, 40 percent of the total NDSF assets is held in cash ($259.2 million).[662] This is a remarkably high amount of cash for an SWF to have on hand.[663] Funds like the NDSF whose mandates include priorities such as "the advancement of education, research, innovation, social purposes"[664] and so on are referred to as strategic development SWFs. Because the NDSF has also been used to shore up the country's budget deficit, it also seems to serve as a kind of stabilization fund. But analysis of investment strategies across different fund types indicates that stabilization funds tend to keep over 50 percent as cash and cash equivalents.[665] Strategic development funds on the other hand "tend to invest up to 50 percent of their assets domestically, with the difference globally spread across fixed income securities, public equities and cash equivalents, and private market investments."[666] This investment strategy also seems to largely mirror that of the NDSF. But strategic development funds tend to invest on average only 10 percent of their assets under management in cash or cash equivalents. The amount of unallocated cash in the NDSF's budget given the fund's stated purpose is surprising. If the cash is unallocated and does not earn interest, and if the law does not specify guard rails for its use, those are significant red flags for potential corruption and mismanagement.

Finally, as other chapters in this report have highlighted, minimizing potential conflicts of interest between those tasked with managing investments and the areas that the fund is investing in is critical to mitigate corruption risks. With the NDSF, the governance structure of the fund raises concerns. As displayed in figure 3, David Curmi, who was the NDSF's chairman from 2015 to 2021, had individual interests in several companies that NDSF also had stakes in. [667]

Figure 3. Overlapping Investment Interests of the NDSF and Former Chairman David Curmi



Note: Arrows represent the ownership structure of companies.
Source: Author's illustration.

Per the Paradise Papers, David Curmi either currently serves or has served on the boards of multiple Maltese companies, including Growth Investments Limited, Tigne' Point Marketing, Mapfre Middlesea, Middlesea Assist, Premium Realty, Tigne' Contracting, Midi, LB Factors, and Plaza Centers. While some of the entities are publicly traded, others are subsidiaries that can be traced back to the NDSF through either ownership or shared investments. For example, Premium Realty is owned by a consortium of companies that includes MSV Life. Curmi has served on the boards of both companies and on that of one of MSV Life's parent companies, Mapfre Middlesea (a publicly traded entity).

The other owner of MSV Life, Bank of Valetta, is a publicly traded company in which the NDSF holds an equity interest. As a result, multiple parties have made investments into companies in which Curmi exerts a certain degree of influence. There is nothing inherently illegal about this significant overlap in investment choices. However, from a governance and anti-corruption standpoint, it raises questions about the independence and oversight mechanisms used for the investment decisionmaking process within the fund.[668]

The Profitability of "Mining Sovereignty"

It is striking how profitable "mining sovereignty" has been for the Maltese government. Malta had a year-over-year budget deficit from the early 1990s until about 2015. The deficit rapidly shrank following the introduction of the IIP in 2013, and in 2017, the country's budget surplus was €438.6 million ($495.6 million)—as one article stated, this amounted to "an astonishing 3.9% of GDP, higher than any other EU country, and fourth highest in the world."[669] The same article went on to say that 90 percent of this surplus was attributable to the revenue generated from passport sales. Reportedly, as tweeted by Muscat, within four years of the program, the country was able to reverse the deficit created by the three previous administrations. To some commentators, this may seem like shrewd economic policy, but from an anti-corruption standpoint, this indicates that there is little incentive to adhere to the highest standards for processing applicants in the CBI program.

The NDSF's capitalization via the golden passport scheme also means that the SWF is directly intertwined with Malta's CBI. The risks of the NDSF's direct capitalization from Malta's CBI can be inferred from the European Parliament's 2018 report on CBI and RBI schemes, which noted that these schemes were typically located in in member states with heightened risks of tax avoidance, money laundering, and corruption.[670] This again highlights a potential reputational risk for the NDSF because of its close association with and direct capitalization from a CBI scheme.[671]

NDSF's complex relationship with corruption risks does not involve only the source of its funds but also how its investments have been structured; the investments are deeply embedded into the Maltese economy and can therefore threaten its stability. For instance, in 2018, the NDSF acquired a 49 percent stake in Lombard Bank, one of Malta's largest banking institutions. In the same year, the Maltese SWF was considered the forty-third-largest SWF in the world by assets under management.[672] The CBI program allowed the NDSF to grow incredibly profitable—to the point that it recorded a balance of half a billion U.S. dollars in 2018, which placed it "on par with the sovereign wealth fund of Vietnam . . . a country of nearly 100 million people with an economy 20 times the size of Malta's."[673] However, since the coronavirus pandemic, the NDSF's assets under management have fallen sharply, and the fund now ranks as the ninetieth-largest SWF in the world.[674]

Nonetheless, surveys show that only a minority (26 percent) of Maltese citizens support the sale of citizenship.[675] The European Parliament report makes the case that "the vulnerabilities associated with CBI/RBI schemes . . . can negatively affect the population's trust in the institutions." The report also noted that a Eurobarometer survey carried out in November 2017, not long after Galizia was murdered, "showed that the Maltese citizens trust the justice system and police less than the EU average: trust in the Maltese justice and legal system stands at 35%, which is less than the EU average of 50%. The police are trusted at a level of 53%, also below the 72% EU average."[676] The authors recognize that "it is difficult to determine a direct causal link," but "arguably the multiplication of allegations and ongoing investigations in Malta probably have an impact on its population."[677] If so, one must wonder what impact this has on the viability of funding an SWF through the proceeds of a CBI program and whether the Maltese authorities will need to reconsider the manner in which the NDSF is funded.

The European Union is closing its remaining CBI programs, but plenty of other CBI programs endure around the world, and they may provide many of the same benefits and risks to the international system as Malta's program.

While the goals of such programs—to provide additional investments and jobs—are laudable, the risks associated with them are extremely high. As argued in this chapter, funding a state's SWF through potentially illicit proceeds undermines a country's rule of law and its citizens' trust in democratic institutions. The development associated with such funding mechanisms can also give ruling parties an edge in elections, helping solidify their state capture. Further, such funding approaches can create perverse incentives whereby states come to rely on illicit funding to stay afloat. Current Maltese Prime Minister Robert Abela noted that maintaining Malta's CBI program, even in the face of EU pressure, enabled the country to create a budgetary buffer from coronavirus challenges: "We will be defending Malta. Had it not been for the contributions from that [CBI] programme, which we are in the process of winding down, we would probably not have been in a position to present a budget of this scale."[678]

The modus operandi of the NDSF also raises significant concerns about the way money held in state-owned investment vehicles is able to move through the international financial system with reduced scrutiny, as it is assumed that the source of funds is legitimate. CBI and RBI schemes can lead to very real risks to the larger international system, especially when they are run by states like Malta that appear especially vulnerable to criminal state capture. These schemes have the potential to facilitate strategic corruption in Western states by making it easy for authoritarians to seed their crony facilitators abroad under the cover of Western residency or citizenship. In turn, these authoritarians can better avoid sanctions and facilitate the laundering of kleptocratic assets that help keep their regimes in power. Their money can then be used to influence Western politicians and other power brokers in ways that may undermine larger national security considerations—as the public outing of Russian oligarchs' roles in state capture and in undermining the West has made clear.

CHAPTER 11

Sovereign Wealth Funds and Arms Exports: The Case of UAE's Mubadala and Tawazun

Jodi Vittori

The defense sector has long been recognized for its association with corruption. Around the world, the shielding of large amounts of money and equipment under a veil of national security secrecy creates conditions ripe for bribes, kickbacks, and patronage.

Especially worrisome to good governance and arms control advocates are defense offset agreements. Defense offsets, sometimes referred to as "industrial participation" or "countertrade," are provisions in arms contracts that promise specific benefits to the contracting country as a condition of that country purchasing defense articles or services from a nondomestic supplier. In the United Arab Emirates (UAE), the details of these "sweetener" side deals—and sometimes even their existence—are secret. The UAE wraps an additional layer of complexity and opacity around defense procurement arrangements by funneling much of the funds and contracts through Emirati sovereign wealth funds.

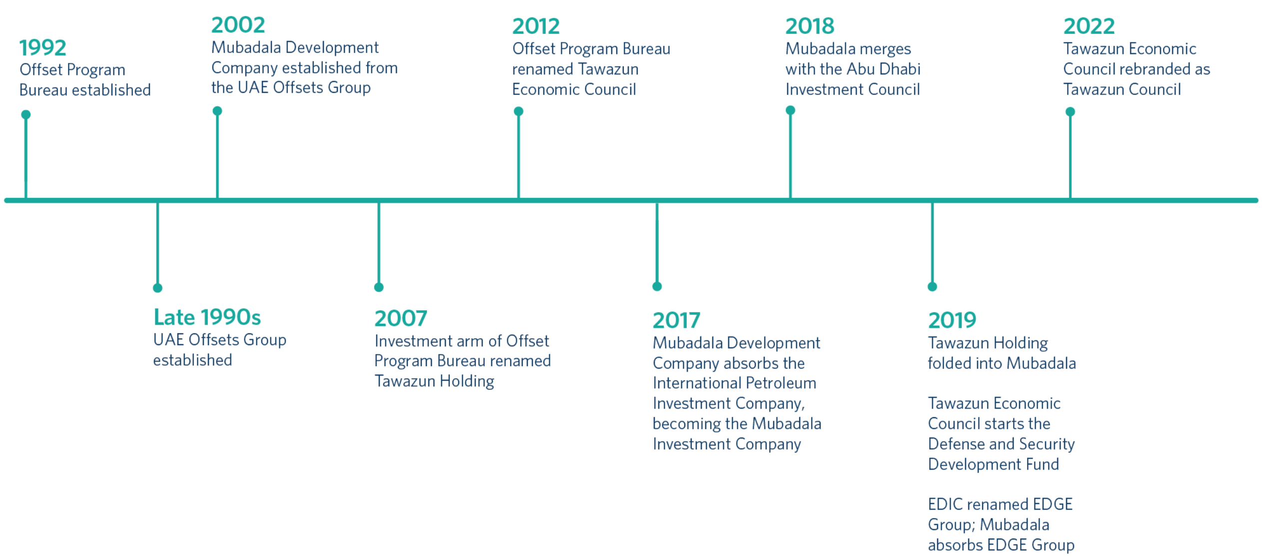
This chapter discusses defense offsets and their corruption risks, the role of the UAE's sovereign wealth funds in offset projects, and the associated potential for rent-seeking behavior. This chapter does not allege any illegal activity by the Emirati government or Western defense firms. However, Transparency International has rated the UAE as especially susceptible to defense corruption. The UAE's history of abuse of its sovereign wealth funds for money laundering (see chapter 3) and the secrecy surrounding many aspects of the Emirati defense sector create concerns that the Emirati defense procurement system could be at risk for abuse.

