Sovereign wealth funds – state investments during the financial crisis

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Editorial note

- This presentation provides data and evidence as an update of previous Deutsche Bank Research publications on this topic, especially "SWFs and foreign investment policies – an update", Deutsche Bank Research, Current Issues, October 22, 2008.
- The data provided in this presentation is valid as of June 5, 2009, unless specified otherwise.
- The data provided in this presentation cannot be directly compared with evidence in previous publications by Deutsche Bank Research as changes have occurred in the external databases used for this analysis and data categorisation.
- Authoritative or authorised information on asset sizes, asset allocation, funding, investment strategies and investment transactions of SWFs is still very scarce. The figures presented in this presentation have been collected from various publicly available sources and checked against public market information with the aim of maximising plausibility. Given the fragility of underlying data, all SWF-related figures and the calculations based upon them in this presentation should be considered as indicative and treated with due caution.

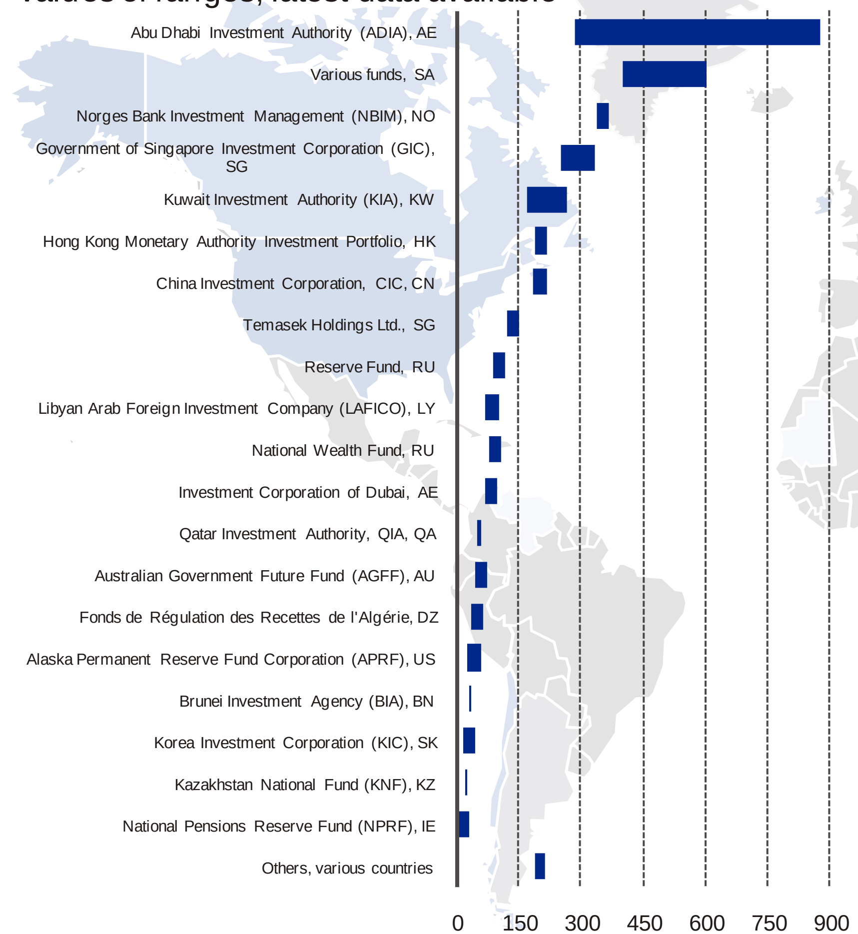
Agenda

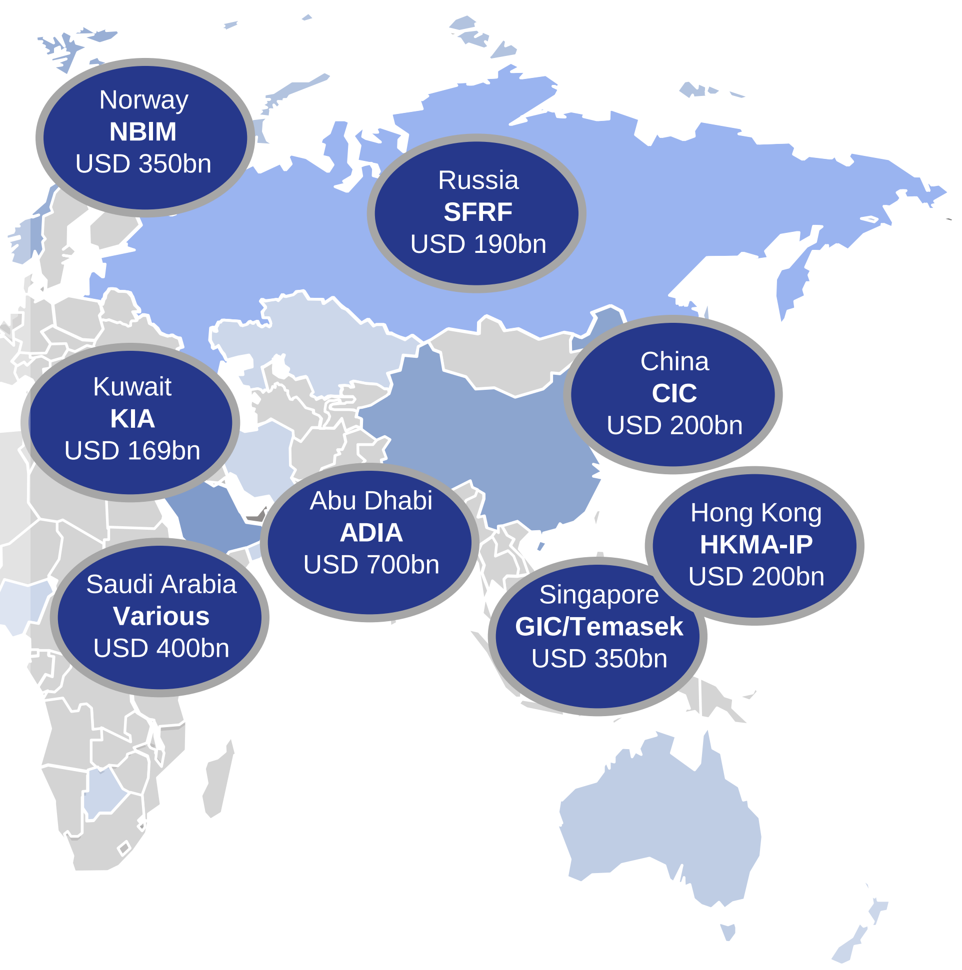
1. Industry overview
2. Impact of economic crisis
3. Growth prospects
4. Investment trends
5. SWF disinvestments
6. Policy issues

SWFs – a more than USD 3 trillion business…

Major SWFs worldwide

Assets under management in USD bn, estimated values or ranges, latest data available





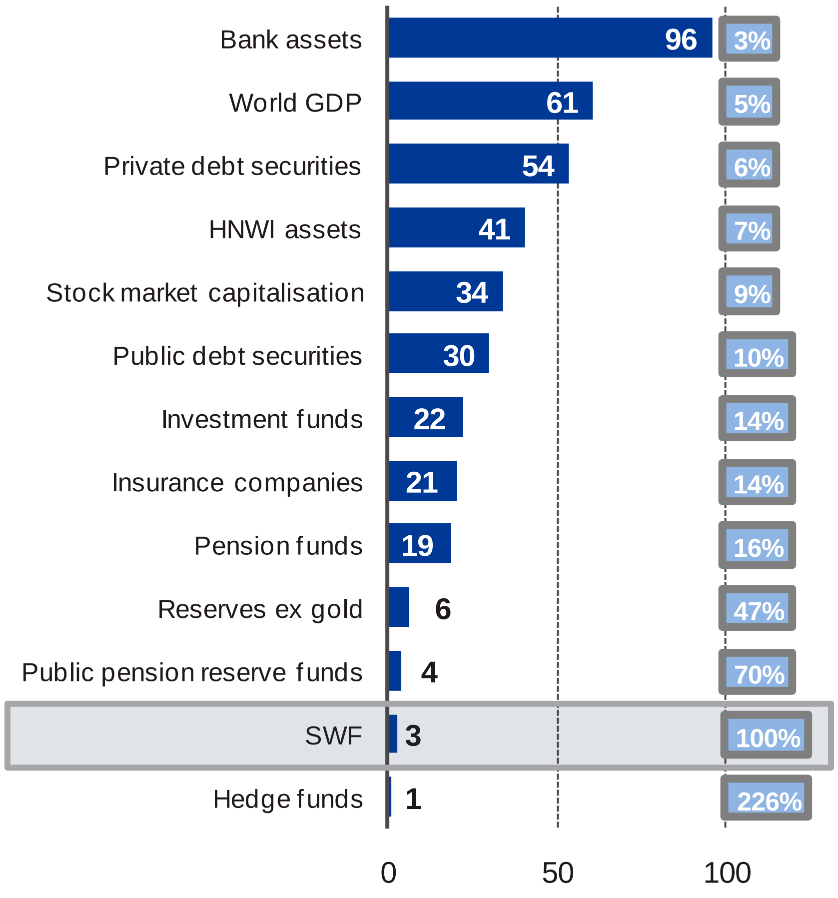
Source: DB Research

… that thus far plays a limited role in global finance

- **SWF assets under management are estimated to amount to more than USD 3 tr**
- **This is an impressive figure, representing a multiple of the assets held a decade ago**
- **In comparison with other asset classes and financial market segments, the size of SWFs is still limited**
  - Despite being more than twice the size of the hedge fund business…
  - … SWF assets make up less than 1/2 of global foreign exchange reserves …
  - … less than 1/6 of global pension assets, around 1/7 of global investment funds and insurance assets …
  - … less than 1/10 of global stock market capitalisation…
  - … and only 3% of bank assets worldwide
- **This aggregate comparison, however, cannot detract from their importance in individual – often high-profile – investment transactions**

