

## Institutional Structure of Natural Resource Funds

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### Key messages

- A clear division of responsibilities—for example, between the legislature, president or prime minister, fund manager, operational manager and external managers—can help funds meet their objectives and prevent corruption.
- Putting day-to-day management in the hands of a capable and politically independent body with strong internal controls can help meet investment targets and prevent mismanagement. The choice of where to house this day-to-day operational manager—whether as a unit within the central bank, a unit in the ministry of finance, as a separate entity or at a custodial institution—is context-specific.
- Formal advisory bodies, drawn from the academic and policymaking communities, have made significant contributions to improving fund governance at the national level in countries like Chile, Ghana, Norway and Timor-Leste and at the subnational level in the United States.
- Codes of conduct and monitoring systems to prevent misconduct by the fund’s executive, staff and external managers are useful tools for preventing patronage, nepotism and corruption. In order to be effective, such mechanisms must be vigorously enforced.
- Good fund governance requires that appropriate organization, staffing policies and internal controls be complemented by transparency, independent oversight and the political will to follow the rules.

### What is natural resource fund management and why is it important?

Government decisions about the *institutional structure, staffing policies and internal controls* of a natural resource fund (NRF) have a huge impact on a fund’s success. Establishing an effective organizational structure, clear lines of communication between different levels of the institutional hierarchy and a strong internal chain of accountability, both within an NRF and between the fund and higher authorities, can:

- Help the fund meet its objectives (e.g., savings; budget stabilization) by aligning the goals and strategic direction set by political authorities with the day-to-day decisions taken by operational and investment managers
- Prevent misuse of resource revenues for political purposes
- Prevent corruption by officials or external managers

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By contrast, a poorly designed management system can undermine government strategy and impede good governance. In particular, a failure to clarify roles and responsibilities of different bodies—such as internal advisory committees, board members and managing directors—can lead to turf wars or, at the other extreme, neglect of essential work.

In one notorious example of poor fund management, the Kuwait Investment Authority (KIA) invested \$7 billion in Spanish firms beginning in the mid-1980s. By 1992, these investments had declined in value to \$2 billion. According to audits and newspaper reports, these losses were facilitated by an absence of internal controls, supervision and transparency. For instance, the in-house managers of the London-based KIA subsidiary that made the investments refused to share trading information with the executive committee, which was meant to oversee fund activities. This system made possible not only mismanagement of assets but also high commissions and profits for insiders. In response, parliament now oversees KIA activities, a monitoring system was established and internal operational rules were tightened.<sup>1</sup>

This policy brief focuses on NRF institutional structure, both at the macrolevel and within the body responsible for the fund's day-to-day operational management (the "operational manager"). The macromanagement structure involves the relationship between lawmakers, the executive, various advisory bodies, the auditor-general and the operational manager, which may be located within a ministry or the central bank, or in a separate dedicated organization. The internal management structure of the operational management entity involves a governing or supervisory board, the fund's executive office or committee, and various units organized around its front, middle and back office, which deal with investments (and possibly external fund managers), risk management and settlements, respectively (see Figure 1 for a model NRF organogram). The operational manager must also set standards for staff compensation and ethical behavior as well as ensure appropriate administrative capacity to meet the fund's mandate. Where applicable, the policy brief highlights the variations in the distribution of authority and responsibility seen among a number of well-established NRFs.

### The macromanagement structure

The macromanagement structure refers to the high-level arrangement among the legislative branch, executive branch, policy advisers and the senior operational management of the fund. This section outlines the different roles each of these actors may play. Specifically, it describes the impact of decisions on how and where funds are established, which body has ultimate control over fund behavior, which body manages the fund, who advises the fund manager, and how and by whom day-to-day operations are carried out. Finally, it discusses the role of legislatures in fund management.