The UAE, Sovereign Wealth Funds, and Defense Offset Agreements

States use offset agreements to help make up for, or "offset," some of the foreign currency leaving the country when arms or defense services are purchased from abroad. Offset agreements are divided into two types: direct and indirect. Direct offsets are directly linked to the specific defense goods in an agreement, such as requiring some of the components of a fighter aircraft to be made in the purchasing country.[679] Indirect offsets can be any side sweetener contracts agreed to as a condition for a defense contract, such as a deal for training associated with an aircraft purchase. And they do not need to have any links to the defense sector at all: as part of fulfilling offset obligations of selling arms to Saudi Arabia, defense firms Raytheon (U.S.) and Thales (France) financed a Saudi shrimp farm.[680] Consequently, indirect offset agreements are considered especially high-risk for patronage and corruption due to the secrecy surrounding them and the ability to funnel the contracts and subcontracts, and their associated funding, into any enterprise.

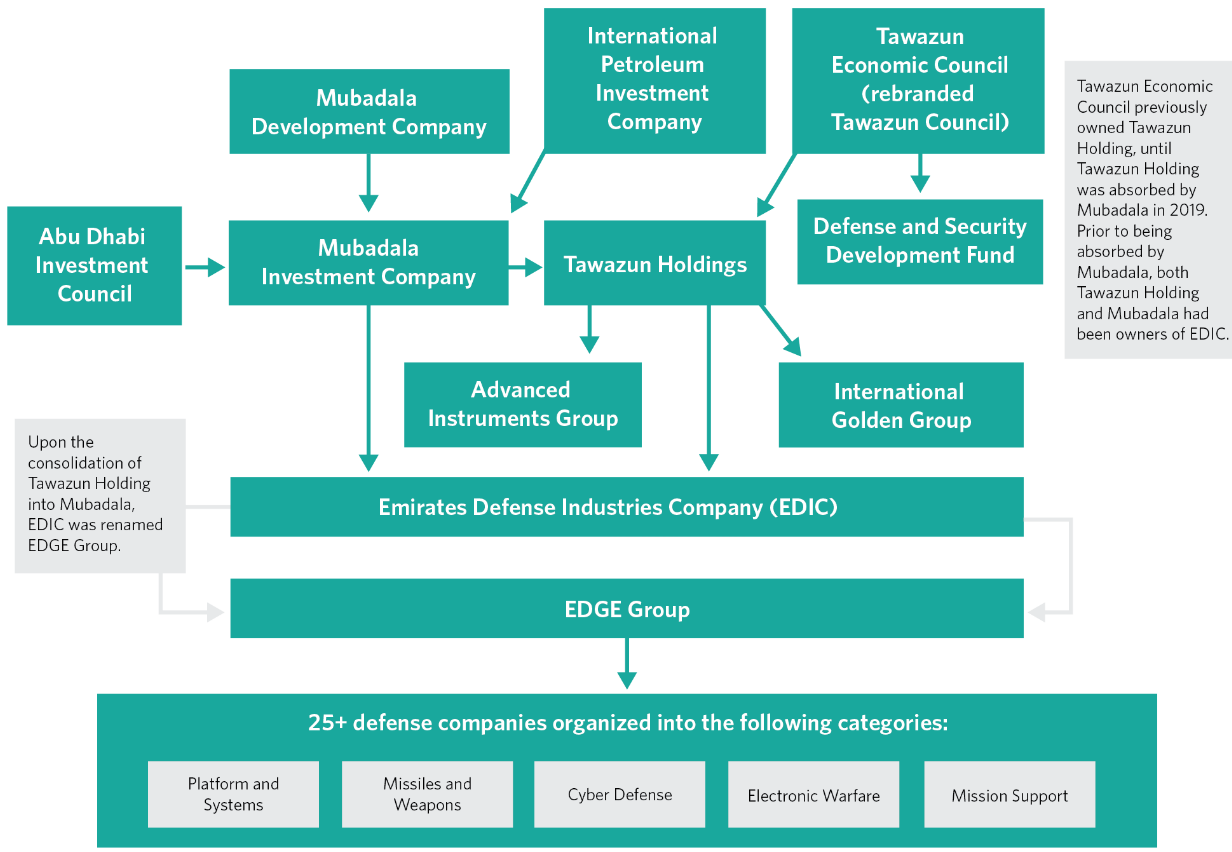
The UAE is unique in that two of its major sovereign wealth funds, the Mubadala Investment Company and the sovereign funds associated with the Tawazun Council (formerly known as the Tawazun Economic Council), were initially established to funnel proceeds from defense offsets to Emirati companies and citizens.[681] Through a complex series of mergers and reorganizations, they remain intimately tied to the Emirati defense industry. Figure 1 displays a timeline of the development of key actors that comprise the nexus of their sovereign wealth funds and the arms trade; figure 2 demonstrates the relationships between the various actors.[682]

Figure 1. Timeline of the Development of the UAE's Defense-Associated Sovereign Wealth Funds



Source: Author's illustration.

Figure 2. Relationship Among Emirati Sovereign Wealth Funds and the Defense Industry



Source: Author's illustration.

Mubadala, which is Arabic for "exchange," was founded in 2002 as the Mubadala Development Company to diversify the UAE economy,[683] but it originates with the UAE Offsets Group (UOG), which is sometimes cited as the Offsets Development Company. The UOG was founded by Amin Badr el-Din, a Jordanian who at the time was an adviser to then chief of staff of the UAE Armed Forces (now Emirati President) Sheikh Mohammed Bin Zayed Al Nahyan (commonly referred to by his initials MBZ). El-Din is credited with writing the UOG's guidelines and elevating offsets as part of the UAE's larger economic development plans.[684] A 2022 filing with the U.S. Securities and Exchange Commission (SEC), regarding a company in which el-Din is a board member, states, "Between 1990–2000, Dr. Badr el-Din has been Chairman and Chief Executive to the UAE Offsets Group, also known as Mubadala, which he created in the early 1990s." The SEC filing goes on to note that it was the UOG which established the "Mubadala sovereign fund."[685]

Mubadala was created as a civilian adjunct to the overall defense offset program of the Emirate of Abu Dhabi's military-procurement-focused, high-tech industrial development program.[686] The fund is a public joint stock company, with the Government of Abu Dhabi as its sole shareholder.[687] Mubadala acts as a holding company for local start-ups and joint ventures, often with foreign firms as coinvestors. The fund also makes strategic investments in foreign firms, with the goal of moving some of their production to Abu Dhabi.[688] Today, Mubadala's portfolio is much larger than just defense offset–related financing and includes investments in sectors such as healthcare, pharmaceuticals, metals and mining, and real estate spanning over fifty countries.[689] It is nonetheless still used to help funnel Emirati defense offsets, such as a 2021 deal between a Swiss aircraft manufacturer, Pilatus, and the UAE company Strata. That deal was funneled through Mubadala to complete an offset deal for the UAE's prior purchase of Swiss trainer aircraft.[690]

In 2017, the Mubadala Development Company absorbed another Emirati sovereign wealth fund, the International Petroleum Investment Company (IPIC). The merged funds are now called the Mubadala Investment Company.[691] As described in chapter 3, IPIC—and especially its subsidiary Aabar Investments—had been embroiled in the infamous Malaysian 1MDB money laundering scandal in which Emiratis who ran IPIC helped Malaysian elites launder at least $4 billion from Malaysia's 1MDB sovereign development fund.[692] In 2018, Mubadala was merged again, this time with the Abu Dhabi Investment Council, bringing its assets to $284 billion[693] and becoming the third-largest sovereign wealth fund in the UAE and the thirteenth-largest in the world.[694]

Another series of Emirati sovereign development funds within the UAE's defense offset program are those under the control of the Tawazun Council (commonly referred to simply as Tawazun).[695] It was established in 1992 as the investment arm of the UAE's Offset Program Bureau until it was renamed in 2007 and again in 2022.[696] Tawazun oversees the military component of the various defense offset agreements.[697] Per its website regarding its core functions, "Tawazun Council is an independent government entity that works closely with the Ministry of Defense, Abu Dhabi Police and security agencies in the UAE"[698] To maintain a dialogue between the Tawazun Council and defense contractors, there is also a Foreign Defence Contractors Council, which consists of the representatives of the Tawazun Council, companies that supply the UAE Armed Forces, and any third parties they choose to invite.[699]

Mubadala and Tawazun co-owned a group that until 2019 was called the Emirates Defence Industries Company (EDIC); it was renamed EDGE Group in 2019 and absorbed into Mubadala. EDGE is now the UAE's main state-owned defense industry conglomerate, with more than twenty-five companies.[700] In addition to absorbing EDIC, Mubadala also absorbed Tawazun's sovereign development fund, called Tawazun Holding, as well as another defense conglomerate called the Advanced Instruments Group.[701] (Confusingly, despite Tawazun Holding moving under the Mubadala SWF, the Tawazun Council remains distinct from Mubadala.)

