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Developing The Philippine Sovereign Wealth Fund

Russell Stanley Q. Geronimo

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DEVELOPING THE PHILIPPINE SOVEREIGN WEALTH FUND

*Russell Stanley Q. Geronimo**

Abstract *Through a sovereign wealth fund, the Philippine government can invest its financial assets in the global financial markets to maximize long-term returns. This mitigates the adverse effects of surplus foreign exchange reserves and high influx of remittances. It can help the government stabilize its currency, increase national savings, protect the competitiveness of exports, prevent inflation, avoid local asset bubbles, and diversify its portfolio of investments across asset classes and markets.*

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This paper explores the prospect of developing the fund. It also attempts to operationalize the 27 Generally Accepted Principles and Practices for Sovereign Wealth Funds, otherwise known as the Santiago Principles, within the Philippine legal environment. The paper explores the regulatory framework governing the proposed Fund under four possible modes of creation: (i) a government-owned and -controlled corporation (GOCC) with special charter, (ii) a GOCC registered with the Securities and Exchange Commission, (iii) a government instrumentality with corporate powers, or (iv) a special administered fund managed by a national government agency.

INTRODUCTION

A sovereign wealth fund is a pool of government-owned financial assets invested in the global financial markets for the purpose of maximizing long-term returns.¹ It also pertains to the investment fund or government financial institution created to manage these assets.² The source of funding includes (i) surplus foreign exchange reserves, (ii) revenues from commodity exports and exploitation of natural resources, (iii) mandatory premium contributions held in trust for social security, and (iv) dividend income from state-owned enterprises or GOCCs.³ The fund invests in a broad range of asset classes, including foreign currencies, bonds, shares of stock, commodities, derivatives, joint ventures, private equity, and real estate.⁴

While central banks hold financial assets for the purpose of currency stabilization and liquidity, sovereign wealth funds are authorized to deal with riskier assets to generate higher returns.⁵ The earnings of the fund form part of national savings and may contribute to the national budget, except they are already earmarked for a specific purpose, such as funding pension schemes and social welfare benefits.⁶

¹ Moore, M., "Globalisation and Power in Weak States", 32 *THIRD WORLD QUARTERLY* 10 (2011).

² Otinche, S.I., "Perspectives on the Santiago Principles and the Nigeria Sovereign Wealth Fund", 4 *AFRREV IJAH* 1 (2014).

³ Megginson, W.L., and Fotak, V., "Rise of the Fiduciary State: A Survey of Sovereign Wealth Fund Research", 29 *JOURNAL OF ECONOMIC SURVEYS* 4 (2015).

⁴ Johan, S., Knill, A., and Mauck, N., "Determinants of Sovereign Wealth Fund Investment in Private Equity vs Public Equity", 44 *JOURNAL OF INTERNATIONAL BUSINESS STUDIES* 2 (2013).

⁵ Xiang, J., et al., "Investment Analysis of Sovereign Wealth Funds in the World", 1 *INTERNATIONAL JOURNAL OF ECONOMICS AND FINANCE* 2 (2009).

⁶ Clark, G.L., and Monk, A., "The Norwegian Government Pension Fund: Ethics Over Efficiency", 3 *ROTMAN INTERNATIONAL JOURNAL OF PENSION MANAGEMENT* 1 (2010).

There are multiple reasons why countries would choose to set up sovereign wealth funds. *First*, countries which heavily rely on revenues from raw material exports face the risk of exhaustion of natural resources.⁷ Sovereign wealth funds are then created to act as “intergenerational transfer mechanisms”, allowing the country to generate long-term returns on raw material export earnings for the benefit of present and future generations.⁸

Secondly, countries with a massive buildup of foreign exchange reserves face the opportunity cost of keeping their surplus reserves in low-return investments.⁹ This is especially true for central banks, which are legally precluded from investing in risky assets in the global financial markets.¹⁰ Sovereign wealth funds help countries generate higher returns by specializing on investment fund management.¹¹

Thirdly, countries with a high influx of overseas remittances face the exchange risk of weakening foreign-denominated currencies vis-a-vis the domestic currency, which lessens the competitiveness of its export industry and the effective earnings of migrant workers.¹² This effect is also called the “Dutch Disease”.¹³

Sovereign wealth funds are recent creations. The term was conceived by Andrew Rozanov only in 2005.¹⁴ The earliest example of the fund is the Kuwait Investment Authority, which was set up in 1953 to invest the country’s oil export earnings.¹⁵ In 1956, Kiribati established the Revenue Equalization Reserve Fund.¹⁶

⁷ Drysdale, P., and Findlay, C., “Chinese Foreign Direct Investment in Australia: Policy Issues for the Resource Sector”, 2 *CHINA ECONOMIC JOURNAL* 2 (2009).

⁸ Ainina, F., and Mohan, N., “Sovereign Wealth Funds: Investment and Governance Practices”, 11 *JOURNAL OF ASIA-PACIFIC BUSINESS* 4 (2010).

⁹ Aizenman, J., Cheung, Y., and Ito, H., “International Reserves before and after the Global Crisis: Is There No End to Hoarding?”, 52 *JOURNAL OF INTERNATIONAL MONEY AND FINANCE* (2015).

¹⁰ Datz, G., “Governments As Market Players: State Innovation in the Global Economy”, *JOURNAL OF INTERNATIONAL AFFAIRS* 35-49 (2008).

¹¹ Greene, E., and Yeager, B., “Sovereign Wealth Funds—A Measured Assessment”, 3 *CAPITAL MARKETS LAW JOURNAL* 3 (2008).

¹² Acosta, P., Lartey, E., and Mandelman, F., “Remittances and the Dutch Disease”, 79 *JOURNAL OF INTERNATIONAL ECONOMICS* 1 (2009).

¹³ *Ibid.*

¹⁴ Gelpert, A., “Sovereignty, Accountability, and the Wealth Fund Governance Conundrum”, 1 *ASIAN JOURNAL OF INTERNATIONAL LAW* 2 (2011).

¹⁵ Megginson, W.L., and Fotak, V. (n 3).

¹⁶ Bernstein, S., Lerner, J., and Schoar, A., “The Investment Strategies of Sovereign Wealth Funds”, 27 *THE JOURNAL OF ECONOMIC PERSPECTIVES* 2 (2013).

These funds have a massive global economic impact. As of June 2016, the combined assets of sovereign wealth funds reached USD 7.32 trillion.¹⁷ The largest fund in terms of asset size is the Government Pension Fund - Global of Norway (USD 885 billion), followed by China Investment Corporation (USD 713.8) and Abu Dhabi Investment Authority (USD 792 billion).¹⁸ In CY 2015, the Middle East had the largest share at 40.24%, followed by Asia at 39.74%.¹⁹ Funds related to oil and gas exports contributed 56.93% of the total global financial assets.²⁰ The following is a list of the top 10 largest funds:

TOP 10 LARGEST SOVEREIGN WEALTH FUNDS
BY ASSET SIZE²¹ (AS OF JUNE 2016)

Country	Sovereign Wealth Fund Name	Assets USD-Bil	Inception	Origin
Norway	Government Pension Fund – Global	885	1990	Oil
China	China Investment Corporation	813.8	2007	Non-Commodity
UAE – Abu Dhabi	Abu Dhabi Investment Authority	792	1976	Oil
Saudi Arabia	SAMA Foreign Holdings	598.4	n/a	Oil
Kuwait	Kuwait Investment Authority	592	1953	Oil
China	SAFE Investment Company	474**	1987	Non-Commodity
China – Hong Kong	Hong Kong Monetary Authority Investment Portfolio	442.4	1993	Non-Commodity
Singapore	Government of Singapore Investment Corporation	350	1981	Non-Commodity
Qatar	Qatar Investment Authority	335	2005	Oil & Gas
China	National Social Security Fund	236	2000	Non-Commodity

PROSPECTS FOR A PHILIPPINE SOVEREIGN WEALTH FUND

Creating a sovereign wealth fund mitigates the adverse effects of surplus foreign remittances and surplus foreign exchange reserves in the Philippines.²²

¹⁷ Sovereign Wealth Fund Institute, Fund Rankings, SWFI Official Website, available at: <http://www.swfinstitute.org/fund-rankings> (accessed 3 January 2017).

¹⁸ *Ibid.*

¹⁹ *Ibid.*

²⁰ *Ibid.*

²¹ *Ibid.*

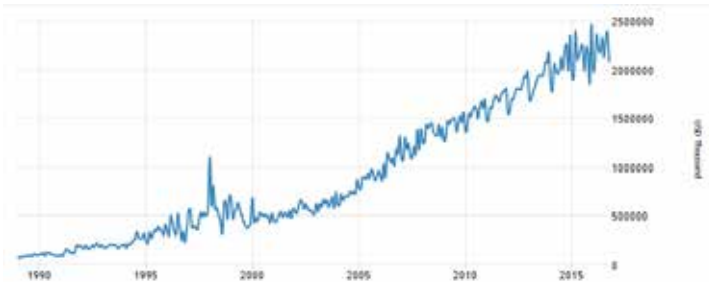
²² Rozanov, A., “Definitional Challenges of Dealing with Sovereign Wealth Funds”, 1 *ASIAN JOURNAL OF INTERNATIONAL LAW* 2 (2011).

The fund can address three main policy concerns. *First*, surplus foreign remittances weaken the value of foreign-denominated currencies with respect to the value of domestic currency, eroding the effective earnings of Filipino migrant workers and lessening the competitiveness of Philippine exports.²³ *Secondly*, surplus foreign exchange reserves can lead to asset bubbles and inflation, even as the government issues more debt.²⁴ *Thirdly*, keeping surplus reserves represent an opportunity cost.²⁵ The BSP cannot actively invest the surplus portion of the reserves in global financial markets due to its charter limitation, which mandates a passive investment approach exclusively for currency stabilization and liquidity purposes.²⁶

A sovereign wealth fund can address all these concerns by purchasing the surplus portion of the international reserves, bringing them down to an optimal level, and investing the excess portion in various asset classes abroad with a view toward earning higher returns.²⁷

Foreign remittances in the Philippines reached an all-time high in December 2015 at USD 2.47 billion, which is 273.9% higher than average remittances of USD 901.77 million from CY 1989 to 2016.²⁸ Remittances in October 2016 stood at USD 2.09 billion.²⁹ Growth has been consistent for the past 27 years, as can be seen from the graph below:

Foreign Remittances in the Philippines³⁰
(1989 to 2016)



²³ Van der Ploeg, F., and Venables, A., “Absorbing a Windfall of Foreign Exchange: Dutch Disease Dynamics”, 103 *JOURNAL OF DEVELOPMENT ECONOMICS* 229-243 (2013).

²⁴ Dominguez, K., Hashimoto, Y., and Ito, T., “International Reserves and the Global Financial Crisis”, 88 *JOURNAL OF INTERNATIONAL ECONOMICS* 2 (2012).

²⁵ Aizenman, J., Cheung, Y., and Ito, H. (n 9).

²⁶ S. 66 of R.A. No. 6645 (*New Central Bank Act*).

²⁷ Drezner, D., “Sovereign Wealth Funds and the (In) Security of Global Finance”, *Journal of International Affairs* 115-130 (2008).