SWF assets in comparison

Asset classes by volume, USD tr and SWF assets as % of other asset classes, latest data available



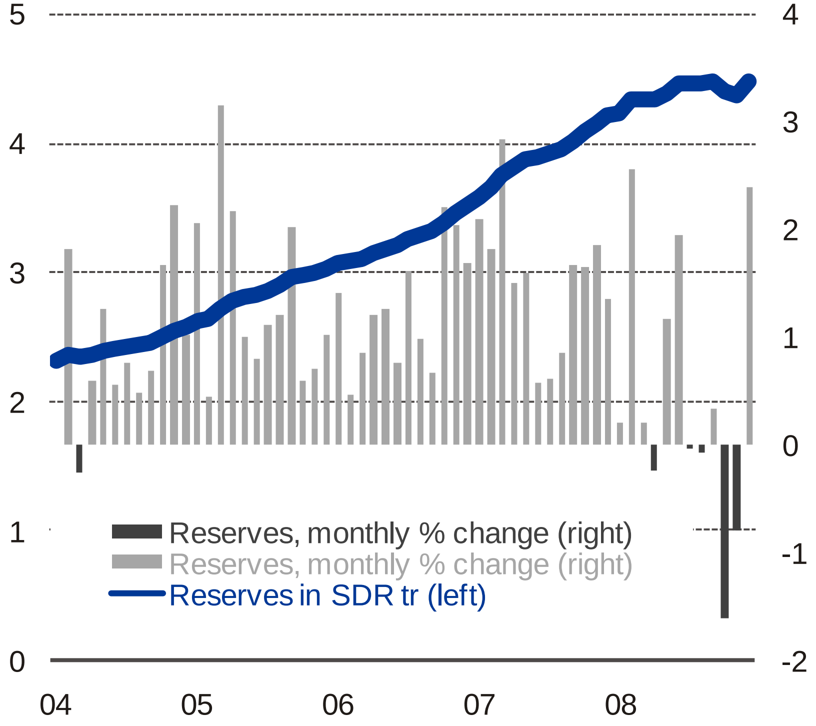
Source: DB Research

Agenda

SWFs affected by sudden erosion of revenues…

Reserves growth losing steam

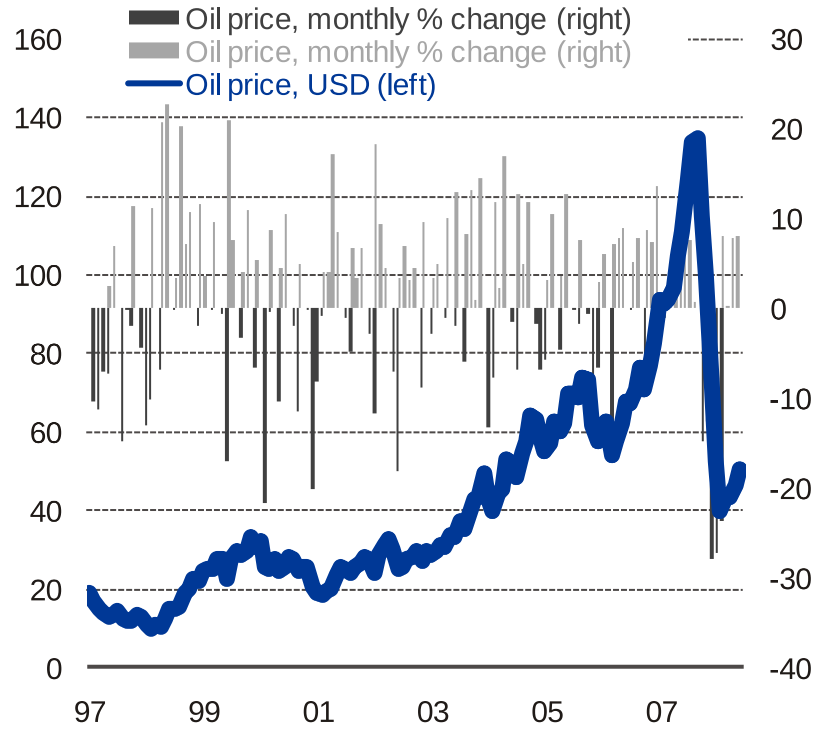
Foreign exchange reserves excl. gold in SDR tr (left), and monthly rate of change in % (right)



Source: DB Research

Oil price decline

Spot oil price, Brent, USD (left) and monthly change (right)



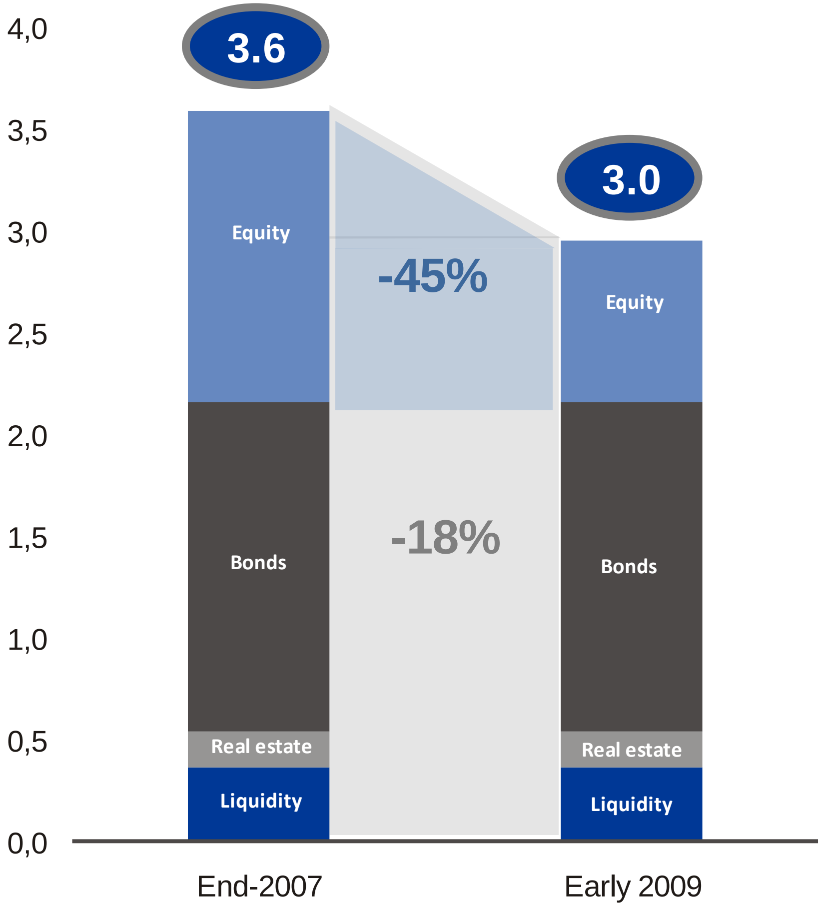
Source: DB Research

… and decline of book value of investment portfolios

- **Revenue erosion**
  - Current account surpluses of parent countries of major SWFs have narrowed as trade surpluses decline, …
  - … and dramatically diminished oil and other commodity prices reduce revenues from sales of natural resources …
  - ... leading to a visibly decelerated accumulation of foreign exchange reserves
- **Decline of portfolio book value**
  - As for other institutional investors, mark-to-market values of SWF portfolios likely to have suffered during financial crisis
  - Typical equity portfolios held by SWFs may have lost 45% between end-2007 and early 2009, reducing overall SWF portfolios by around 18%
  - Additional changes in portfolio values may result from price variations in other asset classes
  - Overall, such changes in portfolio values have – with very few exceptions – not been realised so far, with SWFs holding on to their investments

Decline of SWF portfolio values

Estimated values of assets for stylised portfolio distribution in USD tr



Source: DB Research

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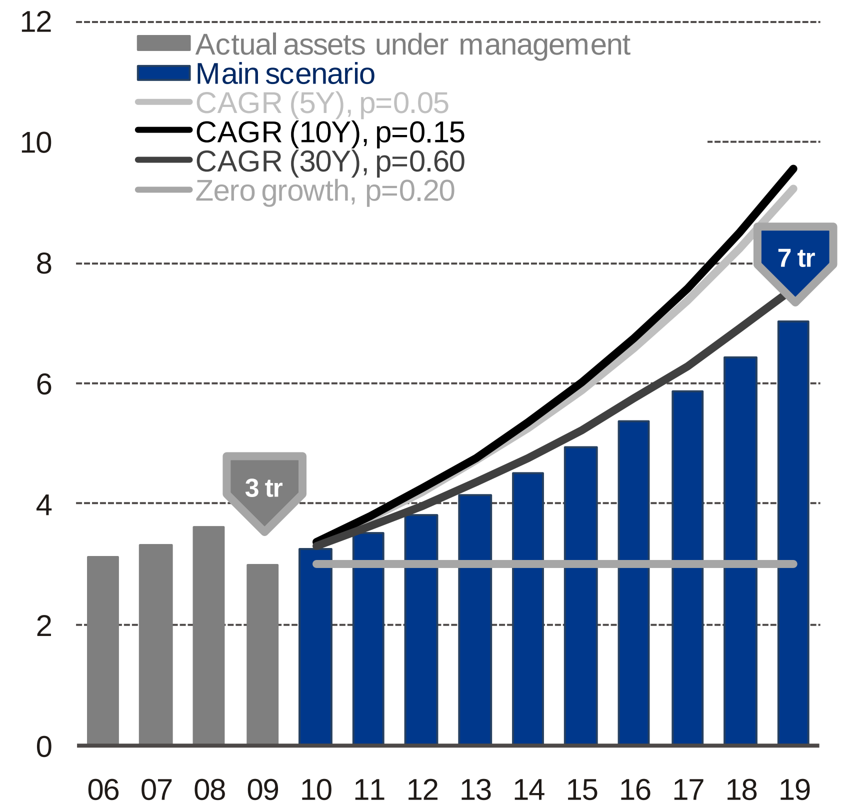
Still, growth prospects in the long run…