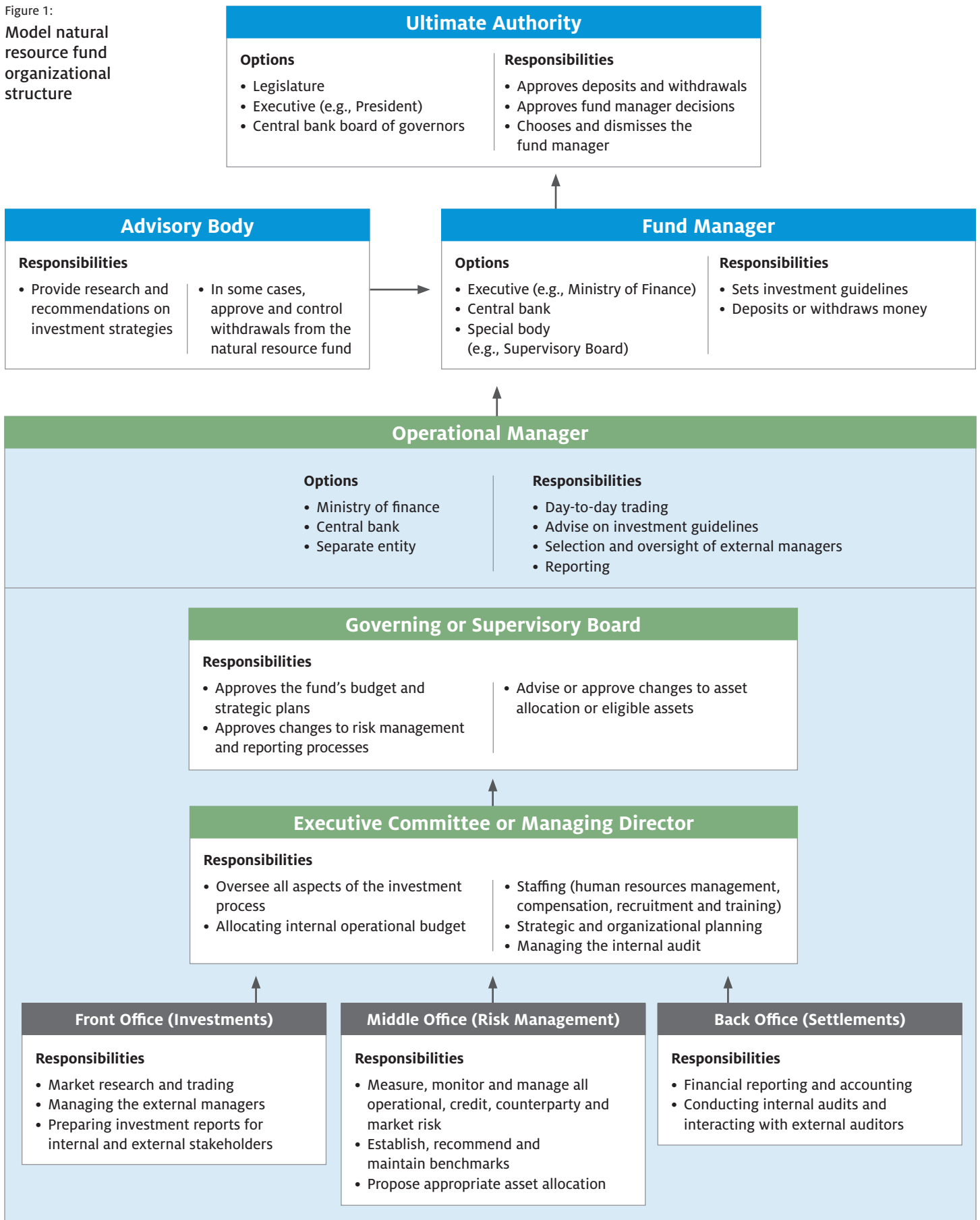
### Where and how is the fund physically established?

Natural resource funds can be established through the constitution or by legislation, regulation or executive decree. Though rare, national or subnational constitutions can call for the establishment of a fund. For example, Article 153 of the Niger Constitution makes reference to the creation of a petroleum fund. In the United States, Article IX, Section 15, of the State Constitution of Alaska establishes the Alaska Permanent Fund. The Alabama, North Dakota and Wyoming funds were also created through constitutional amendments. North Dakota took the process one step further by asking voters to approve the fund's creation.

<sup>1</sup> Sara Bazoobandi. *Political Economy of the Gulf Sovereign Wealth Funds: A Case Study of Iran, Kuwait, Saudi Arabia and the United Arab Emirates*. New York: Routledge, 2012.

Figure 1:

Model natural resource fund organizational structure



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More commonly, funds are established through legislation (e.g., Abu Dhabi [UAE]; Alberta [Canada]; Botswana; Chile; Ghana; Norway; Russia; Timor-Leste; Trinidad and Tobago) or by executive decree (e.g., Azerbaijan; Kuwait). While the permanency of a constitution can institutionalize a long-term vision for managing resource revenues and promote policy consistency over many years, legislation and decrees are more flexible and often more detailed.

