

# FISCAL RULES FOR PERMANENT FUNDS: GLOBAL TRENDS AND PRACTICES

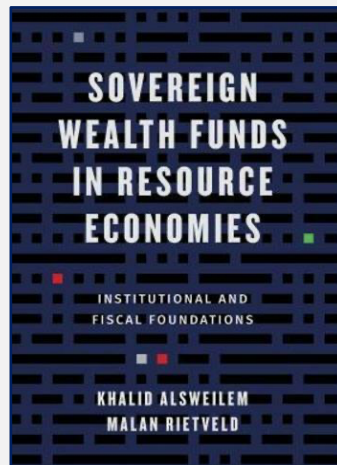
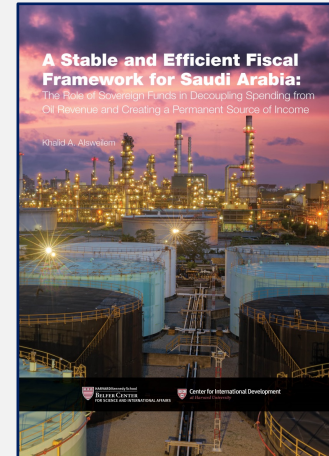
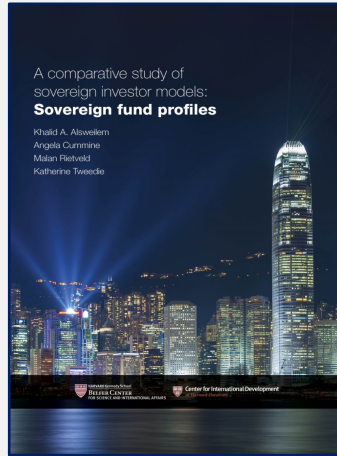
**Malan Rietveld, PhD**

International Sovereign Wealth Fund Advisor

# BACKGROUND

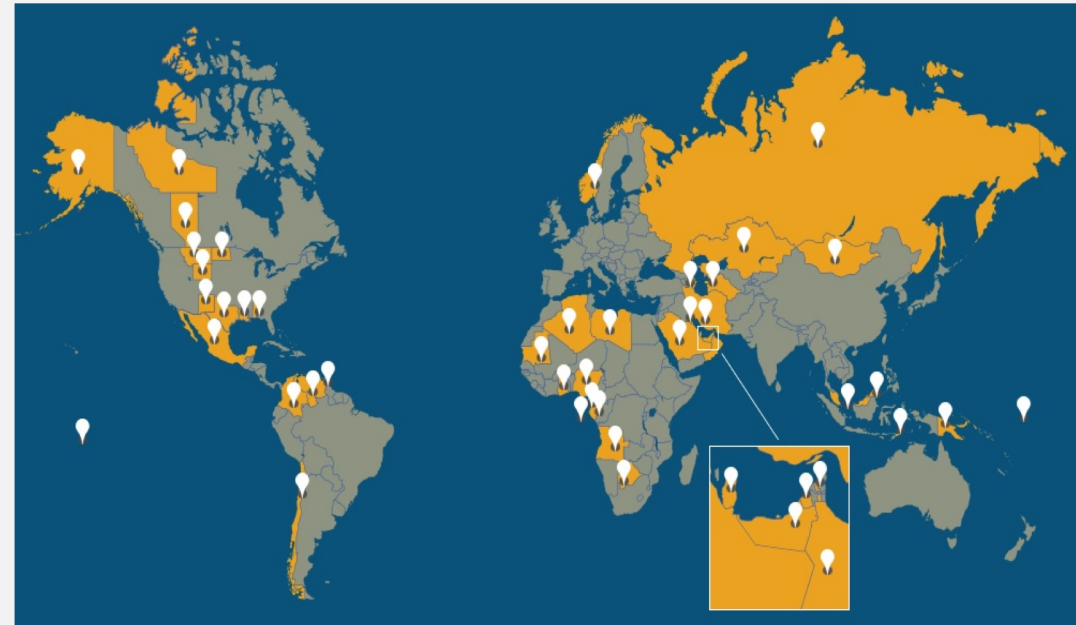
- Public sector, fiscal reform & sovereign wealth funds
  - Senior Expert Consultant to Asian Development Bank
  - Advisor and testimony on fiscal reforms in Alaska (2016-17)
  - Researcher for Board of Trustees of The Alaska Permanent Fund Corporation (2019)
  - Establishment of the Mongolian SWF (savings fund)
  - Pula Fund reforms in Botswana (fiscal rules)
  - The establishment of a new SWF framework in Namibia (fiscal and operational)
  - Mongolian Ministry of Mining on establishment of a Sovereign Development Fund
- Pension funds
  - Australian Superannuation (US\$100bn AUM)
  - FirstState Super (US\$70bn AUM)
  - Construction and Building Unions Superannuation (US\$25bn AUM)
  - OPSEU Pension Trust (US\$15bn)