- **Long-term prospects for SWFs are nevertheless positive, on the whole**
  - Past performance of foreign exchange reserves – as a key indicator for liquidity that can be allocated to SWFs by parent governments – suggests that, in future, funds available for sovereign savings will continue to mount
- **In 10 years, total assets under SWF management are likely to amount to USD 7 tr, more than twice the volume of today**
- **Given the volatility in commodities and asset markets, other scenarios are conceivable and the development of asset volumes is subject to substantial uncertainties**

SWF asset growth

Scenarios for the development of assets managed by SWFs, based on past foreign exchange reserves growth, USD tr, 2006-2019



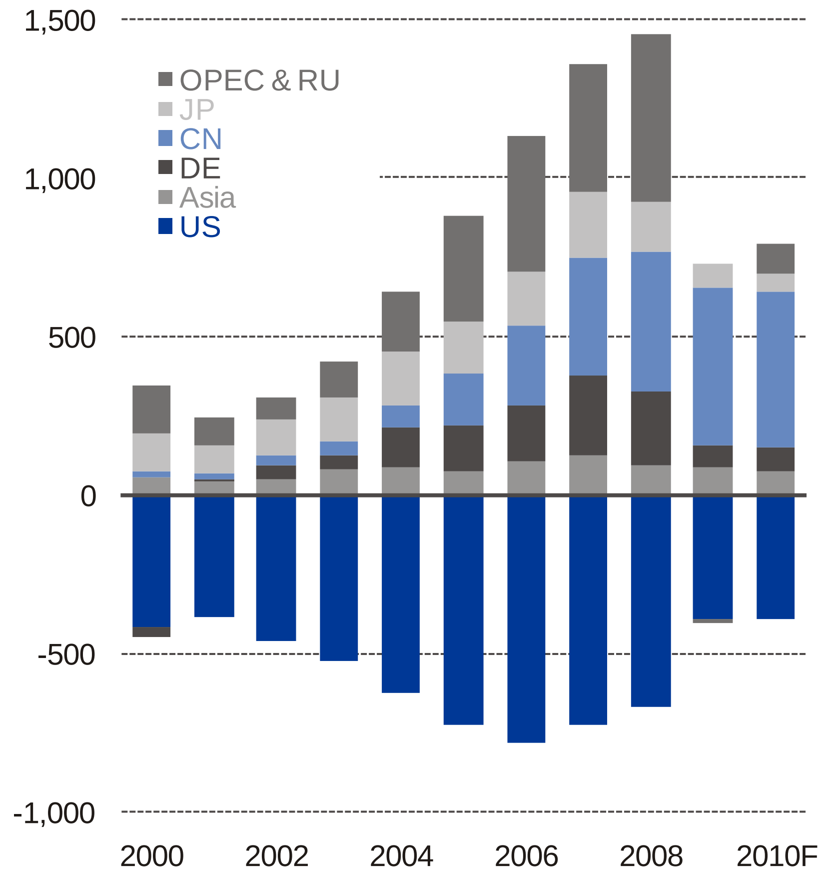
Source: DB Research

… depending on the future of trade and capital flows

- **Underlying SWF growth potential is contingent upon the future of globalisation**
  - Should current account balances resume their recent trend of widening deficits in the US and strongly growing surpluses in the EMs, then fundamentals for SWF development remain strong
  - If significant reductions in current account balances occur, i.e. especially trade activities remain subdued for a longer while, then SWF inflows are set to remain clearly below the levels seen in the recent past
- **As a result, SWFs particularly sensitive to global macro risks**
  - Macroeconomic risks: Exchange rate movements, commodity price changes, trade and capital flows
  - Global political risks: Potential protectionism in recipient countries, political climate between governments

Global imbalances

Current account balances, USD bn



Source: DB Research

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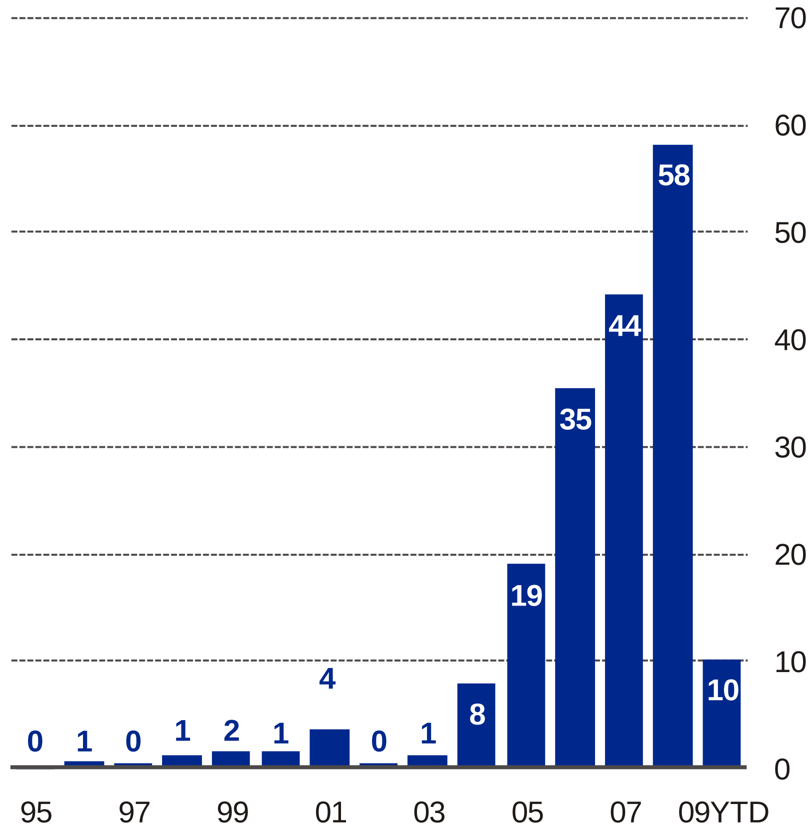
SWF investments reflect fund inflows … and their decline

- **For 1995 to 2009 YTD, publicly reported investment transactions by sovereign investment entities in publicly listed companies amount to USD 185 bn**
- **2004 to 2008 represent the heydays**
  - Strong overall acceleration of global investments especially across EU, Asia and also US
  - 2007 and 2008 volumes driven by investments in financial sector, especially in US, UK and CH
- **First evidence of activities in crisis environment suggests sharp decline**
  - Investments well over 50% down from 2008 levels
  - No more investments in financial sector
  - Some funds have publicly announced a moratorium on overseas investments until further notice, including QIA, ADIA

Sovereign investments over time

Completed investment transactions by state-sponsored investment vehicles, USD bn



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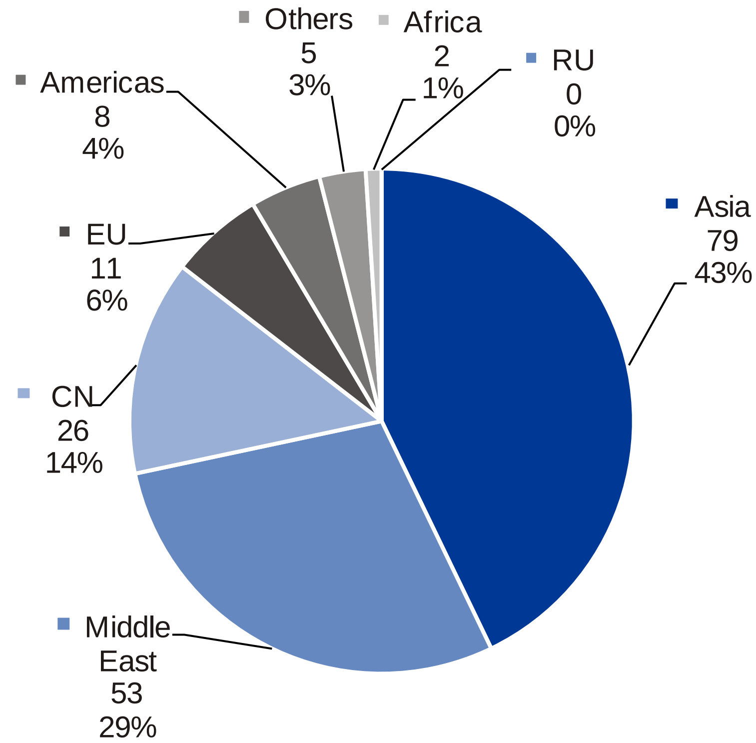
Asia and Middle East are busiest investors

- **As homes to the largest SWFs worldwide, Asian and Middle Eastern economies are the origin of most SWF transactions**
  - 43% from Asia
  - 29% from Middle East
  - Only 18% from other economies

Sovereign investments by domicile of investor

Completed investment transactions by state-sponsored investment vehicles, by domicile of investor, USD bn and % of total, 1995 – 2009 YTD