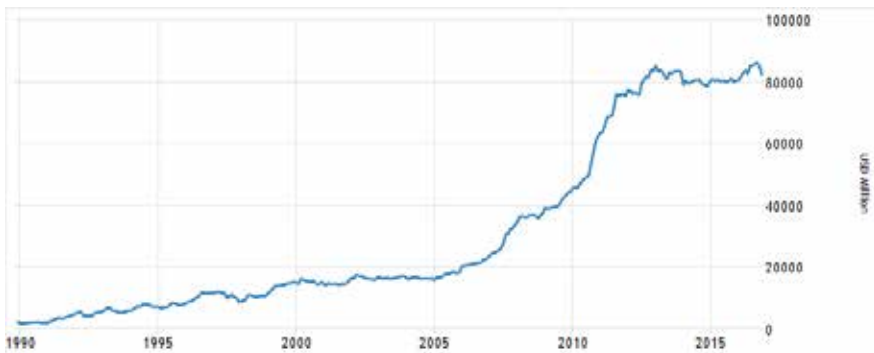
²⁸ Bangko Sentral ng Pilipinas, Statistics, BSP Official Website, available at: http://www.bsp.gov.ph/statistics/efs_ext3.asp (accessed 3 January 2017).

²⁹ *Ibid.*

³⁰ *Ibid.*

Foreign exchange reserves also reached an all-time high in September CY 2016 at USD 86.14 billion, which is 591% higher than the average foreign exchange reserves of USD 14.57 billion from CY 1960 to 2016.³¹ In November 2016, foreign exchange reserves stood at USD 82.7 billion.³² Foreign exchange reserves consist of gold, foreign currency, special drawing rights, and foreign currency-denominated marketable securities.³³ Their growth has been consistently rising for the past 27 years, as illustrated in the graph below:

Foreign Exchange Reserves in the Philippines
(1989 to 2016)



The current level of foreign exchange reserves in the Philippines exceeds international benchmarks of reserve adequacy. Another benchmark is the import cover, which is the number of months of average imports that can be funded by gross international reserves.³⁴ As per international standards, an import cover of 3 to 4 months already represents an adequate reserve level.³⁵ Import cover in the Philippines, on the other hand, grew from 3.5 months in CY 2000 to 9.7 months in October CY 2016,³⁶ as illustrated below:

³¹ Bangko Sentral ng Pilipinas, Gross International Reserves, BSP Official Website, available at: <http://www.bsp.gov.ph/statistics/sdds/table12.htm> (accessed 3 January 2017).

³² *Ibid.*

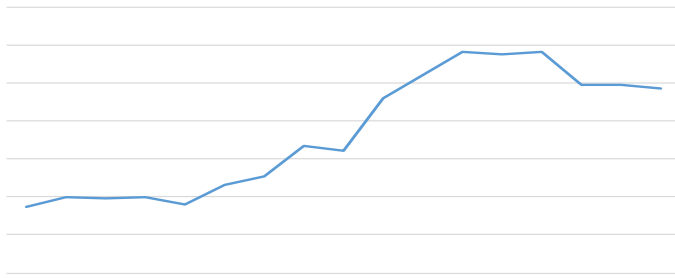
³³ *Ibid.*

³⁴ Rajan, R., Siregar, R., and Bird, G., "Precautionary Reserve Holdings in Asia: Examining the Case for A Regional Reserve Pool", 9 *THE ASIA PACIFIC JOURNAL OF ECONOMICS & BUSINESS* 1 (2005).

³⁵ Rossouw, J., "An Analysis of Macro-Economic Convergence in SADC 1", 74 *SOUTH AFRICAN JOURNAL OF ECONOMICS* 3 (2006).

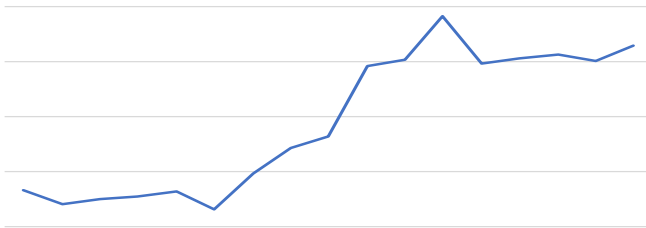
³⁶ Bangko Sentral ng Pilipinas, (n 31).

Import Cover³⁷
(CY 2000 to 2016)



Another benchmark is the short-term external debt cover, which is the adequacy of gross international reserves to fund outstanding short-term debt in the public and private sectors.³⁸ As per international standards, a short-term external debt cover which is at least equal to the gross international reserves represents an adequate reserve level.³⁹ Short-term external debt cover in the Philippines, on the other hand, grew from 165.1% in CY 2000 to 430.1% in October CY 2016.⁴⁰

Short-Term External Debt Cover Based on Residual Maturity⁴¹
(CY 2000 to 2016)



The gross international reserves of the Philippines has reached surplus level, with an import cover of 9.7 months out of a benchmark of 3 to 4

³⁷ *Ibid.*

³⁸ Rodrik, D., “The Social Cost of Foreign Exchange Reserves”, 20 *INTERNATIONAL ECONOMIC JOURNAL* 3 (2006).

³⁹ International Monetary Fund, “Debt and Reserve-Related Indicators of External Vulnerability (2000)”, IMF Official Website, available at: https://www.imf.org/external/np/pdr/debtres/#III_D (accessed 3 January 2017).

⁴⁰ Bangko Sentral ng Pilipinas, *Gross International Reserves*, BSP Official Website, available at: <http://www.bsp.gov.ph/statistics/sdds/table12.htm> (accessed 3 January 2017).

⁴¹ *Ibid.*

months, and a short-term external debt cover of 430.1% out of a benchmark of 100% as of October CY 2016.⁴²

Problems with excess reserves

The primary benefit of reserve buildup is rooted in the Asian Financial Crisis in 1997-1998, which prompted central banks to purchase foreign currencies to insure their country against unexpected shortage of international liquidity.⁴³ Excess reserves, on the other hand, have costs to the economy, as follows:

“The three major costs of reserve accumulation are inflation, fiscal costs and higher interest rate. A central bank’s issuance of domestic currency to purchase foreign currency increases the monetary base, which in turn leads to inflation. In order to sterilize the inflationary impact of reserve accumulation, a central bank typically issues bonds, i.e., domestic liabilities, in exchange for currency in circulation, withdrawing domestic liquidity in the process. However, sterilization may entail a fiscal burden — the second major cost — if the interest rate a central bank pays on its outstanding bonds exceeds the interest rate it earns on its foreign reserve assets. The third major cost — higher interest rate — is also associated with sterilization. Sustained accumulation will eventually lead to a higher interest rate since there is a limit to the general public’s appetite for sterilization bonds.”⁴⁴

In CY 2012, the International Monetary Fund (IMF) already warned the Philippine Government of its surplus reserves, which are beyond optimal.⁴⁵ Since the BSP, which manages the internal reserves, is legally constrained from investing the excess portion of the reserves in global markets, BSP Governor Amando Tetangco Jr. on 21 March 2013 suggested the creation of a sovereign wealth fund which will be funded by excess reserves and which in turn will purchase foreign assets with higher returns.⁴⁶

⁴² *Ibid.*

⁴³ Aizenman, J., and Marion, N., “The High Demand for International Reserves in the Far East: What is Going On?”, 17 *JOURNAL OF THE JAPANESE AND INTERNATIONAL ECONOMIES* 3 (2003).

⁴⁴ Park, D., and Estrada, G., “Does Developing Asia Have Too Much Foreign Exchange Reserves? An Empirical Examination”, 11 *The Journal of the Korean Economy* 103-128 (2010).

⁴⁵ Matulis, P., “IMF Warns versus Excessive Foreign Exchange Reserves”, *The Philippine Star* (20 December 2012), available at: <http://www.philstar.com/business/2012/12/20/887902/imf-warns-versus-excessive-foreign-exchange-reserves> (accessed 3 January 2017).

⁴⁶ *Ibid.*

THE PROPOSED PHILIPPINE INVESTMENT FUND CORPORATION

On 19 October 2016, Senate Bill No. 1212 was filed, entitled Philippine Investment Fund Corporation Act, or “*An Act Establishing a Philippine Sovereign Wealth Fund: Providing for the Management, Investment, and Use of Proceeds of its Assets, Appropriating Funds Therefor and For Other Purposes.*” The bill seeks to create the Philippine Investment Fund Corporation for the purpose of accumulating national savings for the present and future generations. Its other mandates include the following:

1. To contribute to the annual national budget; [and]
2. To provide an investment function platform for GOCCs and their subsidiaries, government owned and controlled funds with investment and development goals, and investments of government financial institutions and government instrumentalities mandated by Congress[.]⁴⁷

The proposed Fund is authorized to place its money in alternative investments, or asset classes other than stocks, bonds, or cash. This is perhaps the most important aspect of the bill, since the largest government financial institutions in the Philippines, like GSIS, SSS and BSP, have asset class restrictions provided in their respective charters, which prevent them from carrying out the functions of a sovereign wealth fund. Under the bill, the proposed Fund has the power to participate in the global financial markets and invest in futures contracts, private equity, and commodities.⁴⁸

The proposed Fund has three investment accounts: Primary Investment Fund, Special Investment Funds, and Reserve Investment Account. The Primary Investment Fund is a basket of foreign currencies meant to be invested internationally. The Fund has a withdrawal limit of 50% of the net new gains for the purpose of contributing to the National Budget. The Special Investment Funds are those that are set up in accordance with Investment Mandates from GOCCs and other government instrumentalities with investment purposes. The withdrawal limits are to be stipulated between the Fund and the GOCC or government instrumentality. The Reserve Investment Account is a pool of assets not committed for investment purposes.⁴⁹

⁴⁷ S.B. No. 1212, available at: http://www.congress.gov.ph/legisdocs/basic_16/HR00376.pdf (accessed 3 January 2017)

⁴⁸ *Ibid.*

⁴⁹ *Ibid.*

In terms of governance, the Fund provides a Supervisory Council, which is separate and independent from the Board of Directors. The Council meets twice a year and is composed of the President of the Republic as Chairman, the DOF Secretary as Vice Chairman, the National Treasurer, the DBM Secretary, the BSP Governor, the GCG Chairman, and the Solicitor General. The Board is composed of nine appointive positions.⁵⁰

The proposed Fund aims to observe the Santiago Principles. As of 07 November 2016, the bill is still pending with the Committee on Economic Affairs and the Committee on Government Corporations and Public Enterprises.⁵¹

THE SANTIAGO PRINCIPLES

One of the growing concerns about sovereign wealth funds is that most of them are based in authoritarian regimes facing risks of political instability, and that these funds could be utilized to further their international political agenda.⁵² The lack of transparency about the funds' portfolio composition and investment mandate, as well as the lack of regulatory framework to enforce disclosure of information to the international community have contributed to this suspicion.⁵³

The reality is that foreign control of sensitive economic activities is a major source of geopolitical risk. Even developed nations operating under a free trade are now beginning to recognize the growing risk of sovereign wealth fund investments. "Increasingly, corporations are political tools used by nations to exert influence over other nations. In times of peace and economic prosperity, foreign control of strategic industries and infrastructure may not be an immediate threat. But during major economic recessions — or, worse, times of geopolitical upheaval and war — the loss of ownership and full control of national industries can be catastrophic."⁵⁴

Sovereign wealth funds raise several national security concerns for host countries receiving their investments, including the "destabilization of the financial markets (to the detriment of the host country), protection of SWF

⁵⁰ *Ibid.*

⁵¹ *Legislative History of S.B. No. 1212*, available at: http://senate.gov.ph/lis/bill_res.aspx?congress=17&q=SBN-1212 (accessed 3 January 2017).