# BACKGROUND



# THE GROWTH OF SWFS

- A number of very established, large funds
- Proliferation of new funds since 2000, with new funds in the works in at least 15 countries
- Non-commodity funds growing; as are “sovereign development funds”
- Aggregate AuM of \$8-10 trillion
- Alaska Permanent Fund is a major player and its investment team is very highly regarded





## CURRENT EXAMPLES

- Abu Dhabi Investment Authority
  - Multi-year effort to establish a comprehensive, integrated fiscal framework
  - Preparing for unexpected disruptions in path to post-oil future
  - ADIA is (dominant) part of large “sovereign balance sheet” of assets and liabilities
- Kuwait Investment Authority
  - Very large drawdowns on Kuwait Investment Authority assets
  - Breakdown of governance arrangement
  - Standoffs between Board, Minister and Legislature
- Norway
  - Still enjoys an embarrassment of riches
  - Draws on fund earnings potential have been increasing (2009; 2016; and 2020-21)
  - Rules are still too informal – something is going to give

## SWF head says Norway now ‘an oil fund nation’

Yngve Slyngstad's comments follow 20 per cent return for \$1.1tn oil fund



Yngve Slyngstad has ridden a more than decade-long bull market in equities

Richard Milne in Oslo FEBRUARY 27 2020



# Norway dips in to wealth fund for relief during pandemic

The level of government withdrawals from the fund forced it to start liquidating assets last year, but the fund has seen near-record returns as markets rebound

11 MAY 2021 - 12:45 by OTT UMMELAS



CURRENT EDITION

IPE magazine  
July/August 2021

MEMBERSHIP OPTIONS | REGIST

Search our site

U.S. Politics Economy Business Tech Markets Opinion Books & Arts Real Estate Life & Work WSJ Magazine Sports

SEARCH SPONSOR

HOME NEWS COUNTRIES REPORTS STRATEGIES ESG TOP 500 COMMENT QUEST EVENTS HUB IPE REAL ASSETS

It Is Time To Stop Portfolio Greenwashing



www.scientificbeta.com/green

NEWS

## Norway takes record withdrawal from SWF in revised budget

BY RACHEL FIXSEN | 11 MAY 2021

NEWS

## Norway ramps up SWF withdrawal to plug 2020 budget hole

BY RACHEL FIXSEN | 14 MAY 2020



Huge extra costs from the recent pandemic combined with drastic falls in oil revenue have forced Norway's government to take a hitherto unseen amount out of the Government Pension Fund Global (GPFG) this year to balance the budget.

According to the draft revised 2020 budget of Prime Minister Erna Solberg's government published on Tuesday, NOK382bn (€34.6bn) will flow out of the now NOK10.1trn sovereign wealth fund this year, instead of the NOK3.9bn inflow it was set to receive when the budget was outlined in October.



THE WALL STREET JOURNAL CMO TODAY

Get the facts on shifting marketing trends.

Sponsored by: Deloitte.

SIGN UP

UPCOMING EVENTS

Sep 12:30 PM - 2:00 PM EDT



OUTPERFORMANCE OVER THE LONG TERM.