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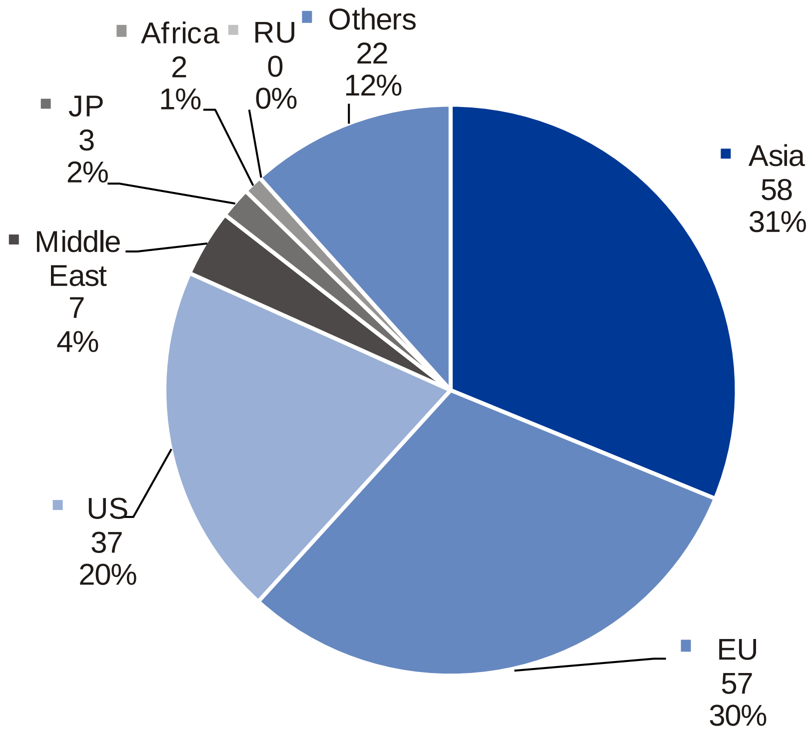
Asia and Europe remain preferred targets for investments

- **Asia and the EU remain the preferred targets for SWF investments**
  - 31% to Asia
  - 30% to EU economies
  - 20% to US
- **Shares reflect…**
  - … prospect of strong long-term growth potential of Asian economies
  - … balanced growth expectations for EU
  - … desire to currency-diversify out of USD, into EUR

Sovereign investments by target region

Completed investment transactions by state-sponsored investment vehicles, by domicile of target, USD bn and % of total



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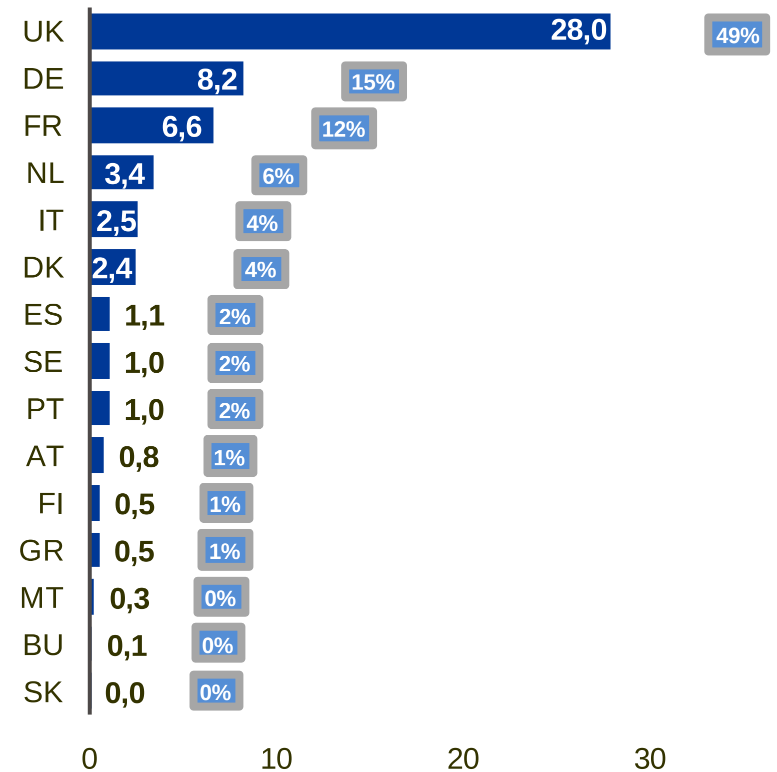
EU investments: UK on top owing to bank participations

- **UK tops the league of EU recipient economies, largely reflecting strong inflows into UK's financial sector**
  - UK 49% share in SWF EU investments
- **Continental EU shows balanced distribution of SWF investments among largest economies**
  - DE 15%
  - FR 12%
  - NL 6%
  - IT 4%

Sovereign investments in EU member states

Completed investment transactions by state-sponsored investment vehicles in the EU, 1995 – 2009 YTD, by member state, USD bn and % of EU total



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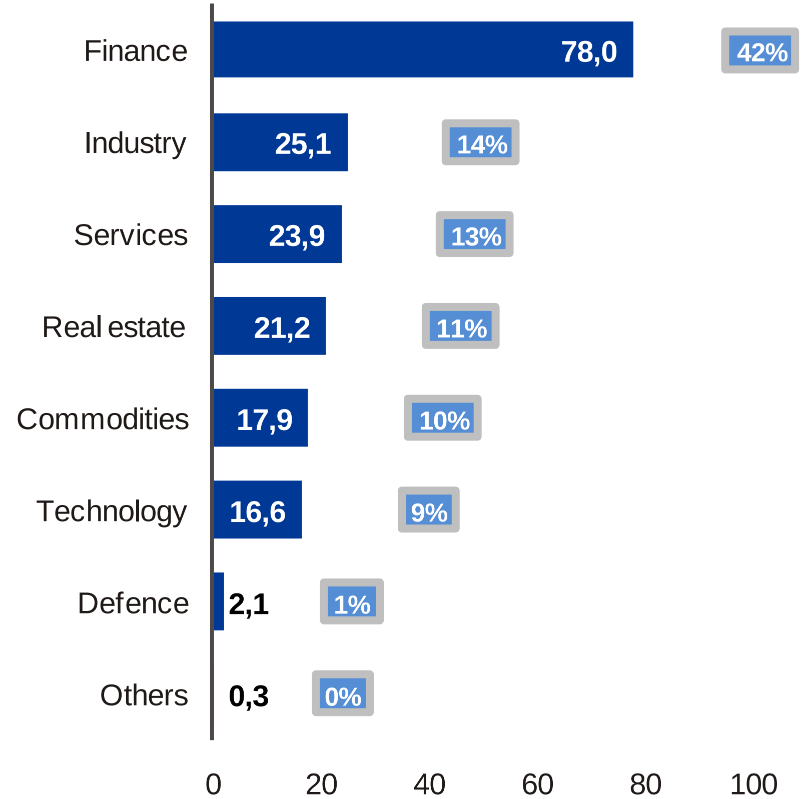
Global investments: Strong bias towards financial targets

- **Sectoral composition of SWF investments reflects huge investments in financial sector in 2007 and 2008**
  - 42% of all SWF investments
- **Investments in manufacturing industries, services, real estate and commodities distributed fairly evenly**
  - 14% manufacturing industries
  - 13% services
  - 11% real estate
  - 10% commodities

Sovereign investments by target sector

Completed investment transactions by state-sponsored investment vehicles, 1995 – 2009 YTD, by target sector, USD bn and % of global total



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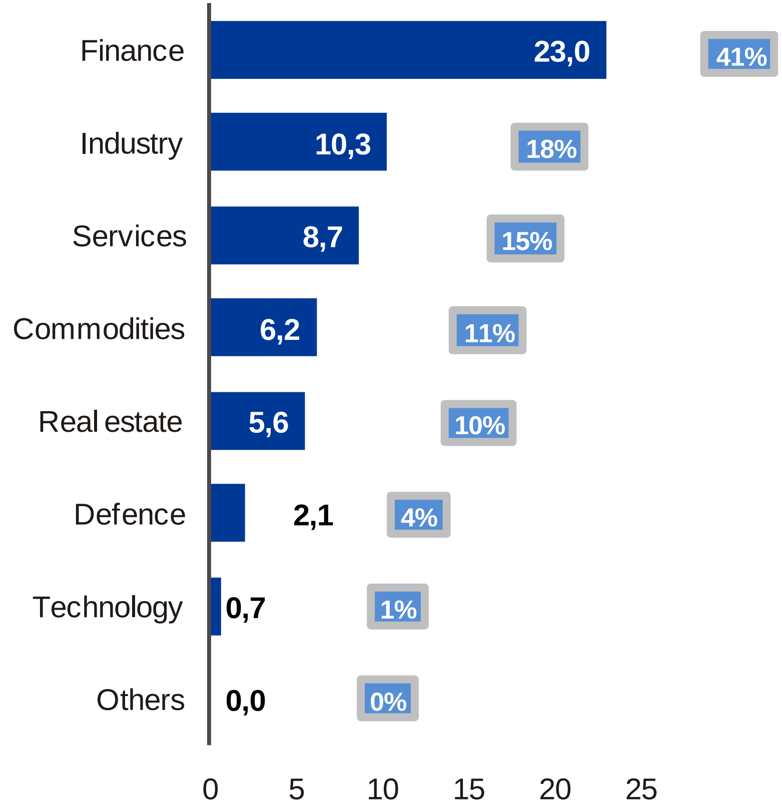
EU investments: More balanced sectoral distribution

- **SWF investments in UK financial sector raise finance share to 41%**
- **Other industries more evenly distributed**
- **Investments in industries that are often cited as particularly relevant to public security and order play a negligible role in investment patterns**
  - Defence 4%
  - Technology 1%

Sovereign investments in the EU by target sector

Completed investment transactions by state-sponsored investment vehicles, 1995 – 2009 YTD, by target sector, USD bn and % of global total