When Tawazun Holding was moved under Mubadala in 2019, the Emirati government created a new $680 million sovereign fund under the control of the Tawazun Council called the Defense and Security Development Fund (now called the Strategic Development Fund).[702]

This 2019 fund invests both domestically and internationally. For instance, it has signed agreements to set up a factory in the UAE for 3-D printing with an Australian firm[703] and has invested in Al Marakeb, an Emirati firm that develops and updates unmanned surface drones.[704] With a Singaporean partner, the fund has also invested in an Israeli satellite firm, hiSky Ltd.[705] The Strategic Development Fund has also partnered with three UAE state-owned banks to provide low-cost, low-collateral loans to Emirati small and medium sized enterprises in the security and defense sectors.[706]

UAE's Defense Offset Corruption Risks

Offset contracts are a major means for defense companies to improve an arms contract proposal's standing vis-à-vis other bidders, but they can also be a pathway for kickbacks and patronage, whereby senior officials of the purchasing country can direct offsets to their own companies or to underlings in return for loyalty.[707] Countries can require offset deals to be public and transparent, but a high degree of secrecy is more often the norm. Some countries, including the UAE, declare these contracts to be secret. Others, like the United States, provide only the bare minimum of information, as described in box 1.[708]

Box 1: U.S. Defense Offset Agreement Oversight

The United States provides minimal transparency into U.S. defense firms' defense offset agreements. The U.S. Congress acknowledged in legislation in 1992 that ". . . certain offsets for military exports are economically inefficient and market distorting" and as a result, congressional legislation directed the executive branch to take a hands-off approach to offsets between companies and purchasing governments. Thus, any offset decisions are solely for the companies involved. U.S. government funds cannot be used to finance offsets associated with security assistance.

There are numerous loopholes, however. For instance, offset administration costs incurred as part of foreign military sales contracts can be considered a legitimate cost of the contract, including offset staffing, brokering and trading services, legal support, some consultant activity, market assistance, employee travel, and taxes and duties. There is limited information about offset contracts available to the U.S. government or American public. For any defense exports that require congressional notification (offset contracts valued at over $5 million), Congress must be told if an offset is known to exist, if the country has a standard offset requirement, and if it is a direct or indirect offset, as well as provide a general description. Defense offset information must be treated as confidential information, however, so there is no public oversight. Congress may ask for additional information on any proposed offset agreements.

For foreign military sales, the exporting company is not required to provide the Department of Defense contracting officer cost or pricing data so long as the foreign government has assured U.S. foreign assistance personnel that "adequate price competition" has occurred. While defense companies can theoretically fall afoul of the Foreign Corrupt Practices Act, these are technically contract provisions that are explicitly allowed under U.S. laws, so the companies will almost certainly technically be in the clear.

With direct commercial sales (DCS, or defense agreements made directly between a company and foreign government without the U.S. government acting as an intermediary), there are even fewer oversight or transparency requirements. Almost no disclosure is required for indirect offsets associated with DCS sales, unless the proposed DCS sale requires congressional notification. Even when companies are required to provide information to the U.S. government on offset deals associated with the sale, there is no requirement to list the foreign recipients of these deals. The U.S. Department of Commerce's Bureau of Industry and Security has recently proposed a rule to expand the requirements to report offsets in defense sales agreements within their purview. Laws such as the Foreign Corrupt Practices Act, however, still apply.

The large monetary value of these side contracts—plus their secrecy—has led to some breathtaking examples of corruption. For instance, a British law enforcement investigation of the Al Yamamah arms deal between the British government, British Aerospace (now called BAE Systems), and the Saudi government documented at least 6 billion British pounds ($12 billion at the time)[709] in bribes going to the Saudi royal family through secret accounts, shell companies, and fraudulent invoices.[710] Many of these kickbacks were part of the offsets associated with the deal. Likewise, the ongoing corruption trial against former South African president Jacob Zuma involves kickbacks from corrupt arms deals from 1999 to 2005 when he was deputy president.[711] Many of the bribes and preferential contracts to Zuma and his cronies were allegedly funneled through the associated offset contracts. The World Peace Foundation's online Compendium of Arms Trade Corruption documents the use of offsets for corrupt purposes in at least eleven of the forty cases they assess,[712] thus raising red flags among anti-corruption and arms control advocates.

Global totals of offset contracts are hard to come by, but some aggregate figures and estimates suggest they are substantial. For the United States, in 2019 (the latest data available), indirect offsets made up 70 percent of obligations by American defense companies (and direct offsets made up the other 30 percent), with ten U.S. defense contractors signing thirty-one new offset agreements with eleven countries.[713] The total value of these offsets was $8.2 billion, or 62.5 percent of the value of the arms contracts signed that year. Lockheed Martin alone had $17.5 billion in offset agreements outstanding at the end of 2020, up from $12.1 billion in 2018.[714]

The management consultancy Avascent estimates that the worldwide total value of defense offset contracts from 2021 to 2025 will be $371 billion, but only $229 billion will be fulfilled.[715] There is no means of estimating what percentage of these contracts may be diverted for patronage, overpriced for kickbacks, or paid for but never completed. However, even if it is a mere 10 percent of the expected value of all offset contracts over the next five years, then $37 billion could disappear from government treasuries—a staggering sum.

The aggregate numbers above are an undercount, as not all offset agreements are officially declared. In some cases, firms may camouflage offsets, for example by becoming major shareholders in local firms. Firms would not report such deals as official offsets, and a U.S. foreign military sales contract notification would claim that there were no known offsets associated with the arms agreement in question.[716]

The UAE requires that any defense contract over $10 million must contain associated offsets worth at least 60 percent of the contract value.[717] That is, if a company were to fulfill a $10 million contract, it would also have to expend $6 million worth of direct or indirect offsets. Tawazun handles the offset contract negotiations and monitoring.[718] Companies have a variety of means of fulfilling their offset obligations, including investing in projects where at least one entity is a local partner; manufacturing products in the UAE and exporting them or providing the products to foreign buyers; taking part in technology transfer; establishing a company in the Abu Dhabi Global Market free zone; and offering internships and job placement for UAE nationals.[719] Indirect offsets have been funneled into a wide array of investments, including luxury real estate; leasing programs for aircraft, oil tankers, agricultural and fish farming, shipbuilding, and waste management; and agreements for Western legal and financial firm services.[720]

As scholar Shana Marshall has explained in her study of offsets in the UAE, Saudi Arabia, and Kuwait, “Official rationales have focused on increasing employment opportunities for Gulf nationals, attracting new technologies and foreign investment, and reducing the Gulf economies’ reliance on oil and gas exports through strategies of diversification.”[721] These are all worthy goals. She notes, however, that offsets have created few actual jobs, especially compared to the large burden that offsets place on state budgets, particularly since the cost of defense purchases increases to cover the cost of the offset deals. Moreover, because the countries making the purchases front much of the cost of offsets through tax credits and other investment incentives, these programs can be an especially inefficient means of generating job growth and facilitating technology transfer.[722]

Marshall contends that “the primary area where offsets do have a discernable impact is on investment portfolios of influential domestic elites.”[723] She argues this is the real driving force behind these side deals. When examining a 2008 study by an Abu Dhabi–based investment bank, Marshall found that eight of the ten most powerful families in Abu Dhabi held significant shares and/or board seats on an average of 3.8 companies that had been established by, or received substantial investment from, an offset agreement. The families included that of UAE’s president, MBZ.[724] Such investments may legitimately advance the UAE’s goal of diversifying its economy away from oil, but they appear to be extensively linked to UAE’s elites.