⁵² Drezner, D. (n 27).

⁵³ Bernstein, S., Lerner, J., and Schoar, A. (n 16).

⁵⁴ The Trumpet, "Airbus and the Perils of Foreign Ownership" (26 October 2006), The Trumpet Official Website, available at: <https://www.thetrumpet.com/article/2969.2.0.0/world/globalization/airbus-and-the-perils-of-foreign-ownership> (accessed 3 January 2017).

home-country industries at the expense of the host country's industries, and the expropriation of technology[.]”⁵⁵

Despite the importance of sovereign wealth funds in the global economy, there is currently no multilateral treaty prescribing the acceptable behavior of these funds. However, concerns about the accountability, independence, and transparency of sovereign wealth funds led to the formulation of a set of voluntary guidelines for fund managers around the globe. The closest code of conduct in the international community is the Generally Accepted Principles and Practices (GAPP) for Sovereign Wealth Funds, otherwise known as the Santiago Principles, which are self-imposed and non-legally binding.⁵⁶

The Principles are a product of a summit organized by the International Monetary Fund (IMF) in September 2008.⁵⁷ The major funds from around the globe formed an International Working Group of Sovereign Wealth Funds, which drafted the Principles as guidelines on institutional governance and risk management.⁵⁸ Subsequently, in 2009, the International Forum of Sovereign Wealth Funds (IFSFW) was founded by 23 member entities for the purpose of promoting the guidelines in the investment management community.⁵⁹ The current membership base of 30 funds represent 80% of the total global assets.⁶⁰

OPERATIONALIZING THE SANTIAGO PRINCIPLES IN THE PHILIPPINES

The GAPP has 24 principles, which cover these three major areas:

1. Legal framework, objectives, and coordination with macroeconomic policies;
2. Institutional framework and governance structure; and
3. Investment and risk management framework.⁶¹

⁵⁵ Hemphill, T.A., “Sovereign Wealth Funds: National Security Risks in A Global Free Trade Environment”, 51 THUNDERBIRD INTERNATIONAL BUSINESS REVIEW 6 (2009).

⁵⁶ Norton, J., “The ‘Santiago Principles’ for Sovereign Wealth Funds: A Case Study on International Financial Standard-Setting Processes”, 13 JOURNAL OF INTERNATIONAL ECONOMIC LAW 3 (2010).

⁵⁷ Jensen, O., and Seele P., “An Analysis of Sovereign Wealth and Pension Funds’ Ethical Investment Guidelines and their Commitment Thereto”, 3 JOURNAL OF SUSTAINABLE FINANCE & INVESTMENT 3 (2013).

⁵⁸ *Ibid.*

⁵⁹ International Forum of Sovereign Wealth Funds, About IFSWF, IFSWF Official Website, available at: <http://www.ifswf.org> (accessed 3 January 2017).

⁶⁰ *Ibid.*

⁶¹ “Santiago Principles -- International Working Group (IWG) of Sovereign Wealth Funds”, available at: www.iwg-swf.org/pubs/eng/santiagoprinciples.pdf (accessed 3 January 2017).

The following sections reproduce the original text of the Principles, each followed by an explanatory note on how it can be applied to the proposed Philippine sovereign wealth fund (hereinafter, the “Fund”) and operationalized within the Philippine legal environment.

Gapp 1. The Legal Framework for the Swf Should be Sound And Support Its Effective Operation and the Achievement of Its Stated Objective(S).

Gapp 1.1. The Legal Framework for the Swf Should Ensure Legal Soundness of the Swf and Its Transactions.

Gapp 1.2. The Key Features of the Swf’s Legal Basis and Structure, As Well As the Legal Relationship Between the Swf and Other State Bodies, Should be Publicly Disclosed.

The Fund has four possible legal forms or modes of creation. *First*, the Fund can be set up as a government-owned or -controlled corporation (GOCC) created and vested with functions by a special law.⁶² This is known as a Chartered GOCC. Examples of Chartered GOCCs are the Government Service Insurance System (GSIS), the Development Bank of the Philippines (DBP) and the Land Bank of the Philippines (LBP).⁶³ Each is governed by the terms of the legislative act creating the entity.⁶⁴

Second, the Fund can be created through the Corporation Code (B.P. 68) by way of registration with the Securities and Exchange Commission (SEC), which is the manner by which private corporations are created.⁶⁵ This is also known as a Non-Chartered GOCC. Examples include the United Coconut Planters Bank (UCPB) and the subsidiaries of Chartered GOCCs, such as the Philippine Postal Savings Bank, Inc. (PPSB), whose parent GOCC is the Philippine Postal Corporation (PPC).⁶⁶

Third, the Fund can be set up as a special fund owned and administered by an existing National Government Agency (NGA), such as the Department of Finance (DOF), or by a Government Financial Institution (GFI), like the Bangko Sentral ng Pilipinas (BSP).⁶⁷ Examples of special administered

⁶² *Rufino v. Rufino*, G.R. No. 139554, 21 July 2006.

⁶³ Governance Commission for GOCCs, Classification of GOCCs by Sector as of 13 April 2016, GOCC Official Website, available at: http://gcg.gov.ph/site/public_files/gcg1461826721.pdf (accessed 3 January 2017).

⁶⁴ *Feliciano v. Gison*, G.R. No. 165641, 25 August 2010.

⁶⁵ *Republic v. City of Parañaque*, G.R. No. 191109, 18 July 2012.

⁶⁶ *Feliciano v. Gison* (n 64).

⁶⁷ *Rufino v. Rufino* (n 62).

funds include the International Reserves, which is managed by the BSP, and the Social Insurance Fund, which is administered by GSIS and the Social Security System (SSS).⁶⁸

Fourth, the Fund can be set up as a Government Instrumentality with Corporate Powers (GICP), which pertains to an “instrumentality or agency of the government, which is neither a corporation nor an agency integrated within the departmental framework, but vested by law with special functions or jurisdiction, endowed with some if not all corporate powers, administering special funds, and enjoying operational autonomy usually through a charter.”⁶⁹ Examples include the Manila International Airport Authority (MIAA), the Philippine Ports Authority (PPA), and the Philippine Deposit Insurance Corporation (PDIC).⁷⁰

Chartered GOCCs and GICPs are primarily governed by the special legislative act creating them, with the Corporation Code being of supplementary application.⁷¹ Non-Chartered GOCCs are primarily governed by the Corporation Code, and the Articles of Incorporation and By-Laws.⁷² Special administered funds are limited by the powers, function and mandate of the NGA or GFI administering these funds, and governed by the implementing rules and regulations promulgated by the administering NGA or GFI.⁷³

A Fund created as a Chartered GOCC, Non-Chartered GOCC, or GICP has a separate juridical personality, while a special administered fund has none. All transactions affecting the fund are carried out by the administrator, which holds the fund as an off-balance sheet item or trust account.

A Fund created as a Chartered GOCC, Non-Chartered GOCC, or GICP falls within the regulatory jurisdiction of the Governance Commission for GOCCs (GCG), and subject to the governance provisions prescribed in the *GOCC Governance Act of 2011* (R.A. 10149), particularly on: (i) selection of governing board, (ii) fit and proper rule, (iii) term of office, (iv) chief executive officer, and (v) extraordinary diligence.

All appointive directors are nominated by the GCG and selected by the President of the Philippines.⁷⁴ All appointive members of the governing board

⁶⁸ See, e.g., S. 66 of R.A. No. 6645 (*New Central Bank Act*).

⁶⁹ S. 3(n), R.A. No. 10149.

⁷⁰ *Feliciano v. Gison* (n 64).

⁷¹ S. 4, B.P. 68 (“Corporations created by special laws or charters shall be governed primarily by the provisions of the special law or charter creating them or applicable to them, supplemented by the provisions of this Code, insofar as they are applicable.”)

⁷² *Commr. of Internal Revenue v. Puregold Duty Free Inc.*, G.R. No. 202789, 22 June 2015.

⁷³ *Rufino v. Rufino* (n 62).

⁷⁴ S. 15, R.A. No. 10149.

and the CEO must qualify under the fit and proper rule prescribed by the GCG and approved by the President of the Philippines.⁷⁵ The term of office of each appointive director is only for one year, subject to renewal, removal for cause, and a holdover clause.⁷⁶ The chief executive officer must be a member of the governing board, and must be selected through an election by the board.⁷⁷ The governing board and officers must exercise extraordinary diligence in the management of the corporation.⁷⁸

The foregoing governance arrangements are applicable if the SWF is a Chartered GOCC or GICP and the special law creating it is silent in these areas. Otherwise, the terms of the statute govern the manner of selection of the governing board and the chief executive officer, their qualifications, terms of office, and the standard of care expected in performing their official functions. A Non-Chartered GOCC, on the other hand, cannot depart from these provisions simply through its Articles of Incorporation and By-Laws, which do not have the status of “law” capable of altering the terms of R.A. No. 10149.

A special administered fund is not subject to these governance arrangements, since it does not fall within the regulatory jurisdiction of the GCG under R.A. No. 10149. The fund is directly under the control of the governing body of the administering NGA or GFI. One example of such fund is the Government Pension Fund Global of Norway, with the Ministry of Finance as the legal owner and the Norges Bank (which is Norway’s central monetary authority) as administrator.⁷⁹

The general trend is to create SWFs through a special law, which means either a Chartered GOCC or a GICP. The SWFs of Korea, Kuwait, Qatar and United Arab Emirates have a legal form which is functionally similar to Chartered GOCCs and GICPs.⁸⁰ The SWFs of China, Malaysia and Singapore are similar to Non-Chartered GOCCs in that they were created in the same manner as private corporations, i.e. through the general corporation law.⁸¹ In the Philippines, however, Non-Chartered GOCCs as a form

⁷⁵ S. 16, R.A. No. 10149.

⁷⁶ S. 17, R.A. No. 10149.

⁷⁷ S. 18, R.A. No. 10149.

⁷⁸ S. 19, R.A. No. 10149.

⁷⁹ Backer, L., “Sovereign Wealth Funds as Regulatory Chameleons: The Norwegian Sovereign Wealth Funds and Public Global Governance through Private Global Investment”, 41 *GEORGETOWN JOURNAL OF INTERNATIONAL LAW* 2 (2009).

⁸⁰ International Forum on Sovereign Wealth Funds, “Santiago Principles: 15 Case Studies (2014)”, IFSWF Official Website, available at: http://www.ifswf.org/sites/default/files/SantiagoP15CaseStudies1_0.pdf (accessed 3 January 2017).