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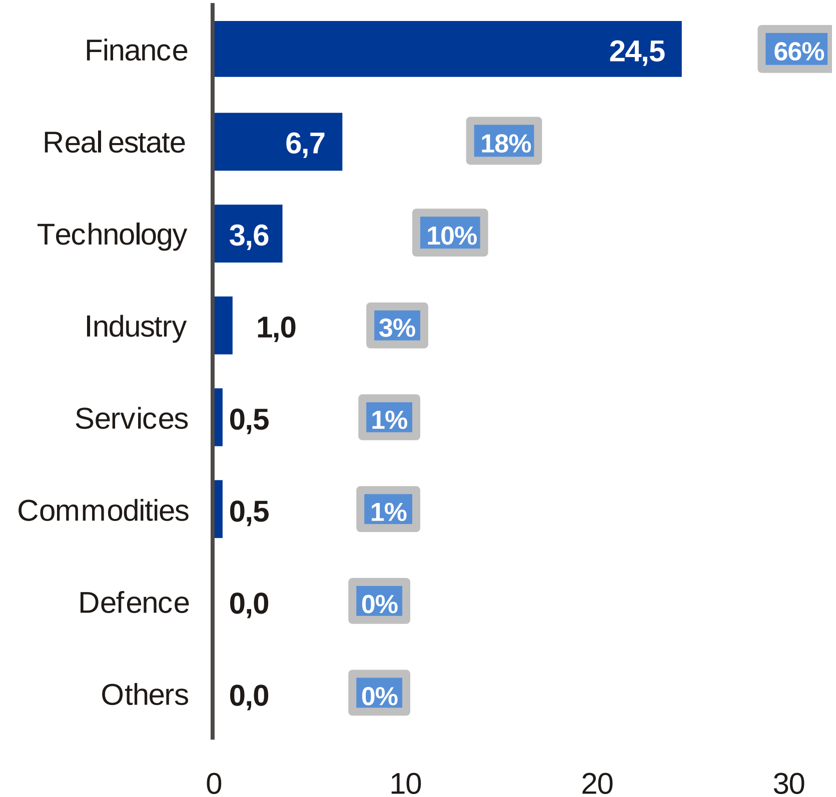
US investments: Heavy bias towards finance visible

- **Large investments in US banking sector in 2007 dominate US inward SWF investments**
  - 59% finance
- **Other industries much less balanced than in EU**
  - 18% real estate
  - 10% technology
  - 3% manufacturing industries

Sovereign investments in the US by target sector

Completed investment transactions by state-sponsored investment vehicles, 1995 – 2009 YTD, by target sector, USD bn and % of global total



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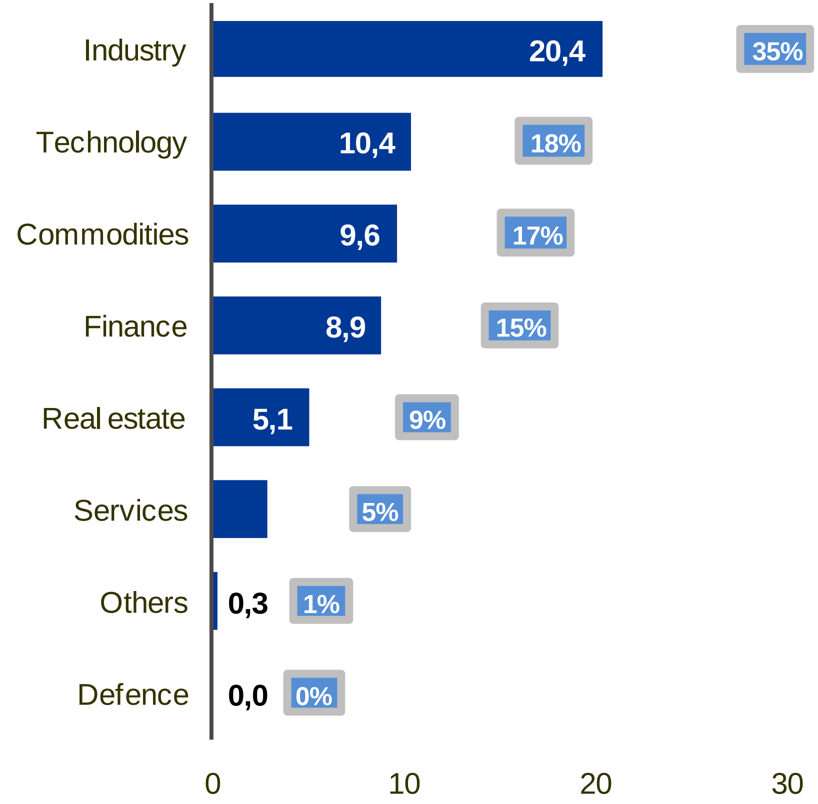
Asia investments: Balanced approach

- **Investments in Asia are very balanced by international and US standards**
  - Finance makes up only 15% of total investments
- **Industry is prime target in Asia**
  - 35% manufacturing industries
  - 18% technology
  - 17% commodities

Sovereign investments in Asia by target sector

Completed investment transactions by state-sponsored investment vehicles, 1995 – 2009 YTD, by target sector, USD bn and % of global total



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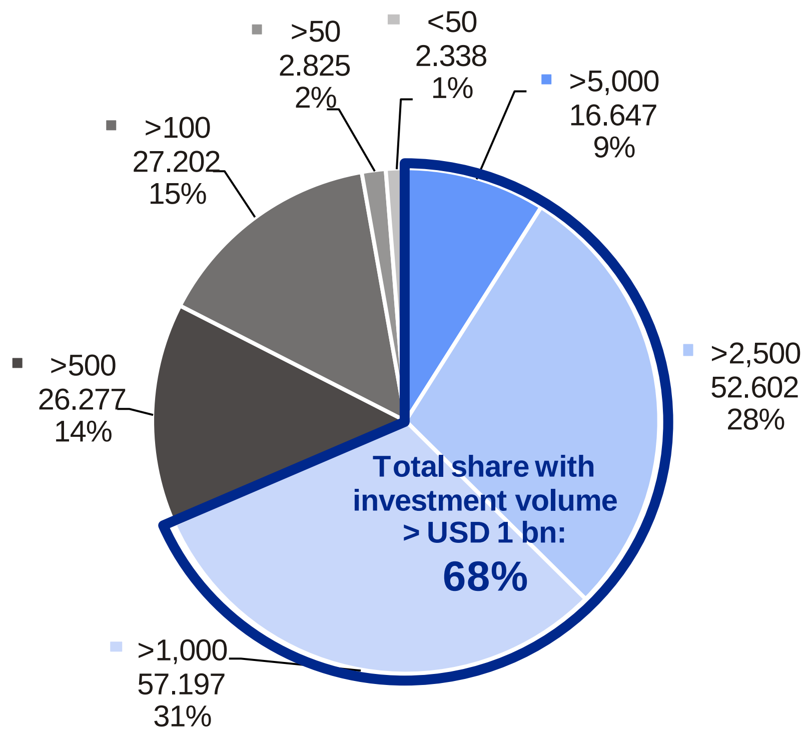
Agenda

Global investments: Large-scale investments dominate

- **Publicly reported sovereign investments in companies tend to be large transactions…**
- **… with 68% of all deals valued at USD 1 bn or higher**
  - 9% are USD 5 bn or higher
  - 28% are between USD 2.5 bn and USD 5 bn
  - 31% between USD 1 bn and USD 2.5 bn
- **No evidence exists on the size of undisclosed investments**
  - The publicly reported transactions analysed here are likely to contain a significant bias towards large transactions
  - Undisclosed transactions are probably of a significantly smaller size

Sovereign investments by size of individual transactions

Completed investment transactions by state-sponsored investment vehicles, by size of transaction, USD m and % of total, 1995 – 2009 YTD



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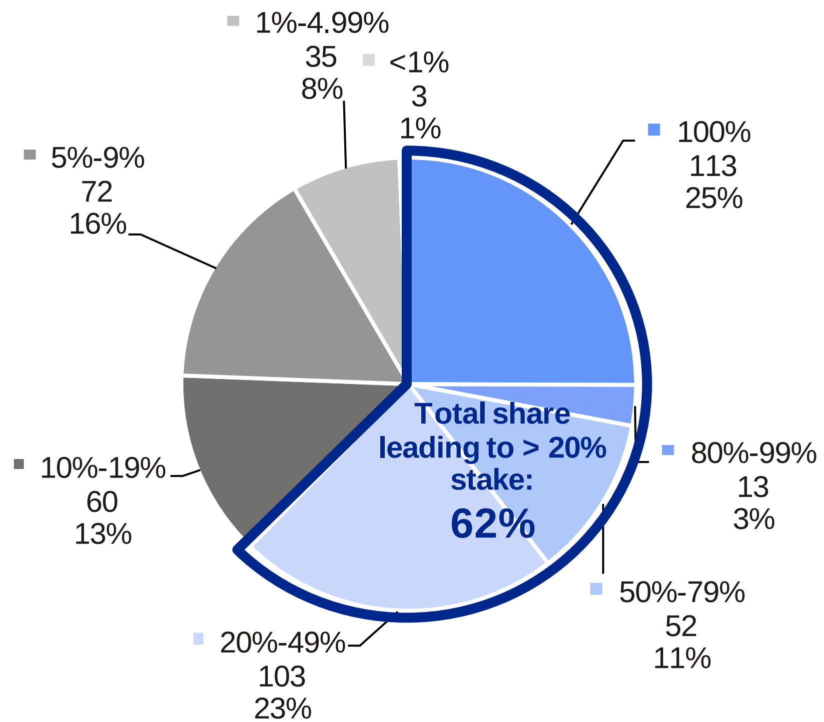
Global investments: Controlling stakes not uncommon

- **Sovereign investments in listed companies tend to lead to controlling stakes in the target entities**
  - 62% of all deals lead to final stakes of 20% or higher
  - 1/4 of all deals lead to 100% acquisitions
- **No evidence exists on the size of undisclosed investments**
  - Norway's NBIM alone, for example, owning 0.77% of global equities, holds a total of 7,900 different securities by 2,200 issuers worldwide. Individual equity investments are limited to 10% stakes per company statutorily. The vast majority of NBIM's equity investments are understood to be lower than 2% stakes. Only 195 companies worldwide have a stake higher than 2%. Only 4 have a stake higher than 5%. The largest NBIM shareholding is reported to amount to 8.7%.