# A COMPARISON WITH ENDOWMENTS

<i>numbers in percent (%)</i>	<b>Total Institutions</b>	<b>Over \$1 Billion</b>	<b>\$501 Million– \$1 Billion</b>	<b>\$101–\$500 Million</b>	<b>\$51–\$100 Million</b>	<b>\$25–\$50 Million</b>	<b>Under \$25 Million</b>
	<b>809</b>	<b>97</b>	<b>82</b>	<b>275</b>	<b>157</b>	<b>113</b>	<b>85</b>
Spend all current income	<b>3</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>4</b>	<b>3</b>	<b>6</b>
Percentage of moving average	<b>73</b>	<b>48</b>	<b>63</b>	<b>77</b>	<b>82</b>	<b>80</b>	<b>73</b>
<i>Average percentage</i>	<b>4.7</b>	<b>4.6</b>	<b>4.8</b>	<b>4.7</b>	<b>4.8</b>	<b>4.6</b>	<b>4.6</b>
Decide on appropriate rate each year	<b>9</b>	<b>6</b>	<b>2</b>	<b>9</b>	<b>10</b>	<b>12</b>	<b>11</b>
Grow distribution at predetermined inflation rate	<b>1</b>	<b>0</b>	<b>4</b>	<b>**</b>	<b>0</b>	<b>1</b>	<b>0</b>
Spend pre-specified percentage of beginning market value	<b>2</b>	<b>0</b>	<b>1</b>	<b>1</b>	<b>3</b>	<b>6</b>	<b>1</b>
<i>Average pre-specified percentage spent</i>	<b>4.6</b>	<b>N/A</b>	<b>4.8</b>	<b>4.7</b>	<b>4.6</b>	<b>4.5</b>	<b>5.0</b>
Last year's spending plus inflation with upper and lower bands	<b>5</b>	<b>12</b>	<b>15</b>	<b>3</b>	<b>2</b>	<b>0</b>	<b>4</b>
Weighted average or hybrid method (Yale/Stanford rule)	<b>9</b>	<b>21</b>	<b>13</b>	<b>9</b>	<b>4</b>	<b>5</b>	<b>4</b>
Meet IRS minimum of 5 percent	<b>**</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>0</b>
Other	<b>9</b>	<b>19</b>	<b>12</b>	<b>7</b>	<b>9</b>	<b>4</b>	<b>9</b>

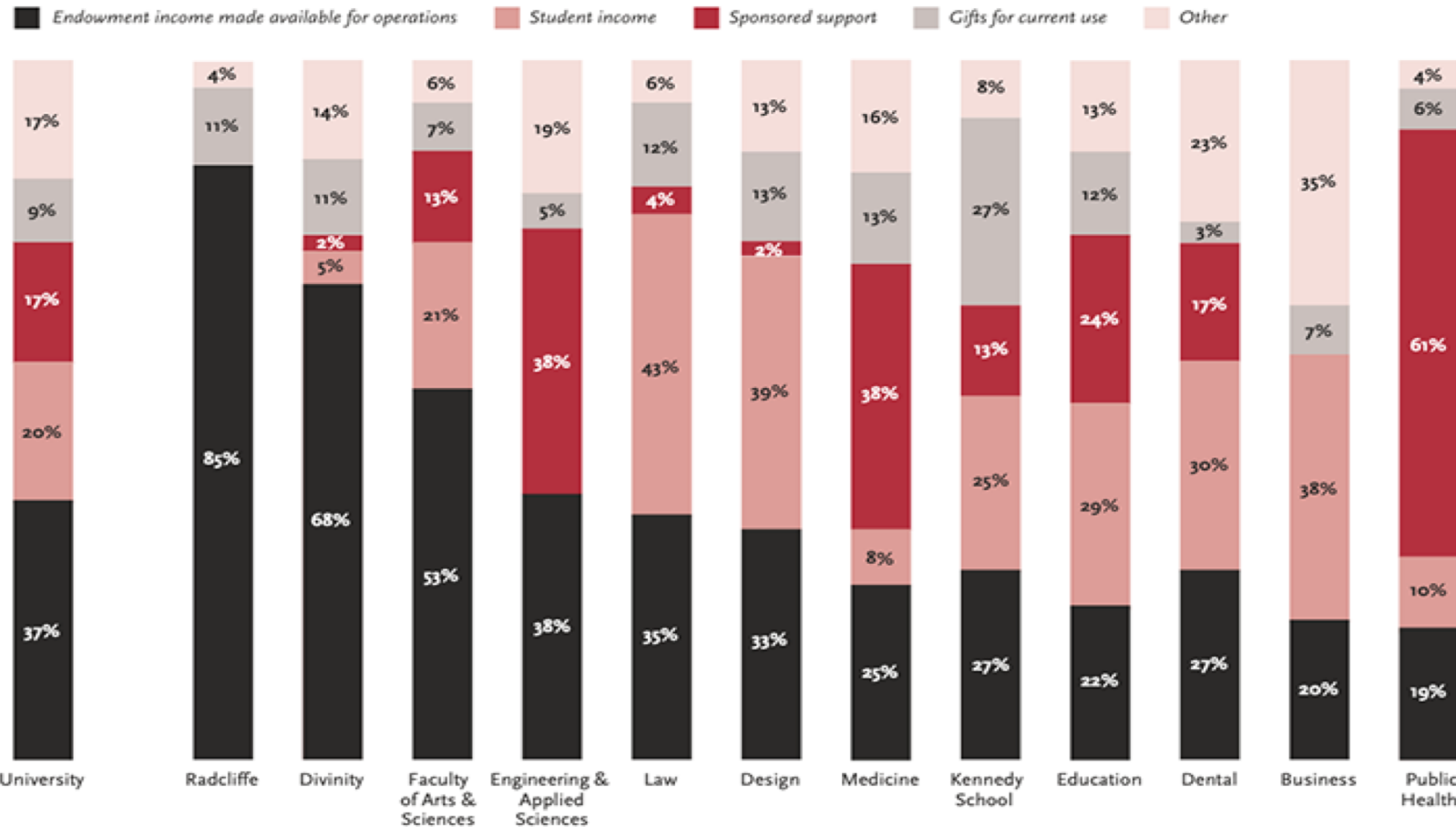
Source: National Association of College and University Business Officers' NACUBO-Commonfund Study of Endowments® (NCSE)