⁸¹ *Ibid.*

of State corporate ownership are ordinarily utilized in conducting purely commercial activities, rather than being vested with a public purpose.⁸²

Gapp 2. The Policy Purpose of the Swf Should be Clearly Defined and Publicly Disclosed.

The International Monetary Fund (IMF) classifies SWFs according to their policy purpose, as follows: (1) reserve investment funds, (2) pension-reserve funds, (3) stabilization funds, (4) savings funds, and (5) development funds.⁸³

Reserve investment funds invest reserve assets to increase the return on reserves.⁸⁴ This requires a long investment horizon, typically at 20 years. Examples include the GIC Private Limited of Singapore, which aims to “achieve good long-term returns for the Government” and “to preserve and enhance the international purchasing power of Singapore’s foreign reserves.”⁸⁵

In the Philippines, the BSP is legally prevented by its charter to function as a reserve investment fund with a long-term investment horizon, which is necessary in increasing the return on international reserves. Section 66 of R.A. No. 6645 (*New Central Bank Act*) states:

Composition of the International Reserves. – The international reserves of the Bangko Sentral may include but shall not be limited to the following assets:

- a. gold; and
- b. assets in foreign currencies in the form of: documents and instruments customarily employed for the international transfer of funds; demand and time deposits in central banks, treasuries and commercial banks abroad; foreign government securities; and foreign notes and coins.

The Monetary Board shall endeavor to hold the foreign exchange resources of the Bangko Sentral in freely convertible currencies; moreover, the Board shall give particular consideration to the prospects of continued strength and convertibility of the currencies in which the reserve is

⁸² *Feliciano v. Gison* (n 64).

⁸³ International Monetary Fund, “Sovereign Wealth Funds: Aspects of Governance Structures (2013)”, IMF Official Website, available at: <https://www.imf.org/external/pubs/ft/wp/2013/wp13231.pdf> (accessed 4 January 2017).

⁸⁴ *Ibid.*

⁸⁵ International Forum on Sovereign Wealth Funds (n 80).

maintained, as well as to the anticipated demands for such currencies. The Monetary Board shall issue regulations determining the other qualifications which foreign exchange assets must meet in order to be included in the international reserves of the Bangko Sentral.

The Bangko Sentral shall be free to convert any of the assets in its international reserves into other assets as described in subsections (a) and (b) of this section.

In short, the BSP may only hold liquid, short-term and freely convertible assets, and is therefore unable to function as the administrator of a reserve investment fund. The phrase, “other qualifications which foreign exchange assets must meet in order to be included in the international reserves of the Bangko Sentral” does not authorize investment in non-liquid and long-term assets abroad, since it must necessarily be limited by the restrictive intent of the provision. For this reason, a Fund set up to have a long-term investment horizon and to increase returns on international reserves must be further mandated by a legislative act.

A pension-reserve fund is established “to meet unfunded superannuation liabilities that will become payable during a period when an aging population is likely to place significant pressure on government finances.”⁸⁶ Examples include the Future Fund of Australia, the Pension Reserve Fund of Chile, and the Government Pension Fund Global of Norway.⁸⁷ In the Philippines, SSS manages the pension fund for workers in the private sector, including self-employed persons, Overseas Filipino Workers (OFWs) and workers in the informal sector, while GSIS manages the pension fund for all government workers.⁸⁸ Both entities are created as Chartered GOCCs.

SSS and GSIS are not sovereign wealth funds because of their respective charter limitations in investing assets abroad. While Section 26 of R.A. No. 8282 (*Social Security Act of 1997*) authorizes the SSS to invest in a variety of financial assets, including equities, fixed income instruments, foreign currencies, and real estate, it can only invest in the following foreign-currency denominated financial instruments:

- j. In domestic or foreign mutual funds in existence for at least three (3) years[;]
- k. In foreign currency deposits or triple “A” foreign currency-denominated debts, prime and non-speculative equities, and other

⁸⁶ International Monetary Fund (n 84).

⁸⁷ International Forum on Sovereign Wealth Funds (n 80).

⁸⁸ *Feliciano v. Gison* (n 64).

Bangko Sentral ng Pilipinas approved financial instruments or other assets issued in accordance with existing laws of the countries where such financial instruments are issued: *Provided*, That these instruments or assets are listed in bourses of the respective countries where these instruments or assets are issued[.]

Furthermore, the same section limits foreign-currency denominated investments to 7.5% of the SSS Reserve Fund. On the other hand, Section 36 of R.A. No. 8291 (*Government Service Insurance Act of 1997*) provides the following allowable foreign investments of GSIS:

- j. In foreign mutual funds and in foreign currency deposits or foreign currency-denominated debts, non-speculative equities and other financial instruments or other assets issued in accordance with existing laws of the countries where such financial instruments are issued: *Provided*, That these instruments or assets are listed in bourses of the respective countries where these instruments or assets are issued: *Provided*, further, That the issuing company has proven track record of profitability over the last three (3) years and payment of dividends at least once over the same period.

Stabilization funds “insulate the budget and the economy against commodity price swings.”⁸⁹ This includes the Economic and Social Stabilization Fund of Chile, and the Heritage and Stabilization Fund of Trinidad & Tobago.⁹⁰

Savings funds “convert non-renewable assets into a more diversified portfolio of assets to meet public sector superannuation liabilities in the future and mitigate the possible Dutch disease effects of spending resource revenue.”⁹¹ Examples include the State Oil Fund (SOFAZ) of Azerbaijan, which was established for the purpose of “accumulation and management of the revenues generated from implementation of oil and gas agreements.” The Pula Fund of Botswana invests “proceeds from non-renewable resources (minerals) for the benefit of future-generations.” The National Development Fund of Iran (NDFI) aims to “turn a portion of revenues originated from selling oil, gas, gas condensates and oil products into durable wealth and productive investments as well as conserving the share of future generations.” The Alberta Heritage Savings Trust Fund of Canada aims to “provide prudent stewardship of the savings from Alberta’s non-renewable resources

⁸⁹ International Monetary Fund (n 84).

⁹⁰ International Forum on Sovereign Wealth Funds (n 80).

⁹¹ International Monetary Fund (n 84).

by providing the greatest financial returns on this savings for current and future generations of Albertans”. The Fund may be set up as a savings fund to address the negative macroeconomic impact of excess international reserves.⁹²

Development funds are SWFs which invest for development purposes, such as infrastructure and energy.⁹³ Examples include the China-Africa Development Fund, which aims to “stimulate investment in Africa by Chinese companies in power generation, transportation infrastructure, natural resources, manufacturing, and other sectors.”⁹⁴

The policy purpose of the SWF is the most important consideration in designing the fund because it dictates the investment policy, asset management strategy, investment horizon, general approach to withdrawal, and corporate governance structure of the Fund.

Gapp 3. Where The Swf’s Activities have Significant Direct Domestic Macroeconomic Implications, Those Activities Should be Closely Coordinated with the Domestic Fiscal and Monetary Authorities, so As To Ensure Consistency with the Overall Macroeconomic Policies.

The Fund has potential impact in four areas of macroeconomic policy: fiscal policy, monetary policy, public balance sheet, and balance of international payments. For this reason, the Secretary of Finance and the BSP Governor must sit as *ex officio* member of the governing board of the Fund for closer coordination.⁹⁵

Gapp 4. There should be Clear and Publicly Disclosed Policies, Rules, Procedures, or Arrangements In Relation to The Swf’s General Approach To Funding, Withdrawal, And Spending Operations.

Gapp 4.1. The Source of Swf Funding Should be Publicly Disclosed.

⁹² International Forum on Sovereign Wealth Funds (n 80).

⁹³ International Monetary Fund (n 84).

⁹⁴ International Forum on Sovereign Wealth Funds (n 80).

⁹⁵ See, e.g., S.B. No. 1212, available at: http://www.congress.gov.ph/legisdocs/basic_16/HR00376.pdf (accessed 3 January 2017).

Gapp 4.2. The General Approach to Withdrawals from the Swf and Spending on Behalf of the Government Should be Publicly Disclosed.

a. Funding

The funding sources of the Fund depend on its policy purpose, identified pursuant to GAPP 2. An investment reserve fund obtains funding from foreign exchange reserves.⁹⁶ Examples include the Korean Investment Corporation, China Investment Corporation, and Future Fund of Australia.⁹⁷

A savings fund obtains funding from revenues in extractive economies or exploitation of non-renewable natural resources.⁹⁸ Examples are the Kuwait Investment Authority, the Libyan Investment Authority and the Oil Income Stabilization Fund.⁹⁹ The savings fund may also obtain funding from fiscal surpluses,¹⁰⁰ such as in the case of the Exchange Fund Investment Portfolio of Hong Kong, Khazanah Nasional of Malaysia, Shanghai Financial Holding of China, and Superannuation Fund of New Zealand.¹⁰¹

A pension-reserve fund obtains funding from employee contributions.¹⁰² Examples are the California Public Employees' Retirement System, the Stichting Pensioenfonds ABP of Netherlands, and Government Pension Investment Fund of Japan.¹⁰³

The funding source of the Fund may also come from dividends from State-Owned Enterprises or GOCCs.¹⁰⁴ One example of this practice is Temasek Holdings of Singapore.¹⁰⁵ In the Philippines, GOCCs remit dividends to the National Government, but these are directly deposited in the National Treasury to support general public spending.¹⁰⁶

b. Withdrawal And Spending

If the legal form of the Fund is a Chartered GOCC or Non-Chartered GOCC, the Fund is liable to pay annual dividends to the National Government, by

⁹⁶ International Monetary Fund (n 84).

⁹⁷ International Forum on Sovereign Wealth Funds (n 80).

⁹⁸ International Monetary Fund (n 84).

⁹⁹ International Forum on Sovereign Wealth Funds (n 80).

¹⁰⁰ International Monetary Fund (n 84).

¹⁰¹ International Forum on Sovereign Wealth Funds (n 80).

¹⁰² International Monetary Fund (n 84).

¹⁰³ International Forum on Sovereign Wealth Funds (n 80).

¹⁰⁴ International Monetary Fund (n 84).

¹⁰⁵ International Forum on Sovereign Wealth Funds (n 80).

¹⁰⁶ R.A. No. 7656.

virtue of R.A. No. 7656 (*An Act Requiring GOCCs to Declare Dividends Under Certain Conditions to the National Government*), which states:

Section 1. *Declaration of Policy.* – It is hereby declared the policy of the State that in order for the National Government to realize additional revenues, government-owned or -controlled corporations, without impairing their viability and the purposes for which they have been established, shall share a substantial amount of their net earnings to the National Government.

[...]

Section 3. *Dividends.* – All government-owned or -controlled corporations shall declare and remit at least fifty percent (50%) of their annual net earnings as cash, stock or property dividends to the National Government. This section shall also apply to those government-owned or -controlled corporations whose profit distribution is provided by their respective charters or by special law, but shall exclude those enumerated in Section 4 hereof: *Provided*, that such dividends accruing to the National Government shall be received by the National Treasury and recorded as income of the General Fund.