No matter what method is used in its establishment, by definition an NRF is ultimately owned by the government. That said, a fund can be set up legally as a unit within the central bank, as a unit within the ministry of finance or revenue authority, or as a separate legal entity.

The decision of where to physically locate the fund can have significant implications for fund transparency, accountability and effectiveness. For example, where central banks are independent professional public institutions with a high degree of operational capacity, placing the funds in the central bank's control can help prevent mismanagement. The governments of Botswana, Ghana, Norway, Russia and Trinidad and Tobago have each chosen to have their central banks host their respective funds on their behalf. Since subnational governments do not often have formal relationships with their central banks, subnational funds may be located within a nonpolitical department, such as the Department of Revenue (e.g., Alaska [USA]).

Abu Dhabi (UAE), Alberta (Canada), Azerbaijan and Kuwait have each chosen to establish separate entities to manage their natural resource funds. The Abu Dhabi Investment Authority (ADIA), Alberta Investment Management Corporation, the State Oil Fund of the Republic of Azerbaijan (SOFAZ) and KIA are essentially parastatals reporting directly to the executive. In low-capacity environments, this approach can generate islands of expertise within the government capable of managing complex financial instruments. However, creating these institutions can also be a way to maneuver around reporting and oversight requirements associated with central bank or ministry activities.

Many funds choose to appoint a custodial institution—such as JPMorgan Chase, BNY Mellon or Northern Trust—to hold their assets in safekeeping and perform additional financial services such as arranging settlements or administer tax-related documents. Custodial institutions are completely independent of the government, which can help minimize the chance of fund mismanagement. However, private banks can charge large management fees. Where custodial institutions are used, it may be important to set strict guidelines on their mandate and fee structure.

### **Who has ultimate control of the fund?**

The body with *ultimate control* either approves the decisions of the fund manager or has the right to dismiss the fund manager. Regardless of where the fund is physically located, ultimate control over fund activities can rest with the legislature, the executive or the central bank. In Alaska (USA), Norway and Trinidad and Tobago, for example, the legislature approves the fund's annual budget. In Azerbaijan and Kazakhstan, the president has ultimate control. In Chile, Russia and Timor-Leste, the minister of finance has ultimate control, though that person reports to the president or prime minister. In a unique case, the Central Bank of Botswana's Board of Governors is responsible for the Pula Fund.

### **Who is the formal fund manager?**

The *fund manager* sets investment guidelines and deposits or withdraws money from the fund. While the details vary from fund to fund, typically the official fund manager is a part of the executive branch (e.g., Office of the President, Office of the Prime Minister or Ministry of Finance), though responsibilities are sometimes delegated to a special body (e.g., Supervisory Board in Azerbaijan) or the central bank. While executive control allows the most senior government

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officials to better coordinate government policy—for example, by ensuring that investment policy is consistent with fund objectives and that withdrawals are consistent with the government’s macroeconomic framework—it may also politicize decisions around fund investments, inflows and outflows.

In some cases—for example, in Alaska (USA), Ghana, Timor-Leste and Trinidad and Tobago—legislation dictates the conditions under which deposits and withdrawals can be made, limiting the discretionary powers of the fund manager to manage (see section below on legislative oversight for more details). In others—for example, Norway—while there is no legislation, the parliament does control deposits and withdrawals. However, in most cases, the fund manager has a large degree of discretion, subject to oversight by the body with ultimate control over fund activities and independent monitoring groups.

### **What formal advisory bodies support the fund manager?**

Many fund managers make use of formal advisory bodies whose members are drawn largely from the academic and policymaking community within or outside the country or region. In some cases, a formal advisory committee can in fact wield significant influence or even constrain government decision making—for instance, by approving and controlling withdrawals from NRFs (e.g., Chad’s Collège de Contrôle et de Surveillance des Ressources Pétrolières). In other cases, it may simply make nonbinding recommendations and provide in-depth research and advice to the fund’s executive committee (e.g., Alaska’s Investment Advisory Group; Ghana’s Investment Advisory Committee; North Dakota’s Legacy and Budget Stabilization Fund Advisory Board).

Chile has one of the most elaborate sets of advisory bodies, some with binding formal powers and some without. The Advisory Committee for Trend GDP provides the Chilean Ministry of Finance with key projections that are used to calculate trend GDP and the output gap. The Advisory Committee for the Reference Copper Price provides the ministry with projections of the international long-term copper price. These two inputs are particularly important in Chile where objective projections of trend GDP and copper prices are used to calculate how much revenue to save and spend in any given year according to the fiscal rule. In this context, relatively accurate calculations are essential for helping mitigate expenditure volatility and saving revenues for future generations. The projections are binding on the government.