Sovereign investments by size of acquired stakes

Completed investment transactions by state-sponsored investment vehicles, by size of stake acquired in individual enterprises per transaction, by number of transactions and % of total, 1995 – 2009 YTD



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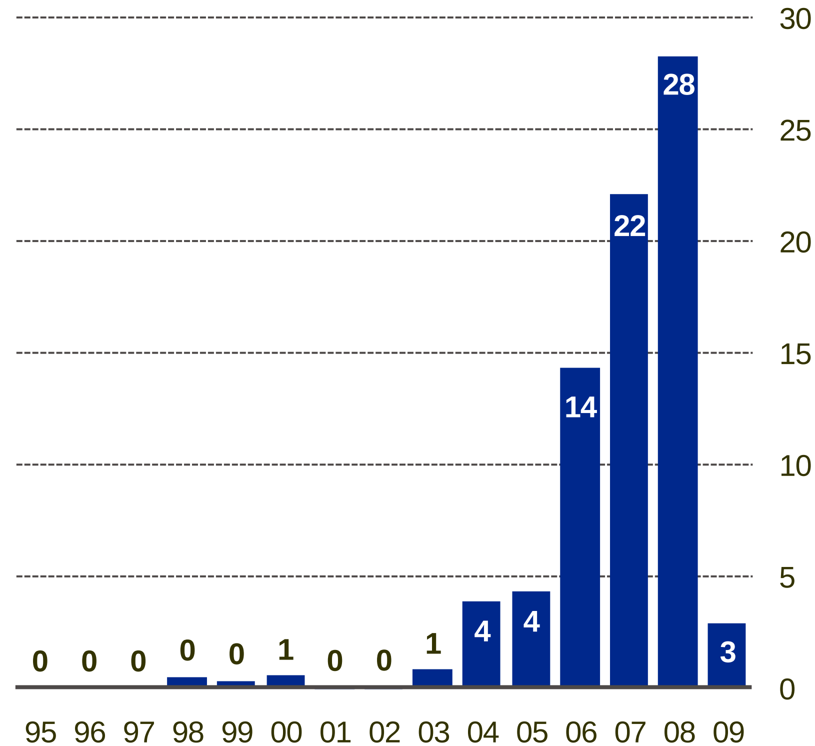
SWFs and global financial industry – massive investments…

- **SWFs have become an important and sought-after source of capital for banks worldwide, especially during the financial crisis**
  - Total gross investments by SWFs and state-sponsored investors since 1995 in the global banking industry amount to USD 113 bn
  - Investments in the financial industry at large amount to USD 137 bn (includes non-bank financial institutions)
  - Publicly reported individual investments amount to USD 78 bn
- **Beyond the immediate importance of SWF capital contributions in recent months, the volume of SWF investments remains limited**
  - The USD 113 bn of SWF investments in global banks make up 2.6% of USD 4.3 tr of global stock market capitalisation of banks

Sovereign investments in the financial industry over time

Completed investment transactions by state-sponsored investment vehicles in the financial sector globally, USD bn, 1995 – 2009 YTD



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… have led to high stakes in prominent institutions

- **7 SWFs are large or single largest shareholders in the most prominent Wall Street banks and some important European banks**
- **Dubai state-sponsored investors are controlling shareholders in the global stock-exchange landscape**

Concentration of shareholdings — major SWF interests in financial firms

Funds	Target	Country	Share (%)
China (CIC)	Blackstone Group	US	**9.9**
	China Development Bank	CN	**NA**
	Morgan Stanley	US	**9.9**
	VISA Inc.	US	**NA**
Singapore (GIC, Temasek)	Bank of China	CN	**15.5**
	Barclays Bank	GB	**3.1**
	China Construction Bank	CN	**5.1**
	Citigroup	US	**11.1**
	ICICI Bank Ltd.	IN	**9.6**
	Merrill Lynch	US	**9.9**
	Standard Chartered Bank Ltd.	GB	**20.0**
	UBS	CH	**9.0**
South Korea (KIC)	Merrill Lynch	US	**7.4**
Qatar (QIA)	Barclays Bank	GB	**8.9**
	Credit Suisse	CH	**10.0**
	London Stock Exchange	GB	**15.1**

Funds	Target	Country	Share (%)
UAE, Dubai (DFG, DIFC, DIFX et al.)	Bombay Stock Exchange	IN	**4.0**
	Deutsche Bank	DE	**2.2**
	Euronext	NL	**3.5**
	Hellenic Exchange	GR	**3.0**
	HSBC Holdings Plc.	GB	**0.5**
	ICICI Bank Ltd.	IN	**2.9**
	London Stock Exchange	GB	**28.0**
	Nasdaq OMX Group	US	**43.6**
	Och-Ziff Capital Management Group	US	**51.4**
	Perella Weinberg Partners LC	US	**10.0**
	Standard Chartered Bank Ltd.	GB	**2.7**
UAE, Abu Dhabi (ADIA et al.)	AP Alternative Asset LP	US	**40.0**
	Apollo Management	US	**40.0**
	Carlyle Group	US	**7.5**
	Citigroup	US	**4.9**
Kuwait (KIA)	Citigroup	US	**6.0**
	Merrill Lynch	US	**5.7**

Note: Stakes by state-sponsored investors in financial firms worldwide at mid-June 08, country of domicile of investment target, % share in target. Largest investments only, no complete list.

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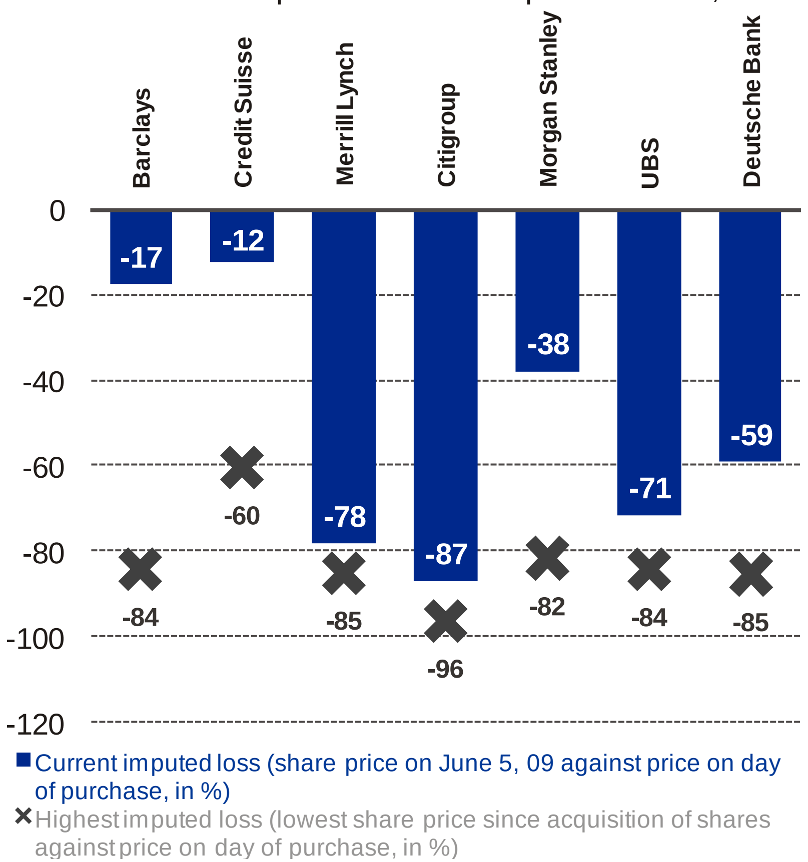
Substantial imputed losses – which have remained unrealised

- **At the point in time they were undertaken, SWF investments in the banking sector appeared economically reasonable**
  - — For a detailed analysis see "SWFs and foreign investment policies – an update", Deutsche Bank Research, Current Issues, October 22, 2008
- **Subsequently, share prices of the banks targeted by SWFs fell dramatically**
  - — Maximum imputed losses on the investments at times amounted to between 60% and 96% against the prices at which the shares had initially been acquired
- **In recent months, bank share prices have recovered, somewhat mitigating the imputed unrealised losses**
  - — As of June 5, 2009, imputed unrealised losses had narrowed somewhat to between 12% and 87%

Unrealised losses on SWF investments in the banking sector

Imputed, unrealised losses on investments in individual banks since the acquisition of the respective stake, %



Source: DB Research

Despite isolated asset sales, shareholdings expected to remain stable

- **SWFs are likely to hold on to their shareholdings in major banks, as they will try to keep final realised losses at a minimum, and are in a more comfortable position to wait for improved market conditions than their private-sector counterparts**
  - So far, sale of financial-sector assets by SWFs very limited, and mainly caused by isolated cases (e.g. privatisation-related transactions in PRC)
  - Without privatisation transactions, total volume of financial-sector asset sales by SWFs amounts to USD 12 bn since 1995, i.e. 1/10th of banking-sector investments in that period
- **Nevertheless, individual disinvestments can occur in order to restructure portfolios or create liquidity**