In this provision, “net earnings” means “income derived from whatever source, whether exempt or subject to tax, net of deductions allowed under Section 29 of the National Internal Revenue Code, as amended, and income tax and other taxes paid thereon, but in no case shall any reserve for whatever purpose be allowed as a deduction from net earnings.”

The law covers all “corporations organized as a stock or non-stock corporation vested with functions relating to public needs, whether governmental or proprietary in nature, and owned by the Government directly or through its instrumentalities either wholly or, where applicable as in the case of stock corporations, to the extent of at least fifty one percent (51%) of its capital stock.”

Notably, the language of the coverage provision does not include a GICP, which is defined in *Manila International Airport Authority v. Court of Appeals*¹⁰⁷ as a government instrumentality not organized as a stock or non-stock corporation. R.A. No. 7656, on the other hand, limits covered corporations to stock or non-stock corporations. It must be noted, however, that GICPs, such as PDIC, remit dividends to the National Government as a matter of actual practice. The obligation of the GICP to remit dividends

¹⁰⁷ G.R. No. 155650, 20 July 2006.

under the GOCC dividends law can be a potential source of dispute, and it is submitted that the charter creating the Fund (whether as a Chartered GOCC or GICP) should clearly state whether it is covered or exempted from R.A. No. 7656.

The law provides two ways to mitigate the GOCC's annual dividend obligation. First, Section 4 (*Exemptions*) excludes GOCCs "created or organized by law to administer real or personal properties or funds held in trust for the use and the benefit of its members." This includes GSIS, Home Development Mutual Fund (HDMF), Employees' Compensation Commission (ECC), Overseas Workers Welfare Administration (OWWA), and Philippine Medical Care Commission (PMCC), and similar entities. Accordingly, if the Fund is a special administered fund of the GSIS, SSS or any social security institution that may be set up in the future (such as a pension system for uniformed personnel), it is not liable to pay annual dividends to the National Government because the beneficial owners of the pension fund are its members.

The second mitigating provision is Section 5 (*Flexible Clause*), which states, "In the interest of national economy and general welfare, the percentage of annual net earnings that shall be declared by a government-owned or -controlled corporation may be adjusted by the President of the Philippines upon recommendation by the Secretary of Finance."

The Philippine government should carefully consider whether the Fund should be covered by R.A. No. 7656. Remitting 50% of annual net earnings to the National Government can be detrimental to the investment objectives of the Fund and pre-empt the macroeconomic policy for which the Fund was created in the first place. For example, a Fund set up as a stabilization fund will have a withdrawal policy consistent with the financing of budget deficit, but R.A. No. 7656 can distort this general approach to withdrawal by fixing the rate of dividends at 50% of net earnings, payable annually, regardless of the level of budget deficit. The rate and timing of return required under R.A. No. 7656 can also distort the Fund's investment horizon. This is true if the policy purpose of the Fund is to be a savings fund, which has long-term investment objectives, "typically aim[ing] at generating higher returns over a long time horizon."

The special law creating the Fund as a Chartered GOCC or GICP may explicitly exempt the Fund from R.A. No. 7656. A Fund created as a special administered fund, not being a corporation, is excluded from this statutory obligation. However, a Non-Chartered GOCC is compelled to comply with

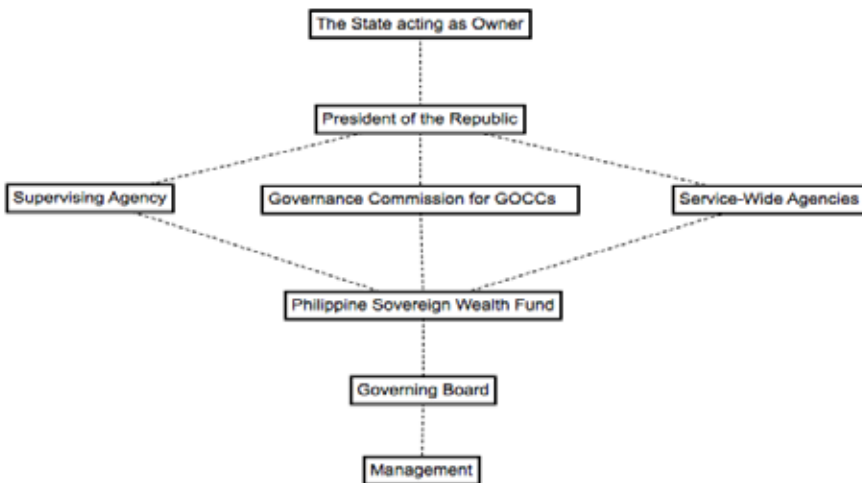
the dividends law and may not be exempted by its Articles of Incorporation or By-Laws alone.

Gapp 5. The Relevant Statistical Data Pertaining to the Swf Should be Reported on A Timely Basis to the Owner, or As Otherwise Required, for Inclusion Where Appropriate In Macroeconomic Data Sets.

The Fund is responsible for providing a data set corresponding to the data collection efforts in reporting national financial accounts, official financial statistics, and balance of payment positions. The BSP serves as a compiler of macroeconomic statistics.¹⁰⁸

Gapp 6. The Governance Framework for the Swf Should be Sound and Establish A Clear and Effective Division of Roles and Responsibilities In Order to Facilitate Accountability and Operational Independence in the Management of the Swf to Pursue Its Objectives.

A Fund created as a Chartered GOCC, Non-Chartered GOCC or GICP will have the following governance framework:



¹⁰⁸ See, e.g., Bangko Sentral ng Pilipinas, Selected Philippine Economic Indicators, BSP Official Website, http://www.bsp.gov.ph/statistics/statistics_selected.asp#.WG0aY7Z97eQ (accessed 4 January 2017).

The State primarily acts as an owner through the President of the Republic. The powers and responsibilities of the President, in turn, are delegated by legislative fiat to the Supervising Agency, the Governance Commission for GOCCs, and Service-Wide Agencies. A Supervising Agency is a National Government Department headed by a Secretary, who is a Cabinet Member.¹⁰⁹

Gapp 7. The Owner Should Set the Objectives of the Swf, Appoint the Members of Its Governing Body(Ies) In Accordance with Clearly Defined Procedures, and Exercise Oversight Over the Swf's Operations.

The State, acting through the GCG, may set the objectives and exercise oversight of the Fund through the Performance Evaluation System (PES) in the GOCC Sector, pursuant to GCG Memorandum Circular No. 2013-02 (Re-Issued). On the other hand, the procedure for appointing members of the governing board of the Fund are governed by GCG Memorandum Circular No. 2012-04 (3rd Issue).

The purpose of the Performance Evaluation System is to set organizational targets for the Fund. The achievement of the targets shall serve as basis for: (a) determining the grant of Performance-Based Incentives, (b) determining whether appointed directors of the governing board are eligible for re-appointment, and (c) ascertaining whether the Fund should be reorganized, merged, streamlined, abolished or privatized.¹¹⁰ The targets are negotiated between the GCG and the Fund, embodied through Performance Agreements, which contain the Charter Statement, Strategy Map, Performance Scorecard, and Strategic Initiatives. Setting of targets and review of performance accomplishments are done annually.

Nominations for members of the governing board are submitted to and vetted by the GCG, which in turn comes up with a shortlist submitted to the Office of the President of the Republic. Consequently, the President appoints the directors from the GCG shortlist. The appointment has a term of 1 year from date of appointment, with a holdover clause.¹¹¹

¹⁰⁹ GCG Memorandum Circular No. 2012-06 (*Ownership and Operations Manual for the GOCC Sector*).

¹¹⁰ GCG Memorandum Circular No. 2013-02 (Re-Issued).

¹¹¹ Ss. 15-17, R.A. No. 10149.

Gapp 8. The Governing Body(Ies) Should Act in the Best Interests of the Swf, and Have A Clear Mandate and Adequate Authority and Competency to Carry Out Its Functions.

The governing board is the repository of all the Fund's corporate powers, and is primarily responsible for the governance of the fund. The mandated functions and responsibilities of the board include the following: (i) providing corporate leadership, (ii) establishing the Fund's vision, mission, strategic objectives, policies and procedures, including charter statements and strategy maps, (iii) determining long-term policies to enable competitiveness, (iv) establishing the Fund's organizational structure, including the compensation system, (v) providing overall policy on personnel selection, (vi) providing overall guidelines on expenditures, (vii) providing an accountability system for meeting compliance requirements, (viii) adopting a performance evaluation system, and (ix) ensuring equitable treatment of all stakeholders.¹¹²

Gapp 9. The Operational Management of the Swf Should Implement the Swf's Strategies In an Independent Manner and In Accordance with Clearly Defined Responsibilities.

The operational autonomy of a Fund created as a GOCC or GICP is guaranteed in Article 9 of GCG Memorandum Circular No. 2012-06 (*Ownership and Operations Manual for the GOCC Sector*), which states:

“The National Government shall not be involved in the day-to-day management of GOCCs, and the Boards shall be allowed full operational autonomy to achieve the defined objectives of the GOCCs.”

With regard to Supervising Agencies, Article 8.3 of the same Manual states that *“Supervising Agencies shall extend autonomy at the operational level to its attached GOCCs[.]”* Article 10 of the same Manual guarantees the provision of adequate operational flexibility in GOCCs. It states:

“GOCCs shall be provided with adequate operational flexibility in order to function properly and efficiently, especially under conditions of market competition. Such flexibility shall nevertheless be consistent with the requirements of public accountability.”

10.1. Differential Treatments. – To implement the concept of adequate operational flexibility, GOCCs shall, subject to existing

¹¹² GCG Memorandum Circular No. 2012-06 (n 109).

laws, be accorded differential treatment by the various Service-Wide Agencies, such as the DBM, the DOF, the COA, the CSC and NEDA, in the exercise of their respective powers and functions. Such agencies shall distinguish corporate organizational and procurement practices of GOCCs from those of bureaus and regular line agencies of the National Government.”

Gapp 10. The Accountability Framework for the Swf’s Operations Should be Clearly Defined in the Relevant Legislation, Charter, other Constitutive Documents, or Management Agreement.

There are several mechanisms of ensuring and enforcing accountability in a Fund created as a GOCC or GICP. Under Section 5(a) of R.A. No. 10149, the GCG may “[e]valuate the performance and determine the relevance of the GOCC, to ascertain whether such GOCC should be reorganized, merged, streamlined, abolished or privatized, in consultation with the department or agency to which a GOCC is attached.” The decision to restructure the Fund under any of these modes is guided by the following parameters:

- (1) *The functions or purposes for which the GOCC was created are no longer relevant to the State or no longer consistent with the national development policy of the State;*
- (2) *The GOCC’s functions or purposes duplicate or unnecessarily overlap with functions, programs, activities or projects already provided by a Government Agency;*
- (3) *The GOCC is not producing the desired outcomes, or no longer achieving the objectives and purposes for which it was originally designed and implemented, and/or not cost efficient and does not generate the level of social, physical and economic returns vis-à-vis the resource inputs;*
- (4) *The GOCC is in fact dormant or nonoperational;*
- (5) *The GOCC is involved in an activity best carried out by the private sector; and*
- (6) *The functional, purpose or nature of operations of any group of GOCCs require consolidation under a holding company.*

Under Section 5(d), the GCG may recommend the suspension of a board member to the governing board of the GOCC or GICP, on the ground of participation in the approval of an act giving rise to a violation or non-compliance with the ownership manual of the GOCC.