# WHAT HAPPENED AT HARVARD?

- Most famous and largest endowment in the world
- Spending rule leaves some wiggle room
  - Balance of “spending stability” (highly influenced by non-endowment revenue) and endowment growth/preservation
  - “Generally targets” 5.0% to 5.5% POMV – but not binding, and not how the Harvard Corp decides
  - Low of 4.2% in 2006 and pre-Covid high of 6.1% in 2010
- In 2020: highly unusual draw on restricted funds inside the Endowment
- In 2021: growth of dollar value of draw on Endowment originally capped at 1%; but later increased to 2.5% (note: dollar-value spend, not POMV)
- POMV calculation is tricky at Harvard, given timing of financial-planning process and no 5-year averaging
- Harvard has a diversified pool of revenue sources (and access to CARES and PPP funds); with none subject to expectations of structural decline

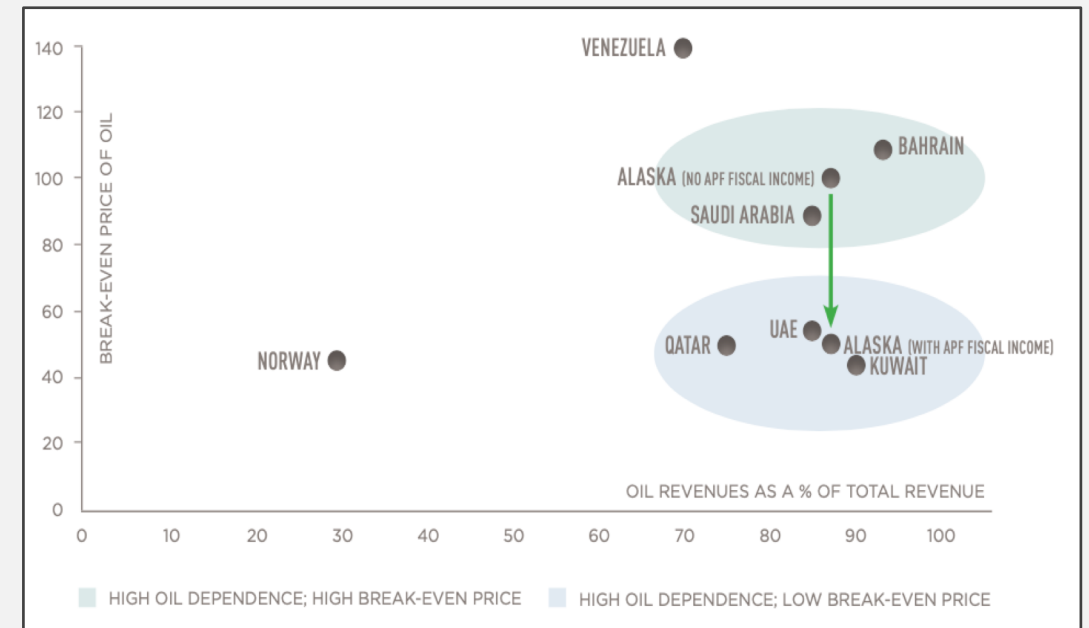
# WHAT HAPPENED AT HARVARD?