Major divestments by SWFs

Date	Status[1]	Target		Divestor		Acquiror		Transaction volume (USD m)
Aug 97	C	**Burgan Bank SAK**	KW	Kuwait Investment Authority	KW	Kuwait Projects Co (Holding) KSCC - KIPCO	KW	158
Jun 00	C	**Arab African Investment Bank**	EG	Kuwait Investment Authority	KW	Market Purchase	NA	NA
Jun 05	C	**China Construction Bank Corp.**	CN	Central Huijin Investment Co Ltd.	CN	Bank of America Corp	US	3,000
Jun 05	C	**China Construction Bank Corp.**	CN	Central Huijin Investment Co Ltd.	CN	Temasek Holdings (Pte) Ltd	SG	2,466
Feb 07	C	**Vietnam Investment Fund Ltd.**	SG	Abu Dhabi Investment Authority	AE	Keppel Corp Ltd	SG	NA
Feb 08	C	**OMX AB**	SE	Qatar Investment Authority	QA	Borse Dubai Ltd	AE	491
Mrz 08	C	**Merrill Lynch & Co Inc.**	US	Temasek Holdings (Pte) Ltd.	SG	Hana Bank	KR	50
Mrz 08	C	**London Stock Exchange plc.**	UK	Qatar Investment Authority	QA	Market Purchase	UK	664
Mrz 08	C	**Bank of Communications Co Ltd.**	CN	Central Huijin Investment Co Ltd.	CN	People's Republic of China	CN	NA
Mai 08	C	**China Construction Bank Corp.**	CN	Central Huijin Investment Co Ltd.	CN	Bank of America Corp	US	1,864
Jun 08	C	**PT Lippo Bank Tbk.**	ID	Khazanah Holdings Bhd	MY	Bumiputra-Commerce Holdings Bhd	MY	634
Nov 08	C	**Lotus India Asset Management Co.**	IN	Temasek Holdings (Pte) Ltd.	SG	Religare Enterprises Ltd	IN	NA
Nov 08	C	**China Construction Bank Corp.**	CN	Central Huijin Investment Co Ltd.	CN	Bank of America Corp	US	7,058
Feb 09	D	**BTA Bank AK**	KZ	Samruk Kazyna National Welfare Fund	KZ	Savings Bank of the Russian Federation	RU	2,634
Mrz 09	C	**Bank of America Corp.**	US	Temasek Holdings (Pte) Ltd.	SG	Market Purchase	US	1,467
Apr 09	C	**Barclays plc.**	UK	Qatar Investment Authority	QA	Market Purchase	UK	102
Jun 09	P	**Barclays plc.**	UK	International Petroleum Investment Co.	AE	Market Purchase	UK	5,641

[1]) C=Completed. D=Preliminary discussion. P=Pending.

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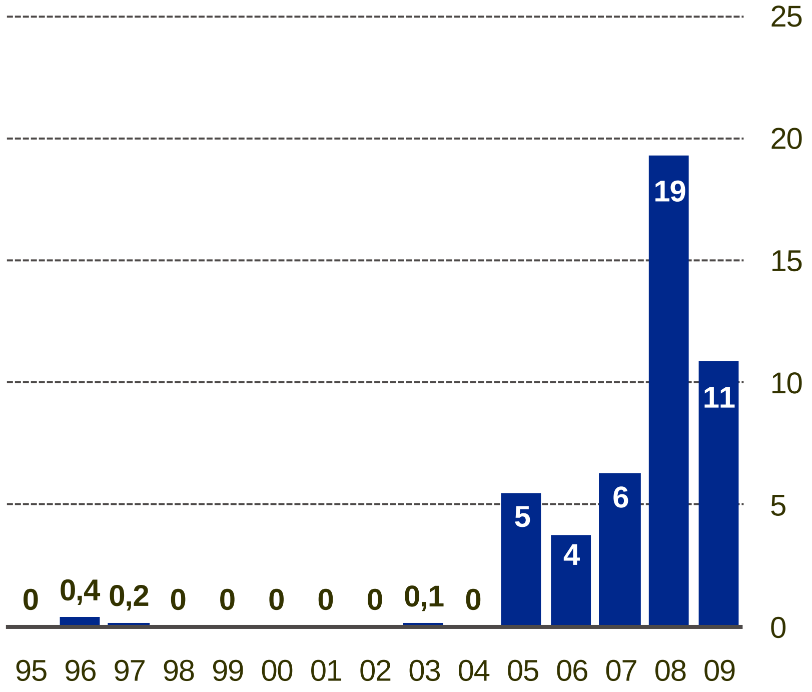
Agenda

Asset sales have risen in line with investments

- **Disinvestments by state-sponsored investors have risen in line with massive increases in asset purchases**
- **However, asset sales have amounted to merely USD 46 bn since 1995, and thus represent a fraction of investment volumes**

SWF asset sales over time

Completed divestment transactions by state-sponsored investment vehicles globally, USD bn, 1995 – 2009 YTD



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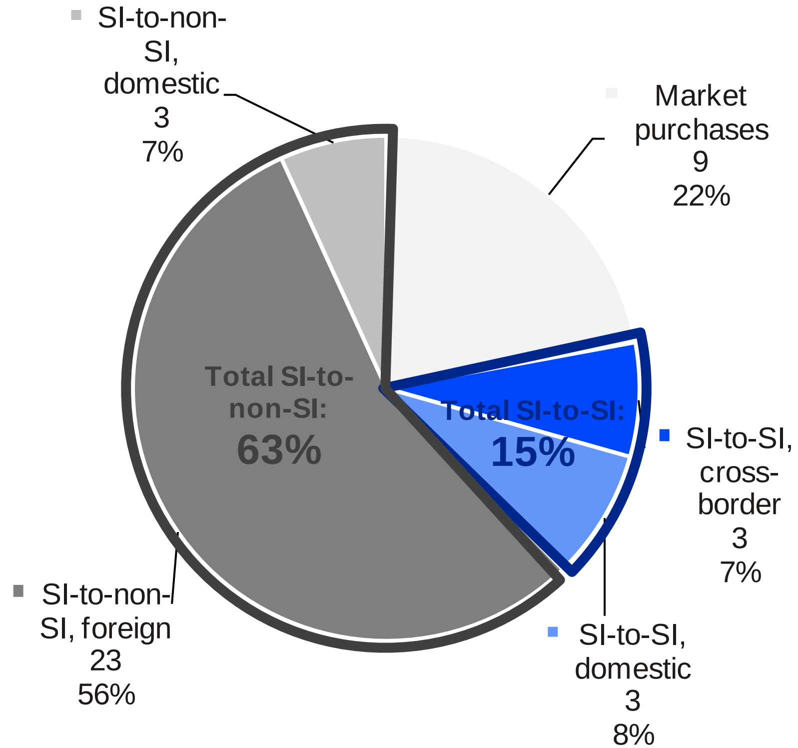
Foreign non-state investors are primary buyers

- **Majority of SWF assets, if sold, get privatised**
  - Vast majority of assets owned by state-sponsored investors are sold on to private investors abroad
  - 56% of state-owned assets are sold on to foreign non-state investors
  - 7% of the assets are sold to domestic investors
- **Limited circulation of assets among state investors**
  - Only a total of 15% of assets sold by sovereign investors are purchased by other state entities
  - At 7%, assets are passed on to sovereign investors in foreign jurisdictions only in exceptional cases
  - 8% are transferred to other state-sponsored investment vehicles domestically

SWF asset sale typology

Asset sales by sovereign investors (SI) by type of transaction, USD bn and % of total, 1995 – 2009 YTD



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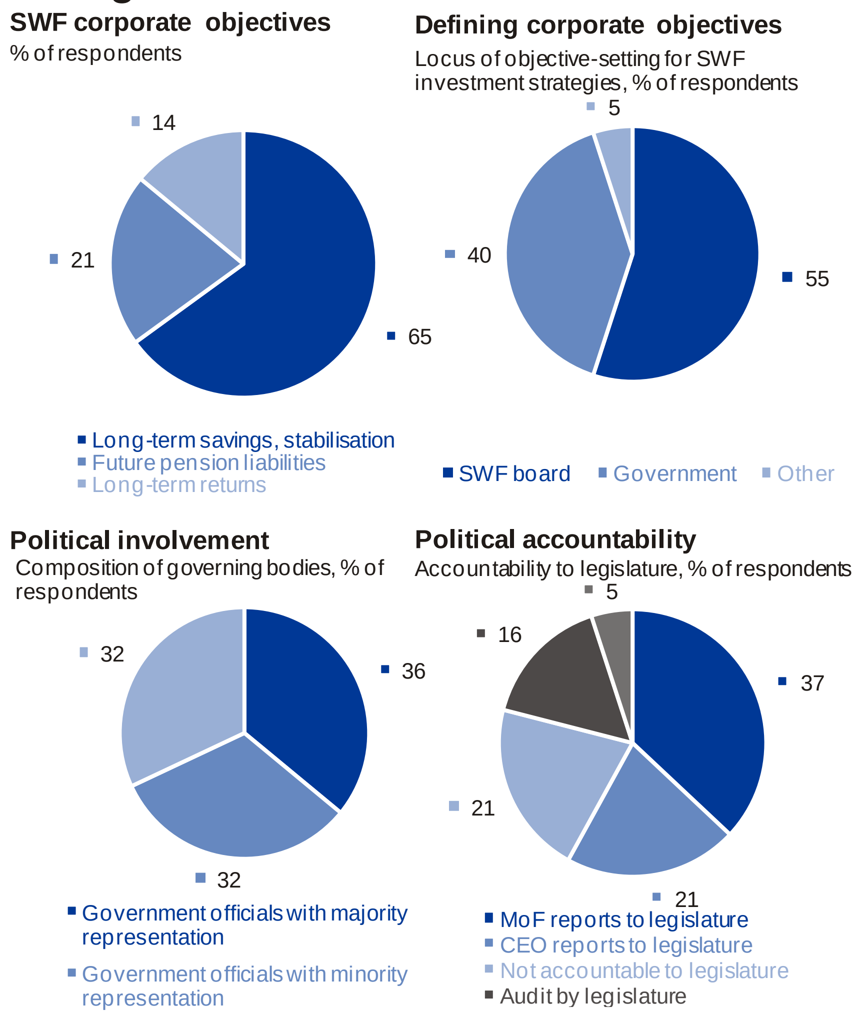
Agenda

1. Industry overview
2. Impact of economic crisis
3. Growth prospects
4. Investment trends
5. SWF disinvestments
6. **Policy issues**

Santiago Principles: SWFs have delivered

- **SWFs have delivered a set of Generally Accepted Principles and Practices for Sovereign Wealth Funds**
- **Santiago Principles (GAPP) as non-binding code**
  - Commitment to financial, non-political objectives
  - Transparency, incl. details on the use of voting rights, risk management, use of financial leverage
  - Governance, organisational structures and processes, incl. commitment to separation of fund management and government
  - Monitoring of GAPP by Standing Group of SWFs
- **Policy issues going forward**
  - **Adherence**: Will SWFs apply the GAPP? Will the GAPP become a seal of quality for SWFs? Will this incentivise them to ensure compliance?
  - **Scope**: Will parent governments apply similar quality standards to other forms of state-sponsored investors, including pension funds, state-owned enterprises and other vehicles? Are there incentives for parent governments to channel politically controversial acquisitions through vehicles not subject to the GAPP?