Chile also has an Advisory Committee for Fiscal Responsibility Funds—otherwise known as the Financial Committee—that is responsible for evaluating fund management by the Central Bank of Chile and issuing recommendations about fund investment policy and regulation to the Ministry of Finance as well as the two houses of Congress. While the committee’s recommendations are not binding, a press release after each meeting and publication of an annual report on the funds’ financial results and its recommendations on investment policy pressures the government to implement its recommendations.<sup>2</sup>

In the case of the Norwegian Pension Fund Global, the advisory structures (consisting of academics and investment consultants) serve on a much more ad hoc basis, providing detailed commissioned research to the Norwegian Ministry of Finance, the Norges Bank (Norway’s central bank) Executive Board and the fund’s executives on long-term strategic investments, risks and opportunities, the fund’s investment performance, and changes and trends in the financial markets and investment industry. Reports and presentations submitted by the fund’s external advisers are made public.

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<sup>2</sup> Klaus Schmidt-Hebbel. “Fiscal Institutions in Resource-Rich Economies: Lessons from Chile and Norway” (working paper 416, Instituto de Economía, Pontificia Universidad Católica de Chile, 2012).

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## Who is the day-to-day operational manager?

While the executive branch is usually the official fund manager, it often delegates day-to-day trading on financial markets, the selection and oversight of external portfolio managers and reporting duties to an *operational manager*. The operational manager can be chosen among the ministry of finance, central bank or a separate entity (see Table 1 for examples of the division of responsibilities). The operational manager, in turn, can delegate asset management responsibilities to a special unit within the central bank or external managers.

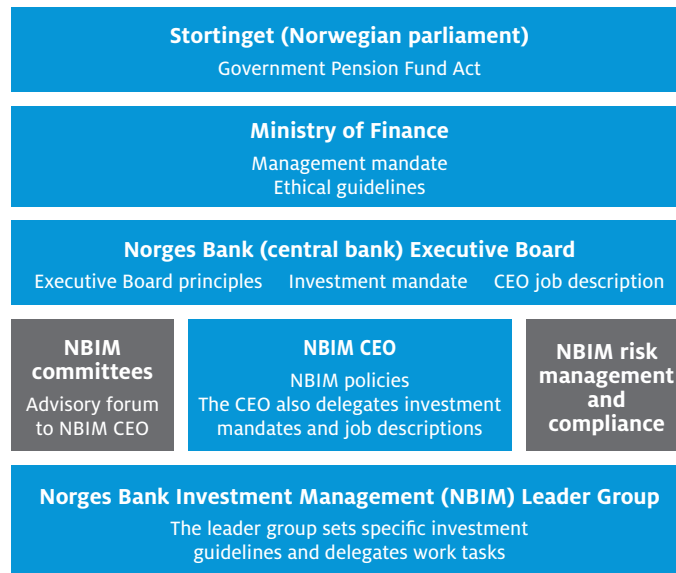
Table 1:  
Division of responsibilities over fund management in four resource-rich countries

	Azerbaijan	Botswana	Chile	Norway
<b>Ultimate control</b>	President	Central Bank Board of Governors	Minister of Finance	Storting (parliament)
<b>Manager</b>	Supervisory Board	Central Bank Board of Governors	Minister of Finance	Minister of Finance
<b>Operational manager</b>	Executive Director of the State Oil Fund of the Republic of Azerbaijan (SOFAZ)	Bank of Botswana Investment Committee	Central Bank of Chile	Norges Bank (central bank) Executive Board
<b>Physical location</b>	Bank of New York Mellon and National Depository Center of the Republic of Azerbaijan	Bank of Botswana	JPMorgan Chase Bank	JPMorgan Chase Bank

In the Norwegian case, which is widely regarded as an exemplary model of governance and intragovernmental organization, the parliament set the fund’s legal framework in the Government Pension Fund Act, the Ministry of Finance has the formal responsibility over the fund’s management, operational management is relegated to the Norges Bank, and Norges Bank’s Executive Board has delegated fund management to a unit within the bank called the Norges Bank Investment Management (see Figure 2).<sup>3</sup>

Figure 2:  
Management structure for the Norwegian Government Pension Fund Global

Source: Norges Bank Investment Management



3 "A Clear Division of Roles and Effective Controls," Norges Bank Investment Management, <http://www.nbim.no/en/About-us/governance-model>.