FISCAL YEAR 2020 SOURCES OF OPERATING REVENUE



# ALASKA IN CONTEXT

- Functions: savings, income and stabilization
- The savings function is firmly established (constitutional certainty); although large share in ERA is a risk
- The income-producing has come into sharper focus with the POMV
  - However, it currently rests on less solid institutional foundations than savings
  - Can be undermined fairly easily
- The POMV rule also promotes the stabilization function
  - Could be enhanced through a rule to transfer surplus revenues to APF (spending cap; oil price ceiling, etc.).
  - Increases the size of the APF and revenue it generates



Source: APFC Trustee Paper 2020-09; data from Fitch, Goldman Sachs and IMF

# ALASKA IN CONTEXT

- Alaska has considerable advantages over peers
  - Constitutional clarity and history of savings
  - Very large asset pool
  - World-class investment capacity and asset allocation
- But also weaknesses and vulnerabilities
  - High oil revenue dependence & uncertain long-term production outlook
  - Spending rule lacks constitutional certainty: ERA balances are really exposed (in downturn and a boom)
  - More can be done to save windfalls and break boom-bust link between oil revenues/prices and spending

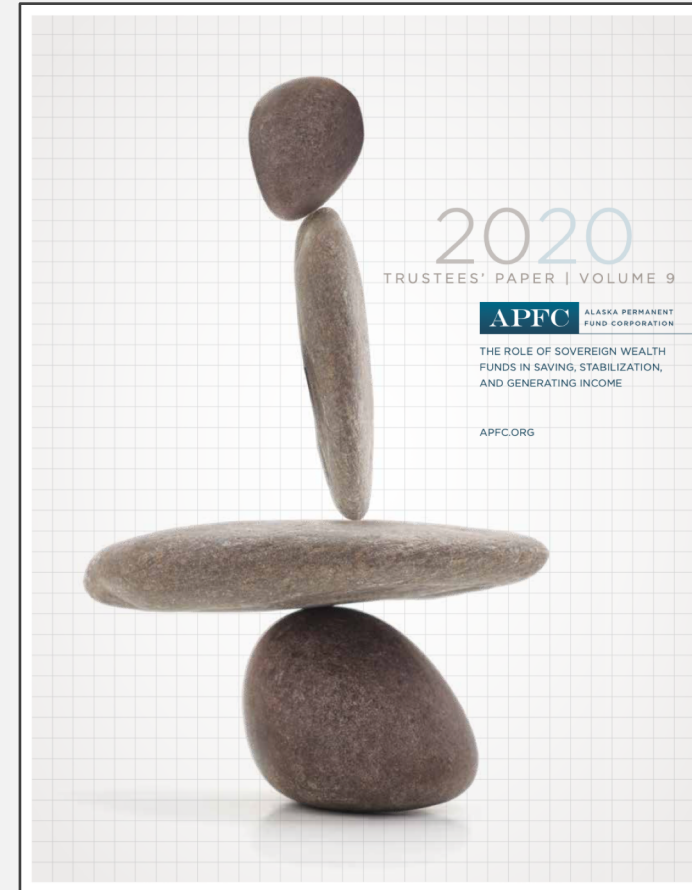
FUND SIZE, STRUCTURE, AND PURPOSE	ALASKA	WYOMING	NORWAY	ALBERTA	SAUDI ARABIA
RELATIVE SIZE OF SAVINGS	✓✓✓	✓	✓✓✓	XX	✓
SWF'S CONTRIBUTION TO FISCAL STABILITY	✓	✓	✓✓✓	X	XX
PROVISIONS FOR SUSTAINABLE INCOME GENERATION	✓	✓✓✓	✓✓✓	✓✓	XX
RULES					
SAVING RULE	✓✓	✓✓	✓✓✓	✓	XX
SPENDING RULE	✓	✓✓✓	✓✓✓	✓✓	XXX
FISCAL DEPENDENCE AND RESOURCE PRODUCTION					
SHORT-TERM SCOPE FOR NON-RESOURCE TAXES	XXX	XX	✓✓	X	XXX
LONG-TERM RESOURCE PRODUCTION OUTLOOK	XX	X	X	XXX	✓
FUND MANAGEMENT					
FUND GOVERNANCE STRUCTURE & INDEPENDENCE	✓✓✓	✓	✓✓✓	✓✓	XX
ASSET ALLOCATION (RELATIVE TO PEERS)	✓✓✓	✓	✓	✓✓✓	XX
RE sourcing OF INVESTMENT MANAGEMENT ENTITY	XX	XXX	✓✓✓	✓✓✓	✓✓
LEGEND: ✓✓✓ SIGNIFICANT STRENGTH    ✓✓ STRENGTH    ✓ MODERATE STRENGTH XXX SIGNIFICANT WEAKNESS    XX WEAKNESS    X MODERATE WEAKNESS					