Under Section 5(f), the GOCC or GICP is governed by a performance evaluation system, which include performance scorecards, which shall be a basis for a dispositive action under Section 5(a) above.

Under Section 22, *“the Board [of the GOCC] shall have the authority to discipline the CEO, or order the removal from office, upon a majority vote of the members of the Board who actually took part in the investigation and deliberation.”*

Under Section 24, illegally spent and misappropriate property and money belonging to the GOCC or GICP shall be restituted by the erring board member or officer, upon determination by the COA of the illegality of the spending. *“Failure to make the restitution within thirty (30) days after a written demand has been served shall, after trial and final judgment, be punished by an imprisonment of one (1) year and a fine equivalent to twice the amount to be restituted, and in the discretion of the court of competent jurisdiction, disqualification to hold public office.”*

Gapp 11. An Annual Report and Accompanying Financial Statements on the Swf’s Operations and Performance Should be Prepared In A Timely Fashion and In Accordance with Recognized International or National Accounting Standards In A Consistent Manner.

A Fund created as a Chartered GOCC, Non-Chartered GOCC or GICP shall be governed by the policy and requirements on disclosure and transparency prescribed by the GCG. Section 41 of GCG Memorandum Circular No. 2012-07 (*Code of Corporate Governance for GOCCs*) lays down the general principle on public disclosure of material information, as follows:

“The essence of corporate governance is transparency; the more transparent the internal workings of the GOCC are, the more difficult it will be for the Board and/or Management to mismanage the GOCC or to misappropriate its assets. It is therefore imperative that GOCCs disclose all material information to the National Government and the public, its ultimate stakeholder, in a timely and accurate manner at all times.”

Unless exempted by its charter or is created as a special administered fund, the Fund has the obligation to periodically disclose the following to the public:

- a) “[...] latest annual audited financial and performance report within thirty (30) days from receipt of such report;
- b) Audited financial statements in the immediate past five (5) years;
- c) Quarterly, annual reports and trial balance;
- d) Current corporate operating budget;
- e) Complete compensation package of all the board members and officers, including travel, representation, transportation and any other form of expenses or allowances;
- f) Local and foreign borrowings;
- g) Performance scorecards and strategy maps;
- h) Government subsidies and net lending;
- i) All borrowings guaranteed by the government; and
- j) Such other information or report the GCG may require.”

In addition to the above information, Article 28 of GCG Memorandum Circular No. 2012-06 (*Ownership and Operations Manual for the GOCC Sector*) states that “the GCG shall initiate and formulate an integrated corporate reporting system (ICRS) for all covered GOCCs to meet the following objectives: (a) To streamline the various corporate reports submitted by GOCCs to the GCG and Service-Wide Agencies to prevent redundancy and ensure consistency in the content of these reports and (b) To harmonize the frequency and timing of submission of corporate reports in order to reduce the burden on the GOCCs. The ICRS for GOCCs shall be managed by the GCG and shall maintain forms control and the computerization of the database.”

Section 43 of the Code of Corporate Governance for GOCCs also directs that all GOCCs should maintain a website and post for unrestricted public access the following:

“Section 43.1. On Institutional Matters:

- (a) For Chartered GOCCs, the latest version of its Charter;
- (b) For Non-Chartered GOCCs, the latest General Information Sheet (GIS) and brief company background, including date of incorporation, history, functions and mandate;
- (c) List of Subsidiaries and Affiliates; and

- (d) *Government Corporate Information Sheet (GCIS) as mandated by the GCG in its Memorandum Circular No. 2012-01.*

Section 43.2. On Board and Officers:

- (a) *Complete listing of the Directors and Officers with attached resume, and their membership in Board Committees;*
- (b) *Complete compensation package of all the board members and officers, including travel, representation, transportation and any other form of expenses or allowances;*
- (c) *Information on Board Committees and their activities; and*
- (d) *Attendance record of Directors in Board and Committee meetings.”*

It is submitted that a Fund created as a special administered fund should likewise adopt these disclosure and transparency requirements to be compliant with GAPP 11.

A Fund created in any legal form is also covered by Executive Order No. 02 s. 2016 (*Operationalizing in the Executive Branch the People’s Constitutional Right to Information and the State Policies to Full Public Disclosure and Transparency in the Public Service and Providing Guidelines Therefor*). Section 3 states that “[e]very Filipino shall have access to information, official records, public records and to documents and papers pertaining to official acts, transactions or decisions, as well as to government research data used as basis for policy development.” This covers all government offices under the Executive Branch, including Chartered GOCCs, GICPs and special administered funds which form part of a department of the national bureaucracy.

Gapp 12. The Swf’s Operations and Financial Statements Should be Audited Annually in Accordance with Recognized International or National Auditing Standards in a Consistent Manner.

No statute or administrative regulation can remove the Fund from the audit jurisdiction of the Commission on Audit. Section 2(2), Article IX-D of the 1987 Constitution states, “*The Commission has the power, authority and duty to examine, audit and settle all accounts and expenditures of the funds and properties of the Philippine government. Towards that end, it has the exclusive authority to define the scope, techniques and methods of its auditing and examination procedures. It also may prevent and disallow*

irregular, unnecessary, excessive, extravagant or unconscionable expenditures, or uses of government funds and properties.”

Audit procedures and standards are embodied in Presidential Decree No. 1445, otherwise known as the Government Auditing Code of the Philippines. COA is mandated by Section 43 of PD No. 1445 to report the results of the annual audit of the accounts and operations of government agencies, instrumentalities and GOCCs. The annual report includes the Independent Auditor’s Report, the Audited Financial Statements, the Observations and Recommendations, and the Status of Implementation of Prior Year’s Audit Recommendations. The COA has the power to issue Audit Observation Memoranda and Notices of Disallowances.

A Fund created as a Chartered GOCC, Non-Chartered GOCC or GICP, being within the regulatory jurisdiction of GCG under R.A. 10149 unless exempted by law, may be subject to special audits. Section 26 of R.A. No. 10149 states:

- (a) *“The thirty (30) GOCCs with the highest total assets shall be subject to periodic special audit by the COA. The periodic audit shall, at the minimum make a determination whether:*
- (1) *The accounting records of the GOCCS are complete and in accordance with generally accepted accounting practices and standards; and*
 - (2) *The statements prepared from the accounts present fairly and comprehensively their GOCCs financial position and the results of its financial operations.*
- (b) *As may be necessary or convenient in the performance by the GCG of its functions, the Chairman of the GCG may direct at any time a special COA audit of any other GOCC for any specific purpose or when authorized by law, direct an audit by independent auditors.”*

Gapp 13. Professional And Ethical Standards Should be Clearly Defined and Made Known to the Members of the Swf’s Governing Body(Ies), Management, and Staff.

In a Fund created as a Chartered GOCC, GICP or special administered fund, the members of the governing board, the management and staff are considered public officers.¹¹³ However, excluded from this status are personnel who are not appointed in the official staffing pattern or the so-called

¹¹³ *Khan v. Ombudsman*, G.R. No. 125296, July 20, 2006.

plantilla of the Fund, such as contractual employees and consultants.¹¹⁴ This is because a public office cannot be created through contract. The Supreme Court in *Malabanan v. Ombudsman*¹¹⁵ states, “*The characteristics of a public office [...] include the delegation of sovereign functions, its creation by law and not by contract, an oath, salary, continuance of the position, scope of duties, and the designation of the position as an office.*”

In a Fund created as a Non-Chartered GOCC, only the members of the governing board, including the CEO, have the status of public officers, while the management and staff are private employees.¹¹⁶ With regard to the board and CEO, their status as public officer is due to Section 15 of R.A. No. 10149, which states, “*An Appointive Director shall be appointed by the President of the Philippines from a shortlist prepared by the GCG.*” This includes the CEO because Section 18 of the same law states, “*The CEO or the highest-ranking officer provided in the charters of the GOCCs, shall be elected annually by the members of the Board from among its ranks.*”

With regard to the management and staff of a Non-Chartered GOCC, their exclusion as public officer is because of Section 2, Article IX-B of the 1987 Constitution, which states, “*The civil service embraces all branches, subdivisions, instrumentalities, and agencies of the Government, including government-owned or controlled corporations with original charters.*” The coverage excludes, by necessary implication, Non-Chartered GOCCs from the civil service.

For the purpose of criminal liability, the Revised Penal Code covers such management and staff of Non-Chartered GOCCs, as well as contractual employees and consultants (whether in a Chartered GOCC, Non-Chartered GOCC, GICP or special administered fund), within the definition of “public officer”. Article 203 states:

“Who are public officers. — For the purpose of applying the provisions of this and the preceding titles of this book, any person who, by direct provision of the law, popular election or appointment by competent authority, shall take part in the performance of public functions in the Government of the Philippine Islands, or shall perform in said Government or in any of its branches public duties as an employee, agent or subordinate official, of any rank or class, shall be deemed to be a public officer.”

¹¹⁴ G.R. No. 125296, July 20, 2006.

¹¹⁵ *Ibid.*

¹¹⁶ S. 15, R.A. No. 10149.

The Philippines has a plethora of laws, administrative rules and regulations, and professional and ethical standards guiding the conduct of public officers. Article XI of the 1987 Philippine Constitution lays down the accountability of public officers. Section 1 states, "*Public Office is a public trust. Public officers and employees must at all times be accountable to the people, serve them with utmost responsibility, integrity, loyalty, and efficiency, act with patriotism and justice, and lead modest lives.*"

R.A. No. 6770 (*Ombudsman Act of 1989*) provides that the "*Ombudsman and his Deputies, as protectors of the people, shall act promptly on complaints filed in any form or manner against officers or employees of the Government, or of any subdivision, agency or instrumentality thereof, including government-owned or controlled corporations, and enforce their administrative, civil and criminal liability in every case where the evidence warrants in order to promote efficient service by the Government to the people.*"

R.A. No. 3019 (*Anti-Graft and Corrupt Practices Act*) proscribes "*certain acts of public officers and private persons alike which constitute graft or corrupt practices or which may lead thereto.*"

R.A. No. 6713 (*Code of Conduct and Ethical Standards for Public Official and Employees*) aims "*to promote a high standard of ethics in public service.*" It provides norms of conduct of public officials and employees, their duties, a system of incentives and rewards, prohibited acts and transactions, statements and disclosure, and divestment of interest in order to avoid conflicts of interest.

R.A. No. 1379 (*An Act Declaring Forfeiture in Favor of the State Any Property Found to have been Unlawfully Acquired by Any Public Officer or Employee and Providing for the Proceedings Therefore*) provides the procedure for the forfeiture of unexplained wealth.