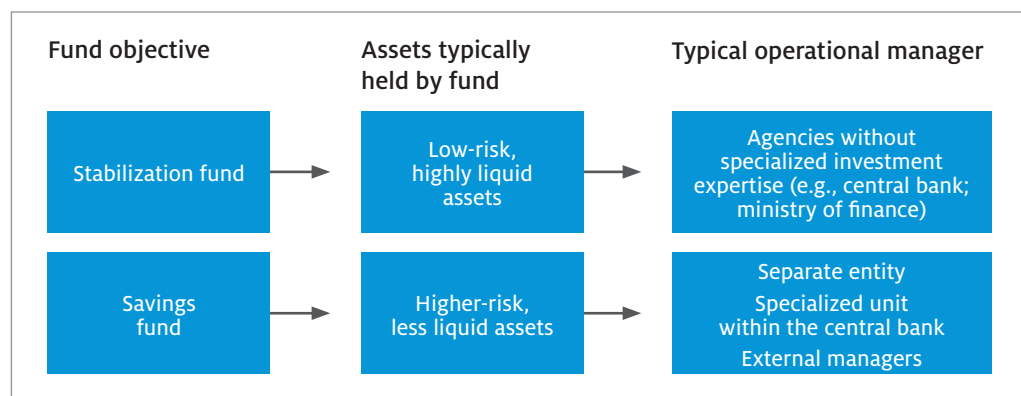
A fund’s objectives and investment strategy should help determine which body acts as the operational manager (see Figure 3). In general, funds with relatively less complicated and low-risk investments, such as stabilization funds that invest exclusively in money-market instruments and highly liquid, short-duration sovereign bonds, can be placed under the operational management of agencies without extensive experience in managing complex financial instruments. These funds require comparatively less investment expertise and discretionary judgment, as they are essentially managed as cash balances within the overall fiscal framework or annual budget process.

In practice, many countries give their national central banks operational responsibility for the management of stabilization funds. This is due to their operational capacity for managing the kind of investments that stabilization funds make, which are typically very similar to those of the central bank’s foreign exchange reserves. In addition, central banks tend to enjoy high levels of credibility and professionalism, which can make them good custodians of public assets. Examples of stabilization funds managed by central banks include the Algerian Revenue Regulation Fund, Trinidad and Tobago’s Heritage and Stabilization Fund and Venezuela’s Macroeconomic Stabilization Fund.

For NRFs with more complex investment strategies that require specialist skills—such as more diversified sovereign bonds, corporate bonds, equities and alternative assets—the operational management of the fund is typically relegated to a special unit within the central bank or a separate, dedicated fund management structure. In practice, when the allocation to more complex asset classes is largely done through “passive allocations,”<sup>4</sup> the central bank often retains operational responsibility. This is true in Botswana, Ghana, Kazakhstan, Norway, Timor-Leste, and Trinidad and Tobago. In such cases, government ministries still have critical roles to play in terms of oversight and setting long-term strategic objectives for the fund. In addition, ministries need to ensure that NRF policies and cash flows are coordinated with other areas of economic policy, such as the annual budget and (in the case of domestic development funds) with public spending and investment more generally.

Where investment managers are given more discretion to take risks or where funds are owned by subnational governments, a dedicated investment management agency, corporation or authority is often created, as in the cases of Abu Dhabi (UAE), Alaska (USA), Alberta (Canada), Brunei, Kuwait, Nigeria and Qatar. The Alaskan NRF, for example, is managed by the Alaska Permanent Fund Corporation, which is described as “a quasi-independent state entity, designed to be insulated from political decisions yet accountable to the people as a whole.”<sup>5</sup>

Figure 3:  
Choosing an operational manager based on the fund’s objective



4 This means that the fund essentially attempts to follow the movement of the market by tracking an index. Passive management is opposed to active management, where investor skill is employed to attempt to “outperform” the market.  
5 Alaska Permanent Fund Corporation, “An Alaskan’s Guide to the Permanent Fund,” 2009

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Finally, in low-capacity environments or where investment strategies are more complex, operational managers—whether they are central banks or separate entities—often hire external managers. This puts the operational manager in the position of being a “manager of managers.” While it may sound simple, managing the managers can be an incredibly analytical and data-intensive process (see Box 1).