Source: APFC Trustee Paper 2020-09; data from Fitch, Goldman Sachs and IMF



# BUILDING ON REFORMS

- APFC Trustee Paper 2020 Vol. 09
  - *The Role of Sovereign Wealth Funds in Saving, Stabilization and Generating Income*
- Considered what has worked and what has failed in past amongst comparable peers
- SWFs and Permanent Funds in accountable, commodity-based democracies
  - Alberta, Wyoming, New Mexico, Texas, Norway and Chile



# BUILDING ON REFORMS

- Lesson #1: Mission clarity
  - There has been a shift in the APF's mission: income generation and fiscal stability increasingly important
  - This is now well understood, and should be supported by constitutional language
- Lesson #2: Rules matter
  - Very clear that reliance on custom, discretion and negotiation leads to inferior long-term outcomes
  - Rules de-escalate tough decisions and promote consistency
- Lesson #3: Enforcing rules
  - Alaska (and other US Permanent Funds) have saved because it is Constitutionally mandated
  - Same is rarely true where it is not Constitutionally mandated (many examples: Alberta, Middle Eastern funds, US permanent funds)

# BUILDING ON REFORMS

- Lesson #4: Getting a POMV rule right
  - Focus on total returns rather than realized earnings: mindset shift
  - Moving averaging is essential
  - Long-term POMV rate must match long-term portfolio returns, minus inflation and costs
- Lesson #5: Mechanics of the draw and the ERA problem
  - The ERA/principal split creates unnecessary risks: political and financial
  - Having the POMV and the appropriate risk allocation is more important than the Fund's mechanics
  - Trustee Paper 2020-09 considered reform options
  - But no compelling reasons to have the ERA, if one move away from earnings-based spending rule

# KEY MESSAGES

- Alaska enjoys a number of critical structural advantages
- Big reforms have been made: income- and stabilization functions established
- Time to invest in infrastructure, mechanisms and institutions that ensure this transition – which is permanent – enjoys Constitutional certainty
- The ERA created unnecessary political and financial risks under POMV
  - No compelling reasons to have the ERA, if one move away from earnings-based spending rule
- Ensure unanticipated future revenue windfalls aren't immediately spent, but rather grow the APF or replenish other fiscal buffers
  - For example, spending caps, oil-price trigger, supplementary windfall savings rule
- A bridge period is needed as Alaska transitions to a system with Constitutionally protected savings and spending
  - The bridge should be comprehensive, with all available options on the table
  - One-time higher draws do happen,
  - Key is having a credible commitment mechanism to sustainability and rule-based constraint