The public and private sectors in the UAE—especially in strategic sectors like defense—have long been intertwined. As a foreign executive quoted in the *Financial Times* put it, “The line between royals and business [in Abu Dhabi] is getting blurred. I don’t think it exists now; it’s very hard to say what is the exclusive preserve of the private sector . . . I don’t think there are any credible private sector players in strategic sectors.”[725]

Because so many of the deals are extremely complex, tracking the various flows of funds and potential conflicts of interest can be a challenge, even when the deals are publicized. For example, in 1997, an offset deal for Jordan involving Royal Jordanian airlines' lease payments included the UAE government, thirty-seven banks, and four defense companies.[726] In another example, a 2007 deal called Project Alpha, facilitated by a defense offset broker called Blenheim Capital, involved fifteen defense companies that were pooling funds to provide financing for the main highway between Dubai and Abu Dhabi, plus the Al Raha Beach development, partnering with a then three-year-old company called Aldar Properties.[727] The project did indeed assist with the development of the UAE: today, Aldar is one of the largest developers in the UAE. At the time of the investment, the founder and chairman of Aldar, Ahmed Ali Al Sayegh, had also served on the board of the UAE Offsets Group (now called Tawazun) and since then has been a board member on many other firms funded with offset contracts.[728] He is also a founding board member of Mubadala.[729] Mubadala was a founding stakeholder in Aldar and continues to hold a 25 percent stake in the company.[730]

There are additional mechanisms for firms to keep an arm's length from the actual offset contract. For instance, in the UAE, a defense company does not actually have to be a part of a joint venture to fulfill an offset obligation. Instead, it can encourage a third-party supplier to enter a joint venture. In addition, company "offset credits" can be applied not only to the contract at hand but also—if there are "leftover" credits—to other defense contracts it has been awarded, or they can even be traded to other firms who need offset credits to reach their requirements.[731]

To help handle these complex exchanges, companies often use offset brokers. A few key firms stand out, such as Chescor Capital, which is incorporated in Mauritius, located in a Dubai free zone, and was started by Amin Badr El Din, the aforementioned founder of the UAE Offsets Group and Mubadala.[732] One of the most prolific offset brokers had been the aforementioned London-based Blenheim Capital (formerly called Summit Corporate Services), which was established by a former adviser to the UAE offsets program in the 1990s, R. Grant Rogan, and by the UAE Offsets Group. One oil industry journal noted at the time that it was the "brainchild" of el-Din and MBZ. Blenheim Capital was initially financed through offset funds provided by Lockheed Martin and funneled through Mubadala; it was recently dissolved after its founder declared bankruptcy.[733] Firms like Blenheim Capital handle the buying and selling of offset credits on behalf of defense companies, while allowing defense companies to keep an extra layer between themselves and whoever ultimately receives the offset funds. This especially concerns anti-corruption and arms control advocates. According to Transparency International's Defense Companies Index, which measures the defense industry's commitment to combating corruption, defense companies are less committed to combating corruption involving defense offsets than any other area of their corporate policies. Based on an analysis of 134 defense companies worldwide, 90 percent of surveyed companies exhibited "limited" to "very low" commitment to combatting corruption in this area.[734]

In the UAE, there is an additional option for fulfilling offset contract obligations: cash. In 2016, Tawazun introduced an Accelerated Project Funding option for offsets. Contractors could invest cash into projects that were part of Tawazun. As an offset trade publication noted at the time, "the process would be transparent to overcome the challenges for US primes concerning cash payments and the Foreign Corrupt Practices Act."[735] Details were scant because defense contractors who attended a meeting where the announcement was made were forced to sign nondisclosure agreements. The cash payments would be given a multiplier of six, meaning that if a company owed $6 million in offset commitments, paying $1 million in cash to the fund would yield the equivalent of the $6 million requirement.[736] More recent trade publications note that cash contributions now have a multiplier value of 2, the same multiplier that salaries of UAE nationals hired via offset agreements have.[737]

The scheme received unwanted attention in 2017, when a series of leaked emails revealed the cash payment option.[738] (This arrangement violates the basic tenets of offset contracts, which are supposed to support the Emirati economy by bringing in new technologies or know-how or providing local employment.[739]) At the time, an arms industry expert, William Hartung, noted, "Offsets are a common practice in the global arms trade, and they are largely unregulated . . . I'm less familiar with the idea of using cash payments, which seem at best a form of legalized bribery."[740] Despite the publicity, cash contributions are still permitted per the UAE's 2019 offset guidelines.[741]

UAE Defense Sector Procurement Corruption Risks

According to Transparency International's Government Defence Integrity Index (GDI), which assesses the comprehensiveness of anti-corruption measures in national defense institutions,[742] the UAE is considered a "very high risk" country for defense sector corruption. Procurement processes are opaque, underregulated, and lack public oversight—and are therefore highly susceptible to corrupt schemes.[743] Based on research conducted in 2019, the GDI found no laws or regulations that address the UAE's defense procurement process. Instead, acquisitions are guided by a secret strategy derived by a small team of Emirati officials and foreign consultants. The UAE has no official reporting mechanisms regarding defense acquisitions except for occasional disclosures to defense industry journalists and experts. While some basic internal auditing practices are in place, there are no external oversight bodies that can monitor the administration of the UAE's defense purchases.[744]

Yet funneling defense offset contracts and associated financing through sovereign funds does not necessarily impede transparency and accountability if those funds are fully transparent and accountable. Indeed, Mubadala scored a 75 out of 100 in 2019 on the Peterson Institute's sovereign wealth fund scorecard on transparency and accountability. (The average score was 66.) Mubadala also largely complies with the Santiago Principles for governing sovereign wealth funds.[745] Further, it received a score of 10 out of 10 on the Linaburg-Maduell Sovereign Wealth Fund Transparency Index (LMTI).[746]

On the other hand, funds run by Tawazun have not been rated by the Peterson Institute or in the LMTI, nor is Tawazun a member of the International Forum of Sovereign Wealth Funds or a signatory to the Santiago Principles. The organization and administration of its funds and projects have also been excessively secretive. While Tawazun has publicly provided broad offset guidance, its treatment of specific policies has been described by contractors as "paranoid, secretive, and bizarre."[747] For example, when new offset guidelines were sent out to contractors by the Emirati government in 2019, every page of the eighteen-page document was embossed with the following: "Highly Restricted. This information must not be shared in any circumstance with anyone other than its intended recipients." The document also included other confidentiality warnings within the policy.[748]

Both Mubadala and Tawazun are ultimately run by UAE's president, most known by his initials MBZ.[749] He has also personally been closely linked with defense offsets, having headed the UAE Offsets Group in the 1990s and early 2000s when he was chief of staff of the UAE Armed Forces.[750]

Leadership between Mubadala and Tawazun and the entities that they control is fluid, which could lead to conflict-of-interest concerns. For instance, the current director of Tawazun, His Excellency Tareq Al Hosani, was formerly an associate director at Mubadala.[751] In addition to his duties at Tawazun, he sits on the boards of many companies funded by Mubadala and/or administered by Tawazun. For example, he is on the board of the International Golden Group (IGG), which was funded in part by Tawazun and in part by the Kaabi family,[752] while its chairman is former Armed Forces deputy chief of staff Major General Mohammad Helal Al Kaabi.[753] In September 2021, Tawazun increased its holdings of IGG by an undisclosed amount. The IGG provides "partnering services" for foreign defense companies and thus has numerous joint ventures with Tawazun-associated firms.[754] Al Hosani is also on the board of Al Yah Satellite Communication (Yahsat), where he was the executive director before taking up the Tawazun position.[755] Yahsat was 100 percent capitalized by Mubadala through offset partners Thales, Astrium, and European Aeronautic Defence and Space (EADS, a division of Airbus).[756] He also sits on the board of the EDGE Group, the consortium of companies run by Tawazun. This is not to suggest that these links have led to specific acts of corruption, undue influence, or other impropriety—only that there are potential risks associated with the linkages.

Some firms taking part in Emirati offset agreements have expressed concerns about the appearance of corruption. In 2012, for example, an offset trade magazine reported how firms were especially concerned at how Tawazun's former chief executive officer, Saif Al Hajeri, was also the chief executive officer of Tawazun Holding (a predecessor to the current SDF). The director of Tawazun's offset unit at the time, Matar Al Romaithi, justified this by stating, "[Saif Al Hajeri] is not getting anything personally. Tawazun Holding is our investment arm, which is part of the Tawazun Economic Council, and both of them are government entities. So where is the conflict of interest?"[757] He later stated, "We don't want international companies to feel or to have a sense of doubt . . . The international firms we have consulted confirm we are not in breach of any conflict of interests or bribery acts."[758]

It Is Not Only the UAE: Global Defense Offset Risks

The UAE is not the only country that executes defense offset contracts through its sovereign wealth funds. Saudi Arabian Military Industries (the main partner for companies engaged in offset obligations there),[759] the Helicopter Company, and other Saudi defense companies are wholly owned subsidiaries of the country's Public Investment Fund (PIF),[760] and civilian offsets are managed by the PIF.[761] PIF is one of the largest sovereign wealth funds globally, with over $600 billion in assets, and it seeks to have over $1 trillion in funds by the end of 2025, with about 30 percent of those being international investments (more details on PIF can be found in chapter 6).[762] Saudi Arabia's General Authority for Military Industries, which is a subsidiary of the PIF and which is responsible for managing the country's defense-related offset programs,[763] also recently signed a memorandum of understanding with Tawazun to facilitate cooperation between both groups, including joint ventures.[764] As with the UAE offset program, "cash donations" are also acceptable to fulfill offset obligations.[765]

According to Transparency International's GDI Index, Saudi Arabia is also at critical risk of defense corruption.[766] The Saudi defense sector has been embroiled in large-scale corruption scandals, including the aforementioned Al Yamamah deal. In March 2024, two middlemen employed by British company GPT Special Project Management Ltd (now part of EADS) were acquitted by a British court for bribing then head of the Saudi Arabian National Guard, Prince Miteb bin Abdullah (son of then Saudi King Abdullah), with millions of dollars between 2007 and 2010. A jury acquitted the middlemen after they successfully argued that their payments had been authorized by the Saudi and British governments.[767] And PIF, headed by Saudi Arabia's Crown Prince Mohammed bin Salman, is currently involved in a civil dispute over $3.5 billion missing from a Saudi counterterrorism fund.[768]

Bahrain has also developed an offsets program. The Bahrain Defense Forces recently signed a memorandum of understanding with Tawazun to "share expertise on offset programmes."[769] This memorandum came after Bahrain established a formal offset program for the first time in September 2020, which was reported to be almost identical to the UAE's program.[770] Per a November 2021 agreement, foreign suppliers with offset obligations in Bahrain can meet those requirements in the UAE and vice versa.[771] Bahrain's sovereign wealth fund, Mumtalakat, has also recently signed a co-investment deal with Mubadala.[772] Per an offset trade publication regarding Bahrain's offset guidelines,

> The guidelines are almost entirely a replica of the policy published by the UAE. Large parts of the document are identical, with the words "Bahrain" and "BDF" (Bahrain Defence Force) replacing "UAE" and "Tawazun." The quotas, multipliers, penalties, project categories and performance periods are also identical, although Bahrain sets a lower threshold.[773]

Like Saudi Arabia and the UAE, Bahrain's defense sector is considered to be at critical risk for susceptibility to defense-related corruption.[774] The royal family maintains absolute control over politics and the economy, controlling the country's oil wealth, its security sector, and its sovereign wealth fund.[775]

Ramifications and Recommendations

One area that requires additional study is the potentially significant ramifications for regional security. The lack of transparency into defense offset agreements makes such assessments exceedingly difficult, but the activities of some companies funded through the combination of offsets and sovereign wealth funds indicates a possible troubling nexus.