### Box 1: Manager of managers

Natural resource funds (NRFs) often make use of external fund or portfolio managers. This is true for funds that are largely passively managed (in which case fees are much lower), but more typically when the NRF’s management seeks additional returns by outperforming the market using active strategies (which involve higher fees). The reasons for using external managers include: (i) the perceived superior technical and infrastructural capacity of external managers; (ii) allocations to highly specialized asset classes, such as real estate and land, private equity, emerging market debt and equities, and small-cap equities; and (iii) the need to develop internal investment capacity through technical training and skills transfer from an external manager.

The management of an NRF using external investment managers needs to guard against the principal-agent problem. Investment managers often push the sale of complex and high-risk financial instruments for at least two reasons. First, there are often higher fees associated with trade in more complex investments. Second, performance bonuses may be linked to large returns, while the external manager may not bear the burden of financial losses.

Operational managers can guard against excessive risk-taking, high fees and mismanagement in at least three ways. Following the customs of the investment industry, the NRF can involve a well-regarded global investment consulting firm to conduct a rigorous selection process. Operational managers can constrain the options available to external managers through strict investment guidelines and mandated restrictions. Finally, operational managers must constantly monitor and scrutinize their external managers.

The key point for legislators and other oversight bodies is that the use of external managers does not reduce the operational managers’ responsibilities. Being a prudent and effective “manager of managers” requires comprehensive information systems, sound internal processes and constant monitoring, interaction and evaluation.

### What role does the legislature play in overseeing the fund?

Legislators often have ultimate authority over establishing what the NRF can and cannot do. In many cases, NRFs are created through the passage of an act or a law that establishes most of the fundamental aspects of the fund, such as its purpose, deposit and withdrawal rules, investment objectives, risk tolerance and eligible assets. In short, parliamentary lawmakers often set the goalposts, even if the responsibility for scoring goals is delegated to other authorities.

Lawmakers also serve an important role in the year-by-year management and operation of any NRF, as well as potentially serving a critical role in ensuring appropriate levels of oversight, transparency and accountability. With regard to the former function, the most transparent, accountable and professionally run NRFs produce extension reports, presentations and testimonies to parliament. The relationship should be two-way. On the one hand, legislators should ask tough (but informed) questions around the fund’s inflows and outflows, investment performance, management of risk and decision-making process. On the other hand, the NRF’s managers should inform the legislature whenever the legal framework and provisions of the fund need to be changed in order to make prudent investment decisions (for example, if the fund needs



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to be allowed to invest in new asset classes or to implement certain derivatives strategies in order to manage risk or enhance long-term investment returns).

In Norway, for example, the Storting (legislative body) approves the Government Pension Fund Global's annual budget, appoints members of a fund supervisory council and reviews the council's reports. In addition, legislative committees are often established to hold hearings and report on legal compliance, as well as identify cases of government mismanagement. In the Canadian province of Alberta, a standing committee is tasked with approving the fund business plan annually, reviewing quarterly reports on fund operations, approving the fund's annual report, reporting to the legislature on whether the fund is meeting its objectives and holding public meetings with Albertans on fund activities.<sup>6</sup>

### **The internal management structure**

This section turns to the internal management structure within the operational management entity. A key decision is how to establish appropriate senior management and oversight structures. A commonly encountered management structure is a governing or supervisory board that oversees an executive committee or managing director. Front, middle and back offices, which handle investments, risk management and settlements, respectively, report to the executive committee or managing director. The separation and specification of duties of the different bodies may feature small variations from fund to fund but are broadly summarized below.

#### **What is the operational manager's highest authority?**

Most NRFs with significant assets under management and relatively sophisticated investment processes have a governing or supervisory board that sits on top of the fund's executive committee or managing director (though the managing director may sit on the board). The board, which is accountable to the official fund manager, typically approves the fund's budgets, strategic plans and changes to the investment, risk management and reporting processes. If the board is granted a relatively high degree of authority, it may advise on—and in some cases even approve—changes to the fund's asset allocation, permitted investment strategies and eligible assets (a less empowered board may simply help the executive communicate and explain these requirements to the ministry and/or parliament). The board typically reports to the minister of finance, council of ministers and/or parliament.