SWF governance

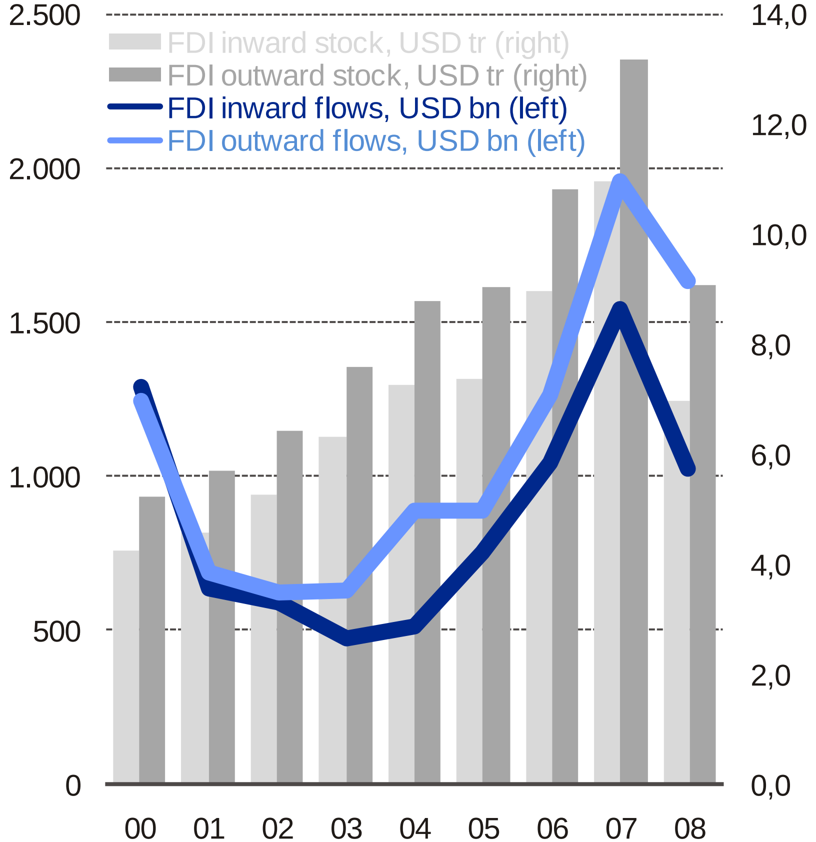


Source: IWG

Cross-border investments and political momentum behind capital account liberalisation is weakening

Foreign direct investment collapse in wake of crisis

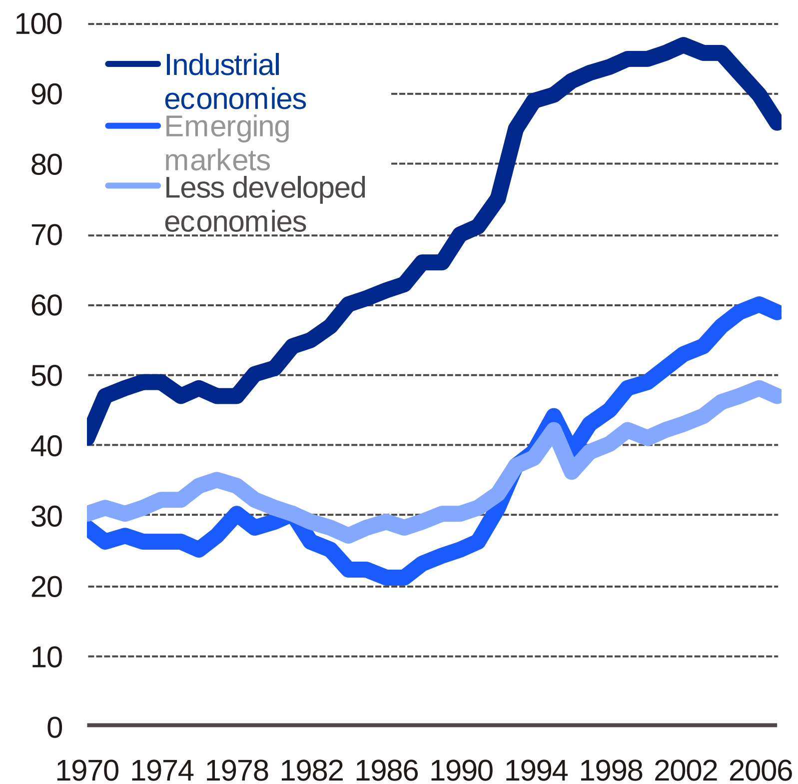
OECD FDI stocks and flows



Source: DB Research

Global capital account openness

Index for openness of capital accounts, based on KAOPEN/Chinn-Ito Index, maximum capital account openness = 100



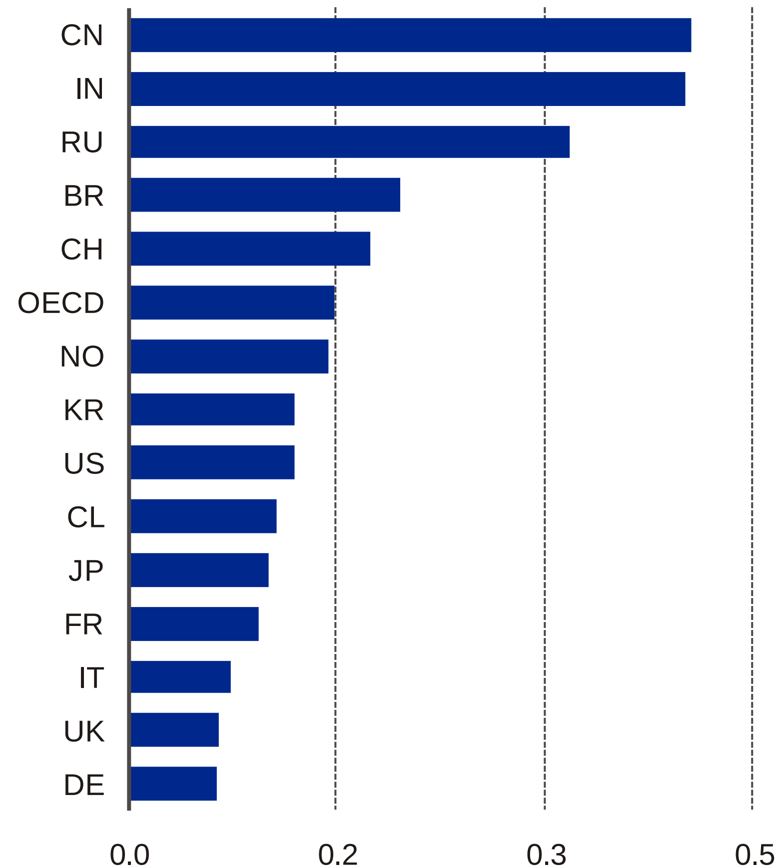
Source: DB Research

Recipient economies: Need to ensure open markets

- **Criteria for optimal investment policies in recipient countries**
  - Open markets
  - Symmetry in open market access
  - Equal treatment of all foreign investors
  - Proportionality of policy measures
  - Transparency of policy rules
  - Minimal political intervention
  - International cooperation and standards
- **OECD multilateral initiatives on securing open markets at international level**
  - OECD Guidance on Sovereign Wealth Funds, Oct 2008
  - OECD Freedom of Investment Project
- **National investment policies have been refined in recent years, but no systematic protectionist revision of investment rules in response to financial and economic crisis so far**

FDI regulatory restrictiveness

OECD regulatory restrictiveness index (0=open, 1=closed), end-06



Source: OECD

Recent national policies – no systematic protectionism

United States

- **1988 Exon-Florio, CFIUS review**
- **2007-2008 reforms (FINSA)**
  - Extended range of relevant transactions
  - Broadened definition of review criterion
- **Implementing regulations**
  - Lower trigger value for CFIUS
  - Increases in reporting requirements

Russia

- **2008 Law on Foreign Investments**
  - Specification of 42 strategic sectors
  - Threshold values for foreign shares in Russian companies
- **Additional general or sectoral rules**

Australia

- **1975 Foreign Investment Review Board**
- **Broad criteria**
  - National interest, implications for national security, economic development or government policies
- **2008 Principles for State Investors**
  - Operational independence from government
  - Commercial objectives
  - Adequate, transparent supervision
  - Impact on Australian business

Germany

- **Revised Foreign Trade Act**
- **Establishment of review process**
- **Investments originating outside EU or EFTA**
  - Stake in listed or unlisted German company of more than 25%
  - Criterion: Country’s security or public order
  - No sectoral limitation

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