For example, Horizon Flight Training Academy was started in 2002 with funds from Mubadala and remains 100 percent owned by the fund as part of the new EDGE conglomerate. Its purpose is to train civilian and military pilots, trainers, and technicians.[776] The majority of its pilots go to the Emirati military, [777] where they have flown in highly controversial military operations in Yemen.[778] One of the members of Horizon Flight Academy's board is retired U.S. Army Lieutenant Colonel Stephen Toumajan, who appears to have commanded the UAE's Joint Aviation Command (its combat helicopter wing). According to reports, Toumajan has officially been a contractor for Knowledge International, a U.S. sister company of Knowledge Point, another EDGE company.[779] Though he has previously told the press that he is merely an adviser to the UAE, he has also identified himself as a "commanding general of the Joint Aviation Command of the UAE" and wore a uniform with insignia designating him as such in a U.S. Defense Department video from 2017.[780] Toumajan has sat on the board of directors of other EDGE companies including Knowledge Point,[781] which demonstrates the close links between Mubadala, Tawazun, their associated companies, and Emirati military activities and oversight.

Moreover, the IGG has been identified in arms sale deals with signs of malfeasance. The former head of a Ukrainian arms firm told the Organized Crime and Corruption Reporting Project (OCCRP) in 2017 that Emirati firms, including IGG, sponsored arms shipments to places such as South Sudan. Documents provided to OCCRP from a Ukrainian arms firm included a "framework agreement" to ship $169 million worth in arms to South Sudan despite an EU arms embargo, with IGG acting as a broker.[782] In January 2024, IGG was added under the EDGE Group umbrella owned by Mubadala.[783]

Given these allegations regarding UN sanctions violations and possible human rights violations associated with defense companies under the auspices of Mubadala and Tawazun, more insight into these funds and their associated offset contracts would help civil society, scholars, and the intelligence community better understand these entanglements.

Ideally, both the United States and the UAE would open up their offset-related arms procurement and export contracts to public scrutiny. At a minimum, the U.S. Congress should legislate changes to defense offset contracts that require public disclosure of summaries of these contracts, pricing details, and the beneficial owners of any associated contracts and subcontracts. The beneficial owners of offset agreements that are part of the U.S. Foreign Military Sales program could be made known under Section 885 of the Fiscal Year 2021 National Defense Authorization Act, which requires making beneficial ownership information for federal contracts available. This information could also be publicly posted through the Federal Awardee Performance and Integrity Information System,[784] as well as the more easily accessible USAspending database.[785] These steps would partially solve the problem, but they still would not enable the public disclosure of offsets associated with arms sales made through direct commercial sales between defense export companies and a government, nor would they cover military exports classified as “dual use” or those offsets that shirk the “offset” moniker. While there are substantial corruption concerns regarding the use of defense offset agreements globally, taking these steps would at least help ensure that the U.S. government is not complicit in corrupt offset-related activities abroad.

This compilation has documented how elites can use sovereign wealth funds for rent-seeking activity, including corruption. The combination of opaque defense procurement contracts intertwined with sovereign wealth funds in countries already considered highly susceptible to defense-related corruption should be of concern to governments, the defense sector, and civil society. Furthermore, the fact that potential corruption activities can have significant effects on peace and security only heightens the need for sovereign wealth funds to undergo much higher levels of scrutiny and associated government regulation by arms-exporting nations.

CHAPTER 12

What's Next? A Road Map to Address SWF Illicit Finance, Corruption, and Governance Gaps

Lakshmi Kumar

When used appropriately, sovereign wealth funds (SWFs) can help address budget deficits by using natural resource revenues, help save resources for future generations, or serve as a bulwark against natural resource–associated long-term economic harms, better known as "Dutch disease."[786] Yet as the preceding chapters of this compilation have demonstrated, SWFs can sometimes severely "undermine public financial management and become sources of patronage and nepotism."[787] Essentially, within the universe of SWFs, there is a significant governance gap, which has created the opportunity for systemic corruption and associated issues to take hold. Instances of corruption can be traced to a variety of institutional and environmental factors, including

- absence of clear definitions for SWFs;
- corruption-rich environments or those with weak rule of law;
- weak or absent independent oversight of SWFs;
- ever-changing objectives and mandates of SWFs;
- poorly defined withdrawal, deposit, and investment rules;
- conflicts of interest between private sector intermediaries and SWFs; and
- absence of mandated financial reporting and financial transparency obligations.

The problem at the heart of this compilation is that without adequate protections it is easy for SWFs to operate in a potential "sea of corruption" instead of operating as "islands of good governance." Therefore, a path toward improved governance must focus not only on strengthening how SWFs operate institutionally but also on reforming the international environment of norms that affect SWFs and the array of actors that interact with and benefit from SWF activity. This chapter sets out recommendations to achieve such reform, focusing on the reform in three areas:

1. countries where SWFs invest and private sector intermediaries that interact with SWFs;

2. countries where SWFs are created (particularly reforms related to how these SWFs should implement well-defined governance and operational norms); and

3. international standards for SWFs.

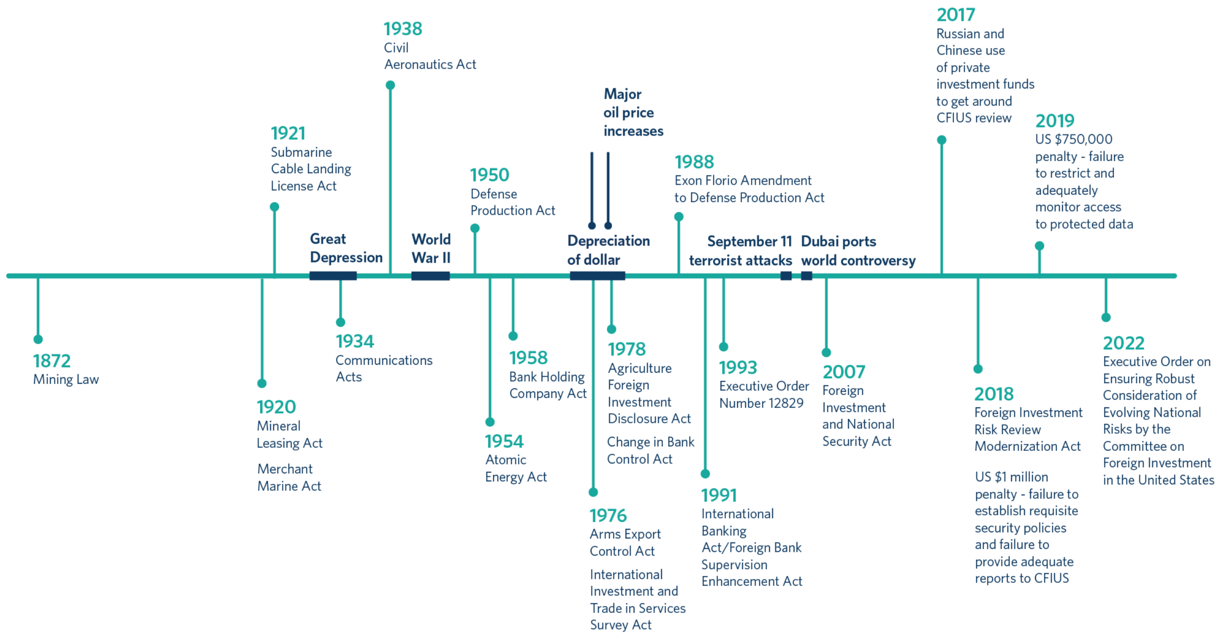
Policy Reform for Countries Where SWFs Invest and Private Sector Intermediaries That Interact With SWFs

As outlined in the first chapter, SWF investment is inexorably tied to the larger international regulatory debate on foreign direct investment (FDI) and the protection of national security. This debate has birthed laws at the national level that scrutinize SWF investment for national security intrusions.