Board membership varies greatly from country-to-country, from technocratic independent experts to government officials to senior members of the executive branch of government. In Canada, the Alberta Investment Management Corporation's Board of Directors consists entirely of experienced private-sector executives appointed by the government. In Botswana, where the Pula Fund is managed by the central bank, the Board of Governors consists of the Governor of the Bank of Botswana, Permanent Secretary of the Ministry of Finance and seven other members of various backgrounds appointed by the Minister of Finance. The SOFAZ Supervisory Board consists of government ministers, central bankers, parliamentarians and other Azerbaijani officials. Finally, the Abu Dhabi Investment Authority's Board of Directors consists almost entirely of members of the ruling family.

In some more authoritarian systems, it is common for representatives of the fund manager to sit on the board. For example, in the cases of Azerbaijan's State Oil Fund, Kazakhstan's National Fund, the Kuwait Investment Authority and the Qatar Investment Authority, ministers, the speaker of parliament, economic advisers to the president or even the president himself may sit on the board of a supposedly independent operational manager.

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<sup>6</sup> World Bank Institute, *Parliamentary Oversight of the Extractive Industries Sector*, 2010. [http://www.agora-parl.org/sites/default/files/parliamentary\\_oversight\\_and\\_the\\_extractive\\_industries.pdf](http://www.agora-parl.org/sites/default/files/parliamentary_oversight_and_the_extractive_industries.pdf).

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### Executive committee or managing director

The executive committee or the managing director is the highest management structure within the operational management entity. Its function is to bear responsibility and oversee all aspects of the investment process, across the front, middle and back offices. The executive committee or managing director is also responsible for allocating the internal operational budget, managing the internal audit, strategic and organizational planning and all aspects of staffing policy (human resources management, compensation, recruitment and training).

Where the operational manager is a state-owned corporation or entity, the executive reports to a board of governors or directors. For example, in Azerbaijan the SOFAZ Executive Director, though appointed by the president, reports to the Supervisory Board. In Abu Dhabi, the Abu Dhabi Investment Authority's Executive Committee reports to the Board of Directors. Where the central bank is the operational manager, the executive typically reports directly to the Minister of Finance (e.g., Chile; Botswana; Ghana; Norway; Russia).

### Front office (investments)

The front office is the NRF's investment team (for further details on investment strategies, see policy brief on "Rules-Based Investment for Natural Resource Funds"). The exact specification of tasks and functions to be performed by the front office will depend on the size of the fund's assets under management, its basic investment style (passive, active or mixed), the size and number of external management mandates it operates and the complexity of the investment strategies being pursued. For larger organizations the views and concerns of the front office are consolidated and communicated to senior management and oversight bodies through an investment committee or department. The front office usually reports to the chief executive and chief investment officer of the fund. The following are tasks commonly associated with the front office:

- Investing internal portfolios, including trading in financial instruments
- Researching and analyzing financial market trends and asset valuations
- Monitoring the performance and managing the relationship with external fund managers<sup>7</sup>
- Facilitating feedback and skills transfer between external managers and the fund's employees
- Communicating and articulating the fund's evolving market views and investment philosophy, process and decisions
- Preparing quarterly and annual investment reports to the executive committee, as well as the governing board, ministry of finance and other external stakeholders

### Middle office (risk management)

The middle office consists of the risk management and performance and attribution team. As with the front office, the views of the middle office can be consolidated and coordinated through a Risk Committee or Department that reports to senior management structures. The middle office usually reports to the chief operating officer and/or the chief investment officer. Some of the important tasks performed by the middle office are:

- Measure, monitor and manage all operational, credit, counterparty and market risk
- Propose appropriate asset allocation based on risk profile
- Enhance risk forecasting and modeling capabilities
- Establish, recommend and maintain benchmarks
- Determine how returns of the various portfolios are obtained by attributing the measured return to investment decisions made and the various internal and external managers

<sup>7</sup> In a small number of cases, the oversight of external managers is the responsibility of the middle office. This is typically when external managers are tasked with pursuing highly passive (low fee) investment strategies that largely follow the market. In such cases, the monitoring of external managers essentially becomes exclusively a risk management issue, ensuring that external managers are not adding to underlying market risks by taking active bets of market movements.

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### **Back office (settlements)**

The back-office function is responsible for what is often described as “post-trade” activities that are critical to accurate and timely recording and documentation of investment activities (for further details on reporting, see policy brief on “Natural Resource Fund Transparency”). Many institutional investors, including public investors, outsource much of the back-office function to established custodians and asset servicing firms such as BNY Mellon, State Street, JPMorgan Chase or Citigroup. In such cases, the NRF’s back office is responsible for supervising and interacting with external service providers, and ensuring that the required data is received in a timely and accurate manner and integrated with the central bank’s own IT systems. The back office usually reports to the chief operating officer and chief financial officer. Some of the most important tasks performed by the back office include:

- Financial reporting and accounting in compliance with the NRF’s stated accounting framework and standards, and in compliance with regulatory and tax requirements
- Clearing and settlement of trades

The back office also conducts internal audits and interacts with external auditors. An internal audit is an examination and evaluation of an organization or system’s internal controls. The goal of a natural resource fund internal audit is usually to assess compliance with governance and investment rules and make recommendations to improve the effectiveness of governance processes.