R.A. No. 7080 (*An Act Defining and Penalizing the Crime of Plunder*) defines and penalizes the act of plunder. Section 2 states, "*Any public officer who, by himself or in connivance with members of his family, relatives by affinity or consanguinity, business associates, subordinates or other persons, amasses, accumulates or acquires ill-gotten wealth through a combination or series of overt or criminal acts as described in Section 1(d) hereof in the aggregate amount or total value of at least Fifty million pesos (PHP 50,000,000.00) shall be guilty of the crime of plunder and shall be punished by reclusion perpetual to death. Any person who participated with the said public officer in the commission of an offense contributing to the crime of plunder shall likewise be punished for such offense.*"

Gapp 14. Dealing With Third Parties for the Purpose of the Swf's Operational Management Should be Based on Economic and Financial Grounds, and Follow Clear Rules and Procedures.

The practice of hiring external fund managers is common in SWFs. In GIC Private Limited of Singapore, “*External managers are chosen for their ability to exploit investment opportunities beyond GIC’s current skill sets and to complement [its] internal management capability.*”¹¹⁷ The authority of the Fund to hire external fund managers, whether local or foreign, under an investment management agreement should be clear in the charter or constitutive documents creating the Fund.

In the case of Philippine Health Insurance Corporation (PhilHealth), which is a Chartered GOCC, Section 17 of R.A. No. 101606 (*National Health Insurance Act of 2013*), amending Section 27 of R.A. No. 7875, provides, “*As part of its investments operations, the Corporation may hire institutions with valid trust licenses as its external local fund managers to manage the investment reserve fund, as it may deem appropriate, through public bidding. The fund managers shall submit annual reports on investment performance to the Corporation.*” Pursuant to such authority, PhilHealth entered into an Investment Management Agreement with BDO Unibank Inc., designating the latter as a local external fund manager.¹¹⁸

The external fund manager must follow clear and objective parameters and criteria for performing its functions. For instance, GSIS, in planning to invest USD 1 billion in foreign currency-denominated instruments pursuant to a portfolio diversification plan, issued the *Guidelines for Externally-Managed Global Investments (Absolute-Return Portfolio)*, which prescribe the investment philosophy, and rules on portfolio diversification, target return, portfolio volatility, portfolio rebalancing, liquidity requirement, instrument selection, permissible investments, and other restrictions. In the selection of external fund managers, GSIS likewise issued the minimum qualifications, criteria and procedure for evaluating proposals from prospective fund managers.¹¹⁹

¹¹⁷ Backer, (n 79).

¹¹⁸ Philippine Health Insurance Corporation, “PhilHealth Taps BDO Unibank Inc. as Local Fund Manager”, PhilHealth Official Website, https://www.philhealth.gov.ph/news/2015/taps_bdo.html (accessed on 4 January 2017).

¹¹⁹ Government Service Insurance System, Q&A on RFP 2007-01, GSIS Official Website, www.gsis.gov.ph/downloads/gip/QA%20GFM2%20_6-4-07.pdf (accessed 10 October 2016).

The ability to enter into an investment management agreement or the hiring of external fund manager is regulated by R.A. No. 9184 (*Government Procurement Reform Act*), which applies to the “*Procurement of Infrastructure Projects, Goods, and Consulting Services, regardless of source of funds, whether local or foreign, by all branches and instrumentalities of government, its departments, offices and agencies, including government-owned and/or -controlled corporations and local government units, subject to the provisions of Commonwealth Act No. 138.*”¹²⁰ The investment management agreement or hiring of an external fund manager falls within the provision for procurement of consultancy services. The Fund is included within the coverage of the law, regardless of its mode of creation or legal form. The coverage does not distinguish between a Chartered and Non-Chartered GOCC.

If the external fund manager is a foreigner, the Fund must observe Section 4.3 of Appendix 7 of the Revised Implementing Rules and Regulations of R.A. No. 9184, which provides that “[i]n the procurement of consulting services, foreign consultants may be hired if local consultants do not have the sufficient expertise, capability, and capacity to render the services required under the project, as determined by the head of the procuring entity.”

Gapp 15. Swf Operations and Activities In Host Countries Should be Conducted in Compliance with All Applicable Regulatory and Disclosure Requirements of the Countries in Which they Operate.

The host country of the Fund is the country receiving its investment abroad. The Fund must observe the investment regulatory regime of each host country, including but not limited to its securities, banking, tax and other financial rules and regulations.¹²¹ It is important for the Fund to observe the financial market rules of the host country because the Fund carries the reputation of the Philippine government. One of the justifications for hiring an external fund manager, as provided in GAPP 14, is to help the Fund know the investment regime in each host country and respect its unique regulatory environment. Another option is to create within the Fund, an organizational unit dedicated to monitoring developments in foreign business regulation of every host country.

¹²⁰ S. 4, R.A. No. 9184.

¹²¹ Sornarajah, M., “Sovereign Wealth Funds and the Existing Structure of the Regulation of Investments”, 1 *ASIAN J INTL L* 2 (2011).

The Pula Fund of Botswana appoints a “global custodian” whose main function is legal compliance in all investments in the host country. The National Development Fund of Iran trains all its external asset managers to comply with the regulations of recipient countries. The Government Pension Fund Global of Norway has a dedicated Compliance and Control unit responsible for international compliance requirements.¹²²

Gapp 16. The Governance Framework and Objectives, As Well As the Manner in which the Swf’s Management Is Operationally Independent from the Owner, Should be Publicly Disclosed.

The governance framework, as substantiated in GAPP 6, should be explicitly outlined in the charter or constitutive documents of the Fund. The common practice in special legislative acts constituting GOCCs or GICPs is to state the powers, responsibilities, composition and manner of selection of the members of the governing board, including the chief executive officer, and the delineation of authority between the board and management.¹²³ A more holistic articulation of the governance framework should also include the relationship between and amongst the Fund and the Office of the President of the Philippines, the Supervising Agency, and the GCG.¹²⁴ This is because ownership rights are exercised by the State through the President of the Republic, the Secretary of the Departments, and the GCG, pursuant to the role of the State acting as owner.¹²⁵

Gapp 17. Relevant Financial Information Regarding the Swf Should be Publicly Disclosed to Demonstrate Its Economic And Financial Orientation, so as to Contribute to Stability In International Financial Markets and Enhance Trust In Recipient Countries.

The Fund, being an international investment fund, must comply with standard data reporting practices in the international financial markets. These may overlap, and therefore should be integrated, with domestic data

¹²² Backer, (n 79).

¹²³ See, e.g., S.B. No. 1212, http://www.congress.gov.ph/legisdocs/basic_16/HR00376.pdf (accessed 3 January 2017).

¹²⁴ GCG Memorandum Circular No. 2012-06 (*Ownership and Operations Manual Governing the GOCC Sector*).

¹²⁵ Backer, L.C., “Sovereign Investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State Owned Enterprises and the Chinese Experience”, 19 *TRANSNAT’L L & CONTEMP PROBS*, 1 (2009).

reporting practices. One example of an international data reporting practice is the SDDS Plus, which guides countries in the reporting of economic and financial data for the purpose of generating accurate reports on stability in the international financial system.¹²⁶ While describing the advantages of the SDDS Plus practice, the IMF stated, “*The SDDS Plus aims to include economies that play a leading role in international capital markets and has institutions that are interconnected; through channels such as interbank lending, security lending, repurchase agreements, and derivatives contracts.*”¹²⁷

Gapp 18. The Swf’s Investment Policy Should be Clear and Consistent with Its Defined Objectives, Risk Tolerance, and Investment Strategy, As Set By The Owner or the Governing Body(ies), and be Based on Sound Portfolio Management Principles.

Gapp 18.1. The Investment Policy Should Guide the Swf’s Financial Risk Exposures and the Possible Use of Leverage.

Gapp 18.2. The Investment Policy Should Address the Extent to Which Internal And/Or External Investment Managers are Used, the Range of their Activities and Authority, and the Process by which they are Selected and their Performance Monitored.

Gapp 18.3. A Description of the Investment Policy of the Swf Should be Publicly Disclosed.

The Fund must come up with an Investment Policy Statement, which is a document that sets forth how the fund will be managed.¹²⁸ It should provide the purpose and objectives of the fund, its portfolio characteristics, the permitted investments, the manner of diversification of asset classes, the performance benchmark, prohibited transactions, and other investment limitations.¹²⁹ While the charter of the Fund may provide the minimum guidance on investments abroad, the Investment Policy Statement is a more detailed set of principles and rules which guide the behavior of fund managers in the purchase and sale of securities. This is to ensure that the financial condition and performance of the Fund is in accord with its policy purpose in GAPP 2.

¹²⁶ Heath, R., “Why are the G-20 Data Gaps Initiative and the SDDS Plus Relevant for Financial Stability Analysis?”, 4 J INTL COM, ECON & POL., 3 (2013).

¹²⁷ International Monetary Fund, SDDS Plus Overview, IMF Official Website, <http://dsbb.imf.org/Pages/SDDS/Overview.aspx?sp=y> (accessed 3 January 2017).

¹²⁸ Boone, N.M. and Lubitz, L.S., “Developing an Investment Policy Statement for the Qualified Plan”, 5 J. OF FIN PLAN 2 (1992).

¹²⁹ *Ibid.*

Gapp 19. The Swf's Investment Decisions Should Aim to Maximize Risk-Adjusted Financial Returns in A Manner Consistent with Its Investment Policy, and Based on Economic and Financial Grounds.

Gapp 19.1. If Investment Decisions are Subject to Other Than Economic and Financial Considerations, these Should be Clearly Set Out in the Investment Policy and be Publicly Disclosed.

Gapp 19.2. The Management of An Swf's Assets Should be Consistent with What Is Generally Accepted as Sound Asset Management Principles.

The Fund may exclude a certain host country, industry, company, or asset class from the Fund's investment universe because of political, environmental, ethical or religious grounds.¹³⁰ This is the meaning of the phrase, "*investment decisions [...] subject to other than economic and financial considerations.*" This is generally called *responsible investment exclusion decisions*, which must be embodied in the Investment Policy Statement.¹³¹

The investment exclusion policy must provide a catalogue of the exclusions, the grounds for the decision to exclude, and the list of corporations excluded.¹³² Other than exclusion, the Fund can decide to put a host country, industry or corporation under an observation list.¹³³ The Fund must have internal guidelines for an ethical screening of investments, and a procedure for making investment exclusion decisions.¹³⁴ The most common areas for ethical exclusion are investments in alcohol, gambling, tobacco, armaments, pornography and nuclear power. In the Norges Bank of Norway, the exclusions are *product-based* (e.g. production of coal or coal-based energy) or *conduct-based* (e.g. serious violation of human rights, severe environmental damage, gross corruption, serious violations of individuals rights in situations of war or conflict).¹³⁵

¹³⁰ Sparkes, R. and Cowton, C.J., "The Maturing of Socially Responsible Investment: A Review of the Developing Link with Corporate Social Responsibility", 52 J. BUS ETHICS 1 (2004).

¹³¹ *Ibid.*

¹³² Reynolds, J.N. and Newell, E., "Religion and Business Ethics", Ethics in Investment Banking (2011).

¹³³ Backer, (n 79).

¹³⁴ Sparkes & Cowton, (n 130).

¹³⁵ Backer, (n 79).

Gapp 20. The Swf Should Not Seek or Take Advantage of Privileged Information or Inappropriate Influence by the Broader Government in Competing with Private Entities.