The United States, as both the world's top foreign investor and the top recipient of foreign investment, presents an example case of how reforms targeting SWFs have developed. The United States has traditionally championed open investment environments,[788] which has greatly benefited its economy. A report from the U.S. Department of Commerce found that 10 percent of U.S. employment (16 million jobs) were attributable to foreign investment in 2019.[789]

At the same time, the United States and other countries that have traditionally welcomed foreign investment are worried about SWF investment undermining their security. The concerns around security and foreign investments have always been closely linked to the challenges stemming from ongoing global geopolitics at the time of investment. For instance, in the late 1980s, the Japanese government attempted to acquire a U.S. semiconductor company, which led to the passage of the Exon-Florio amendment to the Defense Production Act.[790] The amendment gave the president the power to block any potential foreign investments or to divest foreign investments from U.S. companies if they constituted a threat to U.S. national security.[791] The Japanese government's attempted acquisition in fact came at a time when U.S.-Japan relations were tense amid a trade war and U.S. concerns about how the rise of Japan as a global super power could threaten U.S. economic interests.[792] Fast forward to today, and there are similar but perhaps even more pressing concerns around potential Chinese government investments in sensitive U.S. technology sectors (see figure 1). These concerns resulted in the passage of the Foreign Investment Risk Review Modernization Act of 2018 and the 2022 Executive Order on Ensuring Robust Consideration of Evolving National Security Risks by the Committee on Foreign Investment in the United States (CFIUS).[793] The 2022 executive order represented the first time that a U.S. president "expressly directed CFIUS to prioritize certain national security risks when reviewing covered transactions."[794]

Figure 1. Timeline of U.S. Foreign Investment Laws and Influencing Events (1872–2022)



Source: Adapted from "Sovereign Wealth Funds: Laws Limiting Foreign Investment Affect Certain U.S. Assets and Agencies Have Various Enforcement Processes," U.S. Government Accountability Office, May 2009, 20, https://www.gao.gov/assets/gao-09-608.pdf.

With SWFs, national security risks are only magnified due to the size of the assets at their disposal, their investment strategies, and the assumptions that because they are "of" the government their actions are intertwined with the country's foreign policy objectives. These concerns and risks have been at the heart of a debate on how to protect a country's national security while also fostering an open investment environment. In 2006–2007, when security concerns among countries of the Organisation of Economic Co-operation and Development peaked, more than a dozen countries representing more than 40 percent of inward FDI adopted or debated new laws to scrutinize SWF- or foreign government–linked FDI.[795] In broad terms, these laws and other FDI laws primarily seek to target three kinds of national security threats.

- One threat is the denial or manipulation of access that would make a country dependent on a foreign supplier. An example is the 1990 attempted acquisition of U.S.-based Semi-Gas Systems by a Japanese company, Nippon Sanso Holdings.[796] The acquisition would have raised the Japanese company's global market share to 40 percent.

- A second threat is the leak of sensitive technology or know-how. An example is the 1992 attempted acquisition of a U.S. missile company, Ling-Temco-Vought, by a French company, Thomson-CSF (now called Thales).[797] The successful acquisition would have provided the French company (and therefore potentially the French government) with access to critical U.S. technology.

- A third threat is infiltration, espionage, and disruption. An example is the 2005 attempted acquisition by Dubai Ports World of a company that owned or leased terminal facilities in U.S. ports in Baltimore, Houston, Miami, New Orleans, Newark, and Philadelphia. The acquisition would have provided the United Arab Emirates a mechanism for "clandestine observation or disruption."[798]

National Laws and SWF and Money Laundering Restrictions

A perusal through legal restrictions on foreign or SWF investment across ten jurisdictions demonstrates that the scope of national security threats has expanded, but the scope does not automatically include corruption, money laundering, and other similar risks. This might be an acceptable situation, however, if governments were to use existing national anti-corruption or anti–money laundering (AML) statues in their countries to target risks from specialized vehicles like SWFs.

In the United States, federal laws do not specifically restrict SWF investments but rather look to scrutinize or restrict foreign investments that pose a national security risk. These laws operate in conjunction with sector-specific restrictions in areas such as telecommunications or energy and other state-specific laws that restrict foreign investment.[799] But outside of generalized restrictions, there appears to be no publicly available U.S. guidance on how to address or conduct anti–money laundering due diligence on SWFs.

Other countries, such as the United Kingdom (UK), have partial directed guidance on how to address anti–money laundering and counter threat finance (AML/CFT) risks in SWFs. The Joint Money Laundering Steering Group (JMLSG), a private sector body representing the financial sector in the UK, produces guidance to help the industry meet the country's AML/CFT obligations. Though the guidance provided is not legally binding, it does receive approval from the UK Treasury prior to publication. The guidance is noteworthy in that it specifically calls out the national security threats posed by SWFs because the funds can be used for "political, rather than purely financial objectives, by acquiring controlling interests in strategically important industries or destabilising economies." Among other positive features, the JMLSG guidance

- specifically requires an entity with AML/CFT obligations to look at the country context from which the SWF originates;
- states that SWFs will typically not qualify for simplified due diligence;
- draws specific attention to the risk of politically exposed persons and SWFs; and
- instructs obliged entities to check whether withdrawals made from the SWF match its mandate and objective.[800]

While positive, efficacy of the guidance is reduced because of the overarching directive that SWF-related risks be viewed through the possible destabilizing effect on economies rather than the possible theft of funds or problematic origins of the funds themselves.[801] The guidance does not raise the specific factors that lead to money laundering or corruption.

Another limitation of the JMLSG guidance is that it only captures funds owned by the national government as SWFs, thereby excluding funds like the Alaska Permanent Fund from within its purview.[802] This once again exposes how a lack of uniformity in understanding what an SWF is can affect its due diligence treatment.

India, which is another key SWF investment destination (see chapter 1), also provides directed AML/CFT guidance. However, in contrast to the UK, the country's capital markets regulator, the Securities and Exchange Board of India, treats SWF investments as Category 1 investments on par with those of other supranational entities like the United Nations and other multilateral organizations, foreign and central banks, and government-related foreign investors. Under Indian regulations, entities classified as Category 1 are automatically qualified as being of lowest risk. This is especially concerning because there is no distinction to be made for due diligence based on the SWF's origin, mandate, or investment strategy. SWFs get an automatic carte blanche because of their "sovereign" nature.[803] This once again exposes a lack of a consistent international understanding on the types of risks SWFs present.

Because of this lack of scrutiny or interest outside the national security lens, there is almost no information available on certain SWFs that raise red flags. For example, chapter 5 in this compilation highlighted the opacity around the Fund for Future Generations (FFG) in Equatorial Guinea. Two leading data providers on SWFs could not find any verifiable information on how and where the FFG was investing. Similarly, there was no information available on the investment patterns of Malta's National Social Development Fund (NSDF). There were only mentions of art, money granted to charities, and equity and bond investments in the United States and emerging markets (see chapter 10). This is despite the fact that the funds associated with the NSDF stem from the country's controversial and much criticized "golden passport" program.

Another particularly glaring example is the State Oil Fund of the Republic of Azerbaijan (SOFAZ). The fund is known for lacking transparency and operating in a country where, according to a 2022 assessment by the U.S. Department of State, "a small group of government-connected holding companies dominates the economy . . . and judicial transparency is lacking."[804] Critics have raised concerns that projects funded by the SOFAZ are often awarded to companies associated with ruling political elites in Azerbaijan.[805] Despite these legitimate concerns, the fund has invested over $1.2 billion in the real estate sector.[806] The SOFAZ has direct commercial real estate investments in France, Italy, Japan, Russia, and the UK.[807] As of 2021, the fund was also expected to invest $400 million in commercial real estate deals in Asia, Europe, and the United States.[808] The fund has been making investments in U.S. real estate since 2015 and was expected to deploy $50 million in unlisted real estate funds across North America and Asia and Europe in 2023.[809]

A 2020 report titled "The Empty Bucket of the State Oil Fund of Azerbaijan" found that the SOFAZ's real estate investments globally amount to $2 billion and are managed by subsidiary institutions of the SOFAZ.[810] The profits from the real estate sector are supposedly used to pay for the services of these subsidiary institutions, yet the ownership and control of these institutions remain shrouded in mystery. The real estate investments also do not appear to generate profits for the fund itself.[811]

The SOFAZ invests in real estate through private funds. However, in the United States, these funds are not required to carry out AML/CFT due diligence; and in other countries, regulators have struggled to adequately enforce AML/CFT regulation in this space. The secretive investments made in the United States by Russian oligarch Roman Abramovich, for example, were possible because of the secrecy and lack of due diligence required in the real estate sector. The absence or weakness of regulatory mechanisms in investment destination countries therefore creates a perfect situation whereby subsidiary institutions making deals for the SOFAZ do not undergo necessary scrutiny. Taken together, this exposes gaps not just in the AML/CFT and anti-corruption treatment of SWFs but also in how private investment funds are regulated globally.

Finally, there are concerns that SOFAZ is being used to whitewash the image of Azerbaijan—similar to how Saudi Arabia may be using SWF investments in sports to improve its image and increase its influence despite the potential lack of returns on this investment (see chapter 6). Through the SOFAZ, over the past few years, Azerbaijan has been hosting and funding the Eurovision competition, the first European Games, and the Islamic Solidarity Games, as well as a Formula 1 grand prix.[812] But there have been questions about whether these investments have provided benefits to the people of Azerbaijan and about who benefits from the large construction projects undertaken to host these events.[813] The organizing bodies for these large international events that award hosting privileges to Azerbaijan do not appear to be concerned about the inherent risks of self-enrichment by political elites in such an economic environment.

To address this basket of corruption, money laundering, and other governance risks associated with SWFs, national governments and private sector actors must first recognize the enabling role they have in facilitating red flag behavior and then address the governance and regulatory gaps that allow this behavior. With this in mind, several policy recommendations could help address those gaps.