Nearly all NRFs have internal audits, overseen by an audit committee or internal auditor. These audits can either be performed in-house or by independent auditors. Internal audits are submitted to the executive committee or managing director. While some governments (e.g., Alaska [USA]; Chile; Ghana; North Dakota [USA]; Norway; Trinidad and Tobago) release their NRF internal audit reports to the public as a means of improving internal governance, this is not yet standard practice.

### **Preventing misconduct by managers and staff**

Allegations of conflict of interest or outright misuse of public office for private gain by NRF board members, managers or staff is not unheard of. The Kuwaiti example in the first section of this policy brief is but one instance. Many of the Libyan Investment Authority’s assets are yet to be identified, generating speculation of corruption or conflict of interest. And recently members of the Nigerian House of Representatives accused a manager at the Nigerian Sovereign Investment Authority of contracting his former employer, UBS Securities, as an external manager without following due process.<sup>8</sup>

Appropriate governance rules, internal supervision, external oversight and transparency are the key elements in preventing such mismanagement. However, codes of conduct and preventing conflicts of interest are also important. Most NRFs set out behavioral guidelines for board members, executives and staff, either in legislation or in manuals. These typically require individuals to disclose potential conflicts of interest and financial interests, while introducing significant penalties for abuse of inside information, fraud and unethical behavior. The most effective of these codes and guidelines clearly articulate the legal and professional implications of misconduct and unethical behavior, and establish clear processes for dealing with it once it is suspected or detected. Ideally, a compliance officer should be appointed to

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<sup>8</sup> Victor Oluwasegun and Dele Anofi, “APC Reps Question Management of \$200m Sovereign Funds by Foreigners,” *The Nation*, <http://thenationonline.net/new/apc-reps-question-management-of-200m-sovereign-funds-by-foreigners/>.

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ensure compliance with applicable laws, regulations and standards around ethics, conflicts of interest and misconduct.<sup>9</sup>

The University of Texas Investment Management Company's Code of Ethics is a good example of a comprehensive code of conduct for fund managers and staff.<sup>10</sup> It includes sections on conflict of interest, acceptance of gifts, nepotism and financial disclosures. While the Texas Permanent University Fund's Chief Executive Officer (CEO) is responsible for enforcing the code, the Board of Directors is the highest authority in charge of ensuring that the CEO does so.

### Conclusion

Research and practical experience among NRFs demonstrate that—along with strong transparency requirements, external oversight and the political will to manage resource revenues well—effective management and organizational structures are key determinants of good fund governance. Management structures that set out clear and unambiguous roles, powers and responsibilities for governing bodies and staff promote prudent investment and prevent misconduct, corruption and mismanagement.

The specific choices around who has ultimate authority over the fund, who manages the fund, how the operational manager is organized, where the fund is physically located and how these bodies interact, must be context-specific. Policymakers and oversight bodies have significant scope for pragmatically tailoring fund management structures in accordance with local requirements, preferences and competencies. That said, it is preferable to involve a number of public agencies and institutions—for example, ministries, central banks, public investment bodies, legislators and auditors—in the management process. In this way, different bodies can monitor one another, promote compliance with governance rules and make sure that the government is managing natural resource revenues in the public interest.

9 Cornelia Hammer, Peter Kunzel and Iva Petrova, "Sovereign Wealth Funds: Current Institutional and Operational Practices" (working paper, International Monetary Fund 08/254, 2008). <http://www.imf.org/external/pubs/ft/wp/2008/wp08254.pdf>.

10 The University of Texas Investment Management Company's Code of Ethics can be found at <http://www.utimco.org/extranet/WebData/CORPORATE/CodeofEthics.pdf>.



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The Columbia Center on Sustainable Investment develops and disseminates practical approaches and solutions to maximize the impact of international investment for sustainable development. The Center undertakes its mission through interdisciplinary research, advisory projects, multi-stakeholder dialogue, educational programs, and the development of resources and tools.

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