A Fund created as a GOCC or GICP must adhere to the OECD Principles on Competitive Neutrality in State-Owned Enterprises.¹³⁶ This is adopted in the Philippine GOCC Sector, as articulated in Section 2(g) of R.A. No. 10149 (*GOCC Governance Act of 2011*) and Article 11 of GCG Memorandum Circular No. 2012-06 (*Ownership and Operations Manual Governing the GOCC Sector*), which states:

“In order to achieve a level playing field with corporations in the private sector performing similar commercial activities for the public, the National Government shall ensure that there is a clear separation between the regulatory and proprietary activities of GOCCs.

Unless justified by a greater public interest, Government Agencies that have the discretion to grant competitive advantages and benefits to GOCCs, shall avoid the granting of such advantages and benefits, especially to GOCCs that directly or indirectly compete with the private sector. The advantages and benefits mentioned herein include Government guarantees for debts incurred and special privileges such as partial or full exemption from the payment of taxes, duties, imposts, and other charges. This rule shall not apply when the GOCC concerned is organized solely for cultural, educational, civic or scientific purposes.”

Competitive neutrality requires that GOCCs must not enjoy net competitive advantages over their private sector competitors simply by virtue of their public sector ownership. The OECD Working Party definition also states that Competitive Neutrality is a “*state where no commercial entity has a competitive advantage in a mixed market purely as a result of its ownership or control.*”¹³⁷

GOCCs enjoy competitive advantages, such as access to concessional financing or sovereign guarantees, not being required to achieve full cost recovery, and not being required to earn commercial rates of return.¹³⁸

¹³⁶ Capobianco, A. and Christiansen, H., “Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options”, OECD Corporate Governance Working Papers (2011).

¹³⁷ Paul, J., “Competitive Neutrality and State-Owned Enterprises: The Case of the Philippines”, OECD Official Website, <https://www.oecd.org/corporate/ca/corporategovernanceofstate-ownedenterprises/48049463.pdf> (accessed 3 January 2017).

¹³⁸ *Ibid.*

However, they also face competitive disadvantages, such as compliance with government procurement laws, multiple and conflicting mandates, political interference in tariff setting, and lack of flexibility in capital structuring.¹³⁹

One possible and unavoidable exception to the adherence with Competitive Neutrality is when the law and policy of the host country is designed precisely to benefit and attract sovereign wealth funds. The Philippines, for instance, gives tax advantages to foreign sovereign wealth funds, as articulated in Section 32(B)(7) of R.A. No. 8424 (*National Internal Revenue Code of 1997*), which states:

“The following items shall not be included in gross income and shall be exempt from taxation under this Title: [...]

7. Miscellaneous Items. -

- a. Income derived from investments in the Philippines in loans, stocks, bonds or other domestic securities, or from interest on deposits in banks in the Philippines by [...] international or regional financial institutions established by foreign governments.”*

Foreign sovereign wealth funds are covered by the phrase “*international or regional financial institutions established by foreign governments*”, and are therefore exempt from payment of income tax on their investments in the Philippines, which is the host country. This is clearly a competitive advantage for which the Fund and the home country cannot be faulted, under the OECD Principles on Competitive Neutrality.

Gapp 21. Swfs View Shareholder Ownership Rights as A Fundamental Element of their Equity Investments’ Value. If An Swf Chooses to Exercise Its Ownership Rights, It Should Do So In a Manner that is Consistent with Its Investment Policy and Protects the Financial Value of Its Investments. The Swf Should Publicly Disclose Its General Approach to Voting Securities of Listed Entities, Including the Key Factors Guiding Its Exercise of Ownership Rights.

The ownership rights of the Fund in investee companies abroad vary depending on the applicable corporation law of each host country. Article 8 of GCG Memorandum Circular No. 2012-06 (*Ownership and Operations Manual Governing the GOCC Sector*) summarizes the fundamental stockholder

¹³⁹ *Supra* note 139 Plz chk.

rights of the State in relation to GOCCs in the Philippines, which may apply by analogy to the stockholder rights of the Fund in relation to its investee companies, unless the law of the host country provides otherwise.

These rights include: (i) the right to register equity holdings in the books of the investee company for all equity investments, (ii) the right to be issued certificates of stock representing investments in the investee company, (iii) the right to dividends, when declared, pertaining to the Fund's equity holdings, (iv) right to dispose of its equity investment, (v) the right to representation in all stockholders' or members' meetings, (vi) the right to vote on shares in all meetings where the stockholders' or members' vote is obtained or necessary to undertake or to ratify corporate activities, contracts or transactions, (vii) the right to representation, namely to nominate, elect or appoint, and remove and replace, the members of the governing board of every investee company, (viii) the right to formulate and enforce governance standards to realize ownership policy, and (ix) the right to receive proportional share in the net assets of the investee company upon dissolution.¹⁴⁰

The Government Pension Fund Global of Norway has a policy of voting at all annual general meetings, which number at 10,000 general meetings every year, with the number of resolutions exceeding 85,000. The voting instruction data is made publicly available.¹⁴¹ The Petroleum Fund of Timor-Leste votes through external managers, upon the order of the Operational Manager of the Fund, based on ISS voting guidelines.¹⁴² The Alaska Permanent Fund votes through external managers by proxy, with the principal consideration being the best financial interest of the Fund.¹⁴³ The Economic and Social Stabilization Fund of Chile, and the Korea Investment Corporation, however, adopt a neutral approach in exercising voting rights for minor and passive shareholdings.¹⁴⁴

Gapp 22. The Swf Should Have a Framework that Identifies, Assesses, and Manages the Risks of Its Operations.

¹⁴⁰ Article 8 of GCG Memorandum Circular No. 2012-06 (*Ownership and Operations Manual Governing the GOCC Sector*).

¹⁴¹ Backer, (n 79).

¹⁴² *Ibid.*

¹⁴³ *Ibid.*

¹⁴⁴ *Ibid.*

Gapp 22.1. The Risk Management Framework Should Include Reliable Information and Timely Reporting Systems, which Should Enable the Adequate Monitoring and Management of Relevant Risks Within Acceptable Parameters and Levels, Control and Incentive Mechanisms, Codes of Conduct, Business Continuity Planning, and An Independent Audit Function.

Gapp 22.2. The General Approach to the Swf's Risk Management Framework Should be Publicly Disclosed.

A Fund created as a Chartered GOCC, Non-Chartered GOCC or GICP is obligated to adhere with the provisions on risk management in GCG Memorandum Circular No. 2012-07 (*Code of Corporate Governance for GOCCs*). Under Section 8, the governing board shall adopt “*risk management policies and programs, in order to ensure that the GOCC survives and thrives despite financial crises and that its assets and reputation are adequately protected.*” The board shall also “*ensure the integrity of the GOCC’s risk management system, and shall identify and monitor, and provide appropriate technology systems for the identification and monitoring of key risks.*”

Section 16.2.5. of the Code mandates the creation of a Risk Management Committee within the governing board. The Committee shall consist of at least 3 members, one of whom must have a background in finance and investments. The responsibility of the Risk Management Committee includes:

- (a) “*Performing oversight risk management functions specifically in the areas of managing credit, market, liquidity, operational, legal, reputational and other risks of the GOCC, and crisis management, which shall include receiving from Senior Management periodic information on risk exposures and risk management activities;*
- (b) *Developing the Risk Management Policy of the GOCC, ensuring compliance with the same and ensure that the risk management process and compliance are embedded throughout the operations of the GOCC, especially at the Board and Management level; and*
- (c) *Providing quarterly reporting and updating the Board on key risk management issues as well as ad hoc reporting and evaluation on investment proposals;*”

Some of the most advanced risk management systems in the Philippines are found in private and government banks. The BSP Manual of Regulation for Banks provides guidelines for market risk management, liquidity risk

management, information technology risk management, credit risk management, a compliance system, an internal control framework, and an internal audit function. The BSP prescribes a dedicated risk management unit in banks, headed by a chief risk officer, who reports to the risk oversight committee any material information relative to the discharge of its function. The Fund can also adopt the best practices of other government financial institutions in managing risks, such as the PDIC Enterprise Risk Management, which implements the AS/NZ ISO 31000:2009 Risk Management – Principles and Guidelines.

Gapp 23. The Assets and Investment Performance (Absolute and Relative to Benchmarks, If Any) of the Swf Should be Measured and Reported to the Owner According to Clearly Defined Principles or Standards.

The assets and investment performance of the Fund should be reported to the State, as an owner and to the public, through the annual report and audited financial statements. It may also be done through quarterly press releases. One of the best practices in calculating investment performance is through the Global Investment and Performance Standards (GIPS),¹⁴⁵ which is also used by the Economic and Social Stabilization Fund of Chile.¹⁴⁶

The report on investment returns must be broken down into industries and asset classes, and into domestic and foreign deals.¹⁴⁷ Asset classes must show listed equity, unlisted equity, commercial real estate, private equity funds, joint ventures, fixed income, alternative investments, and foreign currencies.¹⁴⁸ Investments in equities must show the investment date, the value of the investment at the inception date, the holding period return from inception to the current reference period, and the overall gains and losses.¹⁴⁹

Gapp 24. A Process of Regular Review of the Implementation of the Gapp Should Be Engaged in By or on Behalf of the Swf.

The governing board of the Philippine Sovereign Wealth Fund must perform an annual self-assessment of the fund's compliance with the 24 Santiago

¹⁴⁵ Yuen, R.W.P., "GIPS: The Revised Standards", CSJ Journal (2011).

¹⁴⁶ Backer, (n 79).

¹⁴⁷ *Ibid.*

¹⁴⁸ *Ibid.*

¹⁴⁹ *Ibid.*

Principles, following the Santiago Compliance Index.¹⁵⁰ They may also validate this through third party reports, such as surveys conducted by the International Forum of Sovereign Wealth Funds or other methods of verification. Currently, third party verification is not widely practiced in SWFs. The Philippines can adopt the best practices on compliance audits in the GOCC sector, which uses the corporate governance scorecards measured by external consultants.¹⁵¹

CONCLUSION

With the high influx of remittances and excess foreign exchange reserves, the economic conditions are ripe for the creation of a sovereign wealth fund for the Philippines. This also allows the country to maximize the long-term potential of returns on the surplus portion of the reserves, instead of retaining them for liquidity purposes at a sub-optimal level. The Fund can be set up as a GOCC with a special charter, a GOCC registered through the SEC, a government instrumentality with corporate powers, or a special administered fund. The first three modes of creation will place the Fund within the regulatory and governance framework of R.A. No. 10149, while the fourth mode will subject it to the powers and limitations of the government agency tasked to administer the fund. Whichever mode is selected, however, it is indispensable to observe the 27 Santiago Principles to promote accountability, independence, and transparency in the management of the financial assets of the National Government.

¹⁵⁰ Santiso, J., Capapé, J., and Guerrero, T., “Sovereign Wealth Funds: A Growing Financial Firepower”, *The Global Context* (2015).

¹⁵¹ Strenger, C., “The Corporate Governance Scorecard: A Tool for the Implementation of Corporate Governance”, *12 CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW* 1 (2004).