- National governments should establish a regulatory rubric that examines SWFs for both national security risks and significant corruption and money laundering risks. This would automatically make verifiable information on particularly high-risk SWFs more readily available.

- Because SWFs often invest through private equity funds, hedge funds, and venture capital funds, jurisdictions should ensure that the private investment fund sector has requisite AML/CFT obligations, such as full customer due diligence. And these obligations should be appropriately enforced.

- Jurisdictions should prioritize the creation of strong beneficial ownership registries that require a business, trust, charity, or other entity to declare who owns or controls it. If the beneficial owner includes a SWF, this should have to be declared as part of the registry process. This is critical for continued information sharing and to track the movement of political elites' ill-gotten gains, which can move more easily via these funds.

- Financial institutions and entities obliged to implement AML/CFT frameworks should be provided detailed guidance on how to assess SWFs for AML/CFT and corruption risks. The "sovereign" nature of a fund should not provide automatic legitimacy to an SWF's financial transaction. The language in the UK's JMLSG offers a good starting point.

- Jurisdictions should implement more stringent penalties, including the loss of a license and criminal prosecution, for individuals who enable corrupt activity. Despite record fines, financial institutions, law firms, accounting firms, and other intermediaries continue to engage in bad behavior, as laid out in numerous examples throughout this compilation.

- Governing bodies for international sporting events should ensure that any SWFs involved are subject to the independent audit or disclosure requirements of contracts awarded, including full financial reporting to address associated corruption and money laundering risks.

- Capital market regulators, such as the U.S. Securities and Exchange Commission, should create more detailed SWF investment forms that include the name and location of all sub-funds, coinvestments, and direct and indirect investments.

Policy Reform in Countries Where SWFs Are Created

Throughout the history of SWFs, the absence of well-defined, robust governance frameworks has contributed to the loss of billions of dollars as a result of poor investment decisions, mismanagement, and corruption. Both the Libyan and Kuwaiti SWFs lost billions because investments from their respective funds were used to benefit allies close to the country's regimes or private sector intermediaries responsible for managing the funds' resources.[814]

In the case of Libya, prior to the Malaysian 1MDB scandal, Goldman Sachs was implicated in the mismanagement of funds at the Libyan Investment Authority (LIA).[815] In a lawsuit filed by the LIA, the fund alleged that Goldman Sachs' mismanagement had lost the fund \$1.2 billion.[816] A subsequent two-and-a-half-year court battle in the UK ultimately cleared Goldman Sachs of wrongdoing but exposed the bank's questionable business practices in securing the LIA as a client.[817] The LIA made similar allegations of fraud and corruption against three other banks: JP Morgan, Credit Suisse, and Société Générale. Société Générale apologized to the LIA and agreed to a $860 million settlement.[818] For both the JP Morgan and Credit Suisse suits, there was no opportunity to decide them on their merits because they were filed after the statute of limitations had expired.[819]

In Kuwait's case, lawsuits filed in New York alleged that the management at Grouo Torras—the holding company for the Kuwait Investment Authority's Spanish investments—used a network of "shell companies, fictitious loans, fraud and embezzlement" and stole $950 million. As a result, the people of Kuwait lost $5 billion through "colossal mismanagement."[820] The scandal led to the conviction of two individuals on embezzlement charges in Kuwait, legal action in several countries, and a new Kuwaiti law that requires parliamentary scrutiny of investment decisions.[821]

In other cases, the lack of clear rules on how and when money from SWFs can be withdrawn has allowed billions of dollars to be removed. That was the case for Nigeria's Excess Crude Account (ECA). The ECA was set up in 2004 to protect Nigeria's budgets against volatility caused by changing crude oil prices, and it has long faced criticism because successive governments have made arbitrary withdrawals that have rarely provided tangible development benefits to Nigeria.[822] In 2022, the ECA was in the headlines because the account's assets fell to around $375,000 from $2.1 billion in 2015 and $20 billion in 2009.[823] In 2019, "$1 billion was withdrawn for the procurement of critical equipment for the Nigerian army, Navy and Air Force; $496 million was paid for 12 Super Tucano attack aircraft for the Air Force, while $380.5 million was disbursed for the procurement of various critical military equipment in a direct government to government contract."[824] There was particular criticism around the acquisition of the Tucano aircraft because that purchase did not receive prior approval from the National Assembly.[825] A report by Nigeria's National Economic Council found that 67 percent of withdrawals from the ECA between January 2005 and June 2015 "violated the operating principles of the fund."[826]

Many critics have noted that the ECA has no governance norms concerning deposits, withdrawals, and how the savings can be used.[827] In 2017, for example, the Natural Resource Governance Institute (NRGI) assessed the ECA as the most poorly governed natural resource–based SWF.[828] The institute found that the government failed to disclose any of the "rules or practices governing deposits, withdrawals or investments of the ECA."[829] The NRGI even asserted that the account was "so opaque" that there was "no way to know how much may be lost to mismanagement."[830] In 2019, the International Monetary Fund (IMF)—using the NRGI's methodology—found that out of thirty-three natural resource–based SWFs, the ECA was the second-most poorly governed SWF.[831]

Another risk typically seen with SWFs is that ruling governments use them to bypass the budget process, which usually requires parliamentary approval. The SOFAZ, for instance, does not require parliamentary approval, and funds can be directly executed at the behest of the president.[832] Similarly, Türkiye's SWF has been used as a parallel budget that can avoid most parliamentary scrutiny and oversight (see chapter 8).

Fortunately, substantive work has been done to identify the key reforms needed to ensure that states create robust accountability mechanisms. But the absence of global assessments or enforcement mechanisms, such as through civil society mechanisms or investigative journalism, has limited the broad-based uptake of these suggested reforms. Leading experts in the field have identified four internal reform efforts that are critical to addressing SWF-related corruption, money laundering, and governance challenges.

1. Establish a well-defined institutional structure for the SWF, including by setting clear fund objectives. For instance, plainly state whether the fund seeks to stabilize the budget, save for future generations, or dedicate its resources to development goals; disallow the use of vague, undefined terms that can make it hard to assess the SWF's objectives. One of the three objectives of the SOFAZ is "preserving macroeconomic stability," but there is no definition on what exactly this constitutes in Azerbaijan.[833]

2. Set a rules-based investment mandate that spells out what percentage can be made in equities versus real estate versus development projects. Restricting domestic expenditure through the SWF and mandating that domestic investments follow a budgetary process are additional ways to mitigate fund losses and risks around patronage networks and crony capitalism.[834]

3. Develop and operationalize well-defined, rational fiscal rules. The rules would dictate when and how money could be withdrawn and deposited into the fund. For instance, Russia and Abu Dhabi in the United Arab Emirates do not have withdrawal and deposit rules.[835] By contrast, Alaska and Texas in the United States, as well as Chile, Norway, and Timor-Leste, have clear rules on withdrawals and deposits and require disclosures on fund activities, transactions, and fund managers.

4. Establish independent oversight of the fund. This would ensure that there is a clear division of responsibilities between the fund manager, who has overarching authority over the SWF, and those running the day-to-day operations; and it would also help create a clear mapping of the ethical and conflict of interest considerations. Additionally, it would ensure that the fund provides an exhaustive disclosure of its investments, fund managers, and audited financial statements. Independent oversight authorities within the country should monitor fund behavior and raise queries about management and performance. Alberta in Canada, North Dakota and Texas in the United States, and Norway have funds with strong independent oversight mechanisms.[836] SWFs must be accountable politically to a parliament or congress, accountable legally to the judiciary, and accountable operationally to the auditor general or some other supervisory body that is both formal and independent. There should also be sufficient information available for civil society, journalists, and international organizations like the IMF so that they can also serve as effective oversight mechanisms.[837]

Revisiting and Reframing International Standards on SWFs

Chapters 1 and 2 of this compilation set out the international standards, norms, and guidance documents that govern the operation of SWFs. These introductory chapters, and the case studies that follow, show that SWFs globally operate in an environment of soft norms. Notably, the International Forum of Sovereign Wealth Funds (IFSWF), which is the main organizing body for SWFs, and its associated Santiago Principles, which include SWF best practices formalized in 2008, were created to "address the issues surrounding excess reserve accumulation, as well as appease national security concerns emanating from foreign government-affiliated investments."[838] This language from the IFSWF's website is rather telling and demonstrates the dual intent behind these principles: to ensure the appropriate governance of SWFs and provide peace of mind to countries where SWFs invest. However, since their creation, the twenty-four Santiago Principles have remained entirely voluntary and have not been reviewed or updated. The fact that they are voluntary and appear to have been created to "appease" rather than provide a "robust standard" helps make the case that SWFs are ill-equipped to address and enforce the governance challenges such funds and the security concerns of the countries where they invest. This inability to address security concerns is evident, given that in the fifteen years since the principles came into being, countries have had to expand the laws and restrictions governing foreign investment. For example, in 2005, less than five countries had investment screening procedures.[839] By 2022, this number had shot up to over thirty-five countries with investment screening procedures (see figure 3).[840]

While the Santiago Principles have long provided clear context for studying and regulating SWFs' impact, nowhere in the drafting language is there an explicit reference to the potential for abuse. Because the principles have remained static, they do not account for recent changes in how SWFs are used and operated. For instance, principle 14 (more technically referred to as GAPP 14), which supports the creation of adequate internal policies for SWFs when dealing with third parties, does not account for a mechanism to deal with external governance considerations when an SWF directly interacts with the global financial system.[841] Similarly, GAPP 18.2 states that "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."[842] Yet this once again ignores the risks presented from the investments themselves.

When the language was first drafted, SWFs were comprised of primarily passive investors relying on external fund managers.[843] However, since then, the mandates, objectives, investment strategies, and types of SWF funding models have drastically evolved. Today's SWFs are active direct investors that often coinvest with private sector entities (see chapter 1). Yet the Santiago Principles do not advocate that SWFs disclose or assess their investments on economic and financial grounds.[844] As noted by one assessment, the Santiago Principles are inward-looking and appear ill-equipped to address the governance risks of SWFs that operate as external actors.[845]

Critics of the Santiago Principles also note that there is no explicit acknowledgment of the significant increase in "novel forms of partnership and collaboration" in "sovereign-private arrangements."[846] Explicitly recognizing this increase and enhancing the disclosure requirements for these arrangements would alleviate concerns around both national security and corruption risks.[847] For instance, the more recent expansion of powers under the U.S. CFIUS review process was done to address Chinese and Russian investments in sensitive U.S. technology spaces masked as investments through U.S. private investment funds (see chapter 1).[848]

Additionally, there is no requirement to publish audited statements or send them to an international organization that can act as an independent third-party verifier of information. Other international mechanisms such as the Extractive Industries Transparency Initiative—which sets best practices for oil, gas, and mining governance—include this requirement.

Apart from the gaps within the Santiago Principles, another concern is the legitimacy SWFs receive from being part of the IFSWF. Members are only required to carry out self-assessments. For instance, Azerbaijan's SOFAZ assesses itself as meeting the requirements under all relevant Santiago Principles, but there are real concerns about how projects through the fund are approved and how payments are made through the SOFAZ.

Similarly, in its 2016 self-assessment, Angola's Fundo Soberano de Angola (see chapter 4) stated that it was meeting most governance standards, but soon after, an exposé was published on the fund's mismanagement and the conflicts of interest surrounding its fund manager.

IFSWF members in theory support the idea of transparency, as it can enhance domestic legitimacy of the SWF, improve communication with relevant stakeholders, and have an overall positive impact on the SWF's reputation.[849] However, as laid out in chapter 2, "voluntary participants' compliance with the Santiago Principles is still alarmingly low." The IFSWF also lacks any legal authority to enforce its standards, and unlike with money laundering and tax evasion, international organizations and civil society have shied away from naming and shaming as a way of ensuring compliance.

Self-regulation is ineffective because it is simply not in the interest of SWFs to critically examine their frameworks. Also, because the language of the Santiago Principles is broad, there is no effective way to determine whether the required disclosures meet a necessary standard to mitigate the risks of corruption and money laundering and foster good governance. A comparable example would be if countries were allowed to determine whether they adequately meet the international AML/CFT requirements of the Financial Action Task Force's forty recommendations but without the assistance of guiding criteria on what constituted an effective beneficial ownership law or customer due diligence practice. This overhaul of international standards must involve greater dialogue and guidance from both the Organisation for Economic Co-operation and Development (OECD) and IMF. Current language from the OECD entirely focuses on the national security prism; and the IMF, unlike its work on state-owned enterprises, couches best practices in terms of increasing legitimacy and does not outrightly refer to the problem of corruption.

Therefore, SWF reform will not trickle down to the country level unless there are measurable international standards against which SWFs are compared. With this in mind, the following policy recommendations may help address the gaps.

- The Santiago Principles should be revised to reflect current SWF practices and risks. Any such revision effort should seek input from a wide variety of stakeholders and specifically include civil society organizations.

- The Santiago Principles should be revised to serve as both guiding principles *and* effective standards against which international organizations like the IMF can conduct assessments. There is precedent for this: countries allow their AML/CFT standards to be assessed by the Financial Action Task Force or its regional bodies, and the assessment is not perceived as impinging on states' sovereignty.

- The OECD should move its focus beyond the narrow prism of security threats to investment jurisdictions and publish a comprehensive international best practices paper that addresses both the internal and external aspects of SWF corruption risk.

- SWFs that are at high risk for corruption and money laundering should be red-flagged.[850]

The intention of this compilation is not to undermine the tremendous value that a well-governed SWF can provide for a country and its citizens for generations. Valuable lessons abound from the experiences of countries that have successfully transitioned from natural resource dependent economies to diversified economies. At the same time, this compilation and the reforms suggested serve to highlight the need for more critical study around the corruption, money laundering, and associated governance risks of SWFs. Failure to understand these risks will lead to SWFs failing to deliver on their promises of providing economic security and generational wealth for citizens.

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Appendices

Appendix A: Sovereign Wealth Fund Definitions

As noted in chapter 1, this compilation uses the Santiago Principles' definition of SWFs but also examines other funds that are in practice regularly treated as SWFs. Other organizations use more expansive definitions of SWFs. The Sovereign Wealth Fund Institute, a globally recognized subscription-based research platform, states that SWFs include a wide variety of state-owned investment vehicles, and it makes no restrictions based on where the investment is deployed. This definition is in line with the one used by the International Forum of Sovereign Wealth Funds (IFSWF), a leading voluntary organization of SWFs that aims to help SWFs implement the Santiago Principles.[851] Similarly, the United States and the European Union (EU), respectively, define SWFs as "government investment funds, funded by foreign currency reserves but managed separately from official currency reserves" and as "state-owned investment vehicles, which manage a diversified portfolio of domestic and international financial assets, and generally accept a high level of risk in search of higher returns."[852] Table 1 lists the most common SWF definitions.

Table 1. Sovereign Wealth Fund Definitions

No	Institution	Definition
1	Santiago Principles[853]	"SWFs are defined as special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The SWFs are commonly established out of balance-of-payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports." "Three key elements define an SWF: 1. Ownership: SWFs are owned by the general government, which includes both central government and subnational governments. 2. Investments: The investment strategies include investments in foreign financial assets, so the definition excludes those funds that solely invest in domestic assets. 3. Purposes and Objectives: Established by the general government for macroeconomic purposes, SWFs are created to invest government funds to achieve financial objectives, and (may) have liabilities that are only broadly defined, thus allowing SWFs to employ a wide range of investment strategies with a medium- to long-term timescale."
2	U.S. Treasury[854]	SWF funds are government investment funds, funded by foreign currency reserves but managed separately from official currency reserves.
3	IE University Spain[855]	Government-owned investment funds that pursue a long-term investment strategy and have no obligation to pay pensions. The distinction between SWFs and pension funds is a key element of the definition. SWFs, by definition, are free from the characteristic liability of public pension funds: obligations to pensioners. SWF investment policies are clearly influenced by this lack of obligations to third parties. Unlike pension funds, SWFs are not responsible for any regular payments and thus have no periodic liquidity needs. In addition, the focus on long-term investment distinguishes SWFs from private equity, which has defined investment horizons, and from hedge funds, which are often opportunistic.
4	Government of Singapore Investment Corporation (GIC), Singapore[856]	"The essence of a SWF is that it is state-owned and mandated to invest the public funds under its charge."

No	Institution	Definition
5	Sovereign Wealth Fund Institute[857]	"A Sovereign Wealth Fund (SWF) is a state-owned investment fund or entity that is commonly established from: • Balance of payments surpluses • Official foreign currency operations • The proceeds of privatizations, • Governmental transfer payments, • Fiscal surpluses • And/or receipts resulting from resource exports. The definition of sovereign wealth fund excludes, among other things: • Foreign currency reserve assets held by monetary authorities for the traditional balance of payments or monetary policy purposes, • State-owned enterprises (SOEs) in the traditional sense • Government-employee pension funds (funded by employee/employer contributions) • Or assets managed for the benefit of individuals."
6	International Monetary Fund[858]	"SWFs are government investment funds established for various macroeconomic purposes. They are commonly funded by the transfer of foreign exchange assets that are invested long term, overseas."
7	European Union[859]	"Sovereign Wealth Funds (SWFs) are state-owned investment vehicles, which manage a diversified portfolio of domestic and international financial assets, and generally accept a high level of risk in search of higher returns."

Appendix B: Defining Corruption

There is no universal definition of corruption, and what constitutes corruption is controversial.[860] For the purposes of this compilation, the authors use the definition proffered by Transparency International, which is "the abuse of entrusted power for private gain."[861]

Many organizations, including the World Bank, Organisation for Economic Co-operation and Development, the International Monetary Fund (IMF), and Basel Institute on Governance use variations of this definition. The World Bank and IMF, for example, define corruption as "the abuse of public office for private gain,"[862] while the Basel Institute on Governance uses the very similar "abuse of public office for personal gain."[863]

The Transparency International definition has been chosen by the compilation's editors because of the role of "entrusted power" in corruption and other governance lapses associated with sovereign wealth funds. Some of the issues highlighted in this compilation that raise red flags for potential corruption were not undertaken explicitly by those in an official capacity as part of a public office but instead were private enterprises and individuals that had been designated or delegated various authorities by governments. For instance, in some cases, private investment funds undertook investments of sovereign wealth resources on behalf of governments that could be perceived as a potential conflict of interest, such as investing funds in projects owned by those running the private investment fund. While these private firms are not "public offices," they are acting with "entrusted power" on behalf of governments, hence the applicability of the Transparency International definition.

Transparency International is the oldest global anti-corruption civil society organization, and its Corruption Perceptions Index is considered the gold standard of corruption-associated indices (though it has gaps in methodology). Transparency International's corruption definition is thus considered an authoritative one by good governance scholars, civil society, and governments.

Notes

Summary

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Chapter 1

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Chapter 6

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Chapter 8

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